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Increasing Malaysia's competitiveness

POST budget

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Budget 2015 comes with no surprises, as the government continues its agenda of supporting business and growth, while easing the burden of the rakyat through a series of targeted measures for different income groups.

Prime Minister Datuk Seri Najib Razak reinforced the government's commitment to gradually rein in the budget deficit, as evident from the move to further rationalise subsidies as well as broaden the tax base with the introduction of the Goods and Services Tax (GST).

In addition to confirming a number of previously announced measures, such as reduction in corporate and personal tax rates, the budget deals head-on with issues affecting the lower and middle income groups by increasing cash handouts, Bantuan Rakyat 1Malaysia (BR1M), making home ownership easier and improving the public transport network.

As far as businesses are concerned, the 1% reduction in corporate tax will only happen effective year of assessment 2016. This is understandable as any reduction in tax revenues could hamper efforts to bring down the budget deficit. However, tax rates do play an important part in making Malaysia an attractive place to do business.

As Malaysia's neighbours have embarked on a low corporate tax rate strategy — Singapore (17%), Thailand (20%) and Vietnam (22%) — the country may need further reductions in coming years. This is also consistent with the need to diversify our tax revenue base — as revenue from GST increases, there would be appetite for further cuts.

In its efforts to attract targeted investment projects, the government has also announced the introduction of tailored incentives, automation capital allowance for capital incentive industries and grants which are targeted at promoting R&D and innovation.

Incentives for high value-added activities

As part of our quest to move up the value chain, Budget 2015 outlined the upcoming introduction of incentives that focus on investment projects based on technology, innovation and knowledge, involving highly qualified and knowledgeable employees with high salaries. Although there is already an existing mechanism for such projects to obtain tax relief in the form of pre-packaged incentives, the latest incentives represent a much more targeted approach to attract specific projects that would contribute to nation building through knowledge transfer and innovation.

The prime minister also announced the upcoming introduction of a tailored incentive for principal hubs. This announcement is likely to significantly interest multinational companies that are looking at housing high-value added activities in the region in a single location.

The specific criteria for applying for this incentive are yet to be revealed, but it is expected that the focus will be on high-value activities within a value chain, rather than targeting any specific industries. This means, companies looking at centralising certain activities which contribute materially to the value chain — such as R&D, strategic decision-making, branding, intellectual property management and risk-taking — would find this attractive.

In drafting the guidelines for the principal hub incentives, it is necessary for the government to ensure that the qualifying criteria are not unduly onerous, such as the drop shipment limits applicable to the existing incentives for regional distribution and international procurement centres. Such limits only restrict the practicality of the incentives and defeat any competitive parity that Malaysia can gain on its neighbours, which offer similar incentives but without such limitations.

As the size of the operations and level of high-value added activities in Malaysia for these companies could vary significantly, we should be bold enough to offer a range of reduced corporate tax rates to better match their investment in the economy. For instance, some of Malaysia's neighbouring countries offer reduced corporate tax rates of 5% or 10% besides the total tax exemption.

While we go all out to attract multinational corporations to set up their principal hubs in Malaysia, let's not forget the increasing number of Malaysian companies that have become regional and global players. We certainly do not want these companies to move their high-value added activities to other locations. Thus, extending this incentive to them will go a long way towards keeping their core operations at home.

R&D, innovation and commercialisation

It is necessary to intensify the level of R&D locally to ensure that Malaysia is able to compete with developed nations in the region. The additional RM1.3 billion allocated to the Ministry of Science, Technology and Innovation is specially targeted at commercialisation of R&D initiatives.

As with existing funds such as the InnoFund, TechnoFund and ScienceFund, the initiatives listed under Budget 2015 are aimed at promoting R&D commercialisation initiatives by SMEs and public research institutes.

It is a move in the right direction to recognise the contribution of R&D to the country, but the government should consider broadening the scope of its focus to the entire R&D value chain from conceptualisation to commercialisation. This is necessary to bring us up to speed with other more attractive offers from the region, such as the Productivity and Innovation Scheme offered by Singapore, which offers cash payouts to a broader range of R&D activities.

Human capital development

Over the years, a key advantage of Malaysia over its neighbouring countries has been the availability of a qualified workforce and a competitive operating cost environment. However, the availability of talent is now a problem that affects most countries in the world, including Malaysia. The government must ensure a continuous supply of qualified personnel to increase Malaysia's appeal as the ideal location for business investment.

The switch in focus to technical and vocational training indicates the government's recognition of the necessity to produce workers suited to the job market requirements. Surveys show that fast-growing Asian economies have a pool of unemployed graduates that will only grow larger if the situation is not addressed. Even in Singapore, which has a liberal migration policy to import talent, graduate unemployment (3.6%) was higher than the average unemployment rate of 2% in 2013. In India, one in three graduates up to the age of 29 was unemployed in 2012 to 2013.

However, despite the oversupply of university graduates in Asia, employers complain that they are unable to recruit the talent they need. The disconnection between the oversupply of graduates and acute problems of recruitment is due to their lack of workplace skills.

Based on the National Graduate Employability Blueprint (2012 to 2017), the key issues faced by Malaysian employers in identifying suitable graduates are: (i) the mismatch of available graduates with employment requirements, and (ii) the lack of science/technical graduates or qualified graduates with technical skills. The mismatch is primarily caused by the country's rapid move towards a high technology economy, which has resulted in a sharp increase in the demand for technically trained graduates.

Technical and vocational training (TEVT) programmes which are tailored to employer requirements will go towards addressing issues related to graduate employability. Relief in the form of double deductions for training and scholarship-related expenses for vocational students will also encourage corporates to take a role in developing the nation's talent pool.

In summary

For corporates, Budget 2015 continues the government's focus on increasing Malaysia's appeal as an investment hub for technology-driven and high value-added activities, particularly for foreign multinationals.

While the announced incentives and changes in human capital development are the first steps in the right direction towards improving Malaysia's competitiveness in the region, it is necessary to ensure that the implementation of these incentives are properly executed to achieve the nation's objectives of promoting fiscal growth, developing talent and increasing value-added activities in the country. E

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