



## Impact of Asian Financial Crisis in Malaysian Economy with special reference to Multinational Companies

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### Abstract

*Asian Financial Crisis hit the Southeast Asian region in 1997. Due to this currency crisis all major stock markets had been crashed including Malaysia. In the concerned article, the causes of origin of the crisis have been highlighted. The positive measures which had been taken by the Malaysian government that helped the Malaysian economy to recover the foreign investment and multinational business in Malaysia have been discussed. Light has also been shed on the rehabilitated investors' confidence related to the Malaysian currency. There is also a mention of the structural weakness of the Malaysian economy which effected from the colonial period and the export-oriented role of Multinational companies.*

**Keywords:** Currency crisis, stock market, industries, foreign investment.

### Introduction

I would like to describe some issues of the origin and nature of Asian Financial Crisis in Malaysia which happened in 1997 and given attention on the role of Multinational Companies (MNCs) regarding economic and social impact. It has been observed that due to an un-equal distribution of wealth the economic position was weak. On the other hand the Multinational Companies play great role to save the economy from the crisis.

The reason of devaluation of Thai baht in 1997 was losing the confidence of the investors; hence they invested on other economies in the region and also maintained weak U.S. Dollar for their currencies. During early 1997, the Malaysian currency came under pressure due to the fall of Thai baht on 2<sup>nd</sup> July 1997. The efforts of the authorities for the defense of Malaysian currency went in vain in July. The cost was estimated at RM 9 Billion, than over 3.5 Billion American Dollars<sup>1</sup>, the Malaysian currency followed the Thai baht, Indonesian Rupiah and the Pilipino Peso and fell to its lowest rate in January 1998.

On the basis of low foreign exchange value of Malaysian assets, the stock market totally collapsed, the Kuala Lumpur stock exchange dropped from 1300 index in 1997 to lower than 500 in January 1998 and around 300 in August 1998 up to 262 in September 1998<sup>2</sup>. When the stock market fell, it caused to provide the institution to make the boundary calls, hence the loan providers from foreign countries stepped back and withdrew the short terms loans that were being offered by them.

The local and foreign investors were worried about the complication and were hesitant to make deals with Malaysia

and in other country currencies, hence the devaluation of currencies in their stock and other markets made better their stocks and other markets and better investment options were provided. The fund managers had better investment options in order to select and move their funds easily than before, particularly on low amount on the restrictions from Malaysia and other authorities.

According to the foregoing paragraph the investors lost confidence and faced losses in the region, large sale funds of the local stocks by foreign countries also hit the exchange rate of the Malaysian currency with the U.S. dollar. In this respect, it is further mentioned that the Central Bank, Negara Bank of Malaysia have reported that on account to defend the Malaysian country four billion U.S. dollars were spent, in the year 1997 the Malaysian currency exchange rate was around 2.48 against the U.S. Dollar and in January 1988 the currency rate all the time was as low as 4.88 against the U.S. dollar. The reduction in this account almost found at 50%<sup>3</sup>, and KLSE suffered loss in value estimated more than 60%, in selected countries of Southeast Asia from 1970 to 1998. The unexpected crisis found due to the structural weakness of the economy of the county, regarding the inequalities of wealth distribution, fact on the record that from the year 1991 the economic rate in the country continuously extended its output. In 1996 the growth rate of GDP was estimated at 10%. Such growth rate pointed out great in flows of the foreign capital through foreign labour and Multinational Companies.

The efficiency of the subordinate and incorrect allocation of the resources in economy cannot be neglected. These two main points can't be ignored. As per the calculation of the Ministry of International Trade and Industry, the total factor of productivity from the year 1987 to 1995 produced only 1.8%, while during

the year 1997 the growth percentage of the total factor productivity was pointed out as negative by limited stock growth. The growth has instead been driven primarily, whereas increased the use of the capital. It was mentioned in the incremental capital output ratio during 1987-1992 at 3.8% when in the year 1993-1996 noted as 4.8%<sup>4</sup>.

The loss of the product in the era of the financial crisis, particularly when the government drawn and implemented industrial and economic measures, the said policies prepared themselves for formulating the work force with technical and industrial skills and both forwards and backwards, extended the value added activities and increased productivity of the manufactured sector.

The industry felt that unlike other industries of foreign countries the linkages of the industry in Malaysia were weak. As the Malaysian country shifted the capital intensive industrial production which was related with higher value activities when the manufacturing sector was in low value activities, therefore it became necessary to create more human resources for the industries for the development of human resources by increasing the institution and support system. It is a very interesting aspect that the structure of the inter country manufacturing trade had become positively inflexible. The rate of the note had also been changed. In 1980 and 1990 to 1996 what the foreign markets demand was power<sup>5</sup>. So the Malaysian government could not improve the value of the currency through devaluation. Hence, the power of the ringgit was apparent to be the source of weakness.

In the year 1995 the deficit was of RM18.7 million or 9% of Gross National Products (GNP) while the saving rate in Malaysia was at 38.40% of GNP. During the year 1995 and 1997 the GDP investment was above 45%. In fact during this process the current account deficit, mostly financial, by short term capital so such nature not sustainable in long term in the year 1997, the reserve investment was estimated at RM 9.9 billion. In this investment, the main contribution in RM14.8 million current account deficit in the year 1996<sup>6</sup>, the transfer of funds by the foreign workers in Malaysia returned to their own countries. Many legal and illegal millions of foreign workers outflow of RM3 billion per year.

It is pertinent to mention here that in the year 1990 the said trend was growing. Three years before the crisis, high increase was dependent upon the investment in non-productive finance by the short term foreign capital. In the domestic economy through improper controlled financial system the high growth of such type created some damage on the environment on the basis of cheap foreign capital as well as labor. The human resources were completely neglected. The uneconomical process of growth created crisis. The agricultural growth decreased the rural poverty for the education and health sectors. High budget gave a boost to the social and economic sector and proved helpful to secure a firm foundation towards the impact of the crisis.

## Inter-Related Impact of the Crisis

Due to slow down of the domestic demand on declining the country currency, the imports of the luxury goods also became slow and on the other hand it was expected to increase in the resource based export. The demand of electrical appliances seriously affected, the growth rate of export during the year 1995 and 1996 of Malaysian exports particularly exports to Japan, U.S.A and the European Union<sup>7</sup>, because it was the greatest export market for Malaysia. Since January 1998 the export displayed an upward trend in the Malaysian currency particularly in the sectors such as palm oil and rubber. In this regard, the other most important issue related to the private sector, that discouraged the private consumption investment and the high cost of the goods and the services were the main reason of the decrease in private consumption. While on the other hand the private investment also reduced due to the lack of confidence on domestic economy.

The private sector expected the increase between 8% and 12% in the inflation rate in the year 1998 and 1999 because the growth in the rate of Malaysian country is still in danger. The number of importers was diminishing and the margin of the profit was also going low<sup>8</sup>. The Malaysian prices of goods and services were down export cost was not expected to increase. The fixed income earners tried to get high standards of living in Malaysia. In the year 1998, increase was found in the local and imported price. At the end of 1998 the economic position slowed down and the rate of unemployment increased (4.5% - 5.5%) which was 3.5% higher as per the announcement of the Malaysian government in the budget in March 1998. Due to this inflation most of the corporate sectors suffered with shortage of money<sup>9</sup>.

The condition of the financial sector also went down due to the slow economic growth and high interest rate. The amount of total loan outstanding estimated at Malaysian Ringgit was 419.5 billion and at the end of March 1998 ratio of backer sector was up to 9.1%. Hence, due to low position of the Malaysian currency companies faced financial pressure<sup>10</sup>. The slowdown of the economic growth at 4.5% i.e. during last 5 years the average of 8.9% and till the end of 1998, the inflate rate was between 7% and 8%. When the increase in the unemployment rate was at 2-3% there were 2 million migrated workers (World Development Report 2000: 306). The cut off 20% in the budget announced in the year 1998 has compensated by adding 3.7 Billion Malaysian Ringgit and the 18% available on account of assistance to the helpless groups suffered with crisis as funds for the small farmers<sup>11</sup>.

In February 1998 the labor shortage and vacancies in the manufacturing sector were 46900 and 36500 in the plantation sector. Fresh graduates also faced problems of unemployment in the labour market. The Malaysian government also had to face the following problems: i. As per order of the Malaysian government, the deduction made will be 10% from the salary

of the minister, 5% will be deducted from the salary of the civil servant. The ban was imposed on the annual increment of the salaries of higher grade civil servants, and it was also decided not to employ the labour force in the government organizations. Many workers were ice-appointed only on the basis of low wages. ii. The small and medium size enterprises were hit on the deduction in demand and high cost of the working capital need since the month of July 1997. More than 2000 businessmen gone bankrupt. iii. On dramatic assets deflation in the stock and property market were economically in crises at the end of 1997. The stock market came down 50% and at the end of 1998, the prices of the property fell up to 40% household income from the assets. iv. The depreciation of Malaysian currency at 31.4% against trading partner problem for the Malaysian household was estimated at an increased inflation rate of 7% - 8% in the year 1998 and from 2.7% in the year 1997. Even the household had to increase the rate in the toll charges, city, bus, taxi and airline, electricity and water rates from the private service provider in the year 1997 had made an impact on the household lower income of urban areas<sup>12</sup>.

The decline of household income and increase in the medical fees i.e. made on the increase of imported drugs of 30% where as 60% of the drugs were being used in Malaysia. The number of patients seeking treatment is between 15% to 50 %<sup>13</sup>. According to an announcement of the country budget health care shifted from private to public health care center.

The growth in the economic sector in the previous decade was due to the powerful competition on the urban sector. According to the official report during the first five months of 1998, as per report in the construction field found 768,400 employees hired. This was the gross figure that represented migrated workers. For them the expenditure was reduced<sup>14</sup>, and such workers were hired without any documents. They were particularly un-employment, kept under wage cuts, and non-payment of wages up to four months. It is another interesting point to note down that the household were really hit by the crisis which included middle income professionals with advanced payment. Majority of the professionals and the self-employed were saved. During the year 1985 many of them resorted to immigration and the labour markets of Singapore, Taiwan and Japan.

The Look East Policy (LEP) was important for the justification of the involvement of the Malaysian government in the field of economy. It was started with the New Economic Policy in the year 1970 and it is a fact that the adoption of Look East Policy was given a new dimension in the state interference in economy sector. The Japanese model operated in 1980 during Look East Policy<sup>15</sup>. To secure these groups, therefore the structure of defense was to be reverted to the old foundation of redistribution. Therefore, for this purpose guidance from the state needed to meet the international competition.

## Reform Measures by the Malaysian Government

The banking system was basically strong. The financial institutions faced adverse development problems continuously in the financial markets. Due to recent reflection of stress as conducted by the Bank Negara as the Central Bank of Malaysia and given the reasons that four Banks need re-capitalization under the conditions to comply with minimum 8%, as mentioned below. i. All banking institutions will have to show intensive progress. They will remain under supervision and testing on monthly basis, so it is necessary for the banking institutions to take corrective measures. ii. On transparency of the financial system it is needed that the banks must issue the data on key indicators of sound financial position. iii. Loan classification and provision standard in order to reflect the international practice. iv. It is necessary that banking institutions meet the minimum risk weighted capital ratio on the basis of every quarter.

The Malaysian government conducted its sixth exchange of trade with the New Industrialized Economy of Asia. The entire economy slowed down due to crisis, due to Malaysian currency declining, the real impact made on the trading sector of Malaysia presently the products of Malaysia as the powerful competitive in the international market, it has noted that in the region of Malaysia other economics have the experienced market depreciation in the currencies<sup>16</sup>. The next important issue is that the other issue as increased the competition between the countries in order to obtain market share of trade on the situation Malaysia likely to create trading links with the new market, another fact is that the South East Asia started to conduct internal regional trading with each other, it is also in line with ASEAN goal of reducing the shared trading conducted in U.S. Dollars.

On un-expected crisis calls for the re-assessment of the policy, this is consisting with the following facts. i. The high increased in the prices of the food shown that the country is depend upon the import of food due to neglect the production of the agricultural which was in the year 1998 grown 0.9% and 633,753 hectares of agricultural land idle when on the imports of food spend KM a billion, the above estimated given by the university Putra of Malaysia in 1997<sup>17</sup>. ii. It is another aspect which has criticized the cheap foreign labor. Due to the delay in the development of high value technological industrial base, the public also added the urgency and demanded to present the clear policy on the foreign labour. iii. The industry faced the water crisis which had privatized due to inefficiency and inequity and it is the great privatization of infrastructural services that were endangered, such crisis has gained a new edge. iv. The issue of water depends upon the excessive industrial waste pollution of rainfall that flows in the area, in 1998 given the sharp relief.

The process of national investment was not sufficient in the field of health education, skill training and housing, so in absence of adequate social society there was nothing for the

poor. It was the direct effect of the economic crisis, increasing closure of emigration and employment opportunities for the educated workforce.

It can't be avoided that the response of the Malaysian government was characterized by three key decisions. i. Attempts to effect upon the Malaysian market forces as well as on the economy policy. ii. Without the assistance of IMF the government of Malaysia turns towards the macro-economic policy. iii. Decision of the Malaysian government for capital controls for the support of inflation of the financial system.

Other reasons regarding the traditional policy response of the financial problems and need of assistance for the improvement of the issue through IMF, had to undertake economic and financial reforms and also to apply necessary macro-economic adjustment.

Thailand and Indonesia were looking for the remedy of their weaknesses. In this remedy Korea also joined with these countries, but the crisis of their countries were so deep and out of control that these countries decided to approach IMF for obtaining assistance to solve the crisis and agreed to follow the condition of IMF. They had to implement tight financial policies, enforce structural reformation in the financial field and the Malaysian government was not contacted for the help to IMF<sup>18</sup>.

The Malaysian government reduced the allowances of their employees. Many foreign workers left, but without any tight financial policy and conventional tools, improved the issue. It is also pointed out in this study that due to the restriction process, the freedom of the beneficiary decreased. As the economic position of Malaysia was very weak, the policy makers agreed for the imposition of control on the capital flow like a better solution. On one hand it was believed that the decision was better and required confidence in the new support for liberalization.

In February 1998, the government of Malaysia announced the security commission for the government for the distribution of share holding of the companies included in Kuala Lumpur Stock Exchange (KLSE)<sup>19</sup>. It is further added that the minimum number of shares was 750 or 1000 depending upon that the company's paid-up capital, less or more than the Malaysian currency of RM 100 million<sup>20</sup>. In the month of May 1985, the Korean government showed foreign equity ownership and liberal hostility of the foreigners in Indonesia and the related agency permitted the companies for the additional equity directly with the public and not to the limited companies to offer the same directly to the public.

The finance committee recommended the code of corporate governance in the year 1999, which required 1/3<sup>rd</sup> of the members of the Board for independent Directors and also recommended for the nomination of the payment committees

consisting wholly or mainly non-executive Directors. The said code also made the additional function for the adult committee. In this connection, I wish to highlight here that the above referred code also recommends that incase the board failed to take action on the basis of findings of the audit committee, the Director of the committee is required under the listing rules of KLSE, it was directed for increasing the position of nominee directors and voting by mails among other changes. During the month of March 1999, the KLSE imposed the restrictions on the number of directorship to extend the level of corporate governance. According to this not more than 25 directors can hold this position<sup>21</sup>.

The amended securities industry act was enforced since 1<sup>st</sup> November 1998. According to the finance committee report on corporate governance, also recommended the code of restrictions on the rights of voting of the controlling shareholders in relation to the connected directions in the companies act. KLSE imposed the restrictions on the number of directorships in the month of March 1999. The equality of information and the timeliness of announcement for the shareholders and the investors enhanced disclosure shares to protect the interest of the shareholders, specially the minority.

### **Role of the Multinationals for the Rehabilitation after the Crisis**

The process of recovery was to do the re-structuring of the Malaysian economy. It is well-managed with the export of manufacturing, as this sector has a great Malaysian economy wherein the Multinational Companies also play a vital role in the export of this manufacturing sector.

In the year 1997, the manufacturing sector estimated at 36% of the total GDP and the export figures of the total exports in Malaysia at 81% wherein the Multinational Companies contributed by way of electronics export in the year 1997 and the amount was estimated at RM 80.8 billion i.e. 37% of the total exports in Malaysian. Facts and figures cannot be neglected. The role of the Multinational Companies in the consumer electronics as well as in electronics industries estimated at 93% and 91% in Malaysia in the presence of other industries with Multinational Companies. It is also important to note that in the year 1995, the basis of a great role of the Multinational Companies was found 73% of the total export<sup>22</sup>.

During the period of downturn and higher capacity in the cycle of the industry from 1996 to 1998 created the crisis in Malaysia. It is also necessary to add here that the value of exports in U.S Dollars declined from 78.7 billion U.S dollars to 73.3 U.S dollars during the period 1997 and 1998 and in the same year export volume increased by 1.1% but also 111% growth in electronics export in the country. The exports to ASEAN also became low in the year 1998 at 19.2% due to the European Union and the U.S increase at 4.2% and 8.3% respectively<sup>23</sup>.

## Discussion

The business relations of Malaysia and Japan in the economic field having great history as compared to the Association of South East Asian Nations, the member countries of ASEAN comprised with Indonesia, Malaysia, Philippines, Singapore and Thailand, it is forwarding to cover the entire South East Asia with the addition of five members. According to my view the South East Asian Nations have been given attention towards Japan. They feel great pride that the Asian nations have made it to the top. In the 70's and 80's Japan was the leading character of East Asian economic development. No doubt Malaysia by way of overflow effects acquired Japan's economic miracle. The Multinational Companies of Japan have played a great role through industrial networking for integrating the South East Asian economies.

The concept of Malaysia was to serve to go away from the negative process about the willingness of Japan. The initiative process of Malaysia and Japan was to be confident, not on the expense of US and Japan or US-ASEAN economic relation as the Malaysian and Japanese concept served as the model for others. Here it is very clear that the ASEAN having regional free trade area not only with Japan but such activities at present underway, hence I would like to highlight regarding comprehensive partnership in Japan, in this respect stated that the word comprehensive not only covers all ASEAN countries and trades but also goes all the way in the vertical sense. Japan makes bilateral free trade area arrangements as done between Singapore and Japan and total trade exports and imports and regional breakdown of East Asian Trade.

## Conclusion

In view of the facts and figures and as described in this article that Malaysia suffered with the crisis economically and politically due to which this country faced great financial and currency crisis. Most of the Chinese businessman survived because they were not fixed over borrowing from the foreign source and had generally well managed enterprises due to joint venture strategy with the Multinational Companies. In this regard it has been observed that Malaysian businessmen were associated in the shape of Joint-Venture with the Multinational Companies that survived from the currency crisis due to export-oriented policy of the Malaysian government and significant role of Multinational Companies in Malaysia. It is further included that the tiredness of Japanese and ASEAN provide highly pertinent context for Malaysian-Japanese economic relations. Malaysia and Japan sustainably and economically integrated through the trade and investment. ASEAN and Japan was the group of economic partnership which really contributed to the economic resilience of Malaysia and Japan. ASEAN is the small region as compared to the European Union (EU) or with the North American Free Trade Area (NAFTA) except China, as the population of China is double. These economic relations must go beyond trade and investment. The Asian

financial crisis exposed the risks of the Asian countries; in fact the economic relations between Malaysia and Japan include the program for the post crisis.

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