SME BANK GROUP

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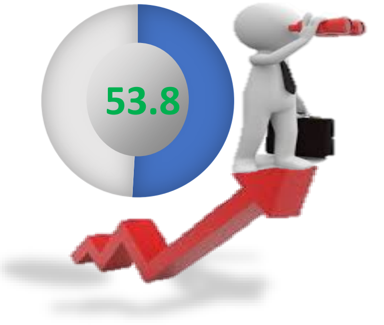
SME Sentiment Index 2022

Optimistic despite challenging prospects ahead

SME Bank had conducted an inaugural survey, named SME Sentiment Index (the Index), between April and June 2022. The survey successfully garnered 730 respondents from various types and sizes of SMEs. **A leading economic indicator**, the Index serves to **gauge SMEs' sentiment on the economy and business environment**, providing a glimpse into the reality of SMEs on the ground.

The Index showed a **positive reading of 53.8**, suggesting that most **business owners are optimistic, resilient and adaptive**. They are able to identify the silver lining in current situation. A score of above 50 reflects optimism/ positive sentiment and vice versa. The majority of SMEs are confident that the unfavorable developments currently faced will subside over the next 6 to 12 months.



Firm size*

Micro	**Small**	Medium	Large
21.4%	**66.7%**	10.4%	1.5%

The common respondents of this survey were Corporations or Private Limited Companies (45.1%), followed by Sole Proprietor (37.1%) and Partnership (17.3%). **By size, most respondents** are in the **Small (66.7%)** business category, followed by Micro (21.4%), Medium (10.4%) and Large (1.5%). The **majority** of respondents are from the **Services (72.0%)** Manufacturing (14.3%) and Construction (12.6%) industries. The Mining & Quarrying (0.3%) and Agriculture (0.8%) sectors collectively make up less than 1.2%.

Results from the survey shows that **57.3% of the respondents expect business environment to improve over the next 6 to 12 months.** Despite ongoing headwinds in the economy, nearly half of the respondents view expansion plans as one of their most important focus areas in the near term, except micro enterprises (39.8%). Notably, **14.6% of those in the Retail sector are keen in expanding their business**.

Profitability of firms is expected to improve over time, with **73.2% SMEs anticipating an increase in their gross revenue, led by the Retail sub-sector**. The remaining 14.8% of SMEs foresees that their revenue will remain stagnant and 11.9% anticipates a decline in their revenue, predominantly businesses in the Manufacturing sector. Among the 73.2% respondents, 45.6% expect their gross revenue to increase by more than 20% over the next 6 to 12 months, while 54.4% expects an increase of around 10%. In fact, 82.3% of respondents from the Accommodation and F&B sub-sectors are confident of an increase in their revenue, in line with the reopening of international borders, which would

*Source: SME Corporation Malaysia. Firm size based on revenue:
1) Manufacturing sector - Micro (<RM300,000), Small (RM300,000 < RM15 mil), Medium (RM15 mil ≤ RM50 mil), Large (>RM50 mil)
2) Services and Other sectors - Micro (<RM300,000), Small (RM300,000 < RM3 mil), Medium (RM3 mil ≤ RM20 mil), Large (>RM20 mil)

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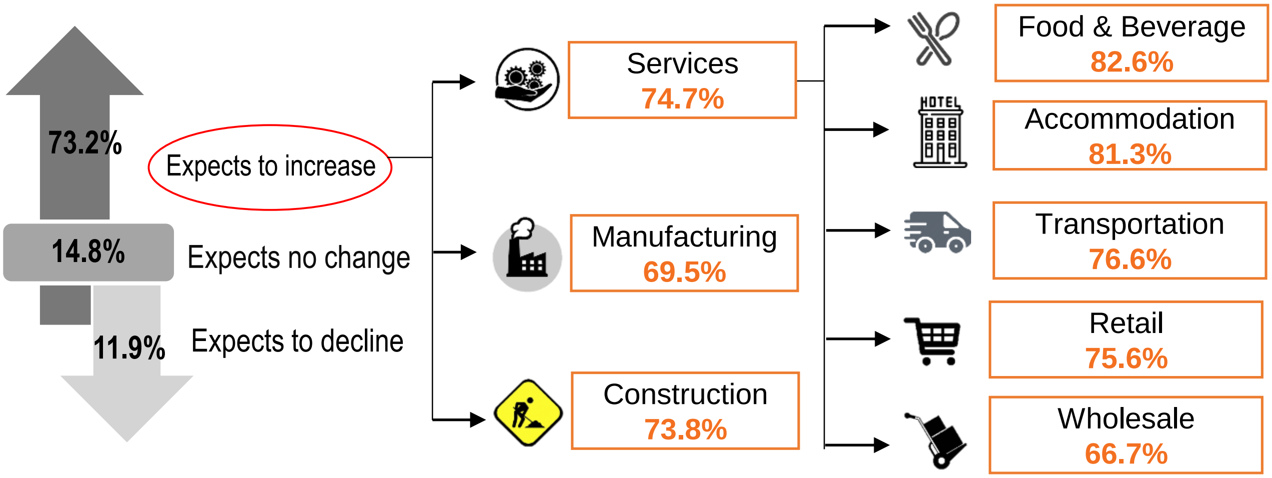
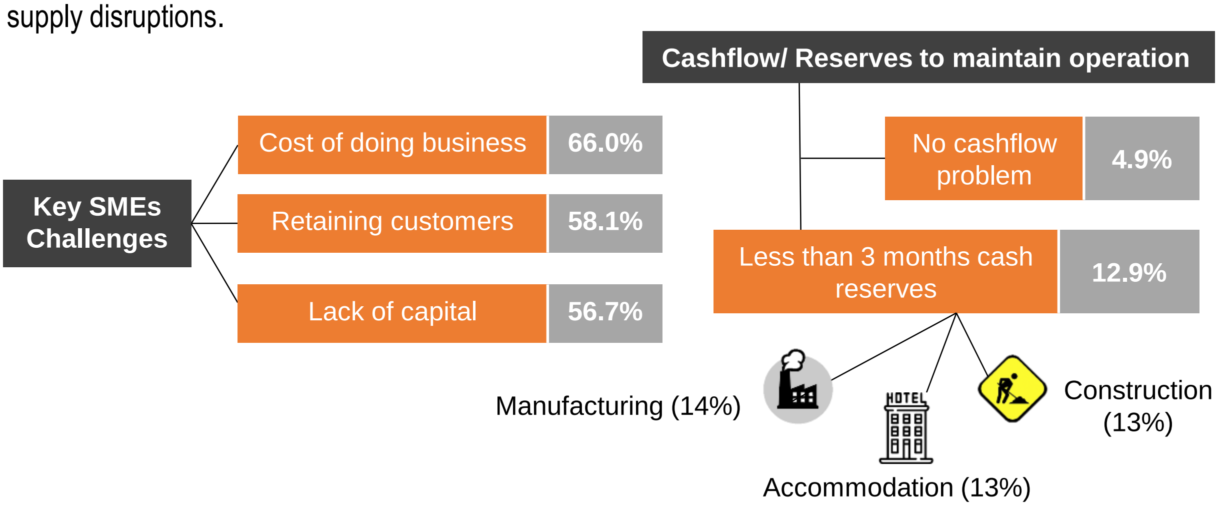
be a boon for the tourism industry that rely on foreign travelers. That said, while 42.2% of survey respondents are willing to hire, they may not be able to recruit sufficient manpower amid the current labour crunch, straining their operating capacity. This **labour shortage issue** is more pressing for those labour-intensive industries, which in turn will **limit their revenue projections**.



A majority (39.0%) of businesses prefer to keep their inventory small for only 2 weeks. This is predominantly true for the Food & Beverage (F&B) sub-sector as their stocks are mostly perishable items. For SMEs in the Wholesale and Retail sub-sectors, 77.9% of respondents expect to stock their inventories up to 1 month in advance. Given global supply chain snarls, this would put some burden on the suppliers as they have to absorb higher costs by stocking up inventories to weather risks arising from supply disruptions.



While SMEs are steadily picking themselves up during this economic recovery phase, they now have to grapple with **rising costs of doing business**, exacerbated by **supply chain disruptions** and **higher raw material prices**. **Two third of respondents** cited cost of doing business as the top factor that will affect their business in 2022. Other factors include difficulty in retaining customers due to rising competition (58.1%) and lack of capital (56.7%). On the other hand, SMEs opined that changes in government and insufficient marketing are factors that may least affect their business performance, in comparison.

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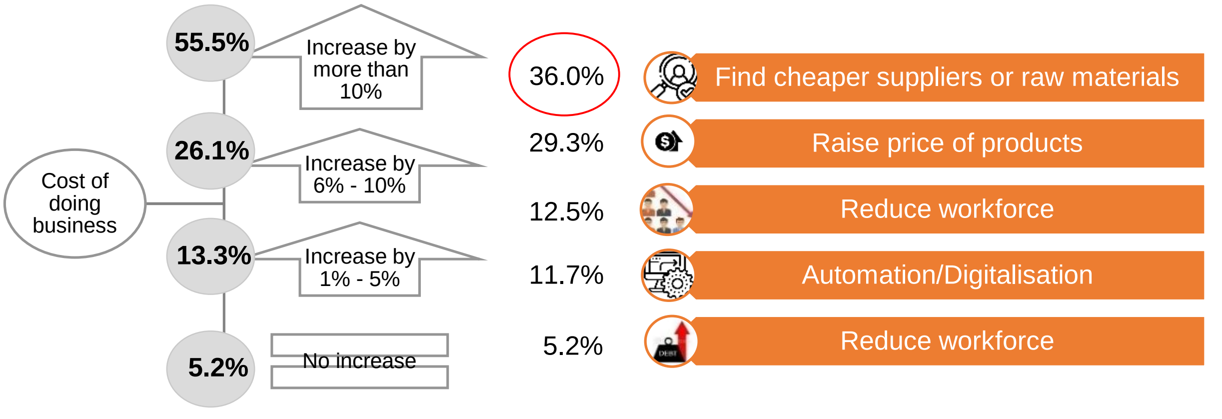
Based on current developments, **almost all of the respondents foresee their cost of doing business to increase over the next 6 to 12 months**. 55.5% of SMEs anticipate cost to rise beyond 10%, while 26.1% expect a 6% to 10% increase. By industry, more than half of respondents from the Manufacturing (71%), Construction (60%), F&B (58%) and Retail (54%) sectors indicated that cost will likely rise above 10% in the near term, owing to the higher prices of goods and inflation spillover effects.



The factory gate price which is measured by the producer price index (PPI), mirrors the SME respondents' view of rising cost. Latest PPI data registered a 10.9% growth in June, the fourth consecutive month of double-digit expansion. To tackle this issue, **most SMEs are trying to switch to cheaper suppliers or find alternative raw materials before opting to pass the burden onto consumers by raising prices of their products.** The cost pass through to end-users led to an escalation in headline consumer price index (CPI) to 3.4% in Jun 2022 (1Q 2022 average: 2.2%), the fastest in 12 months. Case in point is food inflation, which makes up around 30% of the inflation basket, has climbed to 6.1% in Jun 2022, compared to the pre-pandemic's average of 2.5%. This is the highest increase in 13 years.

95.1% of respondents have cash flow difficulties, where a third of them have indicated having less than 6 months of cash reserve to sustain their current operation. Notably, **12.9% of businesses have less than 3 months of cash buffer to stay afloat,** particularly SMEs in the Manufacturing (14%), Accommodation (13%) and Construction (13%) sectors. Hence, we believe SMEs in these sectors are more vulnerable to shocks and require monetary aid to sustain their cashflow to cope with higher salaries, raw materials, utility, and production costs.

As such, **close to 80% of SMEs have indicated the need for cash assistance via financing**, despite the rising interest rate environment. 45% of respondents are looking for additional financing, particularly to manage their **working capital**. Meanwhile, CAPEX financing for land & building acquisition and purchases of machinery & equipment are mainly required by respondents from the Manufacturing sector (19%). Almost half of additional financing needed for commercial vehicles (44.7%) stemmed from the Transportation sector. Some programs offered by SME Bank, such as Lestari Bumi Financing (LBF), the newly launched IBS Promotion Fund 2.0 (IBS 2.0) and Young Entrepreneur Fund 2.0 (YEF 2.0), and other collaborative programs such as Penjana Tourism Financing, Business Accelerator Program (BAP), Skim Pembiayaan Ekonomi Desa (SPED) and Bumiputera Supply Chain (BSC), could be of interest to businesses.

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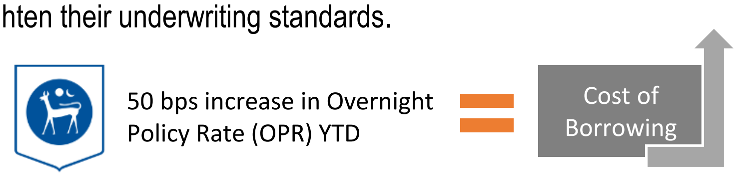
At the national level, **SME financing** extended by financial institutions showed a **resilient growth trend** of 7.5% YoY in Apr 2022 (1Q: 6.0%). The encouraging data was supported by the resumption of economic and social activities. By sector, financing to the **Transportation, Storage & Communication industry went up by 22.7% YoY,** while Mining & Quarrying and Wholesale & Retail Trade, Restaurants & Hotels jumped by 17.2% and 10.0%, respectively. The extra cash injection through financing was in line with a pickup in domestic demand, capital expansion and higher working capital needs. While the **gross impaired loan/financing ratio** of the SME financing in the banking system **remained intact**, at 3.7% in April, **rising interest/profit rates may pose downside risks to the asset quality** which may cause banks to tighten their underwriting standards.



Most of the SMEs (46.5%) intend to maintain their current manpower over the next 6 to 12 months while 11.4% plans to downsize their workforce. For those **firms that intend to hire (42.2%** of respondents), **recruitment preference is for full time staff (38.7%),** followed by contract (29.9%) and part-time (12.5%) staffs. Despite being optimistic on their business and economic growth prospects, only large sized (66.7%) and small sized SMEs (42.1%) have indicated high likelihood of employing full time employees over the next 6 to 12 months. Large enterprises can generally invest more in training and equipment, pay higher wages, and offer better working conditions. This is in contrast to medium SMEs, which illustrates the preference to hire contract workers (43.5%) than full time employees (33.9%). Financial constraints, high employee turnover, and size of business could be factors prompting medium SMEs to prefer contract workers. On the other hand, **one third of micro SMEs will not be hiring** any staff in near term, probably due to higher labour cost. They would likely **leverage on existing workers' potential at the moment.** Moreover, the implementation of the new minimum wage starting May 2022 adds to most SMEs' concerns as labour cost account for 20% - 40% of their operating cost.

Micro	Small	Medium	Large
Full Time [27.8%]	**Full Time [42.1%]**	Full Time [33.9%]	**Full Time [66.7%]**
Part Time [16.7%]	Part Time [12.0%]	Part Time [9.7%]	Part Time [0.0%]
Contract [22.2%]	Contract [30.1%]	**Contract [43.5%]**	Contract [22.2%]
Not Hiring [33.3%]	Not Hiring [15.9%]	Not Hiring [12.9%]	Not Hiring [11.1%]

The solid labour demand among SMEs are in line with Malaysia's labour market data. Vacancies at the national level stood at 463,936 in May 2022, four times above the pre-pandemic average (2017-19: 98,417). The strong numbers were attributable to the manufacturing (178,264), services (200,055), construction (67,416), and agriculture, forestry, and fishing (16,628) sectors. **As revenue improves coupled with sustained demand, we believe business appetite to expand may increase, which could lead to higher hiring.**

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SMEs are generally hopeful and positive on recovery prospects over the next 6 to 12 months with the SME Sentiment Index score of 53.8. As **businesses adapt and adjust better to the post-pandemic operating environment**, we are confident that SMEs are resilient. SMEs can leverage on **technology and modernisation to identify new pockets of opportunities** to capitalise on the evolving nature of doing business and remain competitive.

While the SME Sentiment Index and recent domestic economic data are showing an optimistic outlook, we **remain cautious on the developments on the external front.** The tighter global monetary policy environment, prolonged supply chain disruptions, geopolitical tensions, higher inflation, risk of recession and the emergence of contagious diseases could have spillover effects to the domestic economy and derail our recovery trajectory. Therefore, SMEs need to be resilient and sensitive towards the changing global economic environment.