FACTORS AFFECTING THE FIRM PERFORMANCE AMONG SMALL AND MEDIUM Sized ENTERPRISES (SMES): A CONCEPTUAL PAPER

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ABSTRACT

The purpose of this paper is to examine the factors affecting the firm performance among SMEs owners in food services sector in East Malaysia, Sabah. A conceptual framework was developed to highlight the relationship between the factors and firm performance. This due to many challenges faced by SMEs in order to survive in business and yet the resources is scarce.

Keywords: Financial capital, human capital, social capital, technology and operation

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1.0 INTRODUCTION

Small and Medium Sized Enterprises (SMEs) has been noted played a major roles to economy growth of many countries (Omar, Arokiasamy and Ismail 2009; Ayyagari, Beck and Kunt, 2007; Audretsch, 2002; Beck, Kunt and Levine, 2005; Storey, 1994). In Malaysia perspectives, the numbers of SMEs is growing has reported by (Shankar, Pandian, Sulaiman and Munusamy, 2010) and SMEs also expected to contribute around 50 per cent of the Gross Domestic Product (GDP) in the year 2020 (Hashim, 2000). Moreover, SMEs act in order to serve the community through job creation, accelerating competition among business players, introducing innovation and acting as a supply chain to the Multinational Companies in Malaysia (Hashim and Wafa, 2002).

Table 1: Malaysia: Definition of Small and Medium Enterprises

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Micro enterprises</th>
<th>Small enterprises</th>
<th>Medium enterprises</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing, manufacturing-related services, and agro-based industries.</td>
<td>AST less than RM250,000; or FTE less than 5.</td>
<td>AST from RM250,000 but less than RM10 million; or FTE between 5 and 50.</td>
<td>AST between RM10 million and RM25 million; or FTE between 51 and 150.</td>
</tr>
<tr>
<td>Services, primary agriculture, and information &amp; communication technology (ICT).</td>
<td>AST less than RM200,000; or FTE less than 5.</td>
<td>AST from RM200,000 but less than RM1 million; or FTE between 5 and 19.</td>
<td>AST between RM1 million RM5 million; or FTE between 20 and 50.</td>
</tr>
</tbody>
</table>

Source: SME Corporation Malaysia 2013.

Table 2: Malaysia: SME Profiles

<table>
<thead>
<tr>
<th>Sector</th>
<th>Total Establishment (a)</th>
<th>Total SMEs (a)</th>
<th>Percentages (%) of SMEs over Total Establishment (b)/(a)*100</th>
<th>Total Employment by SMEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall Total</td>
<td>662,939</td>
<td>645,136</td>
<td>97.3</td>
<td>3,669,259</td>
</tr>
<tr>
<td>Services</td>
<td>591,883</td>
<td>580,985</td>
<td>98.1</td>
<td>2,610,373</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>39,669</td>
<td>37,861</td>
<td>95.4</td>
<td>698,713</td>
</tr>
<tr>
<td>Agriculture</td>
<td>8,829</td>
<td>6,708</td>
<td>76.0</td>
<td>78,777</td>
</tr>
<tr>
<td>Construction</td>
<td>22,140</td>
<td>19,283</td>
<td>87.1</td>
<td>275,631</td>
</tr>
<tr>
<td>Mining &amp; Quarrying</td>
<td>418</td>
<td>299</td>
<td>71.5</td>
<td>5,765</td>
</tr>
</tbody>
</table>

Source: SME Corporation Malaysia 2013
Based on Table 2 above, 98.1 per cent of SMEs in Malaysia are in the service sector, followed by 94.5 per cent in manufacturing, 87.1 per cent in construction and 76.0 per cent in the agriculture sector. Meanwhile, the Service sector alone contributes around 2,610,373 employment opportunities as compared to other sectors. Below on table 3 stated the lists of agencies that assist and support the SMEs activities in Malaysia.

Table 3: Agencies to support SMEs activities in Malaysia

<table>
<thead>
<tr>
<th>Agencies</th>
<th>Year establish</th>
<th>Functions</th>
</tr>
</thead>
<tbody>
<tr>
<td>MARA (Majlis Amanah Rakyat or the Council of Trust for the Indigenous Peoples)</td>
<td>1966</td>
<td>Education, training, provisions of technical and financial assistance, establishment of new industrial enterprises and management of enterprises in the initial stages with a view to the ultimate transfer of their ownership to the bumiputera themselves.</td>
</tr>
<tr>
<td>PERNAS (Perbadanan Nasional Berhad, The National Corporation)</td>
<td>1969</td>
<td>To promote Malay participation in insurance, construction, trading, properties, engineering, and securities.</td>
</tr>
<tr>
<td>UDA (Urban Development Authority)</td>
<td>1971</td>
<td>Commercial and property development for Malays.</td>
</tr>
<tr>
<td>PUNB (Perbadanan Usahawan Nasional Berhad)</td>
<td>1991</td>
<td>To increase participation of bumiputera entrepreneurs in industry sector by equipped them with knowledge and experience to ensure more competitive in the market.</td>
</tr>
<tr>
<td>TEKUN (Tabung Ekonomi Kumpulan Usaha Niaga)</td>
<td>1994</td>
<td>To provide the micro loan and support for business among bumiputera.</td>
</tr>
<tr>
<td>SMIDEC (Small &amp; Medium Industries Development Corporation), currently known as SME Corporation (SME Corp).</td>
<td>1996</td>
<td>To promote the development of Small and Medium Industries (SMIs) in the manufacturing sector through the provision of advisory services, fiscal and financial assistance, infrastructure facilities, market access and other support programmes.</td>
</tr>
<tr>
<td>MECD, Ministry of Entrepreneur and Co-operative Development</td>
<td>2004</td>
<td>To provide an environment that is conducive for the development of genuine entrepreneurs who are innovative and progressive; possessing the quality, resilience and competitiveness in all sectors; and to inculcate an entrepreneurial and co-operative culture amongst Malaysian citizens.</td>
</tr>
<tr>
<td>INSKEN (Institut Keusahawanan Negara)</td>
<td>2005</td>
<td>To implement entrepreneurship training and guidance programmes to improve and strengthen the knowledge and expertise of the</td>
</tr>
</tbody>
</table>
Research questions
This research addresses the following research questions:

i. What is the demographic profile of bumiputera owners of SMEs in food service sector along the West Coast of Sabah?

ii. What are the challenges faced by bumiputera owners of SMEs in food sector from the perspective of financial, human, social, technology and operation in determining performance along the West Coast of Sabah.

2.0 FACTORS AFFECTING THE FIRM PERFORMANCE IN MALAYSIA SMES

Many factors influence the firm performance which can be found in the study done by Cooper and Gascon (1992). Therefore, several factors are considered by the researchers in order to measure the firm performance among SMEs owners as:

2.1 Financial capital

Financial capital is defined as the purchasing power or medium that represents saved-up financial wealth, usually in the form of currency, which is used by firms or individual entrepreneurs to invest in start-up in order to purchase physical capital (Curtiss, 2012). She pointed out that, physical capital include machinery equipment, stalls or office equipment and buildings that are repeatedly used over several production cycles. Moreover she explains that, financial capital is accumulated to produce goods or to provide services mainly with the intent of receiving income or achieving capital gains. Therefore, there are two important forms of financial capital includes debt and equity (Van Praag, 2003).

Financial constraint is a most major challenge to SMEs growth around the world. According to Thurik (2007) noted that, SMEs face many complexity which depending on a single product, hard to get fund sources, lack in term economics of scale and insufficient budget control system. Moreover, Alam et.al (2011), a study conducted of food manufacturing in Klang Valley, Malaysia highlighted financial barriers such as high collateral requirements, bank charges, bank bureaucracy, banks ignoring loan proposal, time consuming loan disbursement, costly preparation of a business plan and refusal of bank finance are the major obstruction to growth of the firm.

Kasseeah and Ragoobur (2011) conducted a study 398 of SMEs in Mauritius to find a link between finance, firm size and growth of the firm. They further argued, government give strong support to the SMEs development in Mauritius, but yet firm still tend to report having a problem in access to finance. Therefore, they concluded that, firm performance depending on assessing to finance and finance also slow up the performance of the firms. Therefore, we propose this hypothesis:

Hypothesis 1: The financial capital is positively affects a firm’s performance in service sector.
2.2 Human Capital

Human capital is defined as the range of valuable skills and knowledge a person has accumulated over time (Burt, 1992). This theory on human capital was originally developed by Becker 1964 in his seminal work. Moreover, he argues that an increasing in cognitive abilities which he or she be able to perform a better job was associated with an individual investment in human capital such as education, skills and experiences. According to Florin and Schultze (2000) revealed the human capital into two categorised as general and specific human capital. For instances, general human capital include education and working experience. While, specific human capital refers to skills in industry or firm, business training and managerial experience. Much study has revealed two components of human capital such as general and specific human capital of entrepreneur’s profile (Bosma et al., 2004; Bruderl et al., 1992; Gimeno et al., 1997; Wiklund and Shepherd, 2003). Additionally, human capital such as intellectual resources and industry specific experiences aid for an entrepreneur to face hurdle in business ownership (Coleman, 2007).

Human capital can be divided into two categorises such general human capital and specific. General human capital attributes such as level of education and working experiences in any industries. Meanwhile, specific human capital included the business training and managerial experience. Much studies result revealed that, human capital such education, experience, knowledge and skills associated with small firm success (Florin, Lubatkin, & Schulze, 2003; Rauch & Frese, 2000). Also a number of studies supported that, firm survival and success influenced by the human capital attributes (Bates, 1985, 1990; Bosma et.al. 2004; Brüderl, Coleman, 2007; Preisendörfer, & Ziegler, 1992).

Davidsson and Honig (2003) found that the association between human capital and firm performance consists of education and persistence. According to Cooper, Gimeno-Gascon, and Woo, 1994, (1994) defined education as a combination of knowledge, skills, discipline, motivation and self-confidence. Moreover, different types of human capital study reflect the different stages of decision making styles of SMEs founder toward firm performance (Davidsson and Honig, 2003). Kangasharju and Pekkala (2002) conducted a study in Finnish firms found that during economic recessions and economic booms, those entrepreneurs who had a higher education contributed to higher firm growth. Furthermore, they argued that highly educated entrepreneurs had a lower probability of exiting the business during difficulty of economic crisis (Kangasharju and Pekkala, 2002). This result also supported by Pena (2002) revealed that, firm growth was associated with entrepreneurs who had a college degrees which studied were conducted in Spanish firms. Nonetheless, less likely to fail in the business war is entrepreneurs’ who had a college education as compared those who did not. Therefore, education attribute of human capital had a significant effect on both firm survival and growth (Cooper et.al, 1994). Nonetheless, in United States, success seems to be associated with better education (Burns, 2008).

Next, second attribute of human capital in this study refers to working experience. According to Parker (2006) explained that, through experience, an individual become more productive and (Davidsson and Honig, 2003) allowed them to adapt to new situation. Consequently, point highlighted by Bate (1990) and Gimeno et.al. (1997), an individual ability to start a new business is associated with work experiences. Furthermore, a study of 1000 firms in Netherlands result revealed that, small firm performance in terms of survival, profitability and growth are associated with prior experience in an industry (Bosma, et.al, 2004). Moreover, Batjargal (2005) reveals that industry experience among Russian entrepreneurs have positively impacted on firm revenue growth. Nonetheless, as the “individuals with more
human capital than other people have (such as experience and formal education) will achieve what they intend to (Becker, 1964 as cited in Chen, Su & Wu, 2012 p.1313). A study among 198 manufacturing SMEs in UK by Jayawarna, Macpherson and Wilson (2007) has found the formal training is significantly associated with performance rather than informal training. In addition, Yahya, Othman and Shamsuri (2012) revealed, training is positively related with performance where the study was conducted among 138 SMEs in Malaysia. Therefore, we propose this hypothesis:

Hypothesis 2: The human capital is positively affects a firm's performance in service sector.

2.3 Social Capital

Social capital is defined as “the aggregate of the actual or potential resources which are linked to possession of a durable network of more or less institutionalised relationships of mutual acquaintances or recognition” (Bourdieu, 1986, p. 248). He argued in his seminal work that, network and social obligation are included in social capital. Moreover, Putnam (1993) pointed out that, trust, norm and network are associated with social capital and these feature led to mutual benefit. Further argued by Nahapiet and Ghoshal (1998), social capital also led to increases the efficiency of action and aids cooperative behaviour. In general, network divided into informal or personal contact networking and formal network or inter- organisational contact. As refers to informal network or personal contact networking (PCN), this occured among family members, friends and social contacts from local community. Meanwhile, formal network or inter-organisational contact started to build during growth stages of the business which link with many parties such as lawyer, supplier, banker, accountants, governement agencies and others to obtain needed business information. Davidsson and Honig (2003) pointed out that, through social structures, networks and memberships, an entrepreneur’s or actor be able take benefits on it.

Coleman (1988, p. 96) defined social capital as “a set of resources inherent in family relations and in community social organizations that are useful for the cognitive or social development of a child or young person”. Putnam (1995) defines social capital as the features of social organizations, such as networks, norms, and social trust, all of which facilitate coordination and cooperation for mutual benefit. Much previous research referred social capital with network (Brass, 1995; Burt, 1992). According to Nahapiet & Ghoshal (1998) explained that, exchange information among members were associated with competitive advantage of the firm.

Lerner, Brush and Hisrich, (1997) found that, Israel women entrepreneurs perform better in term of profitability which association with a single network, but shown opposite unfavourable relationship with multiple networks towards revenues and number of employees.

A study of SMEs in South Africa by Fatoki (2011) revealed that, social capital has positively relationship with firm performance. This study demonstrated among 122 entrepreneurs who involved in four sectors such as manufacturing, retail, wholesale and service. An addition, this study also found out the positive relationship between human and financial capital with firm performance. Therefore, we propose this hypothesis:

Hypothesis 3: The social capital is positively affects a firm’s performance in service sector.
2.4 Technology

Technology in this study refers to “a transformation of key business processes by using an Internet technology (IT)” (Meckel et al., 2004). According to Hamill (1997) argued that, internet connected the business to other business or network to network and also the one with the ultimate business potential. For example, in 1995, Amazon.com and e-Bay were both created the most significant booms in trade history (Philipson, 2005). Moreover, small firms adopt this technology, carry the potential to gain leverage in competing in international markets (Bennett, 1997). Thus in Malaysia perspective, the important of technology adoption among Small and Medium sized Enterprises (SMEs) is significant to the Malaysia economics development (Abdullah, 2002).

However, according to Ein Dor and Segey (1978), argued that small firm face many barriers to IT adoption and are less likely to adopt IT as compared to larger organisation. This due to many contraints on financial resources, a lack of in-house IT expertise and short-range management perspective (Welsh & White, 1981; Blackburn & Athayde, 2000; Ndubisi & Jantan, 2003). In addition, Ssewanyana & Busler (2007) revealed that, 143 firms in Uganda do appreciate of Information and Communication Technology (ICT) was associated with firm performance, but the many barriers such as high costs of hardware, software, Internet and ICT professionals among others are an hindrance to their progress.

Thus study in Malaysia, Hashim (2007) surveyed has been conducted 383 SME owners in Malaysia revealed that, the level of ICT skills is poor and the SME owners seldom use internet at their workplace. Other study among 85 manufacturing companies in Sarawak East Malaysia shows that information technology is positively related with firms’ performance (Lo, Mohamad & La, 2009). Therefore, we propose this hypothesis:

*Hypothesis 4: The technology is positively affects a firm’s performance in service sector.*

2.5 Operation

Operation is defined as the management of systems and processes that are involved in the manufacturing of products and also relates with good quality, competitively priced and provide excellent customer services (Stevenson, 2002). Moreover, operation associated with the consistency between business capabilities and policies and business competitive advantages (Adam and Swamidass, 1989). Strategy guided the organization to move to the right path by consistency in decisions making in achieving the vision (Russell & Taylor, 2003). Stock, Gries and Kasarda (1998, p.40) refers strategy as a business strategy on how a business unit will achieve and maintain a competitive advantage within its industry. Hence, operations strategy also called as a manufacturing strategy (Johnston, 1994; Skinner, 1969). Reid and Sanders (2002) pointed out that, the role operation strategy is related to the action taken by the organization in order to utilize its resources. In addition, operation strategy is relates with how strategic decisions are made in an organisational setting (Ho, 1996). For instance, the operation strategy is involving four dimensions such as low cost, quality, flexibility and delivery performance (Stonebraker and Leong, 1994 in Badri, Davis & Davis, 2000; Heizer & Render, 2009).

First dimension of operational strategy is low cost. Cost refers to the sum of all discounted costs to the firm involved in developing, producing, delivering, servicing, and disposing of the product (Badri et al., 2000, p.159). Secondly, quality is defined as, a quest for excellence,
creating the right attitudes and controls to make prevention possible by increased efficiency and effectiveness (Prasad, Jha & Prakash, 2015). Third, flexibility stated by Gerwin (1986, p. 39) as, “flexibility is the ability to respond effectively to changing circumstances.” Other definition of flexibility is the ability to respond with little penalty in time, effort, cost and performance to the ever-changing and increasing customers’ needs (Sethi & Sethi, 1990; Upton, 1994). Verdu and Gomez-Gras (2009), argued that the flexibility can affect the cost and speed of company operations’ response, as well as triggers changes that are generally reversible or short-term in nature. The last dimension is delivery. Delivery involve two points which emphasis on meet delivery schedule as delivery dependability and react quickly to customer orders to delivery fast or delivery speed (Spring & Boaden, 1997).

Perçin and Ustasüleyman (2006) shown that cost and quality positively affect a firm’s business performance which involve 200 firms in Turkey. Anwar, Subroto, Alhabsji and Djumahir (2014) revealed that, the operations strategy has directly enhanced implementation of competitive strategy and business performance in 153 small scale business of coconut oil. Schroeder, Goldstein and Rungtusanatham (2011) found that the operations strategy significantly affects competitive strategy in order to increase firm’s performance. A study conducted by Butt (2009), revealed that the cost, quality, flexibility, and delivery is associated with the firm financial performance. Therefore, we propose this hypothesis:

_Hypothesis 5: The operation (low cost, low cost, quality, flexibility and delivery) is positively affects a firm’s performance in service sector._

### 2.6 Firm Performance

Firm performance indicators can be measured by financial and non-financial. In traditionally term of an accounting, firm performance was includes sales growth, market share and profitability. Chong (2008) revealed that, the owners-managers in SMEs combining the financial and non-financial measures to evaluate performance against the predetermined goals and time. Many studies regarded performance referred to firm growth (Davidsson et al. 2002; Kolvereid 1992; Rodriguez et al. 2003) and also consists of sales growth, the growth of the company’s assets and profit growth (Lee and Tsang, 2001). Nevertheless, non financial indicator can be measured by the number of the employees (Wren and Storey, 2002). To summarise the discussion above, a conceptual framework about the factors affecting the firm performance can be illustrate in Figure 1.
3. CONCLUSION

In summary, financial capital, human capital, social capital, technology and operation are important to the sustainability of the SMEs. Each variable had a direct effect on firm performance among SMEs. The conceptual framework put forward in this paper clarifies the importance of each variable that must be taken into consideration in order to get the entire prospect on SMEs performance.

Figure 1. A Conceptual Framework about the factors affecting the firm performance
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