CHAPTER 1

INTRODUCTION

1.1 Background of Study

Small and medium enterprises (SMEs) across the globe influence the world modern economy. By January 2021, Asia-Pacific Economic Cooperation (APEC) reported 97 percent of all business across APEC economies are SMEs and they employed over half of the workforce. SMEs also contributed from 40 to 60 percent of GDP to APEC economies that is significant for economic growth. In Malaysia, 98.5 percent of business establishments are SMEs which contributes 38.9 percent share to the national GDP (Majlis Pembangunan Usahawan dan PKS Kebangsaan, 2021).

Every country has its own definition of SMEs according to their context, number of employees, annual turnover, capital assets, input usage, production capacity, level of technology adoption, management practices, sectors, and even regions of the country (Akbar et al., 2017; Prasanna et al., 2019). Hence, there is no general definition of SMEs across the globe. In Malaysia, SME Corporation Malaysia set three conditions for a business to be categorized as SME. The conditions are the qualifying criteria, type of establishment, and shareholding structure. The detail of each condition is as follow.

i) Qualifying criteria – The qualifying criteria is sales turnover and full-time employees. A business must fulfil any one of the criteria, whichever is lower. Sales turnover means the total revenue of the business, including other incomes. Full-time employees are all paid workers who work at least 120 hours per month, including foreign and contract workers. However, working proprietors, active business partners, and family members or friends who are working for the business but did not receive regular wages are excluded. A summary of the qualifying criteria of small, medium and micro enterprise of manufacturing and services and other sectors is presented in Table 1.1. Any enterprise of any sector with sales turnover of less than MYR300,000 or full-time employees less than five is considered micro enterprises.

ii) Type of establishment – The business must be locally incorporated under Companies Act 2016; or registered under the Registration of Business Act (1956) or Limited Liability Partnership (LLP) Act 2012; or registered under respective authorities or district offices in Sabah and Sarawak; or registered under respective statutory bodies for professional service providers.

iii) Shareholder structure – Any companies and subsidiaries that are publicly listed only in secondary market in Malaysia or other countries are considered as SME. The companies and its subsidiaries must also fulfil the SME definition.

Table 1.1: Definition of SMEs based on sectors, size, sales turnover, and number of employees.

Size	Sectors			
	Manufacturing		Services and other sectors	
	Sales turnover	Employees	Sales turnover	Employees
Medium	RM15 mil ≤ RM50 mil	75 ≤ 200	RM3 mil ≤ RM20 mil	30 ≤ 75
Small	RM300,000 < RM15 mil	5 < 75	RM300,000 < RM3 mil	5 < 30
Micro	< RM300,000	< 5	< RM300,000	< 5

Source: Majlis Pembangunan Usahawan dan PKS Kebangsaan (2021)

Therefore, a micro business is a business with sales turnover less than RM 300,000 a year, and/or have less than five employees. Silva et al. (2016) also added micro business or microentrepreneurs are businesses that qualifies to apply for microcredit or microfinance, including micro producers and informal entrepreneurs. Micro producers exists to improve the function of the whole economy by providing diversity (Yagi, 2018).

1.2 Importance and Challenges of SMEs

SMEs are the main source of economy development of every country (Akbar et al., 2017; Kot, 2018). SMEs are important for economic growth, job opportunities, generation of entrepreneurial spirit and is an essential tool to reduce poverty (Akbar et al., 2017; Wang, 2016) because the owners have functional, marketing, and entrepreneurial capabilities (Ioniţă, 2013). These skills allow SME owners to decide the price and products in response to market changes.

SMEs also face various issues that may hinder their growth or even end the business. Among the problems face by SMEs are financial constraint, financial management, competition, and lack of knowledge and skills. SMEs also lacks financial capital, have limited resources, and are less capable of absorbing cost and risk associated, therefore limits their capability to acquire technical skills and introduce new and useful technologies to promote innovation (Prasanna et al., 2019). Abundance of new entrepreneur also creates a high competition among SMEs owners. SMEs in Malaysia face business interruption risks and economic slowdown risk which leads them to opt for business continuity plan to manage the risks (Tan & Lee, 2021).

However, SMEs have a wide range of opportunities to grab and areas to explore. Prasanna et al. (2019) specifically highlighted on the chance to explore the technological innovation. The participation of everyone in technological innovation for the company helps to shift the production function upwards, hence increasing the economic output. In addition, adaptation of technology in SMEs helps to minimize waste and optimize efficiencies in the production process. Adaptation of technology indirectly creates an effective communication among employees. Apart from that, exploring the use of technology in a business allows SMEs to learn from large firms. Learning new knowledge indirectly allows SMEs to collab with big companies and helps SMEs to grow and later develop their own brand (Ahmedova, 2015; Herliana, 2015).

1.3 Sole Proprietorship

Micro enterprise can be of organized in different ways and can be structured as sole proprietorship, partnership, or family enterprise (Munoz et al., 2014). Sole proprietorship is a business owned wholly by a single individual who uses his or her own name as in the identity card or trade name (Suruhanjaya Syarikat Malaysia, n.d.). Sole proprietor is a famous classification of micro business because it is easy to set up, of low cost for first investment and requires simple legal process (Md. Sum & Hamir, 2019). In the United States, self-employment or freelancers are also considered as sole proprietors. The Merriam Webster defines sales agents as an authorized, self-employed person appointed by manufacturers to sell their products or services within a given territory.

On the other hand, sole proprietors SMEs have many opportunities that can be explored. Permwanichagun et al. (2014) point out the strengths and opportunities of sole proprietorship which includes: self-reliance to implement any decisions to the business; no profit sharing; simple legal requirements; comfortable channel of transportation to product distribution; opportunity to utilize information technology (IT) and internet which is accessible throughout the country.

Despite the popularity and opportunities of sole proprietorship, there are many challenges and threats faced by sole proprietors. Permwanichagun et al. (2014) in a case study find out that owners have unlimited responsibilities for all liabilities; limited capital; difficult to find financial support; owners lack ability to think and manage since the relationship between the owners and the administrative bodies are too far; owners must work hard to ensure continuity of the business; customers' values that changed too fast; high competitions due to rise in numbers of entrepreneurs; and insufficient support from the government. In general, most of micro businesses are unregistered, the sole proprietor as no work experience, and normally do not keep any financial records (Akbar et al., 2017; Md. Sum & Hamir, 2019; Md. Sum & Mahussin, 2017).

1.4 Problem Statement

In 2020, The Borneo Post reported Malaysia's SMEs suffered losses amounting RM40.7 billion due to the enforcement of Movement Control Order (MCO) to curb the Covid-19 pandemic (Lim How Pim, 2021). Meanwhile, The Edge Market reported 49% of the micro, small, and medium enterprise in Malaysia is under the risk of failing by October 2021 and causing up to seven million people to be unemployed. Although the government provides monetary assistance for SMEs that are impacted by the pandemic, a survey by Ministry of Entrepreneur Development and Cooperatives reported up to 30% of the respondents did not receive the assistance (Cheryl Poo, 2021). In addition, as stated by Abdul Aziz & Abdul Manab (2020), a poor risk culture and weak risk management practices have triggered many business collapsed and lost with huge amount. Risk culture is important not only to drive an effective sustainable risk management practice, but also to indicate the significance of risk resilience and leadership in sustaining the business (Abdul Aziz & Abdul Manab, 2020)

Md Sum & Hamir (2019) argue that micro enterprises do not have a formal risk management because it requires large resources and costly. However, despite not implementing a formal risk management, micro enterprises manage to overcome their problems and challenges, and successfully sustain their businesses. Results of the research finds micro enterprises owners do plan actions to prevent risks from occurring and reduce the impacts of risks if the risks materialised. Md Sum & Hamir (2019) find sole proprietor micro enterprise owner in Malaysia aware of the risks faced by the business and can mitigate the risk. However, risk management is informal (Falkner & Hiebl, 2015; Gao et al., 2013) and business owners are not aware that they are implementing risk management.

According to Jayathilake (2012), SMEs main aim is to focus on the core business. Owners of micro enterprise hold unlimited responsibilities for all liabilities (Jayathilake, 2012). Unfortunately, according to Žigiene et al. (2019), SMEs lack resources, capabilities, and competencies to manage risks. Unlike large firms, they do not have the necessary resources to employ workers for every position, such as managing risks. Business owners, especially sole proprietor, lack trainings and knowledge in formal risk management. In addition, they do not feel the need to obtain knowledge in risk management and believe they can manage their risks. In fact, as argued by Bowen et al. (2009), SMEs are dominated by people with relatively low levels of education.

Bayarçelik et al. (2014) emphasizes that owners of business, who are also the decision makers, are influenced by management skills, technological capability, financial factor, and firm size. Therefore, a good business owner must have good management skills, strong technological capability, strong financial foundation, and suitable firm size within their ability and capacity.

In terms of research, Naude & Chiweshe (2017) find that SMEs lack research that deals with risk management, particularly operational risk framework. Operational risk is one of the risks faced by SMEs owner (Jayathilake, 2012; Md. Sum & Hamir, 2019; Md. Sum & Mahussin, 2017). Islam et al. (2017) find having a risk management framework helps employees to identify and compare offers by existing solution providers for risk mitigation. The framework also allows the users to run in depth analysis for mitigation decision. Risk management in SMEs is a developing topic and there is abundant of literature on risk management. However, there are a few references on risk management in small and medium organizations (Ferreira de Araújo Lima et al., 2020; Marcelino-Sádaba et al., 2014).

Risk management has become a necessity and requires a systematic consideration in decision-making processes of businesses (Gorzeń-Mitka, 2015). However, not all SMEs business owners, especially micro business owners, implemented a formal and systematic risk management practice. Risk management standards developed by International Organization for Standardization (ISO) and Committee of Sponsoring Organizations of the Treadway Commission (COSO) supply frameworks for businesses to implement risk management. However, risks are subjective and not all companies can fit in the framework provided by the standards. The application of the standards can be customized to the needs of the organizations (Technical Committee ISO/TC 262, 2018). For example, ISO 31000: 2018 suggests organizations to modify the applicable decision-making processes where necessary. Modification needs to be made according to the business' risk appetite and tolerance level. Large companies that implement the standards risk management framework generally have enough financial and intellectual resources. They can always manage the risk top-down and bottom-up, depending on the business culture and needs. Listed companies have risk management committee in board of directors which helps to oversee risks in the company. Unfortunately, SMEs are of small size and have limited resources (Marcelino-Sádaba et al., 2014). In general, risk management is expensive since it requires management to buy equipment or tools to mitigate risks, apart from the needs of intellectuals and skills to identify, analyse and manage the risks.

Against the circumstances leads to the need of a formal, practical, and easy to use risk management process for SMEs particularly sole proprietor micro business owners. A proper risk management enables businesses to have a sound risk culture which is a key indicator for a sustainable organization (Abdul Aziz & Abdul Manab, 2020). Therefore, this research aims to investigate risk management needs of SMEs and develop a practical and easy to use risk management process for SMEs.

1.5 Research Aim and Objectives

The research aims to build a practical and easy to use risk management process for micro business in Malaysia. The research objectives are:

- To explore and analyse the risk management processes developed for businesses.
- To propose a risk management process for micro businesses using ISO 31000: 2018 Risk Management Guidelines as the basis.

- To evaluate the practical usability of the risk management process for micro businesses.

1.6 Research Questions

Based on the research objectives, the research questions are:

1. What are the risk management processes developed for businesses?
2. What is the risk management process for micro businesses that uses ISO 31000: 2018 Risk Management Guidelines as basis?
3. How can the risk management process be practical and easy for micro business owners?

1.7 Significance of the Study

This research contributes to in-depth understanding on the risk management practices of micro businesses especially among sole proprietors. Hence, the add to increasing and more research on risk management process for SMEs. There is many research on risk management in SMEs, but still limited research focusing on micro businesses. The risk management process developed in this research enables sole proprietors, who commonly have limited resources, to manage their business risks so the business can grow and expand. SMEs policymakers can also utilize the result of this thesis as a reference to develop a new policy, guidelines, directions, training, and awareness on risk management for micro business owners.

1.8 Scope and Limitation of the Study

The sustainability and resilience of small and micro businesses are continuously vulnerable to risk even though the enterprises are one of the key factor in development of the national economy in the world (Hanggraeni et al., 2019). Hence, this thesis studies micro businesses in Malaysia. The respondents are limited to sales agents and micro producers. The result cannot be generalized to all micro business owners and sole proprietors since there are many different sectors of business. Different sectors of micro businesses may need different guidelines or approach of risk management to manage their risks. The data is limited to previous studies and feedbacks from respondents.