SME SENTIMENT INDEX 2H 2024

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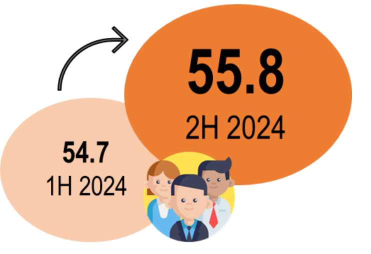
The SME Bank Sentiment Index for 2H 2024 rose to 55.8 (1H: 54.7), the third consecutive round of increase and the most optimistic since the survey's inception. This is mainly **driven by improved economic growth and business sales expectations as well as expansion plans and hiring more workers.** As a leading economic indicator, this Index serves to gauge Micro, Small and Medium-sized Enterprises (MSMEs)'s view of the business environment which can be the yardstick in measuring how the overall economy is expected to behave.



The score aligns with other forward-looking indicators such as the Department of Statistics Malaysia's (DOSM) Business Tendency Survey, which predicts favorable business conditions in the coming months. Nonetheless, MSMEs continue to grapple with higher cost pressures and increased exposure to exchange rate volatility as they import and export more, which could affect their profit margins if not managed properly. The SME Sentiment Index Survey, conducted between August and November 2024, hit a **new record high of 1,485 respondents** (1H: 1,295), encompassing participants from various sectors and business sizes.

MSMEs more confident on economic growth - led by accommodation sector

54% of MSMEs are positive about the economic environment over the next 6 to 12 months, a significant increase from 38% in 1H as this round's survey marked **the highest optimism since our first survey** in 2022 (57%). The result is in tandem with a better national GDP growth expectation for 2025, where SME Bank forecasts the economy to grow between 4.5% to 5.5% (9M 2024: 5.2%).

Economic growth in 2025 will be fueled by:

- Expansionary Budget 2025
- Continuous improvement in the labour market
- Civil servants' salary revision
- Acceleration of 12MP's projects in the final year
- Full recovery of tourism activities

Growth is still subject to downside risks:

- Potential escalation of US-China trade war following Trump's election win
- Worsening geopolitical conflicts
- Lower-than-expected commodity production and prices

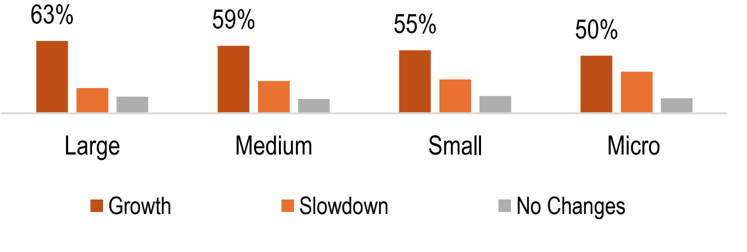
Growth
54%
1H: 38%

Slowdown
32%
1H: 37%

No Changes
14%
1H: 25%

Figure 1: MSMEs foresee growth, across all business sizes

...mostly coming from **large** businesses...



...and concentrated in sectors below:

Accommodation
72%

Mining & Quarrying
68%

Information & Communication
67%

Note: All figures are rounded; they might not add up to 100%.

Majority of the respondents from **all business sizes foresee an economic expansion with large sized businesses taking the lead** (63% of respondents) while the **micro sized are the least optimistic** (50%). This was a **complete reversal compared to 1H's results** where large-sized businesses were the most pessimistic, expecting for an economic slowdown compared to micro-sized ones which expect for economic expansion. Large companies could be riding on resilient domestic demand and improvement in international trade, where merchandise trade volume is expected to further expand by 3.0 % YoY in 2025 (2024e: 2.7%). Micro businesses currently have the least exposure to exports (5%) but are the keenest (20%) to sell their products to foreign countries in the future.

By sector, **accommodation is the most optimistic on the economic outlook** (72% of respondents), where it has been **trending upwards from the last 2 surveys**, since 2H 2023 (33%). This is **aligned with the gradual recovery of tourist arrival** where it reached 18.4 mil in Jan-Sep 2024 (Jan-Sep 2023: 14.5 mil), although still below pre-pandemic level of 91% (2019). Among the top 3 countries, tourist arrivals from China (105%) have surpassed 2019 level, while Indonesia (96%) and Singapore (83%) continues to recover. We foresee the tourism sector to fully recover in 2025 as improving household disposable income would also lend support to greater domestic tourism activities. Higher allocation amounting to RM1.4 bil (2024: RM450 mil) in Budget 2025 for the maintenance and conservation of tourist attractions in the lead up to Visit Malaysia 2026 would boost further support to the industry growth momentum.

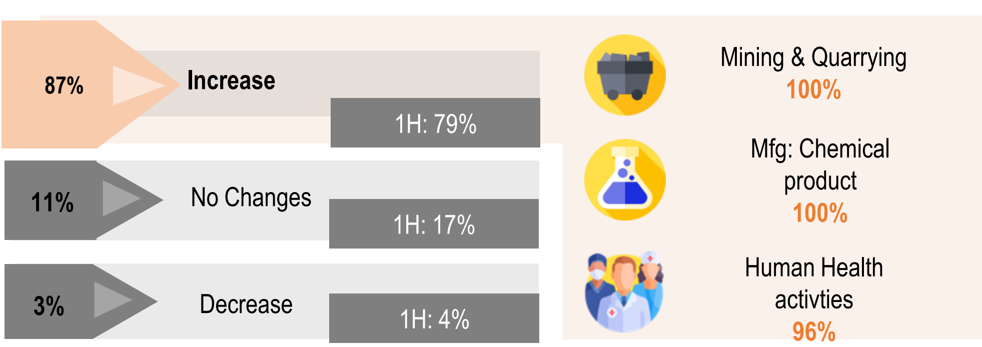
Second to accommodation, 68% of respondents in the **mining sector expect a positive economic outlook** over the next 6 to 12 months **despite negative GDP growth projections of -1.0% YoY in 2025 by MOF**. Notwithstanding scheduled plants shut down for maintenance purposes, such **maintenance activities may present opportunities to related MSMEs** in the Oil & Gas Support Activities subsector that could benefit from the increased demand for their services (84 .5% of players in the oil & gas services and equipment industry are SMEs).

By state, the majority of respondents in 13 out of 16 states and federal territories expect better economic growth with Negeri Sembilan and Pahang recording the highest expectation (72% of respondents). On the other hand, 49% of respondents in Kelantan anticipate an economic slowdown.

MSMEs may face lower profitability despite higher sales – due to a broad-based increase in costs

Corresponding to a brighter economic outlook, **expectations for sales also improved** to 64% (1H: 53%), again **driven by large businesses** where 76% of them anticipate higher sales performance. **All subsectors expect higher sales**, led by manufacture of basic metals (88%), accommodation (79%), and manufacture of chemical and chemical products (77%). While more than 50% of respondents in the following subsectors still expect sales to improve, furniture (54%), fabricated metal products (55%) and repair and installation of equipment (57%) are the least optimistic. Malaysia's export of wood products declined by -0.2% YoY in 3Q 2024 (2Q: 7.5%), reversing 3 straight quarters of growth.

Figure 2: MSMEs are facing renewed cost pressures



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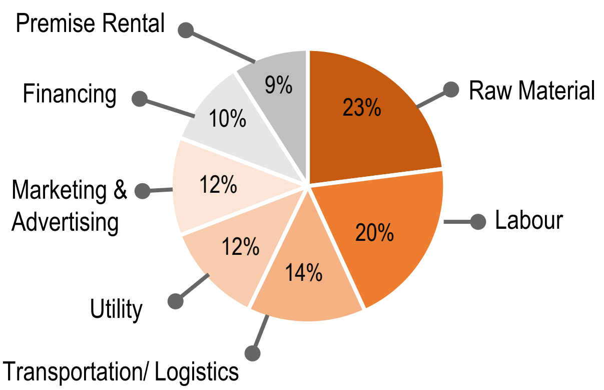
Despite better expectations in terms of sales performance and economic growth, MSMEs are facing **renewed cost pressures**, where 87% of respondents foresee business costs will rise over the next 6 to 12 months (1H 2024: 79%; 2H 2023: 88%), **suppressing profitability**. This time around, the increase is **more broad-based** where raw materials accounted for 23% of the higher cost (1H 2024: 49%), followed by labour (20%), transportation/ logistic (14%), utility (12%), marketing & advertising (12%), financing (10%) and premise rental (9%).

Figure 3: Cost increase is broad-based



Large and medium firms continue to be the most affected by the higher cost environment, which has been the trend **since 1H 2023**. **Small and micro businesses are more sensitive to raw material costs, while large and medium on labour costs.** This reflects the impact of economies of scale where larger companies tend to benefit from lower raw material cost per unit, given higher volume of goods. Nonetheless, **a series of labour-related measures announced in Budget 2025 could drive labour cost up**, especially companies **in labour-intensive industries**. Measures include: 1) higher minimum wage of RM1,700 effective 1 Feb 2025 (current: RM1,500); 2) non-citizens workers' mandatory EPF contributions; and 3) multi-tier levy system for foreign workers.

All sectors foresee higher costs of doing business. In particular, respondents from the mining and quarrying and manufacture of chemicals and chemical products are unanimous in view. This is followed by human health activities (96%), accommodation (93%), manufacture of food products (91%) and education (90%). By state, MSMEs in Perak (98%) anticipate the greatest increase in business costs, alongside Pahang (95%), and Terengganu (92%). Interestingly, **Terengganu (1H: 79%) and Perak (73%) saw a significant jump in the cost of doing business** compared to the previous survey. While Pahang and Terengganu are more concerned about raw materials cost, Perak struggles with labour cost..

Connectivity and infrastructure are important for export activities

In terms of exposure to the external market, **respondents have higher exposure to both exports** (2H: 11%; 1H: 8%) **and imports (**2H: 33%; 1H: 20%) in this round's survey compared to previously. At national level, MSMEs ' exports of goods and services accounted for 12.2% of total national exports in 2023 (2022: 10.6%; average 2017-2019: 17.5%). By sector, manufacture of rubber and plastic products and basic metals are export-oriented with 50% or more exposure to export market while the most domestic-oriented subsectors are administrative and support service activities (100%), construction (99%), and human health activities (98%).

Figure 4: Most of the MSMEs are still domestic-oriented

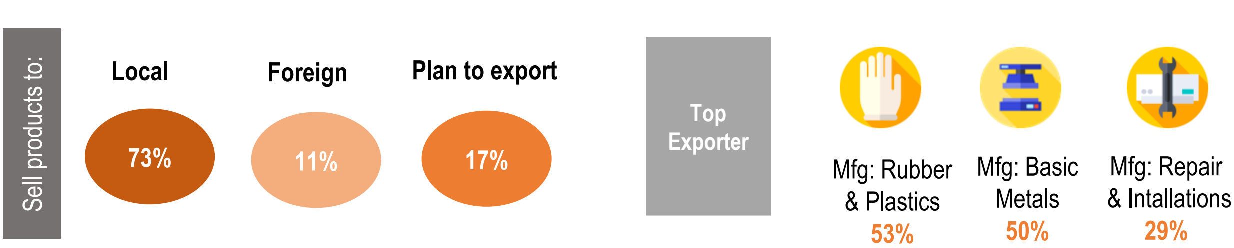


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Figure 5: Sectors with high import dependency, more than 50% of their raw materials

Although **most MSMEs are focused on the domestic market**, some sectors such as manufacture of chemicals and chemical products (33%), manufacture of food products (31%), and agriculture (31%) are **considering tapping into the export market to diversify and expand revenue streams.**

Connectivity plays a significant role in facilitating exports. **MSMEs located in West Malaysia particularly, near Port Klang and/or major ports have greater tendency to export.** The survey finding shows that higher proportion of respondents in Pulau Pinang (17%), Johor (16%) and Selangor (16%) are currently engaged in export activities compared to other states. This underscores the importance of infrastructure and connectivity in trade and logistic activities, where **States with better access are more likely to reap export opportunities.**

Meanwhile, a **higher proportion of MSMEs importing raw materials** from foreign countries could be attributed to **shortages of locally made raw materials and/or the relatively stronger Ringgit in recent months** . For instance, furniture makers were facing shortages of rubber wood since mid of this year and our survey captured a higher share of respondents in the manufacture of furniture subsector indicating an increase in raw material imports (2H: 31%; 1H: 13%). Moreover, Ringgit has appreciated against the US Dollar (Aug-Nov average: RM4.35) compared to 1H's survey (Jan-Jul average: RM4.72), providing an added advantage to importers.

Expansion plans spur worker hiring decisions

The **hiring landscape reflects a cautious yet optimistic shift** as MSMEs adapt to evolving economic conditions and changes in the labour law and policies. 49% of MSMEs plan to increase hiring over the next 6 to 12 months, an improvement compared to 1H (37%), although still below the peak observed in 2023 (1H: 61%; 2H: 67%). Meanwhile, 43% indicated the preference to maintain their current workforce level.

Figure 6: Top 3 hiring sectors:

Decision to hire is largely guided by business expansion plans, according to 73% of respondents – a surge from 45% in 1H's survey. Furthermore, MSMEs (63%) across **all business sizes continue to choose permanent employee over temporary ones, albeit lower than 1H** (67%). Some businesses view permanent roles as crucial for stability, avoid repetitive training cycles and encourage employees' long-term contribution.

The **manufacture of chemicals and chemical products retained its position as the top subsector with intention to increase hiring** (2H: 77%; 1H: 78%), followed by human health services (2H: 60%; 1H: 46%), and food and beverages services (2H: 58%; 1H: 45%). The intention to hire is in line with the respective sectors' expansion plans i.e. manufacture of chemicals and chemical products (2H: 86%; 1H: 56%), human health services (2H: 81%; 1H: 68%), and food and beverages services (2H: 66%; 1H: 50%). As **demand for take-away rises**, reflected by revised weightage of inflation basket this year at 13.4% (2023: 11.5%), this corresponds to the survey's finding of **increased hiring intention and expansion plans in the food and beverages services subsector.** On the contrary, manufacture of printing and recorded materials (59%), manufacture of fabricated metal products (55%) and education (53%) are only looking to maintain their workforce level status quo.

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Neutral impact from targeted subsidy, progressive wage and e-invoicing

With many new and ongoing developments initiated by the Government, we decided to deep dive into several significant policies: 1) targeted subsidy; 2) higher minimum and progressive wage; 3) e-invoicing; 4) automation; 5) e-commerce and cashless transaction; and 6) artificial intelligence, to gauge their distinct impact on MSMEs' business performance. Based on our findings, MSMEs indicated that **e-commerce and cashless transaction (61% of respondents), artificial intelligence (53%) and automation (48%) have positive impact on their business performance**.

Figure 7: E-commerce and cashless transaction, artificial intelligence and automation have positive impact on businesses

	Negative Impact	Neutral	Positive impact
Implementation of Targeted Subsidy	27%	**38%**	35%
Progressive Wages	30%	**37%**	33%
Implementation of E-Invoicing	18%	**43%**	39%
Automation	6%	46%	**48%**
E-commerce and cashless transaction	3%	36%	**61%**
Artificial Intelligence	3%	44%	**53%**

Manufacture of wearing apparel seem to have benefited the most from e-commerce and cashless transaction (86%) and artificial intelligence (71%), evolving alongside consumer's lifestyle and shopping preferences. Automation (58%) and technology advancements help manufacture of wearing apparel manage inventory, spot trends, predict new styles as well as cut fabric efficiently. These helps reduce waste and minimise human error, leading to lower costs while boosting profits in the long run. Although majority of respondents (54%) in the manufacture of wearing apparel still intend to increase their workforce, the proportion came down from 60% in the 1H.

On the other hand, MSMEs have conveyed **neutral impact from the rolling out of targeted subsidy, progressive wage and e-invoicing** given that some of these developments have yet to be fully implemented.

- E-invoicing is currently only effective for businesses with over RM100 mil in revenue and it will be mandatory in July 2025 for all businesses with revenue above RM150,000. Most of the **large companies** (39%) which are supposed to be on board already, **view it to have neutral impact** on their business performance probably because they have the **capacity to absorb** the cost related to it.

- On targeted subsidies, diesel subsidy has been rationalised, but RON95 will only start mid of next year. The **land transport services** (41% of respondents) sector is **the most impacted**, even though targeted subsidies are provided. Such sentiment probably stems from the fact that **not all transport service providers are eligible for diesel fleet cards or RM200 cash subsidy** such as travel bus/van, tow truck and tipper lorries, and those that are eligible have **quota limits which are insufficient** to fully cover their operations.

- New minimum wage will only be effective in February 2025 with grace period provided for micro businesses until August 2025. Additionally, the Progressive Wage Policy (PWP) will be fully enforced in 2025. Adverse impact from this policy corresponds to business sizes, where **large** (42%) and **medium** (40%) businesses which generally employ **bigger number of employees, have the highest negative impact.**

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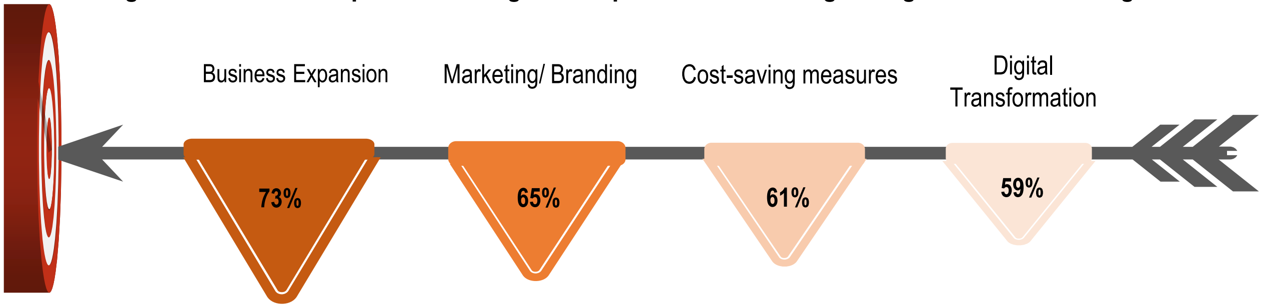
MSMEs shift focus to business expansion

In terms of MSMEs' focus areas in the next 6 to 12 months, **business expansion emerged as top focus area** (73%) for MSMEs, followed by marketing/branding (65%), cost-saving measures (61%) and digital transformation (59%). **Marketing/branding has lost its crown** to business expansion this time around, **after preserving its top spot since the inception of this survey**. This change indicates growing confidence among MSMEs and their strategy to capitalise on potential demand.

Figure 8: Business expansion emerged as top focus area amid growing confidence among MSMEs



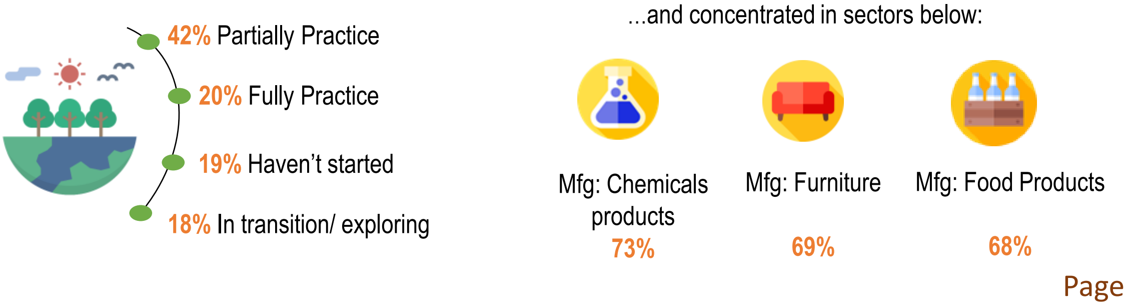
The **top sectors for expansion plans are manufacture of food products** (86%), **manufacture of chemicals and chemical products** (86%) as well as education services (84%) and manufacture of wearing apparel (84%). Food processing and chemical manufacturing are some of the sectors **covered under New Industrial Master Plan (NIMP) 2030**, with the latter listed as priority. The plan is for the food processing sector to **expand into high value-added activities of the value chain** such as ready-to-eat meals and alternative proteins and for the chemical sector, a shift from basic to specialty chemicals. Food processing also comes under specialty chemicals' focus area where nutrition chemicals are being used on food products to enhance their qualities including taste, texture, appearance or perseveration.

Meanwhile, sectors that are most keen to focus on cost-savings measures are manufacture of printing and recorded materials (76%), manufacture of wearing apparel (76%) and motor vehicle sales and repair (72%). Surprisingly, these sectors are not among the top three that foresee business costs to increase. Regardless, they still expect costs to go up compared to 1H survey.

MSMEs continue to steer towards sustainability-ready

On Environmental, Social, and Governance's (ESG) specific findings, the survey revealed **that 62% of MSMEs have partially or fully implemented ESG practices, while 18% are in the transitioning or exploring process** and the balance 19% have yet to start anything. Those who have embraced ESG acknowledged that it **helps them save costs** (46%). It is not surprising that there are more ESG practising MSMEs in the medium (78%) and large (63%) sized businesses. By sector, respondents from the information and communication services (35%), education services (30%) and manufacture of wearing apparel (29%) claimed that they have fully implemented ESG practices.

Figure 9: Majority of respondents are practicing ESG



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Meanwhile, those who are still exploring and yet to embark on ESG practices have relayed that **lack the clarity on how to start and where to go for support** (34%) is the main reason. This is followed by other reasons such as unclear definition of sustainability (26%) and additional costs (23%). Centre for Entrepreneur Development and Research (CEDAR), a subsidiary of SME Bank, provided free training on ESG related matters, namely *Skim Insentif Kelestarian*, to guide MSMEs in adopting ESG best practices and implementing effective strategies. Through this training, MSMEs also had the opportunity to receive ESG adoption grant, worth up to RM40,000 per company. Nevertheless, Bank Negara Malaysia (BNM) has recently cautioned on the associated **costs for the transition to a green economy being passed on to consumers**, leading to increased prices, termed **'greenflation' which could significantly affect businesses and consumers alike.**

Perak (76%), **Pahang** (73%) **and Melaka** (72%) **stand out as States with the highest ESG adoption rates, supported by their respective States' sustainability plans** i.e. Perak Sejahtera 2030, Pahang Net Zero 2030 and Smart Melaka Blueprint 2035. Perak has unveiled its state budget of RM1.5 bil for 2025, prioritising initiatives under the Perak Sejahtera 2030 development plan, with RM69.8 mil allocation to safeguard Perak's natural resources which focuses on environmental sustainability. Meanwhile, Melaka has been actively organising Melaka Green Awards since 2015 to 1) acknowledge communities that conduct sustainable green technology practices; 2) serve as a platform to boost awareness on sustainable environment; and 3) promote green technology.

Micro businesses have the lowest cash reserves

Figure 10: Top 3 vulnerable sectors with less than 6 months of cash reserves:

Mfg: Repair & installations	Mfg: Rubber & Plastics	Education
83%	63%	48%

Most MSMEs (68%) **have more than 6 months of cash reserves** and are deemed to be financially sustainable. However, this is a **significant reduction if compared to 1H** (90%). Proportion of those with more than 3 years and 1 to 3 years of cash buffer came down to 12% (1H: 45%) and 22% (1H: 27%), respectively. Meanwhile those with 6 months to 1 year and below 6 months of cash reserves rose to 35% (1H: 18%) and 32% (1H: 10%), respectively. We observed a similar trend last year where **cash reserves tend to diminish in the second half of the year.** Companies probably defer major expenses in 1H and utilises it towards the later part of the year.

By size, **micro businesses** which are generally more vulnerable are the most responded (41%) with **low cash reserves** (<6 months) while **large size businesses have the highest** (82%) cash buffers. Manufacture of repair and installation (83%) and manufacture of rubber and plastics (63%) are the most vulnerable sectors with low cash reserves.

In contrast, manufacture of furniture (77%), manufacture of printing and recorded materials (76%) and land transport services including petrol stations (76%) topped the list of the highest cash reserves. **Financing for working capital purposes** (70%) **was cited as the top assistance required by respondents**, followed distantly by financing for sustainability practices (8%) and digitalisation (5%). This aligns with BNM's end-Sep 2024 data, which shows that the bulk of total SME financing outstanding comprised of working capital purposes (43%), surpassing other categories such as non-residential financing (34%) and fixed assets (8%).

Figure 11: Some assistance needed by MSMEs:

70%
Financing for working capital

8%
Financing related sustainability

6%
Other entrepreneurship training

5%
Financing for digitalisation

Note: All figures are rounded; they might not add up to 100%.

Overall, we remain confident that **MSMEs are resilient as they continue to demonstrate stronger performance and growth potential**, showcasing their vital role as the country's key pillars of growth and stability. Nevertheless, regular assessment of their business operations and strategies to adapt to new trends and business dynamics are essential to fulfil the changing needs of consumers and market conditions. Below are funding programs provided by SME Bank as well as trainings by our subsidiary, CEDAR.

Table 1: SME Bank financing programs

- Agro Food (AF)
- All Economic Sectors (AES)
- BizCashPlus
- Contract Financing (CF)
- Dana Kemampanan PMKS Bumiputera (DKPB 2.0)
- Disaster Relief Facility (DRF) 2022
- HalalBiz Financing Program (HalalBiz)
- High Tech & Green Facility (HTG)
- Jaguh Serantau (JS)
- Low Carbon Transition Facility (LCTF)
- PENJANA Tourism Financing (PFT)
- Rolling SRF (RSRF)
- Rolling TRRF (RTRRF)
- Skim Anjakan Usahawan (i-SMART)
- SME Automation & Digitalisation Facility (ADF)
- SME Technology Transformation Fund (STTF)
- Social Enterprise Financing Scheme (SEFS)
- Tabung Khas Pelancongan (TKP)

For more information, please visit www.smebank.com.my

Table 2: CEDAR entrepreneur development programmes

- Business Advisory
- Business Exporter Program 2.0
- Customized Grow! Coaching
- ECOTHON 2023
- HRD Corp Signature Programmes-Credit Securing Strategies
- I-Smart
- Mandatory Training Programme
- MDEC 100 Go Digital Accelerator Programme
- Program New Gen (N-Gene) Entrepreneur Online Bootcamp 3.0
- Program Usahawan Perantis (SPACE)
- Skim Insentif Kelestarian
- Skim Juara Lestari
- TITAN Program
- Upward Migration Programme

For more information, please visit www.cedar.my

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