Growth Strategies to Expand role of Capital Market

CHAPTER 3

GROWTH STRATEGIES TO EXPAND ROLE OF CAPITAL MARKET

The CMP2 outlines the strategies to transform the competitive dynamics of Malaysia's capital market over the next 10 years. The development of the capital market is an important aspect of the nation's economic transformation since deep and broad markets are necessary prerequisites to achieving high growth and high income.

The strategies aim to expand the role of the capital market in financing business ventures, creating jobs, widening ownership of assets, and generating returns on long-term savings.

GROWTH STRATEGIES:

1. **Promote capital formation.** Create a conducive intermediation environment to seed emergent companies and industries, nurture the growth of small and mid-cap companies, finance large and high-risk ventures, and promote investments in socially responsible projects.

2. **Expand intermediation efficiency and scope.** Address structural constraints to increase the efficiency of savings intermediation and foster an innovative and diverse intermediation environment to expand the supply of assets to meet the needs of investors.

3. **Deepen liquidity and risk intermediation.** Broaden the diversity of investment strategies and strengthen market connectivity through risk intermediation products and widening the range of participants.

4. **Facilitate internationalisation.** Expand growth boundaries by tapping global opportunities to facilitate an expansion in scale and to capitalise on hub opportunities in areas of comparative advantage.

5. **Build capacity and strengthen information infrastructure.** Strengthen the knowledge base through talent development and acquisition to support the expansion of the capital market into high value-add areas and build a strong information infrastructure to address information asymmetries and promote service innovation and efficiency in a highly-electronic environment.

3.1 Promote capital formation

There are abundant growth opportunities in Malaysia with prospects across a broad front of emergent competitive niches in service-based segments such as healthcare, tourism, logistics, education and food as well as knowledge-based segments such as creative industries, green technology, biotechnology and information technology.

There are also opportunities arising from innovative re-design of service processes and products in traditional sectors such as manufacturing, agriculture and infrastructure while new markets and opportunities are likely to emerge from growing cross-border regional trade and investment.

"Addressing these gaps and inefficiencies will overcome investment bottlenecks and increase the rate of capital formation as well as the supply of quality assets..."

Since CMP1, business enterprises in Malaysia have considerable choice in financing their growth with the broadening of fund-raising avenues. This provides flexibility to opt for varying debt or equity financing arrangements depending on market conditions and to choose a capital structure that optimises returns to shareholders.

Malaysia has more than sufficient domestic financial resources to finance higher levels of domestic investments to achieve higher growth. However, there appear to be gaps in the eco-system from the start-up stage through the entire deal-flow pipeline which inhibit a higher level of completion of primary transactions. Addressing these gaps and inefficiencies will overcome investment bottlenecks and increase the rate of capital formation as well as the supply of quality assets in the Malaysian capital market to match the substantial needs of investors.

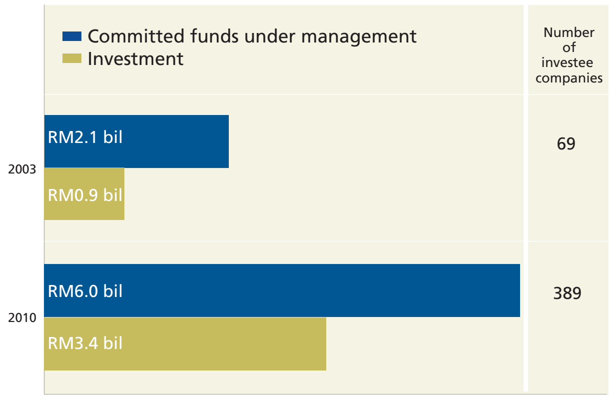
3.1.1 Increase private sector participation in the venture capital and private equity industries

The government recognised the important role of the venture capital (VC) industry as a source of financing to emerging high-growth companies and provided significant funding and tax incentives to promote the growth of the industry. Arising from the strong government commitment, the Malaysian VC industry has enjoyed high growth with committed funds growing by 16% annually from RM2.1 billion in 2003 to RM6.0 billion in 2010 with about half of the funds disbursed for investment. (See Chart 6)

Despite the growth, the VC industry has yet to achieve sufficient critical mass to generate self-sustaining growth momentum. A broad range of industry challenges were highlighted in a study on funding for an innovation economy overseen by the Malaysian Venture Capital Development Council (MVCDC) while the NEM has made several key recommendations to strengthen the growth of the industry.

As an outcome of these recommendations, there are on-going efforts to streamline national initiatives to promote innovation and to ensure more coordinated and effective public sector funding of the VC industry. In this regard, there are considerable benefits from closer partnerships based on public funding and private sector expertise through co-investment approaches such as matching government grants or initial funding schemes.

Chart 6
Venture capital funding and investee companies



Source: Securities Commission Malaysia

There are also opportunities for further public-private sector collaboration in the critical areas, namely at the start-up stage or in nurturing patents towards the commercialisation stage. Initiatives such as angel networks will assist in seeding the formation of innovation-based companies.

Moving forward, the expansion of the role of the private sector in developing the VC industry and the complementary development of the private equity (PE) industry are important strategies to broaden the sources of financing. Higher private sector involvement in these industries are critical to providing technical skill sets and market knowledge to assist new ventures to quickly build commercial track records to increase VC deal flow.

Currently, private sector participation in the VC and PE industries is relatively low-key and loosely organised. This is partially due to the limited range of legal structures for pooling of investments and will be addressed through corporate law reform and regulatory changes to facilitate a widening of the asset classes for intermediation. It also underlines the need to attract investment from institutional and high net-worth investors.

In addition, the PE industry comprises a broad range of regulated and unregulated participants investing in a broad spectrum of unlisted and listed assets. The lack of formal regulatory oversight hinders the orderly development of a highly professional industry.

Towards this end, a framework to formalise regulatory oversight will be developed to promote investor confidence in the VC and PE industries, taking into account the unique characteristics of these industries. Regulatory oversight will aim to establish standards of professional management and safeguards. It will also provide for the maintenance of records and facilitate a more effective tax regime.

In tandem with this, it is strategically important to expand the participation of the public and private sector investment management industry in VC and PE. First, increasing the portfolio allocation into primary investments will strengthen the intermediation linkages between savings and capital formation. Second, it will reduce the correlation between investment portfolios with market risk, thereby reducing systemic risks. Third, the investment management industry is now sufficiently large to be able to dedicate the necessary resources to accumulate the expertise and build the capabilities to assess and manage the risks of investing in primary transactions, either on their own or through outsourcing mandates. An increase in institutional demand for VC and PE assets and services is critical to promoting the growth of the industry.

"...increasing the portfolio allocation into primary investments will strengthen the intermediation linkages between savings and capital formation."

One major constraint for institutions to invest in unlisted assets relates to the illiquidity of these investments. A review would be undertaken to assess the viability of establishing facilities to mitigate illiquidity risks of investing in VC and PE assets.

Efforts will also be made to promote greater PLC participation in seeding the formation of innovation-based companies or through providing greater support to the VC and PE industries. In this regard, collaborative initiatives will be identified to facilitate PLCs to provide greater support to VC investee companies via vendor schemes, co-investment arrangements or through their participation in an angel network.

The VC industry is also generally constrained by the inadequate number of professionals, high staff turnover and a general lack of the deep technical and market knowledge to assist successful commercialisation of technological-based ventures.

It is important to target the critical talent linkages that may affect the investor's perception of the prospects for a large pay-off within a reasonable time frame. The selection of management teams with the perceived capability of overcoming challenges typically associated with new ventures would provide greater confidence and increase the willingness to invest in companies without a track record.

Towards this end, Talent Corporation Malaysia Bhd (TalentCorp) can facilitate connecting domestic and international talent with global industry knowledge and track records with the opportunities that are available in Malaysia's VC and PE industries. These strategies will provide the foundation to strengthen professional management and ensure more organised and efficient efforts in promoting early-stage capital formation.

Box 3

Promoting venture capital investments through the capital market

To promote the growth of the venture capital industry, the MESDAQ Market was launched in 1998 to cater for the listing of high-growth and technology companies. MESDAQ has been a major success as a growth platform and has now been re-positioned as a sponsor-driven market called the ACE Market to further broaden access to equity capital for domestic and international companies.

The number of companies listed on ACE Market (formerly MESDAQ) has increased from 12 companies in 2002 to 113 companies in 2010. The market has also nurtured growth companies which have been promoted into the Main Market of Bursa Malaysia. In total, 23 companies have transferred to the Main Market; of which 15 companies had a market capitalisation in excess of RM100 million as at the end of 2010.

The ability of the investment management industry to participate in primary investments and in the VC and PE industries has been expanded over the past decade. Flexibilities were provided for the investment management industry to invest in unlisted securities and wholesale funds to invest in venture capital funds. Collective investment schemes such as unit trust funds and closed-end funds were also allowed to invest up to 10% of their net asset value (NAV) in unlisted securities. The framework for listing of special purpose acquisition companies (SPAC) provides another vehicle for capital-raising by VC and PE firms.

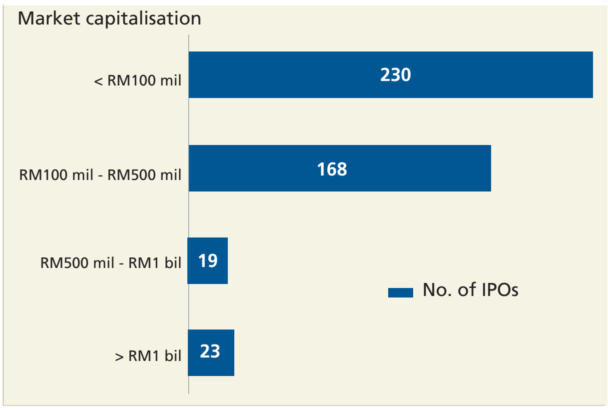
3.1.2 Strengthen economic functionality of the stockmarket in promoting growth of small and mid-cap companies

Once companies reach a sufficient size, public markets can promote their growth through providing a healthy initial public offering (IPO) market for small and mid-cap companies. Small and mid-cap companies contribute significantly to innovation, job creation, economic growth and shareholder returns over the long term.

Over the past decade, the Malaysian stockmarket has been successful in providing equity finance to small and mid-cap companies. Of the 440 IPOs on Bursa Malaysia over the past 10 years, 230 companies or 52% of IPOs started with a market capitalisation of less than RM100 million. Another 168 companies or 38% of IPOs had market capitalisation of between RM100 million and RM500 million. (See Chart 7)

Chart 7

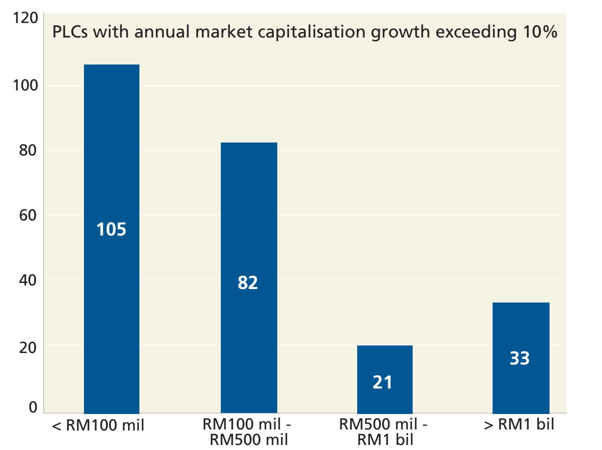
IPOs by market capitalisation 2000–2010



Note: IPO size based on listing year-end market capitalisation
Source: Securities Commission Malaysia

Chart 8

Growth companies by market capitalisation 2000–2010



Note: Based on initial market capitalisation as at end-2000 or year-end of IPO listing
Source: Securities Commission Malaysia

Small and mid-cap companies contribute on the margin to current market capitalisation and trading value. Nonetheless, they are an important source of future growth both for the economy and the capital market. Many of Malaysia's large companies today were once small companies two or three decades ago.

Of the 955 companies on Bursa Malaysia, 241 public-listed companies (PLCs) grew their market capitalisation by more than 10% annually for the period 2000 to 2010. Of these, 60 companies had annual growth rates exceeding 25%. The majority of the high-growth companies, comprising 78% of the 241 PLCs, started with a market capitalisation of less than RM500 million. (See Chart 8)

Longer-term global trends in relation to changes in equity market structure portend future challenges in nurturing the growth of small and mid-cap companies using traditional intermediation models. In many markets, the viability of the traditional agency distribution model (comprising research, distribution and market-making) that supported active trading in small and mid-cap stocks has diminished since the emergence of electronic trading which has tended to concentrate liquidity within the largest stocks.

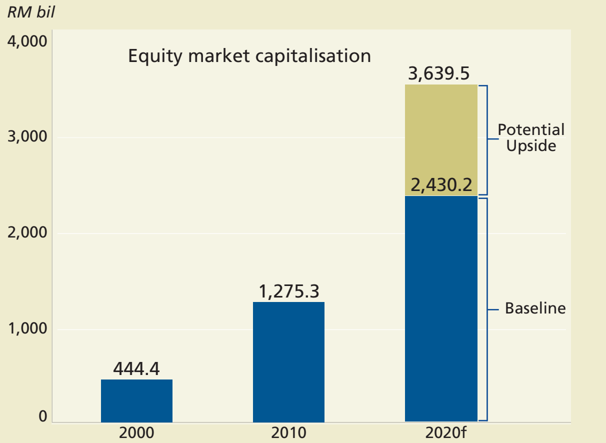
The equity market structure changes have resulted in a weak IPO environment and low valuations and trading inactivity of listed small and mid-cap companies. The weak equity market environment has also raised concerns over the knock-on effects affecting venture capital, private equity and mergers and acquisition (M&A) activities. As a consequence, some developed markets have experienced a decline in IPOs and an increase in de-listings since 2005.

There is also a need to anticipate challenges to the Malaysian equity market arising from the relative maturity of the economy. Therefore, greater efforts are required to strengthen the economic functionality of markets in promoting the growth of small companies and in serving the interests of long-term investors.

Box 4

Growth prospects for equity market to 2020

Equity market capitalisation to double to RM2.4 trillion in 2020



Source: Securities Commission Malaysia estimates

Historical trends suggest that underlying growth in equity market capitalisation is largely driven by long-term economic and corporate earnings growth. At the baseline level, it is projected that the size of equity market capitalisation will double from RM1.2 trillion to RM2.4 trillion by 2020 – based on real GDP growth of 6.5% and a historical average market capitalisation to GDP ratio of 139%.

There are significant upside growth prospects from the structural reforms and investment projects being undertaken under the NEM and ETP. In this context, the implementation of structural reforms can accelerate the growth of the real economy while greater internationalisation of domestic listed companies and additional foreign listings can facilitate a significant expansion in equity market capitalisation. It is estimated that internationalisation of the stockmarket can increase its potential size by 50% to RM3.6 trillion in 2020.

In addition, the large domestic investments, new listings of government entities and the rapid growth of Malaysia's broad base of small and mid-cap stocks will contribute significantly to market capitalisation growth over the decade.

Further collaboration with capital market intermediaries, PLCs and relevant organisations is required to identify and address issues relating to the growth of listed small and mid-cap companies. Regulatory facilitation will be provided to enable intermediaries to evolve business models that promote research, distribution and market-making support for these companies. The establishment of venues for unlisted companies, where access will be limited to sophisticated investors, will also provide greater access to funding and fast-track their transition to a listing in a public market.

Investor confidence has also been affected by investments in listed companies which experience persistent losses or are in financial distress. Poor corporate performance may arise from a combination of difficult industry operating conditions, mismanagement or weak governance. It is important that investor confidence issues in relation to poorly-performing companies are proactively managed including through initiatives that facilitate a turn-around in operational viability.

3.1.3 Widen access to the bond market

The development of a significant bond market provided critical long-term financing to many large-sized and catalytic economic projects, resulting in Malaysia having one of the best infrastructures in the region, ranging from international airports and highways to power plants and telecommunications. The bond market has also been a source of financing support for banks and corporations and provided liquidity to balance sheets through the securitisation of mortgages and other receivables.

> "Widening the credit spectrum therefore requires strengthening investor confidence, increasing the participation of the public and private investment management industry, expanding the product range and enhancing the market infrastructure."

In tandem with the economic transformation plans, there is a need to broaden the capability and capacity of the bond market to supply financing to a wider base of industries and projects; particularly in supporting the structural shift towards the services and knowledge-based industries.

The ability to widen access to bond financing for more sophisticated ventures is critically dependent on broadening the investor base and appetite for a wider array of debt products and credit risks.

Widening the credit spectrum therefore requires strengthening investor confidence, increasing the participation of the public and private investment management industry, expanding the product range and enhancing the market infrastructure.

Towards this end, market standards and practices will be enhanced through improving documentation and disclosure standards as well as clarifying post-issuance disclosure obligations and requirements. The credit rating agency (CRA) framework will be further enhanced to converge with new international standards and best practices covering key areas such as the transparency of rating criteria and policies, rating reviews and the governance structure of CRAs.

"The participation of the public and private sector investment management industry in fixed income investments needs to be further strengthened."

The default process for bonds will also be reviewed to provide greater clarity and certainty to investors. In tandem with this, efforts will be made to promote a more active market for the pricing of distressed issues.

The participation of the public and private sector investment management industry in fixed income investments needs to be further strengthened. This will require building their fixed income investment capabilities to enable their participation in a broader spectrum of structures and credits.

There is also a need to increase transparency and liquidity in the secondary market to match the growth in primary issuance. This will be achieved through strengthening the environment for electronic trading and infrastructure in the areas of bond lending, market-making, trading, clearing, settlement and custodian services.

Efforts will also be made to promote greater retail participation in the bond market through developing a framework to facilitate the offering of corporate bonds to retail investors, covering the eligible issuer base, mode of offering, format of offering documents, price transparency, investor protection and education activities. In addition, distribution channels will also be widened to enable greater retail investment.

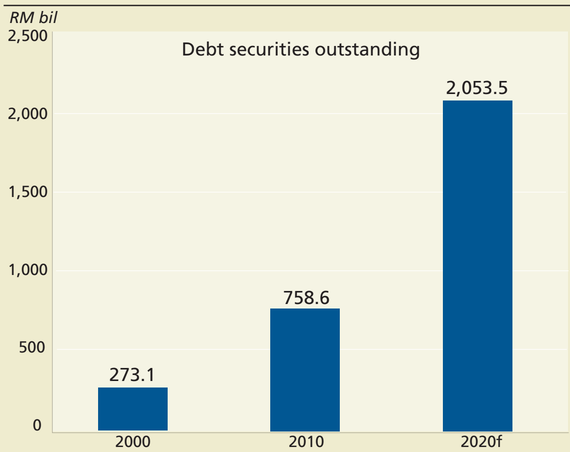
The availability of a broad range of interest rate-sensitive products is required for the application of sophisticated fixed-income investment strategies and to promote active trading and arbitrage in the bond market. In conjunction with increasing institutional investment in fixed income, the product range will be broadened to include fixed-income indices and inflation-linked products.

Further additional mechanisms will be considered to widen participation and deepen liquidity in the bond market. The establishment of Danajamin Nasional Bhd provides a means for less-established companies to gain access to the bond market and to establish their track record for credit-worthiness while a review will be undertaken to assess the viability of establishing facilities to mitigate illiquidity risks of bond funds.

Box 5

Growth prospects for bond market to 2020

Debt securities to exceed RM2 trillion in 2020



Source: Securities Commission Malaysia estimates

Malaysia's bond market is relatively well-developed with outstanding bond issuances approximating 97% of GDP. It is ranked the third largest bond market in Asia by GDP. Market depth is reflected by an average weighted bond tenure of 16 years and an average issuance size of RM670 million, while market width is reflected by the diversified range of conventional and Islamic instrument.

The bond market is expected to sustain reasonable growth over this decade. The ETP has already identified several major infrastructure projects which will underpin strong domestic issuance. Demand growth will be driven by the increasing participation of the investment management industry in fixed income investments and through growing international participation in Malaysia's bond and sukuk market.

Further improvements in the legal, regulatory and institutional framework will support the continued deepening and broadening of the bond market. The growing pool of fixed income professionals will provide the necessary expertise to originate debt and sukuk structures to match the financing requirements for infrastructure projects and the investment needs of both the private and public sectors.

3.1.4 Promote socially responsible financing and investment

Financial innovation can be harnessed to create market-based solutions to mobilise investments in technology and projects that promote sustainable and inclusive development. There is room to expand the role of the capital market in developing innovative approaches to finance environmental projects such as the development of alternative energy sources or clean technologies. A broad range of financing instruments can also be developed to finance community infrastructure development and the building of educational, healthcare and cultural facilities.

The financing of these projects typically requires multi-stakeholder involvement including governments, regulators, businesses, NGOs, consumers, intermediaries and investors. Many aspects of environmental projects are dependent on collaboration to create the necessary infrastructure for standardisation, certification and transparency. These projects usually require government support, including incentives.

Innovative products such as green funds or bonds can be used to finance investments in low-carbon technologies and support various programmes to test innovative approaches to managing climate change such as forestry and energy renewal. The creation of these funds usually requires coordination between academic and research institutions to provide businesses and intermediaries access to technical expertise. Greater coordination in financing green technology investments will also assist the fulfilment of national commitments on environmental sustainability.

Malaysia's economic and resource base will provide longer-term opportunities for the trading of environmental products such as carbon credits or alternative risk transfer mechanisms such as weather derivatives or catastrophe bonds.

As Malaysia becomes increasingly affluent, it is critical that PLCs and intermediaries enhance their international reputation through increasing their participation in projects which promote sustainable development.

Globally, the investment management industry has provided substantial impetus in recognising societal concerns as part of its corporate responsibility. The momentum of socially responsible investing (SRI) funds reflects the growing interest of institutional investors to build a sustainable economy that generates long-term wealth. Their innovative investing styles have influenced corporations to improve their practices on environmental, social and governance issues.

SRI provides a base for the launch of investment products such as SRI indices and exchange-traded funds (ETFs). SRI can also be used to finance small and local community projects such as for affordable housing, small business creation, development of community facilities, empowerment of women and minorities, education, childcare and healthcare.

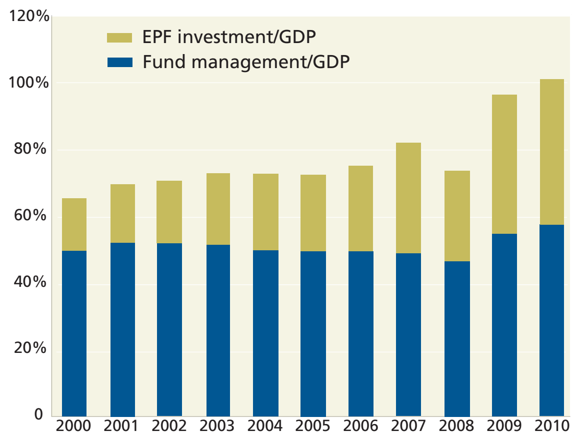
3.2 Expand intermediation efficiency and scope

There have been structural changes in the channels of savings mobilisation and intermediation in Malaysia since 2000. The first occurred with the diversification of the sources of financing in the Malaysian capital market. The financial deepening broadened the intermediation base and increased the avenues for financing large-scale projects to reduce concentration risks and maturity mismatch.

The second structural change occurred with the rapid growth of institutional funds relative to the size of the economy, similar to the trends witnessed in developed markets. Using assets under management (AUM) by licensed fund managers and the Employees Provident Fund (EPF) as a proxy, aggregate institutional funds as a percentage of nominal GDP rose from 65.4% in 2000 to 101.7% in 2010.

Chart 9

Institutional funds as a % of nominal GDP



Note: Fund management excludes Employees Provident Fund mandates
Source: Securities Commission Malaysia

The large amount of savings managed by organised public and private investment schemes relative to the size of the economy reflects the increasing influence of investment strategies of institutional investors on the capital market and economy. Effectively, their collective demand for assets shapes the intermediation landscape and how savings are invested in the economy.

Institutional investors have tended to concentrate their investments in liquid and high-quality assets. This "narrowness" of the demand for assets implicitly limits the availability of financing to high-risk ventures. As an outcome, Malaysia's intermediation landscape is similarly characterised by relatively narrow product silos, reflecting in part the lack of substantial demand for a broader range of intermediation services.

The growth of Malaysia's capital market and its contribution to economic activities can be expanded by addressing structural constraints to the efficient recycling or intermediation of high national domestic savings.

Fostering an innovative and diverse intermediation environment requires tackling demand through broadening the risk profile of savings intermediation as well as simultaneously expanding supply by strengthening capabilities and the range of products and services.

3.2.1 Facilitate efforts to enhance efficiency of public sector savings intermediation

Historically, investment institutions such as the EPF and Permodalan Nasional Berhad (PNB) were established to mobilise savings to finance government infrastructure development and to broaden Malaysian participation in the industrialisation process.

As the capital market deepened over the decades, public and private sector investment institutions inevitably shifted from their developmental objectives towards greater emphasis on prudent and passive investment strategies aimed at ensuring safety and returns to contributors and investors. This resulted in a tendency to replicate the most successful investment strategy, namely buying and holding the largest PLCs.

While risks may appear diversified at the level of the individual investment institution, when the effects are viewed on an aggregated basis, the adoption of similar investing strategies inadvertently reduces diversification of national savings. The replication of portfolios across investment institutions increases the correlation of national savings with market risks.

Passive institutional investment strategies also result in long-term funds being largely invested in liquid instruments. This leaves an equity gap in entrepreneurial financing that is critical to driving the nation's economic growth which, in turn, reduces the supply of risk capital to support the creation of new assets for the capital market. With savings outpacing the creation of equity assets, this aggravates the effects arising from an imbalance between domestic savings and investments.

"...the optimal deployment of GLIC funds is central to increasing the intermediation efficiency of national savings..."

In this context, the structural imbalances evolved out of the success in implementing policies to ensure prudent institutional management of national savings. The domestic institutional funds are responsibly managed and represent a strategically important liquidity buffer that lends strength to Malaysia's financial soundness and underpins its ability to internally finance future growth.

Therefore, addressing the savings-investment structural imbalance requires careful assessment of the system-wide effects of institutional investment strategies and the impact of subsequent changes to existing policies on the capital market and economy.

Arising from the NEM and ETP, there are already on-going efforts to review the government's role in business and to optimise the deployment of Government Linked Investment Corporation (GLIC) funds. In this context, the optimal deployment of GLIC funds is central to increasing the intermediation efficiency of national savings with substantial positive benefits on capital formation, private sector participation, secondary market liquidity, risk-taking and product and service diversity.

There is room to reduce areas of overlapping activities among GLICs to achieve greater diversity in investment strategies to optimise returns and reduce the correlation of aggregated portfolios with market risk.

There is a need to review the impact of the GLICs' collective investment strategies on the development of the capital market particularly in relation to their role in increasing the supply of investible assets to more closely match their investment needs.

"...the broad objectives are to achieve greater diversification of GLIC investment strategies and allocations from a system-wide perspective..."

In this regard, GLICs are a natural source of "patient" capital given the long-term nature of their funds. It will be consistent to match their long-term funds with a higher level of investments in ventures or projects with long-term pay-offs. This will require a change in mindset and investment mandates to provide greater tolerance for risks and a strengthening in the capabilities for assessing, monitoring and managing the risks associated with these ventures. Towards this end, there is room for some GLICs to either directly build up direct investing capabilities or to increase their portfolio allocations to the VC and PE industries.

Another key area relates to the need to increase the diversification of aggregated portfolios either at the level of the individual GLICs or through re-positioning of some GLICs to adopt more specialised investment mandates. In this context, some GLICs can be positioned to act as cornerstone investors to stimulate demand for a broad range of capital market products and services or have targeted mandates such as investing in small and mid-cap stocks.

Ultimately, the broad objectives are to achieve greater diversification of GLIC investment strategies and allocations from a system-wide perspective as this is a critical factor in reducing systemic risks and in ensuring more efficient intermediation of national savings to promote the growth of the capital market and the economy.

The diversification in investment strategies can either be directly undertaken by GLICs or through increasing their outsourcing fund mandates to private sector players, which offers the additional benefit of building private sector intermediation capabilities.

3.2.2 Expand diversity and value-add of private sector savings intermediation

The broadening of portfolio risk profiles is an important aspect of enhancing savings intermediation efficiency. Effectively, when investment preferences are limited to safe and liquid instruments, this reduces demand for higher-risk and less liquid products on the capital market. The widening of risk profile in organised investment schemes is critical to ensure more widespread and effective deployment of long-term savings to finance economic growth.

The intermediation of savings through public institutions moderates the level of risk-taking and active management on account of the higher level of responsibility and sensitivity inevitably associated with investments made by government entities.

Enhancing savings intermediation efficiency therefore requires an expansion in the role of the private sector in managing long-term savings. In this regard, the private sector is better positioned to increase the variety of financing alternatives and investment outlets, and to implement strategies for managing risks.

"...the investment management industry acts as a value-add intermediation layer that amasses high-level skill sets and connects the different segments of the capital market with the economy."

The ability to pool risks through multiple investments provides the ability to absorb losses from a majority of investments as high pay-offs from some successful investments will still result in a net positive return on capital. This characteristic of widening the risk profile will be instrumental in encouraging more active exploration of investment opportunities in new growth and innovative areas.

The private sector, through expanding the range of value-add products, can therefore play a key role in diversifying system-wide risks with positive benefits on domestic direct investment, secondary market liquidity, and product and service diversity.

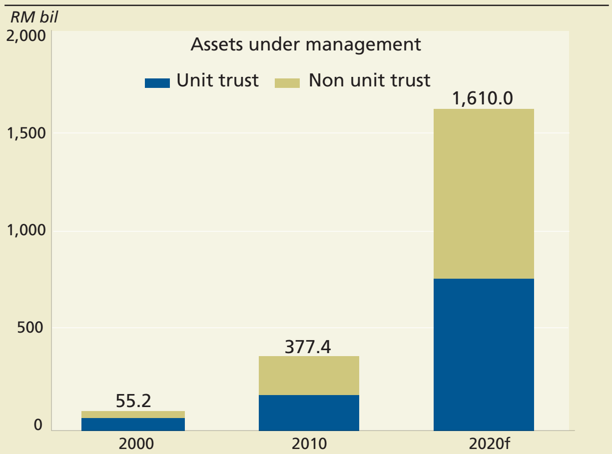
Over the past decade, the private sector investment management industry has grown rapidly due to product and channel deregulation undertaken in tandem with a strengthening in the standards of investor protection through enhancing disclosure and governance standards. The AUM grew at a compounded pace of 21.2% per annum from RM55.2 billion in 2000 to RM377.4 billion in 2010.

The investment management industry performs two valuable functions. First, the industry manufactures investment products for savings and second, the industry provides advice on the management of savings and purchase of products. In this manner, the investment management industry acts as a value-add intermediation layer that amasses high-level skill sets and connects the different segments of the capital market with the economy.

Box 6

Growth prospects for investment management industry to 2020

Assets under management projected to reach RM1.6 trillion in 2020



Source: Securities Commission Malaysia estimates

Malaysia's investment management industry is among the fastest growing segments in the capital market. Based on historical trends, AUM is projected to rise from RM377.4 billion in 2010 to RM1.6 trillion in 2020 as critical mass effects facilitate the adoption of volume strategies and higher efficiencies from increased economies of scale.

The unit trust NAV is projected to increase to RM827.9 billion in 2020. The penetration rate for unit trusts is likely to almost double from 18% in 2010 to 34% in 2020 – a feature typical of an economy in transition from middle income to developed status.

Long-term growth prospects continue to be favourable due to Malaysia's encouraging demographics, expanding workforce and high savings rate. Domestic demand for professional advice from fund managers, investment advisers, and financial planners is expected to grow in tandem with rising affluence and sophistication.

In addition, the pace of growth in the wholesale segment is expected to outpace the retail segment as the industry broadens with contributions from the private retirement scheme industry, Islamic fund management, and external mandates.

The role of the investment management industry is expected to further expand with the establishment of a private retirement scheme industry to complement existing mandatory schemes. The private retirement scheme industry will assist in promoting greater diversity in the management of long-term savings. (See Box 7)

The participation of the investment management industry in direct investing will be enhanced by expanding the range of legal structures to facilitate pooling of investments. The introduction of limited liability partnerships and managed investment schemes will broaden the range of vehicles for risk-sharing and investing in long-term projects.

In tandem with this, a regulatory framework will be established for the VC and PE industries to attract greater institutional investment. This will be complemented by the development of Islamic funds that invest based on the principles of active partnership and risk-taking.

Box 7

Development of the private retirement scheme industry

Malaysia's mandatory provident fund is considered among the leading schemes in the world and has served the needs of its contributors well. However, the mandatory scheme mainly covers employees and does not provide sufficient replacement income to meet post-retirement needs. Hence, the government decided to establish a voluntary private retirement scheme to ensure a robust and sustainable multi-pillar pension system.

Under the framework, employers and contributors will have greater flexibility and a wide range of choice in supplementing mandatory retirement savings to ensure greater sufficiency of retirement income. Approved providers will offer a choice of dedicated fund options catering to the different investment and risk profiles of contributors.

A strong regulatory and supervisory framework will be established to ensure an effective governance structure, sound risk management practices, and internal controls to safeguard the interests of contributors.

Malaysia's private retirement scheme industry, which is being developed in line with international best practices, represents a new growth segment for the capital market. Over the next ten years, it is projected that assets under management in the private retirement scheme industry will grow to RM30.9 billion.

The range of asset classes for intermediation will also be broadened to facilitate portfolio diversification into commodities and other non-securitised investment opportunities. To add greater dynamism and diversity to the industry, a framework will be established for eligible boutique fund managers.

It is also critical to strengthen the branding of the investment management industry through promoting its participation in SRI. Industry is encouraged to develop specialised funds and listed investment products that promote investing in socially-oriented and sustainable projects.

3.2.3 Expand scope of market intermediation

Capital market intermediaries play a key role in connecting customers with products. They provide services through originating products, providing advice, facilitating transactions through various channels, and ensuring seamless and convenient execution and settlement of transactions. Intermediaries also rely on the use of their balance sheets, skills, and relationships to provide liquidity through underwriting, distribution, and active trading to ensure markets are vibrant and efficient.

Compared to a decade ago when the intermediation landscape was fragmented and weak, Malaysia today has strong domestic intermediaries offering a broad range of services to both domestic and regional clients in a liberalised environment. The strong balance sheets and capabilities of the domestic intermediaries provide a sound foundation for further expansion.

> "...Malaysia today has strong domestic intermediaries offering a broad range of services to both domestic and regional clients in a liberalised environment."

The changing intermediation landscape is already posing new challenges. The emergence of new technologies is eroding the value in traditional order-taking business. In this regard, there is still too much reliance on static and narrow product silos and traditional low-cost models which are ineffective in meeting changing customer preferences.

The future growth of Malaysia's capital market therefore requires further broadening of the range and scope of intermediation activities. Diversity provides greater choice and will attract more customers who can have varying preferences in terms of costs, efficiency, convenience, product customisation, advice and service requirements.

Expanding the range of value-add services is key to fostering an innovative and competitive intermediation environment where intermediaries are quick to identify new areas of demand growth and capture productivity gains from delivering services in a seamless manner in a highly electronic environment.

It is a core strategy of the CMP2 to increase intermediation efficiency and scope through fostering a conducive environment for innovation, facilitating greater diversity and expanding growth prospects across the value chain. This includes providing a regulatory environment that supports the ability of capital market intermediaries to offer a wide range of services subject to their capabilities in managing the risks of their operations.

> "...there is room to explore growth opportunities in ancillary industries that support the capital market."

The regulatory framework will also be revised to facilitate de-coupling and outsourcing of business functions including separating trading and settlement membership. This would create an enabling environment for industry to reconfigure their operations to leverage on their competitive strengths rather than incur the costs of maintaining full service operations.

Improvements will also be made to the market infrastructure to broaden the use of technology through a wide array of electronic devices and interfaces to enhance customer reach and increase operational efficiency.

The SC will collaborate with industry to strengthen their competitive positioning through facilitating the development of business models such as for promoting the growth of small and mid-cap companies and for market-making.

In particular, strategies will be identified in collaboration with industry to strengthen the role of remisiers, unit trust agents and financial planners in the changing intermediation landscape, given their value-add in providing personalised customer services. This would include increasing the opportunities for upskilling and expanding the range of products and services.

Intermediation diversity will also be expanded through facilitating the entry of domestic and international participants that offer value propositions which can promote the growth and competitiveness of the Malaysian capital market.

While the core intermediation industries are reasonably developed, there is room to explore growth opportunities in ancillary industries that support the capital market. The SC will extend its developmental focus across a broad range of middle and back-office functions covering advisory services, research, risk management, compliance, settlement, custodian, trustee and other services in capital market-related areas.

Efforts will be made to attract international players to use Malaysia as a regional base for their middle and back-office functions. The development of more competitive niches will foster productivity and higher value-add activities with the supporting clusters providing positive feedback effects.

3.3 Deepen liquidity and risk intermediation

Secondary market liquidity in Malaysia remained persistently low throughout the last decade despite efforts to enhance the trading environment through upgrading market infrastructure and widening participation. As a result, turnover velocity has lagged the other Asian stockmarkets. (See Chart 10)

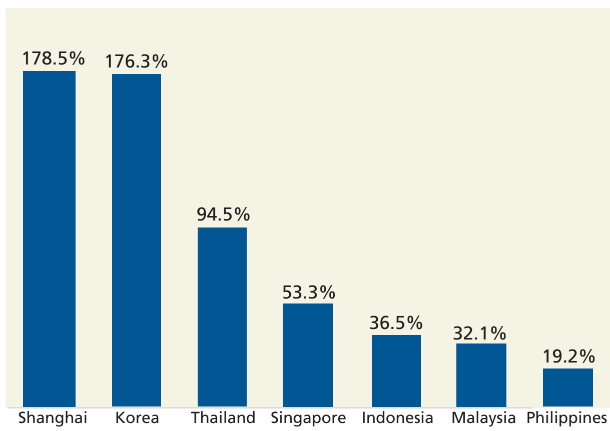
The low liquidity is also reflected in Malaysia's narrow risk-return profile. The annualised standard deviation of return for Malaysia's stockmarket index, the FBMKLCI, hovered around an average value of 13.1% over the past decade, far below the average of 22.8% recorded by other markets. In tandem with the lower volatility, the average annualised returns of 8.0% from FBMKLCI surpassed those of developed markets but were below those in Indonesia, India and Korea. (See Chart 11)

The risk-return profile of Malaysia's stockmarket reflects its attractions to long-term investors as the narrow dispersion between risk and return signifies an orientation towards safety. However, the low price volatility also implies reduced trading opportunities relative to other markets and this decreases the level of transactions relative to market capitalisation.

It is critical therefore to deepen secondary market liquidity to provide efficient exit markets that incentivise upstream investing activities by the VC and PE industries to finance start-ups and small firms which are an important source of economic growth.

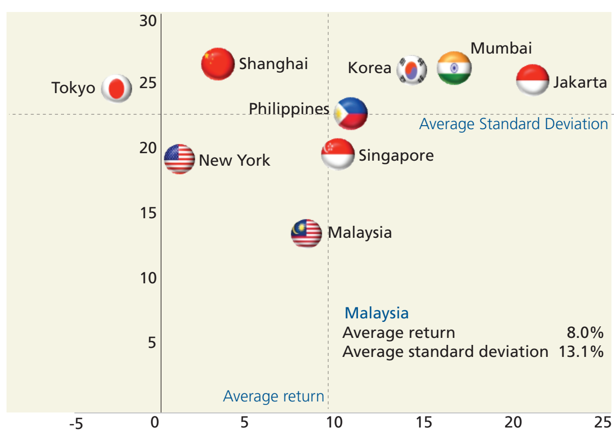
The role of secondary market liquidity in promoting investments becomes more important as the economy structurally shifts from traditional manufacturing activities, which offer tangible collateral, towards services and innovation-based activities where the assets are intangible and future values are often associated with higher levels of uncertainty and volatility.

Chart 10
Regional turnover velocity in 2010



Source: World Federation of Exchanges

Chart 11
Risk-return profile of selected markets 2000–2010



Source: Securities Commission Malaysia estimates

The shift to a high-growth path may therefore be constrained by bottlenecks caused by relatively low levels of risk intermediation. Short-term risk intermediation activities assist in facilitating greater completion of secondary market transactions which in turn improves the level of risk-taking activities and generates economic growth momentum.

"Short-term risk intermediation activities assist in facilitating greater completion of secondary market transactions..."

3.3.1 Address concentration of savings

Generally, in most other markets, liquidity tends to be concentrated in the largest stocks. This is not the case in Malaysia where the trading velocity of the largest market-capitalisation stocks, about 45 PLCs accounting for 72.4% of equity market capitalisation and 60.8% of total equity trading value, is unusually low at 25%. Therefore, it is important to increase trading in the largest market-capitalisation stocks to increase turnover velocity in Malaysia.

Table 3
Turnover velocity by market capitalisation in 2010

Market capitalisation segment	No. of PLCs	Outstanding market cap (RM bil)	Turnover value (RM bil)	Turnover velocity (%)
More than RM5 bil	45	902.1	224.5	25
RM1 bil – RM5 bil	96	207.5	75.7	36
RM100 mil – RM1 bil	369	118.4	57.9	49
Less than RM100 mil	445	18.4	10.9	59
TOTAL	**955**	**1,246.4**	**369.0**	**30**

Notes: Market capitalisation excludes non-equity instruments and is based on year-end. Turnover value includes direct business transactions.
Source: Securities Commission Malaysia

The anomaly in the distribution of market liquidity arises from the relative dependence of domestic institutions on investing in the domestic equities market to generate returns on their funds. The size of these funds, which are concentrated in several investment institutions, exceeds the supply of sizeable and liquid equity assets.

The requirement for major domestic institutions to hold large and liquid stocks on a long-term basis reduces the amount of readily-available sizeable blocks for trading. This in turn increases the price impact of large trades, thereby making it more expensive to buy or sell stocks.

The deepening of secondary market liquidity in Malaysia therefore requires promoting greater diversification of portfolio asset allocations by the major domestic institutions. An important aspect of these efforts is to broaden the range of investment strategies and styles to even out the distribution of investments by asset size and class.

3.3.2 Facilitate efficiency of price discovery and hedging across markets

Financial innovation has shifted price discovery from underlying physical markets to derivatives markets because of their cost-efficiencies and flexibilities for hedging. Around the world, trading on futures and derivatives has expanded to a multiple of trading volumes in the physical market.

Futures and derivative products have become increasingly popular as they can be engineered to provide more precise combinations of risk, return and liquidity and to provide cost-effective cover to hedge risk exposures. They also perform the important function of increasing connectivity between market segments and various asset classes through facilitating efficient price arbitrage.

> "A vibrant and comprehensive derivatives market is therefore required to reinforce dynamism in other segments of the Malaysian capital market..."

Currently, Malaysia's secondary market for risk intermediation is narrow due to the limited range of products on the derivatives exchange. As a result, derivatives trading on Malaysian assets has migrated to offshore and OTC markets.

The lack of a comprehensive derivatives market poses challenges to increasing liquidity and connectivity between different market segments and asset classes. This leads to pricing inefficiencies which increases transaction costs and reduces trading activities due to the high costs of hedging and arbitrage.

The development of a well-regulated derivatives market in Malaysia is also critical to strengthening the industry learning curve, retaining talented risk product specialists and developing onshore capabilities for risk intermediation thereby creating more business opportunities.

A vibrant and comprehensive derivatives market is therefore required to reinforce dynamism in other segments of the Malaysian capital market and to underpin an expansion in the range of intermediation products and services.

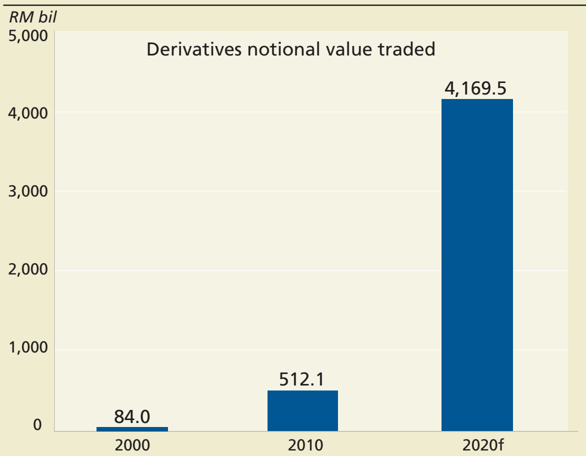
The re-positioning of Malaysia's derivatives exchange has already started with a strategic alliance between Bursa Derivatives and the CME Group. This will be followed by an expansion of the product range to enable hedging and arbitraging activities across market segments. In tandem with this, the infrastructure for clearing, cross-margining and settlement will be enhanced to ensure higher levels of operational efficiencies.

The SC will also collaborate with industry participants to facilitate a broadening of the range of product and service offerings by futures brokers, promoting a strengthening in the capabilities and standards of industry participants and through expanding reach to customers.

Box 8

Growth prospects for derivatives market to 2020

Projected growth in derivatives market



Source: Securities Commission Malaysia estimates

Malaysia is the global price discovery centre for crude palm oil (CPO) prices. Over the next decade, this strength will be complemented by substantially widening the product range to match the rapid advances made by other Asian derivatives markets.

The strategic alliance between Bursa Derivatives and the CME Group and migration of trading to CME's Globex trading platform will widen distribution of Malaysian products to international participants and facilitate the ability of domestic intermediaries to trade international products.

The broadening of Malaysia's capital market, the increasing sophistication of the investment management industry and the increased use of technology will underpin demand for an expansion in the range of derivative products. This will have a positive spill-over impact on liquidity in the equity and debt markets as higher levels of hedging and arbitrage activities occur across different market segments.

3.3.3 Widen market connectivity and participation

Structural changes in the global market landscape have transformed trading venues from national-centric silos into nodes in a global electronic trading network. As market structures evolve, the patterns of liquidity flows have altered with the emergence of electronic proprietary and hedge fund trading eroding the traditional dominance of market-makers and retail participants as the main suppliers of liquidity.

In the changing landscape, the challenge for the Malaysian capital market is to attract more short-term international and domestic traders, including retail investors, to bring about better balance to a market environment that is currently dominated by long-term investors.

There will be continued efforts to increase market connectivity through strengthening market infrastructure to promote greater use of technology. Regulatory facilitation will be provided to encourage the stock exchange and intermediaries to pursue cross-border alliances that promote higher levels of cross-border flows, particularly within ASEAN in line with the aspirations to promote integration of capital markets in the region. This will include regulatory mutual recognition agreements that would facilitate cross-border offerings, listings and exchange alliances.

"Regulatory facilitation will be provided to encourage the stock exchange and intermediaries to pursue cross-border alliances..."

The prevailing market arrangements and tax structure deter individuals from being effectively organised into firms as professional traders who can provide liquidity across a broad range of markets. A review will be undertaken to facilitate the establishment of specialist trading firms that will undertake proprietary trading and market-making across market segments.

The trading patterns of retail investors have also changed with a trend favouring electronic access through the internet or other telephony devices. In this regard, the costs of technology have fallen so rapidly that relatively sophisticated tools, such as algorithmic trading and technical analysis software, and the convenience offered by electronic services are now readily available to individual clients at relatively low costs.

Towards this end, the role and capacity of remisiers, unit trust agents and financial planners will be strengthened to enable them to meet the challenges from the changing intermediation landscape with a view to attracting higher retail participation in the market.

3.4 Facilitate internationalisation

Globalisation presents new challenges but globalisation also provides opportunities that form the basis of future growth in productivity and living standards. In this context, global financial deepening and the convergence to international standards are enabling greater international mobility with issuers, investors, and intermediaries increasingly accessing more markets. At the same time, exchanges are offering a cosmopolitan menu of products to complement traditional equity products.

The changing landscape dynamics require strategies that facilitate connectivity to improve access to global transaction flows and to expand product and service offerings to attract more customers.

Internationalisation is also a key requirement for an economy seeking to make a transition from middle-income to high-income. Internationalisation expands business relationships and operational scale and therefore enlarges growth boundaries beyond the constraints of a domestic economy.

Domestic intermediaries gain new business opportunities from transacting in foreign products and, in the process, reduce the leakage of intermediation value-add. International competition also provides a useful benchmark to domestic firms and accelerates learning curves and the building of capabilities. Inevitably, domestic firms must compete with international firms, whether onshore or offshore, to generate high income and to attract and retain talent.

3.4.1 Expand international intermediation capabilities

Global trends suggest equity markets grow in tandem with the economy. As markets mature, the size of the domestic economy tends to constrain the growth of the market. However, the growth of markets can be augmented by internationalisation. (See Box 9)

Over the past decade, Malaysia has already liberalised its capital market through facilitating international fund-raising, listings, participation, access, and investments abroad. The future growth of Malaysia's capital market will increasingly be shaped by internationalisation strategies aimed at maximising international participation and strengthening the ability to build scale and take advantage of business opportunities.

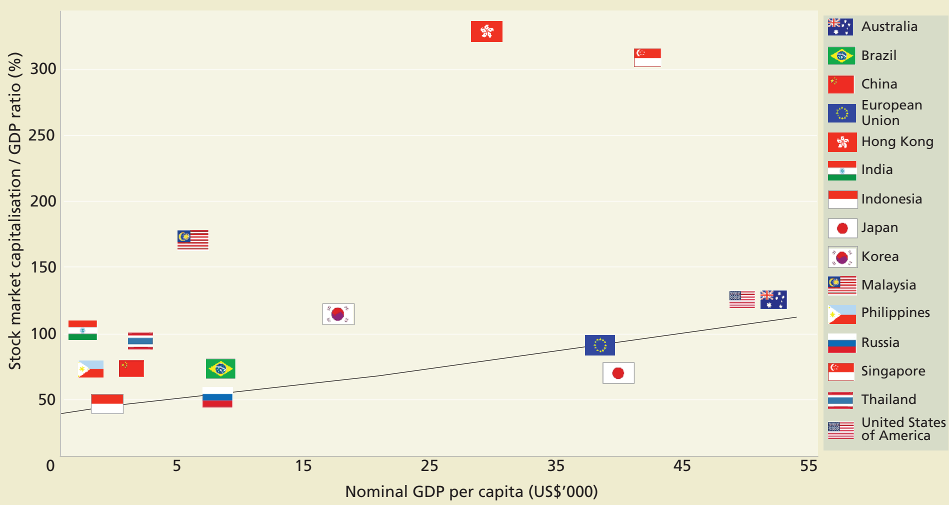
It is anticipated that the future landscape will become characterised by a multi-venue, multi-product and multi-asset environment. The effects of these landscape changes are already evident with new competitors such as multilateral trading facilities and dark pools eroding the market share of traditional exchanges. This has already triggered several transnational exchange take-overs as well as a re-configuration of exchange business models to de-couple trading, clearing, and settlement functionalities.

Malaysia had adopted a pragmatic approach in responding to the changes in the exchange landscape. Bursa Malaysia has pursued strategic alliances with other exchanges, particularly within ASEAN and its subsidiary, Bursa Malaysia Derivatives, has already tied up with the CME Group to widen its reach to global customers. Further opportunities will be identified to strengthen Malaysia's positioning in the fast-changing global exchange landscape including through strategic alliances and partnerships.

Box 9

Equity market capitalisation to GDP ratios

Global equity market capitalisation to GDP ratios



Note: The world stockmarket line is estimated based on a sample of 98 countries in 2010. Hong Kong's market capitalisation to GDP ratio exceeded 1,200% as at end-2010.
Source: International Monetary Fund, World Bank and World Federation of Exchanges; Securities Commission Malaysia estimates

There is a long-term relationship between stockmarkets and economies with corporate profits acting as the causal link between market capitalisation and nominal GDP. As depicted in the chart, developed stockmarkets tend to converge around a market capitalisation to GDP ratio of between 90% to 120%. Malaysia can be regarded as having a well-developed stockmarket with its market capitalisation to GDP ratio fluctuating within a range of 90% to 170% during 2000 to 2010.

International financial centres such as Hong Kong and Singapore have been able to maintain high market capitalisation to GDP ratios in excess of 300% through their ability to attract foreign listings to sustain expansion in market capitalisation relative to the size of their economies. Internationalisation can also add to market capitalisation growth through domestic companies expanding abroad.

Malaysia has also strengthened the positioning of its bond market with the removal of withholding tax coupled with a facilitative approval framework. These developments have resulted in Malaysia being recognised as an important hub for cross-border investments and issuances in the region. Since 2004, foreign issuers have issued RM18.6 billion worth of bonds and sukuk. Foreign investments in local currency bonds amounted to RM121 billion in 2010.

Overall, further improvements will be made to enhance the connectivity of the clearing and settlement infrastructure while friction costs will be reduced to attract more active international investor trading in the secondary equity, bond, and derivative markets.

The changing pattern of global savings intermediation augurs strong growth prospects for domestic intermediaries based in Asia. Asian intermediaries benefit from home ground advantage in recycling substantial domestic savings surpluses and from their proximity to new growth opportunities.

"Internationalisation will be an important catalyst to unlocking hub opportunities in a broad range of middle and back-office functions."

In recognition of the benefits of higher intra-regional participation, the ASEAN Finance Ministers endorsed an Implementation Plan from securities regulators to promote the development of an integrated capital market in ASEAN by 2015.

The Implementation Plan offers a comprehensive set of strategic initiatives and specific implementation actions to pursue regional integration. This includes mutual recognition frameworks for cross-border offerings, listings, and professionals, the formation of exchange alliances, and the development of a conducive regulatory framework and infrastructure to facilitate cross-border transactions among capital markets in the region.

Domestic intermediaries have already been preparing to operate in a more open and competitive environment. They have strengthened their presence in the regional market and advised on international transactions. They have also embarked on distribution of international products to domestic clients. (See Box 10)

The SC will continue to pursue cross-border regulatory arrangements to facilitate the expansion of domestic intermediaries and distribution of products in other markets. In addition, intermediary standards and capabilities will be strengthened across a broad range of industry segments to facilitate their participation in international transactions and markets.

Apart from its core industry segments, Malaysia has natural strengths in many parts of the value chain for capital market transactions. Internationalisation will be an important catalyst to unlocking hub opportunities in a broad range of middle and back-office functions covering advisory services, research, risk management, compliance, settlement, custodian, trustee and other services.

In this regard, Malaysia is well-positioned to attract international participants as it offers an attractive choice of locations in Kuala Lumpur, Labuan and Iskandar; each with its own advantages. This needs to be complemented with strategies to attract talent with knowledge of international practices related to the capital market, law, accounting, tax and Shariah, to build an eco-system that provides cost-effective support for the structuring and processing of international capital market transactions.

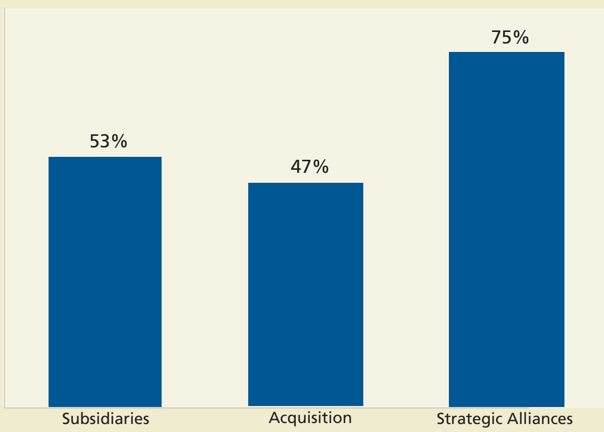
Box 10

SC survey on international expansion plans of intermediaries

In 2009, the SC conducted a survey of 89 capital market intermediaries on their international expansion plans over the next ten years. The survey results are highlighted below:

- 94% of domestic intermediaries anticipate expanding business abroad through establishing strategic alliances, subsidiaries and through acquisition of foreign entities;
- The share of profits from international operations is expected to grow from less than 10% of total profits to between 30% and 50% over ten years; and
- Domestic intermediaries expect their sales of foreign products to rise from 10% currently to about 30% of revenues.

International expansion by strategy



Source: Securities Commission Malaysia

3.4.2 Widen Islamic capital market's international base

Malaysia is among the pioneers in Islamic finance and has a successful track record in innovating and commercialising many Shariah-compliant products. Arising from this, Malaysia's sukuk market has evolved into the world's largest with Bursa Malaysia as the leading exchange for listed sukuk in terms of value. Malaysia is also among the global leaders in the Islamic fund management industry. (See Box 11)

Box 11

Growth prospects for Islamic capital market to 2020

ICM by Segments

Market segments	2000 (RM bil)	2010 (RM bil)	CAGR % (2000–2010)	2020 (RM bil)	CAGR % (2010–2020)
Market cap of Shariah-compliant companies	254.1	756.1	11.5	1,551.1	7.4
Sukuk	39.6	294.0	22.2	1,331.5	16.3
Total ICM	293.7	1,050.1	13.6	2,882.6	10.6
Shariah-compliant unit trust NAV	1.7	24.0	30.3	158.0	20.7

Source: Securities Commission Malaysia estimates

Malaysia's ICM has grown rapidly over the past decade, generally outpacing the conventional sector, with double-digit growth in the market capitalisation of Shariah-compliant equities, value of sukuk outstanding and NAV of Shariah-compliant unit trust funds. As at the end of 2010, 88% of companies listed in Malaysia and 39% of total bonds outstanding were Shariah-compliant.

Reflecting the strong underlying demand for Shariah-compliant assets, the range of Shariah-compliant products has also expanded to include real estate investment trusts (REITs), exchange-traded funds (ETFs) and this has been complemented by the establishment of a commodity *murabahah* market.

Over the decade, the ICM is expected to sustain double-digit growth to almost RM3 trillion in 2020. The ICM will achieve critical mass and will benefit from increased scale efficiencies from sustained product and service enhancement and innovation. In addition, there is potential growth upside from increasing internationalisation of Shariah-compliant intermediation activities through on-going efforts in product development, fund management and cross-border collaboration.

Malaysia already has the advantage of having a capital market where the majority of assets are Shariah-compliant, which therefore attracts participation of both Shariah and conventional investors. The broad customer demand and liquidity provide positive reinforcement while Islamic products and services also benefit from the advantages of the broader investor protection framework with the additional assurance of greater consistency and clarity in Shariah governance.

Greater internationalisation of the capital market is a critical aspect of the strategy to strengthen Malaysia's positioning as a global ICM hub. This will be complemented by strategies to strengthen the distinctive value propositions offered by Malaysia for a broad range of Islamic intermediation activities.

The sukuk market, where Malaysia is a global leader, represents an attractive international value proposition. There is a need to strengthen the capacity to structure multi-currency and cross-border transactions and to build greater scale to enable Malaysian intermediaries to make further inroads into the international market.

Malaysia has a strong base in equity and equity-related products and services. In this regard, the SC will collaborate with industry players to expand the range of Shariah-compliant stockbroking and portfolio products and services. At the current stage of development, there is also a need to strengthen the service and operational infrastructure so that domestic Islamic products and services can be effectively marketed to global customers. This requires a widening of international distribution channels coupled with intensified profiling of Malaysia's ICM.

There is also a need to accelerate the building of critical mass for the onshore portfolio management. The development of a significant Islamic fund management industry is critical to build domestic take-up capabilities for innovative domestic and international Islamic products. In this regard, widening the range of Shariah-compliant products – in the form of collective investment schemes, indices, ETFs and REITs – and the diversity of their investments by sector and by geography, can attract more domestic and international investors. Mutual regulatory arrangements to facilitate cross-border distribution will be expanded.

"A seeding strategy will be developed to increase the diversification of Islamic investment strategies and styles."

A seeding strategy will be developed to increase the diversification of Islamic investment strategies and styles. Priority will be placed on nurturing Islamic fund management services with high value-add such as the Shariah-compliant VC and PE industries that invest based on the principles of active partnership and risk-taking, and SRI based on Islamic principles. In this context, the Islamic fund management industry will play a key role in developing products and services that not only generate economic returns but also comply with universal ethical standards to strengthen the distinctive value proposition of Malaysia's ICM.

In order to further facilitate internationalisation of the ICM, the SC will promote a shift from a Shariah-compliant approach to a Shariah-based approach where the underlying structures of products such as *mudharabah* and *musharakah* would originate from risk-sharing principles and offer significantly different pricing and returns characteristics. There is a need therefore to focus on product innovation and development efforts that will provide a comprehensive array of Shariah-based products for the industry. Towards this end, there will be further development of the Shariah legal, regulatory and governance framework.

The shift to a Shariah-based approach will require a higher level of risk tolerance and acceptance of the longer gestation arising from participating in business ventures with more direct linkages between risk and returns.

The SC will also collaborate with the industry to identify potential hub opportunities in ICM-related services, particularly in the provision of middle and back-office functions. This will be supported by initiatives to ensure a facilitative operational, tax and human capital infrastructure to enhance the attractiveness of Malaysia as a base for regional and international operations.

"The depth and width of Malaysia's ICM has broadened the base of intermediation capabilities in terms of Shariah research, advisory and compliance expertise."

The depth and width of Malaysia's ICM has broadened the base of intermediation capabilities in terms of Shariah research, advisory and compliance expertise. Further efforts will be made to enhance Malaysia's contribution to Shariah research through increased international collaboration on Shariah research and product development to sustain the rapid pace of innovation. The SC will also develop a code of conduct for Shariah advisers and further strengthen training and professional education to increase the supply of Shariah experts on a broad range of capital market activities and to maintain Malaysia's position as a leading centre for ICM.

3.5 Build capacity and strengthen information infrastructure

Over this decade, intermediaries will increasingly need to adapt to a changing workforce, a diffused working environment, and the pervasive use of technology in many aspects of capital market activities. In the changing environment, knowledge in the form of skills and capacity for innovation will increasingly define competitive advantage and economic growth potential.

Initiatives are required to strengthen the knowledge base to support the expansion of the capital market into high value-add areas and to ensure the availability of skills to support innovative business processes. This requires ensuring that the educational and training pipeline provides a sufficient supply of skilled workers whose knowledge is reinforced through an effective learning environment through close collaboration between industry, academia and the public sector.

The rapid assimilation of skills and application of knowledge also requires an information infrastructure that facilitates cost-effective and efficient regulatory oversight, risk management, service innovation, and operational efficiency as the capital market shifts into a highly electronic environment.

3.5.1 Build capacity to meet future requirements

Achieving high income and sustaining high growth require public and private sector investment in skills and capacity to build a strong knowledge base and to acquire the ability to transform knowledge into growth in the form of innovative products, processes and solutions.

In line with this, there is a need to increase the supply of capital market specialist skills that underwrite growth in processes such as quantitative and modelling techniques, technology, regulatory compliance, and middle and back-office operations.

Increased interaction between industry, academia and investors is needed to create a favourable environment for the diffusion of knowledge and to strengthen the discovery and innovation process.

Greater industry input and participation are required to deepen applied and specialist research and training and to enhance linkages between theoretical research and product development. Grants and incentives from intermediaries can encourage universities to undertake innovative research to design, improve and integrate advanced technology in capital market processes.

In recent years, global competition for talent has intensified and Malaysian talent is highly sought after in many countries. Malaysia's high income strategy is clearly inter-linked with a strategy to attract and retain talent which requires narrowing the remuneration differential with international financial centres. This underscores the urgent need for high growth strategies for the Malaysian capital market to generate revenue growth to increase the capability to offer higher salaries to compete for talent.

The demand for Malaysian talent overseas and Malaysia's ability to draw foreign students suggests that Malaysia has strengths in the education industry to evolve into a regional centre for education and professional development in capital market-related areas. Strategies will be developed to pursue hub opportunities for education, training and professional development in capital market-related areas and to develop specific niches for thought leadership through establishing world class centres of excellence.

It is also important to promote greater diversity of the workforce to benefit from broadened perspectives as this would result in more robust processes and innovation. Knowledge of international practices is also required to build greater cross-border capabilities and market share in international transactions.

This needs to be complemented with an open policy that creates jobs to attract international talent in the capital market as well as in other professional and ancillary industries such as the legal and accounting professions. Lack of openness inhibits the industry learning curve and technical deepening as on-the-job exposure to global work cultures and environments is critical to reinforce classroom learning.

3.5.2 Strengthen information infrastructure to support transition to a highly electronic environment

It is envisaged that there will be pervasive use of technology across a broad spectrum of products, activities and processes over the decade. As the Malaysian capital market becomes increasingly advanced, there will be a need to strengthen operational efficiencies and to provide cost-efficient access to information.

Malaysia's trading infrastructure for equities, derivatives, and bonds has already been upgraded to improve market access and connectivity. However, market participants require further reductions in friction costs and a seamless post-trade infrastructure for clearing and settlement.

There are several areas to be addressed to achieve straight-through processing (STP) which include reducing the gap in delivery versus payment (DvP) arrangements, strengthening the process for failed trades and improving the efficiency of depository, custody and collateral management practices. The integration of the clearing and settlement system with the payments system will also be a priority.

"...pervasive use of technology across a broad spectrum of products, activities, and processes..."

Increasing market connectivity will also require the ability to cater for an environment with national differences in legal and taxation regimes, differing disclosure and corporate action requirements, ownership and custodian requirements, various administrative and approval processes, and settlement time frames and operating hours.

Moving forward, there will be a need to address how best to integrate efficiencies across diverse entities with their varying systems, data environment, protocols and processes. Market participants will also seek better access to trade transactions and control, higher levels of data consistency and quality, more efficient collateral management and more convenient processes for securities lending and borrowing. There is a need to facilitate greater electronic connectivity starting at the client level and to provide the necessary inter-operability with different back-office systems.

The importance of information is underscored by how real-time information gaps in the global financial crisis posed considerable challenges for the detection and management of operational and financial risks for market participants and regulators.

The quality of markets is also judged by how information asymmetry – a situation where one party has more information than the other party – is addressed. It is not only important that there is adequate disclosure of information, but that the information is also easily available and accessible to all investors.

Overall, it is envisaged that the Malaysian capital market environment will be highly electronic in the future. This would necessitate substantial increases in building information capacities and infrastructures as well as in terms of information technology (IT) expenditures. There is a need for a clear and holistic roadmap for the development of the information infrastructure to ensure greater synchronisation of industry IT strategies to achieve cost-effective investments in technology. The roadmap will cover:

- Benchmarking of implicit and explicit transaction and post-trade costs to identify areas for improvement;

- Enhancing post-trade settlement efficiencies through the implementation of STP capabilities. This will include identifying required improvements in clearing and settlement, depository, custody and collateral management practices, and the requirements to facilitate integration of clearing and settlement with the payments system;

- Establishing the technological standards, protocols and capacity requirements to ensure greater inter-operability across a broad range of systems, data environment, and entities in various market segments;

- Identifying infrastructure improvements to support technology-driven innovation and business strategies and to enhance service capabilities. This would enable intermediaries and participants to undertake specialised functionalities in trading, products, and services on a cost-effective basis and support enhancements in customer interfaces and back-office connectivity; and

- Addressing information asymmetry challenges through strengthening the infrastructure for cost-effective and efficient data capture, information gathering, analysis, disclosure and corporate communication.

  – Efforts will be made to establish a data framework for taxonomy with unified naming conventions while data management policies will be developed to ensure data consistency and integrity to meet requirements for aggregation and automation of data flows.

  – Data reporting requirements would also be strengthened to facilitate aggregation of enterprise-wide and market data on a real-time basis for risk monitoring, surveillance and supervision.

  – The SC will establish a central electronic disclosure system based on interactive data formats such as the eXtensible Business Reporting Language (XBRL) for prospectuses, financial reports, and updates for continuous reporting obligations to facilitate efficient information access.

  – Greater use of technology will be facilitated for the dissemination of information and communication by PLCs to their shareholders as well as for the conduct of AGMs and for voting. Regulatory changes will be undertaken to facilitate transition to a highly electronic environment, including the abolishment of non-electronic disclosure requirements, and through mandating the dissemination of information through electronic channels for disclosures and corporate actions.

GROWTH STRATEGIES TO EXPAND ROLE OF CAPITAL MARKET

PROMOTE CAPITAL FORMATION

Increase private sector participation in the venture capital and private equity industries

- Establish regulatory framework for VC and PE industries
- Expand participation of investment management industry in VC and PE
- Establish facilities to mitigate illiquidity risks for investments in VC and PE
- Promote PLC participation in supporting growth of VC investee companies
- TalentCorp to facilitate connecting talent with VC and PE opportunities

Strengthen economic functionality of the stockmarket in promoting growth of small and mid-cap companies

- Industry collaboration and regulatory facilitation to evolve business models to promote growth of small and mid-cap companies
- Facilitate establishment of venues for unlisted companies
- Proactively address investor confidence issues in poorly-performing PLCs

Widen access to the bond market

- Strengthen disclosure and documentation standards and practices
- Enhance the CRA regulatory framework
- Review bond default process and promote active market for pricing of distressed issues
- Expand participation of investment management industry in bond market
- Strengthen bond trading and post-trade infrastructure
- Facilitate greater retail participation in bond market
- Expand range of fixed income products

Promote socially responsible financing and investment

- Facilitate innovative approaches to finance socially responsible projects
- Promote socially responsible investing

EXPAND INTERMEDIATION EFFICIENCY AND SCOPE

Facilitate efforts to enhance efficiency of public sector savings intermediation

- Review impact of GLICs' investment strategies on the development of the capital market

Expand diversity and value-add of private sector savings intermediation

- Establish private retirement scheme industry
- Enhance participation of investment management industry in direct investing
- Widen range of asset classes for intermediation services
- Establish framework for eligible boutique fund managers
- Strengthen branding of the Malaysian investment management industry

Expand scope of market intermediation

- Widen the range of capital market intermediation services
- Facilitate de-coupling and outsourcing of business functions
- Facilitate greater use of technology in intermediation
- Extend developmental focus across the capital market value chain

DEEPEN LIQUIDITY AND RISK INTERMEDIATION

Address concentration of savings

- Broaden diversity of investment strategies in the investment management industry

Facilitate efficiency of price discovery and hedging across markets

- Expand range of derivative products
- Strengthen infrastructure for derivatives cross-margining, clearing and settlement
- Collaborate with industry to expand products and services and to strengthen the capabilities and standards of futures brokers

Widen market connectivity and participation

- Increase connectivity through technology, cross-border alliances and facilitating regional integration
- Facilitate establishment of specialist trading firms
- Enhance the role and capacity of remisiers, unit trust agents and financial planners in attracting retail participation

FACILITATE INTERNATIONALISATION

Expand international intermediation capabilities

- Strengthen Malaysia's positioning in the global exchange landscape
- Strengthen connectivity of clearing and settlement infrastructure and reduce friction costs
- Pursue cross-border regulatory arrangements to facilitate the expansion of domestic intermediaries abroad
- Identify hub opportunities in middle and back-office functions

Widen Islamic capital market's international base

- Build scale in the Shariah-compliant equity, sukuk and investment management segments
- Strengthen service and operational infrastructure to expand ICM's international reach
- Promote shift from Shariah-compliant to Shariah-based approach
- Collaborate with industry to expand range of Shariah-compliant stockbroking and portfolio products and services
- Develop seeding strategy to increase diversification of value-add Islamic investment strategies and styles
- Increase international collaboration on Shariah research and product development
- Develop a code of conduct for Shariah advisers
- Strengthen training and professional development to increase supply of Shariah experts

BUILD CAPACITY AND STRENGTHEN INFORMATION INFRASTRUCTURE

Build capacity to meet future requirements

- Increase public-private sector collaboration to strengthen capital market skill sets
- Pursue hub opportunities for education, training and professional development
- Promote a deepening of knowledge of international capital market industries

Strengthen information infrastructure to support transition to a highly electronic environment

- Benchmark transaction and post-trade costs
- Facilitate implementation of straight-through processing
- Enhance infrastructure to support technology-driven business strategies
- Strengthen infrastructure for information reporting, disclosure and communication