



The Penang Economy, Where Is It Heading?

A great deal has been said about how much the Penang economy is dependent on the US economy. This is mainly due to its reliance on exports to the US and US investments that bring about employment and technology transfer. The US economy had experienced boom years throughout the past decades and so has the Penang economy, particularly in the 1990s. However, with the current American recession, the question that arises is where is the Penang economy heading?

US Economy – An Update

The US Commerce Department announced growth for the US economy at 4 percent in Q3, higher than the 3.1 percent growth rate estimated earlier. However, growth may likely be slowing down as the year comes to an end. This is mainly due to the slowdown from reduced household spending, which had been the main driver for growth in Q2 and Q3 as well as the turbulent stock market and worries about a possible war with Iraq. Nevertheless, on the brighter side, there are more optimistic signs of increased business investment in buildings, equipment and software.

Trade deficits continue to hamper growth. While most of the sectors in US actually have recorded deficits, the high tech products is one of the few sectors that have been running a surplus even though this surplus is disappearing. For the first eight months of 2002, negative trade surplus was recorded (US Census Bureau, <http://www.census.gov/>) and unless there is a sudden turnaround, US is heading for its first ever deficit in trade in high tech products. If trade surplus is used as a measure of success in commercialising science globally, as it is often done, does this trade deficit in high tech products in the U.S. signify a declining trend in American competitiveness?

American unemployment remains high, at 5.7 percent in October, even though the wage rate has risen slightly (US Department of Labour, <http://www.bls.gov/>). At the same time, the Federal Reserve had also made a series of interest-rate cuts (11 in less than a year), since 2001 to encourage consumer spending. The rate cuts and wage increase have not boosted employment figures. The drop in factory orders and car sales has led to declining consumer confidence that is further aggravated by the recent corporate scandals.

After the November 6th House of Representative and Senate election, Alan Greenspan and his colleagues at the Federal Reserve announced a cut in the federal funds rate, which is already at a 40-year low by 50 basis points down to 1.25 percent, and the discount rate down to 0.75 percent. However, its result has yet to be seen. Notwithstanding these less than optimistic views, the US economy today does not appear to be at its worst point when compared to the oil crisis in the early 1970s and the stagflation experienced during the early 1980s.

Japan Economy – A Synopsis

The impact of the Japan's economy on the Penang economy is not as extensive compared to that of the US. Economic growth in Japan is rather uncertain. The economy contracted 0.5 percent in 2001 and is projected to further contract to negative 1.5 percent in 2002 before a recovery in 2003, to a projected growth of 2.0 percent (SIA, <http://www.semichips.org/>).

A major source of Japan's economic problems is the resistance to change, particularly in the present political system. The ineffective banking system has also resulted in huge sums of non-performing loans. While the latest reports indicate that bank lending has fallen to its lowest level in over 10 years in October (Financial Times November 11, <http://news.ft.com>), the recent rise in the value of the yen, a two-month high against the US dollar, will threaten to paralyse Japan's export-led economic recovery.



In addition to the issue of the strong yen as well as bad loans, Japan is also the first industrial country, since the Depression, to experience Deflation. Deflation, indicated by negative rate of nominal growth caused by tumbling prices also results in declining demand, particularly when export sales are slowing, bank lending falling and companies cutting costs. It becomes more worrisome when debt burdens become heavy and companies are forced into bankruptcy as is happening, especially in the troubled construction and real estate firms, along with the escalating unemployment problems.

Highlights of the Malaysian Economy

The Malaysian economy experienced a slow and steady y-o-y growth in Q1 (1.1 percent) and Q2 (3.8 percent). As for Q3, present economic indications are for a growth rate of around 5 to 6 percent (NST Oct 23, "Malaysia can post GDP growth of 5.6 pc in 2002" and MIER).

The recent MIER's (Malaysian Institute of Economic Research) Consumer Sentiment Index (CSI) shows that households are feeling comfortable about the near future and they rated the prospects six months from now a little higher than they did in Q2 and during the same period a year ago. It is noted that the overall consumer sentiment index is closely correlated with spending patterns. Private consumption in Q3 has also risen compared with Q2 and during the same period a year ago. This is mainly due to a balanced mix of firm job markets, steady inflation and stable business growth.

On the other hand, MIER's Q3 Business Conditions Survey, however, revealed poor business confidence. Businesses are stumped by weaknesses in sales, production, domestic orders, investment in plants and equipment, expected production, export orders, expected export sales as well as capacity utilisation. Weaker sales have also resulted in increasing inventory. Although employment remains steady and job prospects are still favourable, wages have begun to build up.

Despite the mixed reactions from the consumer and business segments, Credit Suisse First Boston forecasted that the Malaysian GDP would grow at 5.6 percent for the whole year (NST Oct 23, "Malaysia can post GDP growth of 5.6 pc in 2002") while MIER's projection for 2002 GDP is 4.0 percent, a downward revision from a previous figure of 4.5 percent.

Penang – Where Is Its Economy Heading?

Presently, the Malaysian scenario seems to be more optimistic than that in the US and Japan. The Malaysian economy, as a whole depends not only on the manufactured exports market but also on other sectors, which are also domestic-oriented. In contrast, the Penang economy is more reliant on the manufactured exports market, since in its thirty years of progress, the export-oriented manufacturing sector was the main engine of growth, prising Penang out of its economic doldrums and the significantly high unemployment situation experienced in the late 1960s and early 1970s.

Penang encountered and pulled through the mid-1980s crisis, registering significant growths in the 1990s. When the 1997 Asian financial crisis hit Malaysia, the export-oriented sector in Penang was still thriving, and the economic situation in the State recovered robustly in 1999. However, this growth was short-lived and now the State's economy is impacted by the developments in the US as well as other developed countries such as Japan. The present crisis in Penang is dissimilar from that in 1997 because both the export-oriented and the domestic-oriented sectors are affected, mainly because of lower export sales, incidences of retrenchments and lay-offs, rising unemployment, lower spending power as well as poorer consumer confidence.

Investments in the manufacturing sector both in terms of applications and approvals recorded from January through June 2002 are well below the 2001 figures and worse still compared to 2000 figures. Bringing about a positive climate that promotes investments would therefore be the major concern for the government, private sector and the people alike.



The more optimistic news is that the government's effort to address production costs have been working, because since capital controls the producer price index in the manufacturing sector have remained very stable until today. Unfortunately, these positive signs have not shown up in the labour market in which retrenchment and job vacancies figure as of the end of the first quarter of 2002, particularly in the manufacturing sector, have yet to improve. Despite these shortfalls in the labour market, unemployment rate remains low at 2.4 percent for 2002 (DOS).

Currently, the US and Japan are the top trading partners of Malaysia (Table 1), accounting for almost 35 percent of Malaysia's total exports. With both of these economies facing crises, Penang, by nature of its export-oriented condition could be highly impacted. Likewise, Singapore, which is Malaysia's third largest trading partner, is also facing a shrinking economy. Preliminary figures have show that Singapore's GDP for Q3 contracted 10.3 percent compared with the previous three quarters and this is accompanied by rising unemployment rate (4.8 percent) (NST Nov 16, "Singapore economy continues to deteriorate"). Deteriorating and deferring growths in these countries will significantly affect Penang's economy.

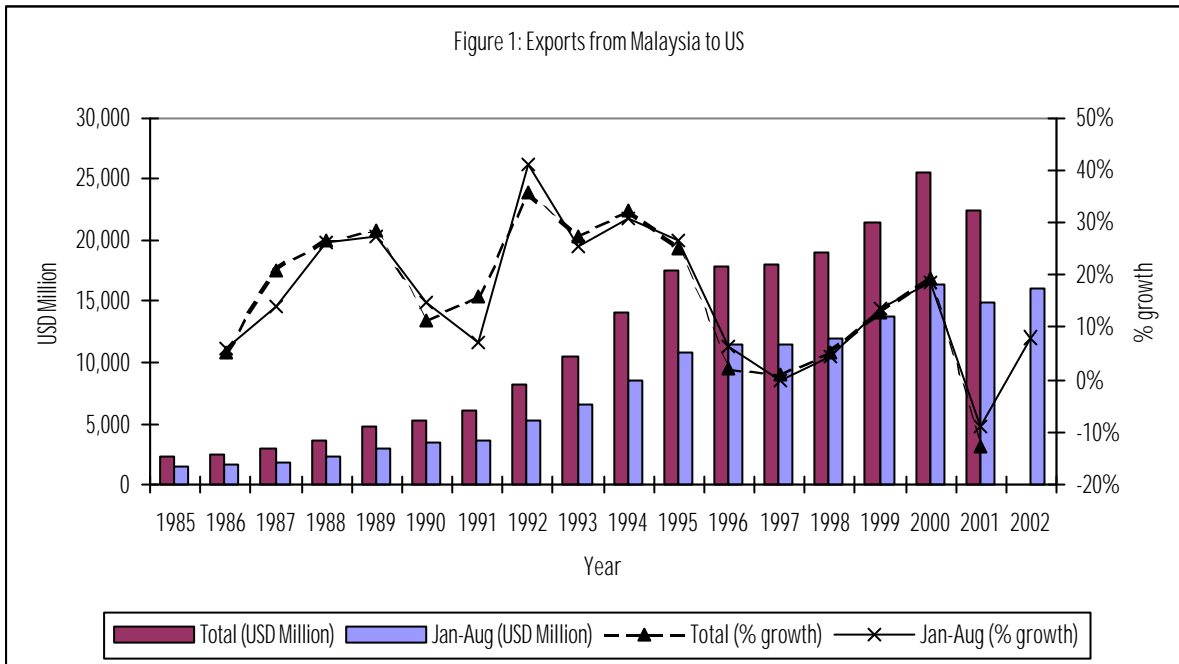
A quick look at the figures on exports from Malaysia to the US in Figure 1 indicates that exports to the US (in value terms) have increased over the past 17 years. A slight drop in exports was recorded in 1997 but a more significant decline in exports was registered in 2001. Nevertheless, exports to the US seems to have improved in 2002 -- the first eight months of 2002 registered an increase of 8 percent over the same period in 2001.

Table 1: Malaysia's Top 10 Trading Partners (2001)

Country	Value (RM Billion)	Percentage
United States of America	112.51	18.29
Japan	98.50	16.01
Republic of Singapore	91.98	14.95
People's Republic of China	28.98	4.71
Taiwan	28.05	4.56
Thailand	23.89	3.88
Hong Kong	22.49	3.66
Republic of Korea	22.40	3.64
Federal Republic of Germany	18.19	2.96
Netherlands	17.90	2.91
Others	150.22	24.43
Total	615.11	100.00

Source: <http://www.matrade.gov.my/economy-trade/top10.htm>

Despite the optimistic scenario in the export figures, prices are dropping in Malaysia. The inflation rate is relatively low at 1.8 percent in 2002. Theoretically, when prices drop as a result of technological progress, it leads to rising productivity or output per hour of work and thus, the economy is able to produce more with the same amount of input. The fall in prices of computers is a good example of this phenomenon. On the other hand when falling prices are attributed to declining demand, resulting in a glut or oversupply situation or low consumer confidence and declining consumers spending, the economic scenario will be one of accumulating debts, that will lead to a situation of deflation where supply exceeds demand.



Source: Derived from U.S. Census Bureau, Foreign Trade Division, Data Dissemination Branch, Washington, D.C.

The economic scene in Penang remains uncertain as it is highly exposed to external threats and challenges such as the US-led attacks on Iraq; possibility of sharp increases in oil prices, possibility of US economic recovery stalling, possibility of significant weakening of the US dollar, strong yen derailing Japanese recovery, electronics demand remaining subdued as well as sluggish FDI inflows. (MIER Malaysian Economic Outlook Q3).

It is well-known that economic growth is assured if export and domestic sales increase, FDI inflows become more vigorous, employment and wages increase and more importantly, consumer confidence is restored. However, how could we stimulate the economy if all these fail? ***§ Anna Ong & Chan Huan Chiang***



Outlook And Prospects of the Wholesale And Retail Sector in Penang

Introduction

The wholesale and retail sector plays an important role in the country's economy as it signifies the distribution channels for products and services. The wholesale & retail sector in Penang comprises wholesalers, grocery and provision shops, supermarkets, boutiques, departmental stores, eateries, and markets. The different channels cater to different market segments. Traditionally the grocery and provision shops made up a large segment of the retail market. However, as the economic and consumer trends change, various factors such as price disadvantage, limited working capital, brand and product preference as well as inadequate land and space resulted in the decline in the number of grocery and provision shops. Nevertheless, this segment still contributes to a significant percentage (22%) of retail sales in Malaysia.

The development of major wholesale & retail outlets has seen tremendous growth since the 1980s. Today, there are around 400 supermarkets in Malaysia. Major players include Cold Storage, Parkson, Makro Cash and Carry, Giant, Carrefour, Cosmart, Jaya Jusco, Metrojaya and The Store. Penang has also experienced such growth. Establishments such as Bandar Baru (Air Itam) Supermarket S/B. and the Suiwah Corporation Group, which operate several retail outlets on Penang Island such as the Sunshine-Farlim Hypermarket and the Sunshine Square, are examples of Penang-grown enterprises that have expanded over the years.

Upon recovery from the 1997 Asian financial crisis, Penang witnessed the revival of two shopping-mall projects namely, Prangin Mall and Gurney Plaza. The development of these two shopping malls have resulted in two new entrants into the wholesale & retail sector in Penang namely, Extra and Parkson. The establishment of Makro at Sungai Dua recently also indicates business confidence in the Penang's wholesale & retail sector.

Outlook

The best indicator to gauge the state of the wholesale & retail sector is the level of consumer confidence. The MIER Consumer Sentiment Index (CSI) for Q3 of 2002 stands at 108.9, which is reasonably above the 100-point benchmark. However, the consumer confidence index survey was conducted during the preparation for Budget 2003 as well as before the Bali bombings. As such, its results could have been influenced by the hopes and aspirations for bonus payouts as well as other goodies.



Figure 1: Consumer Sentiments Index, Malaysia



Figure 1 shows that the consumer sentiments index is closely related to the employment index. However, when the employment index extended beyond 150 points, the consumer sentiments index hovered around 140 points. When the employment index dropped below the 100-point mark in 2001 and 2002, the consumer sentiments index hovered around 100 points, which is a different scenario from that in 1998. During the Asian financial crisis of 1997/98, the consumer sentiments index dropped in accordance to the employment index. This indicates that spending power in 2001/02 remains strong although employment figures may have dropped.

Despite the relatively optimistic statistics, the general outlook is not as rosy as it seems. External factors such as the Bali bombings and the numerous warnings and threats on terrorism have had significant impacts on consumer confidence. It is no longer easy to market Malaysia as a safe haven for tourism and trade while its neighbours are enduring economic and social turmoil. Significant drops in tourism and trade activities mean significant drops in the wholesale and retail businesses. As such, the wholesale & retail sector managed only a marginal growth this year. This downward trend in the wholesale & retail sector is further exacerbated by the influx of investments and opening/expansion of foreign-owned giant retail and wholesale outlets, which create a situation of oversupply.

The immediate outlook of the wholesale & retail sector in Penang is not too promising because the populace of Penang, by nature are rather thrifty and conscious about spending unnecessarily. In addition, the limited and small domestic market in Penang, coupled with an oversupply of wholesale & retail outlets as well as a slowdown in the tourism sector have resulted in declining profit margins.

Despite the fact that each wholesale & retail entity gets a smaller return for its investment, it should not be concluded that the consumers in Penang are spending less than before. This is mainly because the wholesale & retail industry has expanded but the domestic market remains the same while the 'tourist' market has shrunk.

Rationale for Slowdown

The slowdown in the wholesale & retail sector is attributed to several factors. The tendency to be thrifty could be a result of rumours being spread about the economy and security of the country. For instance, most Malaysians tend to link the performance of the Kuala Lumpur Stock Exchange (KLSE) with the economic well being of the country. Trivial news about any national politician or a key corporate figure in the country or a disaster will trigger a tumble in stock prices. Such misconception has to be corrected, as it will jeopardise the government's efforts to increase and instil business and consumer confidence.

Such psychological effects also serve as the basis for employers to slash salaries and/or headcounts as well as withhold bonuses. These moves will have indirect effects on the spending power of the people but encourage more savings. While savings should be encouraged, it is detrimental to the growth of the wholesale and retail sector. The lack of business will result in wholesalers & retailers withholding or delaying the arrival of new stocks. When this happens, brand and product choices will decline and will further discourage the consumers from spending in Penang.

Consumers will normally look forward to MegaSales Carnivals, which are being held three times a year. Although such carnivals managed to attract local shoppers as well as tourists from neighbouring countries, particularly from Singapore and Indonesia, they pose a threat to retailers. As the sales carnivals are held seasonally, normally near festive seasons, which are also peak shopping seasons, the retailers have to sell their products at reduced prices due to vigorous competition. This means retailers get to sell their products at normal prices only for three-quarters of the year. However, retailers are also entitled to conduct their own sales carnivals with the approval of the Ministry of Domestic Trade and Consumer Affairs. These sales carnivals are normally known as 'Bargain Sales', 'Annual Sales', 'Stock Clearance Sales', etc. With so many sales carnivals, prices of products would normally drop six months after being introduced in the market. This will affect the spending habits of a typical Malaysian who will only begin to shop for a particular product after it has been introduced in the market for some time. In addition, customers in Penang normally compare prices before making their purchases.



The establishment of foreign-owned wholesale and retail outlets with huge resources and financial clout pose a great threat to the local wholesalers and retailers. This has resulted in not only the closure of grocery and provision shops but also local supermarkets like Looking Good and Fajar. In addition to their resources and financial influences, the foreign players have better procurement and distribution networks, unlike the local companies that have to resort to sourcing from 'middle men'. Such networks also allow the foreign players to source from the cheapest source available regardless of geographical location. By doing so, the foreign companies are able to sell their products at cheaper prices. On the other hand, local companies normally source locally for their products.

Although the local players might have to pay a higher cost for local sourcing, they are indirectly generating a multiplier effect for the domestic economy. For example, a manager of a local supermarket indicated that they source for their fresh products from "Sia Boey" and farms located in Seberang Prai. This implies that the local wholesalers and retailers are helping to sustain the agriculture as well as traditional trading sectors in Penang. Interviews with local wholesalers & retailers show that about 90 percent of the local produce sold in their outlets are sourced from Penang. A local retailer even obtained the drinking water that they sell from a bottler at Bukit Mertajam.

As a result of competition from the foreign wholesale & retail outlets, some local retailers, especially the grocery & provision shops have to close down or relocate to residential areas, providing supplementary support to the larger wholesale & retail outlets. These shops have many disadvantages and find it more difficult to survive compared to the larger wholesale & retail outlets, whether foreign- or local-owned, because:

- They represent the traditional family-managed neighbourhood stores, which are typically operated during hours convenient to the owners rather than the customers. As such, these shops are likely to be closed at night and on weekends and holidays.
- They occupy small floor spaces and have small budgets. As such, product and brand choices are limited and advertisements are almost zero. In addition, there is hardly enough volume to hold special sales.
- In most cases, staff strength is small, comprising mainly family members and training is almost nil. As such, these stores are unable to cater to special orders and requirements from customers, such as gift-wrapping services.
- Profit margins are normally small, and as such these stores are unable to offer special discounts.
- They have to purchase their merchandise on cash basis rather than on credit terms. If credit terms do exist, the amount is usually small and insignificant. As such these shops remain small and are unable to expand.

On the other hand, these grocery & provision shops have their own advantages. The owners normally know the customers and thus are able to provide personal and individual service. For example, they are able to provide special accounts or allow their regular customers to purchase on credit terms. They are also more likely to know their customers' preferences and dislikes.

Other areas of competition are direct-marketers such as Amway, Cosway, and Avon who visit the homes or offices of the customers or have their outlets in various places in town. In addition to direct-marketing, mail- and phone-orders and more recently internet-orders also pose a threat to the local wholesalers and retailers. Most of these businesses are operated from abroad and as such outflows of the Malaysian Ringgit occur whenever a customer places a mail-, phone- or internet-order.

Another area of competition is the influx of cheap electrical and non-electrical home appliances. Cheap products from China, Indonesia and even Thailand are flooding the local wholesale & retail markets. Recently, Penang experienced the emergence of the 'RM2 Stores', which sell a wide variety of products that are priced at RM2. This provides an alternative for the consumers to obtain relatively cheaper products but creates a tough competition for the local retailers. This is especially so when the customers focus on the prices rather than the quality of the products.



The influx of such cheap products could be attributed to the inadequacy of regulations and laws on anti-dumping, thus making Penang and Malaysia a dumping ground for sub-standard electrical and non-electrical home appliances. Presently, the Malaysian Countervailing and Anti-Dumping Duties Act 1993 only provides protection for certain items such as paper and corrugated paper, plaster/gypsum board, carbon and bicycle.

Strategies & Action Plans

Singapore, Hong Kong and Thailand are known to have resorted to organising MegaSales as a means to attract tourists. However, these countries only have annual MegaSales unlike Malaysia, which holds it three times a year. Interviews with retailers indicate that they would prefer to reduce the number of MegaSales to twice a year. This will enable better usage of resources for the promotion and preparation of larger-scale and effective Megasaes. In addition, tour operators in Penang can collaborate with their counterparts in neighbouring states and cities to offer shopping-cum tourism packages such as "Shop At The Pearl of the Orient, Relax in Langkawi" or "Shopping & Food Extravaganza in Penang & Haadyai". This will not only help to boost the sales in the retail sector but also the hotel and other tourist product sectors.

In addition to MegaSales and promotional packages, it is also crucial to disseminate the right information to the target audience. The role of the media will have to be upgraded to educate the public and to clear the misconceptions that link the performance of the KLSE with the performance of the State's economy as well as the economic fundamentals.

It is also crucial to improve on the services rendered to the customers. Staff training is very important in providing good public relations as well as information and advice on the products. Presently, the training programmes and courses under the Human Resource Development Fund (HRDF) do not include training for the wholesale and retail sector. It is imperative that not only sales personnel and promoters receive the appropriate training but it is also equally important for buyers to receive training on selection and negotiation skills. Interviews with local managers show that the employees would normally leave for better-paid jobs after they have received training. As such, the employees turnover in the retail sector remains high.

Local wholesalers and retailers should make their goods and services more accessible to the consumers. They should explore the various channels of information dissemination, marketing and distribution. It would be appropriate for the larger wholesale and retail outlets to adopt and implement e-business, encompassing e-procurement; e-marketing, namely to advertise their goods & services in the Internet; as well as e-logistics. In short, they should take advantage of ICT (information communication technology) as a tool to shift their business towards a new paradigm, from the old-economy to the knowledge-based economy.

Currently, data collection on the wholesale & retail sector is lacking. It would benefit the entrepreneurs in the wholesale & retail sector as well as the general public if the department of statistics could extend the survey of the services industry, to include the wholesale & retail sector on a yearly basis.

Lastly, due to the small and limited market size in Penang, the government should prioritise the development of the local-owned wholesale and retail firms. If possible, the government should restrict the influx of foreign investments in the wholesale & retail sector, thus creating a more favourable business environment for the local wholesale & retail sector. ***§ Lim Peng Keong & Anna Ong***