ANALYSIS OF MARKET RISK TOWARDS SMEs PERFORMANCE

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DECLARATION

"Hereby, I deaclare that this thesis entitled "*Analysis of Market Risk towards SMEs Performance*"

is the result of my own research except as cited in the references. The thesis has not been

accepted for any degree and is not concurrently submitted in candidature of

any other degree.

Signature:

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Date: 26th June 2015

DEDICATION

Infinite thanks to

my precious Mak and Ayah, without those prayers, I will never be here

Dr. Haslinda Binti Musa, your patience is virtue

and my best friends that always stay by me during my ups and downs

Huge supports from all of you are priceless

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ABSTRACT

Market risk is one of the crucial factors in driving a business to become more successful. However, many of the entrepreneurs are unaware of it. In this research, *"Analysis of Market Risk towards SMEs Performance"* the researcher wants to find out the factors that influencing the market risk and how through the market risk, the SMEs (Small and Medium Enterprises) can increase their sales performance. To explore the factors and effects of the market risk towards SMEs sales performance, quantitative method were used and it is of a self-completion questionnaire in order to collect data from the selected SMEs around Malacca. Due to the fact that market risk is crucial to a business, the target respondents must be a person who owns one or more businesses in order to get more valid and reliable result. This research found three factors that influence the SMEs sales performance. These factors are competition, market price change and technological change. These three factors can influence the SMEs sales performance in Malacca.

ABSTRAK

Risiko pasaran adalah salah satu faktor penting dalam memacu perniagaan untuk menjadi lebih berjaya. Walau bagaimanapun, kebanyakan usahawan tidak menyedari hal ini. Dalam kajian ini, "Analisis Risiko Pasaran ke arah Prestasi PKS" pengkaji ingin mengetahui faktor-faktor yang mempengaruhi risiko pasaran dan bagaimana melalui risiko pasaran, PKS (Pengusaha Kecil dan Sederhana) boleh meningkatkan prestasi jualan mereka. Untuk meninjau faktor-faktor dan kesan risiko pasaran terhadap prestasi jualan PKS, kaedah kuantitatif telah digunakan dan ia adalah daripada soal selidik diri-siap untuk mengumpul data daripada PKS terpilih di sekitar Melaka. Kerana kenyataan bahawa risiko pasaran adalah penting untuk perniagaan, responden sasaran mestilah seseorang yang memiliki satu atau lebih syarikat perniagaan dalam usaha untuk mendapatkan hasil yang lebih sah dan boleh dipercayai. Kajian ini mendapati tiga faktor yang mempengaruhi prestasi jualan PKS. Faktor-faktor ini adalah persaingan, perubahan harga pasaran dan perubahan teknologi. Ketiga-tiga faktor boleh mempengaruhi prestasi jualan PKS di Melaka.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF APPENDICES

CHAPTER 1

INTRODUCTION

This chapter will explain the introduction and the background of the study, the problem statement, the research question, and the research objective. Other than that, this chapter also briefly explains about scope, limitation and key assumption of the project. Last but not least, the importance of this project and summary will cover in this chapter too.

1.1 Background Study

Market risk is the risk of loss resulting from changes in the value of assets and liabilities (including off-balance sheet assets and liabilities) due to fluctuations in risk factors such as competition, market price change, technological change and the risk of loss resulting from changes in earnings generated from assets and liabilities.

However, market risk management has traditionally focused on the distribution of the portfolio value changes produced by changes in the midpoint of bid and ask prices. Therefore, the market is traditionally assessed under the assumptions of an idealized market with a negligible bid-ask spread. Other than that, the development and establishment of a system for market risk management is extremely important from the viewpoint of ensuring the soundness and appropriateness of a financial institution's business so that, the institution's management is charged with and responsible for taking the initiative in developing and establishing such a system. It is also important for the researcher to review whether the market risk management system developed is an appropriate one suited to the financial institution’s strategic objectives, the scale and nature of its business and its risk profile. The type and level of the market risk measurement and analysis methods should be noted to be used by a financial institution to determine accordingly to the institution’s strategic objectives, the diversity of its business and the level of complexity of the risks faced by it and therefore a complex or sophisticated market risk measurement and analysis methods are not necessarily suited to all financial institutions.

Next, as a rapidly developing country, Malaysia is planning to raise the living standards of its people and economy. In the drafting stage of New Economic Policy (NEP) in 1971, Malaysia has identified that the factor of absence funds and expertise and there is no exposure and the opportunity to manage business causing the number of Bumiputera entrepreneurs is very low compared with other minority races in Malaysia. At the time of formulation of the NEP, the Bumiputera also found to be not capable conducting business and commerce for not being trained and mentored to do so.

However, small and medium-sized enterprises (SMEs) play a significant role in the economy. SMEs consists of a huge majority of firms worldwide. Consequently, the performance of SMEs is strongly related to the performance of the nation and SMEs make a remarkable contribution to regional economic development. SMEs often the only feasible engines of development, especially in peripheral regions because they generate societal growth in terms of new jobs and revenues. In other words, SMEs create innovations and they also form the flexible production networks. In fact, small enterprises can serve as a foundation, the backbone, and the proponents to fulfill the aspirations and ambitions of the country's economic development vision after 2020.

1.2 Problem Statement and Research Question

Market risk is becoming the crucial issue in forecasting the risk of loss resulting from changes in the value of assets and liabilities due to fluctuations in risk factors such as competition, market price change, technological change and the risk of loss resulting from changes in earnings generated from assets and liabilities. It is important to review whether the market risk management system developed is an appropriate one suited to the financial institution's strategic objectives, the scale and nature of its business and its risk profile.

Next is SMEs performance refers to the SMEs success in the market, which may have different outcomes and it is a focal phenomenon in business studies. However, it is a complex and multidimensional phenomenon and it seems to be conceptualized, operationalized, and measured in several ways. Strategically, SMEs performance is often referred to as SMEs success or failure.

Therefore, the problem statement that can lead to this research is;

How does market risk influence the SMEs sales performance?

In short, it is important to analyze the market risk towards SMEs performance in order to increase SMEs sales. It is because the market risk can also influence the SMEs performance either in long-term or in short-term. The research questions are as below:

1. What are the factors of market risk in a SME?
2. Which market risk factor influence SMEs sales performance the most?

1.3 Research Objective

Based on research questions that has been discussed, there are two objectives to be achieved in this research:

1. To examine the factors of market risk in a SME.
2. To determine the dominant market risk factor that influence the SMEs sales performance.

1.4 Scope, Limitation and Key Assumptions of the Project

This research will focus primarily on market risk and SMEs performance. This research is limited to a certain demographic, which researcher will set an age limit in the range of 18 to 60 years old to become respondents, which this area of age has the potential to conduct its own business. This research also limits to the entrepreneurs or workers of an enterpise either sole proprietary, partnership and corporations especially whom closely involved in sales.

Next, the limitation of this research is to not include the person who does not involve with a business or does not own a business. Therefore, any information collected from them would be irrelevant. This process will take a long time to complete a number of respondents. Besides, not all the selected people willing to be the respondent.

Last but not least, the key assumption for this project is the SMEs entrepreneurs will knowledge the factors of the market risk and effects on market risks towards SMEs sales performance. Thus, they can increase their sales performance in the future.

1.5 Importance of the Project

The importance of this project to researcher is to explore more on market risks in term of its factors and effects to SMEs towards increasing their sales. The other importance of this project is the other researcher is having the opportunity to refer to this research if it is related. Finally, the importance of this research other than gives knowledge, it also gives experience to the researcher that will teach the researcher in all skills to make the researcher a better person in the future.

1.6 Summary

From this chapter, the researcher found out that the introduction and background study is a starter. After studying about market risk, the researcher detected the related problem statement with the SMEs sales performance. Then, the research questions and research objectives were developed. Therefore, in this research, the focus will be on market risks which explains more on its factors and effect towards SMEs sales performance. It can also help the party responsible for obtain data to enable them to further develop this kind of research in the future.

CHAPTER 2

LITERATURE REVIEW

This chapter presents the theories and articles relevant to the research topic of **"Analysis of market risks towards SMEs performance".** The researcher was briefly reviews on market risk factors where it can give impact to the SMEs sales performance. In this chapter, the researcher was looking about the previous studies, books and journals which explain about market risk, factors influencing the market risk, SMEs performance and sales performance.

2.0 Introduction

In this chapter, the researcher will explore about the right references for this whole research. Over the last few decades, risk management has become an area of development in financial institutions. The area of financial services has been a business sector related to conditions of uncertainty.

Risk is a function of the likelihood of something happening and the degree of losing which arises from a situation or activity. Losses can be direct or indirect. For example, an earthquake can cause the direct loss of buildings. Indirect losses include lost reputation, lost customer confidence, and increased operational costs during recovery. The chance of something happening will impact the achievement of objectives (Partnerships BC, 2005 and NIST, 2004).

Risk can be classified into systematic and unsystematic risk. Systematic risk refers to a risk inherent to the entire system or entire market. It is sometimes called market risk, systemic risk or un-diversification risk that cannot be avoided through diversification. Whereas, unsystematic risk is risk associated with individual assets and hence can be avoided through diversification. It is also known as specific risk, residual risk or diversifiable risk.

Based on the explaination above, the researcher was collecting the theories to prove the significant relationship between the market risk and the SMEs sales performance.

2.1 Market Risk

Meucci (2012) states market risk management and liquidity or funding risk management are among the top challenges in buy-side quantitative finance. Loosely speaking, market risk is the uncertainty of the profit and loss (P&L), at a given investment horizon in the future and liquidity risk is the potential loss with respect to a reference mark-to-market value due to the action of trading.

Market risk involves interest rates, commodities, equities, foreign exchange, sovereign bonds, corporate bonds, distressed debt products, high yield products, mortgage and loan instruments and derivatives of these asset classes. With massive transformations technologically and in risk management concepts, market participant can also witness the ineffectiveness of using Greeks such as alpha, beta, delta and theta to measure risks and their efficiencies at preventing market risk crises. Companies' news affects the markets and prices as well as external environment phenomena. Hedge fund risk managers review market risks by strategy, by individual subfunds and by integrating all funds and strategies as aggregate total market risk (Guizot, 2007).

Market risk is described by categories such as asset class, by type of instruments used, by geographic region, by industry sector and by top concentrated positions. Risk managers implement a consistent framework for measuring the risk of loss for a portfolio as a whole or as subparts depending on the granular level of transparency for the risk strategy or transaction information. Market risk has been measured with methodologies such as value at risk (Guizot, 2007).

There are three proposed independent variables in the market risk that will influence the dependent variable, SMEs sales performance. They are competition risk, market price change risk and technological change risk.

2.1.1 Competition Risk

According to Teece (2009), having a differentiated and hard-to-imitate but at the same time effective and efficient architecture for an enterprise's business model is important to the establishment of competitive advantage. The various elements need to be cospecialized to each other and work together well as a system.

A firm's competition is assumed to include not only all of its current competitors but also potential competitors poised to enter an industry at the same date. Thus, a firm that enjoys a competitive advantage or a sustained competitive advantage is implementing a strategy not simultaneously being implemented by any of its current or potential competitors. (Barney, Mc Williams, & Turk, 1989).

A sustainable competitive advantage occurs when an organization acquires or develops an attribute or combination of attributes that allows it to outperform its competitors. These attributes can include access to natural resources or access to highly trained and skilled personnel human resources. It is an advantage (over the competition), and must have some life. It is an advantage that is not easily copied and, thus, can be maintained over a long period of time. Competitive advantage is a key determinant of superior performance and ensures survival and prominent placing in the market. Superior performance is the ultimate, desired goal of a firm. It gives firms the ability to stay ahead of present or potential competition and ensure market leadership (Boundless, 2014).

Capabilities become important when they are combined in unique combinations which create core competencies which have strategic value and can lead to competitive advantage. Thus, core competencies should be valuable, rare, costly to imitate and nonsubstitutable.

2.1.2 Market Price Change Risk

Pricing is the process of determining what a company will receive in exchange for its products. In the global marketing mix, pricing factors are manufacturing cost, market place, competition, market condition, and quality of product. As one of the four "Ps" in the marketing mix, pricing is the only revenue generating element.

Like national marketing, pricing in global marketing is affected by the other variables of the marketing mix. Price in global marketing strategies can be influenced by distribution channels, promotional tactics, and the quality of the product. For instance, if distribution is exclusive, then prices are likely to be higher. High prices will also be needed to cover high costs of manufacturing, or extensive advertising and promotional campaigns. If manufacturing costs go up due to the rise in price of some raw material, then prices will need to rise as well.

Price will always vary from market to market. However, global marketers must be prepared to deal with not only cultural expectations of pricing, but also external variables including trade tariffs, political and economic fluctuations, and the administrative or legal criteria of specific jurisdictions. Pricing can also be affected by the cost of production (locally or internationally), natural resources (product ingredients or components), and the cost of delivery (e.g., the availability of fuel). For instance, if a country imposes a minimum wage law that forces the company to pay more to its workers, the price of the product is likely to raise to cover some of that cost. Natural resources, such as oil, may also fluctuate in price, changing the price of the final good (Boundless, 2014).

According to Guizot (2007), risk factors are supposed to measure risks and returns for individual funds and for aggregate fund with all the investment strategies combined. Factors are calculated depending on the quantitative models used. They take into consideration market rates and prices, credit spreads, volatilities, correlation between products and sometimes strategies.

In addition, from all the various external risks to which companies competing on international market are exposed, market price changes gives impact on the success of an enterprise. It could be a profound effect on the amount, present value or timing of payment flows. Operative business and treasury transactions are affected by the market risks. Based on that, in order to determine and manage risks fully, it is important to bring together all the risk related to the company activities.

2.1.3 Technological Change Risk

Technological change often provides the impetus for new and better ways to satisfy customer needs. The horse, than the railroad, the auto and the airplane have all been technological solutions to society's basic transport needs that successively complemented and displaced each other and formed the basis of competing business models for carrying people from one place to another.

The Internet and the communication and computer revolution have empowered customers, and both allowed and required more differentiation in product service offerings. Social networking is also trumping the age-old ability of using advertising to get an audience (Teece, 2009).

According to Smith (2007), technology and business strategies should complement and support each other relative to the business environment. Strategy development should be a two-way process between technology and business.

Research has already identified many organizational challenges to effective technology strategy management. If organizations strategy development processes are not compatible, it is unlikely that business and technology will be working towards the same goals at the same time.

Theoretically, prior research had identified that computers and software programs are business tools, which could be used to reduce production and labour costs (Nguyen, 2009), innovate and facilitate niche marketing, increase productivity and effectiveness, increase efficiency of internal business operations, become more innovative and even to gain competitive advantage (Thong, 1999; Nguyen, 2009; Shabanesfahani and Tabrizi, 2012). Other benefits include connecting SMEs to external contacts such as other related businesses, stakeholders and institutions and networking with other parties more easily and cheaply. However, the most important features of IT are high speed data processing, extremely high accuracy, and high speed access to information.

Consequently, advancement in IT had increased the ability of organizations to make good business decisions based on large amounts of data and the speed in which information is produced by their enterprise (Ismail, 2009).

Renn (2008) states the responses to the change of technology over time seem to oscillate between courage and caution, and between overconfidence in the human ability to manage risks and the paralysis of immobility in the light of pending opportunities and threatening hazards. Most former critics of technological changes have learned over time that cultural evolution rests on innovation and that innovation implies risk-taking.