

SPECIAL FEATURE 2

REINVIGORATING CAPITAL FORMATION FOR SUSTAINABLE ECONOMIC DEVELOPMENT

Introduction

As Malaysia continues its transition towards being a high-income nation, the domestic capital market has increasingly grown in importance while catering to a more diverse economic structure. Reforms undertaken to improve access to the capital market over the years have helped to enable firms meet their funding needs more effectively and support economic development. From financing being predominantly bank-based in the 1990s, market-based financing of economic activities has seen tremendous growth, with the capital market now serving as the main source of financing for large-scale investment projects.

Improving capability and capacity of the capital market in directing capital towards productive economic activities has led to the continued rise in gross fixed capital formation (GFCF – henceforth investment) over the years¹. This is key as continued growth in capital formation, facilitated by easier access to financing, is essential in raising productive capacity of the economy, accelerating technological progress, and creating employment opportunities.

Given the unprecedented impact of the pandemic, an assessment was undertaken to examine the latest trends in investment growth *vis-à-vis* the capital expenditure (CAPEX) and financial performance of PLCs, as well as to contextualise the future path of the investment landscape in the Malaysian economy.

Malaysia's recent economic recovery accompanied by subdued private investment momentum

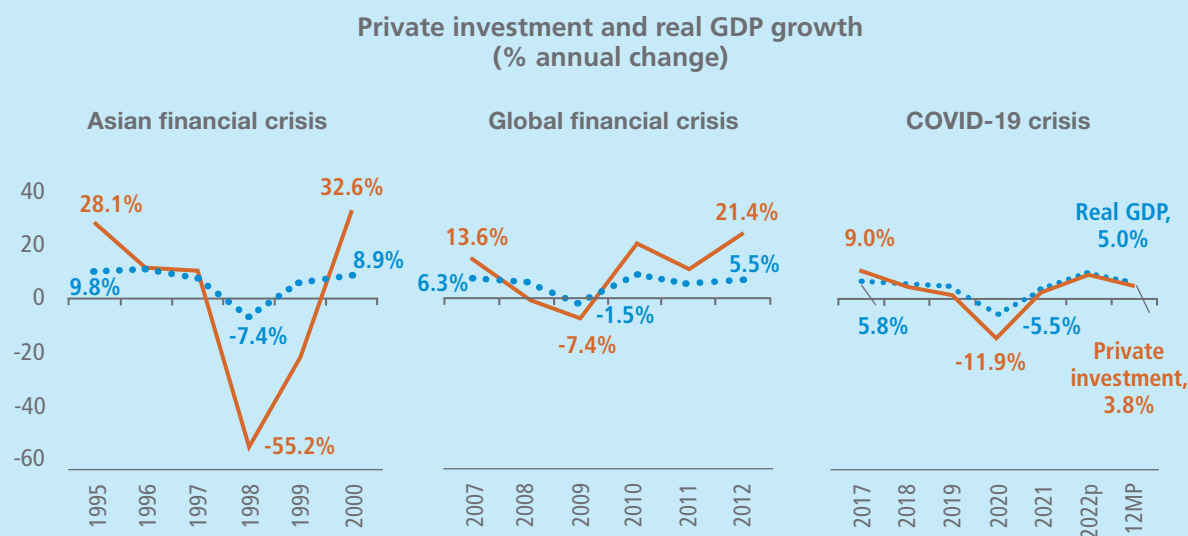
As the Malaysian economy recovers from the pandemic, the momentum in private sector investment, however, has remained relatively subdued. Unlike in past economic crises, private investment growth continued to trail that of real GDP (Chart 1). While this can be attributed to the general increase in macroeconomic uncertainty affecting overall business sentiments, it also partly reflects the uneven and acute impact of the pandemic on Malaysian businesses, especially on smaller firms and contact-intensive industries.

In particular, the GDP of MSMEs grew by 1.0% y-o-y in 2021, while the overall Malaysian economy expanded by 3.1% y-o-y (non-MSMEs: 4.4% y-o-y). This marked the second consecutive year in which MSMEs' GDP growth lagged that of the Malaysian economy, and the first time since 2003 that MSMEs growth trailed that of the overall economy. Continued rise in input costs, alongside ongoing supply-chain imbalances also made the operating environment increasingly challenging and has likely affected the overall capacity of MSMEs to undertake meaningful expansion in capital expenditure.

¹ *Growth of the Malaysian Capital Market in the Last 25 Years: Mobilising Financial Resources for Economic Development*. Feature article in Part 4, SC Annual Report 2018.

CHART 1

Recent recovery in private investment lagged that of recovery in past economic crises

Source: Department of Statistics Malaysia (DOSM); 12th Malaysia Plan; CEIC; the SC's calculations.**PLCs led investment recovery, underpinned by improving financial positions**

Malaysia's PLCs showed tentative recovery in CAPEX in 2021, in contrast to the trend seen among MSMEs. Aggregate CAPEX growth of PLCs rebounded swiftly, reflecting increasing contributions of larger firms in driving domestic investment. This reversed the trend seen prior to the pandemic where total PLCs' CAPEX growth historically trailed that of total investment in the economy (Chart 2).

It is worth noting that CAPEX by PLCs is about 20% of the size of total investment in the economy, 70% of which are from FBMKLCI PLCs. Based on the constituents of FBM Indices, FBMKLCI PLCs demonstrated stronger CAPEX growth performance of 8.2% in 2021, outperforming their pre-pandemic trend and the rest of the economy. In comparison, CAPEX growth by non-FBMKLCI PLCs² was relatively slower at 2.3%, although overall growth remained faster than the 0.5% expansion for total investment (Chart 2).

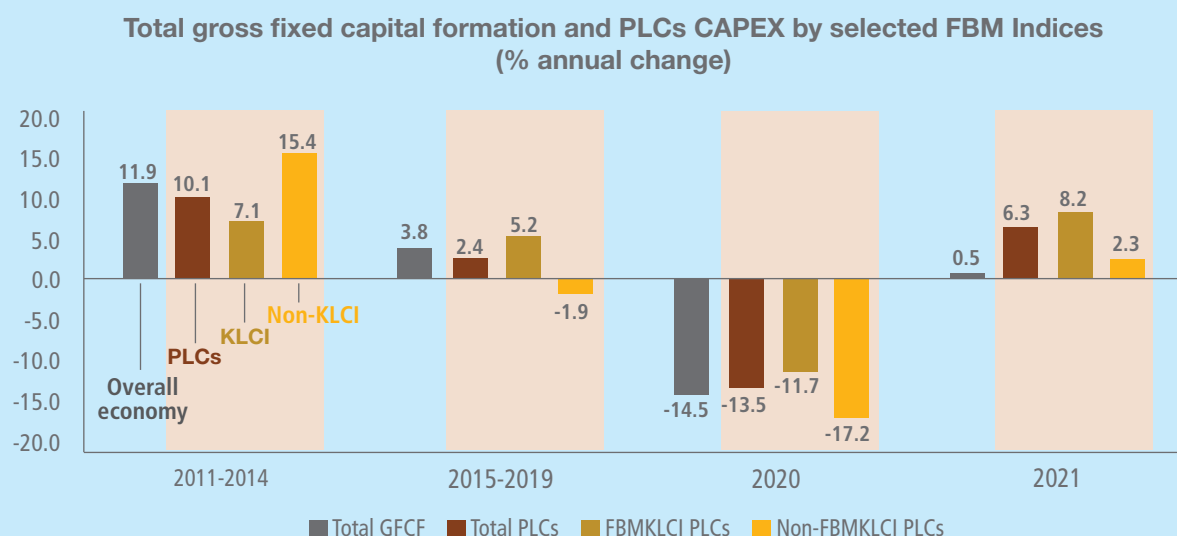
From a sectoral perspective, the recovery in FBMKLCI PLCs' CAPEX growth was led by the utilities and telecommunication sectors, comprising 47% of FBMKLCI PLCs' CAPEX and 19% of FBMKLCI market capitalisation. Meanwhile, among the non-FBMKLCI PLCs, growth in CAPEX was led by the technology, telecommunication and healthcare sectors, which accounted for a combined 21% of non-FBMKLCI PLCs' CAPEX and 23% of non-FBMKLCI market capitalisation. This was in tandem with accelerated global demand in areas of technology and communication induced by the pandemic.

Overall, the improving trend in CAPEX growth was supported by stronger financial position of PLCs, which reflected the resilience of listed firms following the sharp contraction in activities in 2020. Both aggregate net income, and cash and equivalents of PLCs rose significantly to a new height in 2021, well beyond their pre-pandemic average (Chart 3).

² Non-FBMKLCI PLCs comprise constituents of FBM 70, FBM Small Cap, FBM Fledgling and FBM ACE, which amounted to 741 PLCs.

CHART 2

PLCs posted stronger CAPEX growth in 2021 compared to the rest of the economy

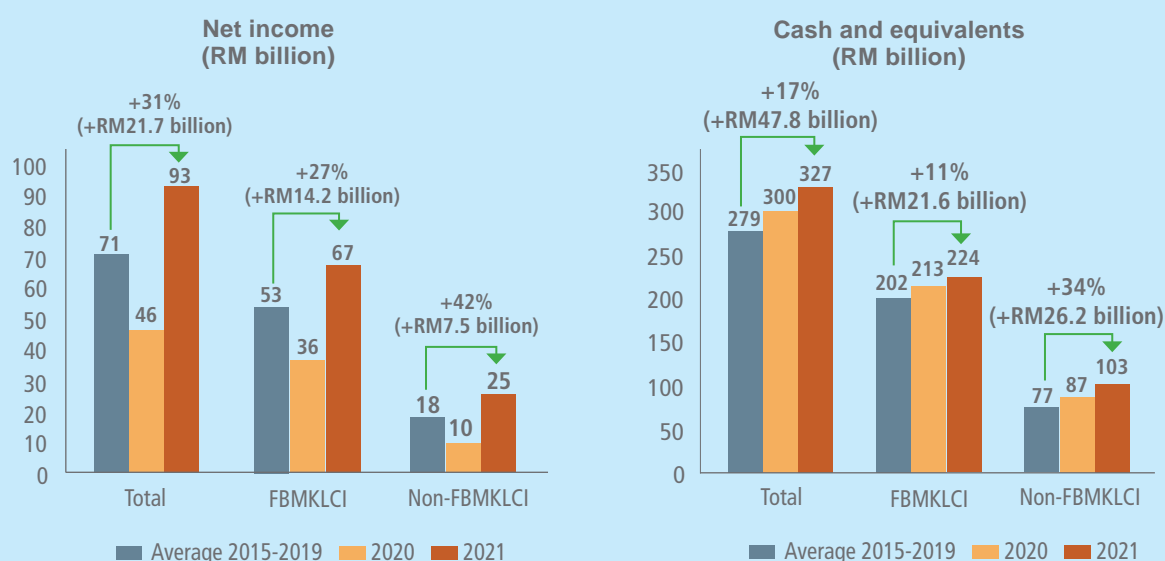


Note: Non-FBMKLCI comprise constituents of FBM 70, FBM Small Cap, FBM Fledgling and FBM ACE, which amounted to 741 PLCs.

Source: Department of Statistics Malaysia (DOSM), S&P Capital IQ, the SC's calculations.

CHART 3

Net income and cash balances of PLCs recovered above their pre-pandemic average



Source: S&P Capital IQ, the SC's calculations.

Going forward, reinvigorating private investment is key to unlocking future growth potential

Going forward, a sustained expansion in capital formation is essential for an entrenched economic recovery and to support economic development. Reinvigorating private investment is key to unlocking future growth potential, especially among smaller businesses and in new growth areas. This can lead to an acceleration in technological readiness and adoption, as well as the creation of high value jobs, all of which will lead to strengthening the economy's productive capacity and ensuring the sustainable growth of the Malaysian economy.

Against the backdrop of an increasingly competitive global environment, the future investment landscape in Malaysia will likely be shaped by three key underlying trends:

- **The changing nature of investment**

Investment activity will likely witness a change in nature as we transition into a higher income and higher value-added economy, in which the focus will increasingly be on quality and its spill-over impacts on wider segments of the economy, rather than just the sheer size of investment. In recognition of this, the recently launched National Investment Aspiration (NIA) serves as a guide to Malaysia's New Investment Policy which will ensure prospective investments are focused on increasing economic complexity, creating high-value jobs, extending domestic linkages, developing new and existing economic clusters, and improving economic inclusivity. With ESG as a key overarching theme for the NIA, the new investment strategies also aim to strike a balance between economic development and sustainability.

- **Recovery of MSMEs will be vital**

MSMEs are the backbone of the Malaysian economy and have become increasingly important for capital formation. MSMEs currently account for 37% of total fixed assets owned in the economy (2010: 25%), generating 37.2% of Malaysia's GDP and providing employment to nearly half of the country's workforce. The recovery of MSMEs will be key to unlocking a more robust and broad-based revival in private sector investment.

In this aspect, the SC continues to facilitate the development of alternative financing avenues that connect issuers with traditionally untapped pools of investors through cheaper, faster, and more convenient delivery channels. This has allowed more Malaysian businesses to obtain access to financing to address their needs at various stages of development. Although still small, alternative fundraising avenues such as ECF and P2P financing have become an important source of financing for MSMEs, increasing their reach by fourfold since their inception.

- **PLCs to spearhead sustainable investment**

The recovery in CAPEX by PLCs is anticipated to continue, increasing their importance in driving investment activities, and further underpinning the productive capacity of the economy. This will be in tandem with the recovery of the Malaysian economy.

The emerging global developments in sustainability and social movements have resulted in increased expectations of corporate accountability to the environment and society. Indeed, increasing numbers of PLCs have initiatives or plans in place that are geared towards sustainability. Furthermore, a number of PLCs have increased CAPEX commitments towards research and development (R&D) especially in mechanisation and digitalisation, towards enabling the ESG transition. This is expected to continue to intensify going forward in line with the national aspirations and initiatives towards ESG, with PLCs spearheading private sector investment towards sustainability.

Conclusion

As Malaysia continues to undergo necessary structural reforms in its transition to a high-income and high value-added economy, the SC's development initiatives will continue to focus on capital formation by facilitating the relevant evolution of the capital market and enhancing access to financing, particularly in new growth areas. The introduction of various strategic initiatives and targeted policy support by the SC since the pandemic have helped underpin economic recovery, ensure business continuity, and maintain the orderliness of capital market activities. Importantly, continuous development of the wider capital market ecosystem will cultivate firms, especially smaller businesses with the potential to structurally upgrade the economy. These are necessary for a more modern economy while ensuring that it remains sustainable and inclusive.