

Chapter 1

INTRODUCTION

As Malaysia thrives to achieve the status of a fully developed nation by the year 2020, it is imperative that the local Malaysian industry has to play a major role in realising this goal. Malaysia's manufacturing sector's reliance on the multinational giants is well known. The total fixed assets of foreign equity was RM 33.2 billion as on 31st December 1996 slightly more than RM 33.0 billion of local equity in 1996. The dependence on foreign investment is more obvious in the electrical and electronics manufacturing sector, which is Malaysia's, major export earner. The total fixed assets employed in the electrical & electronics manufacturing companies was RM 13 billion as on 31st December 1996. Eighty seven percent of which or RM 11.4 billion was foreign owned assets (MIDA, 1996).

But the dynamic changes taking place in the nearby ASEAN countries, and sweeping economic reforms being undertaken in China and India, may mean that Foreign Direct Investment (FDI) will eventually be siphoned to these economies instead of landing in Malaysia. Increasing manpower crunch and rising wage structure may also blunt the competitive advantage of Malaysia as a manufacturing base.

In 1996, companies such as Thomson Electronics and many other Taiwanese companies in Penang shifted their manufacturing base to Vietnam and China respectively, due to rising cost of labour in Malaysia. These trends indicate flight of capital from once competitive Malaysia to other burgeoning economies like Vietnam, China and India. This is an early symptom that points to the fact that the Malaysian economy is graduating into the league of newly industrializing country (NIC).

This looming threat accentuated by the present economic crisis may slow down the rapid economic growth of over 8.0 per cent per annum, experienced during the past nine years and may pose a serious deterrent in achieving the ambitious

goal of VISION 2020. The recent economic turmoil in the money and stock markets has exposed Malaysia to threats from different sources included that from foreign ones. To avoid such future debacles, Malaysia has to further strengthen its economic base by building on its consistently booming manufacturing sector, improving its export competitiveness and enhancing its service sector amongst others.

1.1 ELECTRONICS MANUFACTURING SECTOR IN MALAYSIA

The manufacturing sector contributed over 34.5 per cent or RM 44.9 billion to the GDP and 81 per cent of manufactured export of Malaysia in 1996 (MIDA, 1996). The economic policies pursued by the government of Malaysia during the last three decades have sought foreign direct investments as one of the strategies for development. Studies conducted by Nazari (1993) and Jomo (1989) in the past have highlighted that many states prefer direct foreign investment, rather than local investment, as they give priority to balance their social responsibility, especially to the natives of the land. The local state governments feel that the status of the natives and Malays can be enhanced by creating work opportunities for them, which are mainly fuelled by FDI, instead of local capital, which was in the 1970s mainly controlled by the Chinese.

Politicians, businessmen and academicians have argued at length the advantages and disadvantages of foreign direct investment, in boosting a nation's economy. Though surely it is one of the fastest ways of achieving rapid economic development, but the same is achieved at the cost of losing economic sovereignty to transnational corporations.

A study conducted on Transnational Corporations in Malaysia's electronic industry (Nazari, 1993) highlighted that the Malaysian electronics industry is highly deficient in terms of indigenously owned manufacturing capability, when compared to other Asian tigers notably Korea, Taiwan and Singapore. This implies that despite overall economic development, Malaysia lags in economic development compared to East Asian Newly Industrialized Countries (NICs). The

study also highlighted that this lag is primarily due to the non-interfering role of Malaysia's state and federal government in the operations of foreign owned corporations.

Interestingly, countries like India and China prefer foreign investment in terms of Joint Ventures, which allows the local partners ample control, besides giving them opportunities to capitalize on the value addition offered by the foreign partner.

The heavy dependence of Malaysia's electrical and electronic manufacturing sector on foreign direct investment has been finally realized by the Malaysian policy makers. Under the Industrial Master Plan IMP I (1986-1995) and IMP II (1995-2005) they have taken some corrective steps which fosters development of the local manufacturing sector. Although the policies are still heavily skewed towards promoting Bumiputra owned businesses. It is envisaged that this in the long run will allow backward and forward integration of the industry, opening up new opportunities accrued by linkages with foreign owned firms.

1.2 THREAT FROM CURRENT ECONOMIC CRISIS

The current economic turmoil being faced by S. E. Asia has affected the Malaysian economy. The free floating of Thai Bhat, on 2nd July 1997 triggered the economic crisis. This started a region wide economic and currency crisis affecting currencies of Malaysia, Indonesia and Korea. These currencies depreciated against major hard currencies by 30 – 80 per cent over a span of six months. The sharp drop in currencies led to outward flight of short-term capital from the money and stock markets in these economies, resulting in major stock market crashes in these affected economies. This has led to failure of major financial institutions in Thailand, Indonesia, and Korea. The current economic crisis has severely battered the investor's confidence, who have preferred to shy away from these markets for safer havens. Malaysia's ability to retain and attract long-term capital will largely depends on its policy makers, who have to take necessary steps to regain and boost investors confidence. So far Malaysian

policy makers have taken stringent fiscal and non fiscal damage control measures, which has at least helped in avoidance of monetary assistance from International Monetary Fund (IMF).

A more fundamental question facing the policy makers now is the extent to which the Malaysian manufacturers should depend on their foreign partners and how to promote more domestic investment in the electronics sector.

Long term survival of the Malaysian economy will largely depend on its local industry's ability to survive and prosper in the domestic and world markets, especially against the onslaught of global giants who have the knowledge, technology and monetary power. One essential indicator of development, is the economy's ability to nurture local firms and to see them mature as multinational organizations in their own rights.

1.3 NEED FOR STUDY ON DOMESTIC PARTNER'S ROLE IN JOINT VENTURES

Malaysian government has been promoting formation of Joint Ventures (JV) since the early 1960s. Many Joint Ventures are in operation presently and more are approved every year by Malaysian Industrial Development Authority (MIDA) and Ministry of International Trade and Industry (MITI). Usually in a JV both partners' i.e. domestic and foreign partner have to play specific roles. At the time of formation of a JV, some of the traditional roles of domestic partner are - to provide local market access, political and government support, capital and risk sharing and providing cheap human resources. Whereas the foreign partner plays the role of providing technology, technical know-how, access to managerial skill amongst others.

These roles change as the relationship between partner matures and learning takes place. It often leads to conflict amongst partners if in case these roles are not fulfilled according to partner's expectations, resulting in failure of the Joint Venture. From the point of view of local entrepreneurs and the host country it is important that the local partners should benefit from the partnership. These

benefits are in the form of assimilation of knowledge, which allows the local partner to become self-sufficient in running the business.

If Malaysia has to reduce its dependence on foreign investment then the local industry has to become stronger. This is a process, which can take decades to achieve, but with the use of Joint Ventures, the process of learning can be enhanced and time to achieve desired goals can be reduced.

The current issue facing the Joint Ventures operating in Malaysia is whether there have been any changes in the role of the domestic partners from the time of formation, or they are still fulfilling the same needs of the foreign partner. Also of importance is to understand whether the domestic partners have assimilated knowledge from these partnerships and what have been the extent of gains accrued to them.

1.4 SCOPE OF THE RESEARCH

The research will focus on the local electronics-manufacturing sector related to consumer electronics, electronic component and industrial electronics sub-sectors. As Malaysia enters the next millenium, the government has identified information technology as the key for success in today's knowledge-based world. In view of the close relation of electronics manufacturing sector with information technology it would be worth evaluating the challenges faced by the local entrepreneurs in embracing the information technology and becoming an integral part of the ambitious Multi-Media Super Corridor (MSC) project. MSC is brainchild of Dr. Mahathir Mohammed (Prime Minister of Malaysia), which will provide state-of-the-art telecommunication and computers infrastructure for promoting information and multimedia technology. It includes flagship applications, such as electronic government, telemedicine, smart schools and smart cards. MSC will be used as the growth strategy for developing knowledge based industry, which will stimulate the Malaysian economy and help in achieving VISION 2020.

1.5 WHY THE ELECTRONICS SECTOR?

There are three overwhelming reasons for choosing the electronics sector. Firstly electronics sector contributes almost 58 per cent of the output of Malaysia's manufacturing sector (MIDA 1996). Besides the electronics sector employs approximately 226,000 workers or approximately 12 per cent of the workforce (MIDA 1996). Electronics sector was also the biggest export earner for the country generating RM 71.7 billion, or 48 per cent of total export earnings for Malaysia in 1996 (MIDA 1996). Lastly electronic industry has played a significant role in driving the process of industrialization in countries of the developing world, especially the East Asian Newly Industrialized Countries (NICs) like Korea, Taiwan and Singapore (Gan See 1990).

1.6 ANTICIPATED PITFALLS

The biggest problem faced by the study was unavailability or lack of secondary data, as not much research database exist on Joint Ventures in Malaysia. Moreover despite of the fact that Malaysian government actively promotes formation of Joint Ventures, there is a scarcity of research material on Joint Ventures operating in Malaysia. Not much empirical or non-empirical research data is available even from relevant government sources. Some of the other pitfalls are:

- a. Non availability of data on Joint Ventures of local companies
- b. Lack of co-operation from identified companies in sharing information
- c. Lack of response due to financial year ending and economic slowdown

1.7 SIGNIFICANCE OF THE STUDY

The study is of immense significance for the local Malaysian electronic industry as it helps in identifying the changes in the roles of domestic partners in Joint Venture enterprises. The study helps to identify the gains made by the domestic partners and whether these gains are significant enough for them to run the

business independently. The study also helps in analyzing the likely roles of domestic partners in the near future.

Most importantly the study provides inputs for policy recommendations for the industry and the government, who should rethink and realign their long-term policies on foreign investment, especially in context to Joint Ventures in the electronics sector. These policy recommendations can play a significant role in ensuring the long-term survival of Malaysia's electronic sector with or without the presence of foreign direct investors.

The study also highlights the future areas of research on Joint Ventures in Malaysia.

1.8 ORGANIZATION OF THE RESEARCH PAPER

The research paper is divided into six chapters including this introduction. Chapter 2 covers the literature review, which sets the foundation for the research study. This chapter outlines the process of investment by firms abroad and then goes on to review the theories of foreign direct investment and Joint Ventures. It also reviews the process of Industrialization in Malaysia, and briefly discusses the past and present policies of the government towards Joint Ventures. The chapter also reviews the theoretical aspects of needs of partners, which is eventually used for evaluating the roles of domestic partners in Joint Ventures. Lastly the chapter covers an overview of two past research conducted in the area of Joint Ventures, which are used as a backdrop for comparison of results emerging from our survey.

Chapter 3 covers the research methodology used for the survey in detail, encompassing research objectives, Key hypothesis, selection of measures, sampling design, data collection and analysis techniques.

Chapter 4 presents the research findings of the case study on the changing role of the domestic partners in Joint Ventures in Malaysia's electronic manufacturing sector. These changes in roles are evaluated in two time frames, namely, the

roles of domestic partner at the time of formation of the Joint Venture and their present roles. This chapter also analyses the gains made by the domestic partners in terms of technical, managerial and financial capabilities. Besides it also summarizes and compares the findings of our research with previous studies.

Chapter 5 presents the findings of the research survey about the future anticipated or perceived roles of the domestic partners. The Chapter also discusses the new opportunities and threats faced by the Joint Ventures in wake of setting up of World Trade Organization. It also discusses new opportunities open for Joint Ventures due to formation of Multimedia Super Corridor (MSC). These are also based on findings of the research survey.

Lastly, Chapter 6 lays out the policy recommendations and conclusions drawn from this research study.