OUTWARD FOREIGN DIRECT INVESTMENT: THE MALAYSIAN EXPERIENCE[1]

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[1] Project supported by the Indian Council for Research on International Economic Relations (ICRIER) www.icrier.org on Intra – Asian FDI Flows: Magnitude, Trends, Prospects and Policy Implications.

Abstract

This paper analyses the trends, patterns and determinants of outward foreign direct investment (OFDI) by Malaysian companies. It shows that Malaysian OFDI had taken a quantum leap since 1993 and the number of Malaysian TNCs investing abroad since the 1990s has increased significantly. The OFDI is focused mainly in services (finance, banking, insurance and tourism) and natural resources (oil and gas) with manufacturing a distant third. This also includes the emergence of offshore financial centres and developed countries as the most important host region for trans-border activity although investments in developing countries especially within ASEAN have shown tremendous growth. The key drivers of OFDI have been to increase efficiency, to access resources and to access markets.

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1 Introduction

The World Investment Report 2006 (WIR2006) noted that the stock of outward foreign direct investment (OFDI) from transition and developing economies in 2005 reached USD1.4 trillion, up from USD335 billion 10 years ago. It also stated that TNCs from Malaysia are extending their global reach [WIR2006: pp. 103]. More impressive is that Malaysia's inward and outward flows are converging. Inward FDI increased from 23.4% of GDP to 36.5% while OFDI rose dramatically from 6% to 34% of GDP in 1990 to 2005.

Malaysian companies have been investing abroad since the mid-1970s. However, Malaysian OFDI became significant in the early 1990s with the changes in the global economic order that came about with end of the Cold War. Internationally, the completion of the GATT/WTO Uruguay Round that began in 1986 and completed in 1994, regionally, the formation of the ASEAN Free Trade Area (AFTA) in 1992 and domestically, the economic liberalisation processes beginning in the mid 1980s were manifestations of the changing global economic order that prompted OFDI.

1.1 Research Approach

This study illustrates the trends and patterns of Malaysian OFDI. The OFDI trends and patterns are then analysed using the framework developed by Aykut and Ratha [2004] to identify its key determinants. Aykut and Ratha's framework looks at the rationale for OFDI and categorises the rationales as push, pull and strategic. These three rationales are then analysed from a structural, cyclical and institutional/policy point of view.

This study relies on existing literature, publicly available data and anecdotal evidence of Malaysian companies. OFDI in general, has not been comprehensively studied in Malaysia. There have only been two notable studies on Malaysian OFDI by Ragayah Mat Zin and Tham Siew Yean. Ragayah [1999] had investigated the factors such as business, production, management and corporate strategy influencing Malaysian TNCs decision to invest abroad. Tham [2006] reviewed the trends, patterns and policy issues of Malaysian OFDI. Both papers used a case study approach due to lack of secondary data on OFDI. Zainal [2005] had also analysed Malaysian OFDI from an enterprise perspective. Ragayah major finding was that to expand and to find new markets for growth was cited as the main reason for Malaysian companies investing abroad. Conversely, Tham's paper had a myriad of findings on why Malaysians invest overseas.

The "Ugly Malaysian? South – South Investment Abused" edited by Jomo K.S. provided a stylised view of corporate behaviour of Malaysian TNCs abroad. As the title suggested, Malaysian OFDI were generally described as being exploitative in nature. Most recently, Bank Negara Malaysia (BNM) had compiled a report on Malaysian OFDI for the period 1999 - 2005 [BNM 2006] describing extensively trends, patterns and determinants of Malaysian OFDI. There have also been a number of studies by international organisations that looked at OFDI from Malaysia as part of the ASEAN region such as Hiratsuka [2006] and international organisations such as UNCTAD and ADB.

Aykut and Ratha [2004] had noted the challenges of estimating the South – south FDI. While macro data on OFDI is available in Malaysia, it is however not at the desired level

of disaggregation. Malaysia uses. OFDI data collected by the Department of Statistics (DoS) [2], Malaysia provides the destination and OFDI type. Bank Negara Malaysia (BNM) began publishing these data in 1993 through its Monthly Statistical Bulletin. Other sources consulted were UNCTAD[3] and the ASEAN[4] Secretariat[5] who both maintain a database on FDI flows. The paper is organised as follows. Section 2 discusses the broad trends and patterns of Malaysian OFDI. Section 3 identifies the key determinants of OFDI using the Aykut and Ratha framework. Section 4 concludes the paper.

2 Trends and Patterns in Outward Foreign Direct Investment (OFDI)

This section describes the trends and patterns of Malaysian OFDI by looking at the total amount in comparison with other NIEs, the destination and the sectors with the view of identifying patterns of Malaysian OFDI. Furthermore, the ownership of companies undertaking the OFDI and through what means will also be described.

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[2] According to the IMF's Balance of Payments Manual, Fifth Edition, direct investment abroad is a form of direct investment, whereby companies invest abroad with the intention of obtaining a lasting interest (defined as holdings of at least 10% ownership) in an enterprise resident of another economy. In Malaysia, data on direct investment abroad (OFDI) in accordance to IMF definition are compiled and released on a quarterly basis by the Department of Statistics, Malaysia (DoS), the official compiler of Balance of Payments statistics. The data includes investment in the form of equity, reinvested earnings and other capital (mainly loans). This data differs from the statistics compiled by Bank Negara Malaysia's Cash Balance of Payments (CBOP) Reporting System, which refer purely to outflow of funds in the form of equity and inter-company loans as well as for real estate acquisitions effected through the banking system, inter – company accounts and overseas accounts. For the purpose of compiling balance of payments statistics, capital invested in or loans extended to subsidiaries abroad must be offset against the capital invested in or loans extended to Malaysia by subsidiaries abroad. At present, the CBOP System is not able to segregate this type of transaction [BNM 2006].

[3] The United Nations Conference on Trade and Development http://www.unctad.org/Templates/WebFlyer.asp?intItemID=3968&lang=1

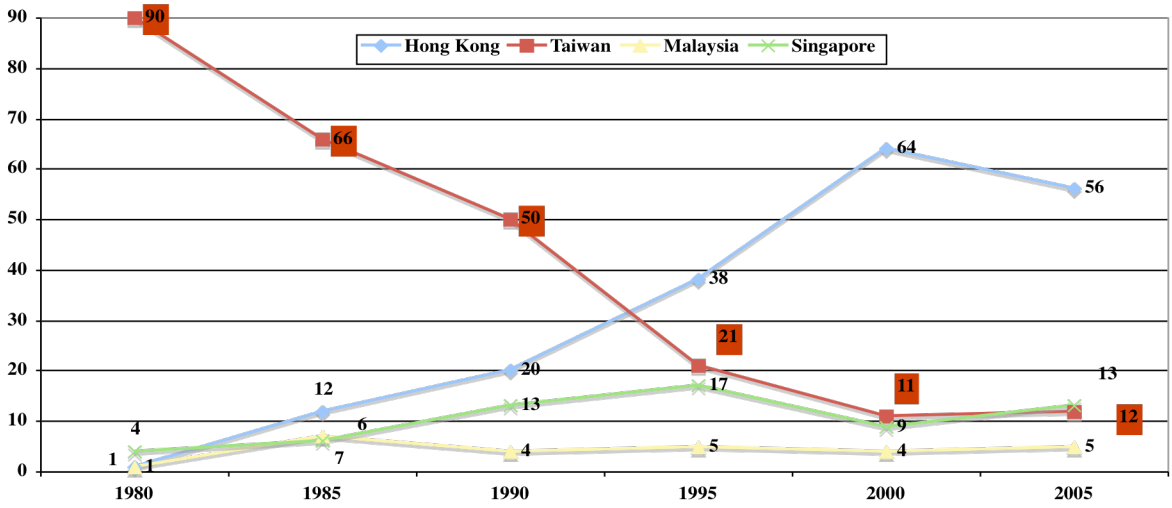
[4] The Association of South East Asian Nations (ASEAN)

[5] http://www.aseansec.org/18177.htm

2.1 Overall performance

Malaysia is well known as a destination for FDI and is now increasingly becoming a significant contributor to OFDI. Malaysia's contribution as a percentage of total FDI from South, East and South East Asia has increased from 1% in 1980 to 5% in 2005. It achieved an all time high of 7% in 1985. Valued in US dollar terms, Malaysia OFDI stock has increased from USD197 million in 1980 to USD44.5 billion in 2005 [WIR2006[6]]. Although the performance does not match that of Hong Kong SAR (HKSAR), it demonstrates a growing confidence of Malaysian firms to venture overseas. HKSAR contributed 56% of total FDI in 2005, down from an all time high of 64% in 2000. Singapore and Taiwan, Province of China are the other high performers in the region.

Chart 1: OFDI as a Percentage of South, East and Southeast Asia Total FDI Stock.



Source: UNCTAD

As a percentage of GDP (measured in current prices), the stock of OFDI from Malaysia has increased from 1% of GDP in 1980 to a remarkable 34% of GDP in 2005. The performance has been one of steady increase with 12% recorded in 1995 and 25% in 2000. HKSAR and Singapore are clearly in the lead with OFDI at 265% and 94% respectively of their GDP. Taiwan on the other hand has shown a decline in OFDI

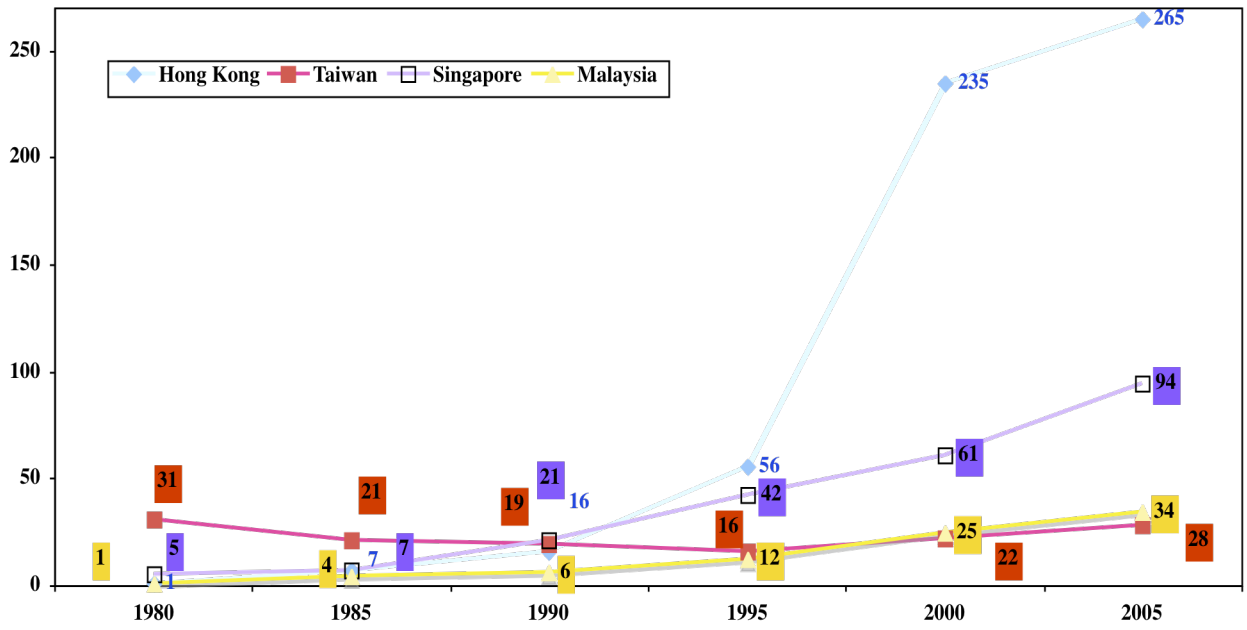


Chart 2: OFDI (Stock) as a Percentage of GDP.

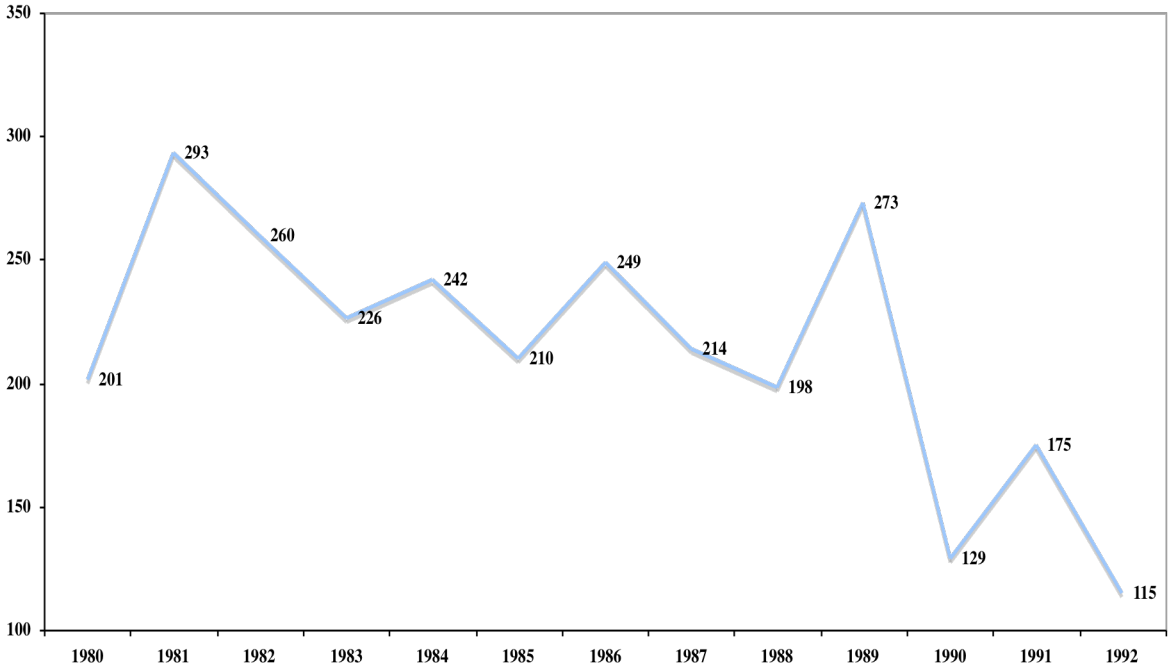
Source: UNCTAD

In terms of OFDI flows, for the period 1980 to 1992, annual flows did not exceed USD300 million. Except for 1981 and 1989, OFDI flows were trending downwards, reaching a low point of USD115 million in 1992. OFDI during this period were

[6] http://www.unctad.org/Templates/Page.asp?intItemID=3277&lang=1

essentially Malaysian state-owned-enterprise purchasing equities of foreign corporations operating in Malaysia. This exercise phased out in the mid 1980s.

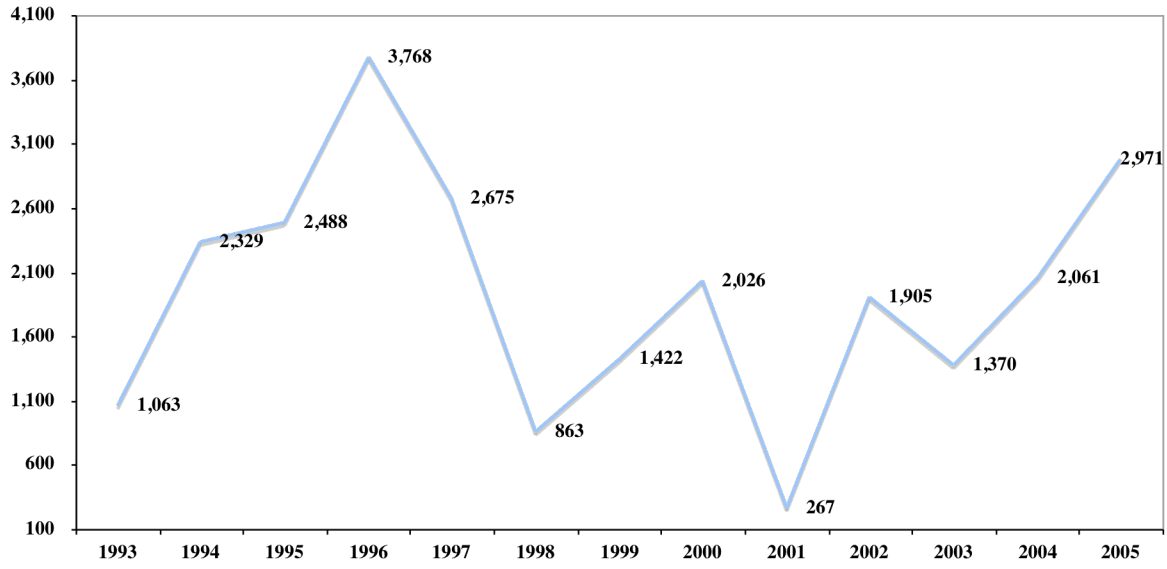
Chart 3: OFDI Flows (1980 – 1992)



Source: UNCTAD

However, this trend changed drastically in 1993 when OFDI flows jumped to USD1, 063 from the previous year – a jump of more than 800% signalling a change in Malaysian strategy. This uptrend continued until the East Asian Financial Crisis in 1997 where it was reversed until 1998 after which it began to rise again. There was a drastic fall in 2001, where OFDI reached the lowest point since 1993 at USD267 million. It has however climbed to USD2, 971 million in 2005. This amount, however, is still lower than the historical high of USD3, 768 million recorded in 1995.

Chart 4: OFDI Flows (1993 – 2005)

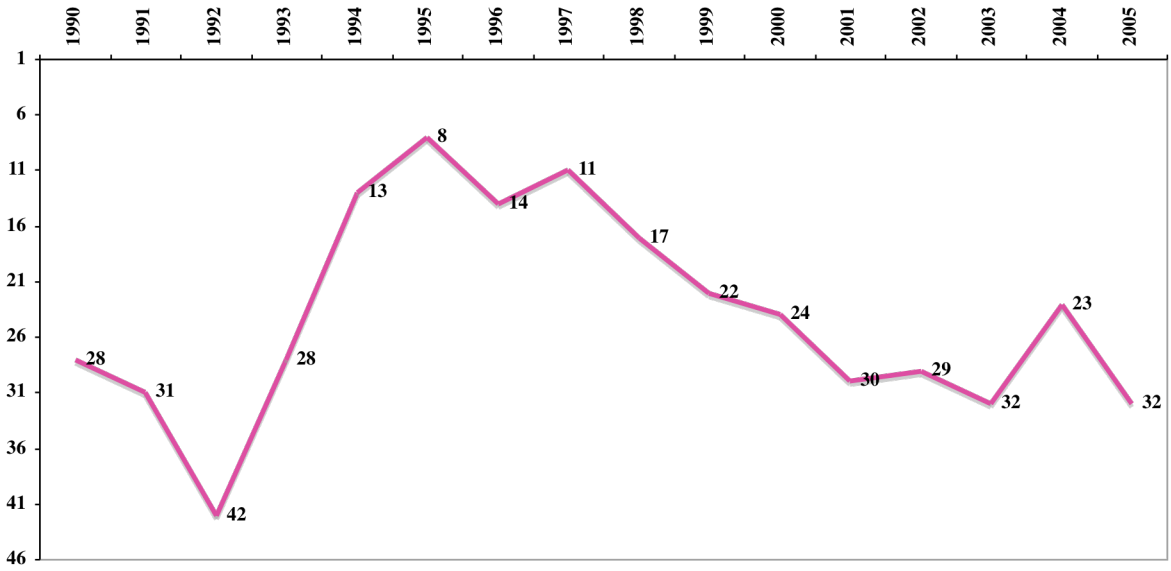


Source: UNCTAD

Malaysia was ranked highly overall as a source of OFDI. In UNCTAD's Outward Performance Index[7] Malaysia has remained in the top 35 except for the period 1990 – 1992 when it was ranked at no. 42. Malaysia's best performance was for the period 1993 -1995[8] when it was ranked eighth.

[7] The Outwards FDI Performance Index is calculated as the share of a country's outward FDI in world FDI as a ratio of its share in world GDP.
[8] http://www.unctad.org/Templates/WebFlyer.asp?intItemID=3241&lang=1

Chart 5: Malaysia's Outward Performance Index Ranking (1988 – 2005)



Source: UNCTAD

2.2 Performance of Malaysian Companies

PETRONAS at 59 is Malaysia's only company in the world's top 100 non – financial TNCs, ranked by foreign asset in 2004. PETRONAS is the national oil company and enjoy monopoly oil and gas rights in Malaysia. Malaysia also has six companies in the top 100 non – financial TNCs from developing countries, ranked by foreign assets [UNCTAD]. Interestingly, four of the six are government-linked companies (GLCs). Malaysian companies were focused mainly in resources such as oil and gas, and forestry as well as capital-intensive industries such as transportation. The two private sector companies were diversified companies.

Table 1: Ranking in Top 100 Non Financial TNCs (by Foreign Assets) in 2004

Corporation	Ranking	Industry	Foreign			
			Assets (US mil.)	Sales (US mil.)	Employment	Affiliates
PETRONAS	2	Petroleum Exp./re	22,647	10567	4016	167
YTL Corp. Berhad	32	Diversified	3,359	571	1423	37
MISC Berhad	45	Transport	2625	1797	3785	16
Sime Darby Berhad	55	Diversified	1838	2636	6207	146
MUI Berhad	77	Diversified	1042	476	8612	39
Kumpulan Guthrie Berhad	86	Forestry	857	279	43514	1

Source: WIR2006

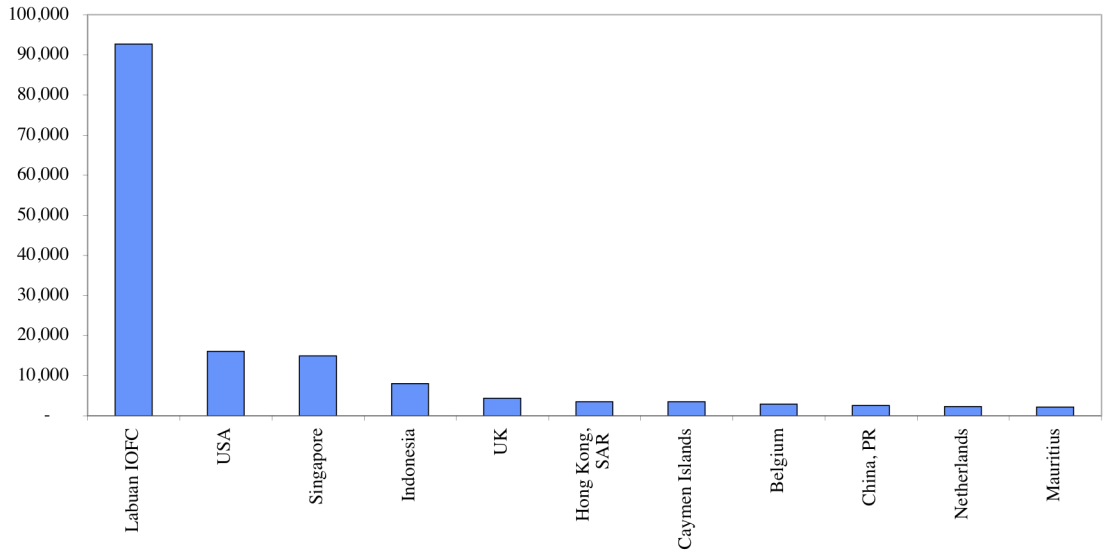
2.3 Destination and Sector

Malaysian OFDI is dispersed over more than 100 countries [BNM 2006]. The Labuan International Offshore Financial Centre (LIOFC) was the top location for Malaysian OFDI, followed by the U.S. and Singapore for the period 1993 - 2005. However, the flows to the LIOFC were far greater than of the other locations. This may reflect the importance of the LIOFC as an investment centre for Malaysian based companies. BNM reported that:

> "…Investments in the finance, insurance and business services sub – sector reflected to a large extent activities of investment holding companies that were set up in IOFCs to centrally manage global investment operations…" *[BNM 2006]*

In the ASEAN region, only Singapore and Indonesia were placed in the top ten destinations while in the Asian region only HKSAR and China were placed. Surprisingly Mauritius made it to the top 10 location of OFDI. The cumulative investment for Mauritius was similar to that of Taiwan, POC.

Chart 6: Top Ten Locations for OFDI (accumulated in RM million, 1993 – 2005)



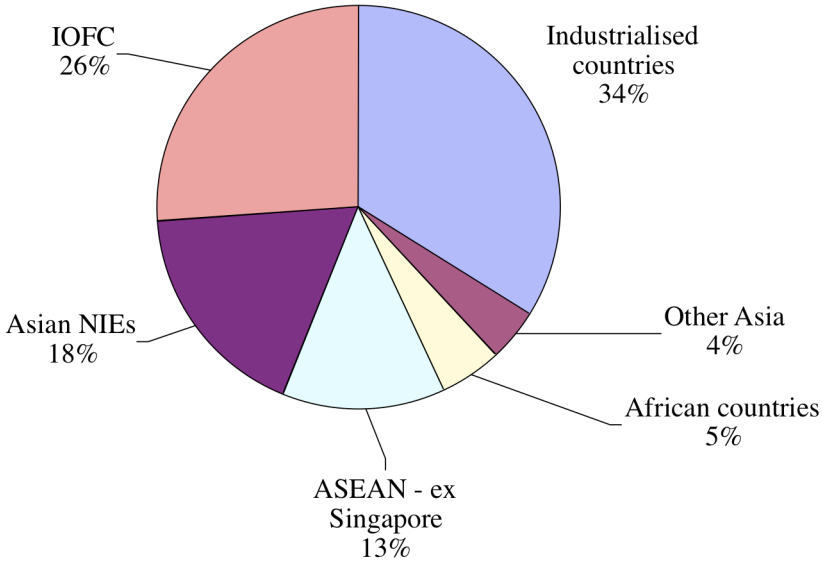
Source: BNM Annual Report – various years

However, the main destination of Malaysia's OFDI abroad by category of countries for the period 1999 - 2005, has been to industrialised countries. 34% of OFDI goes to this category of countries, namely to the United States, the United Kingdom, Belgium and the Netherlands – essentially the European Union (EU). International Offshore Financial Centres such as the LIOFC and the Cayman Islands are also favoured destinations with 26% of Malaysian OFDI heading to these shores. ASEAN[9] and Newly Industrialised Economies (NIEs)[10] investment collectively accounted for 31% of OFDI. Malaysia's OFDI to other parts of Asia (including China and India) and Africa did not amount to more than 9% cumulatively. Neither were the Americas (ex the U.S.) an important destination.

[9] ASEAN here refers to Brunei, Indonesia, Thailand, Philippines, Cambodia, Laos, Vietnam and Myanmar. Singapore is included as NIE.
[10] NIE – Hong Kong SAR, Singapore, South Korea and Taiwan.

BNM notes that for the period 1999 – 2005, OFDI to the developing economies registered the highest growth rate of 25%, with its share of total investment rising from 13% in 1999 to 31% in 2005 [BNM 2006]. Malaysia was also a top ten source of FDI to Africa [UNCTAD 2005].

Chart 7: Direct Investment Abroad by Region in Percentage (1999 – 2005)



Source: BNM 2006

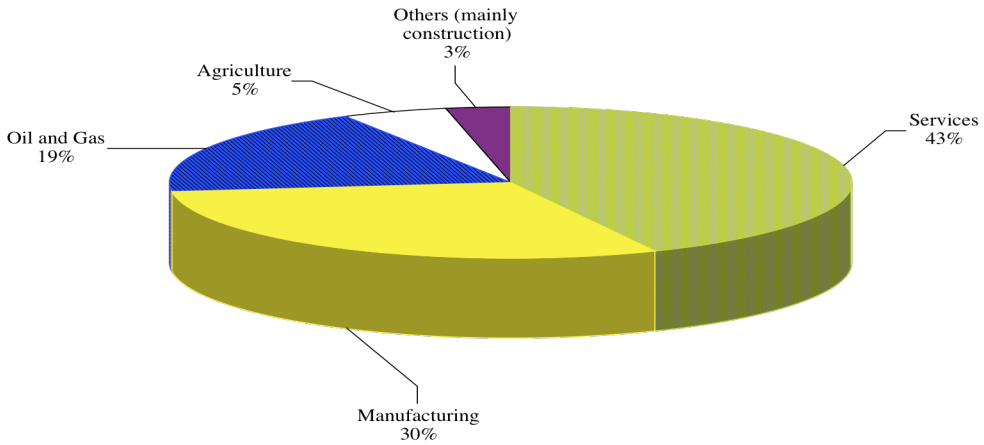
Malaysian OFDI went mainly into the services, utilities, manufacturing and oil and gas sector. Collectively, this amounted to 92%. BNM reported that within the services sector, investment in the finance, insurance and business services was the largest at 43%, followed by transport, storage and communications with 20%, utilities at 20% and distributive trade, hotels and restaurants at 12%.

BNM further reported that investment in the transport, storage and communications sub – sector was conducted mainly by companies in the telecommunications industry via

acquisitions and joint ventures with foreign telecommunications companies. In the utilities (electricity, gas and water) sub – sector, major acquisitions were regulated assets such as water services companies and power plants abroad. In the wholesale and retail trade, hotels and restaurants sub-sector, a significant portion of OFDI was in the distributive trade and hotel industries.

The mining sector was dominated by PETRONAS, Malaysia's national oil company. Investment in agriculture was largely in palm oil plantations. Manufacturing investments abroad were concentrated in three main industries, namely fabricated metal products, machinery and equipment (48%); food, beverages and tobacco (14%) and chemicals and petroleum – related industry (10%) [BNM 2006].

Chart 8: Direct Investment Abroad by Sector (1999 – 2005)



Source: BNM 2006

2.4 Ownership and Outward Foreign Direct Investment Type[11].

The BNM report [BNM 2006] also provides an analysis on Malaysian OFDI by ownership and investment type. Ownership of Malaysian companies can be separated into three categories:

- GLCs – Government Linked Companies are non – financial public enterprises in which the Government has an equity of more than 50% and with sales turnover of at least RM100 million;[12]
- RCCs – private companies in which residents have equity stake of more than 50%; and
- NRCCs – private companies in which total non – resident shareholding is more than 50%

- *Investment by Malaysian Controlled Companies (GLCs & RCCs)*

BNM noted that investments from Malaysian GLCs and RCCs accounted for 61% of OFDI during 1999 – 2005. The bulk of these investments were by companies in the services sector (48%), followed by mining (48%), agriculture and manufacturing (8%) each. GLCs were the dominant investors in the oil and gas, and the telecommunications industries, while the RCCs were the main driver for investment in the manufacturing, utilities, distributive trade, leisure, plantations, construction as well as banking and finance industries.

BNM noted that OFDI by Malaysian controlled companies (GLCs & RCCs) were undertaken mainly through acquisition of equity stakes and joint – ventures with foreign partners abroad. BNM further noted that 70% of these investment flows were for equity

[11] This section borrows heavily from the BNM report on OFDI due to lack of publicly available detailed data on this subject. For the complete report please visit http://www.bnm.gov.my/files/publication/qb/2006/Q3/p6.pdf

investment and real estate acquisition. Investments by these Malaysian controlled companies were sourced mainly from internal funds (62%) and offshore borrowings (26%). BNM also noted that GLCs and RCCs conducted their investment mostly in developing economies with a significant amount channelled to ASEAN and African regions as well as selected countries such as PR China, India, Sri Lanka, Pakistan and some West African countries.

- *Investment by Non Resident Controlled Companies (NRCCs)*

During the period 1999 – 2005, BNM reported that 39% of total gross outflows of OFDI were attributed to NRCCs. BNM noted that the share of NRCCs OFDI to total OFDI has declined from 35% in 1999 to 17% in 2005. The bulk of NRCCs investments outflows were in the form of extensions of inter – company loans to related companies abroad (91%). NRCCs also preferred internally generated funds to finance their overseas investment. NRCCs in the manufacturing sector accounted for more than 60% of these investment flows. Within the manufacturing sector, 53% were in the manufacturing of semi-conductor and other electronic component industry and almost 20% to the manufacturing of radio, television sets, video recorder and other equipment industry.

3 The Key Determinants of Outward Foreign Direct Investment

There are many factors that have contributed towards both the pull and push for OFDI. Analysing OFDI flows, there is a clear indication that the push and pull factors changed in the early 1990s demonstrated by the leap in Malaysian OFDI since 1993. The two

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[12] USD1 = RM3.5 (approximately)

phases, with the first from 1970 to 1990 and the second phase from 1991 onwards demonstrate changes in the relevance of OFDI to the Malaysian economy.

3.1 Push Factors

The key push factors in the case of Malaysia has been rising wealth – both of individuals and corporations, high domestic savings, the rising cost of labour in Malaysia relative to its regional neighbours, the limits of domestic markets, domestic deregulation in strategic sectors such as health, education, telecommunications and utilities, the promotion of OFDI by the government and of south – south trade, and trade liberalisation in general, especially in the ASEAN region.

3.1.1 Structural Factors

A key determinant of OFDI had been the structural changes to the Malaysian economy due to Malaysia's impressive economic growth. Malaysia had recorded an average growth rate of 6.5% in real gross domestic product since Independence in 1957. GDP per capita in current prices grew by 7.0% per annum [9MP: pp. 3]. Average real GDP (RGDP) for 1995 – 1997 was 9.1% and for 1999 – 2005 was 5.4% [ADB].

Concurrent with strong economic growth was full employment, which was achieved in 1991 at 4.3%. For the period 1992 – 1997, average unemployment rate was 3% and for the period 1999 – 2005 was 3.4% [ADB]. Gross domestic savings had also increased from 28.8% of GDP in 1981 to 34.4% of GDP in 1990 and an impressive 43.3% of GDP in 2005. Similarly, Gross national savings increased from 31.1% in 1990 to [ADB].

The development of the Malaysia Stock Exchange[13] further demonstrates the development of the private sector in Malaysia. The number of listed companies on the main board increased at an annual rate of 5.6% for the period 1981 – 2001. At the same time, the Composite Index (CI) grew at an average of 3.1% per annum. The CI reached a historic high of 1238 points in 1996 just before the East Asian Financial Crisis [Ibrahim, M. 2006: pp. 75] The development of the stock market allowed companies to raise funds domestically at low cost and purchase assets in other economies.

3.1.2 Cyclical Factors

Malaysia had undergone a recession in the 1985 and 1998. The 1985 recession particularly had a direct impact in encouraging Malaysian OFDI. The property sector provides an illustrative example. Tham [2006: pp. 5] noted that the collapse of the property market in 1985 redirected OFDI towards business investment overseas from 1989 onwards. Motivated by the need to search for new revenue sources outside Malaysia, construction and property development countries have been making inroads abroad in countries such as the U.K. and Hong Kong China, to infrastructure concession and property development projects in developing countries in Asian and Africa particularly in India, South Africa, PR China, Cambodia and Indonesia [BNM 2006]. Furthermore, Tham [2006: pp. 13] in her seven-company study also noted that the saturation and competition in the services sector in the domestic market were the prime motives for companies to invest overseas.

[13] Bursa Malaysia (Malaysia Stock Exchange) was formerly known as the Kuala Lumpur Stock Exchange

3.1.3 Institutional Factors

As noted earlier, government policies in support of OFDI changed dramatically in favour of OFDI since 1991 in response to the structural bottlenecks and recession of 1985. Support for OFDI was further strengthened after the East Asian Financial Crisis and has become an official strategy of the government to ensure continued growth.

- *Government Policies*

The early push factor that contributed to OFDI was the New Economic Policy (NEP), which promoted "Economic Nationalism" and "restructuring of the Malaysian economy". The objective of controlling the commanding heights of the national economy prompted the first wave of Malaysian OFDI. The Malaysian government through state owned enterprise acquired British owned agency houses in Malaysia [Ragayah 1999, Jomo 2002] in the late 1970s and early 1980s. These agency houses such as Barlows, Boustead, Guthrie, Harrison & Crosfield and Sime Darby were involved in international trade, tin mining and plantation agriculture and had business interest in the Southeast Asian region. The headquarters were in the home countries. The reverse takeovers were through state agencies such as Permodalan Nasional Berhad (PNB) purchasing equity in the open market. An example of these prominent takeovers is the famous "Dawn Raid" on the London Stock Exchange (Martin, Sue 2006).

Another significant event that had an indirect push on OFDI in the 1970s was the implementation of the Industrial Coordination Act (ICA), 1975. The ICA introduced a licensing requirement to manufacturing activity in Malaysia to "ensure the orderly development and growth of industries". Malaysian firms owned by non - Bumiputera had to offer 30% of their equity to Bumiputera interests. Foreign firms had to offer at least

70% to Malaysians, of which 30% had to go to Bumiputera individuals or agencies (Lee HA, 2002). This prompted capital flight from Malaysia by Malaysians of Chinese ethnic origin. Gomez E. T & Jomo K.S. notes the following:

> "…A number of prominent Chinese businessmen such as Robert Kuok, Lim Goh Tong, Tan Chin Nam and Khoo Kay Peng bypassed the state by diversifying their operations overseas." *[Gomez E.T. & Jomo K.S. 1999: pp. 43]*

> "…According to a Morgan Guaranty estimate, total capital flight during 1976 to 1985 amounted to USD12 billion." *[Gomez E.T. & Jomo K.S. 1999: pp. 44]*

However, OFDI during the period 1970 - 1990, as a percentage of GDP was not significant. Since 1991, the Malaysian government has increased the support for OFDI especially in the form of tax exemption, tax incentives and special funds. Ragayah [1999] noted the following:

> "…The Malaysian government introduced a package of incentives in 1991 in the form of tax abatement on income earned overseas and remitted back to Malaysia and tax deduction for pre-operating expenses. Beginning 1995, all income remitted by Malaysian companies investing overseas (except from banking, insurance and se and air transport businesses) is fully exempted from income tax."
> *[Ragayah 1999: pp. 470]*

In 2003, an additional incentive was introduced for acquiring foreign owned companies abroad for high technology production within the country or to gain new exports for local products [MASSA News June 2005].

Subsequent government policies promoting OFDI were focused in the agricultural sector. The National Agriculture Policy III (NAPIII)[14] formulated amidst the East Asian Financial Crisis in 1998, saw OFDI as a means of reducing Malaysia's significant trade

deficit in the agriculture sector. Furthermore, the government sought to ensure food security through OFDI. The NAPIII noted the following:

> "…Reverse and offshore investments for strategic sourcing will be encouraged and judiciously pursued."

> "…Reverse investment in paddy production in low cost price producing countries will be encouraged."

> "…To meet the requirement for raw materials for the processing industries and increasing domestic demand for temperate fruits, reverse investments will be encouraged."

> "…Future production and expansion of oil palm cultivation will be in Sabah and Sarawak or through reverse investment in neighbouring countries, the South Pacific islands, Africa and Latin America."

[Executive Summary, NAPIII]

OFDI then became a definite strategy in Malaysia's long term planning as seen in the Outline Perspective Plan III[15], implemented in 2001. The Outline Perspective Plan III notes:

> "…Efforts to promote reverse investments for food and plantation crops will continue to ensure supply of raw materials to industries while taking advantage of the cheaper production cost and the availability of resources overseas."

[OPP3: pp. 73]

The Malaysia – Singapore Third Country Business Development Fund was co – founded by the two countries. This fund allows Malaysian and Singaporean enterprises to co-operate and jointly identify investment and business opportunities in 'third countries' outside of Malaysia and Singapore. The fund's main objective is to encourage Malaysian

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[14] National Agriculture Policy III: 1998 – 2010.
[15] OPPIII is a long term indicative plan for the period 2001 to 2010

and Singaporean enterprises to expand their business operations in the global arena. [MASSA June 2005]

The recent Budget 2007 also outlined measures to help create Malaysian – owned TNCs. These included an increase in the paid – up capital of EXIM Bank by RM2 billion to enhance the bank's role in providing financing for domestic companies investing abroad and the setting up of a RM100 million Overseas Investment Fund to finance start-up costs of domestic companies doing business overseas [BNM 2006]. In addition, BNM has set-up a RM1 billion fund to assist and stimulate local entrepreneurs especially Bumiputeras to venture abroad [Tham 2006: pp 10]. The EXIM Bank also has the Overseas Project/Contract Financing Facility, which is available to Malaysian companies (investors/suppliers/ contractors) undertaking projects overseas such as infrastructure, manufacturing and other developmental projects[16].

3.2 Pull Factors

The main pull factors that attracted Malaysian OFDI were supply of cheap labour, the abundance of raw materials, large and growing domestic markets, geographic proximity, special tax and other incentives and the development of export markets through preferential treatment.

3.2.1 Structural factors

Beginning in the 1990s, there were signs that Malaysia was facing infrastructural bottlenecks and increasing shortage of labour – especially skilled labour. The rising

costs of wages lead to overall cost of production [Tham 2005]. Facing these constraints, Malaysian based companies' sought to circumvent them through OFDI. Therefore, the key drivers in the case of Malaysia were efficiency seeking OFDI – which was to take advantage of low cost of factor prices in the host country and market seeking OFDI which was to have better access to the markets of host countries and surrounding markets.

Hiratsuka argued using the gravity model that OFDI as a percentage of trade was highest in the ASEAN region, especially for Singapore, Thailand and Indonesia. Hiratsuka's evidence supports the gravity model argument that geographical distance and markets play a crucial role in determining OFDI [Hiratsuka 2006: pp 9]. Malaysian OFDI was also essentially efficiency and market seeking [Hiratsuka 2006].

- *Efficiency seeking OFDI;*

Economic liberalisation through the WTO and AFTA process together with the emergence of new low cost economies in the region gave impetus for companies with high labour dependency to restructure and realign their operations to improve export competitiveness. Malaysian companies relocated to Laos, Cambodia, Indonesia, Vietnam and China in search for low factor prices. This was especially true for the manufacturing and textile sector. Malaysian OFDI in the manufacturing sector was essentially attracted by the opportunity to be low cost producers abroad. These companies employed the strategy of relocating their resource-intensive operations into low cost locations abroad to maintain competitiveness. Economies of scale such as large-scale plantations were

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[16] http://www.exim.com.my/overseas.asp

also an important driver as Malaysian plantation companies invested especially in Indonesia to seek cheap abundant labour and land.

- *Market seeking OFDI;*

Due to the limits of Malaysia's domestic markets, local firms have been driven to search for new markets. Ragayah [1999: pp.479] noted that of the seven companies studied, seeking for new markets or expanding existing ones were the main pull factors of five companies. Malaysia's largest export markets are the United States, the European Union and followed by Japan [MITI 2006b]. Investment in industrialised countries were mostly by NRCCs. Malaysian companies have managed to move up the value chain or develop integrated supply chain management through acquiring interest in or by forming joint ventures with foreign counterparts. These often involved acquiring physical assets such as manufacturing facilities, high technology and management expertise, brands and trademark rights to established products [BNM2006].

Proton for example acquired a British automobile company, which has acted as an R&D centre and also import and distribution centres of cars and parts in the U.K. Similarly LKT, a semiconductor business equipment solution company and Pentmaster, a semiconductor manufacturing automation solution company have set up service support centres and offices worldwide to support their customers and distributors [Hiratsuka 2006].

- *Resource seeking OFDI;*

Malaysia's national oil company (PETRONAS) and plantation companies have been actively investing overseas in search of resources. The said resources (oil fields and

plantation land) have become scarce in Malaysia forcing these companies to seek these resources abroad. Oil and gas is also a strategic resource. PETRONAS underpinned by its vast knowledge and experience in domestic oil and gas exploration and extraction activities and the anticipation of higher global energy demand had embarked on a strategy of global diversification [BNM 2006]. The similar advantages – experience and technical capabilities in plantation management and production – were key determinants of Malaysian plantation companies investing abroad, especially into Indonesia.

3.2.2 Institutional Factors

Developing countries such as Laos, Cambodia, Vietnam and Indonesia in order to attract FDI have offered various kinds of incentives. Although, these incentives were not ranked highly by Malaysian companies [Ragayah, 1999 and Tham 2006] they were still important to attracting OFDI.

- *Investment Guarantee Agreements and Trade Agreements*

Malaysia has to date concluded Investment Guarantee Agreements (IGAs) with 67 different countries including members of two groupings - ASEAN and the Organisation of Islamic Countries (OIC). These IGAs (Bilateral Investment Treaties – BITs) adhere to the provisions of the Convention on the Settlement of Investment Disputes, which Malaysia acceded to in 1966. This convention is under the auspices of the International Bank for Reconstruction and Development. The IRBD also provides international conciliation or arbitration through the International Centre for Settlement of Investment

Disputes.[17] Through these IGAs, Malaysian investors' rights are guaranteed. Malaysia is ranked No. 2, second to only the PRC in the number of BITS signed among developing countries in Asia (Outlook 2004).

3.3 Strategic reasons

Geopolitical reasons have also been an important factor in promoting Malaysian OFDI especially to southern countries. Malaysia's "Prosper Thy Neighbour" foreign policy included technical cooperation and south – south investment. Malaysian foreign policy was also instrumental in Malaysia's national oil company OFDI.

- *South – south co-operation*

Malaysia has been promoting South – south co-operation actively especially during the Mahathir regime. As a member of the Non – Aligned Movement (NAM), the Organisation of Islamic Countries (OIC), and the Group of 77, Malaysia has advocated for south – south co-operation especially in the area of investment and technology. The close relationship between politics and business in Malaysia has also facilitated investments in developing countries as businesses reciprocate favours given by politicians (Jomo K.S. 2002). The Malaysian South – South Association (MASSA) and the Malaysian South – South Corporation Berhad (MASSCORP) demonstrate the importance of South – south co-operation to Malaysia.

[17] http://www.mida.gov.my/beta/view.php?cat=3&scat=5&pg=118

- *ASEAN Free Trade Agreement*

The ASEAN Free Trade Area (AFTA) was established in January 1992 to eliminate tariff barriers among the Southeast Asian countries. The main objective is to integrate the ASEAN economies into a single production base and creating a regional market of 500 million people. Most of ASEAN is now a free trade area with the six major countries having reduced their tariff barriers for almost all products to no more than 5%. Furthermore, ASEAN is determined to reduce tariff levels to 0% by 2010 [ASEAN Secretariat]. As AFTA is a preferential trade agreement, these privileges are only for companies located within ASEAN and where local content (materials used from ASEAN member countries) should be at least 40%.

The Framework Agreement on the ASEAN Investment Area (AIA) was then signed in 1998. The AIA aims to provide a more liberal and transparent investment environment by January 1, 2010. The AIA is part of the building block to contribute to the realisation of ASEAN Vision 2020 which includes free flow of investments. These initiatives has promoted inter – ASEAN trade and investment with Malaysia being the second largest source of intra – ASEAN FDI.

- *World Trade Organisation*

Malaysia acceded to the World Trade Organisation (WTO) in 1994. The Marrakesh Agreement made significant progress in three major areas [Mahani 1994]:

  - market liberalisation, which could add approximately one percent of world real GDP and ten percent to world trade upon full implementation of the Agreement;
  - strengthening of rules and institutional structures particularly the creation of the World Trade Organisation (WTO) which could decide on dispute and impairment of trade rules and principles; and

- integration of new areas into the multilateral trading system such as agreement on services (GATS) and trade –related intellectual property rights (TRIPs), trade – related investment measures (TRIMs) and the traditionally sensitive and contentious sectors (agriculture and textiles and clothing)

The three areas above had been both a push and pull factor to Malaysian companies as it has forced the Malaysian government to comply with multilateral rules. At the same time, other members also had to comply with the multilateral rules allowing Malaysian companies to penetrate international markets.

- *Institutional Support*

After the successful visit led by then Prime Minister Mahathir with the Malaysian business community to Chile, Brazil and Argentina in 1991, two organisations were set-up to promote Malaysian OFDI – the Malaysian South – South Association (MASSA) and the Malaysian South – South Corporation Berhad (MASSCORP). The idea of MASSA was conceived in response to concerns that Malaysia's export driven growth should not be solely dependent on the traditional markets of the U.S., Japan and the E.U. MASSA was a timely springboard for Malaysian companies to explore the relatively untapped potential of the South – South countries. The government has been supportive of the initiatives taken by MASSA and MASSCORP[18].

The Malaysian Industrial Development Authority (MIDA), the Malaysian External Trade Development Corporation (MATRADE) and the Export – Import Bank of Malaysia Berhad (EXIM Bank) although focused on attracting FDI (MIDA) and developing

overseas markets and exporting Malaysian products (MATRADE and EXIM Bank), have nevertheless supported Malaysia's OFDI through MIDA's Cross-border Investment Section, MATRADE's trade counsellors located n 31 branch offices worldwide and the setting-up of funds under EXIM Bank for Bumiputera entrepreneurs to venture abroad [Tham 2006: pp. 10]

The government had also supported the setting – up of the South – South Information Gateway (SSIG)[19], an internet portal that will function as an exchange centre and central depository for information, news and broadcast materials including the sharing of experience, knowledge, expertise and skills.

4 Conclusion

The main factors that have motivated Malaysian OFDI are similar to those that motivate FDI from developed countries. The selection of host locations by Malaysian companies is based on considerations such as production costs, supply chains, market size and access, investment incentives of host economies and access to resources. For Malaysia additional factors have been brands and technology, strategic assets and decentralisation of operations to diversify risks and improve returns.

Furthermore, Malaysia's historically liberal foreign exchange administrative rules, high domestic savings rates and strong economic growth that led to the rising wealth accumulation among domestic companies have also been key determinants for companies in Malaysia to invest abroad.

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[18] Refer to annexe section for description of MASSA and MASSCORP.

GLCs were the dominant players in the oil and gas and the telecommunications industries while RCCs have been the main drivers for investment in the manufacturing, utilities, distributive trade, leisure, plantation, construction and banking and finance sector.

Malaysia's OFDI are essentially sound business decisions are sustainable over a long period. The private sector has ventured into areas that they are competent in, having developed their capacity and capability domestically before venturing overseas. However, the heavy influence of the government in GLCs should be reduced over time to ensure OFDIs are responsive to market conditions.

4.1 Policy Implications

Malaysia is a truly open economy by any measure, with trade and FDI flows playing a pivotal role in the economy. Economic openness is a two-way street with both inflows and outflows. It is in this sense that OFDI represents an important cog in Malaysia's open economy. The emergence of Malaysia as a source of FDI for other countries however has serious macroeconomic implications for the Malaysian economy.

Understandably, much would depend on the macroeconomic circumstances. In the early 1990s, when Malaysia was running persistently large current account deficits, reverse investment was a pain in the neck. Usually, TNCs use their own foreign exchange earnings to make their overseas investments. In the Malaysian case, however, the

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[19] http://web5.bernama.com/ssig/about/index.php

companies investing abroad were not generating foreign exchange, but using foreign exchange generated by others. This would not have been a problem if there were sufficiently large current account surplus, which was not the case in the early 1990s.

Malaysian OFDI had worsened the country's balance of payments situation in the early 1990s. This was problematic as FDI inflows into the country were also drying up due to the massive diversion of foreign investment to China. To finance its balance of payments deficits, Malaysia had to resort to short-term capital inflows, which were volatile and footloose. Malaysia was sucked into the Asian financial crisis in July 1997 when foreign short-term capital fled from the country. The rest is history. Seen in this light, OFDI was one of the factors that had inadvertently contributed to the crisis. That said, one must hasten to add that this is not an argument against OFDI, but just that the timing was wrong.

The post-crisis situation is very different. Malaysia has subsequently been registering substantial current account surplus, which has grown from 13.2 per cent of GDP in 1998 to 16.7 per cent of GDP in 2006. Malaysia's foreign exchange reserves have soared to USD 87 billion, equivalent to 8 months of retained imports, more than 6 times short-term external debt. Malaysia now has far more reserves than it needs. It makes good sense to put surplus earnings to good use rather than to simply add to the ballooning reserves. Outward investment represents a good outlet.

What is more, investment opportunities at home are not all that bright. The fact the country has been garnering Balance of Payment (BOP) surpluses year after year suggests that savings exceed investment. There is a glut of savings that need to find investment

opportunities. As domestic investment opportunities have been lagging behind savings, outward investments have become not only a better alternative but also a necessity.

Since trade and investment are inter-linked, OFDI do generate much trade flows between the host and home countries. No wonder, Malaysia's major trading partners are also the major investment partners, either as sources of FDI inflows or as destinations for its own outward FDI.

5 Annexe

The Malaysian South – South Corporation Berhad[20] (MASSCORP) is a public limited company incorporated in 1992. MASSCORP is a consortium of 86 Malaysian shareholders who are corporate leaders in their respective fields of business. MASSCORP's mission is to promote bilateral trade and investment between Malaysia and South – South countries. MASSCORP also acts as a vehicle for trade promotions, export, investments and management expertise and technology transfer to the host country. MASSCORP's specific objectives are:

- *To initiate and promote joint – ventures between Malaysian entrepreneurs and South – South investors, where either party may set-up investment projects in Malaysia or South countries;*
- *To undertake the privatisation of enterprises in South – South countries, especially in sectors where Malaysia has technical and managerial expertise;*
- *To open up new markets for Malaysian goods and services to South- South countries;*
- *To act as a reference point for business contacts and provide market information on business opportunities; and*
- *To build a stronger South with the injection of Malaysian capital and expertise*

[20] http://www.masscorp.net.my/v2/index.htm

Malaysia South – South Association[21] (MASSA) is a non – profit business association, set – up in 1992, comprising members who are from the Malaysian business sector. The main purpose of MASSA is to promote trade and investment with developing South – South countries. MASSA's specific objectives are to:

- *To promote and enhance members' knowledge and understanding on economic, trade and investment policies and conditions of South – South countries;*
- *To act as an informal liaison body between the private sector and the government pertaining to economic matters in the promotion of trade and investment;*
- *To provide a forum for the dissemination of ideas, discussions and dialogues in relation to trade, economy and culture; and*
- *To enhance trade and investment relations and to foster friendship and cooperation among the members.*

[21] http://www.massa.net.my/about.htm

Table 2: Factors Affecting South – South FDI in the 1990s

Rationale	Structural factors	Cyclical factors	Institutional factors
Push factors	Rising wealth in some emerging market economies increased supply of capital. Rising costs of labour and non – tradables encouraged relocation of production units to cheaper locations. Domestic deregulation to improve competition by breaking up monopolies prompted some large companies to branch into other countries. New technology and telecommunications improved information sharing and reduced transaction costs.	Low interest rates and low growth in industrial countries encouraged diversion of outflows from developing countries to other fast growing developing countries.	Capital account liberalisation allowed resident companies to invest abroad. Growth of South – South trade through regional trading arrangements was often associated with investment agreements. Tariff and non – tariff barriers to trade encouraged the relocation of production units to other developing countries. Government policies encouraging the outflow of investment.
Pull factors	Large and growing domestic markets. Geographic proximity and ethnic and cultural ties. Supply of cheap labour. Abundance in raw materials.		Permitting foreign ownership of domestic companies encouraged FDI through mergers and acquisitions. Special tax and other incentives to attract FDI attracted more foreign investment. Preferential treatment of FDI over resident investment encouraged round tripping of resident capital. Export markets through preferential treatment.
Strategic reasons	Desire to procure critical inputs such as oil		Geopolitical considerations

Source: Reproduced from Aykut and Ratha [2004]

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