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Critical Success and Failure Factors in SMEs – The Retailing Sector

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ABSTRACT

Recently, SMIDEC has extended its instrument, acronym SCORE, to measure the ‘state of health’ of SMEs in the distributive sector. Through this tool, SMEs are rated against six dimensions of capabilities: management, financial, compliance, stock management, marketing, and operations management. The outcome provides an input in identifying the appropriate incentive/assistance and in linking potential SMEs to suitable global partners. This study primarily sets out to assess and enhance this instrument and to compare the success/failure factors of SMEs against SME categorization and ethnicity. An exploratory study by means of focus groups was first undertaken and as a result, ‘non-compliance’ was included in this study. ‘Innovation’, another critical dimension to business success, was also incorporated into the framework. Using a stratified area sampling method, 503 SMEs were administered the survey instrument. Data analyses uncovered several key findings. Bumiputera SMEs had better educational background than their non-Bumiputeras counterparts, they claimed to work longer hours, and they rated themselves as having higher positive entrepreneurial traits but their returns (both on revenue and profits) were lower, indicating inefficiency and ineffectiveness in running the retail businesses. All capabilities contributed to the retail SMEs success led by innovation ($\beta = 0.362$), marketing ($\beta = 0.310$), and operations management ($\beta = 0.310$), while non-compliance proved to be detrimental ($\beta = -0.195$). This study, thus, points out the need to
include ‘innovation’ capability in measuring the ‘state of health’ of SMEs in the distributive sector and must be included in SCORE.

Keywords: Retail capabilities, Business performance, Retail SMEs, SCORE

Introduction

SMEs accounted for 99% (518,996) of the total business establishments (523,132) in Malaysia, but contributed only 47% (RM405 billion) of the total output (SME Annual Report 2005, NEAC). This outcome reflects the huge gap between the SMEs output per establishment and that of the large enterprises (RM0.8 million versus RM127 million). The sheer number of SMEs makes them a major focus of a nation’s strategy as they provide the vehicle not only for income generation but also income distribution. SMEs create substantial job opportunities as they use relatively labour-intensive technologies and employ more people per unit of investment as compared to large firms. Another common reason favoring the focus towards enhancing SMEs is that they provide the platform for entrepreneurs to start their own businesses.

The Malaysian government recognizes that assistance needs to be given to the SMEs and is always on the lookout for prescriptive measures to promote the development of competitive and resilient SMEs. At present, there are more than 12 Ministries and 38 Agencies involved in SME development. While each Ministry has its specified role and respective target groups for SME development, a more focused and coordinated approach is needed. This study, which was part of comprehensive study (covering both manufacturing related and services related sectors) mandated by the Malaysian government, was undertaken to establish an inventory of critical success and failure factors of SMEs in the retail sector therefore, signalled another effort by the government in understanding the peculiarities of this sector and formulating strategic ways in nurturing these SMEs.

Literature Review

The nation’s distributive trade is broad and diverse, driven primarily by two main activities - wholesaling and retailing. In Malaysia, the distributive trade sub-sector is the third largest economic contributor after manufacturing and finance, insurance, real estate and business services sub-sectors (Figure 1). Within this sector, the distributive trade (inclusive of hotels and restaurants) is the second highest contributor (14.7%) and forecasted to be a bigger economic driver by 2010 (15.2%). Without a doubt, the economic potential in this sector is very promising.
The value of Malaysia's retail sector was estimated to be RM72 billion in 2006 (DOS, 2006) and the industry can be characterised by several retail formats. On one side, there are these very large and modern stores such as hypermarkets and department store cum supermarkets, owned mostly by international players. At the other end, there are these small and traditional stores, mostly owned by local operators. Today, the overwhelming acceptance of the large and modern format has made these outlets the most dominant retail players in this nation. In 2006, the 'provision store' experienced a 9% contraction in numbers, while the 'stalls and markets' contracted by 34% (DOS, 2006). On the other hand, the 'department store and supermarket including hypermarket' category experienced an 84% increase from 2005 – 2006 (DOS, 2006). This scenario provides evidences that small retailers need to be given as much assistance as possible to compete in this industry where profit margin is razor sharp.

The Baseline Census of Establishments and Enterprises conducted in 2005 (SME Annual Report, 2007) had indicated that 87% of the SMEs were in the services sector. The 'retail and wholesale trade' led in numbers (Table 1), where almost two third of these establishments were micro enterprises. An inventory of critical drivers and inhibitors to the success of SMEs, in general and of Bumiputera in particular, should provide concrete parameters to aid the government in allocating resources to this cluster of entrepreneurs and would provide further strategic directions for future policy-making.

Thus far, several studies and measures have been used to identify and determine factors leading to the failures and success of SMEs/entrepreneurs in Malaysia. Bank Negara Malaysia, for instance (http://www.bnm.gov.my/files/publication/sme/en/2006/chap_2.pdf), has conducted a number of case studies and found that although the SMEs were from different industries, all the enterprises shared common critical success factors, namely: sound management capability and integrity, sound business culture and entrepreneurial spirit,
prudent financial management, high quality products and services, good programs for human resource development, strong support from financial institutions in terms of lending and advisory services, and strong marketing strategies.

In another study (Commissioned to UiTM by the Malay Chamber of Commerce, 1997), qualitative findings established that many of the critical factors contributing to the success or failures of Bumiputera entrepreneurs were those factors associated with the entrepreneurs themselves (Sofiah, Noraini, Zulkifli and Raja Roslan, 1997). They were: capability to be resilient, having strategic vision, possessing the risk taking attitude, being a technocrat, attitudes associated with being Malays, and being Innovative. Among these factors, empirical tests have shown that ‘innovation’ was the most significant contributor to the success of entrepreneurs (Sofiah et al., 1997). Humam et al. (1985) studied 45 small businesses in Malaysia that had failed and found that almost 38 percent of them were either in the wholesale, retail or food industry. Among the reasons were: lack of initiatives, persistence and assertiveness; inability to convince others, low capabilities in management, marketing, financial and record keeping.

To this end, it is acknowledged that entrepreneurship is valued as one of the alternative measures to improve Bumiputera’s economic status. This strategy has been clearly emphasized since the introduction of the New Economic Policy. The government has invested an overwhelming amount of resources to create more sustainable and self-reliant Bumiputera entrepreneurs. Many financing schemes, entrepreneurship development programmes, and extension services were created to assist the development of Bumiputera Commercial and Industrial Cluster (BCIC). This study, which is to establish an inventory of critical success standards for Bumiputera entrepreneurs.
and failure factors of SMEs in the retail sector should provide further inputs of where resources should be channelled to in order to promote the SMEs growth.

Given the above scenario, this study seeks:

1. To generate further possible critical success and failure factors of SMEs in the retail sector.
2. To empirically confirm the critical success and failure factors of SMEs in the retail sector.
3. To compare the success and failure factors of SMEs against SME categorization and ethnicity (Bumiputera and non Bumiputera) of the entrepreneurs.
4. To profile the SMEs in the retail sector by categorization and ethnicity.
5. To recommend strategic actions to promote the development of competitive and resilient SMEs in general and Bumiputera in particular.

Methodology

Recently, SMIDEC has designed an instrument acronym SCORE (SME for competitive enhancement) for the manufacturing and manufacturing related services to measure SMEs ‘state of health’. Through this tool, SMEs are rated against six dimensions of capabilities: (1) management, (2) technical, (3) financial, (4) production, (5) innovation and (6) quality; and one dimension of performance: - business performance (7). The latest development saw SMIDEC extending its SCORE assessment to the distributive sector (Figure 2). This study, being part of the larger study, where the outcome was to be merged to form an aggregate outcome of all sectors, it was agreed that the proposed research framework is build around the seven manufacturing related SCORE parameters with several emphasis and modifications. As SMEs success is closely linked to the owner, ‘Entrepreneurial Traits’ is crucial and thus included. The ‘Overall Business Performance’, on the hand, reflects the overall business performance and is contingent upon the other capabilities, rather than a dimension as practiced by SCORE. In addition, to accommodate the latest SCORE for the distributive trade sector, the dimensions ‘compliance factor’, ‘stock management’ and ‘operations management’ were included in this study.
In line with the research objectives, two sets of instrumentations were used. First, a ‘moderator outline’ was administered to the participants via focus group method. As noted (Table 2), both external and internal factors were cited as critical to the success of a retail entrepreneur. Further, there seemed to be no new dimension that emerged, with exception of generating more items under the dimension of ‘compliance’ and ‘entrepreneurial trait’ to test the significance of ‘flaunting regulations’. In short, this qualitative study uncovered that ‘non-compliance’ could be significant to the success in retailing, thus it was incorporated in this study (Figure 3).

The population of this study was the retail SMEs in Malaysia. To ensure representative participation, the stratified simple random area sampling was used. Respondents were first stratified according to states and further stratified into two areas – urban and rural. With this pool of respondents, they were further divided into Bumiputera and non Bumiputera owned companies and micro, small and medium sized enterprises. The survey instrument contained mainly questions on the importance and performance of capabilities expected to have significant influence on the success and failure of retail SMEs. Business performance was rated in both quantitative and qualitative measures. Empirical
Table 2: Summary of Focus Groups’ Outcomes

1. What are the important elements to start a business? Why?
   - Good location. We are not happy with MBA and MARA for relocating us. We are very sad. Some of us are crying.
   - Capital to start the business. At the moment we (micro retailers) are facing difficulties because documents are not proper (tak lengkap).
   - Support from the government. Government practices cronism. Government is not fair with the Retailer Micro Scheme.

2. What are the characters of a successful entrepreneur?
   - Creativity; Self-confident; Brave (Berani); Must be involved with the business; Competent with ICT; Knowledgeable (ilmu);
   - Persistent (cekal dan tabah), Documentation of work/activities; Willing to take risk.

3. What are important in managing your retail business?
   - Skill in managing company’s finance; Ability to provide good after sales service; Ability to understand customers; Ability to provide a variety of products; Ability to provide value for money; Ability to diversify; Ability to manage inventory.

4. Why are the Chinese more successful?
   - They do not comply with the regulations that negatively impacted their business. They do not care and they can get away with it. They will raise price of controlled items, they will sell faked goods.
   - The Malays are more bounded by their culture, religion, and fear for flaunting the rules and regulations. We always follow the regulation. We do try sometimes to go round the regulations but we can never get away with it.
   - They help each other, tak dengki/ suka menunjuk-nunjuk macam orang Melayu.

Testing involving factor analysis to understand the underlying structure and reliability analysis to assess the reliability of items describing each capability were carried out. Items with loading greater than 4.0 and components with Cronbach Alpha greater than 0.7 (Hair et al., 2006) were accepted for further analysis. Once the emerging factors (capabilities) were established and described, either simple regression or multiple regression was applied to establish the relationship with business performance. The resulting Beta was taken as the weight.

Results and Discussions

From a total of 503 participating SMEs, ‘provision stores’ and ‘textile, clothing, footwear and leather goods stores’ were the two major retail formats that took part in this survey. This outcome is hardly surprising as they made up a sizeable number of retail outlets in Malaysia (DOS, 2006). Non-Food dominates (57%) the sample achieved and once more this outcome reflected the composition of...
these retailers in Malaysia. Two-third (70 percent) of the businesses had been in operations for more than 5 years. This implies that these businesses had survived the earlier critical years of business operations. Their average annual sales indicated that a large majority of them (67%) were in the micro-sized category. This data relates well with Malaysia’s retail SME statistics (Census 2000, DOS).

Data (Table 4) seemed to suggest that Bumiputera retail owners/managers possessed significantly higher educational background than non Bumiputera, worked longer hours, and had higher positive entrepreneurial traits but their returns (both on revenue and profits) were lower, indicating inefficiency and ineffectiveness in running the retail businesses. Interestingly, when cross-referenced with SME classification, the outcome appeared to support the negative relationship between hours spent at the business premise and retail success. ‘Quality’ time rather than ‘quantity’ is, thus, a key to retail success. In the aspect on ‘non-compliance’, a new capability built in this study, no significant differences were registered across ethnicity of SMEs and SME classification. Nonetheless, medium sized enterprises showed greater preferences for non-compliance.
Table 4: A summary of Group Differences

<table>
<thead>
<tr>
<th>Education Level</th>
<th>Ethnicity</th>
<th></th>
<th>SME classification</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Bumi</td>
<td>Non Bumi</td>
<td>Micro</td>
<td>Small</td>
</tr>
<tr>
<td>Secondary School</td>
<td>63.5%</td>
<td>68.1%</td>
<td>71.5%</td>
<td>55.7%</td>
</tr>
<tr>
<td>Certificate/vocational</td>
<td>22.7%</td>
<td>18.6%</td>
<td>20.5%</td>
<td>20.5%</td>
</tr>
<tr>
<td>/STPM/Diploma</td>
<td>13.7%</td>
<td>13.3%</td>
<td>8.0%</td>
<td>23.8%</td>
</tr>
<tr>
<td>Degree/professional</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| How long in business     |           |                       |                     |                       |                       |                      |
|                          | >5        | 20.9%                 | 14.6%               | 20.5%                 | 12.3%                 | 15.9%                 | 18.1%                 |
|                          | 6-10      | 31.0%                 | 36.3%               | 33.2%                 | 39.3%                 | 18.2%                 | 33.4%                 |
|                          | 11-15     | 17.7%                 | 12.4%               | 12.8%                 | 20.5%                 | 20.5%                 | 15.3%                 |
|                          | 16-20     | 15.5%                 | 14.2%               | 13.6%                 | 16.4%                 | 20.5%                 | 14.9%                 |
|                          | >20       | 14.8%                 | 22.6%               | 19.9%                 | 11.5%                 | 25.0%                 | 18.3%                 |

| Have you ever failed in business? |           |                       |                     |                       |                       |                      |
|                                  | Yes       | 13.7%                 | 7.5%                | 11.9%                 | 10.7%                 | 4.5%                 | 10.9%                 |
|                                  | Hours spent at the store (Mean) | 9.92 | 9.31 | 10.04 | 8.86 | 8.80 | 10hrs |
|                                  | Increase in revenue (Mean) | 3.61 | 3.64 | 3.47 | 3.86 | 4.11 | 3.62 |
|                                  | Increase in profitability (Mean) | 3.57 | 3.64 | 3.47 | 3.79 | 4.09 | 3.60 |

| Entrepreneurial traits (Mean) |           |                       |                     |                       |                       |                      |
| Persistent                    | 4.43      | 4.31                  | 4.31                | 4.48                  | 4.66                  | 4.38                  |
| Driven by achievements and success | 4.36 | 4.37                 | 4.30                | 4.43                  | 4.68                  | 4.36                  |
| Responsible for company’s success/failure | 4.05 | 3.99                 | 4.08                | 3.91                  | 3.93                  | 4.03                  |
| Willing to take risks         | 4.22      | 4.15                  | 4.14                | 4.30                  | 4.34                  | 4.19                  |
| Always finding new business opportunities | 4.14 | 4.09                 | 4.29                | 4.39                  | 4.09                  |
| Always finding new business opportunities | 4.18 | 4.15                 | 4.08                | 4.33                  | 4.43                  | 4.17                  |

| Non Compliance traits (Mean) |           |                       |                     |                       |                       |                      |
| If government policy affects my business, I will find ways not to follow | 2.55 | 2.60 | 2.63 | 2.42 | 2.57 | 2.57 |
| I am willing to break rules that constrained my business | 2.20 | 2.12 | 2.22 | 2.06 | 2.05 | 2.16 |

* Data in bold and italics signify significant differences
It is also the aim of this research to provide an inventory of capabilities considered important by the respondents to the success of SMEs in the retailing sector. This input would enable the researchers to establish gaps (if any) between (the capabilities) importance and performance. Table 5 summarises the mean outcome. From the perspective of the participating retailers, marketing and store operations were the top two important capabilities (do note that, factor analysis has collapse items under management capability into two distinct constructs). It is clear that retail entrepreneurs strived to excel in store operations capability as the gap between performance and importance is almost zero (0).

The highest gap was in quality systems capability. These findings are not uncommon with similar studies relating to SMEs as they are noted for their inability to address quality issues effectively (Kennedy and Hyland, 2003). The attainment of effective inventory management was also rather low as a relatively large gap was observed. In line with both quality system and inventory management is the variable of technical capability, which was considered as an important contributor to success by the retail owners-managers. The large gap indicates the difference between performance and importance, which imply that the retail workers are not technically skilled to handle some of the retail activities/functions.

**Table 5: Importance of Retail SMEs Capabilities (Overall mean)**

<table>
<thead>
<tr>
<th>Capability</th>
<th>Importance</th>
<th>Performance</th>
<th>Gap</th>
<th>Paired sample T-test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management capability - Strategic Direction</td>
<td>4.18</td>
<td>3.81</td>
<td>-0.37</td>
<td>0.000</td>
</tr>
<tr>
<td>Management capability - Strategic action</td>
<td>4.30</td>
<td>4.12</td>
<td>-0.18</td>
<td>0.000</td>
</tr>
<tr>
<td>Marketing</td>
<td>4.28</td>
<td>4.10</td>
<td>-0.18</td>
<td>0.000</td>
</tr>
<tr>
<td>Technical</td>
<td>4.25</td>
<td>3.84</td>
<td>-0.41</td>
<td>0.000</td>
</tr>
<tr>
<td>Store operations</td>
<td>4.37</td>
<td>4.34</td>
<td>-0.03</td>
<td>0.113</td>
</tr>
<tr>
<td>Financial</td>
<td>4.16</td>
<td>3.99</td>
<td>-0.17</td>
<td>0.000</td>
</tr>
<tr>
<td>Inventory Mgt</td>
<td>4.20</td>
<td>3.74</td>
<td>-0.46</td>
<td>0.000</td>
</tr>
<tr>
<td>Innovation</td>
<td>4.23</td>
<td>3.96</td>
<td>0.27</td>
<td>0.000</td>
</tr>
<tr>
<td>Quality System</td>
<td>4.12</td>
<td>3.43</td>
<td>-0.72</td>
<td>0.000</td>
</tr>
<tr>
<td>Entrepreneurial trait</td>
<td>4.21</td>
<td>4.23</td>
<td>0.02</td>
<td>0.339</td>
</tr>
<tr>
<td>Non compliance</td>
<td>2.40</td>
<td>2.36</td>
<td>-0.04</td>
<td>0.517</td>
</tr>
</tbody>
</table>

The ultimate direction of the study is to determine critical success and failure factors of the retail SMEs on the basis of the SCORE instrument through empirical testing. A total of 52 statements measuring the nine capabilities were used for this purpose. Factor analysis, reliability analysis, correlations and multiple/simple regression for each capability were run to access the underlying
structure, reliability and strength of relationship of each capability. At the end, innovation and marketing were the two most important capabilities that drive success (Figure 4).

![Figure 4: Factors Contributing to Retail SMEs' Success](image)

## Conclusions

This study primarily sets out to assess and enhance SCORE as a tool in determining the success and failure of retail SMEs. An exploratory study by means of a focus group interview was first carried out to identify possible new dimensions that could be added to the existing measurement. As a result, 'non-
compliance' and 'innovation' capabilities were incorporated to the research framework.

The findings established that innovativeness is the most important factor in the retail success. Consumers today are time poor and easily bored, thus they seek retail stores that reinvent themselves from time to time. Marketing capability is another critical factor in generating traffics. The interplay of persuasive promotional activities, pricing strategies and product offerings, therefore, is another capability that retailers need to have. On the same note, as retailers operate in a physical store, store operations capability is another critical success factor. While the outcome of the exploratory study suggested ‘non-compliance’ as the reason for Chinese entrepreneurs’ success, empirical testing proved otherwise.

At the end, this study confirmed that all the dimensions under SCORE significantly contributed to the success of retail SMEs and recommends that innovation be incorporated into SCORE. The importance of ‘innovation’ in driving retail success has a big implication to the training programs designed for these SMEs as innovation involves creativity and cuts across the two other capabilities identified as critical - marketing and store operations. An integrated training program that combines these three capabilities must be in place. Similarly, innovation capability must be featured highly in selecting potential retail SMEs for further assistance.

Acknowledgement

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