

*A look at Greater Kuala Lumpur and other major cities in Malaysia as an investment and business hub in Southeast Asia.*

# The Principal Hub Incentive, Malaysia

May 2015





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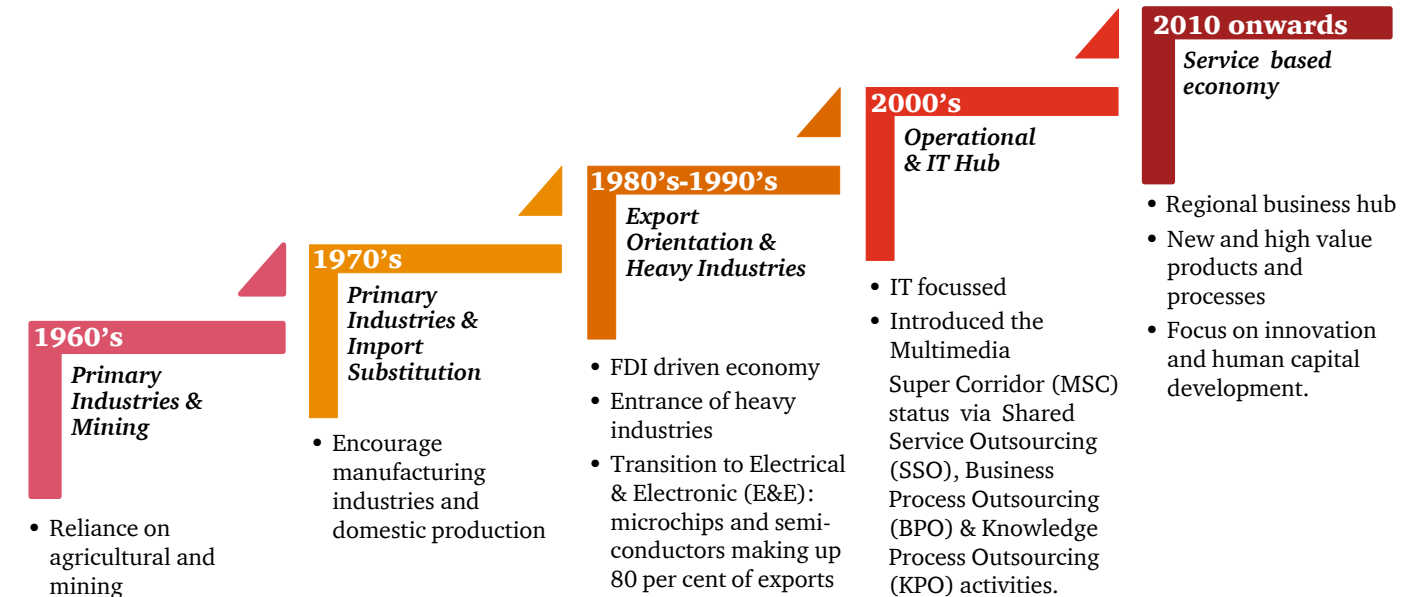
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# Purpose of the incentive

In April 2015 the Malaysian government announced a new customised principal hub incentive that would make Greater Kuala Lumpur (KL) and other major cities in Malaysia more compelling for multinational companies (MNCs) to locate their regional Principal Hub(s).

This incentive was developed in recognition of the evolving economic and business landscape of Malaysia. After establishing a successful manufacturing and operational base for MNCs in the 1980s to 2000s, the government recognised the importance of moving up the value chain, particularly by growing the services sector related to high technology, high value-add and knowledge based activities.

Chart 1: Malaysia economic development journey



Source: MIDA and PwC analysis

Categorised under the 'Strengthening Economic Growth' strategy of the Malaysian Economic Transformation Program (ETP), Malaysia's economic landscape has come a long way from the primary industries and mining era in the 1960's to a sophisticated services based economy.



The incentive is intended to complement:

- ***The evolving global business model***

Regional headquarters and supply chain models are evolving globally, with more and more MNCs adopting the principal hub structure. This structure enables companies to optimise resources, build capacity and quicken decision making to deliver better customer service and shareholder value whilst maximising operational efficiencies.

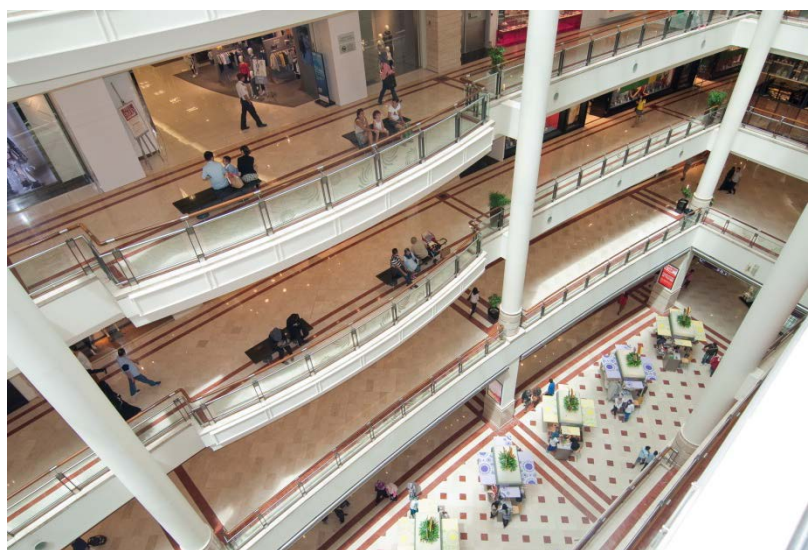
- ***ASEAN Economic Community (AEC) - ASEAN Integration***

The implementation of AEC at the end of 2015 is expected to foster closer economic collaboration between the members of ASEAN, allowing companies to tap a market of US\$2.5 trillion<sup>1</sup> (GDP) in 2014, with a growing population of over 600 million people. Malaysia's efforts will help in positioning the region from a competitive business stand point whilst ensuring balanced and inclusive regional economic growth.

Malaysia is well positioned to help companies spring board to the region's burgeoning markets, with its well established regulatory framework, infrastructure and business networks.

InvestKL initiated a review of Malaysia's existing incentive schemes together with the Ministry of Finance (MOF) and the Malaysian Investment Development Board (MIDA). Together they developed a game changing enhancer, replacing the existing incentives, to ensure Malaysia attracts the best MNCs to expand and grow their operations in the region.

This new incentive for the establishment of Principal Hubs will be implemented effective 1<sup>st</sup> May 2015. The Principal Hub incentive will replace the existing International Procurement Centre's (IPC), Regional Distribution Centre's (RDC) and Operational Headquarters (OHQ) incentive schemes, which will officially be phased out.



<sup>1</sup> Source: IMF World Economic Outlook, April 2015

# How the Principal Hub works

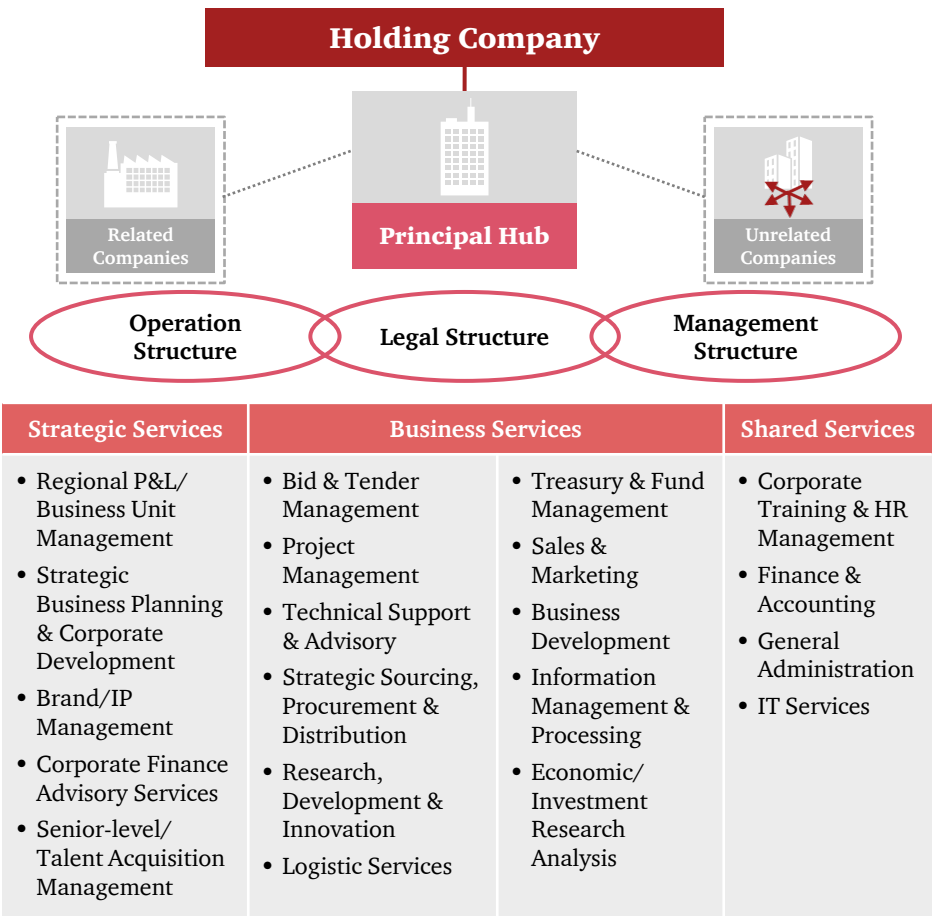
Under Section 127(3)(b) of the Income Tax Act of 1967, MIDA is granting investment incentives to MNCs and local corporations that establish Principal Hubs in Malaysia.

By definition the Principal Hub is a locally incorporated company that uses Malaysia as a base for its regional and global businesses and operations to manage, control, and support its key functions. These include management of risks, decision making and strategic business activities such as trading, finance, management and human resource.

The regional Principal Hub is structured such that MNCs can be closer to customers and supply chains to improve operational efficiency, and to promote product/service quality and speed to market at a lower cost.

The Principal Hub structure also enables MNCs to better share resources and experiences among group companies, thus allowing better integration and harmonisation within the group structure to promote consistent products and service standards to their markets.

Chart 3: The Principal Hub Structure

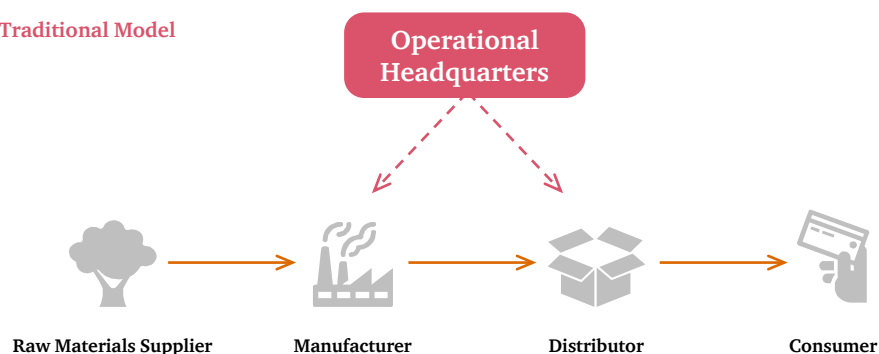


Source: InvestKL, Principal Hub incentive: Guidelines and criteria

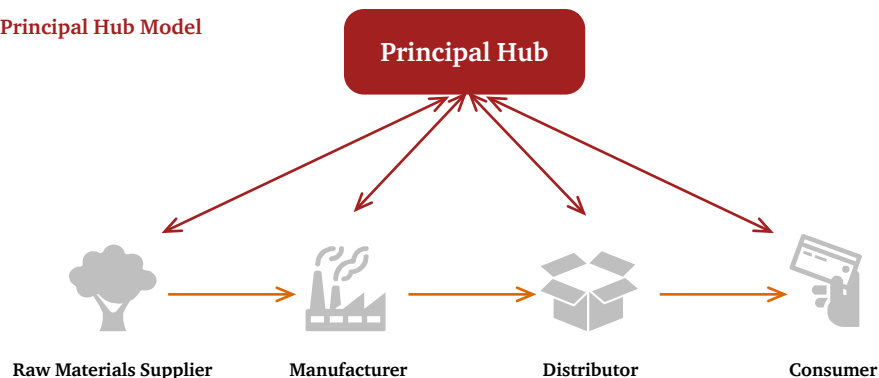
This diagram depicts the inefficiencies of traditional business models that have evolved over the years to more centralised and efficient business models that focus on minimising risks and costs while increasing profitability from a supply chain and operational efficiency perspective.

**Chart 4: Comparison between the traditional model vs the Principal Hub model**


**Traditional Model**



**Principal Hub Model**



**LEGEND**

-  Flow of Goods
-  Management Services
-  Transaction/Trade

Source: InvestKL, Principal Hub incentive: Guidelines and criteria

## How the Principal Hub works

### The Principal Hub structure - A case study

The A Group of Companies (“A Group”) is primarily involved in the manufacturing of oleochemicals. Its presence in the Asia Pacific region (including Malaysia) was previously restricted to manufacturing bases and distribution centres.

“A Group” decided to establish a principal hub to expand its presence in the Asia Pacific region on a large scale. Malaysia was selected as the location for its principal hub, due to ready accessibility to a multi-lingual, educated workforce, ready infrastructure and competitive costs of doing business.

“A Group” retained its contract manufacturing base in Malaysia, and established a separate entity (i.e. “PH Company”) in Malaysia which performed the following activities:

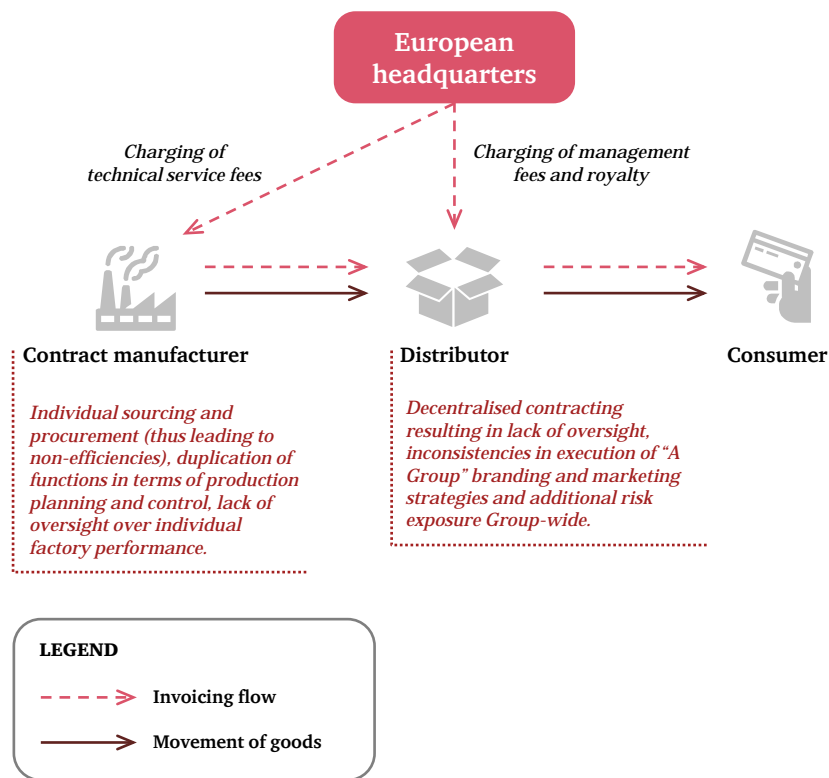
- Branding and marketing;
- Strategic decision making (business development and regional P&L management);
- Research and development;
- Technical design;
- Production control and inventory management;
- Funding and liquidity management; and
- Quality control and assurance.

To carry out the activities listed above, “PH Company” brought in talent from its European headquarters, including 15 expatriate employees across all divisions, and recruited local talent, bringing its total headcount to 80 employees.

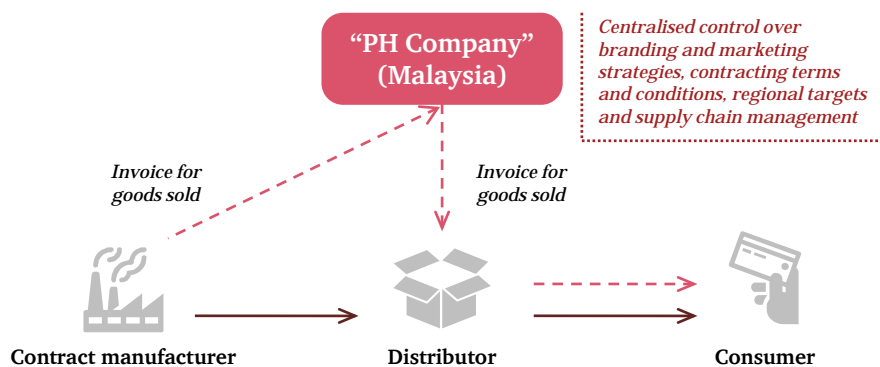
As the controller of “A Group”’s regional P&L, “PH Company” is required to assume the residual risk associated with the Group’s value chain in the Asia Pacific region. This necessitates a transfer of risks which was previously spread out across the Group’s distribution arm to “PH Company”.

The following diagrams illustrate this shift:

#### Before “PH” Company:



**After “PH Company”:**



With “PH Company”, “A Group” targets to achieve 100% growth within five years from its establishment in the Asia Pacific region, with a 150% increase in profit across the value chain due to business process improvements and efficiencies achieved in eliminating duplicative functions across its value chain and a centralised approach to expanding its business in the Asia Pacific.





# Benefits to investors

## Fiscal benefits

An approved Principal Hub company is eligible for a 3–tiered corporate taxation rate as follows:

Chart 2: 3-tier corporate taxation rates

3-tier incentive	Tier 3	Tier 2	Tier 1
Blocks (years)	5 (+5)	5 (+5)	5 (+5)
Tax rate	10%	5%	0%

*\*Please refer to page 13 for details of Principal Hub qualifying criterias*

Source: MITI, Implementation guidelines under the Malaysian Budget 2015

## Non-fiscal benefits

- *Sharing of resources* - services such as management, R&D, payroll, accounting, logistics and quality control and technology can be consolidated in one location
- *Streamlining the supply chain* - by centralising strategic global and regional functions, logistics, risks, and their associated revenue streams
- *Lower production and operation cost* - companies can bring in raw materials, components or finished products with customs duty exemption into free industrial zones, licenced manufacturing warehouses (LMW), free commercial zones and bonded warehouses for production or repackaging, cargo consolidation and integration before distribution to their final consumers for goods-based companies
- *Exercise control* - no local equity/ ownership condition
- *Recruit foreign talent* - expatriate posts based on requirements of applicant's business plan subject to the policies on expatriates at the time of application
- *Improve cash flow and treasury management* - foreign exchange administration flexibilities that will be accorded in support of business efficiency and competitiveness of companies under the Principal Hub

# Greater Kuala Lumpur, Malaysia

## An established regional hub

A lot of companies have or are making Malaysia their regional and global operation centres. As at 31 December 2014, a total of 3,527 projects had been approved to establish regional operations in Malaysia.

From 2013 to 2014, investments approved by the government to encourage MNCs to make Malaysia their global operations hub stood at RM10.3 billion (US\$2.83 billion), with 16 approved projects during the period.

### Greater KL's competitive strengths

Competitive economy 1	Investor protection 2	Talent availability 3	Quality of living 4	Affordable & business friendly 5
Transitioning from an efficiency-driven economy to an innovation-driven one.	Strong investor protection ahead of countries such as Australia, US and UK.	Highest talent ranking in South East Asia with good scores in the quality of the labour force and talent environment	2 <sup>nd</sup> most liveable city in SEA and only one of two SEA cities that made the top 100.	KL scored well in terms of cost and ease of doing business – 8 <sup>th</sup> and 18 <sup>th</sup> position in the world.
WEF Global Competitive Report, 2014-15	World Bank Doing Business, 2015	IMD World Talent Report, 2014	EIU Global Liveability Survey, 2014	PwC Cities of Opportunity, 2014 World Bank Doing Business, 2015

### Regional hub numbers

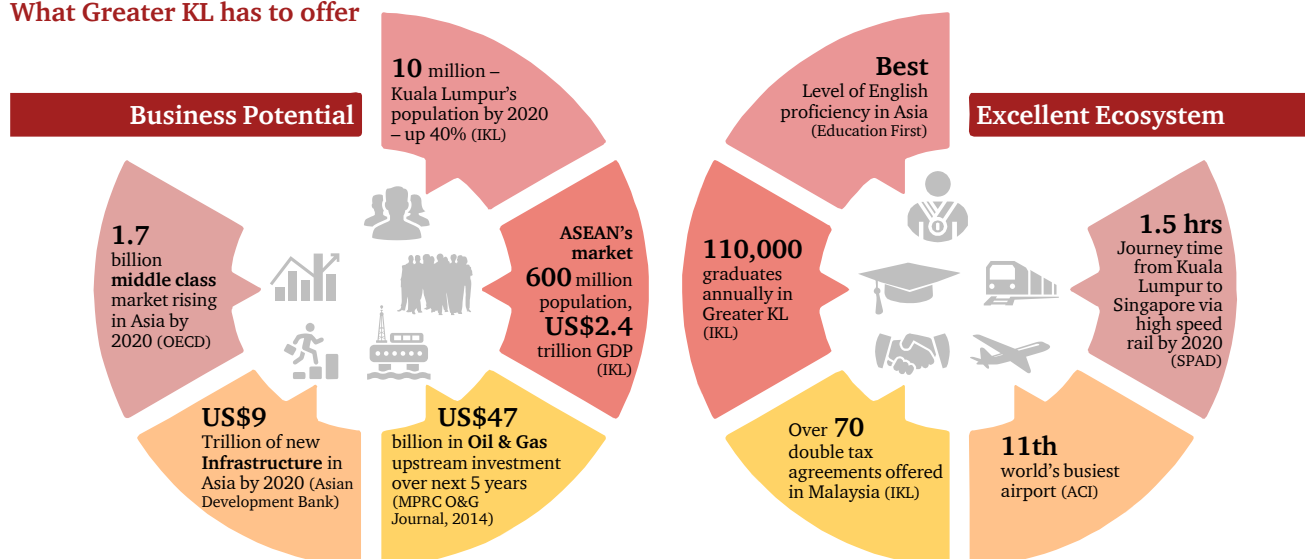
In 2014 alone, a total of 156 regional establishment applications were approved in Greater KL, reinforcing the city's position as an ideal investment hub for MNCs.

The breakdown of foreign regional establishments in the city:

- 16 OHQs
- 6 IPC
- 3 RDC
- 48 Regional offices
- 72 Representative offices
- 4 Treasury Management centres
- 7 Global /Regional operation hubs

Source: MIDA

### What Greater KL has to offer



Source: InvestKL and Forbes, 2014

For more information, please visit [www.GreaterKualaLumpur-forbes.com](http://www.GreaterKualaLumpur-forbes.com)

Greater Kuala Lumpur, Malaysia  
– an established regional hub

#### INTERVIEW:

#### Worldline Malaysia's Principal Hub experience

(Global player and European leader in the payment and transactional services industry)



*"This interview was repurposed courtesy of InvestKL"*

#### *What made Malaysia an attractive destination for setting up the principal hub for your organisation?*

Worldline chose Malaysia as a principal hub as it is strategically located in the heart of South East Asia. Amongst other factors, Malaysia offers a cost-competitive location for expansion to regional and international markets, with a dynamic and vibrant business environment, ideal for growth.

Malaysia's key strengths include its well-developed infrastructure, political stability, a productive and skilled workforce and a well developed legal system.

Another compelling reason making Malaysia a good fit for Worldline's regional expansion is its reputation as one of the most technologically developed industrialised nations in ASEAN.

In addition, its telecommunications network served by digital and fibre optic technology and its five international airports, make Malaysia an ideal springboard to the Asia-Pacific market.

Among the leading cities in Malaysia, our choice of locating to Greater KL was due to the fact that it is a major financial, economic and education centre for the South East Asian region, boasting a multilingual workforce that speak two to three languages, including English. While other parts of Asia such as Hong Kong and Singapore offer similar standards of living, the cost of living in these countries is much higher than Malaysia. This greatly impacts Worldline's cost of acquiring talent.

#### *Please describe your experience in transforming from your previous structure to a principal hub.*

- *What are the key changes from your previous structure to your current structure?*

Our experience transforming into a principal hub has been both interesting and challenging from different aspects. One example is the transfer of the marketing department team to Malaysia. The move was critical in order to have a concerted effort in its strategy and execution. Previously strategy and execution was worked on by various teams in different locations. The new environment is more challenging due to the diverse group of cultures and perspectives from the different marketplace but it is more strategic and cost-effective.

Another key challenge that we face is that while talent is readily available, finding the right fit of people for the right positions that are geared towards regional development has become difficult. An example would be the search for regional roles within operations and sales. The challenge here comes from the competition for talent in the region.

***What are the key benefits in converting your Malaysian operations into a principal hub?***

One of the key benefits is the knowledge and the diverse experience of the teams from both developed and emerging markets. The sharing of knowledge serves to assist the teams in the transfer of knowledge and technology that then enables us to create products that are more competitive and cutting edge.

As a hub there is an overview of the ongoing planning, strategy and execution as well as resourcing capabilities that makes the organisation more cost effective, increases efficiency and heightens productivity as well as the movement of resources across the region.



Note: This interview was conducted by InvestKL

***What are the services provided by the principal hub to its related parties?***

The key management team for Asia Pacific is located in Malaysia. Services provided include management of human resources, sales, marketing and operations such as risk and quality management etc. For Worldline, one of the key strengths of Malaysia as a hub is that it is our innovation centre for Asia Pacific.

***How many countries does the principal hub service currently?***

Generally the hub is to benefit the global marketplace that Worldline operates in, however at present the hub serves most of the ASEAN countries as well as Greater China.

***Which countries do you plan to expand the principal hub operations to in the next 5 years?***

Part of the plan is to expand to the neighbouring countries that are emerging economies such as Sri Lanka and Bangladesh, as well as the upcoming ASEAN countries such as Myanmar and Cambodia.

***What is the role of the principal hub in managing the risk of your organization's value chain? For example, does it take on a role in supply chain management, hedging, pricing negotiations, etc.?***

The overall aspect of management and control for software licensing, strategic planning and management of sales and marketing activities, operational and quality control as well as human resource management are performed by the APAC management team in Malaysia.

One of the other roles of the hub is to have the core risk management team based in Malaysia. Their duty is to assess risks of new and upcoming projects from a financial and legal perspective as well as delivery and resourcing availability. It also tracks, manages and reports on ongoing projects to ensure that delivery is not at risk and is within budget.

***What do you hope to achieve within the next ten years through the establishment of the principal hub?***

Our vision is to have Malaysia recognised as the Centre of Excellence, bridging European technology advancements with Asian creativity to create innovations that will benefit our clients regionally and globally. The other vision for this principal hub is to be a platform that enables the consolidation of our position as a leading player in this region and to continue our ongoing expansion to ASEAN countries and other regions.

# Details on the Principal Hub incentive

Table 1: Incentives for the Principal Hub

3-tier incentive	Tier 3		Tier 2		Tier 1	
Blocks	5	+5	5	+5	5	+5
Tax rate	10%		5%		0%	
High value job by end of year 3 with minimum monthly salary of RM 5,000	15	Jobs: Base commitment +20%	30	Jobs: Base commitment +20%	50	Jobs: Base commitment +20%
<b>High value jobs</b> Jobs that require higher and more diverse set of managerial/technical/professional skills such as management, analytics, communication, problem-solving, and proficiency in I.T						
At least 50% must be Malaysians by end of year 3						
Including key positions- Minimum monthly salary of RM 25,000	3		4		5	
Annual business spending*	RM3M	Business spending: Base commitment +30%	RM5M	Business spending: Base commitment +30%	RM10M	Business spending: Base commitment +30%
Qualifying services	Strategic + 2		Regional P&L + 2		Regional P&L + 2	
Minimum serving/ business control of no. of countries	3		4		5	
Use of local ancillary services	Local financial institution services (including finance and treasury), logistics, legal and arbitration services, finance and treasury services.					
Trading of Goods annual sales turnover (additional requirement for goods-based applicant company)	RM 300 million					

\* USD1 ≈ RM3.60

Source: MITI, Implementation guidelines under the Malaysian Budget 2015



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## Who to contact



### InvestKL

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InvestKL is mandated by the Malaysian Government to attract and facilitate large global multinationals to set up their regional operations in Greater KL/Klang Valley and strategically grow their business in Asia.

InvestKL can assist at any stage of your investment process, offering services such as formulating the most competitive fiscal packages and post investment services.

[www.investkl.gov.my](http://www.investkl.gov.my)

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### MIDA

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Malaysian Investment Development Authority (MIDA) is the government's principal agency for the promotion of the manufacturing and services sectors in Malaysia.

MIDA assists companies which intend to invest in the manufacturing and services sectors, as well as facilitates the implementation of their projects.

All applications received by MIDA from 1 May 2015 until 30 April 2018 are eligible to be considered for the Principal Hub incentive. MIDA will work with the other investment promotion agencies (IPAs) such as InvestKL and the regional corridors to promote the incentive.

[www.mida.gov.my](http://www.mida.gov.my)

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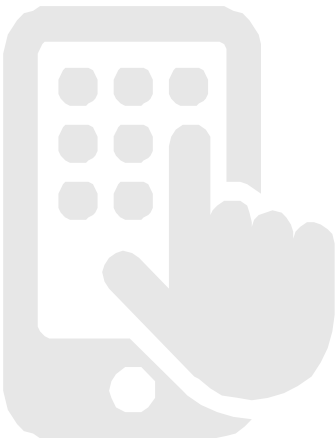
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