The Evolution of Malaysia's Development Strategies and the Global Economy: Responses from SMEs and Civil Societies

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Abstract

This article[1] introduces a triangular model to study small and medium enterprises (SMEs) in Malaysia by examining three points, namely the state, economy and society. It discusses how and why the government has changed the nation's economic development strategies over time in response to the changing global economy. Within the context of these development strategies, the article describes how and explains why Chinese and Bumiputera (Malays and indigenous people in Malaysia) SMEs, and civil societies responded to these changes. It provides analysis on how these development strategies have shaped the development of Chinese and Bumiputera SMEs at different periods in the nation's economic development. It argues that prolonged pro-distributive policies have negative effects on the competitiveness of the nation's economy.

Keywords: *economic policies, the state, Chinese, Bumiputera, SMEs, civil societies*

Introduction

In this article I develop a triangular model to provide a holistic approach to study SMEs in Malaysia. The three points in the model are the state, economy and society. For the state, the evolution of Malaysia's development strategies from 1971 to the present is analyzed. These development strategies include the New Economic Policy (NEP, 1971–1990), National Development Policy (NDP, 1991–2000), National Vision Policy (NVP, 2001–2010) and the current New Economic Model (NEM, introduced in 2009). It examines how and why certain economic policies were implemented in response to changes in the domestic and global economy. In this regard, I take the position that the nation-state plays a rightful role in the globalization process as argued by Henderson (1989) and Weiss (1998) because government initiatives can influence and attract investment.

As for the economy, the article analyzes responses from Chinese SMEs[2] and Bumiputera to these development strategies and to the changing domestic and global economy. It analyzes how the Chinese business community responded to the NEP and how the NEP shaped the size and direction of Chinese SMEs in the 1970s and 1980s and how Bumiputera responded to 'new business opportunities'. It also examines how and why the Chinese business community responded positively to the government's initiatives to encourage business partnerships to expedite the formation of the Bumiputera Commercial and Industrial Community (BCIC) during the NDP and NVP periods. I substantiate my argument by providing empirical case studies to explain how Chinese–Bumiputera partnerships work and why Chinese entrepreneurs responded to this form of partnership. For the period during the NEM, I focus on SMEs in the electrical and electronic (E&E) manufacturing industry, as it is the leading industry in Malaysia's manufacturing sector. The E&E industry has been identified as Malaysia's strength. Thus it is strategic to leverage on its existing infrastructures to sustain Malaysia's leadership position in the E&E supply chains, which are highly competitive and globally integrated (Malaysia 2010: 11). However, Malaysia is facing the challenge to improve industrial policy for this sector to attract private capital investment and develop, retain and recruit talent to ensure the industry's competitiveness. Drawing from two case studies in the E&E sector, the article discusses constraints and challenges, and how entrepreneurs deal with the shortage of talent and skilled workers that have resulted from long-standing pro-distributive government policies and the changing global economy.

As for civil societies, the article examines how and why different ethnic-based civil societies responded differently to these development strategies. Civil societies in this study include non-governmental organizations (NGOs) such as chambers of commerce and protest movements. The article examines the responses of the Associated Chinese Chambers of Commerce and Industry of Malaysia (ACCCIM)[3] to the above-mentioned economic policies. For the period of the NEP, I show how the ACCCIM responded and why they were so hostile towards the NEP. I also show that the ACCCIM held a different stance and took a pro-active role during the NDP and NVP periods in responding to the government's initiatives to encourage its members to form smart partnerships with Bumiputera. I explain why ACCCIM took such a stance. For the NEM period, I examine the policy, describe how and explain why the ACCCIM responded positively to the NEM. I also describe how and explain why Malay civil society represented by *Perkasa* (*Pertubuhan Pribumi Perkasa*, a Malay nationalist organization) responded negatively to the formulation and implementation of the NEM in late 2009 and early 2010. These two ethnic-based civil society groups have great influence on the formulation of the country's economic policies. ACCCIM is a national organization and by default it is a representative for SMEs since most of its members are SMEs. On the other hand, Perkasa has great influence over 76 Malay NGOs throughout Malaysia.

I analyze the innovativeness of the state and civil society (ACCCIM and Perkasa, in this context), in which they influence each other in the formulation and implementation of economic policies that are needed to address problems and issues and enhance the competitiveness of SMEs in a challenging global economy. As I examine the current scenario of Malaysian SMEs from the triangular model, I argue that the development and success of the nation's economy depends heavily on the effectiveness of pro-growth economic policies, such as the NEM. As Malaysia is now at the crossroads by embarking on the NEM, the state, SMEs and civil societies have to reinvent themselves to be relevant in the global economy.

The New Economic Policies, Responses from Chinese Civil Society and Chinese SMEs

Subsequent to communal riots on 13 May 1969, the Malaysian government implemented the NEP in 1971 with the primary aim of restructuring society 'to reduce and eventually eliminate the identification of race with economic function'. Its ultimate goal was to facilitate 'the emergence of a full-fledged Malay entrepreneurial community within one generation', and to achieve a 30 per cent Bumiputera ownership of the corporate sector by 1990. In accordance with the affirmative action policy, ethnic quotas were introduced. Consequently, Bumiputera were favoured when it came to the awarding of government contracts, tender, loans and credit. The policy would maintain the ratio of corporate capital ownership of non-Bumiputera at 40 per cent and that of foreign corporate capital at 30 per cent, compared with 63.4 per cent in 1970. The NEP is basically a policy about promoting distribution, more specifically inter-ethnic redistribution, rather than growth (Jomo 1994: 16).

Under the NEP, one of the regulations that aroused much controversy was the Industrial Coordination Act (ICA) of 1975. The act imposed a licensing system on manufacturing firms that empowered the Minister of Trade and Industry to impose conditions to serve 'national interest' (Jesudason 1989: 131). Business firms with more than RM100,000 in shareholders' funds and more than 25 workers were to ensure that Bumiputera made up 30 per cent of the workforce and held 30 per cent of the equity. The Chinese business community represented by the ACCCIM perceived the ICA as an instrument that undermined the basis of the Chinese business system, particularly the family business that formed the majority of Chinese enterprise. In 1971, typical Chinese family businesses formed 65 per cent of the total manufacturing establishments (Jesudason 1989: 139). It was obvious that almost all Chinese family businesses would come under the jurisdiction of the ICA. Naturally, the Chinese business community felt threatened and questioned why they would have to give up a substantial part of their family business that they had built diligently over the years to Malay 'partners'. Sensing the long-term implications of the ruling, ACCCIM led the Chinese business community in a campaign objecting to the ICA, as it argued that the Act was aimed primarily at the Chinese business community (Jesudason 1989; Hara 1991; Yasuda 1991).

ACCCIM then lobbied for support to persuade the private sector to adopt its position to seek the repeal of the ICA. However, it failed to secure the support of the Malaysian International Chamber of Commerce and Industry, the National Chamber of Commerce and the Malay Chambers of Commerce. The Federation of Malaysian Manufacturers took an intermediate position and recommended that the cut-off point for exempting firms from the ICA be raised to RM1 million in shareholder funds (Jesudason 1989: 140). Ultimately the government amended the ICA in April 1977 to exempt firms with less than RM250,000 in shareholder funds and RM500,000 in fixed investment from the equity condition. It was only in 1986 that the limit of RM1 million in invested capital received official sanction.

The ACCCIM veers away from politics but insists on safeguarding the economic interests of its members and the business community. To play this role, it has found it necessary to exert its influence on certain government policies. Politically, Chinese-based political parties such as the Malaysian Chinese Association (MCA) and Gerakan, which are coalition partners in the government, have lost much of their influence and are not able to act from a position of strength, as they have gone through internal crisis. The ACCCIM seeks to minimize the impact of the declining political clout of the Chinese by filling that vacuum with its actions. In 1978, during the conference of the Associated Chinese Chambers of Commerce, the ACCCIM made known its displeasure with government bureaucrats for their poor performance and for wasting public funds, and voiced the opinion that the NEP was bringing only transitory gains for some Malays (Jesudason 1989: 133).

Under the ICA, well-connected Bumiputera were given privileged access to manufacturing and other 'traditional sectors' in Chinese business, such as construction, trade and transportation. In the late 1980s, when the Malaysian economy went into recession affecting the state-owned enterprises, an economic liberalization policy was adopted. This led to the privatization and Malaysia Incorporation policy under which various state assets were transferred to Bumiputera individuals and interests (Gomez & Jomo 1999; Searle 1999). In the face of state intervention to advance Bumiputera interests in both the corporate and the SME sectors, Chinese entrepreneurs responded in various ways to accommodate and to meet the fresh requirements of state policies.

Some Chinese businesses protected their interests by forming 'Ali-Baba' alliances. 'Ali', or the Malay partner, was the less active or 'sleeping partner', contributing only political influence and connections. 'Baba', or the Chinese partner, was the more active half of the alliance, contributing capital, skills and technical know-how. This kind of partnership gave the Chinese access to licenses and lucrative government contracts reserved for Bumiputera, especially in the construction, transportation, and agricultural wholesaling sectors (Nonini 1983; Jesudason 1989).

One defensive strategy adopted by the Chinese SMEs in the manufacturing sector was to split up their existing family-owned companies to minimize the effects of ICA regulations. Numerous new companies thus maintained a paid-up capital below the ceiling above which a 30 per cent Bumiputera share equity would be mandatory. This approach only suited low technology and small operations, not the larger enterprises. The defensive action indicated the reluctance on the part of Chinese businesses to share with 'outsiders' the hard-earned wealth that they traditionally owned and managed under family operations. They also perceived the ICA as a threat. In 1971, two-thirds of the manufacturing establishments were either sole proprietorships or partnerships and the rest were private limited companies, almost all being small-scale, family-run businesses. Many of the remaining one third of private limited companies were also family-owned firms (Department of Statistics 1971, quoted in Jesudason 1989: 139).[4] The strategy of splitting up family-owned firms did not turn out well for the Chinese SME manufacturers because the scale of their companies came to be constrained by limited family-based capital and, operating largely on the fringe of the mainstream economy, was not cost effective. Adopting this strategy, however, failed to induce the government to amend the ICA. This is apparent when the world economy began to pick up after 1977 and the government successfully brought in foreign investors as major players in the manufacturing sector to replace the sluggish Chinese investment in Malaysia. Simultaneously, the Malays also penetrated the manufacturing sector, steadily increasing their investment from 40 per cent in 1975 to 56.3 per cent in 1982 (Jesudason 1989: 145). The ICA stipulations thus severely compromised the integration of these Chinese-owned family businesses into the mainstream economy from the 1970s to the mid-1980s.

The ICA became a determining factor in the size of Chinese firms in the 1970s and 1980s. However, some of these small Chinese family-owned firms were able to expand when the ICA was amended periodically in 1977, 1986 and 1990. The 1977 amendment was aimed at creating a favourable environment for investment. In the mid-1980s, when the Malaysian economy went into recession, the government in late 1985 liberalized the guidelines for foreign equity ownership in manufacturing and held the NEP in abeyance as a way to curb the recession (Khoo 1995: 136–143). In 1986 the ICA requirement was further relaxed to include companies with more than 50 employees and with a paid-up capital of more than RM1 million. As the country's economy was benefiting from accelerating growth, further liberalization of the regulations took place in late 1990 to attract more foreign investments. The ICA was further amended to include companies with more than 75 employees and RM2.5 million in paid-up capital. Nevertheless, over almost two decades, the Chinese business community seemed incapable of revoking the ICA. This indicates that Chinese entrepreneurs might be rich in cultural resources (ethnic and community-based business networks and family business) but their resources were insufficient to counter the regulations imposed by the strong state. However, in the context of a liberalized economy, Chinese entrepreneurs found their opportunities again. While, the ICA regulations continued to affect the Malaysian Chinese manufacturers, many chose to make short-term business plans in the face of uncertainty regarding their future in Malaysia (Jesudason 1989: 151–152).

In the wholesale and retail sector, the Chinese SMEs also resorted to a defensive strategy to protect their interests, by taking advantage of their business networks. Good *quanxi* (relationships) had been established over many years linking customers, wholesalers and retailers in a strong network. This network shielded the family-based businesses from state and Malay penetration. In 1985, Chinese wholesalers demonstrated the effectiveness of their commercial network in a serious attempt to ward off state intervention to corner the traditional wholesale and retail fruit market for the Chinese New Year festivities (Kuo 1991: 155–175). A proactive strategy taken by the Chinese SMEs was to shift their investment from high-risk manufacturing to the relatively 'easy and safe sectors of expansion' such as commerce, finance, construction, property development, and speculative ventures that generated quick returns but were not subjected to ICA stipulations. Hence, Chinese investment in the manufacturing sector from 1972 to 1985 fell dramatically for lack of security and confidence in the economic policy of the state (Jesudason 1989; Hara 1991; Yasuda 1991). Chinese participation in the wholesale and retail and service sectors expanded during the NEP period. In 1995, the Chinese owned 81.0 per cent of the wholesale establishments compared to 81.8 per cent in 1980 and 66.2 per cent in 1970. However, during the same period, Bumiputera interests registered remarkable progress in the retail sector, with the total establishments increasing from 3.0 per cent in 1970 to 34.2 per cent in 1980 and to 37.1 per cent in 1995 but dropped to 20.4 per cent in 2004. Overall, Chinese business networks in commerce have proven resilient in warding off the ICA regulations for over two decades. In 1975, Chinese entrepreneurs controlled 58.4 per cent of the market share in commerce, increasing to 61.8 per cent in 1980 and 63.8 per cent in 1990 before declining to 54.8 per cent in 1995 and then to 50.7 per cent in 2004 (Malaysia 1981: 71; 1986: 132; 1996: 549; 2006a: 338).[5]

NDP, NVP, Chinese–Bumiputera Partnerships and Civil Societies

In the context of world economic recession, in 1986 the government began to deregulate and liberalize the NEP to support the private sector and later, privatization of the public sector. Though the NEP officially ended in 1990, it was replaced by the National Development Policy (NDP, 1991–2000) and followed by the National Vision Policy (NVP, 2001–2010), which were implemented to further pursue the 'unachieved objectives' of the NEP. The NDP and the NVP were without any explicit repudiation of the NEP. In other words, the NEP was ostensibly still in place. However, the NDP and the NVP emphasized growth and modernization, in contrast to the NEP's stress on redistribution. These policies are in line with Malaysia's 'Vision 2020' Plan (unveiled in 1991); its main goal was for Malaysia to achieve 'fully developed country' status by 2020, mainly by accelerating industrialization, growth and modernization. These two policies showed a significant shift in the government's economic policies towards encouraging inter-ethnic business partnerships (Jomo 1994; Gomez & Jomo 1999; Gomez 2003). At the level of SMEs, since the mid-1980s, the government also relaxed the requirement of the ICA and this resulted in a vast increase of small and medium-scale industries, mostly Chinese owned and operated (Lee 2001: 19). Since 1990, SMEs have no longer been subjected to the ICA stipulation of Bumiputera equity participation. This liberalization of ICA rules benefits Chinese SMEs that did not have to relinquish equity to Bumiputera interests.

One important macroeconomic strategy of the NDP to keep Malaysia internationally competitive was to restructure industry towards more technologically sophisticated and better-quality products that are integrated with the markets of developed countries. Amongst the strategic thrusts of the NDP, three thrusts were to strengthen the manufacturing sector; accelerate the development of science and technology capacity and capability to further increase competitiveness and efficiency; and to increase the use of information and communication technology (ICT) in all sectors to increase productivity. These strategic thrusts were important to address SMEs' lack of technological know-how, little innovation and the low-level application of ICT (Abdullah 1999; Ramayah, Lim & Sulaiman 2004; Malaysia 2006b; Hashim 2007; Rosnah, Saberi & Zulkifli 2009).

In line with this strategy and in order to advance the BCIC, the government encouraged and provided assistance to Bumiputera entrepreneurs to venture into the strategic aerospace, automotive, machinery and engineering, petrochemical and telecommunications sectors (Malaysia 1996: 13). To enable the transfer of entrepreneurial skills to Bumiputera, an important strategy at the micro level was to encourage joint ventures with non-Bumiputera or foreign investors. These joint ventures were expected to serve as vehicles for the transfer of technical and managerial know-how to Bumiputera partners. It was envisaged that Bumiputera 'technopreneurs' would become active in sectors such as advanced electronics; equipment/instrumentation; biotechnology; automation and flexible manufacturing systems; electro-optics and non-linear optics; advanced materials and software engineering; food production and food processing; aerospace; and optical electronics and alternative energy sources (Malaysia 2000: 43).

The four decades of pro-Bumiputera affirmative action policy had transformed many spheres of socio-economic life. Vigorous state-led modernization and economic development managed to produce a new Bumiputera entrepreneurial and middle class during this period (Embong 2002; Searle 1999). Four decades of social engineering programs have witnessed a significant restructuring of the Malaysian society and the economic transformation of the Malays. At the same time, there were visible changes in the attitude and stance of the Chinese business community toward their Malay counterparts and in their general acceptance of the extension of the NEP (Chin 2004, 2010). Within these political and socio-economic contexts, Chinese companies sought to participate in government projects by incorporating capable Bumiputera as business partners to accommodate policy changes. One of the lasting effects of this political and economic scenario was the weakening of the old intra-ethnic and family-based Chinese businesses and the formation of inter-ethnic ones involving Bumiputera partners. The ICA continues to have an impact on the size of SMEs today. Zwart (2006: 96–97) claimed that 'all government institutions and government agencies have been created to support the development of Bumiputera SMEs and Chinese SMEs have been left out in the government's national development plan'. The ICA obliged firms to have a Bumiputera partner on board in order to get government tenders. Those who did not want to incorporate Bumiputera as shareholders decided to look for markets outside Malaysia (Zwart 2006: 105). During this period, Chinese capital in the form of 'outflow direct investment'[6] was leaving and going to the regional emerging markets that were more market-friendly than those in Malaysia, where affirmative action policy stunted economic growth and shunned foreign investors.

As Bumiputera interests, mostly linked to 'rentier activities', occupied an increasingly important role in the economy, Chinese businesses of all sizes were challenged and driven to re-position themselves in response to the NEP and post-NEP policies and the changing economic climate. During the post-NEP period, there were important developments in Chinese-Bumiputera partnerships in SMEs in the manufacturing sector (Mohamed 1994; Chin 2004, 2010). Because of the encouragement by the government in the context of economic liberalization, and the changing political contexts of the NDP, the ACCCIM and the Chinese business community responded in a rational and pragmatic move to foster partnerships with Bumiputera entrepreneurs. This was articulated by ACCCIM in a working paper on Bumiputera and non-Bumiputera partnerships at the Third Bumiputera Economic Congress in 1992 (ACCCIM 1992: 1).

Beginning from 1995, following the establishment of the Genuine Joint Venture Promotion Council by the Ministry of Entrepreneur Development with the co-operation of the Malay Chambers of Commerce Malaysia (MCCM) and ACCCIM, serious attention was given to promoting 'genuine joint ventures' in the late 1990s. The role of the Council is to encourage integration and close cooperation to expand and share experience, knowledge, and expertise between Bumiputera and non-Bumiputera. In late 1997, the Council was enlarged to include the Malaysian Associated Indian Chambers of Commerce and Industry (MAICCI), the Ministry of Entrepreneur Development and representatives from a consortium of 20 commercial banks (Malaysia 1998: 34-35). This partnership, which connects the major ethnic groups and the public and private sectors, represented a new approach to accelerate the formation of a BCIC as outlined in the NDP. This form of 'financial and ownership integration' allows Chinese and Bumiputera SMEs access to government financial aid, easy bank loans and partnerships with government-linked corporations. This multi-party partnership matches with Searle's (1999) notion of 'capital integration'. Such integration helps to accelerate the formation of the BCIC. Between 1995 and 2000, through the Council and with co-operation with ACCCIM, MCCM, and MAICCI, a total of 54 official joint ventures were approved. The majority of the joint-venture companies were SMEs, with 61 per cent of the partnerships involved in manufacturing (Malaysia 2000: 36).

To further illuminate the idea of genuine partnership, following are two case studies that describe the involvement of knowledge transfer, pooling of financial resources and involvement of partners in everyday business operations.

Case Study 1: Accuracy Engineering

We interviewed Khoo, the co-founder of Accuracy Engineering (AE), in June 2006. Khoo and Mahmud were colleagues in their former company. Khoo was in the sales division and Mahmud was a technical engineer. Khoo invited Mahmud to form AE in 1985 and their partnership continues today. AE is a moulding, stamping, tooling design, technical drawing, material and precision company set up with four partners, two Chinese and two Bumiputera. Of these four, two (one Bumiputera and one Chinese) are sleeping partners, according to Khoo. Only Khoo and Mahmud are active partners. As of December 2006, total Bumiputera shareholdings in AE were 36.7 per cent: the Mahmud family of five holds 25.2 per cent of the total shareholdings of a paid-up capital of RM 1.59 million. This undoubtedly is a smart partnership: 98 per cent of AE's products are for export and only 2 per cent at most of its business dealings are with government bodies. Besides capitalizing on Mahmud's technical know-how, another reason for Khoo's partnership could be the licensing factor imposed by the ICA. Khoo and Mahmud have a good division of labour: Mahmud has a degree in engineering, experience in the industry, and is responsible for technical operations. Khoo, meanwhile, is responsible for sales and marketing. We visited the operations side, and confirmed with staff that the company's general manager is indeed a Bumiputera, responsible for production.

Case Study 2: Auto Parts Manufacturing

Auto Parts Manufacturing (APM)—which manufactures auto parts for Proton, Perodua, Toyota, Isuzu, Nissan, Hyundai, Mitsubishi and Daihatsu—was established by Karim and Hong in 1988. We interviewed them in July 2006. Both partners worked for different companies selling different products to Proton. Hong had known Karim for about three years and found him 'a straightforward man who can be trusted, and also enterprising'. Hong therefore suggested to Karim that they should start their own auto business. With an initial capital of RM70,000 (Hong holding 70 per cent, Karim 20 per cent and another Chinese 10 per cent) they started a trading company dealing in auto parts. Their business developed into a medium-scale auto parts manufacturing company with an annual turnover of RM14 million in 2006 and a pre-tax profit of RM269,205. Karim and Hong described how they support each other in the business operation. Each has his own set of customers:

> The relationship with customers is unique. I handle a particular person or customer and Mr Hong handles his own customers. We fully utilize our strength. (Karim)
>
> We share the same authority in managing the company. (Hong)
>
> Mr Hong is in charge of the operational task force with the management to support me to deal with the customers and sustain the business. (Karim)
>
> Joint decisions and sharing the responsibility must be there. (Karim)

On nurturing processes, Karim was proud that he had obtained ISO status for APM within six months, when other companies usually take more than a year. Karim headed the Management Representation (MR) task force and encouraged employees to work more aggressively in following ISO procedures:

> Karim is the MR and he leads very well and within a short period we got the ISO …his humble way helps him to get support from fellow workers and customers, he handles them very well. I have to admit he is a good partner, he shows no temper and is very hard-working. (Hong)

We can verify this complimentary statement from our own attempts to make an appointment with Karim, when his secretary informed us that he was in Indonesia for business meetings. After Hong left the interview, we were accompanied by Karim on a visit to the operation line and he revealed knowledge of the production operations. He explained how the management team had learned from their Japanese customers, Daihatsu and Isuzu. One of the improvements made in the production line was automation. Karim explained:

> I learned more on how to handle the export market from Hong … about the requirements that are needed for export and to conform to customers' requests … how Hong controls the operation … how he deals with down line, areas that I have never learned before.

Another aspect that Karim had probably learned through their partnership was managing money, savings and reinvestment: they plough profits back into their company. As Karim remarked, 'we developed our company to its size today'.

These joint ventures included manufacturing concerns in which Chinese entrepreneurs had been reluctant to risk their investments because of the stringent conditions imposed by the ICA ruling. The willingness to invest in the manufacturing sector through partnerships was an indication of the shift in the business strategy of Chinese entrepreneurs. Judging from the equity distribution of these joint ventures, it is clear that the Bumiputera partners are no longer inactive 'sleeping partners'. Many have become owners and managers and are beginning to have an impact on the Malaysian business scene. Hence, attempts to nurture joint ventures have yielded the desired results in keeping with government intentions and the elimination of the so-called 'Ali-Baba' arrangement. The true joint venture encourages the development of expertise and the sharing of technology between the Bumiputera and non-Bumiputera partners. Bumiputera partners always bring political connections and access to certain sources of capital. These advantages, along with positive perceptions of the capability of Bumiputera partners and favourable services and facilities provided under the Council have contributed much to the success of these joint ventures (Chin 2004 and 2010).

The New Economic Model, Responses from ACCCIM, Perkasa and the SMEs

This section discusses the introduction of the New Economic Model (NEM) announced in mid-2009 and responses from ACCCIM, Perkasa and SMEs to it in late 2009 and early 2010. The protracted implementation of the inter-ethnic pro-distribution policies of the NEP, NDP and NVP had caused an unintended consequence, the middle income trap (Henderson & Richard 2007). Other problems identified within this period include Malaysia's slowing economic growth since the 1997-1998 Asian financial crisis, stagnation of private investments and lack of skilled jobs with high wages. The human capital situation in Malaysia is reaching a critical stage where the rate of outward migration of skilled Malaysians is rising rapidly (Malaysia 2009: 3-7). Conversely, the increasing global economic challenge, especially competition from rapidly emerging neighbouring countries coupled with the 2008 global financial crisis, prompted the government to formulate a New Economic Model to move the country forward.

During the Fifth Malaysia Investment Conference on 30 June 2009, the prime minister announced the deregulation of 27 services and financial subsectors[7] of the economy. Amongst others was the repeal of the 30 per cent Malay equity requirement for Malaysian companies seeking public listing and the Foreign Investment Committee guidelines covering the acquisition of equity stakes, mergers and takeovers. Ownership in the wholesale segment of the fund management industry was also planned to be fully liberalized to allow 100 per cent ownership for qualified and leading fund management companies in order to establish operations in Malaysia. In the interim, for the retail segment, foreign shareholding limits on unit trust management companies were to be raised to 70 per cent from their current level of 49 per cent (*The Star* 2009).

On 30 March 2010, the government unveiled the NEM, which is an ambitious and drastic approach that is envisioned to reduce red tape, ensure equal economic opportunities, encourage more private investment and promote growth in order to get Malaysia out of the middle income trap. The NEM identified Malaysia's competitive position in the global economy and recognized the long overdue, unheard voices of non-Malays that had been calling for economic and political reform. The NEM was formulated to improve Malaysia's economic position, to create a pool of good talent, to attract sound investments—to make Malaysia a high-income nation. The NEM, once fully implemented, will remove the subsidies under the NEP that have benefited ethnic Malays for the past 40 years. The NEM will improve competitiveness and eradicate inefficient rent-seeking and patronage behaviour, which has enriched only an elite group and has failed to achieve the intended aims of the NEP. The NEM will also adopt the concept of inclusiveness as its fundamental economic approach, where all Malaysians contribute and benefit from economic growth (Malaysia 2010).

The liberalization of the 27 services and financial subsectors and the NEM create a 'level playing field' of opportunities for all entrepreneurs of all races. These are significant milestones for enhancing Malaysia's competitiveness in the global economy. These new measures received positive responses from the Chinese business community represented by the ACCCIM but negative responses from Perkasa, which represents the interests of Malays and Muslims.

The NEM, which promotes economic liberalization, has received a positive response from the Chinese business community. The ACCCIM perceived the policy as *laissez-faire* by expanding the scope of markets and providing more open and equal access to opportunities. The ACCCIM, in its official response to the NEM, stated:

> …the New Economic Model (NEM) was very comprehensive, firstly identifying the distortions and hindrances in the market place arising from regulatory, bureaucratic and unfair competition especially from GLCs (Government Linked Companies). The emphasis of the NEM on the Government being a facilitator and being market friendly, transparent based on merit, competition augers well for the future prospects for Malaysia. The frank realization of past implementation of well designed policies that did not benefit those who are genuinely in need and creating a culture of rent-seeking and patronage is bold and truthful thus allowing the NEM to address and improve the implementation giving all Malaysian hope for a more open and equitable access to opportunities and good prospects to build a prosperous and inclusive nation… The divestments of non-core assets by GLCs and Government Agencies should be widened to remove special privileges, licenses and monopolistic conditions enjoyed unfairly by such bodies thereby shielding them from inefficiencies and competition. (ACCCIM 2010)

Conversely, some measures in the NEM, especially those concerning Malay rights, have been received with strong reservations by certain quarters of the Malay community. In particular, the Malay Consultative Council (comprising 76 Malay NGOs), led by Perkasa, has strongly reacted to 'defend' Malay rights and Islam. It attacked the NEM for its lack of a Malay agenda and ambiguity in the affirmative action policy. Perkasa wants to retain the 'spirit' of the NEP in the NEM. Its president, Ibrahim Ali, questioned the NEM: 'Where is the stake for the Malays in the distribution of the country's economic cake? What's important is fairness and not equity. If strategic areas are developed under the open tender system, the Malays will not be able to compete' (*The Star* 2010a). By asking such questions, Perkasa actually suggested that a community is entitled to the national economic pie purely based on their numbers within the nation. This also implies that Perkasa's stance to maintain the affirmative action policies that concern Bumiputera rights and preserve existing distribution policies under the NEP and against the merit-based and needs-based system introduced under the NEM, could reinforce the dependency syndrome of Bumiputera.

The former prime minister, Mahathir Mohamed, adopted an evasive position in an interview with Reuters, which said that the government needs to push ahead with reforms and at the same time engage Perkasa. Perkasa also criticized and condemned outright the calls by the ethnic-based political party, the Malaysian Chinese Association (MCA), for economic liberalization, namely for the government to lower the 30 per cent equity for Bumiputera. The MCA called instead for a merit-based and needs-based system to eliminate the dependency syndrome (*The Malaysia Insider* 2010). Perkasa is worried that the NEM will increase the monopoly of the country's economy by the Chinese community. The president of the Penang Malay Chamber of Commerce also backed Perkasa's stance to continue these affirmative action policies (*The Times* 2010).

The radical measures of the NEM could remove the patronage system that has been enjoyed by many Bumiputera entrepreneurs. For example, the special privileges, licenses and monopoly conditions enjoyed by the GLCs have crowded out some local SMEs and stifled entrepreneurship. Under the NEM, the divestments of non-core assets by GLCs will open up more opportunities for non-Malay local SMEs, but Malay-owned SMEs that have enjoyed certain protected industries will face more competition. Thus, it is seen as a threat to the Malay agenda because GLCs are the major shareholders of corporate equity. Conversely, non-Malay company owners will no longer be able to depend on working with influential Bumiputera and for GLCs to help protect their interests by obtaining sub-contracts or becoming suppliers of goods and services. Responses from the Malay groups characterized a social protection stance that tries to limit the scope of market forces and centres on securing social rights, in opposition to the *laissez-faire* system.

The NEM, which emphasizes the concept of inclusiveness and the more open and equal access to the economy, is a difficult challenge. It was blocked by Perkasa and its supporters, which has become a stumbling block to the realization of the NEM. The NEM Part II, announced in February 2011, clearly engaged Perkasa's demands. The NEM Part II clearly contradicts the prime minister's '1Malaysia' concept because it reintroduces the NEP's 30 per cent Bumiputera equity target with no expiry date. This revised reform policy will cause sceptical investors to turn to other destinations for their investments. The scenario could be even worse, with the continuous exodus of human capital and greater outflow of capital as already identified in the NEM. Since Chinese capital is dominant in SMEs, especially in manufacturing, if the state were to continue with a pro-distribution policy, it is very likely to see a negative trend in the development of SMEs.

The NEM clearly gives more attention to SMEs. Altogether, 15 government ministries and 38 agencies are involved in supporting the development of SMEs. In addition, approximately 30 government programs help SMEs (Malaysia 2009: 122). To ensure that the growth of SMEs is synchronized with the NEM, for the first time an 'SME Masterplan' (2012-2020) has been formulated to help accelerate the growth of SMEs through comprehensive action. The master plan aims to transform SMEs by providing financial support in the form of debt and equity investment in potential SMEs and provide technological support with the potential for innovation. Also, it aims to help SMEs grow beyond the domestic market by emphasizing innovations and new technology as strategies for growth and development. In addition, it recognizes that the growth of large firms and global giants creates a need for clusters and critical masses of SMEs to support their growth and creativity (Malaysia 2010: 33-36). Initiatives and programs formulated under the SME master plan are strategic to address the constraints and challenges of Malaysian SMEs, especially the increased competition from economic liberalization and globalization that affect the competitiveness of Malaysian SMEs in the E&E industry that make up Malaysia's most important manufactured export (Chin 2006; Tham 2001).

The NEM notes that Malaysia should build on its advantages; one of them is Malaysia's leadership in the E&E manufacturing that attracts investment from multinational corporations (MNCs). The E&E sector spawns the growth of other sectors in supply, logistics and services (Malaysia 2009: 8). Moreover, the Malaysian E&E industry is a major part of MNCs' supply chains in East Asia. Once a Malaysian company successfully plugs into global supply chains, it would have the advantage of scale and branding that would be difficult for competitors to dislodge (Malaysia 2010: 11).

The E&E sector is facing a shortage of local talent. This issue has been in existence for quite a while following a long period of the NEP and post-NEP distributive policies plus the migration policy (Henderson & Richard 2007). The inward migration policy has made the Malaysian E&E industry continue to depend on cheap, low-skilled foreign workers. Conversely, four decades of affirmative policy favouring Malays caused an outward migration of talent, especially among non-Malays. The perpetuation of these policies came with social and economic costs. The people that left Malaysia are usually those who possessed skills, knowledge and wealth. This caused a shortage of talented human capital, which became the main stumbling block for technology upgrading in the electronics sector and led MNCs to perceive Malaysia as a low-end production base depending on the inward migration of cheap and unskilled workers. The present government is trying to overcome this problem by establishing the Talent Corporation[8] to retain highly skilled human capital and encourage Malaysian professionals overseas to return home.

The E&E industry in Malaysia has developed into a major global manufacturing base. According to the Malaysian Industry Development Authority's record, there are approximately 1,695 E&E companies in Malaysia with a total investment of RM13.2 billion (US$4.4 billion) for the year 2010 and a workforce of more than 336,000 people. The gross output of this sector totalled RM166.2 billion (US$55.8 billion) in 2010 (Malaysia 2011). Responding to increasingly competitive global supply chain production, Malaysian companies have gradually moved up the value chain into the manufacturing of high-end products, and some have even moved away from labour-intensive to more capital-intensive operations. As the Malaysian economy is export-oriented and integrated into the global economy, two case studies of SMEs in the E&E industry are chosen to understand their constraints, challenges and prospects.

Case Study 3: CS Technology

I interviewed the founder CS Technology (CST) in August 2010. CST specializes in the development, manufacture and marketing of intelligent machine vision systems, which was facing a shortage of human capital. CST's problem reflects the general constraint caused by brain drain in

Malaysia. Generally, workers in SMEs lack the skills and knowledge necessary for their respective work. It was reported that 350,000 Malaysians in 2008 lived and worked abroad, half of them with university education (*Business Times* 2010)[9]. Ong, the founder of CST, has been working with the engineering and physics faculties at Universiti Sains Malaysia (USM) in Penang on a number of joint research projects. Ong was informed by a professor that first-class engineering students were recruited to work in Singapore, Taiwan and China before they stepped into the local job market. Ong's job offer of US$950 per month (equivalent to MNCs' offers) to some top local engineering graduates was declined, as offers from Singaporean companies were more attractive. Ong affirmed that some graduates do not even take up offers from MNCs in Penang but rather choose to work in Singapore for US$2,000 to US$2,450 per month. Hong Kong is even higher, where top graduates can easily earn about US$3,500 per month. It is very difficult for local companies, especially SMEs, to recruit talented workers. Most SMEs do not offer high pay compared with MNCs. This situation reinforces the escalating brain drain problem that Malaysia is facing. According to Ong, the quality of engineering graduates has dropped so much that they do not fit well into SMEs. Furthermore, SMEs do not have the luxury of providing training; even MNCs nowadays are not willing to provide training to new graduates. SMEs, especially in the E&E subsector, are competing with MNCs and large-scale industries for skilled workers as well as for professionals. Often, SMEs have difficulties hiring and retaining talent because MNCs and large-scale industries are better placed to offer generous compensation packages to attract more skilled workers, while SMEs have to settle for others.

To retain Malaysia/Penang as a favourite destination for MNCs, state-funded training institutions such as the Penang Skills Development Centre play an important role in providing semi-skilled and skilled workers that match the demands of the industry. To further overcome the shortage of human capital, Ong provides on-the-job training to interns from local universities for 3–6 months and recruits the best ones when they are in their final semesters.

CST was established in 2001 in Penang. It started as an original brand manufacturer, which is in the highest value chain of the E&E industry, dealing directly with customers and controlling its production processes. CST employs 50 workers at its Penang plant and has an office in Shanghai. The company commands a certain level of branding reputation in several countries. It exports about half of its products to China, Thailand, the Philippines, Taiwan, the US, Costa Rica and Germany. From Ong's experience as an engineer in an MNC, he asserted that Penang's E&E sector is still not moving out of manufacturing, not moving into design and rapid prototyping, for example, to attract high-value foreign direct investment.

Ong realizes that his company cannot escape the brain drain problem and the value chain effect in which his company cannot meet the requirements of his customers that are mostly MNCs. However, he has overcome this in his own way. CST moves ahead in technology utilization and development by collaborating with experts from USM and rides on the university's advanced technology for high-end research. It collaborates with the physics faculty of a university because it has a very advanced laboratory, including a RM200 million piece of equipment that has a molecule breakdown system. Ong claimed that even MNCs in Penang do not have such high-end equipment and they have to rent it from USM because offshore MNCs will not invest that heavily in their local sites, except in their home countries. Ong asserted that new graduates and postgraduates that have had this high-tech exposure are very much in demand by MNCs abroad. However, Ong has been trying to recruit top graduates through his collaboration with USM.

Ong claimed that it is no longer easy to make high profit margins from MNCs:

> Today, MNCs don't spend money on testing compared with the past. Previously, MNCs had budgets for testing prototypes. Now, SMEs have to bear the cost of testing prototypes. SMEs can't absorb these expenses and testing durations; you will die if you put on 2–3 systems and they don't buy. MNCs only spend on cloning, not on development and manufacturing at offshore sites. Capital is needed and risk is high to invest in building a prototype, which is only for customers to test it.

Case Study 4: SD Engineering

I interviewed Suresh, owner of SD Engineering in July 2010. SD Engineering is a software design, precision engineering and tooling company in Penang that coped well with the 2008 economic crisis. In terms of revenue and profit, his company survived the crisis. Suresh asserted that manufacturing activities related to his business such as precision engineering, injection moulding and die-casting in Penang had run at full capacity in 2009. However, the profit margin in this sector is not as good as it was in the early 1990s (45 per cent) and today it is only

10–15 per cent. His company's capital expenses have been reduced owing to difficulties in getting a bank loan. According to Suresh, MNCs are cutting budgets; because of increased steel prices, they rework old moulds. MNCs are also now subcontracting their jobs to large-scale local companies, and these companies then subdivide the contracts to smaller companies; thus, the profit margin has dropped. MNCs' jobs are also being reduced because Vietnam and Thailand are more attractive. Furthermore, the E&E and related industries are facing a shortage of skilled labour. To compete for jobs in a narrowing market, he attracts customers by improving his company's technology and being innovative and creative.

The greatest constraint he faces is the difficulty recruiting skilled and talented workers. Consequently, he set up a software company in Chennai, India where graduates with relevant knowledge and skills are plentiful. Moreover, Suresh claimed that Malaysian graduates request US$830 for starting pay. Conversely, in Chennai there is a large pool of better quality graduates who are well equipped with knowledge to work and the starting salary is just US$580. For his precision and injection moulding business, jobs that require less knowledge and lower technology are sent to China and are then shipped back to Penang for final 'touch-up' and 'branding'. Suresh stressed that Penang lacked skilled workers and had higher labour and material costs.

Conclusion

The historical development and changes in the Malaysian economic policies at different stages illuminate institutional innovations as a result of a complex historical interplay among the state, the economy and civil societies. The changing political and socio-economic policies had a negative impact on the scale of production and direction of Chinese SMEs in the manufacturing sector during the NEP period. It severely compromised the integration of Chinese family businesses into the mainstream economy from the 1970s to the mid-1980s. At the same time, the policy created a dependency syndrome amongst Malays in the form of Ali-Baba partnerships that remain in practice today in the Malaysian economy.

The implementation of the protracted inter-ethnic distributive policy into the NDP and NVP periods, coupled with a migration policy that depends on cheap and unskilled labour, caused the middle income trap and brain drain problems. These policies kept Malaysian E&E companies in low-technology production and with low-cost jobs given by MNCs to local SMEs. Local SMEs not only suffer from a lack of technology transfer from MNCs in the supply chain but also suffer from the lack of human capital to develop and sustain their competitiveness levels in the global economy. These constraints have contributed to the underdevelopment of SMEs, especially Chinese SMEs that are capable of linking with MNCs and maximizing the benefits of foreign direct investment (Henderson & Richard 2007). However, some government incentives have managed to encourage some SMEs to participate in technology-intensive activities, particularly in process technology (Rasiah & Krishnan 2008: 78) and keep the industry striving.

Conversely, the pro-distributive socio-economic policies were successful in restructuring Malaysian society and managed to social-engineer a Bumiputera Commercial and Industrial Community that has encroached especially into the wholesale and retail sector. From the positive responses of the economic-based Chinese and Malay civil societies to the government initiatives during the NDP period, a new form of formal smart partnership between the Chinese and Bumiputera took place and witnessed more Bumiputera forays into the manufacturing sector. Nevertheless, the sector of industries involved in this form of partnerships is not directly integrated into the global supply chain as compared to the E&E industry. The state has attempted to be innovative in its economic policies to develop Bumiputera entrepreneurs and at the same time to stay competitive in the global economy but it has to overcome its greatest political hurdle to achieve its 'complete innovation'. Malaysian SMEs may not remain competitive if new initiatives such as the NEM, propelling the country to be competitive in the global economy, are blocked by a stalemate of competing social forces such as Perkasa.

New measures under the NEM could create a new set of economic behaviours that feed back into the political system. These new measures might also shape the forms of enterprises that emerge under the NEM. Their competitiveness depends on whether the NEM encourages efficiency in the allocation of resources and provides equal opportunities to all. Thus, the competitiveness of Malaysian SMEs will most probably be enhanced along with the implementation of new market-driven measures if it goes according to plan. Three areas where the state should improve are technology, education and R&D infrastructure to constantly provide sophisticated levels of support for SMEs, especially in the E&E industry. Being situated in Southeast Asia, in the region of emerging markets, the prospect for Malaysian SMEs is bright and they would thrive if pro-market policies are guaranteed by the state to help shore-up investor confidence.

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NOTES

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2 The definition of SME used in this article is derived from the National SME Development Council (Malaysia 2005b). The criteria used to define SMEs are based on annual sales of between RM200,000 and RM25 million and number of full-time employees between 5 and 150 people. According to the Census of Establishments and Enterprises (Malaysia 2005a), SMEs in Malaysia accounted for 99.2 per cent or 518,996 of total establishments. In terms of employment, Malaysia's SMEs generated jobs for approximately 3 million workers (65.1 per cent of the total employment of 4.6 million) in 2003 (Normah 2006: 5). SMEs have demonstrated their significance to the Malaysian economy as indicated by their contribution to output and value added, RM405 billion and RM154 billion respectively in 2003. In terms of share contribution, SMEs accounted for 43.5 per cent of total output and 47.3 per cent of value added. In terms of contribution by sector, SMEs in the services sector contributed 56.7 per cent of output and 54.7 per cent of value added (Malaysia 2005b).

3 The ACCCIM is the parent organization of the Chinese Chamber of Commerce in Malaysia. It has 17 constituent members located separately in the 13 states of the nation (ACCCIM 2009: 128). Up to 2006, it represented about 28,355 Malaysian Chinese companies, individuals and trade associations in particular, and the Chinese business community in general (ACCCIM 2006). In terms of companies, more than 90 per cent of these members are in the SME category.

4 A local press report in 1972 showed that an estimated 120,000 Chinese business establishments in peninsular Malaysia comprised 71 per cent of the total. Amongst them, 65 per cent or 78,000 establishments were retail shops and 12 per cent were wholesale outlets. The annual turnover of some retail shops was less than RM10,000 and many supposed 'big' shops failed to gross RM500,000. In the wholesale business, average sales volume was small, about 40 per cent achieving an annual sale turnover of not more than RM100,000 (*Nanyang Siang Pau*, 16 February 1978).

5 Figures from 1975 refer to Peninsular Malaysia only and figures for 1980-95 refer to Malaysia.

6 In the period from 1985 to 2005, the Malaysian private sector invested US$3.832 billion in China (*China Statistical Yearbook* 2006). The Chinese Embassy in Malaysia stated that by the end of June 2002, a total of 2,359 Malaysian companies and individuals would have invested in numerous projects in China. The Embassy confirmed that about 90 per cent of Malaysian investments in China have come from local Chinese

businesses (Lee and Lee 2006: 167). In the period from 1988–2006, Malaysian investment in Vietnam amounted to US$1.6 billion, mainly from the Chinese (Malaysia 2008).

7 In short, the core of the 27 subsectors are: computer and related services, health and social services, tourism services, transport services, sporting and other recreational services, business services, rental/leasing services without operators and supporting and auxiliary transport services (PMO, 22 April 2009).

8 For more details on the Talent Corporation, visit http://www.talentcorp.com.my/.

9 According to the World Bank, Malaysians residing overseas numbered only 9,576 in 1960 and by 2005, the number rose to 1,489,168, an almost 100-fold increase over the 45-year period (*The Star* 2010b).

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