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ICT as engine of growth

S. Jai Shankar

A RECENT conversation with Frank-Jurgen Richter, the World Economic Forum's head for Asian Affairs and co-editor of a recent book called 'Recreating Asia, Visions for a New Century', has produced an interesting observation. The distinguished gentleman points out that without a clear focus on the IT sector and tools, there would be little chance for countries in Asia to compete effectively in the global marketplace.

He notes that the IT sector could help jumpstart economies such as Malaysia that are inexorably being sidelined from the major currents influencing today's economic growth. Competitive advantage built upon Foreign Direct Investment (FDI) inflows and cheap labour is fast losing its edge. Countries such as China and Vietnam can now assume that stance far more effectively. Malaysia as such has no choice but to evolve into a sophisticated high technology-based economy that accommodates a significant services sector.

The confluence of factors such as imminent liberalisation brought forth by global trade forums and regulations such as the World Trade Organisation and ASEAN Free Trade Area (AFTA) plus changed economic climate post-1997 Asian economic crisis compounds the problem. Put simply, the global and regional economic climate has changed and along with it Malaysia's long-term economic fortunes.

A quick look at FDI inflows, which have gone primarily into the manufacturing sector, reflects the growing malaise. It is estimated that Malaysia recorded a slight contraction in approved FDIs from US\$ 5.5 billion in 2000 to US\$ 4.8 billion in 2001. The drop was due to cutbacks in multinational companies' investments as a result of lower global economic growth prospects last year. This year the approved FDIs totalled only US\$568.2 million as of June. Considering the dismal global economic forecast for the year, FDI inflows are not expected to grow strongly in the last two quarters of the year. In fact, AT Kearney's FDI Confidence Index survey for September 2002 showed that Malaysia was not even among the top 25. It was ranked 22nd in 2001 and 2000. This trend, some economists believe, might not be a temporary blip if the current growth model is not fine-tuned.

Local economists such as Dr Cheng Ming Yu, who heads the economic unit of the faculty of management at Multimedia University, agree that there is an urgent need to identify new strategies to drive the country's long-term economic growth. However, they do not prescribe wholesale change, but a gradual approach leveraging on existing strengths. The idea is to continue emphasising the ICT sector, albeit with a modification in approach.

One area that should be the focus is the IT solutions and services market. Recent research has shown that the IT solutions and services sector has the potential to generate significant economic growth. For example, a recent survey by two United States-based consulting firms - Sallstrom Consulting and Nathan Associates Inc - revealed that every 10 per cent increase in the growth rate of IT spending raised Gross Domestic Product (GDP) growth by 13 per cent. The study involved the economies and IT sectors of 28 countries. The global market for IT products and services was estimated at nearly US\$1 trillion in 2001 and is projected to exceed US\$1.4 trillion by 2005.

However, the manufacturing sector, which forms the backbone of the national economy and has played an important role in the country's

industrialisation drive in the last two decades, is currently driven by technology exports such as semiconductors, electronic components and peripherals. In other words, Malaysia's manufacturing strengths lie in hardware. And continued dependency on the lead of multinational companies (MNCs) means that there is an inclination towards the 'soft' option of Original Equipment Manufacturer (OEM) production that can be highly competitive, cyclical and give razor-thin margins.

'Furthermore, value-added ratios, i.e. output less input, have not been high. This indicates labour-intensive assembly operations of MNCs, the relative lack of vertical integration and diversification of MNCs and local companies, as well as inadequate research and development activities,' says Steven C.M. Wong, who heads the socio-economic think-tank INSAP and has done considerable work on ICT-related projects involving local SMEs.

The government's actions and pronouncements over the years have clearly indicated its awareness of the situation. A case in point is the 2003 Budget, which stresses the need to grow the ICT solutions and services sector. In fact, one of the basic objectives of the Multimedia Super Corridor (MSC) project is to ensure that it becomes a new launch platform for economic growth with emphasis on development of application/solution technologies. To some extent it has shown positive results. Total sales of MSC companies, which are primarily related to services and solutions, are expected to grow to nearly RM5.7 billion this year compared with RM3.4 billion in 2001. By year-end, the project would have created an estimated 18,900 employment opportunities, 85 per cent of which are for skilled workers and 88 per cent for local workers.

Unfortunately, the MSC story has waned over the last few years, perhaps suffering from the 'over-hype under-deliver' predicament, as well as the after-effects of the dotcom bubble burst. 'Unfortunately, we are still waiting for proven global success stories to emerge from MSC flagship applications, which are intended to help create the critical mass for development,' Wong notes. According to him, the flagship applications have been slow to be implemented despite the large investments and long implementation period. Such setbacks have affected the growth of the local IT services and solutions market.

IT solutions and services sector

The Sallstrom Consulting and Nathan Associates Inc study, which was commissioned by Microsoft Corp, also cited IDC figures which show that between 1995 and 2001 local spending on software and IT services in proportion to total IT spending has been stagnant at 31 per cent. This is less than percentages recorded in India, the Philippines and Singapore. The relatively small size of the local IT services and solutions market also means that it is not able to make a significant impact on the national GDP or international trade. This should not come as a surprise as in 2001 the manufacturing sector not only contributed 32.8 per cent of GDP growth but also made up 90 per cent of the country's exports.

The future does not look bright either. Although its contribution to total IT spending is expected to increase rapidly to about 41 per cent in 2005, the segment's share of total IT spending will remain well below global numbers. According to IDC's survey, the percentages of current and future estimated global aggregate share are 58.6 per cent and 63.9 per cent respectively.

Furthermore, while IT spending in Malaysia has risen since 1995, Laura Sallstrom, the head of Sallstrom Consulting, says the Malaysian IT sector is not benefiting fully from the growth-generating potential of spending on software and IT services. 'One possible reason for the lack of impact of IT spending is the rampant usage of pirated software in the country,'

she says. According to Business Software Alliance, the software piracy rate in Malaysia is a high 70 per cent. 'The existence of piracy hampers reinvestment possibilities,' Sallstrom says.

If the IT solutions and services market bucks up, its potential contribution can be huge. Malaysia's IT sector employed 141,600 workers in 2001, representing a growth of 10.7 per cent per year from 1995 - more than triple the rate of growth in total employment in Malaysia's economy. However, there is still ample room for growth. For example, India's growth rate of IT sector employment was 15.9 per cent per year between 1995 and 2001, and the sector employed 561,400 people in 2001.

Sallstrom Consulting and Nathan Associates Inc's study indicates that employment in the software and services segment of Malaysia's IT sector currently accounts for only 7.8 per cent of total IT employment. The positive aspect, however, is that job opportunities in software and IT services are growing faster than opportunities elsewhere in the IT sector. According to IDC, employment in the software and IT services market will grow by 18 per cent annually from 2001 to 2005. But again, by comparison, the software and IT services employment in India is expected to grow 20 per cent per year through 2005. Considering that the 20 per cent growth for India is based on its population which is 50 times bigger than Malaysia's, there is certainly a lot of catching up to do.

Challenges ahead

It is clear that IT-based solutions and services need to be cultivated. However, Wong says that making 'big bet' investments like South Korea, where all the chaebols such as LG and Samsung went into IT in a big way, can be extremely risky and hazardous. It can also be a major drag on the economy. 'The safest and best course of action is still to spur small private start-ups but with a liberal and inviting environment created for foreigners and locals with the talent, energy and skills,' Wong says. He claims that at the moment, a large line is still drawn between these two classes of people. Wong reasons that without this group of individuals, the prospect of growth driven by ICT services and solutions would remain a dream for Malaysia.

One way to bridge the gap, he says, is by ensuring that incentives offered to MSC companies should be given nationwide to all eligible companies and individuals no matter where they are located. 'Proportionate funding (one-for-two, one-for-three) should be offered liberally to serious investors in start-ups,' he adds.

Furthermore, local financial institutions have not proven themselves as open to the idea of financing ICT-based initiatives, especially those related to 'intangibles' such as services and solutions. This reticence of the local banking sector to support the growing ICT industry, despite the former recording an 18 per cent jump in pre-tax profits to RM4.5 billion in 2001, is a sore point among public policy makers as well as budding technopreneurs.

The government has tried to circumvent the problem by establishing institutions such as Malaysia Venture Capital Management Berhad (MAVCAP) and Malaysia Debt Ventures Berhad (MDV). These organisations have total fund strength of RM2.1 billion. Thus far, MAVCAP has channelled equity financing to four local venture capital companies in the telecommunications and photonics sectors as well as biotechnology and life sciences.

MAVCAP has also implemented several programmes to develop local technopreneurs and foster cooperation between the venture capital community and local research institutions to commercialise R&D findings. MDV, which began operations on Aug 30 this year, provides an alternative source of financing for knowledge-based and technology-intensive

industries. However, both these organisations are not angel funders, which are usually the lifeblood for technopreneurship endeavours.

The lack of private-sector initiative is another cause for concern. In fact, public-sector spending, driven by expansionary fiscal policies for five years running, has been the backbone of economic growth since 1997. In his 2003 Budget speech, the Prime Minister and Finance Minister, Datuk Seri Dr Mahathir Mohamad, says that while total public investment increased from nearly RM32 billion in 1997 to RM49 billion in 2001, there has not been a corresponding increase in private-sector investment. In fact, investment by the private sector fell from RM90 billion in 1998 to RM34.5 billion last year.

In short, there is a pressing need for increased spending from the private sector. Unfortunately, the local ICT sector is still reliant on the public sector to fuel its growth. This over-reliance is evident from the recent statement by the Association of the Computer and Multimedia Industry of Malaysia (PIKOM) chairman Looi Kien Leong, as reported by a daily, that as the local ICT industry is facing a soft market, the 2003 Budget should have emphasised stimulating the industry by increasing immediate public expenditure on government ICT projects.

The Sallstrom and Nathan study offers a three-pronged policy approach to promote economic growth - general investment policies, targeted software and services policies, and online infrastructure.

In Malaysia, there are compelling reasons to nurture the IT sector and promote economic growth by aggressively focusing on policies targeted at software and IT services industries and spending. What is now required is the realisation of how important and urgent the change must come. The nation's long-term economic well-being rests on it. We simply have to be earnest about it.