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The Role of Foreign Investment in Malaysia

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INTRODUCTION

This paper will discuss some of the basic issues regarding direct foreign investment (DFI) in Malaysia's economic development. Considering the broadness of this topic, therefore this paper will only focus on some central issues. The first part of this paper will cover a survey of the global scenario since global investment configuration has implications on Malaysia and its investment policy and strategies. The second part of this paper will discuss on the trend and pattern of DFI in Malaysia. The role and impact of DFI in the Malaysian economy will be the focus of the third part of this paper. An attempt will also be made to discuss the Malaysian Government's attitude towards DFI.

THE CHANGING GLOBAL DYNAMICS

THE CHANGING FUNDAMENTALS

During the last two to three decades, there have been critical changes to the global economic system. Some of these have affected the overall pattern of DFI and the activities of multinational corporations (MNCs). These include, the prolong stagnation of the international economy, the international debt crisis, the realignment of the foreign exchange market and the emergence of new technologies.

First, after several decades of robust economic growth, since 1980 there has been a down turn in investment quantum, production expansion, and international trade growth. Contraction in the global economy has thus adversely constrained the expansion of international investment. If the major economies experience slow growth rates in the immediate future, it would be difficult to activate a sustained outflow of DFI from the advanced economies.

Secondly, the chronic international debt crisis has damaged the global financial system and credibility of less developed countries

(LDCs). Foreign investors cannot now ignore the ratings and rankings of LDCs with respect to their credit standing in the context of comparative investment environments.

Thirdly, the volatility in the foreign exchange market has amplified traditional business risks. While MNCs can incorporate business risks into their investment functions, one cannot do the same for uncertainties. This has thus distorted somewhat the pattern of investment flow and location of production among countries. The decision to invest, on the basis of simple comparative resource advantage, is now not the sole criterion.

Fourthly, the emergence of new technologies and other innovative corporate instruments have also created new forms of investment opportunities and challenges. For instance, the modality of DFI has diversified in recent years. There is now a widening use of non-equity form of transnational expansion; increased instances of mergers and acquisitions, and increasing investment in the services sector.

ATTITUDE OF HOST GOVERNMENTS: NEW ROLE OF MNCS

There is now a remarkable change in the attitude of LDCs' governments toward MNCs and DFI. LDCs do not regard the MNCs as agents of neo-colonialism or economic imperialism. MNCs are also not the instruments of powerful industrial countries to disadvantage the LDCs in the international economy.

Indeed, there is now a reversal in economic thinking and policy formation. Most LDCs, including even communist governments like China, are now more empathetic in their dealings with MNCs. It is now the new conventional thinking that MNCs and DFI are needed to help the LDCs to escape the poverty trap and to leap into the 21st century as successful Newly Industrialized Countries (NICs). The economic philosophy is that the private sector and MNCs, not governments, would play the central role in pushing economic growth and innovative changes.

THE STRUCTURE OF DIRECT FOREIGN INVESTMENT FLOWS IN THE 1990S

Global time series data indicates that DFI inflows to the LDCs have been declining since 1981. Although this is part of the overall contraction in growth of global DFI, the trend data suggest that the decrease in DFI affects the LDCs more than the developed economies.

During the 1970s, the annual flow of international direct investment to LDCs grew at a rapid pace and reached a peak of 36.8 percent in 1977. Since then it averages 21 percent.

An important reason for the above is that the LDCs appear less attractive because of their high risk rating. This is due to a combination of factors, including high national debt, national mismanagement, poor strategic planning, and a politicized environment. In contrast, the developed economies are now becoming attractive. For instance, during the 1960s the United States received only 10 percent of the global flow of DFI. By the end of the 1970s this rose to 30 percent. Now it averages 45 percent. This has made the United States the most dominant destination for foreign investment.

Among the LDCs, East and Southeast Asian countries have been less affected by the global shift in DFI compared to the Latin American economies. In fact, Asia Pacific LDCs are now the largest recipient of DFI. China, the Asian NICs, and the Association of South East Asian Nation (ASEAN) countries received the bulk of DFI.

NEW MONEY

Another significant feature of the investment pattern in the 1990s is the emergence of new money. This comes from Japan and the NICs. Traditionally, the United Kingdom and the United States had been the world's largest exporter of capital investment. Since the early 1980s there has been a sharp cutback of capital investment from these countries, particularly the United States. The United States, crippled by its double deficits, is now a debtor nation. In contrast, Japan has become the largest creditor nation. Most of its investment is gravitated towards the developed countries, especially the United States. In fact 46 percent of its investment went to North America and 20 percent to Western Europe. Besides Japan, the Asian NICs like Taiwan, once debtor nations, are now net exporter of capital.

The emergence of MNCs and DFI from the LDCs is a recent phenomenon, beginning around the mid 1970s. Asian MNCs and DFI (excluding Japan) have three noticeable characteristics of which are, they prefer joint ventures, they are located mostly in Asia Pacific region, and they are medium size and less capital intensive.

EMERGENCE OF THE SERVICES SECTOR

One last characteristic that needs to be highlighted is the increasing quantum of investment in the services sector. Traditionally, the most important historical form of MNC investment has been raw material extraction and the export of unprocessed raw materials. During the 1970s, there was a shift of MNC investment towards manufacturing. In the last few years, the interest is focussed on the services sector, including finance, insurance, trade and tourist-related activities. For instance, Japan increased its share of DFI in services as a percent of its total DFI from 29 percent in 1965 to 55 percent in 1987.

TRENDS OF DIRECT FOREIGN INVESTMENT PATTERN IN MALAYSIA

Foreign investment has always been significant in contributing to the economic progress of Malaysia. Its historical role in building the plantation and mining industry is well recognized. When Malaysia started to industrialize, DFI also contributed significantly to its growth. In 1970, DFI constituted 59 percent of the paid-up capital of the corporate sector. Now its about 32 percent.

SOURCES OF DIRECT FOREIGN INVESTMENT

With independence, Malaysia diversified its sources of DFI. The role of DFI from the United Kingdom declined dramatically vis-a-vis that of other countries. Thus by 1975, 58 percent of its DFI came from Singapore, Japan and Hong Kong. Only 26 percent was from United Kingdom and United States. In 1988, DFI from the three Asian economies increased to 43 percent, while that of United Kingdom and United States increased to 17 percent. There is now a significant inflow of DFI form Taiwan. There is no doubt that the Asian NICs and Japan are now becoming dominant foreign investors in Malaysia.

DIRECT FOREIGN INVESTMENT BY OWNERSHIP CONTROL

A common form of DFI in Malaysia is joint-venture investment. Since 1980, 60 percent of such DFI has been joint ventures with Malaysian majority. There has been a shift in this lately because of deregulation in the equity policy guidelines. However, during 1987-88, 36 percent of the DFI was wholly foreign controlled. This is expected to increase as the Government continues to relax its control over equity in order to attract more foreign capital.

DIRECT FOREIGN INVESTMENT BY INDUSTRY

The structure of DFI in Malaysia has been influenced by the global economic, industrial and consumer demands, the corporate strategies of the foreign investors, the resource balance sheet of the economy, and the policy framework of the Government. During the 1970s the dominant DFI was in resource-based and import substitution industries. During the 1980s, DFI predominated in the electronic and textile sectors. There was also a significant increase in investment in the petroleum-related industry, including refinery and petrochemicals.

Over the years, there has been a noticeable shift in more value-added downstream activities. There is a significant move towards more sophisticated technology-based investment. For instance, within the electronic industry, DFI has gone beyond more assembly stage to fabrication and manufacturing. They are also becoming more capital intensive.

ASIAN NEWLY INDUSTRIALIZED COUNTRIES

The realignment in the foreign exchange and the change in the dynamics of comparative advantage, had brought an increasing inflow of new money from the Asian NICs to Malaysia. Besides Singapore, the new players are Taiwan, Hong Kong and South Korea. There is still no adequate data on such investment. The new phenomenon is partly "refugee" capital, investment relocation, and new money in search of opportunistic investments. They complement the traditional DFI in that this new money will help to develop the small and medium enterprises. In this way their contributions are very important. The Malaysian Government is therefore making the right strategic move by attracting them to Malaysia.

ROLE AND IMPACT OF DFI ON THE MALAYSIAN ECONOMY

TECHNOLOGY SPINOFFS

The future destiny of mankind is increasingly dominated by technological changes. For both societies and corporations, having the technology edge means control of economic power and market share.

MNCs are reservoirs of technology. Their expenditures on research and development (R and D) are often larger than similar allocations of many LDCs' governments. If properly harnessed the MNCs can therefore be instrumental in accelerating the technological progress of many LDCs. Unfortunately, there is often a misreading of each other's aspirations and requirements. Host governments feel the urgency to accelerate the transfer of technology. MNCs, on the other hand, jealously guard their technology which determines their competitive edge and their very survival in the market place. Very often this has ended in misunderstandings and distortion of the proper perspective of the technology transfer question.

The reality however must be recognized. The technology transfer issue must ultimately be looked at as a proprietary right question rather than as an act of charity. All things considered, there has been a progressive evolution in the technology transfer in Malaysia by the MNCs. The record is somewhat uneven, depending on the sectors and the MNCs.

For the period 1981-85, at least 601 technological transfer agreements have been signed between the Malaysian Government and MNCs. Of this, 92 were in electronics and 90 in the motor vehicle and shipping industry. The rest are spread out over a large number of subsectors and industry groups.

Besides direct transfer of technology as structured in a contractual agreement, most MNCs in Malaysia also transfer technology in less direct ways. It is difficult to quantify the value of such assistance. But the multiplier effect is substantial. For instance, quite a lot of technology transfer is embodied in human resource development.

Another important area where MNCs have made a great impact is in setting standards of quality and productivity, particularly in industrial production and products. This would help Malaysia enhance its image as a producer and exporter of high quality products and services.

As MNCs grow in number and diversity, there is also a noticeable trend to conduct more basic R and D in Malaysia. In the petroleum industry, anyone familiar with this behemoth sector, will realize the tremendous amount of brain and technology power involved. SHELL, as an example, has been in this industry in Malaysia for a long time, and had been using the most up-to-date technology in the industry in Malaysia. SHELL have nurtured the growth of many small and medium size companies that have developed a profitable relationship with it over many decades.

At the general level, MNCs have assisted Malaysia in technology transfer through DFI, joint-venture, licensing, franchising, management contract, technical service contract, marketing contract and international subcontracting.

The Malaysian Government can expedite technology transfer if it adopts a coherent policy and implementation framework for this. Japan has done it, and presently some other Asian NICs are in the process of doing it. What is needed is an active technology transfer strategy plan. What must be done should include at least the following steps of which are:

1. to actively seek the most relevant and practicable imported technology for specific uses,
2. to learn to negotiate and acquire imported technology at cost effective terms,
3. aim at assimilating specific imported technology to the stage where its use and improvement is independent of the MNCs,
4. replicate imported technology using local R and D, and
5. develop new technology where Malaysia has already created its comparative advantages, vis-a-vis in the agro-based industries.

HUMAN RESOURCE DEVELOPMENT

Human resource development (HRD) is a critical factor for economic progress. Investment in human resources is one of the most tangible contributions of MNCs to Malaysia. In training the vast number of managerial, skilled and semi-skilled workers, SHELL is also increasing the total productive human resources of Malaysia. MNCs by giving Malaysian staff opportunities in international travel and visits to MNCs' headquarters or affiliated companies, are exposing them to new learning curves. All such activities are in fact contributing to the value-added of the Malaysian labor force. In the petroleum industry, the total number of staff trained has increased from 44 percent of total employed to an average of 68 percent in the 1980s.

An area of technology transfer which is often overlooked is HRD. Here technology is embodied in HRD. A good example of what the MNCs are doing in Malaysia is the services sector. Here, the MNCs have helped in introducing services technology in banking, finance, insurance, marketing, communications, trading and fast-food business. These are more in "software" than "hardware". Organizational, management, and marketing skills are now passed on to Malaysians.

Most MNCs in Malaysia have successfully conducted in-house training program, both formal and informal. By doing so MNCs have helped to set up minimal standards of efficiency and productivity.

EMPLOYMENT EFFECT

Foreign investments in Malaysia have come to Malaysia in a series of waves. During the 1970s they helped to establish the labor-intensive industries. In doing so, they created large employment opportunities and thus reduced the overall unemployment rate in the country. The recent upsurge in DFI is also responsible for creating employment for Malaysians who have endured a few years of recession and high unemployment. In fact, the sudden inflow of foreign investment, particularly from the Asian NICs, has resulted in a tightening of the labor market and a wage rise in some segments of the labor force. The Klang Valley area and southern Johor are now experiencing increasing labor demand and wage increase.

However, it is not only the direct employment which MNCs can generate but also the indirect employment impact on the Malaysian economy which is important. Such employment is found in the auxiliary industries which support the MNCs major activities.

As far as the petroleum industry is concerned, since 1974 it has been expanding job opportunities. The petroleum industry accounts for about 1.7 percent of the total employment of the country although this is not a labor intensive industry. Actually, this is somewhat misleading as there is also an additional large reservoir of labor who are productively employed in the petroleum auxiliary industry which is not accounted for in this figure. There is no doubt that MNCs' investment and employment generation in Malaysia is closely correlated.

TRADE LINKAGES

One of the appealing factors of Malaysia and other ASEAN countries to DFI and MNCs is their trade-orientation and open economies. Malaysia has, for example, maintained low average levels of protection. One characteristic of such economies is the relative high share of trade in total output. Malaysia has an export-to-Gross Domestic Product ratio of 50 percent. Over the decades, arising from the changing structure of production and investment in Malaysia, the volume of exports has been growing in real terms at a rate of 7 percent. Manufactured exports now constitute 25 percent of total export. It was only 10 percent in 1970.

This change in the export trade, particularly in manufactured exports, is related to the position of DFI and MNCs' activities in the economy. While DFI provide only marginal supplements to most domestic activities, they are the major players in the export trade. The general rationale for this is clear. MNCs use Malaysia as a production base for various strategic reasons. Some of the major reasons are, to tap a part of Malaysia's domestic market; to use Malaysia's low wage labor, resources, and incentives; to use Malaysia as a launching pad, therefore benefiting from trade benefits given to Malaysia into advanced countries such as Generalized System Preferences (GSP); to relocate its production for reexport back to the home country and also as part of the global corporate decentralization plan.

Whatever may be the dominant reason, MNCs because of their large international marketing network, create two-way trade in capital goods, technology, and end products. Data on export and sales ratios of MNC's particularly United States firms, in ASEAN indicate that they contribute a large share of the total exports, especially manufactures, of these countries.

Beside expanding export for Malaysia, the MNCs also create intra-firm trade. Intra-firm exports account for 30 percent of United States and Japanese total and manufactured exports. Overall, net export exceeds import in such intra trade for Malaysia.

One of the constraints of economic growth of LDCs is their inability to sell competitively in overseas markets. Frequently, the major obstacle is the lack of an effective marketing network. One of the contributions of MNCs in Malaysia is to facilitate the building of this network infrastructure. Malaysian companies or entrepreneurs who have joint ventures with MNCs can harvest substantial benefits by being introduced into once protected markets. It is difficult to estimate in dollar terms the worth of such association.

THE SERVICE SECTOR: NEW GROWTH POLE

This is one sector which will experience exponential growth in the future. It is a wide area. Of late, it has also become technologically sophisticated. In some industry-specific areas, like communications and computer-technology, the scientific advances have been incredible. The global market for services is easily much larger than that for trade in commodities. At the international level, the fight for market share in the service industry is indeed intense. This has spilled over to various multilateral negotiations, like the Uruguay Round, which prioritize the service sector for trade liberalization. In bilateral trade negotiations, it is now common for advanced countries to use various leverages to pry open the markets in services of LDCs.

In Malaysia, MNCs have a long history of contribution to the service industry. It began as early as the East Indies Company days. British Agency Houses, forerunners of some of the most eminent Malaysian MNCs like Sime Darby, provided an interesting range of services and service trade in those days. The present banking and financial system is also a fine product of foreign MNCs' contributions.

The MNCs had contributed considerably to the development of Malaysia's banking industry. Until 1974 the foreign banks outnumbered the local banks. Now there are about 16 MNC banks operating in Malaysia. There are another 30 MNC banks which maintain representative offices in Kuala Lumpur. The MNC banks have about 10,000 employees. Bank Negara has estimated that MNC banks outperform the local banks in terms of productivity as measured by returns and asset base per employee. One reason for this is the higher per capita investment for training made by MNC on the staff. On average it comes to about $24,000 per employee.

Since 1986 major steps have been taken by the MNC banks to modernize the banking business. The introduction of automatic teller machine made retail banking not only more efficient but also improves overall liquidity. Computerization also facilitated calculation of interest on savings on a daily basis and thus raised the effective savings rates. Hongkong Bank was the first to move into electronic banking, with a standard as high as that of any global bank. It pioneered Autopay facilities, allowing for direct and indirect transfer of funds.

The positive effects of MNC banks using technological innovations are, better ability to attract customers, increased speed in product development, customer segmentation analysis, more effective managerial control, overall cost reduction and productivity improvement.

The banking and financial sector is pivotal to the process of economic and social change. It is here where the foreign banks and other financial institutions have a tremendous wealth of experience and expertise to contribute to Malaysia. Because of their powerful global network, and competing in very innovative environment, they have the most updated version of financial management system, new financial products and services. However, their full potential role in Malaysia is somewhat constrained by the regulatory environment. Unless the Government adopts a more deregulated policy toward foreign banks and financial institutions, the transfer of such service technology will be slower.

SUBCONTRACTING NETWORK

An important spinoff of DFI and MNCs in the economy is the gradual evolution of a vast subcontracting network system. Small and medium scale enterprises have a symbiotic existence and complement the core economic activities of the MNCs business. The best example of this was the automotive industry. The MNCs built up the automotive industry in the early 1960s. A large local industry which supplied components and other supporting services rapidly developed. The automotive industry is now localized, after having successfully acquired the basic technology. In the petroleum industry, there are at least 2880 companies which are involved in the upstream sector. On average there is less than 20 percent foreign ownership. The next important industry is the computer-technology related industry. MNCs started with assembly of electronic products and are now moving upstream to manufacturing of the component parts. At the same time there is a parallel development in the end-product business, like computers, and supporting services, like software.

CORPORATE CITIZENSHIP RESPONSIBILITY

MNCs do care about their bottom line and market share. They also care about the community they work with and live in. MNCs are involved in a large variety of community-oriented program. SHELL, for instance has an annual $3 million ringgit scholarship program for Malaysians. Hong Kong Bank has a Medical Fellowship Fund while Motorola has adopted a primary school. Many other MNCs have responded to the needs and aspirations of the Malaysian society in their own ways.

ATTITUDE OF MALAYSIAN GOVERNMENT TOWARDS DFI

POSITIVE POLICY FRAMEWORK

MNCs are comfortable with the Malaysia Government's policy in stressing free enterprise and an increasing role for the private sector. It is only when such a framework exists that dynamic economic growth and social progress can be achieved. MNCs do recognize that there is a role for the Government particularly in helping the disadvantaged. However, both history and experience have more than once shown that the private sector is still the most innovative source of change and progress in all economies. The present world-wide phenomenon of deregulation and privatisation has not emerged by accident. Decades of government over-regulation and intervention in both the advanced and LDCs economies have stifled growth and progress. There is now consensus among policy makers, long overdue, that "freeing" the market forces can create more good than has been conventionally recognized. Even hard-core centrally planned economies are thawing out.

Given the competitive environment for foreign investment, no host government can now afford to be inward-looking or negligent in wooing DFI. The investment market situation has changed: it is an investors' market. DFI is now the driving force. As such, the Malaysian Government's attempts to continue to relax controls will bring rich returns to the country in due time. The alternative of holding on to rigid policies which are non-conducive to DFI will only result in Malaysia lagging behind other NICs. It is anticipated that the next Five Year Development Plan will continue to provide the broad policy framework which is friendly toward MNCs and DFI. Anything less will be disappointing.

PHILOSOPHY OF SHARING BENEFITS

Although MNCs are profit-driven, they are cognizance of their corporate responsibility. In as much as Malaysia has been a congenial host government to DFI, MNCs also responded positively to help Malaysia progress. A durable relationship between a host government and MNCs can only be developed if there is explicit recognition of each other's symbiotic relationship and synergistic role which create mutual benefits.

CONTRIBUTIONS OF MALAYSIAN INTERNATIONAL CHAMBER OF COMMERCE AND INDUSTRY

Malaysian International Chamber of Commerce and Industry (MICCI) has played a fine role in helping the development of the Malaysian economy. Incidentally, the MICCI can be traced back to the Penang Chamber of Commerce and Agriculture which was established in 1837 in George Town. In 1974 the present MICCI was formed as a company limited by guarantee.

MICCI presently has about 525 corporate members representing 27 countries. All the major trading nations in the world are represented. 30 percent of MICCI's members are in manufacturing, 20 percent in trading, 10 percent in banking and finance, and the rest spread out over a spectrum of business activities. Thus, MICCI's members are found in every business and market niche of the Malaysian economy. This reflects the significant position of MICCI's members in generating sectoral growth of the Malaysian economy. MICCI's philosophy of free enterprise is consistent with that of the Malaysian Government. MICCI's existence and role help to enhance the image of Malaysia as an attractive country for foreign investors. Through MICCI's constant communications with Government bureaucracy, it aims to promote a high level of understanding and cooperation in achieving its respective objectives.

CONCLUSIONS

Many LDCs are suffering from the prisoner's dilemma. Every LDC competes for foreign investible funds and offers packages of incentives. It is crucial that the Malaysian Government should continue to adopt a friendly posture towards DFI, be consistent and clear with its policies, be complementary, rather than competitive with the private sector, continue to build up the institutional besides the physical infrastructure particularly the infrastructure for R and D, and to foster the competitive spirit of the private enterprise. Malaysia has a good track record which is the envy of many LDCs. Its overall relationship with MNCs and DFI can be an exemplary model to other governments. It is also satisfying to note that Malaysia is now having its own home-grown MNCs. Although its export of capital investment abroad is presently negligible, it won't be long before Malaysian entrepreneurs and corporate leaders review their present strategy and carve out a global niche for themselves.

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