MALAYSIA: TRENDS IN DIRECT INVESTMENT ABROAD

I. Introduction

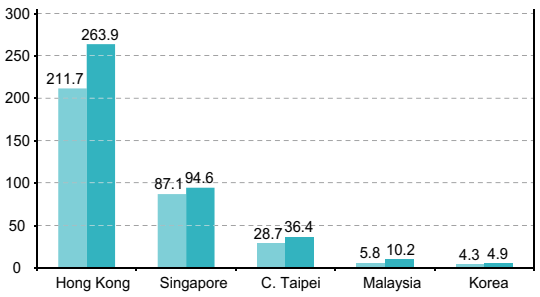
Since 1990s, developing countries have increasingly become significant exporters of capital. In the Asian region, Malaysia is the fourth largest exporter of capital after Hong Kong China, Singapore and Chinese Taipei. Malaysia's stock of outward direct investment rose from a low of 0.8% of GDP in 1980 to 5.8% in 2001, and further to 10.2% of GDP in 2005 (Chart 1). The liberal foreign exchange administrative rules, high domestic savings rates and a history of strong economic growth that led to the rising accumulation of wealth among domestic companies have accorded companies in Malaysia the flexibility to invest abroad. The rising direct investment abroad has yielded positive results, as reflected in the increasing profits and dividends accruing to the Malaysian companies investing abroad, particularly since 2002. This article examines the trend in direct investment abroad[1] by companies operating in Malaysia during 1999-2005 based on Cash Balance of Payments (CBOP) data of Bank Negara Malaysia, which includes the outflows of funds that are effected through the banking system, inter-company accounts and overseas accounts.

II. Overview of Malaysia's Direct Investment Abroad

Direct investment abroad by Malaysia has been broad-based, with companies[2] investing in almost all economic sectors in more than 100 countries. Gross capital outflows for investments abroad ranged between 2% and 4% of GDP during the period 1999-2005 (Chart 2). Investments in the earlier years were undertaken primarily by the government-

Chart 1

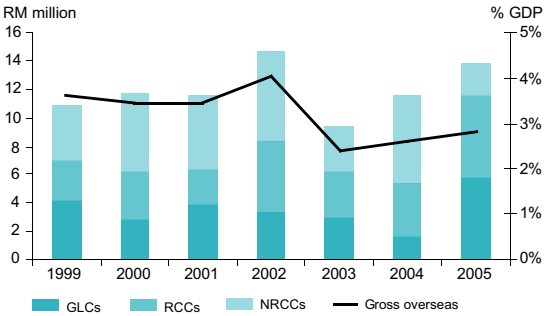
Stock of Outward Direct Investment (% GDP)



Source: National sources; Department of Statistics, Malaysia

Chart 2

Gross Outward Direct Investment Flows



Source: Bank Negara Malaysia

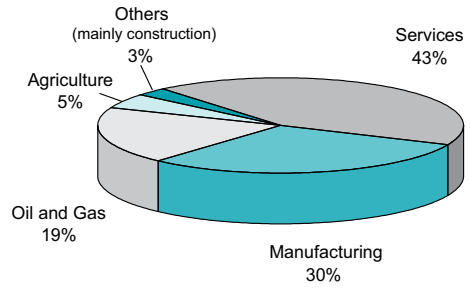
1. According to the IMF's Balance of Payments Manual, Fifth Edition, direct investment abroad is a form of direct investment, whereby companies invest abroad with the intention of obtaining a lasting interest (defined as holdings of at least 10% ownership) in an enterprise resident of another economy. In Malaysia, data on direct investment abroad 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 outflows 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.

2. For analysis purposes, companies are classified into GLCs (non-financial public enterprises in which the Government has an equity of more than 50% and with sales turnover of at least RM100 million), 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%).

linked companies (GLCs), seeking access to natural resources such as oil and gas as well as in the agriculture sector. However, in recent years, private non-GLC companies have become increasingly active overseas investors. These investments have been driven by a variety of reasons including securing market access; gaining access to raw materials, strategic assets, brands and technology; as well as decentralisation of operations to diversify risks and improve returns. The emergence of the new low-cost economies has also provided options for companies with high labour-dependency to restructure and realign corporate operations on a global scale to remain competitive. While Malaysia continues to encourage and attract FDI into the country, the Government is also playing an active role to facilitate companies' initiatives to venture abroad. The Malaysian government has embarked on several collaborative measures with other governments to expand and deepen economic and industrial co-operation via bilateral arrangements as well as through negotiations for Free Trade Arrangements. Thus, over the years, the scope of Malaysia's investment abroad has broadened from just the oil and gas explorations and extractions and oil palm plantations to other industries, including telecommunications, banking and finance, infrastructure and property development, manufacturing, power generation and retail-related industries (Chart 3).

Chart 3

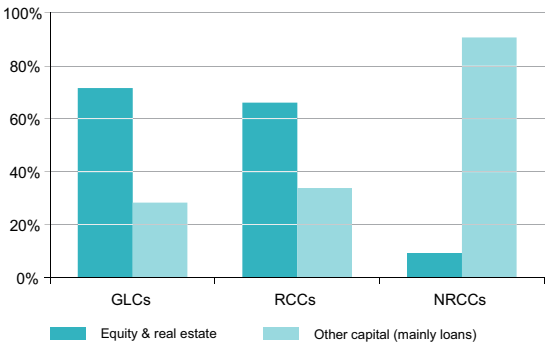
Outward Direct Investment by Sector (1999-2005)



Source: Bank Negara Malaysia

Chart 4

Outward Direct Investment by Type (1999-2005)



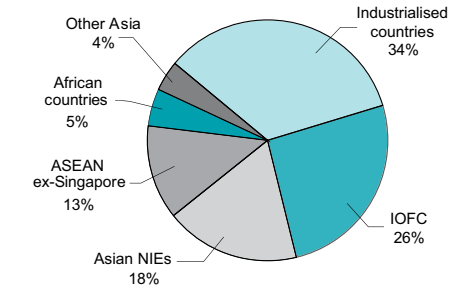
Source: Bank Negara Malaysia

Outward direct investments by the Malaysian-controlled companies (GLCs and resident-controlled companies, RCCs) were undertaken mainly via acquisition of equity stakes and joint-ventures with foreign partners abroad, including investment in greenfield projects (Chart 4). The bulk of these investment flows (around 70%) were for equity investment and real estate acquisition. Meanwhile, the bulk of the non-resident controlled companies' (NRCCs) investments were in the form of extension of inter-company loans (90%) to related corporations abroad. Despite the differences in the mode of investment, most of the companies were prudent in financing their overseas ventures. Internally-generated funds financed the bulk of NRCCs' overseas investment, while investments by RCCs and GLCs were sourced mainly from internal funds (62%) and offshore borrowings (26%).

In terms of geographical distribution of overseas investments, most of the investments were channelled to the more developed economies such as the industrialised countries (34%) and Asian NIEs (18%) (Charts 5 and 6). Investment in the developing economies were conducted primarily by the GLCs and RCCs, with the bulk of the investments being channelled to the ASEAN and African regions as well as selected countries in other parts of Asia (such as PR China, India, Sri Lanka, Pakistan and some West Asian countries). Compared with the other destinations, investments to the developing economies registered the highest growth rate (25%), with its share of total investment rising significantly from 13% in 1999 to 31% in 2005. There were also significant investment outflows to the international offshore financial centres, IOFCs (26% share), including Labuan IOFC, where investible funds were pooled before redirected to other economic sectors in various locations in the world.

Chart 5

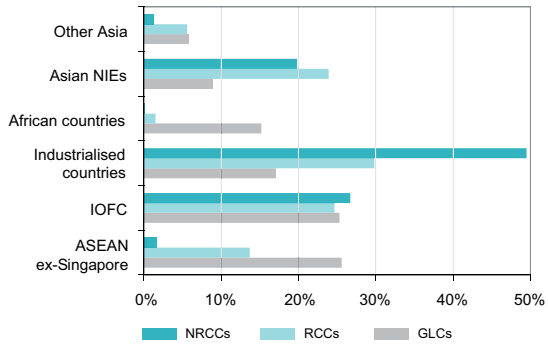
Outward Direct Investment by Region (1999-2005)



Source: Bank Negara Malaysia

Chart 6

Outward Direct Investment by Region and Type of Investor (1999-2005)



Source: Bank Negara Malaysia

III. Investment Trends of Malaysian-Controlled Companies

Investments by both private RCCs and GLCs together accounted for 61% of total gross outflow of funds for direct investment abroad during the period 1999-2005. The bulk of the investment was effected by companies in the services sector (48%), followed by mining (31%), agriculture and manufacturing sectors (8% each). The GLCs were the dominant investors in the oil and gas, and the telecommunication industries, while the RCCs were the main driver for investments in the manufacturing, utilities, distributive trade, leisure, plantation, construction as well as banking and finance industries.

Within the **services** sector, investment in the finance, insurance and business services sub-sector was the largest (43%), followed by transport, storage and communications (20%), utilities (20%), and distributive trade, hotels and restaurants (12%). 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. In addition, several

financial institutions have also ventured abroad to gain a foothold in the regional or international stockbroking and investment banking businesses. Investment in the ***transport, storage and communications*** sub-sector was conducted mainly by companies in the telecommunication industry, via acquisitions and joint-ventures with foreign telecommunication companies from diverse locations including Indonesia, Thailand, France, Sri Lanka and Bangladesh. These investments were motivated particularly by the enormous growth potential given the largely untapped markets in some of these countries. In the ***utilities*** (electricity, gas & water) sub-sector, major investments included the acquisition of regulated assets such as water services companies and power plants abroad. The national power company has also set out and initiated joint-venture partnerships in power projects across Asia as one of its initiatives to strengthen the ASEAN power grid through the optimisation of regional resources.

In the ***wholesale and retail trade, hotels and restaurants*** sub-sector, a significant portion of outward investment was in the distributive trade and hotel industries. The bulk of the investments went to the industrialised countries and the East Asian region, given the anticipation of a strong and improving growth outlook in those economies. This was further supported by the positive demographic attributes and rising incomes of the population which would provide a lucrative set of expanding customer base. Wholesalers that invested abroad specialised mainly in electrical and electronic (E&E) products, building materials, miscellaneous agriculture products such as rubber and timber, while retailers comprised largely those selling general merchandise, computer hardware and software and various household products.

Malaysia's investment abroad in the **mining** sector was conducted primarily by the national oil company, a GLC. Underpinned by the vast knowledge and experience in the domestic oil and gas exploration and extraction activities, and the anticipation of higher global energy demand, the company embarked on a strategy of global diversification and expansion. The successful global upstream ventures have also boosted the company's revenue and international oil and gas reserves. During the period 1999-2005, the company has made petroleum-related investments in many locations in Africa, West Asia, industrialised and ASEAN countries. The investments were mainly for upstream oil and natural gas exploration and extraction activities, largely undertaken jointly with national oil companies in the host countries.

Meanwhile, investments in the **agriculture** sector were largely for oil palm plantations. For more than a decade, Indonesia has been and continued to receive a large share of investments from Malaysia for oil palm cultivation. Given the rising demand for palm oil products globally, and with Malaysian companies' experience and technical capabilities in plantation management and production of crude palm oil, companies are expected to continue venturing abroad to acquire plantation land to augment their total acreage to reap the benefits of economies of scale.

In the **manufacturing** sector, many private RCCs, which originally entered foreign markets as exporters, have increasingly evolved into manufacturers abroad, seeking investment opportunities that will maximise value within their risk-return framework globally. 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%). Industrialised countries and Asian countries received the bulk of investments in the ***fabricated metal products, machinery and equipment*** group, which comprised industries that manufacture electrical appliances and household equipments (e.g. radio, television, semiconductors and other electronic components), and industries related to transport equipment. Companies in the ***food, beverage and tobacco industries*** also invested in the industrialised countries and the East Asian region although some, such as sugar factories and refineries preferred to go through the IOFCs. Meanwhile, investments in the ***chemical and petroleum-related industry,*** in particular plastic products, rubber and chemical-related industries were concentrated in the ASEAN region, with Thailand, Indonesia and Vietnam as key countries.

Manufacturers' investments abroad were underpinned by many reasons, but the E&E manufacturers were attracted mainly by the opportunity to be low cost producers abroad. Thus, the companies adopted the multinational companies' strategy of hiving off and relocating their resource-intensive operations into low-cost locations abroad to maintain product competitiveness. Other companies which have acquired interest in or formed joint ventures with foreign counterparts abroad were able to scale up the production value chain and also have an integrated supply chain management. The desire to acquire physical assets such as manufacturing facilities, high technology and management expertise, brands and trademark rights to established products or vital resources were also the driving force for the companies to venture abroad. To seize the advantage of being in close proximity to clients and markets, companies in the food and beverage industry set up their factories in high-growth developing economies, capitalising on cheap resources and sustained high demand for processed food in tandem with the general rise in income.

Meanwhile, Malaysian **construction** and property development companies have been making inroads abroad. Motivated by the need to search for new revenue sources outside Malaysia, their investments have been broad-based ranging from acquisition of construction companies particularly in UK and Hong Kong China, to infrastructure concession and property development projects in the developing economies of Asia and Africa, particularly in India, South Africa, PR China, Cambodia and Indonesia. Backed by a good track record and expertise in civil engineering and property development and management, these Malaysian companies have, despite intense competition, successfully secured large development projects such as road, bridge, port and airport development as well as other smaller scale projects like residential and urban townships, and other development projects in the water, oil and gas sectors.

IV. Investment Trends of Non-Resident Controlled Companies

During the period 1999-2005, about 39% of total gross outflows of funds for investments were attributed to the NRCCs. Nevertheless, the share of NRCCs to total investment flows has declined over the years from 35% of total overseas investment in 1999 to 17% in 2005, due largely to the increased participation of GLCs and private RCCs in overseas investment. The bulk of investment outflows by NRCCs were in the form of inter-company loans to related companies abroad (91% share), attributed mainly to the excess funds generated from their successful operations in Malaysia. Companies in the **manufacturing**

sector accounted for more than 60% of investment flows. Within the manufacturing sector, most of these loans were extended to the related companies in the manufacturing of semiconductor and other electronic component industry (53%) and the manufacturing of radio, television sets, video recorder and other equipment industry (20%). The bulk of these outflows were channelled to the US, Singapore and Belgium.

V. Policies Concerning Direct Investment Abroad

Malaysia maintains a liberal regime on overseas investment. Prior to the Asian crisis, residents without domestic borrowing can freely remit any amount in foreign currency for overseas investment, while individuals and corporate groups with domestic borrowing were respectively allowed to invest abroad up to the equivalent of RM100,000 and RM10 million per calendar year. Where approval was required, the investment must bring economic benefits to Malaysia such as assisting Malaysia to gain market access, encourage use of Malaysian inputs (raw materials, parts and components), assist in exporting Malaysian products or services and/or involves transfer of technology and know-how to Malaysia. During the period following the Asian crisis, the policy stance remained liberal although there was requirement for resident investors to obtain prior permission. In April 2005, the rules regarding overseas investment were further relaxed, and overall, the guidelines were more liberal than those prevailing prior to 1 September 1998. Resident companies with domestic borrowing are allowed to invest abroad using foreign currency funds maintained in Malaysia or offshore. In addition, resident companies are also allowed to hedge the foreign exchange risk of their existing and new overseas investments.

Equally important, investments abroad were also facilitated by the Malaysian government's active participation in regional and international fora to deepen economic and industrial co-operation. Other initiatives include the provision of fiscal incentives as well as non-financial support, such as advisory and consultancy services for securing construction projects abroad. The recent Budget 2007 also outlined some measures to help create Malaysian-owned MNCs with global operations. These include an increase in the paid-up capital of EXIM Bank by RM2 billion by the Government 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. In addition, Bank Negara Malaysia has also set up a RM1 billion Overseas Project Financing Fund at the EXIM Bank in 2006 to assist Malaysian companies bidding and securing contracts overseas to have greater access to financing in undertaking their projects abroad.

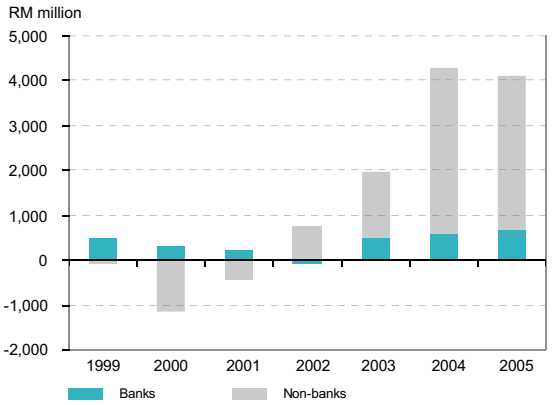
VI. Benefits from Overseas Investment

Given that overseas investment is a long-term investment, conducted in less familiar terrain and subjected to various external risks, such as change in government policies (including ownership laws), exchange rates movements, adverse weather conditions, sudden political changes and competition with international and domestic market players in the host country, the returns on investments would only be realised over a longer timeframe.

Total profits, dividends and interests accrued to Malaysian companies that have invested abroad grew from RM0.4 billion in 1999 to RM4.1 billion in 2005 (Chart 7). The improvement reflected mainly the sharp recovery in profit and dividends accrued to the non-bank sector, while profits and dividends accrued to the banks remained stable. Overall, total direct investment income earned accounted for about 26% of total investment income inflows (which include portfolio and other non-FDI investments) in 2005.

Chart 7

Profits and Dividends



Source: Department of Statistics, Malaysia

VII. Conclusion

Going forward, overseas investments would continue to increase in line with the long-term economic trend whereby increasingly affluent economies would progressively look beyond their shores to augment domestic economic growth and assets. This would be further supported by forces of globalisation and greater liberalisation of investment rules globally. For Malaysia, the Government would continue to adopt a positive stance towards overseas investment, both to support the interest of freer capital mobility and to improve the overall competitiveness of Malaysia corporations. For the corporate sector, opportunities beyond national borders are abundant and overseas investment would be increasingly regarded as an important strategy to maximise company's total growth in terms of revenue, profit and export market share.