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Foreign Direct Investment in Malaysia: Trends and Prospects

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This paper reports on a study analyzing recent trends, pattern and prospects of the foreign direct investment (FDI) in Malaysia in the post-1997 financial crisis period. Among the ASEAN-4 countries, Malaysia continues to remain as the main centre for attracting FDI. The macroeconomic variables such as GDP, exports and employment are found to be positively influenced by the growth of FDI in Malaysia. To enhance the positive effect of FDI on the growth process of the Malaysian economy the flow of FDI into export-oriented sector and use of domestic inputs by the foreign-oriented firms need to be encouraged. It is suggested that for sustained flow of FDI, continual price stability, macroeconomic balances, good governance and economic liberalization reforms are crucially important in the country. In the event of declining inflows of FDI, Malaysia has to shift towards inward looking policies and search other alternatives to sustain its growth and economic prosperity by seeking more investment outflows as a global player.

Field of Research: Foreign Direct Investment

1. Introduction

In the new economic era of the 21st century, foreign direct investment (FDI) set a remarkable trend for expanding and strengthening global business of several developing countries. The success of export-lead growth strategy in the ASEAN-5 (Indonesia, Malaysia, Philippines, Singapore, and Thailand) region is categorically attributed to the FDI inflows in these countries

In the Asia Pacific belt among the ASEAN (Association of South-East Asian Nations) countries, however, Malaysia as a promising nation has acquired a unique position of rapidly growing newly industrialized open economy in the past two decades. As such, it is worthwhile to examine its growth characteristics through FDI in the light of FDI inflows in its development process, performance and prospects.

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2. A Synoptic Select Literature Review

Incidentally, available studies on FDI in Malaysia seemingly have tackled various issues in segregation and most of them have been descriptive in nature. Some have focused on the ASEN region and made a peripheral reference to Malaysian situation. Bhatt (2000), for instance, presents a generalized account and empirical analysis of the trends and pattern as well as determinants of FDI flows in the ASEAN countries. Fry M.J (1994) observed an inverse saving-investment correlation in Malaysia over the period 1979-91. This is attributed to public sector investment and FDI. Hill (1990) furnished an explanation to this by saying that Malaysian authorities might have preferred FDI to local non-indigenous (non-Bumiputeras) investment to check the racial economic imbalance in the country. In the latest study Syed A, A. Sukar and S. Khan (2005) traced the role of some macroeconomic variables such as market size, openness of the economy, interest rates, and other factors, such human capital formation and information in attracting FDI into ASEAN-4 Countries and observed that the market size, interest rate, and exchange rates trend to be significant influencing factors. In the seventies and eighties, Malaysia was regarded as the most attractive place for FDI in the region.

3. Methodology and Research Design

The main focus of the present study aimed to provide a comprehensive study of recent Malaysian experience in FDI since 1990. In particular, this paper has three-fold objectives. Firstly, to review the trends and pattern of foreign direct investment (FDI) inflows in Malaysia, secondly to examine the impact of the FDI inflows on the Malaysian economy and finally to discuss policy inferences towards its future course of direction. The study is database, analytical and comparative with a focus on the ASEAN region. It is interacted to draw some useful lessons for the benefits of policy makers in developing economies.

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4. FDI Growth Trends in the ASEAN and Malaysia

Globally, FDI has increased dramatically over the years. (Refer to Table 1 for details). The Worldwide FDI inflows had an upward trend in 1997 onwards seemingly unaffected by the Asian financial crisis-The inflows of FDI, however, have largely been canalized towards industrial countries. Even by 2001, developed countries remain the prime destination of FDI, accounting for more than 75 percent of global inflows. In the developing countries, FDI has grossly concentrated among a few nations. For instance, over 90 percent of FDI had flown to eighteen developing countries, and half of which was claimed by eight South-east Asian countries (Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan and Thailand). (see Fry, 1991,1993 and Hill,1990).Especially, the success of ASEAN-5 may be attributed to a host of business environmental factors that include sound economic fundamentals and macroeconomic performance, economic, social and political stability, buoyant economy with high capacity, expanding domestic markets, favorable natural factor environment, particularly natural resources, labor supply and availability of other business resources along with conducive macroeconomic policies (Bhatt, P.R., 2000). In the South-East Asia, Malaysia has emerged as a promising developing nation characterized with high institutional quality, excellent physical infrastructure, and large public investments in education, so also consistent commercial policy, sound macroeconomic management and a high degree of openness, investment promotion and efficiency, thus attracting a high level of FDI inflows over the years.

Malaysia, on the whole, represents a rising trend of FDI inflows over the years since 1970.From the bottom of US$ 94 million FDI inflows in 1970, the Malaysian economy had received a peak level of US$5741 million FDI inflows in 1996.Its share in the ASEAN FDI inflows, thus, increased from 25 percent to 35 percent. The rising trend in the flow of FDI in the country may be attributed to the policy shift and growing market orientation of the country.

Data in Table -1 suggest that in the new millennium 2001 onwards the ASEAN countries experienced a declining trend of FDI inflows from $18505 million in 2001to $ 14695 million in 2003, as against the rising trend of the world FDI inflows from 694.5 billion to US $ 149190 million to US $ 557869 million in the same period. In expert's opinions, this is attributed to a diversification of the world FDI inflows towards other channels – the new emerging markets such as China, India and African countries. Global FDI inflows increased to US$ 916,277 million in 2005, compared to US$ 710,755 million in 2004, thus registering 29% rise. Of this, Malaysia received US$ 3,907 million in 2005 which was 14.2 % less than the previous year amount of US$ 4,624 million.

Table: 1
FDI Flows: World, ASEAN and Malaysia
(US $ Million)

Years	World	ASEAN	Malaysia
1970	1259	374	94
1980	5495	2415	934
1985	5760	3448	1397
1986	8644	3163	1261
1987	13984	2754	797
1988	16376	2229	695
1989	19256	2841	489
1990	20278	4305	423
1991	16020	7002	719
1992	17120	7591	1668
1993	22753	12740	2611
1994	25790	13619	4043
1995	33050	12699	5138
1996	38610	16602	5741
1997	47810	20399	4581
1998	69450	25367	5816
1999	108820	29370	7296
2000	149190	30370	6324
2001	73520	18505	2714
2002	65120 *	14500**	3203**
2003	557869	14695	2473
2004	71755	23437	4624
2005	916277	34128	3967

Sources: UNCTAD, *World Investment Reports*, 1998, 2002, 2004, 2006
* Ministry of International Trade and Industries, *MITI Report*, 2003,
** Association of South East Asian Nations, *ASEAN Economic Report* 2005

5. Current Scenario in the ASEAN Setting

Data in Table - 2 portrays the ASEAN-5 scenario regarding the FDI inflows. In 2005, Singapore claimed the highest FDI inflows amounting to USD 20,083 million worked out to be 14.2 % of the total world FDI inflows and claiming 59% share in the total FDI inflows in the entire ASEAN region. On the other hand, Indonesia claimed USD 5,260 million as against USD 3963 million FDI inflows in Malaysia. Malaysia, thus, lost its rank from number 2 to number 3. Thailand has also been a strong competition of Malaysia in attracting the FDI inflows. During the year 2004-2005, year-on-year growth of Thailand has been positive at 161% as against 14 % negative growth rate in case of Malaysia during the same period. This suggests the Malaysian policy makers need to re-assess their policy measures and react strongly to re-establish its global position in the ASEAN-5 group.

No doubt competition today is on different scale. Malaysian reform pace is deemed to be too slow compared with that of regional competitors like Singapore and Thailand. Indeed, “Benchmarked against itself, Malaysia has made lots of improvement. But compared with other countries, especially in the area of foreign investment, it needs to act more speedily,” (Joseph Tan, Singapore-based Economist of Standard Chartered, quoted by Jasin, A.Kadir, 2007).

Table: 2
FDI Inflows in ASEAN-5, 2003-2005

(US$ million)

Countries:

Country	2003	2004	2005
1	2	3	4
World	557869	710755	916277
ASEAN	14695	23437	34128
Indonesia	-597	1891	5260
Malaysia	**2473**	**4624**	**3967**
Philippine	491	688	1132
Singapore	10376	14820	20083
Thailand	1952	1414	3686

Note: Figures in the parenthesis refer to year –on- year growth ratio.
Source: UNCTAD, *World Investment Report*, 2006.

In recent years, cross border Merger and Acquisitions (M&As) activity caused increasing share of a country in the expanding global FDI inflows. Table - 3 refers to the data on cross-border M&As purchased by Malaysia during 1990-2005. It shows that from the bottom of US$ 220 million average during 1990-2000 the amount of the cross border M&As sales of the country had gone up to a peak level at US$ 1454 million in 2005.In the case of country’s M&As purchases had an average of US$ 525 million during 1990-2000, it has reached to a peak of US$ 3685 million in 2003. There was a substantial decrease in 2004, amounting US$ 816 million. It again revived to US$ 1678 million in 2005.

Table: 3
Malaysia Cross-border Merger and Acquisitions (M & As), Overview: 1990-2005
US$ Million

Year	Sales	Purchases
1	2	3
1990-2000 (Annual Average)	220	525
2003	84	3685
2004	638	816
2005	1454	1678

Source: UNCTAD, *World Investment Report*, 2006.

It is heartening to note that there has been a rising trend in outward investment flows of Malaysia in recent years. It has a quantum jump from US$1370 million in 2003 to US$ 2971 million in 2005. In Malaysia, Petronas–Petroliam National Berhad has made remarkable achievements globally. The corporation is placed among the world top 100 non-financial TNCs. It is ranked as 59 on the strength of foreign assets, 95th in terms of trans-nationality index (TNI) and 46th by the Internationalization Index (II). Altogether six main companies of Malaysia – Petronas, YTL Corp, MISC Corp, Sime Darby, Malaysian United Industries and Guthrie have achieved their place among the top 100 non-financial TNCs from developing countries. (WIR, 2006).

Among the ASEAN-5 nations, Malaysia stands second in the rank (next to Singapore) in respect of the largest TNCs from developing economies. As per the UNCTAD's World Investment Report 2006, in the year 2006, Malaysia had six largest TNCs, having Sales-Asset-Ratio worked out 0.53 as against that of Singapore at 0.58 with 13 larger TNCs. The Malaysia's TNCs most favored locations are the South, East and South-East Asia.

6. Malaysia's Competitiveness in FDI

Empirically, a country's competitiveness in the matter of FDI can be viewed in terms of three indices, as follows: (i) the inward FDI performance index, (ii) the inward FDI potential index, and (iii) the outward FDI performance index.

Reviewing the FDI performance and potential indices of Malaysia in the global rankings and especially in the ASEAN-5 settings, from data in Table 4 and 5 we observed that in the case of performance index the country had high order of rank (4) in 1990, among the rankings of 141 countries reported by the UNCTAD. Malaysia's ranking order based on these indices, however, declined to 53 in 2000 and further to 62 in 2005. The country's outward performance index rank, however, improved from 26 in1990 to 17 in 2000, but again gone down to 20 in 2005. Thailand, on the other hand, ranked 17 in the year 1990 for performance index and 40 for the potential index and 40. The country's ranks on this count, however, declined to 107 and 59 respectively by 2005.

Table: 4
Malaysia: FDI Performance Ranking 1990-2005

Year	Inward FDI Performance Index	Outward FDI Performance Index
1990	4	26
2000	53	17
2004	64	18
2005	62	20

Source: UNCTAD, *World Investment Report*, 2006.

Table: 5
Inward FDI Potential Index Ranking of ASEAN-5, 1995-2005

	Countries:				
Year	Indonesia	Malaysia	Philippine	Singapore	Thailand
1995	65	33	70	3	44
2000	76	31	61	2	53
2003	90	32	60	5	56
2004	92	32	61	5	59

Source: UNCTAD, *World Investment Report*, 2006.

Besides, Malaysia's competitive strength is remarkably good among the developing nations. Incidentally, Global Competitiveness Report 1997 ranked Malaysia as number 9 among 53 reporting countries. Malaysia's Public Institution Index in 2003, measured as 5.12 and the country was ranked at 34, as against that of Thailand 4.97 and ranked 37 and China 4.33 ranked 52. As reported by the Asian Development Overlook 2004, Malaysia's corruption Perceptions Index in 2003 was estimated to be 5.2, ranking the country as 37 among the 133 reporting countries, as against that of Thailand to be 3.3 ranked 75, Vietnam 2.4 ranked 105, China 3.4 ranked 66, and India 2.8 ranked 83. Though in the Asian region Malaysia appears to be relatively better, it needs to improve and being a Muslim oriented nation should and can come out as much cleaner to play as a role model of Muslim developed nation by 2020.

7. Discussion and Conclusion

In the 21st century, the FDI world wide increased at an unprecedented speed. It also created its daunting impact in causing the structural shifts in the global economy. Besides dominating role of developed country TNCs in providing the global FDI, a new trend have set in with the rapidly growing FDI coming from the TNCs of the developing and transition economies, in recent years. As such, to swim in the current waves, the Malaysia policy makers need to focus more on the growth of country's investment outflows. Malaysia can find the market potentials for the FDI outflows in the Muslim nations, especially the Arab world. The Middle East countries, particularly Dubai and Abu Dhabi are today's golden spots to invest and prosper with a focus on service sector – especially, information technology, education, finance and medical services.

Although Malaysia has done well in terms of attracting foreign direct investment, there is still a room for further improvement. The country should provide a better system of transparency with a greater degree of flexibility and minimal bureaucratic procedures to overcome delays in the approval and the executions as will as extensions of the projects involving FDI. Especially, the immigration section needs to be more flexible and less bureaucratic in delivering professional and business and employment visas and social pass to the foreign nationals from developing countries such India, Pakistan, Sri Lanka and Indonesia to facilitate the required workforce supply for the direct investment in businesses in core sectors of the economy. There is also scope for further simplification in the Approval System by reducing the bureaucratic procedures, checks and hurdles. There is also need to integrate cooperation between the states and the Central Government in terms of FDI approvals and subsequent follow-ups. Autonomy and decentralization of power is needed for smooth operations of the systems. Customs Administration in Malaysia needs to be more liberal and smooth to avoid unnecessary delays, hassles, and corruption. Malaysia can further reduce its corporate and income tax roles to make its fiscal management more competitive in the ASEAN region. The country should become a member of Multilateral Investment Guarantee Agency (MIGA). It undergoes bilateral agreements for settlement of investments disputes with the major FDI supplying nations. The country needs to adopt aggressive marketing of Malaysia as FDI location in the global arena. For this both the quantity and quality of information on ‘‘Doing business in Malaysia” needs to be optimized and spread world wide, especially among the Muslims countries. A ‘Global Investment and Business Plan of Malaysia’ may be chalked out and executed for an effective marketing of Malaysian industries and Malaysian brands worldwide. In this context, audio visual packages, road shows with continuous updating and services of private foreign consultants and agencies (such as Chambers of Commerce and Industries) may be utilized. Right Malaysian partners for joint ventures need to be identified through industry and trade associations. The government should create a special cell entrusted to compile and publish periodically the latest information about business and investments opportunities available in the country to the foreigners. On this account, the Malaysian High Commission and Embassies can play crucial roles in establishing the business links with agencies in foreign countries. Since India has awakened and moving ahead as a giant transition economy, Malaysia should develop better economic relations with the country. Establishment of Malaysian Embassy at New Delhi - the political city and shifting of Malaysian High Commission to Mumbai – the commercial capital city of India is warranted on this count.

Though Malaysia has scored well on most indicators in attracting the FDI inflows, the policy makers of the country have to be more attentive towards unfinished agenda. These include strengthening the independence of the country’s legal system, arresting the lost at high level non-Bumiputera human capital, time and talent management in the process of upgrading its technological capabilities, extensively and intensively.

Last but not the least, for a meaningful understanding and analysis, the FDI data in developing countries, including Malaysia as well, need to be complemented with detailed statistical information on the business of TNCs and their foreign affiliates pertaining to their sales, trade and R & D.

To sum up, the Malaysian experience of FDI serves some important lesson for the developing economies, such as:

- Export led growth strategy can be substantiated by the FDI inflows into the export sectors.
- Successful growth strategy of a developing country can be planned on three major planks. Trade liberalization, FDI promotion and Market orientation of the economy by optimizing private ownership.
- Openness of the economy to trade can serve as the engine of growth thus contributes to economics prosperity.
- Scale and spill over effects can be traced in the growth model on FDI as the major source of capital formation with heavy reliance on the MNEs.

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