ASIA PERSPECTIVE

Comprehensive Overview Study: Part 2 of 3

Malaysia's Manufacturing Environment & Investment Guideline

Uncover the opportunities and challenges of investment in a rapidly growing market

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About Us

Asia Perspective is an independent management consultancy with global presence and local knowledge. We assist our clients with business advisory regarding analysis, strategy and implementation. Our mission is to turn our clients' Asia business vision into reality and add significant value to their business.

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3 Trading with Malaysia

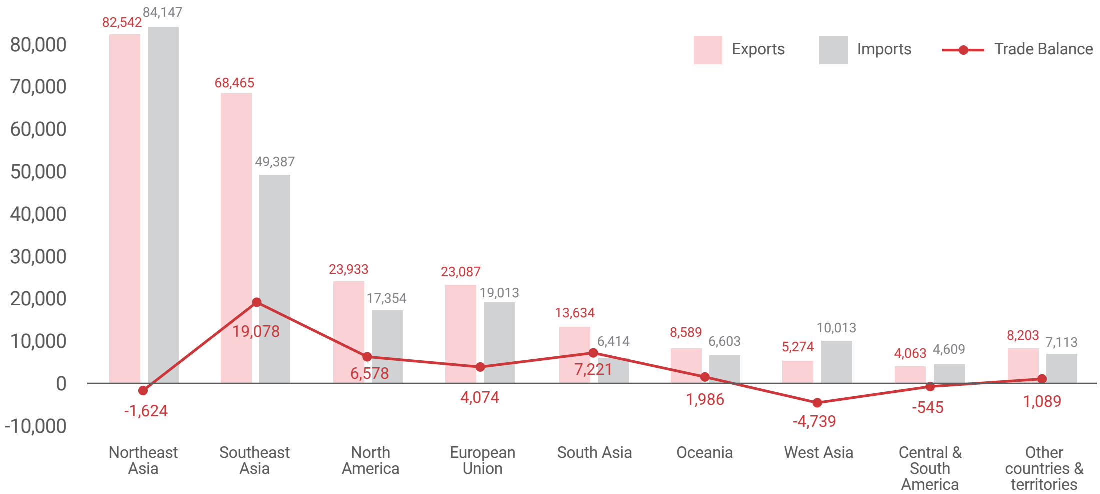
Malaysia is amongst the 30 largest export and import economies globally. In 2019, Malaysia exported USD 226 billion and imported USD 194 billion, resulting in a trade surplus of USD 32 billion. This positive trade balance is an expansion of 10.3% compared to the trade surplus achieved in 2018.

The four biggest trade regions with Malaysia are Northeast Asia, Southeast Asia, North America and the European Union. Malaysia has a positive trade surplus with all of them, except Northeast Asia. Specifically, the top export destinations in 2019 was China (accounting for 14.2% of Malaysia's total exports), Singapore (13.9%), the United States (9.7%), Hongkong (6.7%) and Japan (6.6%). The top import origins were China (20.7%), Singapore (10.5%), the United States (8.1%), Japan (7.5%), and Taiwan (6.7%).

Figure 17

Malaysia's Trade with Other Geographic Regions in 2019

Export values, import value, and trade balance of Malaysia with other regions (million USD)



Source: Raw data from Monthly External Trade Statistics, Department of Statistics Malaysia

3.1 Trading of Manufactured Products

Accounting for 85% of Malaysia's total trade volume, manufactured goods is the fundamental contributor for both imports and exports. The trade of manufacturing products to and from Malaysia in the first ten months of 2019 amounted to USD 309 billion, of which exports accounted for USD 168 billion.

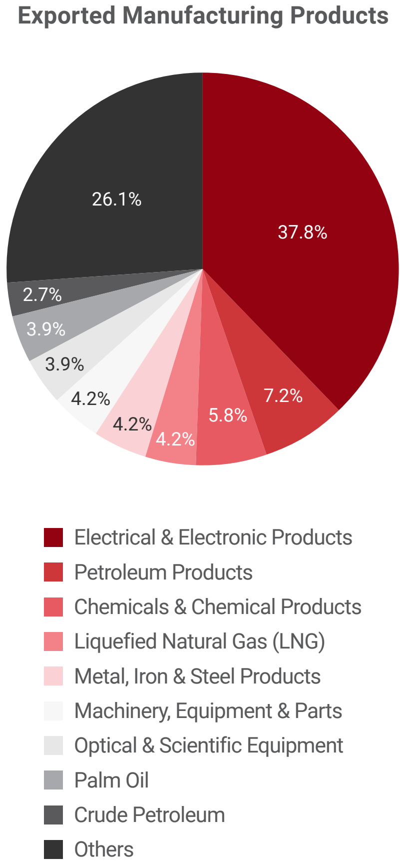
Malaysia's exports are dominated by electronics, which highly contributes to the rapid industrialization of the country and makes Malaysia one of the biggest electronics exporters in the world. The main products include semiconductors, industrial electronic equipment and electrical consumer products worldwide. It is safe to say that the electronics manufacturing in Malaysia won't be less prominent soon, since the demand for the key exported product, semiconductors, continues to increase along the production of new mobile devices, storage devices, optoelectronics, artificial intelligence and 5G-technology. Over the past decades, the industry has become a key driver of Malaysia's economy, and has attracted substantial investments and reduced the unemployment level across the country. To secure its position in the global electronics supply chain, and to enhance the comparative advantage over neighboring countries, Malaysia has constantly made sure of providing a competitive business environment and support for companies in the industry.

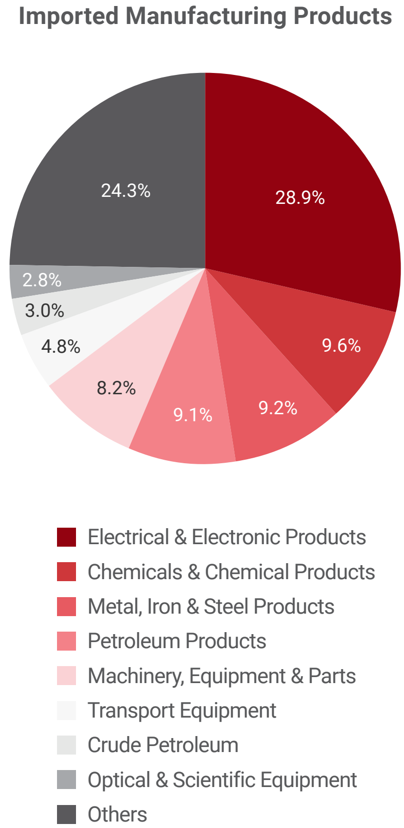
In addition to electronics, products such as petroleum, metals, rubber and palm oil, also contribute considerably to Malaysia's trade. However, only a few of them can achieve a surplus, and many have created a deficit between Malaysia and other countries, especially machinery, equipment parts and chemicals.

Figure 18

Import and Export of Manufactured Products to and from Malaysia in 2019

Percentages of imported and exported manufactured products by value





Source: Raw data from Monthly External Trade Statistics, Department of Statistics Malaysia

3.2 Free Trade Agreements

Malaysia joined the General Agreement on Trade and Tariff (GATT) in 1957, and therefore became a founding member of the World Trade Organization (WTO), which replaced the GATT. The country coasts the Straits of Malacca, a major shipping channel that connects the Indian Ocean to the west and the Pacific Ocean to the east, providing a tremendous trade opportunity with the world. Recognizing the advantage, Malaysia has relied its economic growth heavily on international trade and utilized on Free Trade Agreements (FTA) with multiple countries and regions. In 2019, Malaysias's free trade partner countries contributed to 67.7% of Malaysia's total trade, and 69.6% of Malaysia's exports.

Malaysia currently holds FTA's with most countries in the Asia Pacific area, as well as with Chile in South America and Turkey in Europe/Asia. Simultaneously, Malaysia is undergoing negotiations for additional FTA's with other countries and territories. Companies trading (either by exporting or importing) with Malaysia benefits from this since the FTA's:

- Lowers or reduces tariffs on exports and imports of goods and components assigned under the FTA. This makes products more cost-competitive, compared to exports and imports from non-FTA countries.
- Relaxes, or completely removes, quantitative import restrictions.
- Provides hassle-free customs procedures.
- Improves market access for various services.
- Provides easier entry for investors.

Currently, Malaysia has seven bilateral FTA's with the following countries:

- **Japan**, Malaysia-Japan Economic Partnership Agreement (MJEPA), entered into force on 13th July 2006.
- **Pakistan**, Malaysia-Pakistan Closer Economic Partnership Agreement (MPCEPA), entered into force on 1st January 2008.
- **New Zealand**, Malaysia-New Zealand Free Trade Agreement (MNZFTA), entered into force on 1st August 2010.
- **India**, Malaysia-India Comprehensive Economic Cooperation Agreement (MICECA), entered into force on 1st July 2011.
- **Chile**, Malaysia-Chile Free Trade Agreement (MCFTA), entered into force on 25th February 2012.
- **Australia**, Malaysia-Australia Free Trade Agreement (MAFTA), entered into force on 1st January 2013.
- **Turkey**, Malaysia-Turkey Free Trade Agreement (MTFTA), entered into force on 1st August 2015.

Being one of the founding members of the Association of Southeast Asian Nations (ASEAN), Malaysia also enjoys the regional FTA among the ASEAN members (**Singapore, Brunei, Thailand, Philippines, Indonesia, Vietnam, Laos, Myanmar** and **Cambodia**) (ASEAN Trade In Goods Agreement - ATIGA) and the FTA between ASEAN and other countries and regions, including FTAs with **China** (ACFTA), **South Korea** (AKFTA), **Japan** (AJCEP), **Australia** - **New Zealand** (AANZFTA), **India** (AIFTA) and **Hongkong** (AHKFTA).

In addition, two FTA's have been signed by Malaysia and are waiting for ratification. **The Trans-Pacific Partnership Agreement** (TPPA), signed on 4th February 2016, and the **Comprehensive and Progressive Agreement for Trans-Pacific Partnership** (CPTPP), signed on 8th March 2018.

Malaysia is also currently undertaking negotiations for additional FTAs. The **Malaysia-European Free Trade Area Economic Partnership Agreement** (MEEPA), **Malaysia-EU Free Trade Agreement** (MEUFTA) and **Malaysia-Iran Preferential Trade Agreement** (MIPTA), as well as an agreement of **Regional Comprehensive Economic Partnership** (RCEP) between ASEAN and their six FTA partners.

3.3 Logistical Infrastructure

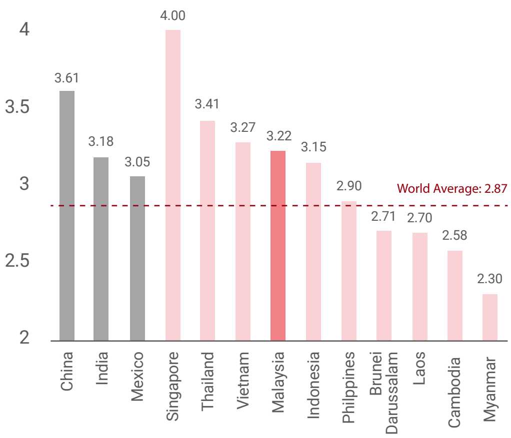
Due to variable factors impacting the global economy in the past couple of years (ex. US-China trade war & outbreak of COVID-19), manufacturing is shifting from the traditional hub in China to alternative locations. SEA has become more attractive to companies searching for low-cost alternatives. One of the reasons for the relocation to SEA is its relatively competitive logistical capabilities. Although the logistics performance of most SEA countries is inferior to China, almost half of the countries in SEA provides better logistics than other popular manufacturing destinations, such as India and Mexico.

According to a logistics performance assessment by the World Bank, Malaysia ranks 41st globally and 4th in SEA, behind Singapore, Thailand and Vietnam. The assessment provides insights on efficiency of the customs clearance process, the quality of trade, the transport infrastructure and the competence & quality of logistics services. It also provides information on the outcome of the service delivery performance, including the ease of arranging competitively priced shipments, the ability to track and trace consignments and if shipments reach the destination within the scheduled delivery time.

Figure 19

Logistics Performance Index of the Southeast Asian Countries in Comparison with China, India and Mexico

Logistics Performance Index (LPI) on scale from 1 (lowest) to 5 (highest)

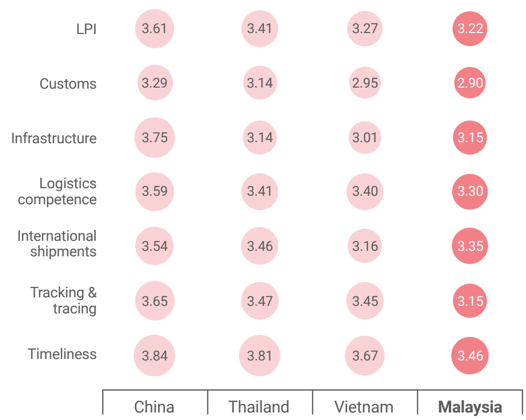


Source: Raw data from LPI Global Rankings 2018, the World Bank

Figure 20

Comparison of Logistics Performance Factors between Malaysia and Top Performers in SEA and China

Sub-indicators of LPI on scale from 1 (lowest) to 5 (highest)



Source: Raw data from LPI Global Rankings 2018, the World Bank

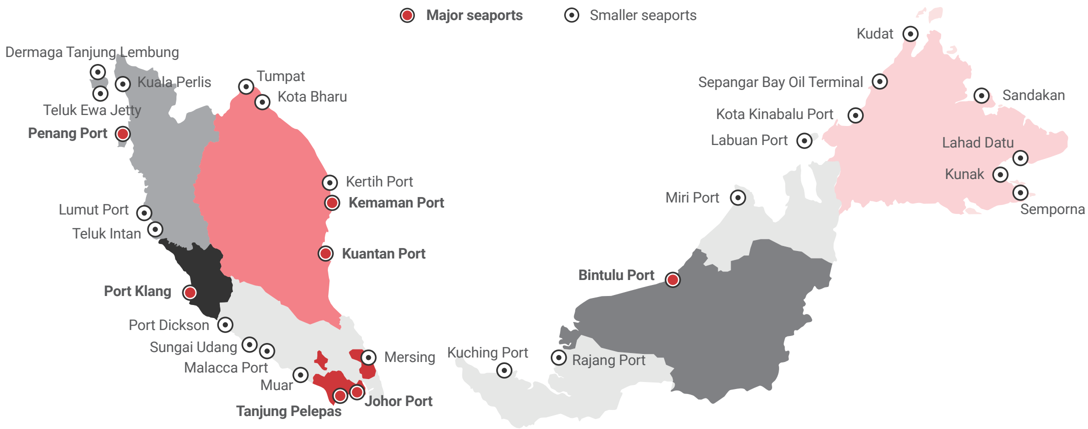
Among the assessed criteria, Malaysia's timeliness of shipments and its ability to track and trace consignments was rated significantly lower than Thailand and Vietnam. Companies whose products are time-sensitive may consider incorporating in other Asian countries or mitigating the risk in Malaysia by only selecting trustworthy transportation service providers to maximize the delivery quality. The inferior performance in these categories can be explained by the complicated customs procedures and average logistics quality of the service providers.

On the other hand, Malaysia displays a better infrastructure compared to both Thailand and Vietnam. All transport channels in Malaysia, including sea, air, road and railway holds good quality, giving businesses in Malaysia access to international shipments. More than half of Malaysia's trade value is transported by sea, while nearly a third is by air and about 13% is carried by road or railway. Major airports for international logistics in the country are Kuala Lumpur International Airport and Penang International Airport, which both holds advanced and sufficient facilities, including EDI systems and adequate cargo-handling capacity. Road transportation benefits from the Malaysian North-South Expressway which runs cross peninsular Malaysia. Its connected sections are well developed with no noticeable bottlenecks. Since the road passes both Kuala Lumpur and Johor Baharu, traffic congestion can occur sometimes, but are not significant concerns for transportation. However, the railway is not preferred for transportation between Malaysia and the neighboring countries. Issues, such as inconsistent travel hours and lack of locomotives on Thailand's side of the border still inhibit the railway from playing a major role in cross-border trade.

Figure 21

Seaports in Malaysia

Main seaports and smaller seaports in Malaysia



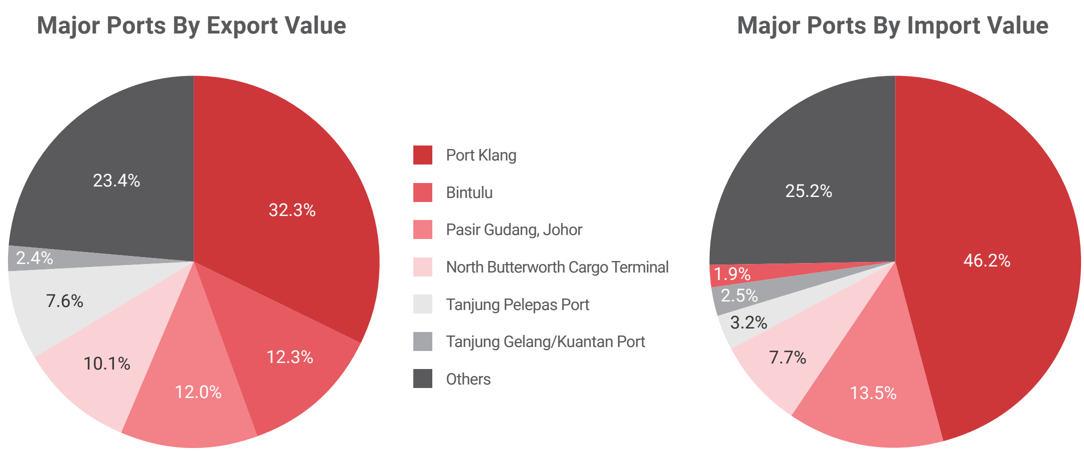
Source: Ports in Malaysia, SMEinfo Portal Malaysia

There are seven major seaports in Malaysia; Port Klang, Johor Port, Penang Port, Bintulu Port, Tanjung Pelepas Port, Kuantan Port and Kemaman Port, in the order of their trade volume. Port Klang, located 38 kilometers southwest of Kuala Lumpur, is the largest container terminal and was ranked the 12th busiest container port in the world 2018, only behind Singapore in SEA. Port Klang currently holds two terminals but are in the finalizing stages of the plan to establish a third, to ensure the capability of handling the rising future demand.

Figure 22

Major Seaports in Malaysia by Trade Value in 2018

Distribution of trade value between seaports



Source: Raw data from Monthly External Trade Statistics, Department of Statistics Malaysia

4 Tax Incentives in the Manufacturing Sector

In Malaysia, a Corporate Income Tax (CIT) rate of 24% is imposed on all foreign companies' incomes accruing in or deriving from Malaysia. However, in order to attract greater amount of foreign investments to focused sectors, the Malaysian Government has introduced a broad range of tax incentive policies. The major tax incentives for companies investing in the manufacturing sector are the Pioneer Status and the Investment Tax Allowance. These incentives are based on certain priorities, such as the level of added value, technology used and industrial linkages. More details of some available tax incentives for manufacturing companies are shown in the following table.

Table 1

Tax Incentives in the Manufacturing Sector of Malaysia

Summary of tax incentives and their applications in different industries and types of business in manufacturing

Eligibility	Pioneer Status	Investment Tax Allowance
Incentives for Relocating Manufacturing Activities to Promoted Areas		
Existing companies that relocate their manufacturing activities to the promoted areas.	100% Income tax exemption of the statutory income for a period of five years.	100% on the qualifying capital expenditure incurred within a period of five years.
Incentives for High Technology Companies		
• Companies where R&D expenditures accounts for at least 1% of gross sales. • Companies where the higher educated staff, with minimum of 5 years' experience in related fields, accounts for at least 7% of the company's total workforce.	Income tax exemption of 100% of the statutory income for a period of five years.	60% (100% for promoted areas) on the qualifying capital expenditure incurred within five years from the date the first qualifying capital expenditure incurred.
Incentives for Small and Medium-Scale Companies		
• Small-scale manufacturing companies incorporated in Malaysia, with shareholders' funds not exceeding USD 121,000 and having at least 60% Malaysian equity. • The added value to the product from the manufacturing process must be at least 25%. • The project contributes to a socio-economic development of the rural population.	Income tax exemption of 100% of the statutory income for a period of five years.	60% (100% for promoted areas) on the qualifying capital expenditure incurred within five years from the date the first qualifying capital expenditure incurred.
Small and medium-scale companies with a paid-up capital of USD 605,000 and lower are eligible for a reduced corporate tax rate of 20% on chargeable income up to USD 121,000. The tax rate on the remaining chargeable income is maintained at 24%.		
Incentives for the Production of Specialized Machinery and Equipment		
Companies undertaking activities within the production of specialized machinery and equipment, such as machinery tools, plastic injection machinery, plastic extrusion machinery, material handling equipment, packaging machinery, robotics and factory automation equipment, specialized/process machinery or equipment for specific industries and parts & components to the mentioned machinery and equipment.	Income tax exemption of 100% of the statutory income for a period of five years.	60% (100% for promoted areas) on the qualifying capital expenditure incurred within five years from the date the first qualifying capital expenditure incurred.
Incentives for Automotive Component Modules or Systems		
New and existing companies that undertake design, R&D and production of qualifying automotive component modules or systems.	Income tax exemption of 100% of the statutory income for a period of five years.	60% of the qualifying capital expenditure incurred within five years from the date the first capital expenditure incurred.
Incentives for the Utilization of Oil Palm Biomass		
Companies that utilize palm oil biomass to produce value-added products such as particleboard, medium density fiberboard, plywood, pulp and paper.	New companies	
	Income tax exemption of 100% of the statutory income for a period of ten years.	100% of qualified capital expenditure incurred within a period of five years.
	Exisiting companies	
	Income tax exemption of 100% of the increased statutory income arising from the reinvestment for a period of ten years.	100% on the additional qualifying capital expenditure incurred within a period of five years.

Source: Incentives in Manufacturing Sector, Malaysian Investment Development Authority

This concludes part 2 of Asia Perspective's overview of Malaysia as a business environment for manufacturing.
For more insight into Malaysia manufacturing opportunities and challenges, see parts 1 & 3 of this report.

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