

GROW, GLOW AND GLOBALISE

Why Diversification and Restructuring Are a Must for Malaysian SMEs

TO what extent will Malaysia's economic fate be dependent on enterprise growth? While we are confident that the Malaysia Economic Transformation Program (ETP) roadmap is a catalyst for enterprise growth, much work still needs to be done to raise productivity and enhance the competitiveness of Malaysian enterprises.

This goal is especially critical in order to achieve a multiplier effect on its wider economy.

Crucial questions that we need to ask: How do we achieve broad-based enterprise growth? What needs to be done and what barriers are we likely to face? This article critically looks at the drivers of enterprise growth and suggests ways on achieving it, taking into account current and future marketplace dynamics.

IMPACT OF BUSINESS FORMATION ON GDP GROWTH

Have Malaysian enterprises made a better contribution towards the Malaysia GDP? Based on the data we studied from SSM and the Malaysian statistics department, it appears to be that Malaysian enterprises have made that contribution.

It is not far-fetched to say that, judging from the way new businesses have been formed, there is a rising optimism among local entrepreneurs in Malaysia's current state of entrepreneurship.

From 2011 to 2016, there has been 23.7% increase in the total number of companies from 972,500 to 1,203,319. Total businesses (sole proprietorship and partnership) shows 37.1% increase from 4,646,722 to 6,375,751.

Another way to illustrate this is by reviewing the latest SME Annual Report 2015/2016 prepared by SME Corp Malaysia, an agency under the Ministry of International Trade and Industry Malaysia.

According to the report, Malaysian SMEs has recorded a significant one-off growth of 7.9% which surpassed average annual growth rate for the period 2011-2015 at 6.7%. This resilient growth contributed to GDP increased from 32.20% in 2010 to 36.3% in 2015.

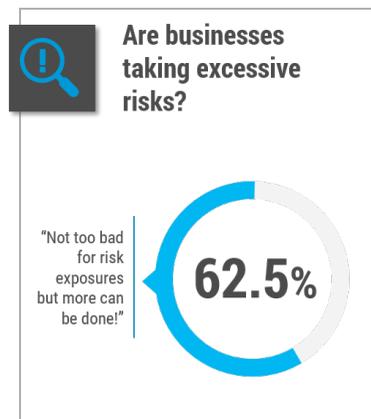
In terms of sectoral performance, SMEs in mining and quarrying and construction sectors are expanding at an average growth rate of 9.3% and 10.9% respectively during this period. The proportion of this sector increased in 2015. Therefore, it is apparent that the formation of new enterprises in a broad-based manner can have a positive impact on Malaysia's GDP.

CURRENT HEALTH OF MALAYSIAN COMPANIES, ESPECIALLY SMES

What exactly is the state or health of Malaysian businesses across sectors? Are we ready to grow, glow, and globalise? What must we do to move into the direction? Let us try to

comprehend Malaysia's current state of entrepreneurship.

In the previous edition, we concluded the review of 200 companies across the four 'Financial Strength' dimensions; via business performance, shareholder value, risk & liabilities and productivity over two-year period (2015-2016). The results are illustrated below:



WHAT SHOULD MALAYSIAN BUSINESSES SHOULD DO: THE "D" WORD

In plain language, diversifying business is about building new products, exploring new market, and taking new risks. In order for Malaysian entrepreneurs to have a good grasp on this subject, let us answer these three fundamental questions:

- Why is it important for entrepreneurs to diversify their businesses?
- What are the necessary and effective steps needed to ensure business diversification reaches its target?
- Where should Malaysian entrepreneurs diversify their businesses given the challenging economic and business growth?

EAC CEO and Global Head of its Data Science and Analytics unit, Nazri Muhammad made the following observation: "Diversification is generally important in order to avoid major repercussions when an industry suffers a downturn. Being diversified also helps to protect their companies against changes. On top of that, the cost of ignoring this can be severe. There will be higher possibility they will lose their capital."

To ensure business diversification leads to success, there are four important points to consider. Firstly, it is vital to ensure that the new offerings create value for the customers.

Since creating value is the fundamental objective for entrepreneurs, they have to ensure that diversification does not lead them astray from their main objective. Secondly, be an expert in the market that your company is expanding.

If your company does not have the system and team needed in the industry, it might be better to rethink the idea of diversifying the business as it might lead to major loss.

Thirdly, building on strengths of what the company already have. This will help to ease the process of transition as the company already has strong foothold in related industry. Finally, it is important to put the right person in place.

Since diversification will serve new challenges in new industries, a company must prepare the best team to withstand the challenges. The more passionate and informed employees are to diversify, the process will become easier and more efficient.

Another essential matter to consider in pursuing business diversification is related to business restructuring. Nazri concurred with this contention by saying that any company looking to promote and experience growth should put business restructuring a high priority as adding new function is key to expanding customer base and increase profitability.

On top of that, business restructuring with the introduction of new technology may enjoy increased operational efficiency.

This can be achieved via two integration strategies namely vertical and horizontal as depicted in Diagram 1. Vertical strategy takes place when a company takes complete control over one or more stages in the production or distribution of a product.

For instance, Carnegie Steel Company (now US Steel), an American steel producing company not only bought iron mines to ensure the supply of raw material but also took over railroads to strengthen the distribution of final product in the 1890's.

Vertical integration can provide companies with multiple advantages. It helps companies to gain full control of raw materials and take over the reins of distribution of their products.

Besides that, it helps companies to cut transportation expenses and reduce turnaround time for companies in financial recovery mode. Vertical integration can be carried out in two ways: backward integration and forward integration.

Backward integration occurs when a company moves backward in its industry chain. Apple Inc. performs backward integration by acquiring companies that manufacture A-series chips for its iPhones and iPads.

Is the value to shareholders of enterprises improving?

41.7%

Are enterprises' assets efficiently managed?

51.6%

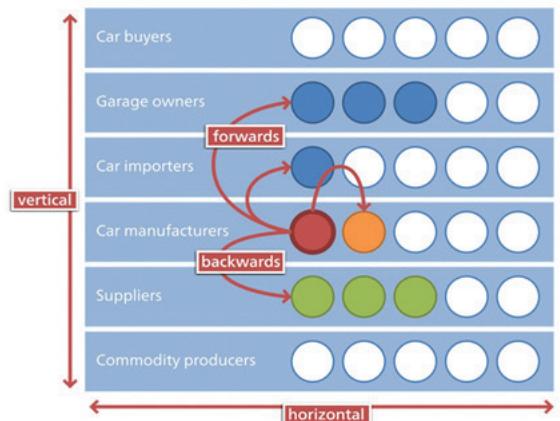


DIAGRAM 1: VERTICAL AND HORIZONTAL STRATEGY
SOURCE: BUSINESS2COMMUNITY

Meanwhile, the forward integration occurs when a company expands forward on the production path. American Apparel is the classic example of a company that employs forward integration through controlling of every aspect of distribution of its products. It manages every form of distribution in-house, including high-profile retail stores to boutiques and the online store that sells throughout the United States and worldwide.

Different from vertical strategy, horizontal integration takes place when companies acquire business activities that are the same level of the value chain in similar or different industries. This can be achieved by internal expansion through a reinvestment of operating profits or by external expansion through a merger or acquisition. Examples of horizontal acquisition includes a fast-food restaurant chain merging with a similar business in another country to gain foothold in foreign market or an oil company acquires additional oil refineries.

Horizontal acquisition can offer range of advantages to the company. By acquiring the products of other companies, a particular company can expand its product range and increase revenue by selling more products to its existing customers. Besides that, the company can increase its distribution coverage if the companies that it acquired have different geographical base.

In one way, it can help the company to enlarge its market share. However, before the company makes the decision to utilize which strategy, it is important to thoroughly delve into its advantages and disadvantages.

Pertaining to this, Nazri adds the decision whether to employ vertical or horizontal integration has a long-term influence on the business strategy of the company.

Another key aspect to consider before diversifying a business is related to the type of organisational structure in used by management.

Diagram 2 shows flat organisational structure where there are only a few levels of management separating executives from lower level employees, it works best for a company with few employees.

There is the opportunity to make quick decisions and cut down unnecessary bureaucracy. Referring to Diagram 3, functional organisational structure is centered on job functions such as finance, marketing, and manufacturing. This works well for project-focused companies. This cuts down time being spent on dividing up tasks and increases work efficiency.

Another form of organisational structure is depicted in Diagram 4, known as product organisational structure where it has managers reporting to the head of company or president by product type. This form of organisational structure is primarily used by retail companies that have stores in various cities.

This is important in order to create clear focus on market segment to meet customer needs more effectively. Referring to Diagram 5, geographical organisational structure works when companies decentralize the functional areas based on region.

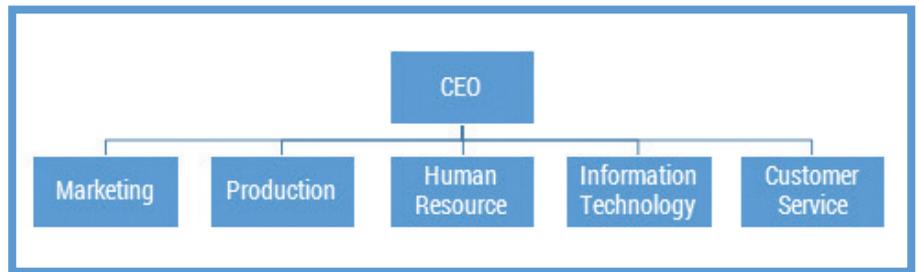


DIAGRAM 2: FLAT ORGANISATIONAL STRUCTURE

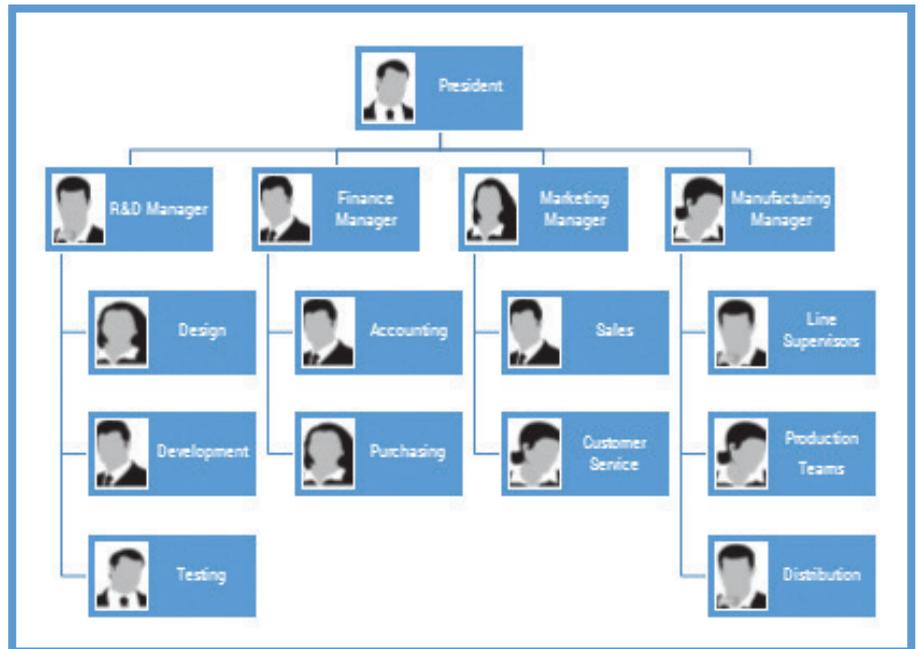


DIAGRAM 3: FUNCTIONAL ORGANISATIONAL STRUCTURE

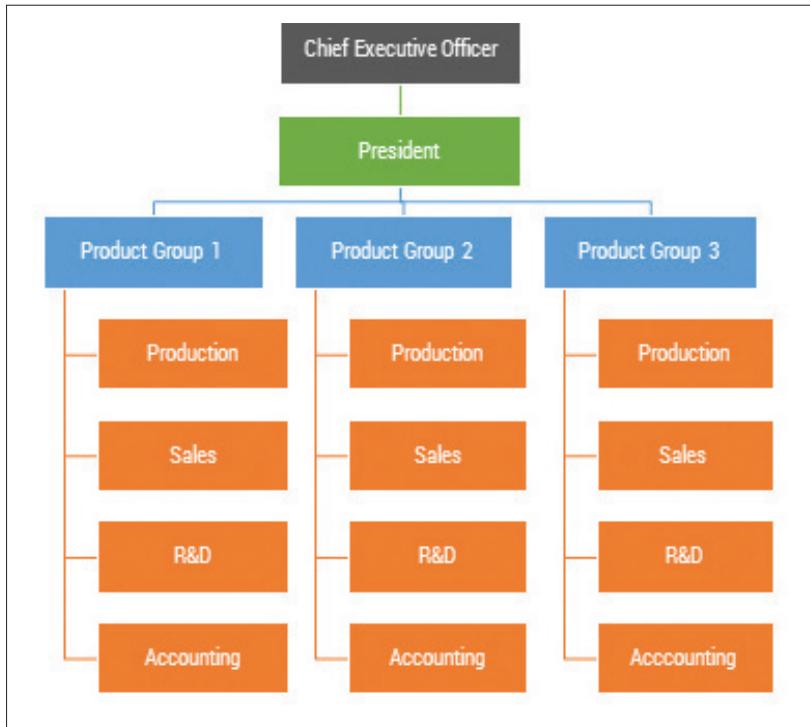


DIAGRAM 4: PRODUCT ORGANISATIONAL STRUCTURE

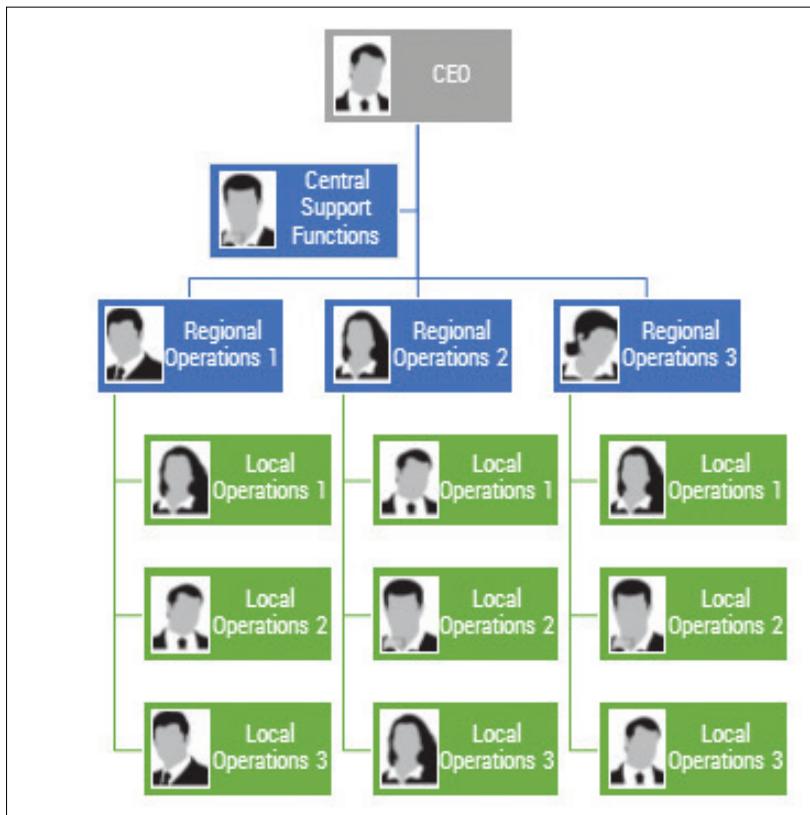


DIAGRAM 5: GEOGRAPHICAL ORGANISATIONAL STRUCTURE

On this note, Chairman of Expert Analytics Center (EAC), Datuk Dr Mohd Daud Bakar said, “As there are many reasons companies might restructure, there are many benefits of restructuring a company. Some benefits are financial, such as reviving a declining business, increasing a company’s value, and preparing it for sale or transfer to the next generation.”

“DIVERSIFICATION IS GENERALLY IMPORTANT IN ORDER TO AVOID MAJOR REPERCUSSIONS WHEN AN INDUSTRY SUFFERS A DOWNTURN” – NAZRI

“Other benefits involve gaining a competitive advantage and allowing for the addition of new accounts or enabling expansion into other geographical areas,” said Dr Daud.

Next question is: which markets should Malaysian entrepreneurs eye when diversifying their businesses? One market with strong economic growth that they should consider is the ASEAN market.

A report by World Economic Forum states that the ASEAN market is now more accessible than European Union and United States. ASEAN’s progress as an economic power comes at a time when United States and European Union are becoming less open.

Although there are gaps and issues that need to be addressed, undoubtedly there are numerous ways that can be undertaken by Malaysian entrepreneurs to grow their business, glow its performance, and globalise their market shares. The strong entrepreneurial ecosystem in Malaysia, a plethora of government-sponsored incentives, and a vibrant regional economic growth serve as an opportunity for them to make a giant leap forward in terms of their business goals.

To quote Mark Zuckerberg; “In a world that changing really quickly, the only strategy is guaranteed to fail is not taking opportunity”. **MB**