CHAPTER TWO

LITERATURE REVIEW

2.1 The Context: Malaysian Economy And The Financial Services Sector

As the process of globalisation and liberalization hastens, and technological development accelerates, the next five years (2001-2005), the period under the Eighth Malaysia Plan, will be a far greater challenging period for the Malaysian economy. To meet these challenges, the government has formulated appropriate policies and strategies, which are embodied in its eighth five-year development plan, i.e. the Eighth Malaysia Plan (8MP) (2001-2005) and also in the Financial Sector Masterplan (2001- 2010) and the Capital Market Masterplan (2001-2010). It is the adoption and implementation of these policies and strategies that will steer and determine the direction and shape of the economy and the financial services sector in the next five years of the 21st century.

Notwithstanding the slowdown anticipated in year 2001, the subsequent four years (2002-2005) will see the economy moving into a higher growth path, bringing growth in real GDP as envisaged in the 8th MP to an average of 7.5% (4.9% in 7th MP, 1995-2000). Although the rate targeted under the present scenario may be ambitious, such a high target is deemed necessary by the government as a stepping stone towards achieving Vision 2020, a goal that needs at least an average real GDP growth of 7.0% per annum.

The manufacturing, agriculture and services sectors will continue to be the major contributors to growth in the 8MP period, and are expected to contribute 35.8%, 7.0% and 55.1% respectively to GDP by 2005 (33.4%, 8.6% and 52.4%, respectively in 2000). Meanwhile, public investment expenditure is envisaged to grow by 1.1% per annum, slower than the growth of 7.1% per annum in the 7MP period. By 2005, its share to GNP is likely to decline to 12.4% from 17.2% in 2000.

The public investment will focus on the further expansion of the productive capacity of the economy as well as productivity and efficiency enhancement through the upgrading of the work force, increasing investment in R & D, fostering and promoting technology development as well as improving physical and social infrastructure. A large proportion of the government's development expenditure will go towards efforts to move Malaysia up the value chain, including RM22.7 billion on education and training and RM5.2 billion for information and communication technology (ICT) – related programmes and projects.

The economy will transform from a production – based (P-based) economy into a knowledge – based (K-based) economy over the next five years. This transformation will not occur in 12 months as it takes time to build up domestic capacity in terms of human resource and capital. Capital investment for ICT may be easy to obtain, but cultivating a higher quality workforce certainly requires more time than just five years.

While it may appear that the Government is rather too ambitious in setting a five year timeframe for the transformation of the economy, it nevertheless demonstrates the government's commitment and seriousness in wanting to steer the economy towards that direction over the next five years. If the economy is not fully transformed within the timeframe sets, at least some significant headway towards that aspiration is anticipated to be achieved by year 2005.

2.2 DEVELOPMENT OF THE FINANCIAL SERVICES SECTOR

In view of the Government's aim to transform the economy from a P-based into a K-based economy, changes will inevitably have to occur in the financial services sector, which has traditionally been the backbone of the country's economic development. In this new economic environment, the financial services sector will be developed to be a key enabler of growth to support the economic growth and transformation process rather than be an engine of growth. A transition into the new economy will definitely require a competitive and diversified financial services sector that is able to meet more complex and sophisticated financing requirements.

Thus, the next ten years (2001-2010), the timeframe sets in the Financial Sector Masterplan (FSMP), shall witness a profound change in the Malaysian financial landscape characterized by: -

- An increasingly more diversified financial sector that would meet the needs of a more diversified economic structure.
- A competitive environment that is likely to result in banking institutions and insurance companies with differentiated strategies and market niches. There would be a few broad based institutions complemented by a few specialist providers successfully leveraging on technology and highly-skilled employees.
- A more significant Islamic banking and takaful industry with greater global orientation with Malaysia positioned as the regional Islamic financial center.
- A focused set of development financial institutions strengthened by the formulation of common rules and regulations; and
- A modern financial infrastructure supported by an efficient and effective payment system, a deep and liquid capital market and a strong consumer protection framework.

In the banking sector, the first three years (2001-2003), which is phase 1 of the implementation period of the FSMP will be focused on building up the capacity of domestic banking institutions and enhancing the financial infrastructure. In enhancing domestic capacity, efforts will be directed towards:-

- developing industry-wide benchmarks
- raising the level of technology

- strengthening skills and access to best talents
- strengthening corporate governance
- encouraging innovation and research and development
- increasing competition
- deregulation of policies
- promotion of consumer and shareholders' activism
- streamlining regulation between merchant banks and discount houses
- enhancing operational flexibility
- facilitating group rationalization
- allowing one entity holding multiple BAFIA licences
- allowing mergers between merchant banks and stockbroking companies/discount houses
- allowing outsourcing
- encouraging new delivery channels.

The second phase of the FSMP which spans from 2004 to 2007, will see further intensification of competition in the domestic banking sector as the domestic banks will be put in a level playing field with incumbent foreign banks. During this period, foreign banks will be allowed to set up shared ATM network and at the same time restrictions on branching will be gradually removed.

From the seventh year onwards, which is the third phase of the FSMP, the domestic banking institutions should be ready to be assimilated into the global arena and face new foreign competition. By the end of the 10^{th} year period, what will evolve is a well-diversified financial sector with key local capabilities and a core of strong and technologically driven banks that could face the challenges of globalisation and liberalization and withstand the economic cycles.

2.3 DEVELOPMENT OF THE CAPITAL MARKET

The restructuring process of the financial institutions in 2001-2010 will be complemented by efforts to further broaden and deepen the capital market as outlined in the Capital Market Masterplan. The need to do this is to ensure that Malaysia remains the preferred fund-raising center for Malaysian companies. It also enhances the development of an internationally competitive and highly efficient capital market with the creation of new financial instruments, amongst others through the development of the Ringgit bond and derivatives markets.

There will be further deregulation of the investment management industry to allow for the development of a larger number and diversity of industry players with greater access to funds available for management. All existing exchanges will be consolidated to create a single market institution that is able to compete in the global marketplace. In addition there will be further deregulation of the market to allow for a more comprehensive range of services and products to be offered and a progressive deregulation of fixed fee structures while other transaction costs will be reduced. (integrated financial services)