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LITERATURE REVIEW

2.1 OVERVIEW : FOREIGN EQUITY

Khatijah (1989) categorized foreign equity as part of foreign ownership of financial assets through capital market, which is included the market capitalization and company equity. In addition, according to Malaysian Industrial Development Authority (MIDA's) reports on foreign investment, Foreign Direct Investment (FDI) inflows are defined to be equal to foreign equity plus loan attributed to foreign interest.

According to Anon.(1993), the economic growth in 1990 continued to be determined by the private sector investment. Based on projects approved in 1987, Japan (proposed called-up capital of US$230.4million) was the leading source of foreign capital. This was followed by Singapore US$135.4million, Taiwan US$118.4million, USA US$61.2million, Australia US$29.6million, United Kingdom US$26.1million, India US$28.2million and France US$15.0million. The total of foreign equity from these eight countries constituted 88.9 percent of total foreign investments in all projects in 1987.

The guidelines for foreign equity allowed to a new investment in Malaysia are as below;

Exports-Oriented Industry	Foreign Equity allowed in a Company
80% or more	100%
51% to 79%	51% - 79%
20% to 50%	30% -50%
Less than 20%	30% maximum

Source : Yong (1998)

In Malaysia, Foreign Investment Committee (FIC) is a government body that is directly responsible to the foreign investment. One of the functions of the FIC is to coordinate and regulate acquisition of assets or any interests, mergers and takeovers of companies and businesses in Malaysia and to manage applications for tax-exemption of equity restructuring, employment and on marketing network restructuring (Yong, 1998).

Malaysia's determination to increase the confidence of foreign investors in the country's stability indicates its readiness to conclude the Investment Guarantee Agreements (IGA)[1] with countries that need protection for investments. Malaysia has to date signed IGA with 20 countries and regional groupings, namely, USA, Germany, Canada, France, Switzerland, Sweden, Luxemburg, United Kingdom, Sri Lanka, Rumania, Norway, Austria, Finland, Netherlands, Organization of Islamic Conference (OIC), Association of Southeast Asian Nations (ASEAN), Italy, Korea, China and Kuwait (Anon., 1993).

Foreign investment was encouraged through a more liberal treatment of new ventures as well as greater flexibility with regard to foreign equity participation in export-oriented industries. Some aspects of the Industrial Coordination Act, 1975 were liberalized to make it more flexible and responsive to changes in the business environment. For example, the formulation of fiscal policy took into account the need to make the tax system more competitive in attracting foreign investments. The government is confident that both the foreign and local partner will benefit from this (Malaysia Government, 1991).

[1] IGA will provide the foreign investor with the following: protection against nationalisation and expropriation, prompt and adequate compensation in the event of nationalisation or expropriation, free transfer of profits, capital and other fees and settlement of investment disputes under the convention of which Malaysia has been a member since 1966.

Mohd Shariff (1991) in his book described that basically, foreign participation in privatization opportunities is limited to a maximum of 25 percent of its share capital. Only projects of strategic and national importance require ownership to be wide spread in nature so as to ensure that no one foreign party will have an undue influence on the economy.

Chee and Lee (1979) in their study regarding Japanese investment in Malaysia described that Malaysia government designed fiscal incentives such as pioneer status to provide tax relief to foreign companies setting up new enterprises and expanding existing ones in Malaysia. For instance, pioneer status companies were exempted from paying the 40 percent company tax and five percent development tax. Azizah (1994), in her study verified another incentive to foreign investors. It is the setting up of the New Investment Fund (NIF) in September 1985 for purposes of financing new fixed investment in manufacturing, agriculture and tourism sectors at moderate rate of interest. Under the scheme, the Central Bank channels government deposits to the Commercial bank for on lending for new eligible investment projects by all enterprises, including non-resident controlled companies, which have fixed investments in Malaysia. The minimum amount of financing is RM250,000 per project and funding is available up to 75 percent of the investment expenditure excluding land, for a period of up to five years.

The era of globalization and the exchange rate factor made Malaysia equities much more attractive to foreign investors. These also influenced to the increase of foreign capital in Malaysia. The weak and declining Ringgit against US dollar encouraged relocation of industries and increased direct investment from outside. For instance, Malaysia Airlines System (MAS) announced on 26 July 2000, that company raised the capital on its foreign shareholding from 30 percent to 45 percent (Business Times, 2000).

2.2 PREVIOUS STUDIES

Lee (1994) in his study examined the after market share price performance of the initial public offerings (IPOs) of the Government-Linked Companies (GLCs) in relation to the market as well as the IPOs of the non-GLCs. The study involved 10 GLCs listed on the KLSE in the period June 1984 to December 1992.

These Government-Linked Companies (GLCs) were divided into three portfolios, namely Privatized GLC IPOs, Private GLC IPOs and non-GLC IPOs. Over the three portfolios, the Privatized GLC IPOs performed the best overall, during the study period. The study recorded that IPOs of Government–Linked Companies generally performs better than IPOs of non-GLCs in the long-term investment. Investors could make abnormal profit by buying the GLCs IPOs at their listing date and holding it for a year to three year.

Rasiah (1995) discussed the role of foreign capital in the emergence and growth of manufacturing in colonial Malaya for the period 1968–1990. It evaluates comparatively the importance of foreign-dominated and local-dominated branches in Malaysia. Three levels of analysis were used in this study. First, an interpretative method was used to illustrate the importance of foreign capital in the emergence of modern manufacturing in colonial Malaya. Second, the study used the foreign and local-dominated branches and industries' classification to demonstrate the relative importance of foreign capital in Malaysia's manufacturing growth. Third, the study also used individual firms to examine the influence of foreign firms on local firms.

The important conclusion was the significance of foreign capital in the expansion of modern manufacturing in Malaysia, which supported the growing evidence that the large mass of developing economies experienced modern industrialization following integration into the capitalist system. The study also shows the strong influence of foreign capital in the growth of manufacturing in

Malaysia. In period 1968–1990, foreign capital's contribution to overall manufacturing employment never dipped below 32.7% and foreign capital's contribution to manufacturing output never dipped below 34.7%. Foreign dominated branches (FDBs) not only show greater increases in capital-intensities but also show higher increments in output-labour ratios in the 1980s. The analysis also shows that, despite significant contributions to output, trade and employment, FDBs generally show weaker pecuniary linkage coefficients than Local Dominated Branches (LDBs) in the Malaysian economy. The two largest foreign-dominated industries, viz., electric/electronics and textiles/garments, showed weak inter-industry linkage coefficients.

The study by Phang (1998) explained on how foreign investment has affected the economy. The study surveyed on 394 companies, focusing primarily on the manufacturing sector. The firms were classified into foreign-controlled companies (FCCs) and Resident-controlled companies (RCCs). The study compared three main aspects of local versus foreign firms, namely the size of firms, their performance and patterns of financing.

The study found that FCCs have concentrated more on intermediate and investment goods, especially the higher technology and larger scale as well as more heavy industry such as telecommunication, professional and scientific equipment. FCCs were found to be more export-oriented compared with RCCs. RCCs has increased exports for consumer goods but reduced exports of intermediate and investment goods. Generally RCCs were found to have concentrated more on import-substitution. They were less able to compete with FCCs in terms of market accessibility and consequently they have tended to cater more for the home market, which supplied 58 percent of home market demand. For consumer goods, RCCs contributed 45 percent of the total output growth whereas for intermediate and investment goods, RCCs contributed only one-quarter of the total output growth.

Fong (1990) studied Multinational Corporations (MNCs) in Malaysia. The study illustrated that all MNCs (10 samples of foreign firms) basically from

USA and Japan had good linkages with their parent companies. They acquired technology through importation of capital equipment and licensing of technical know-how from its parent companies. Even, the local staffs were sent to the parent company for training and development.

Phang (1994) evaluated the relationship between foreign investment and economic growth in manufacturing sector in Malaysia. His analysis showed that foreign equity in this sector increased overtime. For instance, the foreign equity rises from RM2.4 billion in 1980 to RM6.7 billion in 1989. This study also provided some evidence that foreign firms brought in improved technology, marketing innovation and etc. that facilitated production and improved competitiveness of Malaysia products in the world market.

Nor Azizan (2000) found that Bumiputera-controlled companies and Non-Bumiputera companies listed on the KLSE had suffered during the currency crisis due to debt problems. She also stated the evidence that both groups were dependent on the Government assistance to survive during the crisis.

2.4 THEORETICAL ISSUES

In order to develop the research method for this study, this section reviews literature regarding financial crisis, the stock market behavior and the methods of calculating the stock returns.

Patel and Sarkar (1998) studied the effect of the crisis in developed and emerging stock markets in the 1970 -1997 period. The correlation between US and emerging market (Asian and Latin American) were decreased with the holding period and for a sufficiently long holding period. The emerging market investments reduce the risk of US investors' stock portfolios, when the investors hold the stocks for a sufficiently long time. A rise in prices prior to a crash is typical and the magnitude of the price rise is higher for the emerging markets as compared to developed markets.

Kok and Khoo (1995) in their study on the performance of property trusts in the Kuala Lumpur Stock Exchange used weekly and monthly closing prices for the period 1991 – 1995. The KLSE Composite Index (KLCI) is also used to represent the market portfolio index.

Mansor (1997) in his paper examined the day of the week effect using the daily closing stock prices of the KLSE Composite Index (KLCI) from January 1980 to December 1996. The daily returns were calculated using the log-difference of the stock index. The return was not adjusted for dividend yield. Though, the dividend is a component of stock returns.

Meera and Hassanuddeen (2000) analyzed the wealth effects of currency crisis on Malaysian corporations classified between high leverage and low leverage portfolio. This study used the standard event-study methodology in order to find significant wealth loss on the crisis day for both portfolios.

Bacha and Meera (1996) in their study examine bonus stock issues by Malaysian companies over the six years period 1990 – 1995. 41 bonus issues qualified under their sample of study. This study used daily high, low, open and close prices and daily volume in Ringgit for a one calendar year period before and after the announcement date. In evaluating the first issue of abnormal price behavior around bonus announcement date, they used the standard cumulative abnormal returns (CAR); CAR methodology.