

# CHAPTER 1: INTRODUCTION

## 1.1 Introduction

In the era of globalisation businesses become more competitive than ever before at all levels; national as well as international levels. Thus, for most corporations world-wide, the question of survival in a highly intense competitive business environment becomes crucial. As a way to overcome this issue, it is important for corporations to increase their R&D activities as a part of strategic planning. In this way, they could improve their existing product range and production process or coming up with totally new products. This is intended to help the companies to maintain their operation, if not increase their market share. R&D is perceived as a vital element in increasing the competitive edge and even the survival of corporations as it may influence future profit. Scherer (1965) found some evidence in support of this hypothesis in a study of 365 firms in Fortune's 500. A more recent study of the relationship of R&D expenditure and profit was undertaken by Sougiannis (1994). The study found that, on average, a one-dollar increase in R&D led to a two-dollar increase in profit over a seven-year period. Although R&D plays an important role in enhancing the organisation's competitiveness, its importance are often overlooked by managers who are too pre-occupied on achieving a satisfactory level of current earnings. This study attempts to determine the R&D practices in Malaysia and the perceptions of Malaysian Finance Directors pertaining to R&D expenditure allocation.

## 1.2 Purpose and Significance of the Study

This study is conducted in the light of an increasing importance of R&D in today's businesses. In spite of the importance of R&D, studies so far undertaken had revealed that the U.S. and U.K managers' concern for current earnings influenced their decisions to involve in R&D activities. In U.K., the directors are concerned with the level of current earnings, as they feel obliged to please the shareholders with high level of returns through the distribution of dividends.

Malaysia is fast emerging from an agriculture-based country to a new industrialised nation. With the effect of globalisation, the effort directed to make the country emerge as a developed nation by 2020 may become even more difficult to achieve. This is due to the fact that Malaysian business would now have to increase its competitiveness at the international level. Enhancing businesses' competitiveness would further contribute toward reducing the chances of losing out in the long term. One of the means that could be undertaken to raise the level of Malaysian companies' competitiveness is to encourage the private sector to be actively involved in research and development activities. The Malaysian private sector involvement in R&D activities so far, seems still to be below the expectation level. According to Multimedia Development Division manager Sharifah Khamseah Syed Aidid, less than one per cent of the country's gross domestic product was being spent on R&D (Business Trends 29/09/1999). An official of Multimedia Development Corporation (MDC) further added that R&D expenditure must be significantly increased if Malaysia aspires to move into knowledge-based economy. (Ibid). It is evident that a more in-depth research is needed in this area.

Realising the importance of private sector engagement in more R&D activities, this study aims to examine and obtain a general understanding of R&D practices in Malaysia. It also tries to obtain the perceptions of Malaysian Finance Directors regarding R&D activities and the factors that may influence these perceptions.

### **1.3 Research Question**

MASB Standard 4: Research and Development had clearly identified distinct treatments for research and development expenditure. Research is defined as original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding. Development on the other hand is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices,

products, processes, or services prior to the commencement of commercial production or use. (MASB 4, paragraph 6 pp. 4-5). The definition given above distinguishes research and development costs. The distinct definitions subsequently give rise to different treatments. According to MASB 4, research costs should be treated as an expense in the period in which they are incurred and should be recognised as an asset in a subsequent period. (Ibid). Development cost on the other hand is to be treated as an expense unless the criteria laid out in paragraph 17 are met. (Ibid).

Since the entire requirement listed in paragraph 17 should be met before the development costs can be treated as asset, research and development costs are usually expensed off in the year it incurred. This results in lower earnings reported in that year. To avoid such thing, the managers would make a decision to reduce the allocation of R&D expenditure to achieve the satisfactory level of current earnings. This is the finding of two studies carried out in U.K. and U.S. (Discussed in Chapter 2: Literature Review). The objective of this study is to find out the situation in Malaysia.

Hence, this leads to the research question;

**"What is the practice associated with R&D in Malaysia and what are the perceptions of the directors regarding R&D?"**

#### **1.4. Organisation of the Study**

The thesis is organised in 5 chapters. Chapter 1 explains the purpose and significance of the study, outlines the research question and describes scope and organisation of the study. Literature review for this research topic is addressed in Chapter 2. Next, Chapter 3 discusses the research methodology, methods and data analysis. Chapter 4 gives an analysis and discussion of research results. Finally, Chapter 5 summarises the study and discusses the conclusion. It also provides suggestions for onward additional research and the implications of the research upon the business community.