

Zeti Akhtar Aziz: Towards gaining the competitive edge

Speech by Y Bhg Tan Sri Dato' Dr Zeti Akhtar Aziz, Governor of Bank Negara Malaysia, at the Chartered Institute of Management Accountants (CIMA), held in Kuala Lumpur, 17 September 2001.

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Ladies and Gentlemen,

Introduction

It is indeed my great pleasure to be here today to have this opportunity to deliver this lecture on "Towards Gaining the Competitive Edge", organised by the Chartered Institute of Management Accountants (CIMA). Our quest to gain the competitive edge in this increasingly more difficult global environment is aimed at building the foundation on which our future growth can be secured. The emerging developments in the global economy has brought the issue of competitiveness into sharp focus. Increased competition and higher standards of efficiency and quality amidst intensified globalisation have heightened attention on how the Malaysian economy can remain viable in the global market place. With the emergence of new economies with lower production costs, the challenge of the global market place can be expected to be heightened.

The issue before us is **how Malaysia can gain a competitive edge so as to sustain our growth prospects and continue to raise our standards of living**. What are the factors that would determine the competitiveness of the Malaysian economy in the future, in this more competitive environment. How can Malaysia effectively and efficiently utilise its resources in this more difficult environment. What are the strategies that should be adopted by the authorities and by the private sector to enhance competitiveness? Let me begin with a discussion of what we mean by being competitive and the factors that determine competitiveness and then proceed to discuss alternative strategies and approaches that may be adopted to build this competitiveness.

Definition of competitiveness

The term competitiveness has many interpretations. Competitiveness is generally equated with the performance of an economy. As competitiveness relates to competition, it also implies a comparative element, with the implication that competitiveness is essentially about securing market-share. In practice, the alternative definitions of competitiveness used depend on the focus of interest. **The OECD has defined competitiveness for a nation as the degree to which a country can produce goods and services which meet the test of international markets, while its citizens earn a standard of living that is both rising and sustainable in the long run.** For a firm, competitiveness is the ability to produce the right goods and services of the right quality, at the right price, at the right time. It means meeting customers' demands more efficiently and more effectively than other firms.

Generally, discussions on competitiveness focus on **supply-side measures** to strengthen competitiveness, being usually achieved through raising productivity so as to enhance the ability of the economy to generate more output from a given supply of inputs. However, competitiveness as related to increased output growth requires also **demand side measures** to ensure a conducive macroeconomic environment so that resources are allocated in response to market conditions. This suggests that the focus of attention should be both on capacity building and on capacity utilisation.

The changed environment

Previous economic success cannot be expected to be replicated in the new economic environment. The new environment is now characterised with increased competitive pressures and greater uncertainty. The globalisation process and the rapid spread of technology has brought about a more competitive environment as markets become increasingly more open, with an increasing number of new entrants to the market. In this environment, the ability to compete is no longer just based on access to raw materials, land, capital and labour. It will demand much more.

In this new economic environment, businesses can expect to be confronted with increased levels of uncertainty. Previously, under stable business environment, it was possible to identify distinct business trends. In an environment of greater uncertainty, businesses are often caught unaware by sudden changes. In the new economy, gains are accorded to those who are the fastest to recognise change and are the first to exploit the opportunity. Businesses that are rigid and too slow to respond to change can expect to face increasing difficulties in the new economy.

In the new economy, businesses also can expect to face a greater demand for better information, increased disclosure and for more transparent systems. Businesses will therefore need to cope with numerous reporting requirements. Global standards can be expected to be increasingly rigorous. Traditional reporting that have tended to be based on current and previous financial statements will give way to greater emphasis on the future.

Ladies and Gentlemen,

Factors affecting competitiveness

In this rapidly changing economic and financial environment, a continual assessment of our competitiveness is required to provide a basis on how we should respond to the new pressures and challenges. Survival in the new economy will require new approaches. Previous approaches that have brought successes may no longer be relevant. While there are many factors that influence a nation's competitiveness, allow me to highlight ten important areas that are fundamental in affecting competitiveness.

Firstly, a sound macroeconomic environment and a conducive business environment is essential to support the economic growth process and to enhance competitiveness. Appropriate macroeconomic environment will help businesses to respond accordingly to the changes in market conditions. Macroeconomic stability and a conducive business environment provide enterprises with the platform to achieve the highest standards of performance. We are only too aware that economic instability and periods of heightened economic and financial uncertainty are not conducive for private sector investment decisions.

Secondly, the ability to adapt and adjust and to respond to changing economic conditions, changes in comparative advantage and to the new opportunities that the new environment accords. This will involve having the degree of agility to adjust, to move out of those areas where we no longer have comparative advantage and to pursue new growth areas. Very often, such adjustments will involve a contraction in some industries and expansion in others. Economies with a high degree of labour and capital mobility will facilitate this process. Furthermore, industries which are subject to market swings need to increase their adaptability to such shocks, to have the ability to shift resources and to shift from one market to another. The degree of exposure or the degree of concentration of an economy or of an industry will affect the degree of flexibility to adjust to the changing conditions. Excesses or a high degree of exposure will increase the vulnerability and risks to sudden shifts or shocks to the system and would reduce the ability to adjust accordingly. Countries therefore need to enhance the degree of resilience to cope with external shocks.

Thirdly, corporate resilience. There has been a great deal of attention in the recent years given to micro reform, corporate restructuring, and rationalisation, all being part of the process of attaining greater efficiency and becoming more competitive. Other benefits arising from this include better pricing structures, productivity improvements and a strengthened ability to absorb external shocks more effectively.

Fourth, a well developed and efficient physical infrastructure will contribute to enhance competitiveness and support the growth process. The cost of infrastructure services will also affect the competitiveness of the private sector. These include the provision of the various transportation systems, port facilities, energy, telecommunications, utilities, whether the provision is by the public or private sector, cost effective pricing structures need to be in place to contribute to overall competitiveness of the economy in general and industries in particular.

Fifth, Government regulations and procedures have a direct impact on business. An effective and efficient functioning government will contribute to enhance competitiveness. Bureaucratic red-tape and regulations that cause long delays will result in increased financial costs, opportunity costs and financial risks. The higher levels of efficiency of the delivery of public services will contribute toward reducing costs to the private sector. Decisions on locating business in the country would depend not

only on the cost of doing business but also on the quality of services that contribute to the business environment.

Sixth, a well functioning and efficient financial system is vital for achieving robust economic performance. The financial system including an efficient and resilient banking and payment system is important in facilitating the overall functioning of the economy. The banking system and capital market provides an effective and efficient means of financing the appropriate financial structure that meets the requirements of the economy. The financial system needs to provide the range of products and services to support the changing needs of the economy. Key is for the financial system to be competitive and efficient and able to provide financial products and services at competitive rates thus contributing towards the overall competitiveness of the economy. At the same time, the resilience of the financial system is key so that it will be in a position to withstand the destabilising shocks to the system.

Seventh, having the skills is crucial in achieving long-term competitiveness. Knowledge in the new economy will become an increasingly important factor in wealth creation. Marshalling knowledge in the new economy is becoming an important strategy for businesses not only to improve products and services but also to enhance productivity and efficiency. While the education and skills levels of the work force is an important element, of greater importance is the ability to translate the knowledge into enhancing the capabilities of the business. Companies increasingly will have to compete by developing and exploiting skills, knowledge and creativity. In most cases, manpower gaps are found in the areas of science and technology. Deficiencies in management and work force skills would be a constraint. In this environment, qualifications acquired during initial education is no longer adequate and new skills need to be continually acquired.

Eight, investment in technology is vital to improve competitiveness. An important technology that is crucial for future performance is Information and Communications Technology (ICT). Not only are investments in ICT important but more importantly that these new technologies are put to their best use. This can be a major factor elevating the performance and competitiveness of an enterprise.

Ninth, research and development which is important for enabling innovation to generate new and improved products. Strong science and technology capabilities, would enhance the competitive position. Low levels of research and development are usually due to weak technological capability. High levels of expenditure on research and development would contribute to enhance the ability to compete in the global market place.

Finally, institutional developments will be important in ensuring sustainability of performance of an economy. An important part of this is developing strong private and public institutions. It has been recognised that poor systems of corporate governance have contributed to problems that came to the surface during periods of slowdown or crisis. Corporate governance practices including having effective board of directors, strong internal controls, reliable financial reporting, adequate protection of minority shareholders, audits and enforcement to ensure compliance. Other important aspects of institutional development include streamlining the institutional structure and arrangements and ensuring reliability of financial information. Also improving legal and regulatory framework for enforcement of the laws and regulations. All this will contribute to enhance the business environment and thus enhance competitiveness. Strong professional organisations can play an important role to improve and enforce the standards and practices. This includes that of the code of ethics and code of conduct of accountants. While these standards may be in place, of importance is to ensure proper and effective application of these standards.

Programme for competitiveness : a total approach

After several decades of economic success, it is recognised that a major challenge to ensure its sustainability is to address the issue of competitiveness. This would provide the foundation on which our aspirations to achieve high quality, broad-based equitable growth can be realised.

Very often the discussion on competitiveness has centred on the promotion of greater competition and an accelerated pace of liberalisation that will lead to greater efficiency gains and competitiveness thus enhanced competitiveness. However, the global experience has shown that the liberalisation process needs to be managed in a manner that is orderly and not disruptive to the overall functioning of the economy. It also needs to be recognised that the degree of economic liberalisation and increased competitive pressures alone, cannot be relied upon to achieve competitiveness. Domestic capacity has to be built and strengthened to deal with the challenges of the new environment. Thus, while

liberalisation and the increased competition may be a factor driving domestic firms to be more competitive, there is the need also to build the capacities and capability for this to be realised.

An issue that has drawn significant debate in relation to the issue of competitiveness is the choice of exchange rate regime. While Malaysia remains committed to the market mechanism we also want to be assured that we will operate in an environment of efficient functioning markets. As a small open economy, we need to be assured that we will not be subject to mis-aligned rates and that the market forces will ensure a convergence to equilibrium levels that reflect the underlying fundamentals.

An open economy with the volume of trade that is two times the size of the economy, Malaysia requires a stable and efficient functioning exchange rate regime to facilitate international trade and investment. For over three years now we have operated with pegged exchange rate regime. The relative exchange rate stability accorded by the pegged exchange rate regime has reduced Malaysia's vulnerability to sharp short term movements in the exchange rate and has contributed positively to economic activity in the country. Experience in the aftermath of the Asian Financial Crisis has shown that excessive volatility has occurred, with regional exchange rates that have been driven by specific developments changes in market perceptions and by contagion. This becomes disruptive to trade and investment activities. Relying on the exchange rate to gain a competitive advantage in the international markets will only provide temporary advantages as prices adjust and as others follow with competitive adjustments.

Gaining competitiveness therefore necessarily requires a total approach, whereby the factors on all fronts are addressed in a comprehensive manner. Nations that are able to provide more conducive macro-fundamentals environment, more efficient cost structure, more responsive and resilient institutions as well as strengthening the cultural and educational dimensions would have a greater probability of sustaining competitiveness and economic growth over the medium and longer term.

Sustaining macroeconomic fundamentals

Malaysia has over the decades adopted a comprehensive approach. In the changed environment, this approach has been broadened further to address the new issues that have emerged. In terms of macroeconomic fundamentals, Malaysia has a track record of **low and stable inflation**, which has kept the cost of doing business low and has increased the attractiveness of Malaysia as an investment destination. Low inflation has also encouraged capital formation through a high savings rate. **In essence, macroeconomic policies to address short-term concerns have been judiciously implemented while not creating any long-term risks to the economy.** This policy strategy and the conducive macroeconomic environment is often taken for granted. It has however, enabled Malaysia to recover rapidly from periods of shocks to the system experienced by the nation. This policy strategy of sustaining macroeconomic fundamentals is an essential part of the overall programme to restructure and reform the nation to gain competitiveness.

Restructuring and reform

The past strategies of economic diversification and structural reforms have also strengthened the underlying structure of the Malaysian economy and has placed Malaysia in a stronger position to meet the new challenges. Going forward, six areas have been identified for improvement in order to increase the nation's resilience and competitiveness. The six areas are to achieve a broad-based diversified economic structure; to accelerate the development of financial infrastructure, financial sector restructuring and consolidation; to intensify efforts towards corporate restructuring; undertake further public sector reform; and to foster growth and development of small-and medium-scale enterprises (SMEs). The strategies to address these issues have been formulated and are well articulated in the various long-term plans of the Government and key regulatory agencies. The Third Outline Perspective Plan (OPP3) launched this year in April, the financial sector masterplan and the capital market masterplan launched in early 2001 contain the strategies to enhance Malaysia's competitive strength in the international markets place, in terms of both price and quality.

Strengthening the economic structure

A key policy strategy that has been pursued over the decades is the emphasis on strengthening the economic structure with increased diversification of the economic base. The strategy is essentially directed at promoting the development of a broad-based economy. It was recognised that over

dependence on a few export-oriented industries increases vulnerability to external developments. While Malaysia has reduced over the years the concentration in the low-end electronics industries, given its vulnerability to changes in demand and sharp price movements across all electronics goods, including the higher-end products, Malaysia is still affected by the recent electronics down turn. In order to further reduce vulnerabilities to external demand a, balanced approach has been taken, targeted at expanding the traditional areas, whilst developing new sources of growth in the manufacturing, services and agriculture sectors. In the traditional services sectors, issues being addressed pertain to the need to raise efficiency and productivity to optimise the use of large capacity that has been built up as a result of investment in pre-crisis years. The new growth areas will focus on resource-based sectors, services and ICT-related activities. At the same time, the non-traditional agriculture is targeted to increase its contribution as part of this diversification.

Development of the financial sector

Ladies and Gentlemen,

The competitive environment in Malaysia has been enhanced by the development of the financial system that is able to support and facilitate trade and investment. Strategies towards developing a more competitive, efficient and effective financial sector have been outlined in the **Financial Sector Masterplan (FSMP)**. The FSMP includes specific recommendations on measures for building domestic capacity and enabling greater innovation and performance improvement. A key recommendation to drive the banking sector's competitiveness is the **benchmarking exercise**. In this exercise, performance indicators are being developed for monitoring performance over time drive the capacity enhancement of the banking institutions.

In the new financial landscape that will be more open and competitive, only a few will emerge to compete effectively and efficiently across all banking markets and to provide the full range of banking services. As such, financial institutions must **re-examine existing business models** to see where their strengths lie and to what opportunities these strengths can be applied to enhance returns. In this regard, the FSMP has outlined specific recommendations that will allow greater flexibility for banking groups to operate and build internal capacity to compete. Banking institutions would also need to consider new business arrangements and approaches in order to enhance returns.

The broadening and deepening of financial market will provide an efficient and cost-effective source of funds for corporations. In particular, efforts to develop the capital market especially the corporate bond market will aid this process.

Restructuring the corporate sector

Ladies and Gentlemen,

In a fast changing economic and business environment, the restructuring of the corporate sector has also become an increasingly important element of competitiveness in Malaysia. In particular, corporate restructuring would enhance general corporate sector resilience by ensuring that businesses remain agile and are able to increase returns to shareholders and investors. The **reorganization of business strategies and focus, rationalization and consolidation of operations** as well as **process restructuring**, would all contribute toward the minimisation of duplications and overlapping of functions within the group, as well as the optimisation of group strength either financially or operationally. From the investor's perspective, this is an encouraging trend that would ultimately result in enhanced shareholder value.

The sustenance of enhanced corporate sector resilience resulting from corporate restructuring would be greatly facilitated by **high standards of corporate governance**. Good corporate governance would also ensure that the management of companies act in the best interest of shareholders, with the ultimate objective of realising long-term shareholder value through enhanced efficiency, productivity and profitability. Evidence of the receptiveness of the market to good corporate governance has been borne in this respect. The Asian financial crisis has shown that creditors and investors are increasingly viewing good corporate governance as an essential element in their lending and investment decisions. As such, companies that demonstrate good corporate governance practices would find it relatively **easier to attract and retain financing and at a lower cost**, to effectively and efficiently finance their research, development, innovation and capacity expansion activities, that are critical to ensure sustainable **long-term competitiveness**.

Emerging from severity of the recent economic crisis and amidst the global economic slowdown, the Malaysian corporate sector is now undergoing major adjustments and restructuring in order to enhance its resilience and competitiveness. This **corporate restructuring is being undertaken through several avenues**. Under the current economic scenario, most corporate workouts and reorganisations are carried out through structured approach such as section 176 of the Companies Act and restructurings spearheaded by the Pengurusan Danaharta Nasional Berhad, the national asset management company as well as the Corporate Debt Restructuring Committee. Market-driven or voluntary corporate restructurings are also taking place which are initiated either at the corporate level or by the lenders.

In the context of the corporate restructuring efforts under the ambit of the **Corporate Debt Restructuring Committee**, continuous efforts have been made to improve the efficiency and expedite the pace, completion and implementation of corporate restructurings. Irrespective of the route adopted, the **ultimate end-game is the creation of a robust corporate sector** that is responsive to challenges and changes that are taking place. It is therefore the main vision of all stakeholders to cooperate and get their act together in ensuring that restructuring efforts are implemented expediently to preserve the value of the company and more importantly to harness maximum benefits from emerging opportunities to enhance shareholders value. Given the paramount importance of corporate restructuring in the competitive business environment, continuous corporate reorganizations are envisaged to be a natural process in the business scene in order to remain viable.

Given its importance, the authorities have also put in place **several measures to improve the standards of corporate governance**. The release of the Finance Committee Report on Corporate Governance marked a new beginning of our concerted efforts towards enhancing the standards of corporate governance in Malaysia. Since the release, there has been significant progress in implementing the recommendations in the Report. These included among others, the development of the Malaysian Code of Corporate Governance to enhance the self-regulatory mechanisms that promote good governance. Various changes have also been effected to the Securities Commission Act 1993 and to the KLSE Listing Requirements, to strengthen the statutory and regulatory framework for corporate governance.

To enhance **corporate governance in the banking sector**, a number of guidelines and regulations have been introduced. Among these are, the Guidelines on Duties and Responsibilities of Directors and Appointment of Chief Executive Directors, the Code of Conduct for Directors, Officers and Employees in Banking Industry, the Minimum Internal Audit Standards and the Guidelines on the Specimen Financial Statements for the Banking Industry. Indeed, according to a 2001 survey by Political and Economic Risk Consultancy Ltd., **Malaysia's quality of corporate governance was rated the best** among 12 nations surveyed in Asia.

While the authorities will continue in its role to promote the standards of corporate governance, it must also be noted that **the private sector has an equally important role**. It is critical that all stakeholders, both public and private sector participants, inculcate a culture of good corporate behaviour. With the active participation of the private sector, including the management accountants present here today, we are confident that these efforts will be able to achieve the desired results and contribute towards our gaining the competitive edge.

Public sector reform

On the public sector front, a number of the Government outdated regulations, cumbersome procedures and practices are being reviewed. The review aims to enhance operational efficiency and transparency as well as to streamline Government's machinery. Efficient and transparent Government machinery would reduce business costs and financial risk. This would improve the business environment and thereby contribute towards enhancing competitiveness.

Small and medium enterprise (SME) development

An important element of strategies to enhance competitiveness is the development of small and medium enterprises (SMEs). A holistic approach is required to realise the potential of SMEs in the economy. For SME development it is necessary to move towards a well-planned and comprehensive strategic policy to ensure the orderly and systematic development of the SMEs. In this respect, currently, initiatives to develop SMEs by a number of agencies with varying degrees of involvement

are being reviewed to address the issues of viability and survival of SMEs after the AFTA. Moving forward, the development aspect of SMEs in the areas of finance, research and development, training and advisory as well as marketing and distribution strategies are being addressed in order for the SMEs to compete effectively after the AFTA. In this regard, the policy direction is to review the role and function of the existing establishments to minimise destruction of value and expertise that is already developed, and more importantly to adopt measures to facilitate the future development of the SMEs.

Closing the knowledge gap

In order to effectively reap the gains from the restructuring and reforms outlined above, efforts to **narrow the knowledge gap** with the goal of **developing creative and competitive human resources becomes vital**. The efforts are focused on upgrading the quality and relevance of the **education** system while enhancing the **skills** of the labour force. In this regard, the Government has pledged additional resources to the education sector in order to narrow the knowledge and skills gap. In 8MP, the Government continues to finance and support programmes in education and training, in which the expenditure allocated amounted to RM22.7 billion or 21% of total allocation during the plan period (RM19.7 billion was spent during 7MP). The holistic approach taken in education will emphasise higher productivity growth through investments in IT and knowledge-intensive technologies. Hence, measures are in place to promote computer literacy amongst students and workers, improve teaching and learning methods and review the existing curriculum in schools and institutions of higher learning in tandem with current developments and needs. By the end of 2001, a large number of schools are expected to be equipped with computers and software through the Smart Schools programme, with priority being given to rural schools.

In order to upgrade human resource skills to meet the need of the K-economy, training at every level will be strengthened to generate well-trained labour to meet industry demand. Opportunities for lifelong learning after students have completed their formal education are also being created to ensure the continued relevance of skills. Whilst emphasis will be placed on intensifying advanced skills development through training, retraining and apprenticeship schemes, efforts to pool the best talents from Malaysia and abroad have also been intensified. As such incentives have been provided in the 2001 Budget to attract highly skilled Malaysian citizens working abroad to return to Malaysia.

Emphasis on science and technology

In order to enhance efficiency and productivity gains through restructuring and reform, an increased focus is on **science and technology**-related activities. The Government has taken the lead to boost its **investment in IT**, leading the way for the private sector to follow suit. As part of these measures, the Multimedia Super Corridor (MSC) was launched in 1996 to propel the Malaysian economy towards a higher value added and technology driven activities. Similarly, increased in information technology across all sectors is taking place. The incentive structure in terms of fiscal and financial support have aided this process. The potential for this however has yet to be realised.

To intensify the attention towards **research and development (R&D) activities**, the Government has allocated RM1.6 billion for R&D under the 8MP (RM1 billion in 7MP). The Government has also broadened the scope of research under the Intensification of Research in Priority Areas (IRPA) to include venture capital companies interested in carrying out R&D in the MSC. To provide support services as well as R&D for high technology industries, the Government announced an allocation of RM16.7 million in the 2001 Budget for this purpose. Besides IT, public investment in R&D in other traditional areas such as agriculture and natural resources continue to be funded and encouraged. Measures have also been taken to enhance monitoring of R&D activities, including those in the private sector, to ensure better coordination and track the progress towards achieving targets.

To further enhance the nations' capability in science and technology, the promotion of **strategic alliances** through smart partnerships has been encouraged. Various forms of strategic alliances are encouraged between foreign and Malaysian parties, not only by way of foreign equity holdings, but also at the management level in sectors such as ICT, energy, ports, financial as well as the nations' airline and national car industry. Foreign direct investment has an important role in facilitating the transfer of technology. The Government has implemented a number of initiatives to attract FDI into the country through an incentive structure of packages that are customised to meet the interest of specific investors. At the same time, the incentive structure has been designed to improve the quality of FDI

away from labour-intensive to more technology-driven FDI with strong emphasis on R&D and knowledge content.

Conclusion

In conclusion, it is critical that all stakeholders, both public and private sector participants, including the management accountants present here today to direct efforts to contribute towards our gaining the competitive edge. Malaysia's macroeconomic fundamentals are sound. The public sector also remains committed to ensure that macroeconomic environment remains favourable to ensure costs remain low. It is, therefore, important for the private sector to focus on the issue of efficiency to elevate Malaysia to a higher level of performance and prosperity.

Thank you for your attention.