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A New Source of Growth for Malaysia: Digital Trade and the Digital Economy

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KEY POINTS

- Digital trade has been vital for the survival of Malaysian businesses affected by COVID-19 lockdowns
- By transitioning to online platforms, micro, small and medium enterprises have been able to reduce revenue losses and maintain jobs
- Digital trade presents great potential for Malaysian economic growth, particularly as it aspires to become a high-income economy
- The Malaysian government seeks to prioritise the digital economy in post-pandemic recovery with the allocation of funds towards digitisation and automation across various sectors
- Government support for MSMEs is essential to overcome challenges and facilitate growth to build a strong and resilient digital economy

The outbreak of COVID-19 and resulting movement restrictions throughout Malaysia have triggered a boom in digital trade for businesses and micro, small and medium enterprises (MSMEs). Since the start of the Movement Control Order (MCO) in March 2020 that sent the country into lockdown, food delivery services like GrabFood and Foodpanda have recorded a **30 percent increase** in total orders¹.

An increase in online orders was also matched by a sharp spike in digital platform registrations by retail businesses, marts and restaurants that saw digitally-enabled trade as an opportunity to reduce revenue losses and retain their customer bases while the MCO limited in-person consumer activity.



The pandemic has made it clear that digital trade promotes inclusiveness and a somewhat level playing field. During the MCO, a key concern has been maintaining employment and livelihood, especially for those working in the informal sector. As digital trade platforms enable sellers and restaurants to continue providing their services during movement restrictions, income flow has remained relatively steady and encouraged the formalisation of businesses. As an example, for restaurants and other

providers to join the Foodpanda platform, a *Suruhanjaya Syarikat Malaysia* (SSM) registration number is needed. Relaxed conditions were also introduced. Even when businesses do not have a physical restaurant or shop, they are allowed to operate from their homes.

As the number of COVID-19 cases remain high, consumers are increasingly turning to online shopping to get their necessities while staying safe at home.

Even as the pandemic continues to dampen economic activity and increase unemployment rates, this surge in digital trade has cushioned some of the blow, resulting in job creation and greater income security for many workers.

Digital trade is essential for the Malaysian economy

Digital trade can be defined as digitally-enabled transactions of goods and services that can be delivered physically or digitally. These transactions can include consumers, firms and governments. To be more specific, even though all types of digital trade are made possible by the usage of digital technologies, not all forms of digital trade are delivered digitally. For instance, digital trade can involve a digitally-enabled platform but have the goods or services physically delivered or rendered to the consumer. Some examples include the purchase of a physical book through an online bookstore or booking a stay on AirBnB for an apartment in the city.

There is huge potential when it comes to digital trade in the digital economy. According to the Department of Statistics Malaysia's (DOSM) [Digital Economy 2018 report](#), Malaysia's digital economy—including e-commerce and information technology—is estimated to be about RM270 billion, or about 18.5 percent of GDP². On the back of rapid growth in digital trade and the onset of the pandemic, some estimates suggested that this share would have reached more than 20 percent by the end of 2020 were it not for COVID-induced interruptions.

Supporting digital trade to drive economic growth

As Malaysia faces the 4th Industrial Revolution and policymakers work towards overcoming the myriad hurdles to bring Malaysia into the ranks of the world's high-income economies, it is becoming increasingly important to strengthen and support the local digital economy ecosystem.

By strategically tapping into the digital trade sector, the Malaysian government can propel the MSME community to be more competitive in both local and international markets. In 2019, [SME Corp highlighted](#) that 98.5 percent of business establishments, amounting to over 900,000 establishments in Malaysia are MSMEs³. Micro-enterprises in particular made up 76.5 percent of the MSME community. Medium sized enterprises made up the smallest share at only 2.3 percent of the total MSMEs. Most MSMEs are mainly active in the services sector with 89.2 percent of total MSMEs in Malaysia.

The growing importance of digital trade and digitalisation in Malaysia was recognised in the 2021 Budget. The Malaysian government will prioritise MSMEs in post-pandemic recovery by allocating funds towards promoting digitalisation and automation across different sectors for MSMEs. To encourage MSMEs to transition to digital platforms, an allocation of RM150 million in grants with relaxed conditions for micro SME and start-ups is put aside in the budget. A separate RM 150 million was distributed to encourage e-commerce activities by SMEs through training, sales assistance and purchases of digital equipment. For automation and up skilling, RM 230 million was allocated to financing SMEs especially as working capital and upgrading of automation systems.

Given the challenges facing MSMEs in securing financing during the pandemic for digital upgrades and adoption, this allocation is in line with the growing importance of the digital economy in Malaysia.

During the pandemic it has become clear that digital trade is vital for maintaining and creating employment and livelihood.

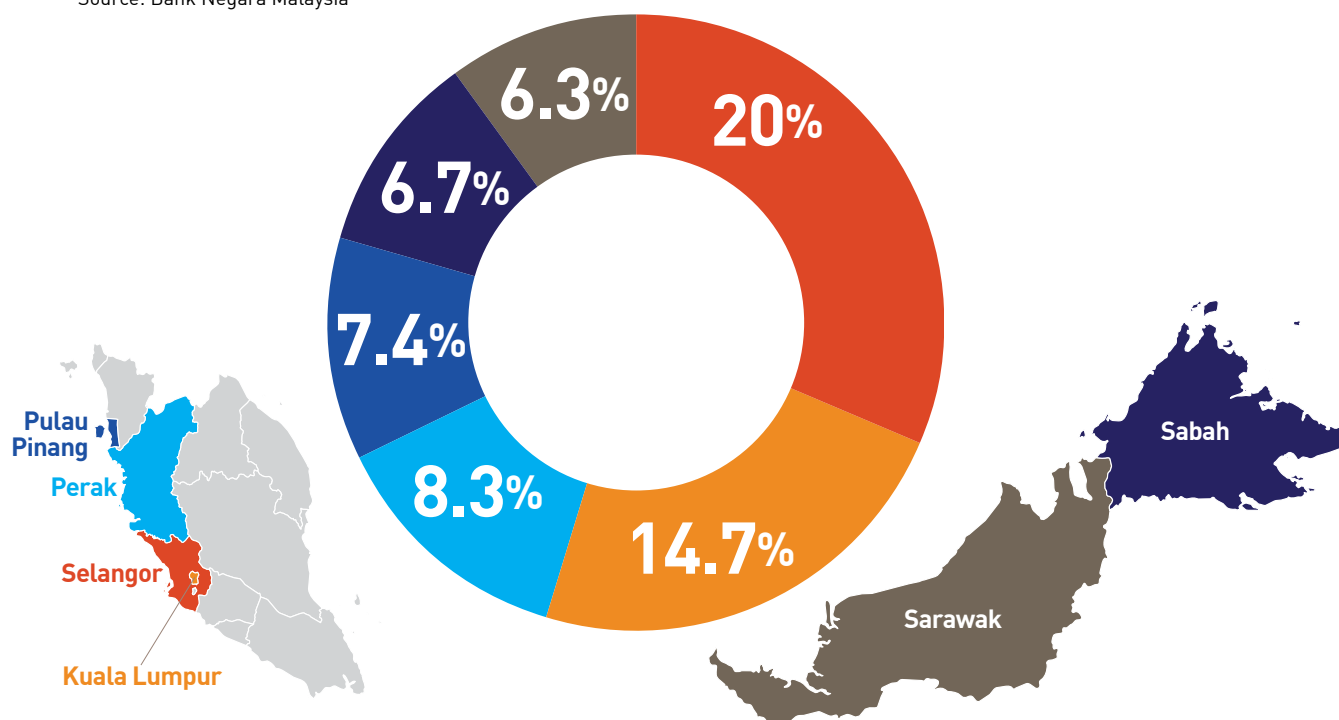
Hence, [support is needed](#) for the MSME community so that they are equipped with the proper knowledge, infrastructure and tools in the immediate term to facilitate the growth of this important sector⁴.

Data shows that MSMEs are slow in transitioning to digital platforms

Even prior to the pandemic, MSMEs have provided a significant portion of employment for Malaysians. In 2018, it was recorded that 66.2 percent of the workforce in Malaysia were employed by SMEs. In the same year, SMEs contributed RM 522.1 billion to GDP, equivalent to almost 40% of GDP. Out of 907,065 MSME establishments, the state of Selangor attracted the most MSMEs, with 20% of the establishments located in the state.

Figure 1 Percentage of total MSMEs by state

Source: Bank Negara Malaysia⁵



The recent improvements in internet access in Malaysia have benefitted MSMEs and their activities tremendously. According to [Bank Negara's 2018 annual report](#)⁶, 83 percent of SMEs used information and communications technology (ICT) in their business operations, with 22 percent owning websites and 14 percent operating online stores. The same survey also highlighted how SMEs are using other financial services which include insurance, takaful (Islamic insurance) and e-payments to support their daily activities. More than 50 percent of the respondents subscribed to insurance or takaful products, although this was less notable among the micro-enterprises. It was the [SMEs mainly who made electronic payments](#) for purchases, but somehow preferred cash when receiving payments from customers⁷. Despite its benefits, there are challenges faced by MSMEs in the country. Recently it was highlighted that businesses in Malaysia have not been adopting digital technologies as anticipated. Digital adoption by Malaysian businesses [lags behind the global average](#), as only 29 percent of businesses have a web presence while 5.2 percent of businesses were engaged in e-commerce in 2015⁸.

A 2018 World Bank Report highlighted that Malaysia had “fewer businesses with websites, and fewer secure servers than per capita income would predict,” compared to that of other countries. In Malaysia it was found that the nature of technology adoption is also very different compared to other countries. It was observed that SMEs digitalise primarily in fundamental and simple technologies and not in more complex digital solutions. This caused small firms to lag behind larger firms that have far more capital to invest in more complex technologies and systems.



According to **Consultancy Asia**, even though 77 percent of digitalised firms are SMEs, only a quarter of the firms are adopting advanced digitalization tools⁹. Malaysian SMEs have adopted the usage of ICT in their businesses, with more than 80 percent of firms using computers and smartphones. While more than 70% of SMEs using were using the internet in their operations in 2018, less than half of them adopted digital finance and accounting systems in their operations.

Overcoming barriers to unlock digital trade

Empowering MSMEs with the proper tools and skill sets is key for enabling businesses to participate in the digital economy. Even though financing for digitalisation was highlighted in the 2021 Malaysian Budget, a more structured approach in targeting MSMEs in need and disseminating medium-term support plans must be developed. Support in financing that is not backed by upskilling and reskilling activities will not enable entrepreneurs to be more competitive in the digital economy.

For the digital economy to be benefitted by all players, the digital divide within Malaysia needs to be narrowed down considerably. While connectivity is not an issue in urban areas, rural areas on the east coast of Malaysia do not benefit from the same luxury. Developing the needed infrastructure to boost internet connectivity is a long term plan, where both federal and state governments need to work together to pool their resources.

Looking ahead, the establishment of a strong and resilient digital economy cannot be emphasised enough, especially when Malaysia is expected to join in more multilateral, mega-trade like the CPTPP. Future free trade agreements and regional commitments will encompass both traditional and non-traditional trade areas.

As the potential driver of economic growth is the digital trade sector, cooperation and collaboration in digital trade is expected with deep reforms anticipated. Therefore, bolstering the sustainable growth of Malaysia's digital trade both locally and internationally would be vital to both unlocking productivity gains in the Malaysian economy, along with propelling Malaysian businesses into the international arena. Nevertheless, policymakers also need to pay close attention to the inclusiveness of these efforts to ensure that first and foremost, MSMEs and smaller businesses are included as an integral part of these efforts.

Endnotes

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