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A Critical Review on the Regulatory and Legislation Challenges Faced by *Halal* Start-up SMEs Food Manufacturers in Malaysia

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Abstract

In Malaysia, there is little research done on the journey of the small and medium industries start-up challenges and success. Therefore this paper is a critical review of the regulatory and legislation challenges faced by *halal* food manufacturing industries in Malaysia. The regulatory challenges that are discussed in this paper include the licenses from Islamic Department Malaysia (Jakim), Department of Environment (DOE), Local Council (Majlis Daerah) and Ministry of Health (MOH). SMEs start-ups have to meet all these challenges in their first three years of operations in addition to other challenges such as finance, marketing, technology, production, operations and management.

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1. Introduction

There are extensive literatures on small and medium enterprises on the key issues of business start-up [1][2][3]. Yet the understanding of what is involved in the creation of new ventures and managing the threats in their early stages of growth of manufacturing sector especially in Malaysia remains patchy. In entrepreneurship research, the identification of factors that develop in start-up business and their growth are important milestone in new economic and development model, as supported by [4], the key topic of the new venture is the identification of these factors. Start-up enterprise is characterized by many challenges and problems [5][5][3]. Research has shown that new ventures are more likely to fail than older ones. According to [6], the identification of barriers to entry is important because it can minimize the impact of failures. Thus understanding the factors and their relationship of both external and internal factors is vital to the start-up of small to medium entrepreneurs. For the food manufacturing small to medium enterprises, it can be more challenging

because of the additional obstacles such as government regulatory issues they have to face in their journey to be successful. Many countries have taken actions and variety of programme designed to stimulate the growth of new ventures and aid their survival.

These enterprises are characterized by many challenges and problems such as marketing, finance, government regulations, technology, production, management practices and other local issues. The Malaysian Government regulatory problems are an important factor to their survival. In view of these issues, this paper will attempt to highlights the government regulatory issues such as the *halal* licensing and environment regulations faced by the Chinese, Indian and Malay start-up entrepreneurs in *halal* food manufacturing industries in Malaysia for the business growth and sustainability

2. The Start-up Enterprise

Start-up company generally refer to firm or new venture that has short operating history and track record. According to [7], start-up generally refer to three different definitional criteria such as ‘new’, ‘active’ and ‘independent’ businesses whereas [8] refer start-up as the creation of an entirely new enterprise which did not formally exist as an organization. Start-up has always been associated with entrepreneurs [9][10][3] and entrepreneurial activity [11][12]. The entrepreneur plays a central role to the formation of the new venture. An entrepreneurial activity is the creation of economic activities by exploiting the opportunities, new products, process and markets. The impact of new company formation in the business activities and industries are critical and their share of economic activities accounted by these businesses was significant [13][14][45].

3. Small and Medium Industries

SMEs have been defined in many different ways all over the world. In general, SME in Malaysia have commonly grouped using the quantitative criteria such as the number of employees, amount of paid-up capital, amount of assets the enterprises possess and the sales turnover per annum. National SME Development Council (NSDC) definition of SME in Malaysia adopts basically two criteria, which are the number of employees and annual sales turnover (Table 1) whereas Bank Negara Malaysia uses the following criteria, number of fulltime, shareholders’ funds and annual sales return.

Table 1: Definition of SMEs in Malaysia

Sector	Manufacturing, Manufacturing Related Services, and Agro-Based Industries	Services, Primary Agriculture , and Information & Communication Technology
Number of Full time Employees		
Micro	< 5 employees	< 5 employees
Small	5 – 50 employees	5 – 19 employees
Medium	51 – 150 employees	20 – 50 employees
Annual Sales Turnover		
Micro	< RM 250,000	< RM 250,000
Small	RM 250,000 & RM 10 million	RM 200,000 & RM 1 million
Medium	RM 10 million & RM 25 million	RM 1 million & RM 5 million

Source: [15]

4. SMEs and Malaysian Economy

SMEs represent the majority of the total business in many countries. In Malaysia, SMEs make up of 99 per cent of business enterprises [16][17], whereas in Thailand about 99.6%, Singapore about 91.5% and Indonesia about 99.9% of SMEs respectively. Even in advanced countries like Japan and Germany, SMEs form more than 99 percent of all establishments [5]. Thus the importance of SMEs especially the start-up enterprises cannot be over-emphasized.

SMEs play a vital role in the country's economic development, intra-regional trade activities and help to increase the competitiveness [16]. SMEs have been the back-bone of economic growth in Malaysia due to their sheer numbers and nature of operations. They are also the supplier to many high-end manufacturers, like the vendor systems or contract manufacturers. Thus it is important that Malaysia should support the development of start-ups, their growth and profitability. According to [18], food processed based SMEs has been as one of the most important contributors for the economic development of many countries. Similarly, SMEs are important to the development and economy of Malaysia.

According to [5], SMEs in 2005 showed that SMEs accounted for 47.3 percent and 43.5 percent of the total value-added and output of business establishment respectively and 92 percent of the total business were SMEs. Thus SMEs form a large portion of the business activities. Therefore ensuring the survival and sustainability of SMEs especially the start-up is crucial to Malaysia economy development. Various researchers and writers have mentioned the various factors of success of start-up companies but there is no consensus on these success factors. [19] explained that the success factors will depend on company's ability to manage the customer expectations, facility preparation and systems integration. Whereas [20] stressed that there is no perfect formula for the start-up company or the entrepreneur to choose a professional advisor that has a sound knowledge of business and finance and an experienced management team that includes having good knowledge of the market, good controls systems and financial knowledge. The company should also possess a good business plan. However, entrepreneurial activities must also be focused on identifying and exploiting the new products, processes and markets because this will lead the start-up to be successful in the future [21].

[5] mentioned that SMEs in the Pacific Rim faces somewhat similar constraints and policies. There are additional constraints in Malaysia like the regulatory factors. These constraints are the huge challenges that need to be manage carefully especially for start-up companies in the first three or five years to get established. In a separate study conducted by [22], they stressed that the business environment can generate a high level of institutional and economic uncertainty for start-up entrepreneurs. Some of the challenges faced by start-up food companies discuss in this paper are the regulatory issues like the *halal* regulations, Department of Environment (DOE), local council and health requirements, in addition to other common factors. Thus SMEs start-ups have to meet and comply with such varieties of external demands in their journey. These external factors form the core of this research.

5. The Challenges of Start-up Halal Food Industries in Malaysia

Start-up companies have to meet and comply with such varieties of external and internal demands in their journey. These challenges especially the regulatory issues faced by the food start-ups can affect the company's growth and survival especially in Malaysia. According to [6], these challenges faced by the entrepreneurs will cause uncertainty in their growth. It is well established that new business formation and development is a hazardous business [23][1] and has a high risk of failure [24]. [25] found that more than 30 percent start-ups failed in the first year; [26] found a 43 percent failure rate within 3 years whereas [27] found that 57 percent of all failures less than 5 years old. [23] and [1] called this risk as the 'liability of newness'. Start-up in Malaysia faced even higher risk because it is closely tied to other additional government regulations or guidelines, economic and policy considerations unique to the Malaysian context.

According to [28], there is an existence of institutional pressures in the *halal* food industries. The demand for *halal* foods in Malaysia comes mainly from the Muslim population of more than 16 million people. In Malaysia alone, the size of the *halal* food market is estimated to be USD 8.2 billion (World Halal Forum 2009). And the world *halal* market is estimated at USD 580 billion (or RM 1856 billion) annually (Abdullah, 2006). Thus the *halal* market is big and the concept of *halal* is an absolute key to business start-up and growth. So, the *halal* status of their products is a pre-requisite to success for all Malaysia food manufacturers. Thus *Halal* compliance will have a major impact in the food sector in Malaysia. In addition to this, other regulatory challenges include the Department of Environment (DOE), local council and health regulations also form a barrier to start-ups.

5.1 Halal Regulations

The food manufacturing industry in Malaysia has been experiencing many changes, upgrading and re-positioning in the last decades. Shifts in demographic, changes in life-style and demand of *halal* foods have great impact on the start-ups. Recognizing the important and potential of this industry, all the ethnic SMEs entrepreneurs especially the Chinese, Indian and Malays take initiative to capitalize on this robust growth.

According to [29], *halal* is an Arabic word meaning lawful or permitted. Therefore *halal* foods are foods permissible under Islamic law. Thus, SMEs manufacturing *halal* foods must meet the comprehensive standards and guidelines to be adhered by the Muslims [29][30]. To secure this huge market, the SMEs have to comply to the *halal* standards of practice. Department of Islamic Development Malaysia (JAKIM) has been given the task of implementing the Standard *Halal* Food Guidelines.

Non-compliance will result in the start-up SMEs not able to claim their foods processed are *halal* and use the logo in the packaging. According to [28], the food manufacturer will try their best to use the certified *halal* logo so that they will not be left behind in the race for the potential customers. Non-compliance and wrong use of the logo will also cause heavy penalty (refer to Akta Perihal

Dagangan 1972) and possible closure of business. Thus the *halal* regulatory compliance pose a serious challenge to the start-up growth and survival.

5.2 Department of Environment (DOE) Regulation

In addition to the *halal* regulations, DOE requirement is another challenge to the start-ups. In practice, the food manufacturer needs to meet the requirements of the environments before actual operations [31]. Plans and operations manual must be submitted for approval to the Department of Environment earlier. These regulations involve the discharge of effluence of the treatment of waste from the process and the discharge from the boiler chimney to the environment. The SMEs food manufacturer must meet the standards set by DOE [32]. There is a number of researches carried out on the challenges on the implementations of the DOE regulatory practice [33][34]. They further explained that the misunderstood concept which says preserving environment means limitation for developing makes the implementing and enforcing the environment laws and regulations much harder. As a result, this irregularity of enforcement creates a challenge to the growth and survival of the start-up SMEs food manufacturer. Despite this irregularity, any infringement will face a penalty under the environment quality act.1974 (Act 127) [31].

5.3 Local Council Regulations

The start-up food manufacturer also has to comply with the local authority (or *Majlis Tempatan*). In order to carry out activities in the manufacturing industry, the start-up is required to obtain a premise license as well as business license [35]. According to Malaysia SME report (March 26-April 6, 2012), a start-up SME needs an average of 10 licenses and permits. Some local authorities issue multiple licenses. The SMEs are subjected to local act 176 [36]. This is a burden to the start-up. Such regulations may prevent some entrepreneurs from operating at all since there are inherent disadvantages.

5.4 Health Regulation

In most of the developing world like Malaysia, the basic food safety rules accommodate the risks, through buying, preparing, preserving and social pressure on food manufacturers. For consumers, the most important food quality characteristic is health-related food safety. Safe food is fundamental to all consumers. Thus, all the food regulations and laws stipulate clear-cut food safety requirements. According to the Ministry of Health (MOH) all food processed by processors in Malaysia especially the SMEs food manufacturers must meet the basic food hygiene and meet the requirements and the Food Act 1983 [37].

However, in spite of the multitude of obstructive barriers to start up food manufacturers, there has been a considerable emphasis on the difficulty of complying with the government regulatory factors in Malaysia [38][32]. According to [32][33][34], the actual problem lies in the implementing and enforcing the regulations or the law. [33] further stressed that the effectiveness of the legal mechanism adopted by Malaysia is dampened by the constraints that exist and our inherent institutional framework.

This resulted in the perception of our government implementations of the regulations by the start-up food manufacturing SMEs.

5.0 Contribution of the Study

While the government continues to provide the necessary incentives and programmes to the SMEs in food manufacturing sector, many start-ups still failed. There is no data published on the number of failures in the first three years of operations. This study aims to contribute to practice, research for academicians and also provide an avenue for future research.

5.1 Contributions to Practice

- To reduce the failure rate or early exit of the start-up food manufacturing small medium enterprises in our country, and provide room to handle the uncertainty in entrepreneurship,
- To introduce the operational procedures on the implementations of Government policy on the regulations. This can be done through in-depth understanding of the factors affecting the governance, for example the bureaucracy, human factor and the government support policy,

5.2 Contributions to Research.

- To develop an empirical formula linking the regulations to growth and survival in the first three years of operations, and

5.3 Contributions to Future Research

- To designing strategies and model supporting the empirical formula.

6.0 Conclusion

These challenges especially the *halal* and DOE regulatory issues faced by the food start-ups can affect the company's growth and survival in Malaysia. The intensity of the challenges varies and can create uncertainty among these companies. If the internal factors are taken into considerations, the failure of small to medium industries start-up can be very high. The failure has been researched in several studies [39][40][41][42]. The government regulatory factors especially the *halal* and DOE environment factors are the specific problems when compared to the other start-up factors in Malaysia especially among the non-Bumiputra or the non-Malay start-up entrepreneurs. [44] showed that government policy and market barriers are the most prominent inhibitor to the SMEs growth in Malaysia. Whereas [6] stated that the government and standards, potential market already dominated by established business and lack of customer demand for new goods are the other obstacles to innovation process of SMEs and survival. These issues can be more difficult to comply when Government bureaucracy and human factors are taken into considerations. The identification to barriers to entry is important to the start-up and growth of a business. In Malaysia, there is little research done on the journey of the start-up challenges and success.

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