FMM Business Conditions Survey

IMPROVEMENT IN MANUFACTURING ACTIVITY IN 2H2023, MODERATE OUTLOOK FOR 1H2024

Issue No. 1/2024 **Released on March 11, 2024**

KEY RESULTS:	
BUSINESS ACTIVITY – 2H2023	• Business conditions improve in 2H2023 • Current domestic and export sales pick up • Production volume and capacity utilisation trend up • Cost of production and employment shift lower • Capital investment beefs up
BUSINESS ACTIVITY – OUTLOOK 1H2024	• Business conditions to improve moderately in 1H2024 • Local and export sales to pick up in 1H2024 • Production volume and capacity utilisation to increase in tandem with higher sales expectations • More capital investment to be injected • Higher production cost and employment in 1H2024
GENERAL BUSINESS ACTIVITY – OUTLOOK 2024	• 3 biggest challenges to businesses in 2024: rising input costs, weak demand and ringgit depreciation • Higher revenue and profit by 1-10% expected in 2024 vis-à-vis 2023 • 45% of respondents are somewhat prepared and 44% are adequately prepared to withstand disruptions to operations
GENERAL	• Assistance needed for export market expansion: expand double tax deduction incentive, and introduce new incentives to increase visibility of Malaysian brands regionally and internationally • Expand market access by negotiating FTAs with important markets like Tanzania, USA and UAE • 55% of respondents have not invested in IR4.0 yet • Government support required to commence IR4.0 (Pilot POC) and to scale up current IR4.0 (expand Pilot scope) • Financial support from government for IR4.0 adoption: incentives, matching grants and double tax deduction • Technical support from government for IR4.0 adoption: training, consultancy, and research and development • Top 3 IR 4.0 technologies and tools used in factory operations: cloud computing, cybersecurity and industrial Internet of Things (IoT) • Cost is biggest challenge to manufacturing sector in adopting or transitioning towards ESG practices • New service tax on logistics expected to increase the product prices of 78% of respondents • 54% of respondents not sure about volunteering their participation in the PWM. Main concern is lack of clarity on the implementation mechanism and requirements • 83% of respondents opined that the new tax measures, as announced in Budget 2024, will likely impact their businesses, with minimal or moderate impact expected

Business conditions in the Malaysian manufacturing sector improved lately amid challenges in the global and domestic economic landscapes. While several indicators within the sector showed improvement, the overall situation remains below the optimism threshold, signalling a slow recovery as the sector continues to grapple with persistent economic headwinds.

Going into 2024, with economic conditions expected to improve, including the easing of global interest rates as inflation continues its descent, manufacturing activity could likely gain some momentum, albeit slowly, with an expected pick-up in sales, production, capital investment and hiring going forward.

Indicators	FMM-MIER Business Conditions Index Values							
	Current (Compared to 6 months ago)				Looking forward (Next 6 months)			
	1H2022	2H2022	1H2023	2H2023	2H2022	1H2023	2H2023	1H2024
Business conditions	109	107	66	**89**	94	92	86	**92**
Local sales	99	98	71	**86**	90	91	81	**92**
Export sales	91	91	66	**80**	89	84	88	**89**
Production volume	102	102	69	**91**	98	97	86	**97**
Capacity utilisation	104	99	68	**91**	100	94	87	**99**
Capital investment	109	104	95	**103**	113	112	100	**110**
Number of employees	100	112	101	**98**	117	113	101	**105**
Cost of production	182	166	157	**154**	177	166	148	**159**

BUSINESS CONDITIONS IMPROVE

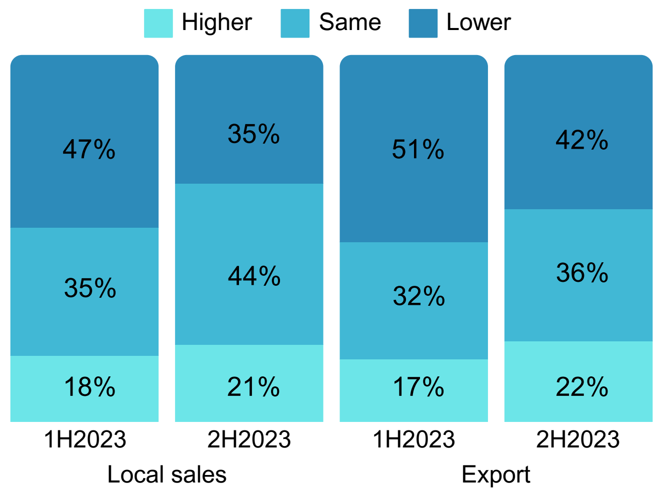
Manufacturing activity picked up in 2H2023, as shown by the general business conditions index which, at 89, has gained 23 points from 1H2023. Its continued stay below the 100-point optimism threshold is an indication that while sentiments had improved, respondents had remained cautious as well. 26% of the 613 respondents noted an increase in business activity in 2H2023, up from 20% in 1H2023. A smaller proportion of 36% responded negatively this time around, compared to the previous survey's 54%.

Local and Export Sales Improve from 1H2023

Domestic and export sales improved in 2H2023 from 1H2023. Indicating this is the latest current indexes for local sales and export sales which rose to 86 and 80, respectively, up from 71 and 66 six months ago. With both indices still hovering below the threshold level of optimism, it suggests that the increase in local and export sales had remained below expectations.

Higher local and export sales were reported by 21% and 22% of the respondents in 2H2023, up from 18% and 17% in 1H2023, respectively. Most, however, reported no change in their sales locally and abroad, as indicated by 44% and 36% of the respondents, respectively, while weak local and export sales were experienced by 35% and 42% of the respondents, respectively.

Local and Export Sales (1H2023 vs 2H2023)

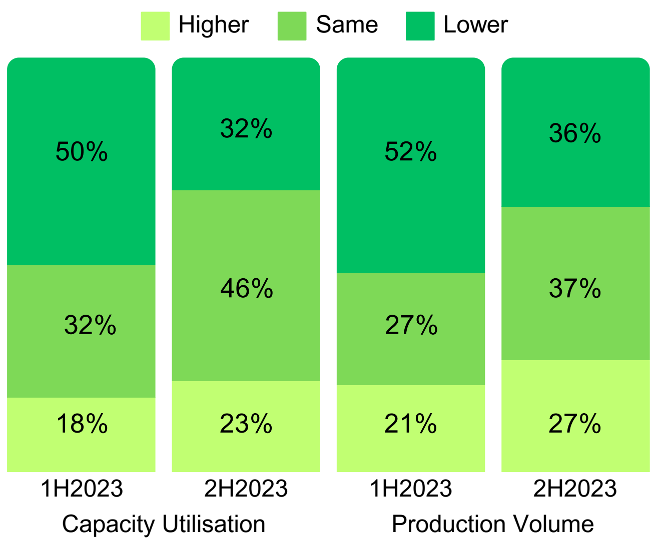


Production Volume and Capacity Utilisation Increase

Production volume and capacity utilisation shifted higher as new orders and sales picked up pace in 2H2023. Both the current production and capacity utilisation indices were higher at 91 each in 2H2023, up from 69 and 68, in 1H2023, respectively. Like sales, their readings below the optimism threshold level suggest much room for improvement.

27% of the respondents produced more in 2H2023, while 23% expanded their capacities during this period. As in the prior survey, larger proportions of respondents continued to cut back on their production and capacities in 2H2023, with 36% and 32% confirming this, respectively.

Production Volume and Capacity Utilisation (1H2023 vs 2H2023)



Cost of Production Trends Lower

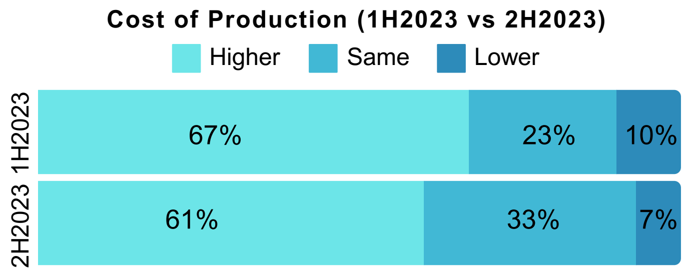
Manufacturing costs eased again lately. Depicting this is the latest index for the current cost of production which, at 154, is the lowest reading in three years. 61% of the respondents had to put up with higher production costs in 2H2023, the smallest proportion tabulated in three years.

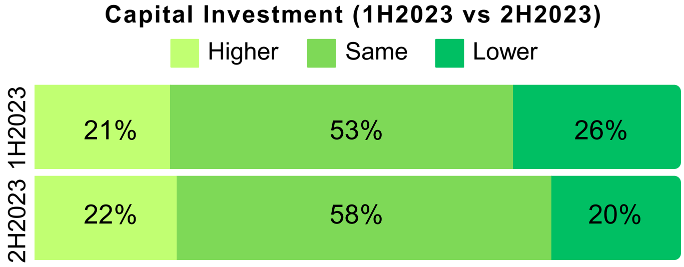
Capital Investment Beefs Up

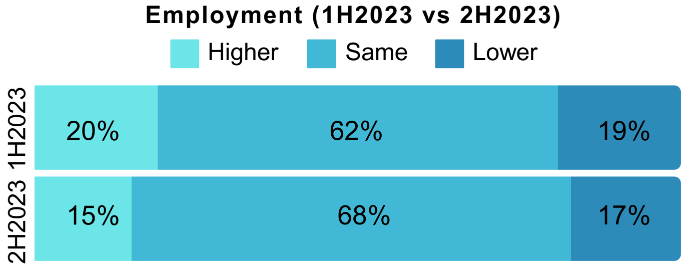
After dipping below the optimism threshold level in 1H2023, the index for current capital investment (CAPEX) gained 8 points to 103, rising above the threshold once again in 2H2023. 22% injected additional CAPEX lately, little changed from 21% in 1H2023.58% were impartial on this, while 7% reduced their investments, down from 10% previously.

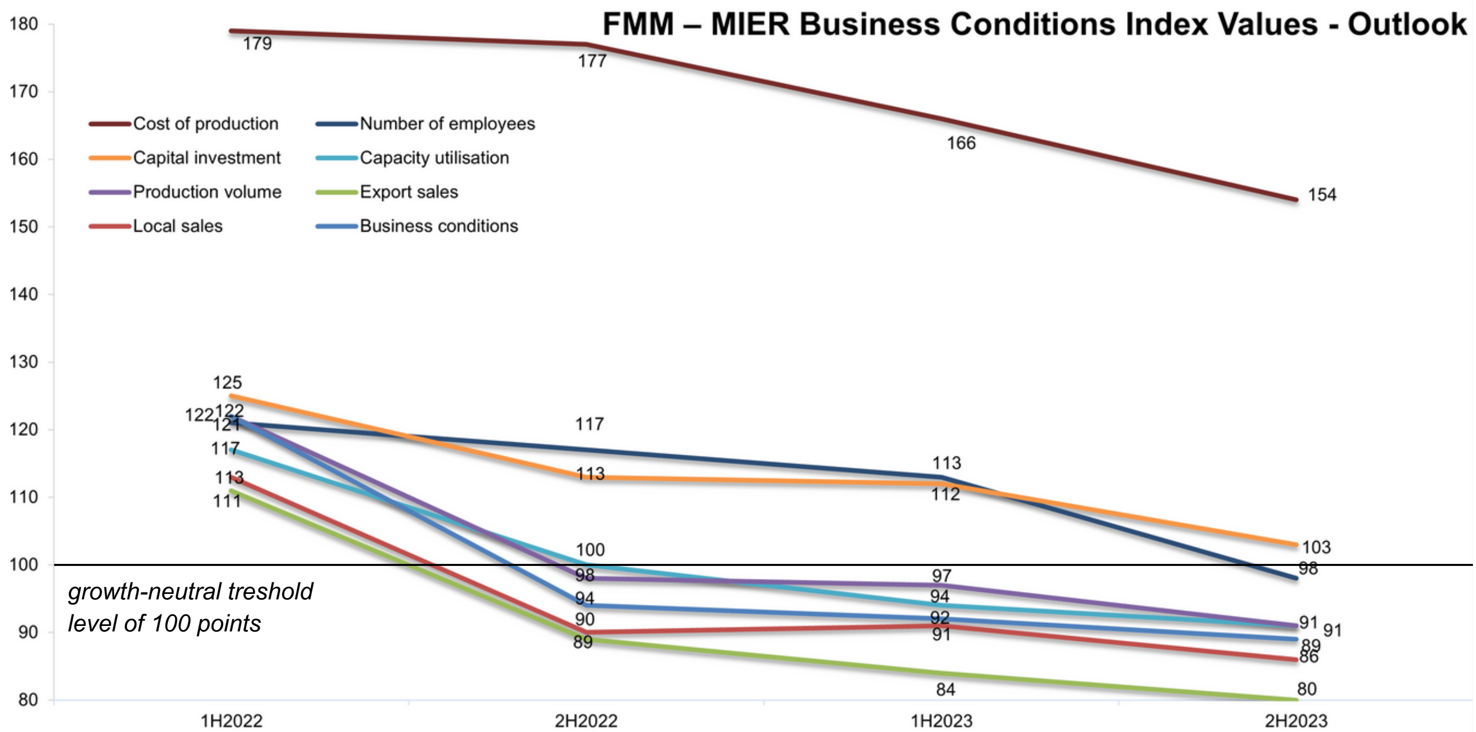
Employment Slows Down

Employment opportunities in the manufacturing sector were generally less prospective in 2023 than they were a year ago. After staying above the optimism threshold for the whole of 2022 and 1H2023, the current employment index fell again below the threshold in 2H2023 to 98. 15% of the respondents hired more employees in 2H2023, the lowest proportion received since 1H2021. 17% reduced their manpower, while 68% had retained their current headcount.









MODERATE OUTLOOK FOR 1H2024

The manufacturing sector is expected to pick up some momentum, albeit cautiously, in the coming months as subdued external demand, supply chain disruptions, and ongoing geopolitical tensions continue to weigh on the Malaysian economy.

Across-the-board improvements were charted for all the forward-looking indicators covered in the survey. Notwithstanding the improvements, some indicators still remained below the optimism threshold, an inference that respondents are cautiously forward looking in 1H2024, in particular, local and export sales, production volume and capacity utilisation.

The latest index for expected business activity rose six points to 92 from the prior survey, an inference that business conditions are expected to improve in the coming months. 23% of the respondents are anticipating a pick-up in business conditions soon, while 31% are expecting a slowdown and 46% opined that the status quo will remain.

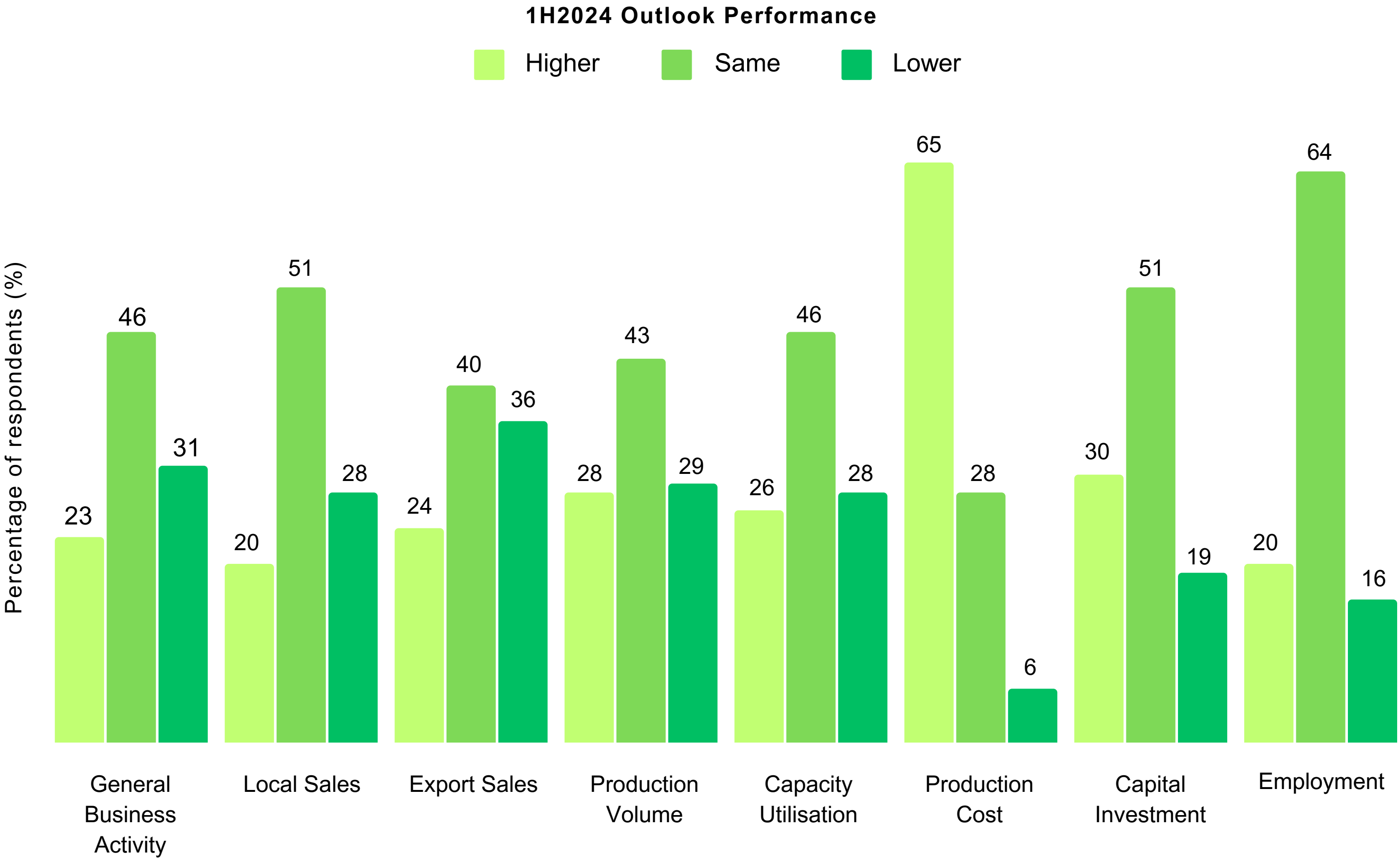
Local and export sales are expected to increase in tandem with higher demand. The expected index for local sales climbed eleven points to 92, while the expected index for export sales rose slightly to 89, signalling a faster pace of domestic sales to export sales in 1H2024. 20% of the domestic-oriented respondents projected an increase in sales soon, up from 16% previously. Of those who export, 24% expected higher sales in the coming months, while 36% revised their forecast lower.

Concomitant to the higher sales forecast, the index for expected production volume picked up thirteen points to 97. 28% of the respondents planned to beef up their production volume in 1H2024, up from 23% previously, while most preferred to maintain their current volumes. Capacity utilisation is also expected to trend higher, as indicated by the expected capacity utilisation index which gained twelve points to 99, with 26% of the respondents responding positively.

Production costs in the coming months are also expected to shore up, with a higher index of 159. A bigger majority of 65% than previously (54%) will likely have to deal with higher production costs in 1H2024, while 28% do not foresee any change in their costs anytime soon.

The latest index for expected capital investment, at 110, was up ten points from the previous period, implying that an increase in CAPEX is likely in the coming months. 30% planned to increase their CAPEX soon, while 51% will maintain their current budgets in early 2024 as well.

The latest index for expected employment stood at 105, higher than the prior period's 101, suggesting that more headcounts will likely be added in the sector in the months ahead. 20% of the respondents planned to increase their manpower soon, while 64% will maintain their existing workforce for now.

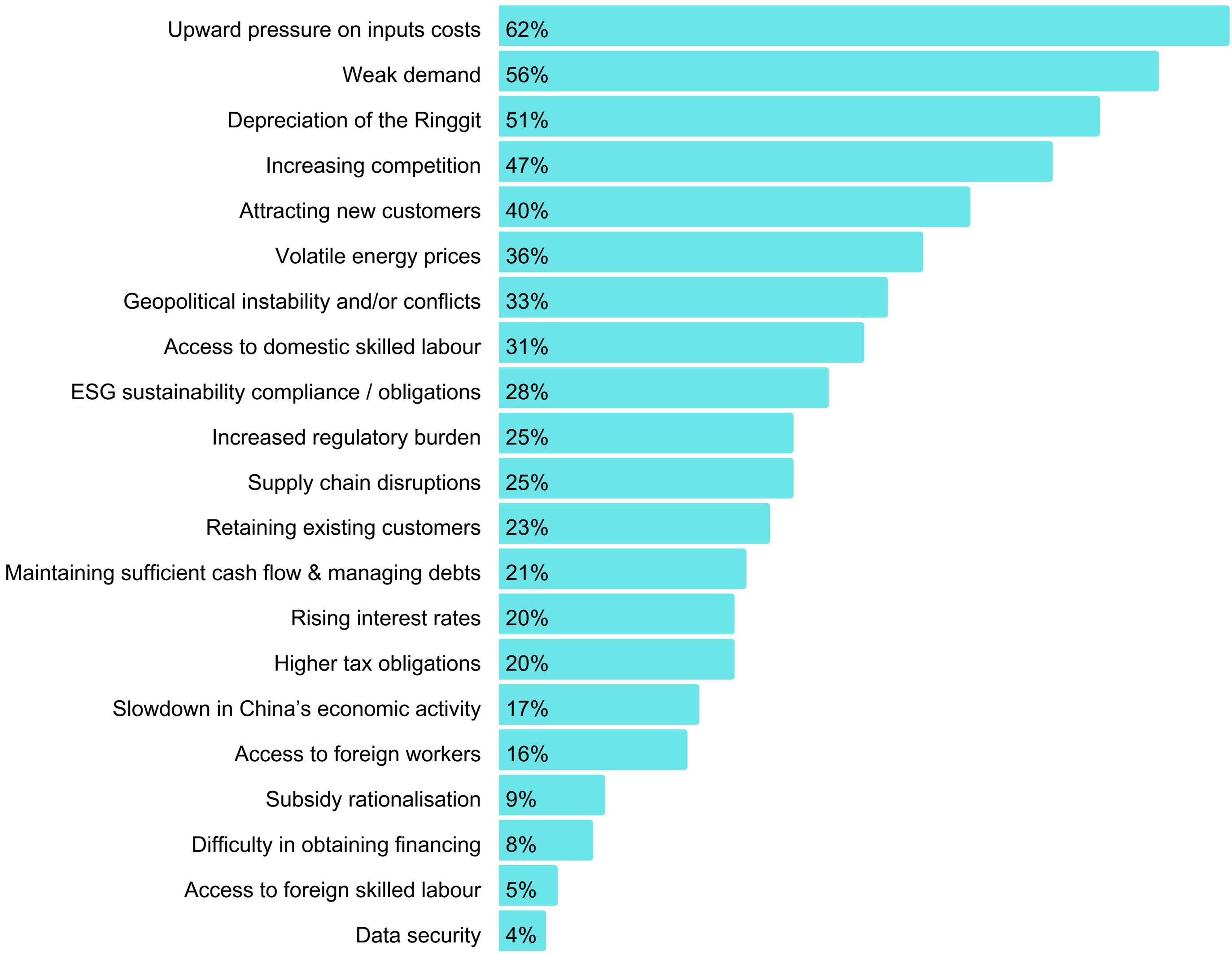


CHALLENGES TO BUSINESS OPERATIONS AND GROWTH

The year 2023 was exceptionally demanding, with both the global and domestic economies having to bear the weight of formidable challenges. Trade tensions, weak demand, supply chain disruptions and fluctuating currencies created an environment of uncertainties globally. As countries and businesses navigated through these complex economic headwinds, the year 2024 emerged as a crucible of economic endurance, shaping policies and practices for the foreseeable future.

What then are the biggest challenges to respondents' business operations and growth in 2024? Most (62%) cited the increasing costs of inputs, followed by weak demand (56% responses) and ringgit depreciation (51%). In descending order of responses, increasing competition, attracting new customers, volatility in energy prices and geopolitical conflicts were cited by 47% to 33% of the respondents. Featuring at the bottom of their lists are, among others, data security, difficulty in obtaining financing, subsidy rationalisation, and access to foreign skilled labour (expatriates).

Challenges to Business Operations and Growth

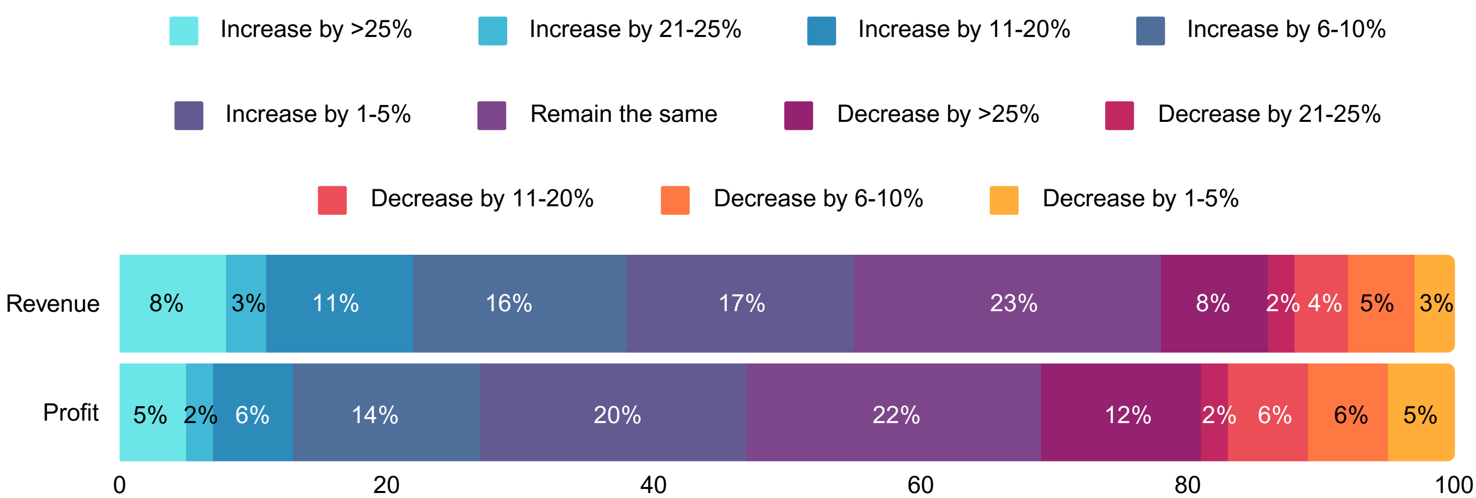


REVENUE AND PROFIT GROWTH 2024

Both revenue and profit expectations in 2024 vis-à-vis 2023 of most respondents (56%) increase and ranged up to 10% generally. Among them, 17% and 16% forecasted an increase of 1-5% and 6-10%, respectively, while 23% believed that their revenue would remain the same in 2024. A significant revenue increase of more than 25% is expected by 8% of the respondents, with the same quantum of decrease expected by another 8% of the respondents.

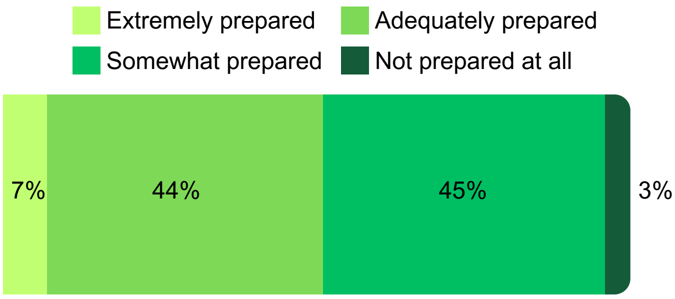
In terms of profits, 22% of the respondents expected their profits to remain the same, while 20% and 14% are looking at an increase of 1-5% and 6-10%, respectively. An ambitious 5% are anticipating profits by more than 25%, while a decrease of the same quantum is envisaged by 12% of the respondents.

Expectations on Revenue and Profit Growth for 2024



MANUFACTURING OPERATIONS: PREPAREDNESS AND RESILIENCE

Against a backdrop of pervasive economic headwinds that tested the resilience of countries and businesses alike, respondents were asked about their level of preparedness and resilience to withstand disruptions to their manufacturing operations. Overall, respondents are either somewhat or adequately prepared, with 45% and 44% saying so, respectively. Only 7% are extremely prepared (with contingency plans in place).

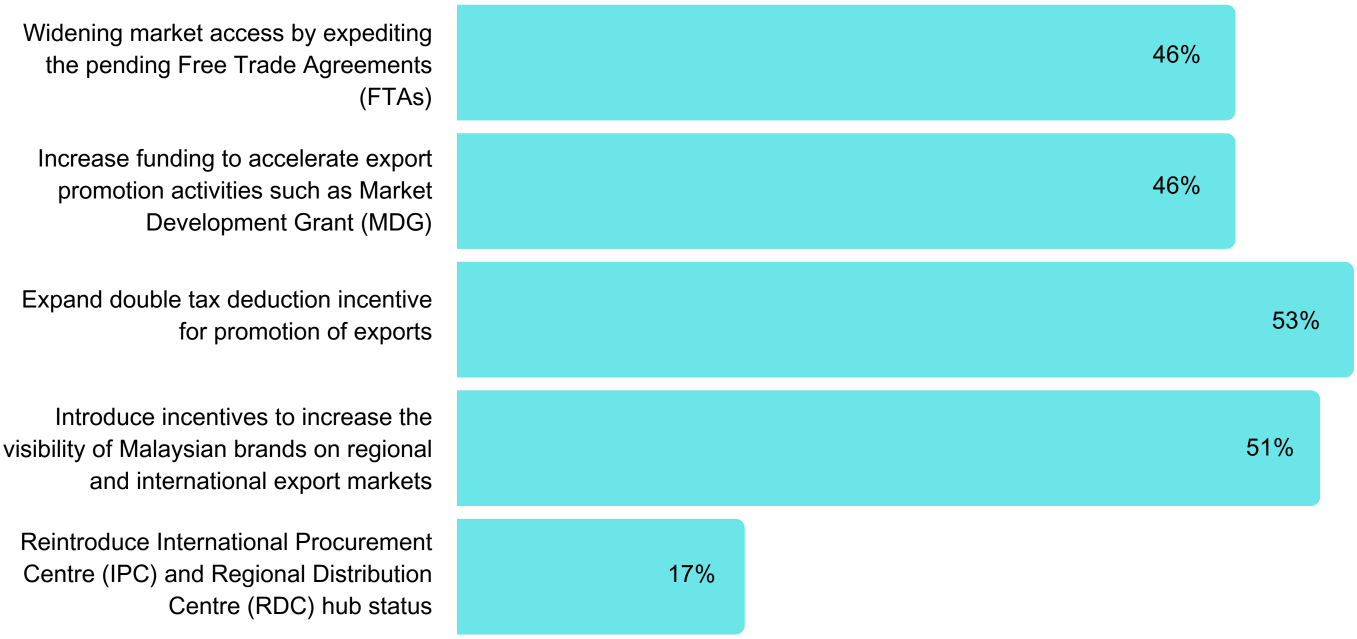


TYPE OF ASSISTANCE NEEDED FOR EXPORT MARKET EXPANSION

Given the challenging external demand performance, most (53%) respondents opined that an expansion of the double tax deduction incentive for the promotion of exports that includes participation in trade and investment missions organised by trade associations would assist them in expanding their export markets. According to 51% of the respondents, the introduction of incentives to increase the visibility of Malaysian brands on regional and international export markets by promoting Brand Promotion Grant would also help.

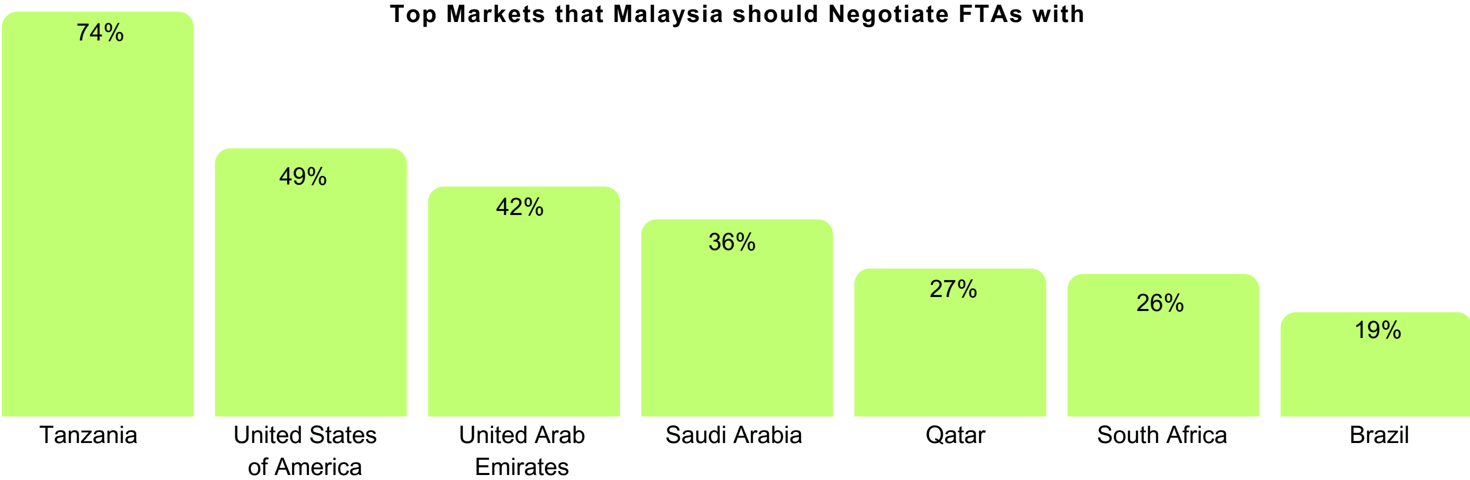
Other popular suggestions by respondents included the widening of market access by expediting the pending Free Trade Agreements (FTAs) negotiations such as the Malaysian-European Union FTA and establishing new FTAs, as well as increasing funding to accelerate export promotion activities such as Market Development Grant (MDG) for participation in trade missions and fairs

Type of assistances needed for businesses to expand their export market



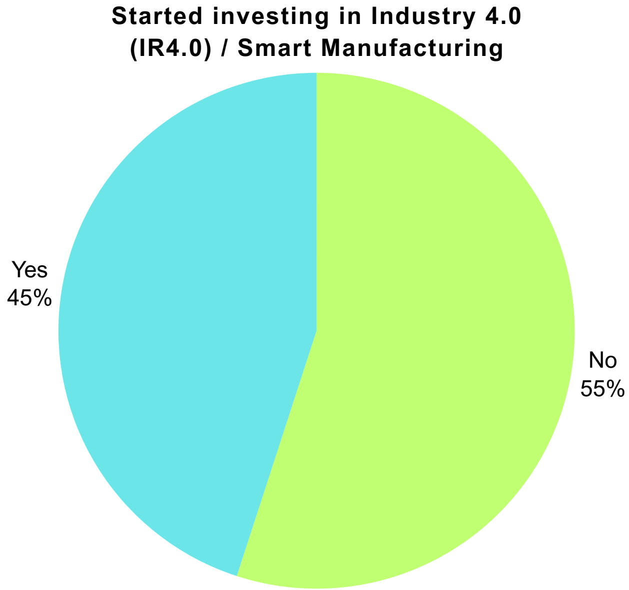
For greater market access, top markets identified for Malaysia to negotiate FTAs with are Tanzania, United Arab Emirates and United States. Saudi Arabia, Qatar, South Africa and Brazil were also popularly listed by respondents.

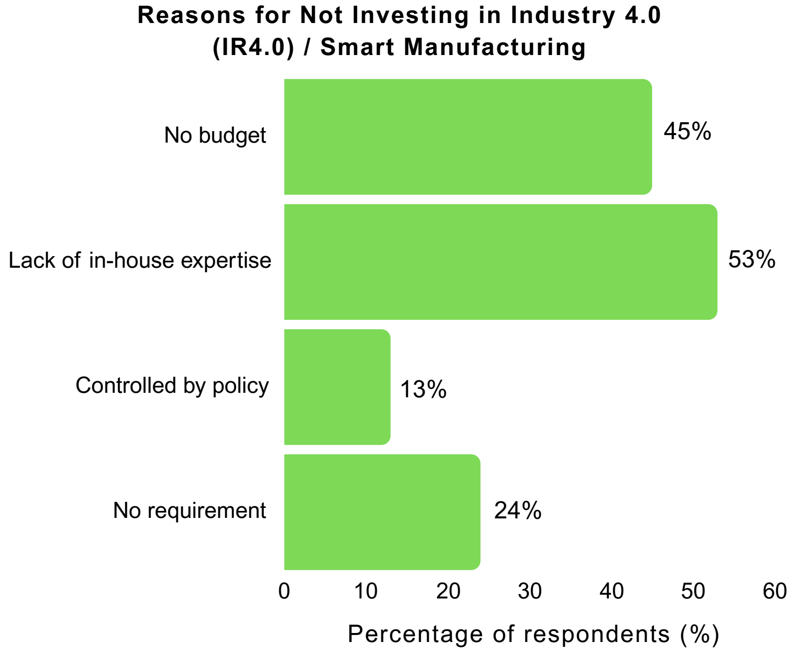
Top Markets that Malaysia should Negotiate FTAs with



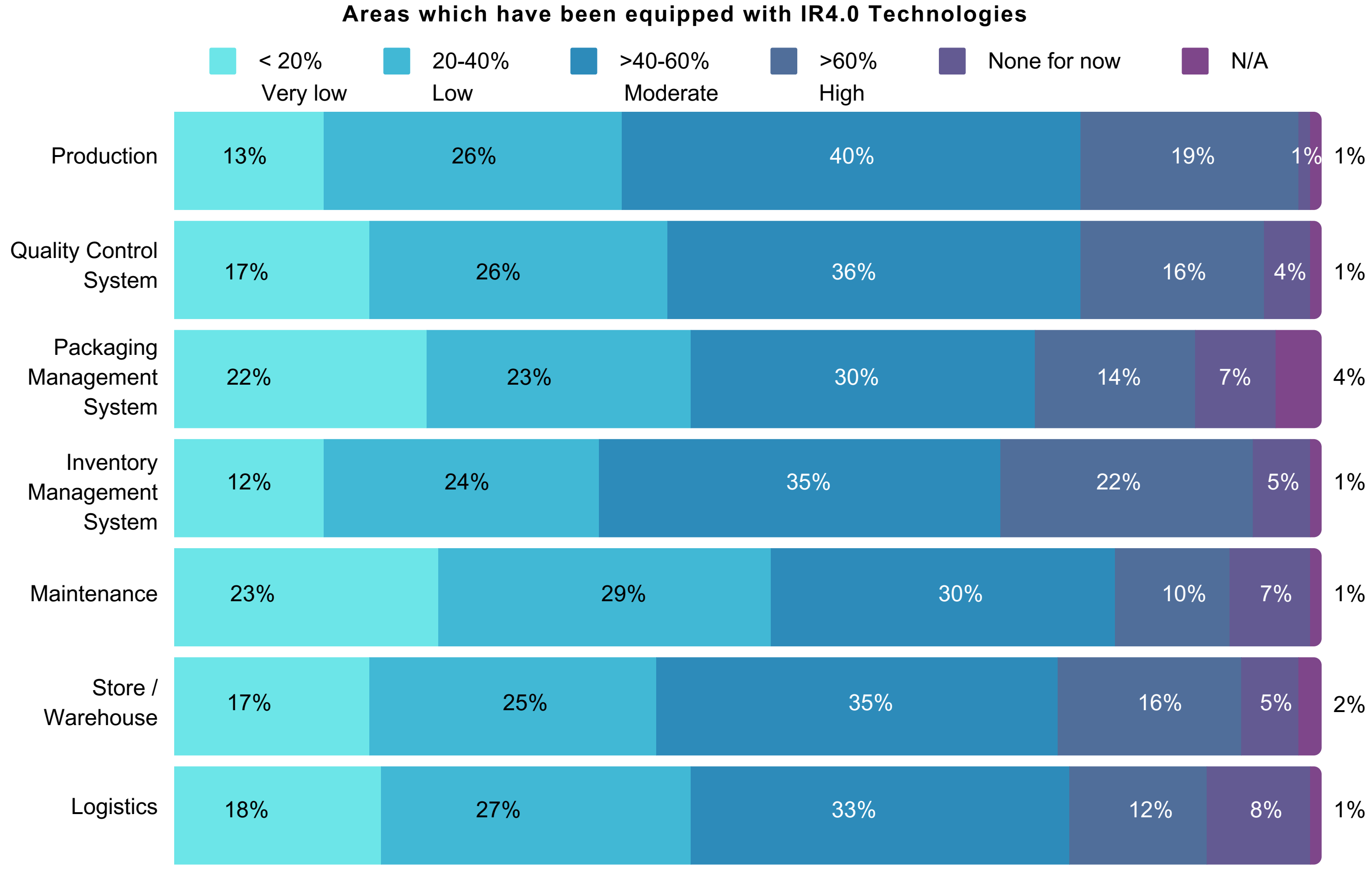
INDUSTRY 4.0 AND DIGITALISATION

Embracing technology and digitalisation to drive innovation, enhance productivity and create new opportunities for economic growth is one of the missions of the New Industrial Master Plan 2030 (NIMP 2030), which also aims to transform 3,000 smart factories. In line with this, respondents were asked if they have started investing in Industry 4.0 (IR4.0) / smart manufacturing, to which 55% replied that they have not. Most (53% respondents) cited the lack of in-house expertise to lead their adoption of IR4.0, while 45% do not have a budget for it.



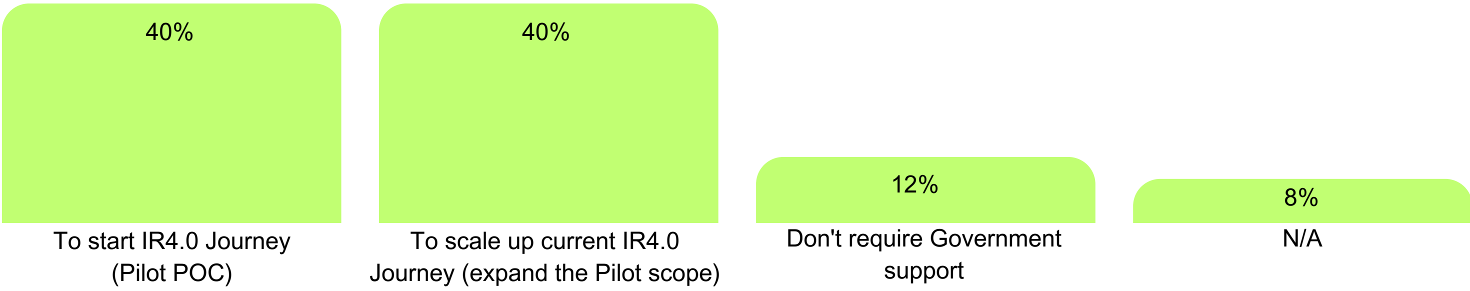


The set-up of IR4.0 technologies at most factories is mostly low (20-40%) to moderate (>40-60%). Most (30-40%) respondents' factories are moderately equipped with IR4.0 technologies in production, quality control systems, packaging management systems, inventory management systems, maintenance, store/warehouse and logistics. While 23-29% of respondents estimated their IR4.0 set up of all processes in their factories as low, the processes at factories of 13-23% of the respondents are fitted with <20% (very low) of IR4.0.



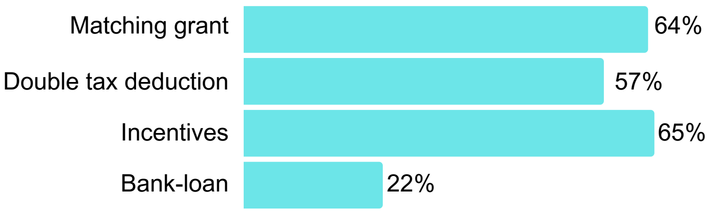
Support from the government is generally required by the majority of the respondents in their IR4.0 adoption. Among them, 40% indicated that they need this support to commence their IR4.0 journey (Pilot Proof of Concept (POC)), while another 40% said the support is needed to scale up their current IR4.0 journey (expand the Pilot scope).

Government's support required for manufacturing activities



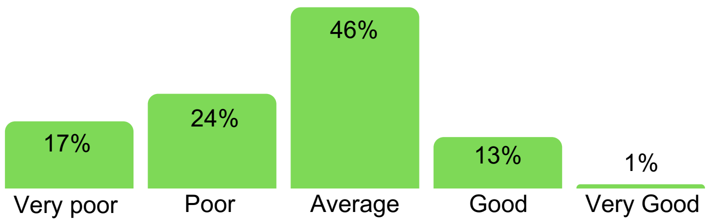
Of those who need financial support from the government, incentives, matching grants and double tax deduction were the most popular, as recommended by 65%, 64% and 57% of the respondents, respectively. Technical support, in the form of training, consultancy and research and development, was also proposed by 45%, 36% and 35% of the respondents, respectively.

Financial Support Required from the Government



Technical Support Required from the Government

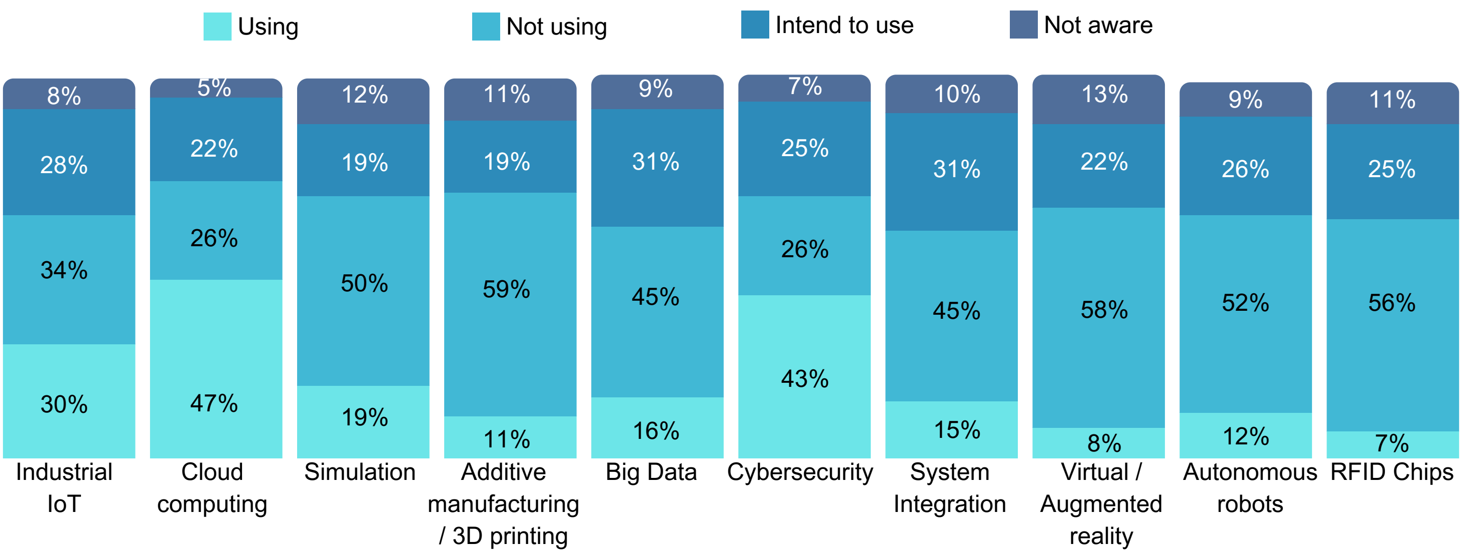
Overall, the 5G internet access and speed for smart manufacturing/factory automation at factories still leave much room for improvement, with most (46%) rating it as average, while 24% and 17% rated theirs as poor and very poor, respectively. Only 1% had very good coverage, while that for 13% of the respondents was good.



IR4.0 technologies and tools are generally not widely used in factory operations. Compared to 7-47% of those who are using them, 26-59% admitted to not using them, especially additive manufacturing/3D printing (59% non-users), virtual augmented reality (58% non-users), RFID chips (56%), autonomous robots (52%) and simulation (50%). There are intentions by 19-31% of the respondents to use some of these IR 4.0 technologies and tools sometime soon, especially big data, vertical and horizontal system integration, IoT, autonomous robots and RFID chips, with potential users totalling 31%, 30%, 28%, 26% and 25%, respectively. However, some 5-13% are still not aware of these IR 4.0 technologies and tools.

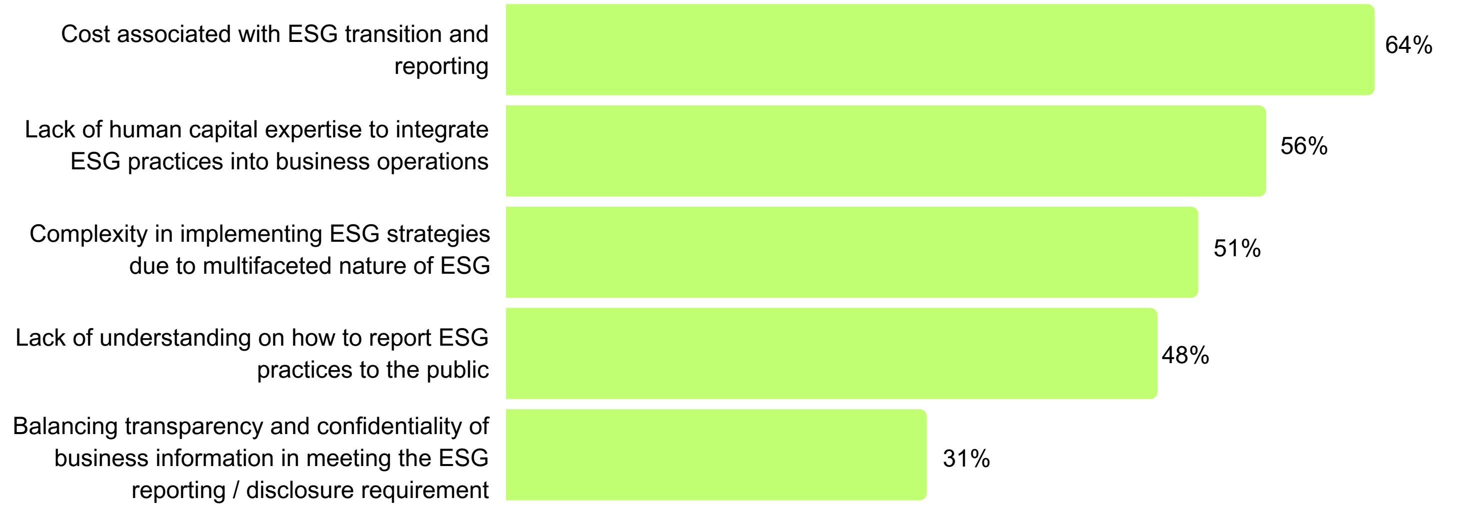
Among the IR4.0 technologies and tools used by those in their factory operations, the top three are cloud computing, cybersecurity and IoT, with respondents using them totalling 47%, 43% and 30%, respectively.

Technologies & Tools related to IR4.0 used in Factory Operations



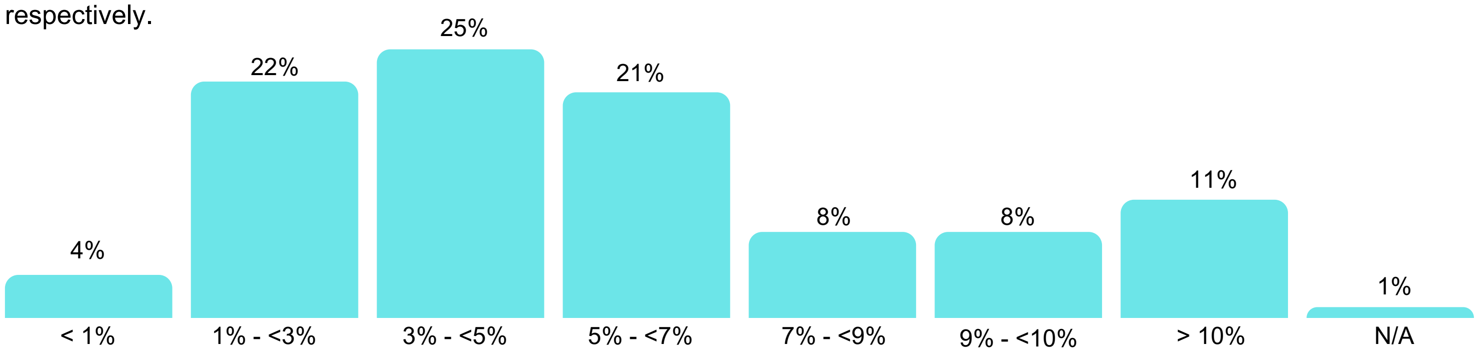
ESG AND SUSTAINABILITY COMPLIANCE

In adopting or transitioning towards Environmental, Social and Governance (ESG) practices, the biggest challenge to the manufacturing sector is cost, with 64% of the respondents saying this. Lack of human capital expertise to integrate ESG practices into business operations, as well as the complexity in the implementation of ESG strategies due to the multi-faceted nature of ESG were also stated by 56% and 51% of the respondents, respectively. Lack of understanding on how to report ESG practices to the public and the balancing of transparency of business information in meeting the ESG reporting/disclosure requirement are other challenges that concern some respondents.

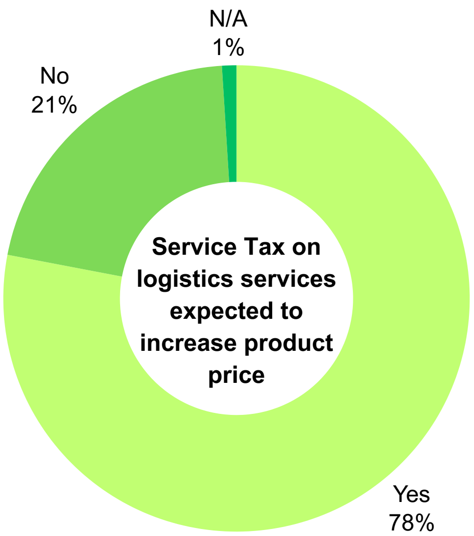


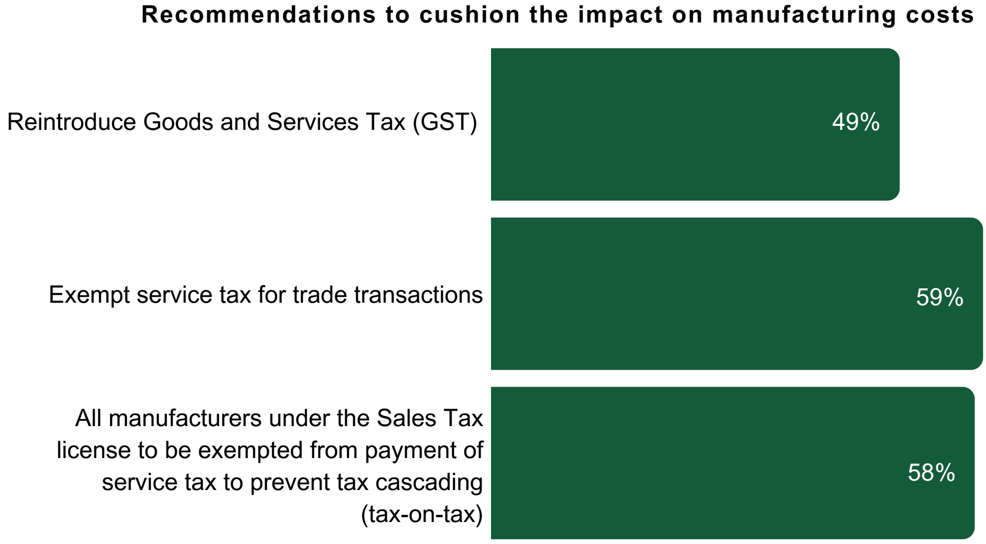
SERVICE TAX ON LOGISTICS

The Budget 2024 announced the introduction of a 6% service tax on all logistics services, except freight services by foreign shipping lines. Currently, 25% of the respondents are incurring logistic costs of 3% to < 5% of their product costs (operation and production cost), while 22% and 21% of the respondents estimated their logistic costs at 1% to < 3%, and 5% to < 7%, respectively.



The new tax, according to 78% of the respondents, is expected to increase the prices of their products. To cushion the impact of the tax on their manufacturing costs, 59% are recommending that the service tax be exempted for trade transactions. Another recommendation by 58% of the respondents is for all manufacturers under the Sales Tax license to be exempted from the service tax to prevent tax cascading (tax-on-tax), and 49% called for the re-introduction of the Goods and Services Tax (GST).

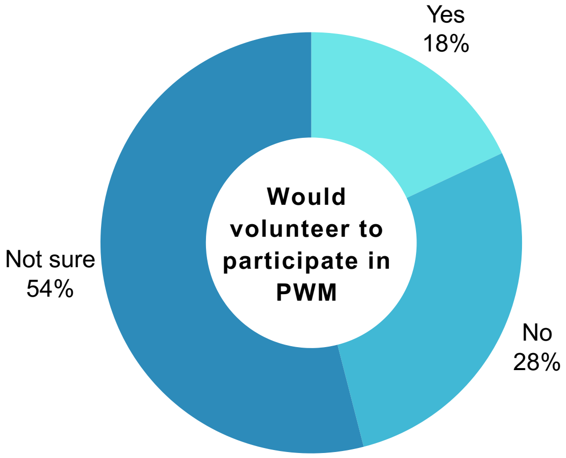


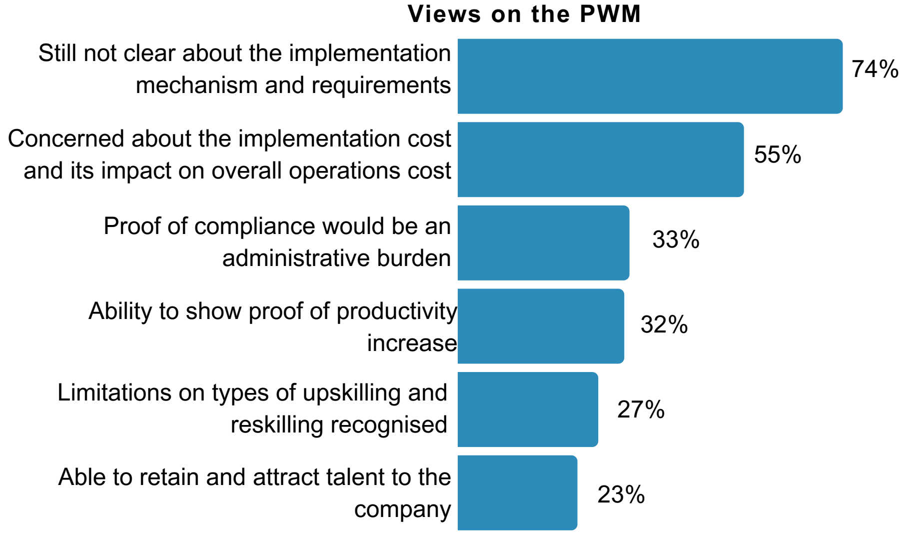


PROGRESSIVE WAGE MODEL (PWM)

The Minister of Economy tabled the White Paper on the PWM on November 30, 2023. The incentive-driven voluntary opt-in PWM will, among others, prioritise workers in SMEs at both entry and non-entry levels earning RM1,500-RM5,000. Incentives would be in the form of cash payments of RM200 and RM300 for entry-level and non-entry level, respectively. Other conditions include proof of upskilling of workers and rise in productivity, and companies would be rated according to a star system.

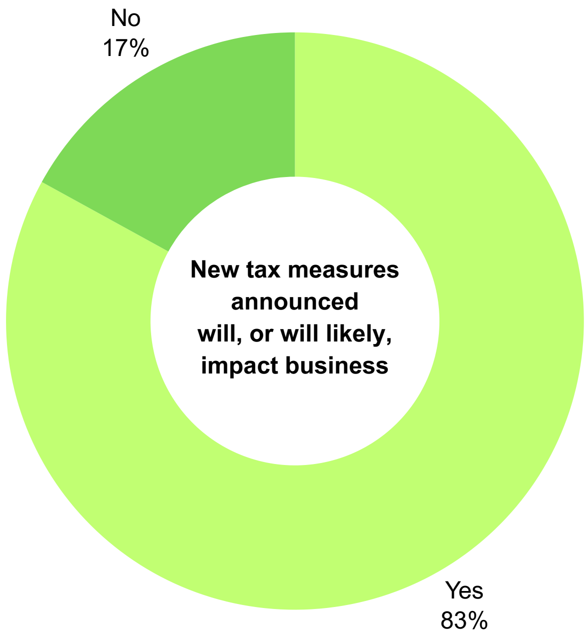
Response to the PWM is less forthcoming as only 18% volunteered to participate in it. Most (54%) are not sure if they would, but 28% would not. Concerns about the PWM abound, with almost three-quarters of the respondents lamenting the lack of clarity on the implementation mechanism and requirements, while 56% are apprehensive about the cost of implementation and its impact on the overall operation cost. While the proof of compliance was viewed by 33% of the respondents as being an administrative burden, the limitations on the types of upskilling and reskilling were recognised by 27%, while 23% opined that PWM implementation may be able to help retain and attract talent to their companies.

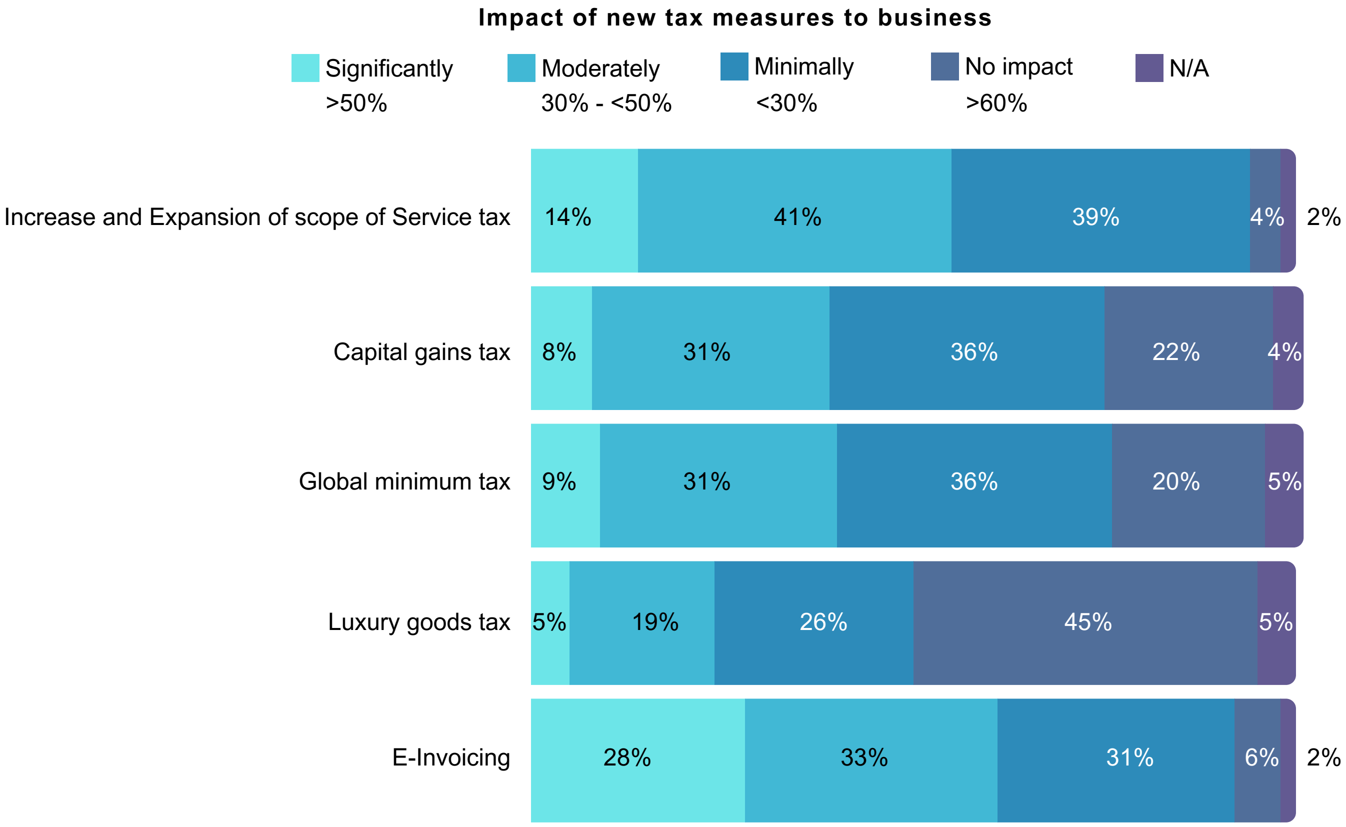




NEW TAX MEASURES

A clear majority of 83% of the respondents opined that the new tax measures, as announced in Budget 2024, will likely impact their businesses, with most expecting the impact to be minimal (<30%), moderate (30 to <50%) or significant (>50%). In particular, the increase and expansion of the scope of the service tax and e-invoicing is expected to impact most respondents. With only 4% and 6% saying the scope expansion and e-invoicing will not have any impact on them, respectively, it further attests to the far-reaching impact these will have on most respondents. The impact of the increase and expansion of the service tax scope and e-invoicing is expected to be moderate for 41% and 33% of the respondents, respectively, and significant for another 14% and 28%, respectively. Other taxes like capital gains and luxury goods taxes, as well as global minimum tax, are also expected by most respondents to impact their businesses minimally.





The FMM Business Conditions Index (FMM BCI) tracks the general state of the economy affecting business viability. The FMM BCI uses the current level of business activity as a proxy for current business conditions, compared to six months ago. Index values range from 0 to 200 points. A value above the growth-neutral threshold level of 100 points indicates an improvement or positive outlook, while that below the threshold indicates a worsening or negative outlook.

The FMM Business Conditions Survey 2H2023 was conducted from January 12 to February 26, 2024 and received 613 responses, of which 66.9% were SMEs (based on full-time employees), with 135, 91 & 85 responses from Klang Valley, Johor & Negeri Sembilan respectively. The top three industries for responses were: Food, Beverage & Tobacco (19.1% of respondents); Chemicals & Chemical Products (10.9%); and Electrical & Electronics (10.8%).

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