

# **CHAPTER 1**

## **INTRODUCTION**

The Bumiputera-controlled company first existed when the government initiated the Malaysian New Economic policy in 1970. The aim of the policy was to stabilize the nation after the incidents of racial violence on May 13, 1969. Under the Second Malaysia Plan, the government restructured society through various strategies such as the redistribution of income and ownership, the restructuring of employment patterns based on racial origins and also the development of a Malay industrial and commercial society. These strategies in the Second Malaysia Plan led to the emergence of Bumiputera-controlled companies in Malaysia.

The number of Bumiputera Companies listed on the KLSE has increased from year to year. This was the outcome of the National Development Policy, which was initiated in 1990. One of the main objectives of the NDP is to increase the holding of Bumiputera equities and their participation in the modern corporate sector. Statistics from the KLSE showed that the percentage of individual Bumiputera holding equities was only 8.2% in 1990 as the actual Bumiputera holdings were through Government agencies and institutions. However, according to the Securities Commission chairman, in the first eight months of 1999, there were 142 Bumiputera Companies listed on the Main Board while there were 62 Bumiputera Companies on the Second Board. Bumiputera holdings were less than 5% in 1971 but between 1996 and 1998 holdings were 40% of the nominal equity value of the KLSE.

In order to increase the Bumiputera participation in the modern corporate sector, Bumiputera companies were encouraged by the Securities Commission to seek listing on the KLSE. This was because through the KLSE, the Bumiputera companies could develop and grow better. The KLSE offers flexibility to the Bumiputera companies as most of them are not family-owned business and do not have a long business history. Flexibility in compliance with the listing requirements is given by the Securities Commission for Bumiputera-controlled companies that have pooled together for listing on the KLSE. However, they must fulfill a number of conditions such as having a genuine pooled arrangement, having been in business operation for at least 5 years, having more than 50% of Bumiputera equity ownership and having been under the control of the same Bumiputera shareholders with a controlling shareholding for at least 3 years and being maintained as a Bumiputera controlled company.

### **1.1 Currency crisis**

The Malaysian stock market ranked third in Asia after Japan and Hong Kong in early 1997. However, the Kuala Lumpur Stock Exchange was affected by the currency turbulence due to the contagious effects of speculative activity on the Thai Baht from mid-May 1997. Based on the data from the economic report in 1997/1998, the stock market in Malaysia started to have a downward trend in July 1997 as the KLCI fell below its psychological level of 1,000 points. Panicking investors throughout Southeast Asia were dumping the Thai Baht, the Indonesian Rupiah and also the Malaysia Ringgit. The foreign investors in Malaysia had a large amount of investments, but started to take out their funds from the country because they were afraid that they might incur losses.

Based on the Economic Report of 1997/98, the stock market prices fell in most sectors especially in the construction sector. In September 4, 1997 the KLSE CI touched its lowest level since 20 April 1993 of 675.15. Datuk Seri Anwar Ibrahim,

as the finance minister during that time, realized that the meltdowns of the economies of Thailand and Indonesia were due to their excessive borrowing and big trade imbalances and this might also happen to Malaysia as the situation was similar. In September 5, 1997 the Government postponed big infrastructure projects such as the Bakun Dam, a Northern Regional International Airport and the Highland Highway. The Government also announced certain other measures that could improve the fundamentals of the economy such as cutting 2% off Government expenditure, reviewing the purchases of foreign goods by Government agencies, providing only Proton cars to eligible public officials, and increasing the use of local content in privatised projects. The announcement improved the market sentiments and the KLCI rebounded to 814.57 at the end of September 1997. However, the market dropped again as the crisis deepened.

The government set up the National Economic Action Council in order to find a solution for the crisis. And on September 1, 1998 capital controls were introduced. In Malaysia the currency crisis deepened when the Kuala Lumpur Stock Exchange Composite Index (KLSE CI) fell sharply to as low as 262.7 points from 1,077.3 points in June 1997, when the Government implemented exchange control on 1<sup>st</sup> September 1998.

## **1.2 Objectives of Study**

The objectives of this study are:

1. To analyze the market performance of the Bumiputera-controlled companies before and during the crisis.
2. To compare the market performance of the Bumiputera controlled companies with the non-Bumiputera companies during the crisis.
3. To compare the performance of high leveraged and low leveraged Bumiputera companies due to the crisis.

In order to see the effect of the currency crisis, this study analyzed the performance of the Bumiputera controlled company before and during the crisis. The expected result of this study is that most of the Bumiputera companies suffered during the crisis because of debt problems. This paper also compares the performance of the Bumiputera owned companies with the non-Bumiputera companies. If the results of this study indicate that the Bumiputera companies performed better during the crisis compared to non-Bumiputera companies, then this can be attributed to the efforts of the Government to help the Bumiputera entrepreneurs. This study also concentrates on the high leverage Bumiputera companies and compares them with low leverage companies in order to prove the hypothesis that high leverage Bumiputera companies suffered more during the financial turmoil.

### **1.3 Contribution**

The findings of this study can provide an overview of the achievement of the National Development Policy with respect to the Bumiputera Group. When the currency crisis hit Malaysia, almost every sector was affected, with Bumiputera companies being hurt as badly as their non-Bumiputera counterparts. This study is expected to show how serious the impact of the currency crisis was on the Bumiputera companies. Seeing that there was effective help given to the Bumiputera-controlled companies to survive during the bad economic situation, certain parties voiced out some controversy issues such as nepotism, cronyism and bailouts. Some Bumiputera companies were criticized because the Government helped them to survive during the bad times by offering easy access to special forms of funds and Government contracts. How far is this true? Lastly, the study aims to contribute an overview of Bumiputera companies at the KLSE that would survive the economic slowdown. Through this study it was hoped that the Bumiputera companies will be inspired to become a new breed of Bumiputera

entrepreneurs which are hard working, tested, and no longer too dependent on Government assistance.

#### **1.4 Organisation of chapters**

Chapter two discusses the achievement of the New Economic Policy and the New Development Policy in relation to the increasing numbers of Bumiputera listed companies at the KLSE. This paper also reviews previous literature on the performance of Bumiputera entities and Bumiputera policy. This paper touches on the study of Government ownership in the stock market. In order to have a broad view of the currency crisis; the study reviews the research done by various authors in relation to the Asian currency crisis. This paper also looks at the Kuala Lumpur Stock Exchange Composite Index (KLSE CI) study, done by local researchers. It also addresses the recent findings about the impact of the currency crisis on the KLSE CI and Malaysian companies. It addresses a number of theoretical studies such as the seasonality effect, stock return, and leverage.

Chapter three consists of research methodology. First it highlights the hypotheses of this study, and the definition of the data. Second, it discusses the data sources, the sample time period and how the selection of the samples such as Bumiputera companies and non-Bumiputera companies was made. Finally, the paper discusses the data analysis techniques and statistical models used in the study.

Chapter four presents the research results. It discusses the summary statistics of the sample, and the explanation of the results based on the statistical test.

Chapter five contains the conclusion and recommendations.