

Empirical Evidence on the SMEs Risks Framework in Malaysia

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Abstract –*The aim of this study is to propose a SMEs risk framework which eventually will be used to develop an appropriate takaful scheme to minority groups. The framework encompasses four critical elements: financial, operational, compliance and strategic risk. A complete survey questionnaire has been collected from 111 micro enterprises located in the state of Johor. Factor analysis was employed to identify the most important risks of takaful products, emphasizing the benefits and expectations, as perceived by the micro enterprises. A confirmatory factor analysis using structural equation modeling (SEM) was conducted to support the concept of SMEs risk. The results indicate that model 2 (four correlated factor) outperformed model 1 (one factor model). The proposed framework is beneficial for takaful operators to introduce a suitable and a marketable takaful scheme that meant for micro enterprises. Copyright © 2016 Penerbit Akademia Baru - All rights reserved.*

Keywords: *SMEs Risk, Risk Management, Takaful, Micro Enterprises*

1.0 INTRODUCTION

Essentially, SME plays a fundamental role in the economy with 98% of total establishments and contributing over 65% of employment. SME is an engine of economic growth with the contribution of more than 33.1% of country gross domestic product. Furthermore, the performance of SME remained encouraging with the GDP growth of SMEs policy up further to 6.3%. Based on SME Annual Report 2013, it reveals that the value added share in the services sector is 62.1% followed by 23.7% for manufacturing sector and 9.7% for agriculture sector. This highlights the manufacturing sector fall the second rank in contributing SME GDP.

However, the recent global financial crisis has exposed SMEs including micro enterprises to possible risks that have resulted in some businesses being shuttered. Such difficulty shows how crucial it is for SMEs to be prepared with some form of protection or takaful to alleviate impending risks. In the global financial crisis, the SMEs have been affected through exchange rate volatility, higher commodity prices and eventually escalating cost of business operation. With these plausible risks, the Government's role is to take initiatives in providing risk protection.

In September 2010, Bank Negara Malaysia has urged Takaful Operators to design micro takaful policies, medical and retirement products to penetrate the low-income market. Low-income and poor who represent the rural and urban poverty groups are the most neglected people in insurance mainstream and are unprotected. It is noted that Takaful Ikhlas had launched its first micro takaful scheme in conjunction with the Farmers Welfare Federation of Malaysia in 2007. Two years later, Etiqa Takaful Berhad and Angkatan Koperasi Kebangsaan Malaysia launched the 'Skim Tabarru' Koperasi', takaful scheme that caters specifically for all

cooperative members. Recently, Takaful Malaysia introduced mySME Takaful for SMEs borrowers for their business protection. The participation of a few takaful operators offering takaful product to low income earners reveal positive signal to takaful industry. From the industry perspective, the micro takaful business seems to grow significantly on an annual basis. The lack of takaful products in the market for micro enterprises indicates a wider opportunity to study the business risk exposed by micro enterprises. Yet, no attention has been given to investigate the types of SMEs risk faced by the micro enterprises. Thus, it is essential to identify the most important types of SMEs risk exposed by micro enterprises.

2.0 LITERATURE REVIEW

Based on budget announcement 2014, Malaysian government take seriously to protect SMEs industries from risks by provide facilities with the growth of innovative SMEs under the Green Lane Policy. Globalizations have construct a new relationships and new structure between growth and risks that SMEs should faced with the result of business decision and actions taken as a part of the world have significant consequences in other places. These globalizations that have impact to the risks and growth of SMEs is due to rapidly changing technological environment, particularly information and the way of communications between SMEs itself. Hence, measuring SMEs risk is very important since it capabilities make it possible in marketing and production operation more efficiently around the world. Therefore, instantaneous communications make it effectively to trade of production and distribution evolving worldwide. An overview of SMEs participation in the global economy reveals at least three lines of activity which is trade, technology and investment where it involves different risks. Thus, the opportunities and challenging facing by SMEs with different level of risk are well known.

Risk identification is the basic stage of firm's risk management [8]. The inability to identify possible gaining risks may perhaps increase the degree of losses. Risk identification such as operational risk, financial risk, strategic risk, compliance risk and social risk are important to achieve sustainable development of the businesses. It also provides signals for businesses to prevent them from falling into bankruptcy.

Financial risk is part of financial structure in the business includes financial system and business transaction. Small and medium businesses often struggle to fulfill their dreams of expansion due to a lack of finance. The lack of working capital can limit the capacity of a business to expand and needs to be planned for correctly. Besides, the compliance risk is quite important for growth SMEs itself since classification of SMEs into three categories, namely, micro, small and medium enterprise which have diverse level of risk. The drawbacks of SMEs, they are facing the lack of knowledge on the legal matters especially on the global markets. Besides, in Malaysia there is no body or agency that advises matters pertaining to legal specifically to SMEs going abroad [11]. According to [15] found the difficulty of SMEs entrepreneur due to the lack of access to gain management experience and exposure regarding the international or global rules and regulations. Due to inappropriate regulations with obsolete information, SMEs may find an access is restricted. Study by [7], in terms of registration and legal corporation, SMEs need to establish a presence in a foreign market in order to be visible to customers. Registration and legal incorporation requirements vary considerably amongst countries and are often unnecessarily complex and expensive. SMEs need a longer time to access information about market opportunities and appropriate regulations especially for a new

products, techniques or services [18]. For foreign trading, SMEs traders need to know a certain specific requirement or controls imposed by foreign government.

In Malaysia, SMEs who wants to starts the business will face higher risk because it is closely tied to some additional government rules and regulations, policy and economic in terms of Malaysian context. These challenges towards the regulatory issues such as halal regulations to obtain licensed from Islamic Department Malaysia (JAKIM), Department of Environment (DOE), Local Council (Majlis Daerah), and health requirements from Ministry of Health (MOH). Besides other challenges such as finance, marketing, technology, production, operations and management will also contribute to higher risk. According to [4], some challenges should face by start-up food companies which are related with halal regulations, health requirement and also other common factors. They also affirm that business environment can create a high level of institutional and economic uncertainty for new SMEs. Moreover, SMEs also faces with a bit similar constraints and policies, whereas Malaysia has some additional constraints especially in the regulatory factors [13]. These constraints give enormous challenges especially for start-up companies where they needed to manage carefully for these challenges.

Companies with the new start-ups should face with regulatory issues where it can affect the growth and survival of the companies especially in Malaysia. [9] has mentioned these challenges will cause the uncertainty in the growth for entrepreneurs and thus, increase the number of failure [6]. In Malaysia, SMEs especially in manufacturing halal foods must meet the comprehensive standards and guidelines in to be adhering by the Muslims [20]. This is to protect the huge market where SMEs need to comply with the halal standards of practice whereas as a part of compliance risk. At the same time, SMEs in manufacturing foods especially need to follows the rules of Standards Halal Food Guidelines ordered by Department of Islamic Development Malaysia (JAKIM). Thus, for those non-compliance and wrong use of logo will cause a heavy penalty and possible closure of business. Hence, halal regulatory compliance creates a serious challenge to the start-up growth and survival or become compliance risk to new SMEs to start-up business [5, 14].

The needs of takaful scheme to protect the SMEs are crucial. Takaful is a scheme based on the spirit of brotherhood; solidarity and mutual assistance which provide mutual financial assistance to the participants in case of defined need whereby the participants have mutually agreed to contribute for that purpose [14]. The acceptance of takaful is based on co-operation among policyholders for common good. In fact, the main principle of the takaful system is mutual co-operation, taawun (brotherhood) and solidarity. This illustrates the implementation of the risk sharing principle in the takaful system. [19] assert that takaful is acceptable in Islam on the basis of risk sharing under the taawun principle through the creation of the tabarru fund.

With regards to low income earners such as micro enterprises in SMEs, the needs of microtakaful come into picture to solve business problems. Micro takaful is defined as the protection of assets and lives against insurable risks of the target population such as the micro entrepreneur and low income people. Micro takaful is one of the mechanisms to fulfil the needs of the lower income, with the concept of providing affordable protection to the poor. Takaful operators should come up with this kind of product, as the alternative to those offered in the conventional market [12].

Conceptually, the fundamental underlying the Takaful concept is quite similar to the cooperative and mutual insurance with the principle of Islamic law. It is argued that novel micro insurance (micro takaful) schemes are emerging to help the poor better deal with any

risks. [15] posit that the protection against risks such as losses and natural perils are important in order to achieve sustainable development of living. It also provides a sense of security for living and prevents poor communities from falling into abject poverty. This implies that there is a need for takaful products for risk protection.

[10] elaborate that micro insurance is the protection of assets and lives against insurable risks of target population such as micro entrepreneur and low income people in relation to cost, terms, coverage and delivery mechanism. Similarly, [3] states that microtakaful is a mechanism to provide Shariah-based protection for the low income groups and under-privileged individuals at an affordable cost. [2] states that the existence of the microfinance and microtakaful is considered as poverty alleviation strategies to empower people to exit from poverty and to retain financial ground. This illustrates the importance of micro takaful as risk mitigation technique to solve business operation problems. However, limited studies are found on the receptiveness of takaful products among SMEs particularly micro enterprises.

3.0 METHODOLOGY

A sum of 120 questionnaires was distributed to the micro entrepreneurs in the state of Johor, Malaysia. Johor was chosen because it has become the third state with the highest number of micro enterprise in Malaysia [1]. In order to improve the response rate of data collection, the questionnaire was distributed through face to face method.

The measurement of the questionnaire was developed from the synthesis of the themes identified from previous studies. The scale for measuring awareness and SMEs risk were operationalized through interviews with the practitioners and further refined by academic peer review. The items were designed to reflect the situation in the micro entrepreneurs sector and study setting. The four main constructs (financial risk, operational risk, compliance risk and strategic risk) were measured using multi item Likert type scale (7 scale- from strongly agree to strongly disagree). The first construct, financial risk comprises of five items concerning about financial risk aspect faced by the micro entrepreneurs. As for operational risks, it was assessed by nine items related to operational activities involved in a business. Aside from these two constructs, the compliance risk and strategic risks were represented by six and five items each.

The study starts with a case study involving in depth interview with few micro enterprises located in Johor. [17] described a case study as a methodology based on interviews, which are used to examine the technical aspects of an existing phenomenon with its real life context; when the boundaries between phenomenon and context are not clearly evident. This case study helps to test the validity of a set of questions which will be used in the next step of the study, namely survey research. A set of questions is used as an interview protocol, and were presented to all key informants in the same order. Overall, the research process involved in depth interview, pilot test and eventually a survey in developing a business risk framework for micro enterprise.

4.0 DESCRIPTIVE ANALYSIS

A total of 120 questionnaires were distributed, 119 were returned and only 111 questionnaires were classified as usable and valid for further analysis. Table I illustrates the demographic information gathered from the respondents included gender, business resources and Takaful's

product. Out of 111 respondents, 36% of micro entrepreneurs were male and the rest were female. Thus, it is clearly indicated that, in small business, female were exposed more than male. As for business resources, information of types of business, initial capital and monthly sales obtained was essential to determine the demographic profile of micro entrepreneurs that affected micro entrepreneur business risks.

Table 1: Profiles of Questionnaire Respondents

<i>Respondent Background</i>	<i>Percentage</i>	<i>Respondent Background</i>	<i>Percentage</i>
Sex:		Types of Business:	
Male	36.0	Sole Proprietorship	18
Female	64.0	Franchise	6.3
		Partnership	75.7
Initial Capital:		Monthly Sales:	
Below RM1,000	13.5	Below RM1,500	9.0
RM1,001 – RM2,000	13.5	RM1,001 – RM5,000	34.2
RM2,001 – RM5,000	39.6	RM5,001 – RM10,000	29.7
More than RM5,000	33.3	More than RM10,000	27.0

Financial risk is the possibility that a company will have lower profit or experience a loss. There are five items or questions related to this study. These questions were developed to represent the financial risk exposed among micro enterprises. Since the degree of Likert scale is up to 7, therefore, any question with an indicated mean of above than average 3.5 will be assumed as having a risk.

Table 2: Descriptive statistics on the financial risk

<i>Item</i>	<i>Question</i>	<i>Mean</i>	<i>Standard Deviation</i>
C1	I have problem in paying back my financial obligation.	2.76	1.625
C2	Most of my clients are not able to pay on time	3.30	1.693
C3	I have problems in obtaining financing for my business.	3.38	1.701
C4	The amount of financing obtained from the finance institution is insufficient	3.64	1.833
C5	The repayment period is short.	3.67	1.770
	Total average	3.35	1.724

As shown in Table 2, in average, respondents experience low degree of financial risks since the total average of these questions is below than 3.5. However, by referring to each question, only two questions deemed to have a mean above 3.5. Hence, this explains that respondents agreed that the amount of financing obtained from the financial institution is insufficient for them to run the business and the repayment period for the financial institution is short. Apart from examining the financial risk, the survey also investigates the operational risk among selected micro enterprises. Operational risk can be summarized as the risk of business operations failing due to other circumstances besides financial and market risks such as human risk. In business field human risk can be classified as supplier risk, customer risk and distributor risk. Thus, for the operational question, total average for all questions was slightly above than 3.5. Consequently, this indicates that most of the respondents have operational risk.

Table 3: Descriptive statistics on the operational risk.

<i>Item</i>	<i>Question</i>	<i>Mean</i>	<i>Standard Deviation</i>
D1	My suppliers always have problems in meeting my request for raw materials on time at required quantity.	3.76	1.922
D2	My suppliers always increase the price of raw materials.	4.32	1.590
D3	My suppliers do always have sufficient stock to meet demand.	4.75	1.719
D4	I have problem to meet the demand for my product.	3.32	1.652
D5	The distributors do not want to market my product.	2.86	1.516
D6	I have problem in marketing my product.	3.03	1.801
D7	The revenue obtained generates small profit.	3.55	1.628
D8	I am not satisfied with my sales to the distributor.	3.07	1.518
D9	I am not satisfied with my sales to the customer.	3.14	1.626
Total average		3.53	1.664

Table 3, shows that the respondents have a problem with suppliers. Most respondents agreed that suppliers failed to fill their demand in providing raw materials plus keep increasing the cost of the materials. In addition, since their business was focusing on small scale of volume with a few numbers of customers, thus, it has indirectly affected their revenue and profits.

Table 4: Descriptive statistics on the compliance risk

<i>Item</i>	<i>Question</i>	<i>Mean</i>	<i>Standard Deviation</i>
E1	I always have problem to meet the standard of The Occupational Safety & Health Act 1994 (OSHA).	3.15	1.805
E2	I always have problem to compete my product in my competitors.	3.77	1.999
E3	I had no problem in putting expiry dates on my products.	4.81	1.956
E4	I have problems in putting nutrition label content certification from the Ministry of Health.	3.70	2.025
E5	I have problem to meet the quality requirement as required by JAKIM Halal certificate.	4.06	2.028
E6	I have a problem in paying KWSP contributions for my employees.	2.77	1.736
Total average		3.71	1.9248

Compliance risk is the current and potential risk to situations where the laws or rules governing certain products may be ambiguous or untested. This risk is important because it may lead to business instability and diminished reputations in futures. As shown in Table IV, most of the respondents have problems to comply with certain requirements such as Halal certificate, labeling product details and laying the expiry dates. This situation occurs because they believe small business does not need to comply with any requirements since it incurs high costs to them.

Strategic risk is a risk that might arise from the pursuit of an unsuccessful business plan, for instance, making poor business decisions and changes in the business environment. Based on Table V, all questions show the mean above 3.50, therefore, these results explains that respondents have a higher risk on strategic risk. Changes in customer's preference, technology, demographic profiles, economic conditions and sales are seen to be a major risk to them and directly affect their business profits.

Table 5: Descriptive statistics on the strategic risk

<i>Item</i>	<i>Question</i>	<i>Mean</i>	<i>Standard Deviation</i>
F1	The taste in customers' preference will affect my business.	4.81	1.703
F2	The changes in technology will affect my production.	4.96	1.732
F3	Changes in the demographic profile (Gender, Age, Race, and Monthly Income) will affect my business.	3.92	1.690
F4	Changes in the economic situation will affect my sales.	5.04	1.678
F5	Changes in sales will affect my profit.	5.29	1.486
Total average		4.80	1.6578

5.0 EXPLORATORY FACTOR ANALYSIS

This study employed a factor analysis to identify the most important risks of takaful products. Four dimensions were used to group related to risks. The dimensions are:

- Financial risk
- Operational risk
- Compliance risk
- Strategic risk

All the items in each dimension were factor analyzed in exploratory factor analysis. The results shown that the Kaiser-Meyer-Olkin (KMO) presented an index of 0.6670 and the Bartlett's Test of Sphericity was significant ($p=0.000$), which indicates that the data were slightly sufficient to perform factor analysis. In the inaugural run of the factor analysis, four factors emerged in principal component analysis with eigenvalues greater than 1, accounting for 47.3 percent of cumulative variance. Based on the result, since a factor analysis, accounting less than 50 percent, therefore the data were not considered as a good fit. Before a decision concerning the number of factors to be retained, Varimax rotation method was then applied to the four factors. Cut off value of factor loadings was kept more than 0.50. Four items with cross loading and communalities below than 0.50 were deleted (C4, C5, D1, D2, D3, D4, E6, F4), resulting 17-item scale for measuring risks. In the second run of factor analysis (after extraction), the remaining 17 variables were tested. The results revealed that KMO's presented an index of 0.7200 with p -value of 0.000 in Bartlett's Test. The rotated component matrix (after extraction) was produced in Table VI. It was observed that 17 variables have been categorized in four factors with eigenvalues more than 1. These factors account for about 57.941 percent of the total cumulative variance. Thus, the data for this study were considered as a good fit.

In this study, a questionnaire's reliability was further verified by using Cronbach's alpha coefficient. The Cronbach's alpha coefficient is a measurement of internal consistency and the coefficient ranges normally between 0 and 1. The closer Cronbach's Alpha to 1 the greater the internal consistency of the items in the scale. Based on Table VII, operational risk, compliance risk and strategic risk with takaful's product have moderate internal consistency and considered acceptable since Cronbach alpha reported above 0.70. Nevertheless, the Cronbach alpha coefficient of financial risk was 0.628 which is beneath than 0.70. According to (Pallent, 2010), if Cronbach alpha less than 0.70, therefore, corrected item-total correlation should be checked. If the value less than 0.30, it indicates that the item is measuring something different from the scale as a whole and may need to be removed. Since the value of C3, C4 and C5 were above 0.30, as a result the item was retained for further analysis.

Table 6: After extraction rotated factor matrix (N= 111)

<i>Factor</i>	<i>Factor's Item</i>	<i>Item Loadings</i>	<i>Principal Components</i>	<i>Sum of Square Eigenvalues,</i>	<i>Cumulative Percentage of Total Variance</i>
1	Operational Risk	D5	0.643	3.776	22.214
		D6	0.503		
		D7	0.728		
		D8	0.711		
		D9	0.794		
2	Compliance Risk	E1	0.564	2.588	37.438
		E2	0.678		
		E3	0.550		
		E4	0.797		
		E5	0.790		
3	Strategic Risk	F1	0.757	2.382	51.453
		F2	0.765		
		F4	0.769		
		F5	0.782		
		4	Financial Risk		
C4	0.753				
C5	0.524				

Table 7: Reliability statistics

<i>Factor</i>	<i>Item Loadings</i>	<i>Corrected Item-Total Correlation</i>	<i>Cronbach's Alpha Coefficient</i>
1	D5	0.543	0.782
	D6	0.485	
	D7	0.499	
	D8	0.625	
	D9	0.656	
2	E1	0.389	0.714
	E2	0.437	
	E3	0.368	
	E4	0.577	
	E5	0.593	
3	F1	0.608	0.782
	F2	0.607	
	F4	0.558	
	F5	0.581	
	4	C3	
C4		0.471	
C5		0.393	

6.0 CONFIRMATORY FACTOR ANALYSIS

Based on the result of exploratory factor analysis, further testing was carried. The 17 items capturing the components of SMEs risks was used as an input for confirmatory analysis. For the confirmatory factor analysis, this study tested and compared two measurement models:

- Model 1 (one-factor model). SMEs risks model is conceptualised as a unidimensional construct where a covariance among the items is accounted for by a single factor. This is shown in Fig. 1

- Model 2 (four-correlated-factor model). SMEs risks model is conceptualised as a multidimensional construct. Covariation among the items is accounted for by the four restricted first-order factors, with each factor representing a distinct dimension of SMEs risk (Fig. 2). The summaries of statistics for these two models are shown in Table VIII.

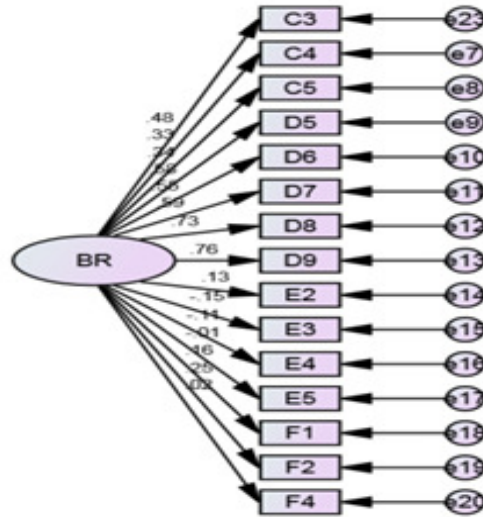


Figure 1: One-factor model

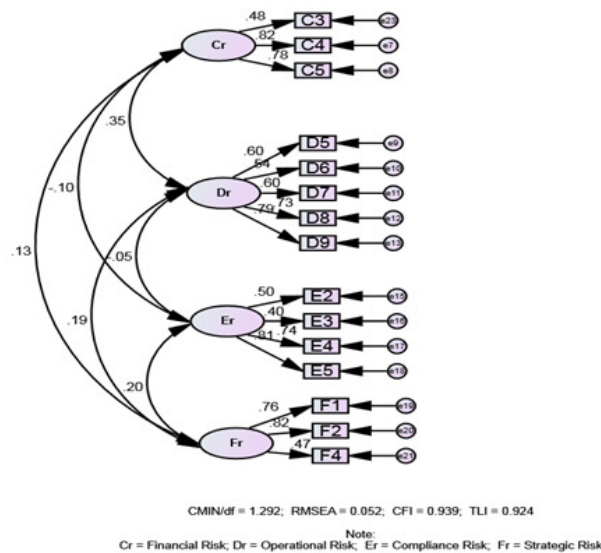


Figure 2: Four-correlated-factor model

A comparative analysis in Table VIII indicates that Model 2 outperforms Model 1. The result advocates that business risk is a multidimensional construct with four dimensions (financial, operational, compliance and strategic). Indeed, Model 2 displays acceptable fit indices with $\chi^2 = 108.54$ (84), RMSEA = 0.052, CFI = 0.939, TLI = 0.924. Even though the χ^2 statistics is significant, this is not unusual. Furthermore, other essential indices namely CFI, RMSEA and TLI meet the recommended levels for a model fit (Hair et al, 20016).

Table 8: Model summary

	Model 1: One General Factor	Model 2: Four Correlated Factors
<i>Absolute measures</i>		
χ^2 statistics (d/f)	318.10 (90)	108.54 (84)
RMSEA	0.152	0.052
<i>Incremental fit measures</i>		
CFI	0.434	0.939
TLI	0.340	0.924
<i>Parsimony fit measures</i>		
NC (χ^2 /df)	3.534	1.292

7.0 CONCLUSION

The present study makes both academic and practical contributions that propose several imperative findings and applications for future research. From the perspective of the academic, this study explores the aspect of SMEs risks in particularly exposed by the micro enterprises which contribute to the existing body of knowledge about SMEs risks. It offers an empirical framework of SMEs risks construct by developing a model with four dimensions (financial, operational, compliance and strategic risks). With this framework, it allows future empirical research on SMEs risks to be conducted. It will help the academicians to move forward in the study of SMEs risks by looking into this construct with other construct(s). Hence better and improved result could be expected.

As for the industry, it is quite critical for the takaful operators to come out with marketable products that can allow a win-win situation. Hence, the marketable product must suite with the demand from micro enterprises. A good understanding on particular risks exposed by interested group would help the practitioners to offer appropriate product to them. This SMEs risks framework that comprises of four SMEs risks can be used by the takaful operator as a parameter in developing suitable takaful scheme to the needy group as a safety purpose. In essence, it is crucial for both academic and practitioner to recognize the dimension of SMEs risks in the development of appropriate schemes of takaful.

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