

Four-point strategy could spur foreign- direct-investment growth in Malaysia

With a renewed focus on its foreign-direct-investment policies, Malaysia could better compete for the financial resources that have spurred economic development across Asia.

by Ee Huei Koh, Kenneth Koh, and Nimal Manuel



From China to Singapore, foreign direct investment (FDI) has shown itself to be a strong force in economic development. Along with infusing a domestic economy with capital, FDI can provide access to overseas markets, technology, and expertise. To capture these benefits fully, Malaysia could consider reexamining its approach toward overseas investors. Our experience and research suggest four promising policy imperatives to reach this goal.

Based on information in the United Nations Conference on Trade and Development *World investment report*, growth of FDI in Malaysia over the past ten years has been weak compared with that of many of its neighbors.¹ Since 2008, FDI in Singapore grew at about 18 percent a year, reaching \$62 billion in 2017; FDI in Indonesia grew at 9 percent a year, reaching \$23 billion in 2017; and FDI in Vietnam grew at 4 percent a year, reaching \$14 billion in 2017. Foreign investment in Malaysia during the period grew just 3 percent annually, reaching only \$9.5 billion in 2017. Recently released figures from the Department of Statistics Malaysia indicate that FDI decelerated further, to \$8 billion, in 2018. However, we see promising signs in the more recent increase in approved investments.

Undoubtedly, trends such as slowing global FDI flows and greater global uncertainty play roles in Malaysia's lower growth rate. But Malaysia's relative performance compared with many other Southeast Asian countries suggests intrinsic challenges that should be addressed if the country is to compete more effectively for investment inflows.

Bank Negara Malaysia has outlined several fundamental concerns surrounding the country's traditional approach to FDI. The central bank's 2017 annual report highlighted indications that the net economic benefits of FDI in Malaysia may be diminishing, particularly in light of slower growth of domestic content in exports and lower R&D spending by foreign companies in the country.²

The central bank added that the effectiveness of Malaysia's policies to attract foreign investment

is unclear. Broad-based investment incentives represent up to 9 percent of total tax revenue, yet a mismatch appears to be developing between the investments the country is receiving and the industries it has targeted for growth. For example, FDI in the real-estate and construction sector has tripled in terms of share between 2010 and 2017. However, these investments are channeled mainly to the higher-end segment and have limited spillover effects in the broader economy.

FDI should be encouraged for prospective investments that deepen linkages in the domestic supply chain and that build new growth clusters. Targeted investments should, for instance, help create high-skilled jobs, as well as expand knowledge transfer and product sophistication.

Drawing from observations and studies in economic development and FDI globally, four policy imperatives could be powerful in accelerating FDI growth and capturing greater benefits in Malaysia:

- *Reassess FDI strategy and priority sectors.* The government could rethink its FDI strategy and chart a deliberate path for long-term benefits. The strategy should focus on sectors that have strong growth and employment prospects, that exploit Malaysia's natural strengths, and that promise demonstrable economic benefits, including those that are less tangible, such as technological adoption. Singapore's evolving yet explicit focus over the past decades—export-oriented industries in the 1970s, technology-intensive manufacturing in the 1980s, knowledge-based manufacturing and services in the 1990s, and innovation-driven enterprises now—is an example of how this strategy can be set, executed, and refreshed over time.
- *Build unique, deal-focused value propositions.* Companies invest in deals, not in countries. Beyond offering typical incentives, the government could present a strong value proposition to targeted investors. The proposition needs to include infrastructure and

¹ *World investment report 2018: Investment and new industrial policies*, United Nations Conference on Trade and Development, June 6, 2018, unctad.org.

² *Annual report 2017*, Bank Negara Malaysia, March 28, 2018, bnm.gov.my.

access to readily available talent and supply-chain ecosystems that meet the investor's specific requirements. Essentially, each investment prospect should be treated as a deal, with concessions tailored to the targeted investor's needs. This does not need to mean a higher quantum of incentives. It rather means taking a long-term view in designing incentives in a way that ensures the long-term benefits largely compensate for the cost of incentives—as well as the impact from profit repatriation.

- *Focus investment-promotion activities.* A more proactive approach can increase the impact of agencies tasked with promoting FDI. High-caliber officers at these agencies must be able to build and maintain lists of targeted investors, monitor relevant sectors, and gather the intelligence needed to understand when and how to approach individual companies. Agencies must also foster clear ownership and accountability for attracting targeted companies—in practice, shifting to much more of a B2B-sales approach.

- *Ensure end-to-end support for committed investments.* Globally, more than half of approved investment projects are abandoned, and this tendency is likely echoed in Malaysia. To help bring more investment plans to fruition, it is important to provide support throughout the project. End-to-end support would include investor-relationship management, help in navigating regulatory procedures, and assistance in securing land, among other activities. In addition, unsuccessful deals should be routinely analyzed to understand how they were derailed and how to mitigate any problems uncovered.

Countries around the world are competing for a finite pool of foreign investment. In recent years, Malaysia has been struggling amid this crowd as it sought to boost FDI growth. A new, supply-focused policy framework that provides tailored support for targeted companies and sectors can help lift the country above this crowd.

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