

## Payoffs from Going Global: Assessing the Returns from Malaysia's Direct Investment Abroad

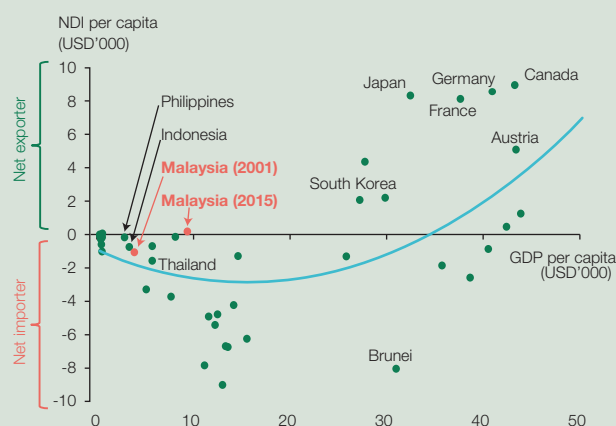
By Mohd Shazwan Shuhaimen and Lim Ming Han

### Introduction

As a highly open economy, Malaysia has been a longstanding recipient of foreign direct investment (FDI), which has been a vital source of capital formation for economic growth. However, compared to its peers, Malaysia has transitioned from being a net importer of long-term capital to being a net exporter within the recent decade on account of the rapid expansion of direct investment abroad (DIA)<sup>1</sup> by Malaysian corporations (Chart 1). This evolution underscores the growing maturity and capability of domestic firms to compete on a global and regional scale and the changing structure of the economy as it progresses towards a high-income nation. Of significance, Malaysia's DIA stands out as among the largest in the region as a proportion to the size of the economy, second only to Singapore (Chart 2). Since such capital outflows reflect, in part, a recycling of domestic savings abroad, this study assesses the returns of Malaysia's DIA from the profitability perspective<sup>2</sup>.

Chart 1

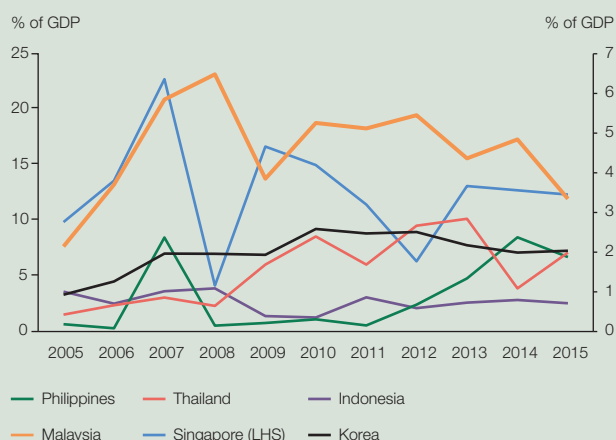
#### Net Direct Investment (NDI) and GDP per capita, 2015



Source: United Nations Conference on Trade and Development (UNCTAD), International Monetary Fund (IMF) and Department of Statistics, Malaysia

Chart 2

#### DIA Flows: Selected Regional Economies, 2005 – 2015



Source: UNCTAD, IMF and Department of Statistics, Malaysia

### Overview of Malaysia's Direct Investment Abroad

The rapid expansion of DIA has been facilitated by key regulatory and policy developments. Foreign exchange administration rules have been progressively deregulated with the aim of enhancing the competitiveness of resident companies by providing greater flexibilities to invest abroad, obtain external financing, manage cross-border movement of funds and hedge their foreign currency exposures. Equally important is the deepening economic co-operation and integration among regional economies through initiatives such as bilateral and regional trade agreements. These initiatives have reduced regulatory barriers, lowered the costs of doing business and opened up new markets for trade and investment. Finally, the domestic financial system has become more diversified, competitive and resilient. This has supported the internationalisation of Malaysian firms through more effective intermediation of cross-border financial flows and greater access to financing.

<sup>1</sup> Direct investment abroad, as defined according to the 5th edition of the Balance of Payments Manual (BPM5) by the International Monetary Fund (IMF), refers to the cross-border investment by a resident in Malaysia having control or a significant degree of influence on the management of an enterprise that is resident in another country. This control or influence is achieved when the direct investor owns at least 10 percent of the voting power in the direct investment enterprise.

<sup>2</sup> DIA investment performance may also be assessed from other dimensions, for example, in terms of cost of financing, dividend policy, asset turnover or operational efficiency perspectives.

Chart 3

**DIA and FDI Flows**

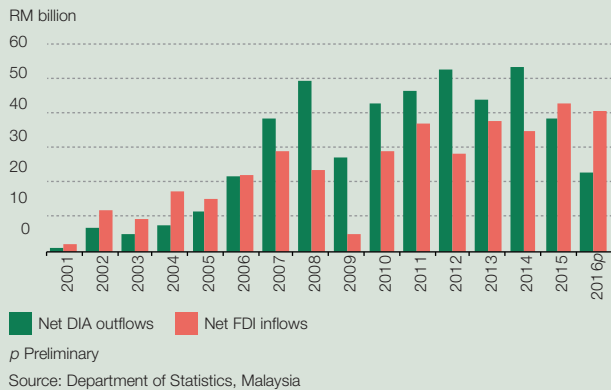


Chart 4

**DIA and FDI Stock (end-position)**

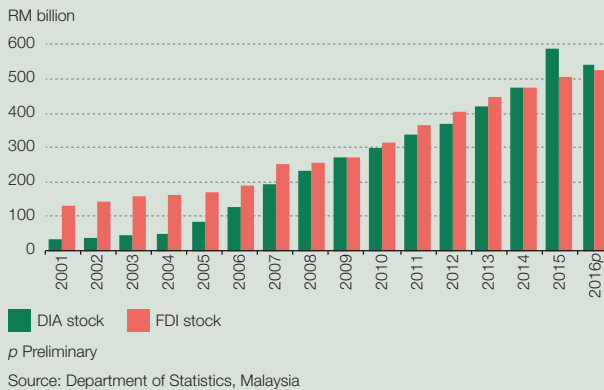
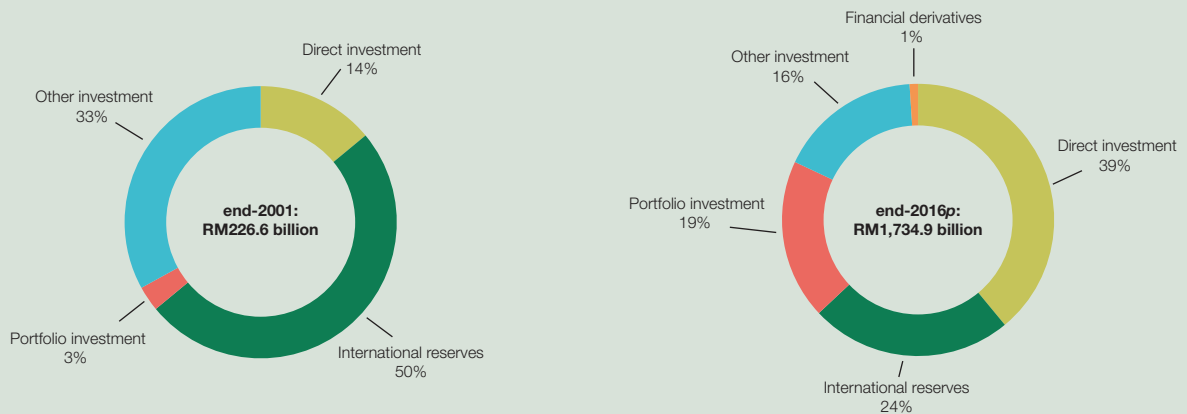


Chart 5

**Composition of Malaysia's External Assets**



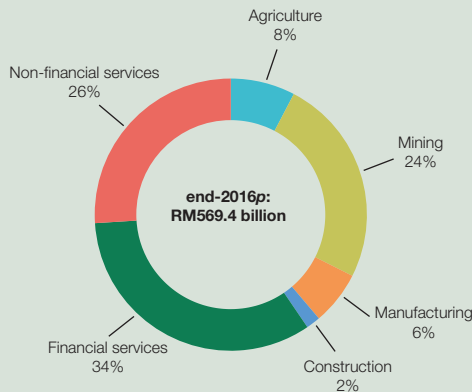
These developments have complemented the aspirations of Malaysian firms to expand their global footprint. Thus, DIA outflows have increased significantly in recent years and have consistently surpassed FDI inflows since 2007. Since 2015, however, DIA has moderated amid subdued global growth environment and prolonged weakness in commodity prices (Chart 3). Nevertheless, from an international investment position (IIP) perspective, Malaysia has become a net creditor of direct investment since 2015. The stock of DIA has exceeded the stock of FDI, in part reflecting capital gains arising from exchange rate revaluation (Chart 4). As at end-2016, DIA accounted for a 39% share of Malaysia's overall external assets. This is even larger than the level of international reserves (24% share) (Chart 5).

It is important to consider the underlying structure of Malaysia's DIA in relation to its FDI, in order to understand the relative characteristics of the returns and income generated by both types of long-term capital. In terms of sectorial composition, DIA is concentrated in the services sector, underscoring the growing regionalisation of Malaysian corporations in the finance, insurance, real estate and business services; information and communication; and utilities sub-sectors. This is followed by sizeable investments in the mining and agriculture sectors (Chart 6). Conversely, the bulk of FDI in Malaysia is channelled into the manufacturing and services sectors (Chart 7).

In terms of its geographical distribution, the bulk of DIA was channelled into the regional economies namely Singapore, Indonesia, India and Thailand, as well as the advanced economies such as Canada and Australia. A sizable share

Chart 6

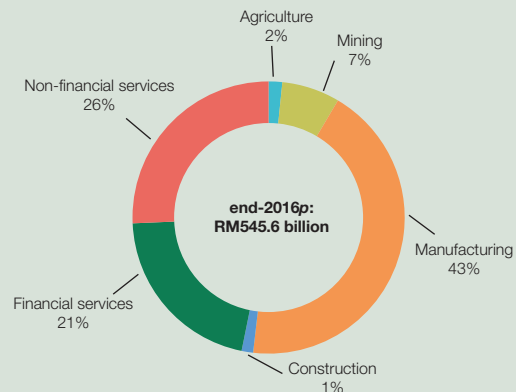
**Direct Investment Abroad Position by Sector**



p Preliminary  
Source: Department of Statistics, Malaysia

Chart 7

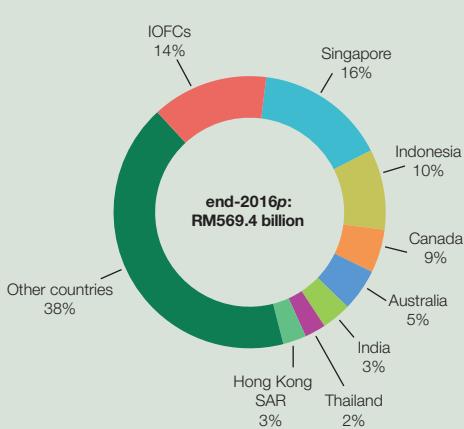
**Foreign Direct Investment Position by Sector**



p Preliminary  
Source: Department of Statistics, Malaysia

Chart 8

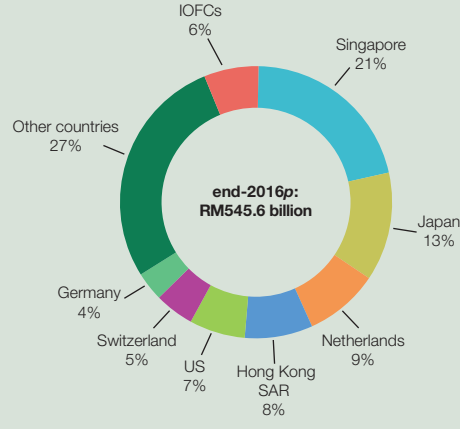
**Direct Investment Abroad Position by Country**



p Preliminary  
Note: IOFCs refer to International Offshore Financial Centres  
Source: Department of Statistics, Malaysia

Chart 9

**Foreign Direct Investment Position by Country**



p Preliminary  
Note: IOFCs refer to International Offshore Financial Centres  
Source: Department of Statistics, Malaysia

went to the International Offshore Financial Centres (IOFCs), where investible funds were pooled before being redirected to economic sectors in various other locations (Chart 8). On the other hand, a larger share of FDI is sourced from the advanced economies directly, namely Japan, Netherlands, United States and Switzerland, followed by the regional economies such as Singapore and Hong Kong SAR (Chart 9).

**Assessing the Returns from Malaysia's Direct Investment Abroad**

In evaluating the returns of DIA on the economy, both the direct and indirect benefits must be considered. Typically, countries that have a large number of home-grown multinational corporations (MNCs) enjoy positive spillover benefits in the form of greater productivity growth from enhanced firm competitiveness; higher wages and inward remittances from employment opportunities abroad; and the formation of backward linkages in terms of input sourcing from its domestic operations and other local firms. However, recent studies for Malaysia<sup>3</sup> suggest that evidence of these benefits was

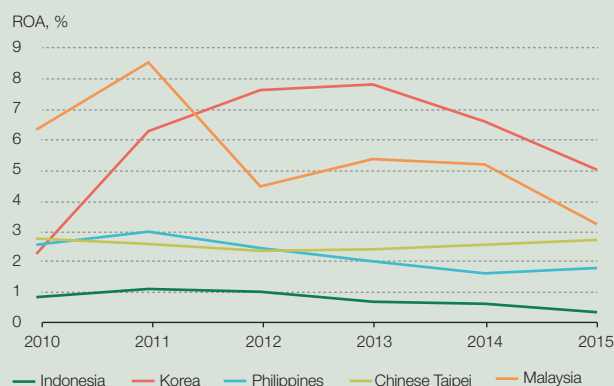
<sup>3</sup> Empirical studies on the impact of DIA on economy by Goh and Wong (2014), Goh et al (2013), Wong (2013) and Chen et al (2012).

inconclusive and would only potentially materialise over a longer timeframe. These studies allude to the fact that Malaysia's DIA has limited scope for backward linkages as it is largely in the services rather than manufacturing sectors. The inability of local suppliers and small and medium enterprises (SMEs) to meet the varied procurement needs of outward bound Malaysian firms was possibly another constraint hindering deeper backward linkages. The studies also demonstrated that the channelling of domestic savings for investment abroad occurred because of relatively low growth in domestic capital formation, particularly from 2005 to 2009. Nevertheless, the sustained inflows of FDI and the revival of domestic capital spending since 2010, particularly by the private sector<sup>4</sup>, were more than sufficient to offset the upward trend in DIA.

The direct benefits of DIA can be measured in a more straightforward manner. From a profitability perspective, a firm's DIA performance can be assessed from the amount of income generated or the return on assets (ROA) arising from its investments abroad. As a percentage of outstanding DIA stock, the direct investment income<sup>5</sup> of Malaysian corporations has fared better compared to some regional peers (Chart 10), underscoring their relative competitiveness. In 2016, the ROA of Malaysia's DIA was 3.5%. This means that an income of RM3.50 is generated for every RM100 invested abroad. Nevertheless, in recent years, the returns have trended downwards in tandem with its regional peers, reflecting the more challenging global economic environment.

Chart 10

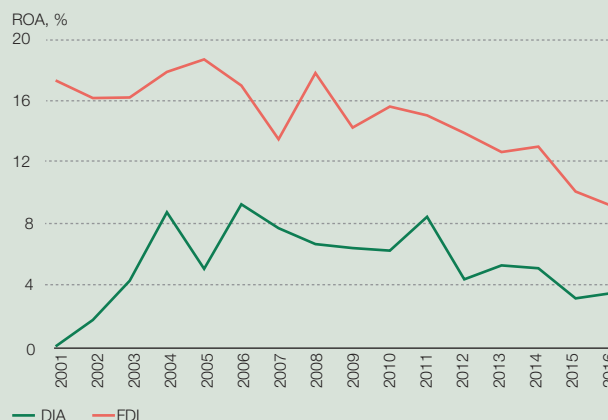
**Returns on DIA of Selected Asian Economies, 2010-2015**



Source: Haver, Department of Statistics, Malaysia and Bank Negara Malaysia estimates

Chart 11

**Returns on Malaysia's DIA and FDI, 2001- 2016**



Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

An alternative approach in assessing DIA returns is to benchmark against the performance of FDI in Malaysia. Chart 11 shows that DIA generated much lower returns compared to its FDI counterpart, though the latter also has been trending downwards. In level terms, the amount of income generated by DIA is also lower than FDI, with the divergence most apparent in the manufacturing, financial and non-financial services subsectors. DIA companies have also repatriated a smaller share of their income to their parent companies, compared to their FDI counterparts (Chart 12). This deficit in the direct investment income account, along with the structural deficits in the services and secondary income accounts has led to a narrowing of Malaysia's current account surplus. It should be noted that Malaysia is not unique in experiencing investment income deficits as several other regional countries with large FDI presence also share a similar characteristic (Chart 13). This is attributable, in part, to the rise of global value chains over the past several decades, whereby multinational corporations (MNCs) had diversified their presence by investing and operating in various stages of production across countries in the region, thus reaping the benefits of improved cost optimisation and profitability through specialisation and greater economies of scale.

<sup>4</sup> For a more detailed account, please refer to Box Article on 'Debunking Malaysia's Investment Myths' in Bank Negara Malaysia's Annual Report 2014 and 'Private Investment in Malaysia: Drivers and Sustainability' in Bank Negara Malaysia's Annual Report 2012.

<sup>5</sup> The receipts of direct investment income measures the returns accrued to Malaysian corporations from their investment abroad. It consists of earnings from the firm's productive activities in the current period that may be distributed in the form of dividends or reinvested into the firm's operations, plus interest on intercompany debt.

Chart 12

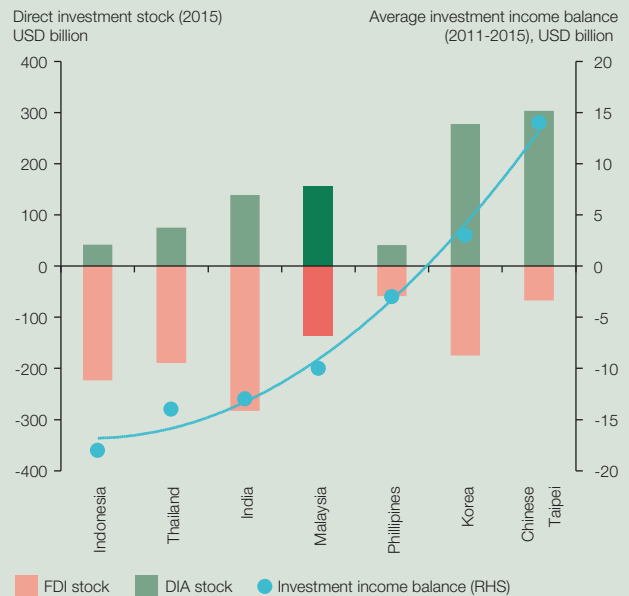
**Average FDI and DIA Investment Income Generated and Repatriated by Sector, 2010-2016**



Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

Chart 13

**Direct Investment Stock and Average Investment Income Balance of Selected Regional Peers, 2011-2015**



Source: UNCTAD, Haver

The differences in the rate of returns between DIA and FDI can be attributable to several factors<sup>6</sup>. The first is the timing and level of maturity between domestic and foreign firms in the global arena<sup>7</sup>. Although Malaysian corporations are market leaders domestically, most are at a relatively nascent stage of venturing abroad in terms of organisational capacity and managerial experience. DIA, which only began in earnest during the 1980s and 1990s<sup>8</sup>, were undertaken mainly by public corporations in the mining and agriculture sector. Since the mid-2000s, private sector participation has increased significantly, expanding mostly in the services sector. By contrast, FDI is led by large MNCs which have established a longer presence in Malaysia. It is worth noting that several reputable foreign financial institutions have been in existence in Malaysia as early as the 1880s, while rapid industrialisation in the 1970s witnessed the influx of Japanese and US investments in the manufacturing sector. As these MNCs possess more recognisable brands, intellectual property assets, better supply chain management and a wider customer base, they are able to obtain a steadier and higher income stream.

The second factor is the divergence in underlying investment motivations. There are a host of reasons that can influence a firm's decision to expand beyond its shores. Based on research<sup>9</sup>, firms most often are seeking natural resources, markets, production efficiency, strategic assets, or some combination of these. In this respect, Malaysia's DIA is driven mainly by market-seeking and resource-seeking motives, whereas FDI is primarily influenced by efficiency-seeking purposes. Being new entrants into the host country, Malaysian firms in the finance and insurance, information and communication and utility sub-sectors (comprising 47% share of DIA) tend to incur high start-up costs,

<sup>6</sup> Adapted from 'On Returns differentials' (Curcuru et al, 2013).

<sup>7</sup> Firms' years of experience in foreign markets are considered a key measure of international competitiveness, in addition to geographical and product variety, and share of foreign operations (Clarke et al, 2013).

<sup>8</sup> For a more detailed account, refer to Box Article on 'Malaysia: Trends in Direct Investment Abroad' in Third Quarter 2006 Bank Negara Malaysia's Quarterly Economic Bulletin.

<sup>9</sup> Research has identified four key motivations for direct investment (USAID, 2005 and Dunning, 1980). They are: 1) *Natural resource-seeking* – to access to a natural resource not available in the company's home market; 2) *Market-seeking* – to gain access to new customers and export markets; 3) *Efficiency-seeking* – to reduce production costs by gaining access to competitively priced input and labour; and 4) *Strategic asset-seeking* – to gain strategic assets in another economy, such as brands or new technologies.

prioritising brand-building strategies over better margins in order to attract customers and gain market share. They also undertake strategic acquisition of established players in the host country to accelerate their footprint expansion process. Similarly, DIA in the mining and agriculture sector (24% and 8% share of DIA, respectively) often involves large expenditure to acquire oil fields and plantations, obtain exploration and land rights and develop the necessary infrastructure. Compounded by fluctuations in global commodity prices, a longer gestation period is therefore needed to recoup these initial capital outlays before it yields steady returns. On the other hand, FDI in the manufacturing sector (43% share of FDI) tends to have a shorter time to maturity. The outperformance of MNCs in export-oriented industries are supported, in part, by their cost-effective supply chain network optimisation strategies, better utilisation of technology and the adaptation into the faster-growing and higher value-added segments.

Third, the macroeconomic and business conditions of the host country also affect the degree of returns. As DIA is channelled into diverse countries, particularly the developing and emerging economies, they are also subjected to the various risks associated with doing business in those markets. These include the growth outlook, level of economic and financial sector development, business regulations, government policies concerning protectionism and liberalisation of industries as well as geopolitical developments. On the other hand, Malaysia has long been favoured as a competitive destination and profit centre for foreign investment, underpinned by pro-business policies, strong rules of protection for foreign investors, educated workforce, sizeable upper middle-income class, well-developed infrastructure and attractive incentives. This can be attested by Malaysia's favourable rankings in international competitiveness surveys such as the World Bank Doing Business Survey (2017: 23rd position), World Economic Forum Competiveness Index (2016 - 2017: 25th position) and the AT Kearney Global Services Location Index (2016: 3rd most attractive location for offshore operations). Thus, MNCs are able to execute their investment plans with a high degree of certainty and predictability, resulting in a shorter time frame between the initial capital injection and when income is eventually realised.

### Strategies to Unlock Greater Payoffs from DIA

While underlying structural factors explain the divergence in the rate of returns between DIA and FDI, it is important to note that this gap should narrow over time as the investments abroad by Malaysian corporations eventually mature. Moreover, there is scope to generate greater returns at the firm-level and optimise the intended spillover benefits to the wider domestic economy. To accomplish this, outward bound Malaysian firms should enhance their synergies with domestic operations and local suppliers, thus strengthening the development of backward linkages. For example, the growing presence of Malaysian firms involved in infrastructure and real estate projects overseas should not only be a conduit for greater procurement of locally produced materials and inputs, but also for ancillary service providers such as architecture and design, project management and consultation, legal and financial services. Domestic SMEs should also bolster their competitiveness by continuously moving up the value chain and exploring opportunities abroad. For example, industries that are heavily reliant on foreign labour such as garments, wood and plastic products could shift their production base to other countries with lower labour costs, while retaining their operational headquarters in Malaysia. In this regard, the success of countries such as Korea in promoting their SMEs to invest abroad can be emulated through facilitation and advisory, dissemination of information and a recalibration of incentives. Lastly, subsidiaries of Malaysian corporations abroad should make concerted efforts to raise their operational efficiencies, identify niche markets and innovate continuously.

### Conclusion

The increasing DIA trend is expected to continue in line with Malaysia's broader economic development and the deepening integration with the global economy and financial system. Despite the greater number of Malaysian corporations going abroad, the commensurate returns have yet to be fully realised. While Malaysia's DIA has generated better returns compared to some regional peers, there remains a structural underperformance against its FDI counterpart. Hence, the ability to generate greater payoffs from their investments abroad going forward is critical both from a macroeconomic standpoint as well as to achieve a more sustainable rate of return over the longer term. In this regard, there is a need for outbound Malaysian firms to continuously move up the value chain and secure their foothold in the ever shifting global business landscape. This would help in equipping Malaysian corporations to compete and even thrive in international markets, and produce the desired spillover benefits for the Malaysian economy.

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