



The Economy, Stock Prices, Bond Market and Malaysia's Middle Class

The Middle-Class And The Economy

Reports that have been coming in from The Edge show that amidst the economy's weak external environment, Malaysia's economy managed to remain steadfast last year as a result of consumption spending. Retail outlet sales up by 4% in 2002 compared to 1.7% during the previous year, new vehicle registration up by 9.7%, a two-decade high, and consumption goods imports up by 15.9% up from 1.4% in 2001. Overall private consumption grew by 4.6% in 2002, thanks to Malaysia's sizable middle-class that has long been recognized as the power source that can sustain the economy's momentum even when the period becomes prolonged in between pulses of strong exports demand and/or foreign direct investments.

The middle-class, as is often pointed out, is the product of post-colonial development built up with the right policies and strategies. It is not as widespread across the developing world as it could or should have been. But in Malaysia, it has propelled the country into its tertiary stage of growth in which, with a 55% share, the services sector, as seen in the national accounts for 2002, has become the major component of the GDP and has relegated manufacturing to second place. With consumer confidence on the rise, domestic private spending is expected to become even more active and grow by 7.3% in 2003. The buoyant consumption spending is also showing up as loans growth, which went up by 4.3% in 2002 up from 3.6% the previous year. More specifically, consumer borrowing arose largely from vehicle financing, up by 21% in 2002, credit card spending, up by 20%, and housing loans, up by 16.3% compared to the previous year.

The Middle-Class And The Stockmarket

Thereby begs the question. Will the consumers return in as big a way into the stock market? It will, but only, if theory is a guide to go by, when public listed companies are able to instill greater confidence in its agency relationship with investors. The theory in question was assembled some years back by Oliver Hart (1995) in his book *Firms, Contracts and Financial Structure*. Everyone knows that when firms go bankrupt, shareholders are the last in line to be eligible to make a claim. Furthermore, there are virtually no laws that give shareholders a say over how firms they have invested in make investment decisions and take business risks apart from the legally required annual stock-holders meetings during which, we also know, firms are rarely swayed by the wishes of stockholders.

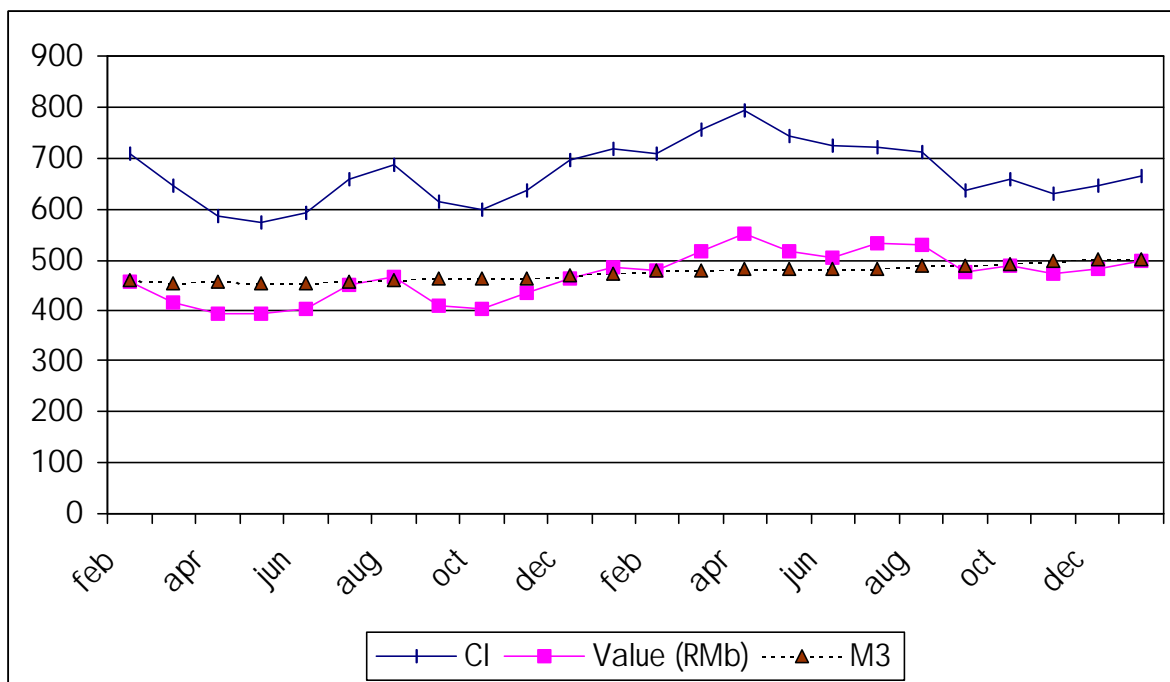
To signal confidence to investors, Dr. Hart argued that firms should take on debt instead of issuing more stocks in order to fund prospective investment projects. Corporate debt constitutes a burden to a firm and thus instills discipline and prudent business decisions. Firms become more sensitive to its revenue and cost figures in order that the project can be safely executed throughout the entire debt period. In contrast, funding investment projects largely by share issues meant that investors, not those managing the firm, will be bearing the greater portion of the risk. The scheme, over several investment cycles, as the firm grows through different stages is for the firm to take on further debt to finance its investments and pay out profits as dividends at the end of each cycle. After each stage of growth, more shareholders will clamor to invest, anticipating future returns from subsequent investment cycles, which are managed with the same degree of prudence. Consequently, the firm's par value and share price can then rise over each stage.

An economy growing through different stages of development, as Malaysia has, needs to be supported by an equally robust capital market so that business and industry, the so-called real-sector, can achieve the needed funding. For years, Malaysia's stock market has played its critical role during which the country's middle class has put easy money in the hands of entrepreneurs. The magic has not been working as well these past years and many business firms seems strapped for cash, not able to operate smoothly, because investors appear to be staying at

the side-lines. Future development will be threatened if the real-sector cannot be financed and by this stage of the country's economic progress state-run public enterprises can remain as only a thing of the past.

For two straight years, Malaysia's stock market has moved only sideways as Figure 1 shows the composite index averaging 671 and the market capitalization RM469 billion. However, despite this lackluster performance, there is middle class support in the KLSE. It is not as apparent in the chart but there are subtle signs that the stock market remains intact. The question to ask, is whether the economy is expanding and if it is, does the expanding economy lead to an increase in market capitalization? Monthly year-on-year growth between 2001 and 2002 on the chart averaged 6% for the M3 or broad money supply series. Money supply is reflective of the potential GDP i.e. the supply side of the economy (not to be confused with actual GDP that records the demand side, which is influenced by cyclical movements that is not usually found on the supply side). Thus, yes, the economy is expanding. Next, on the chart, the average monthly year-on-year growth of the KLSE composite index was 9.6%. Even more remarkable, monthly year-on-year growth of the market capitalization averaged 17.4%. There is therefore indication that as the economy was expanding there was simultaneously a slightly more than proportionate growth in the market capitalization. This is a middle-class phenomenon since both the stock index and market capitalization are outcomes of the secondary market involving many buyers and sellers in the secondary market.

Fig.1: Composite Index and Market Capitalisation of the KLSE (2001-2002)



Source: Bank Negara Malaysia

The Middle-Class And Bonds

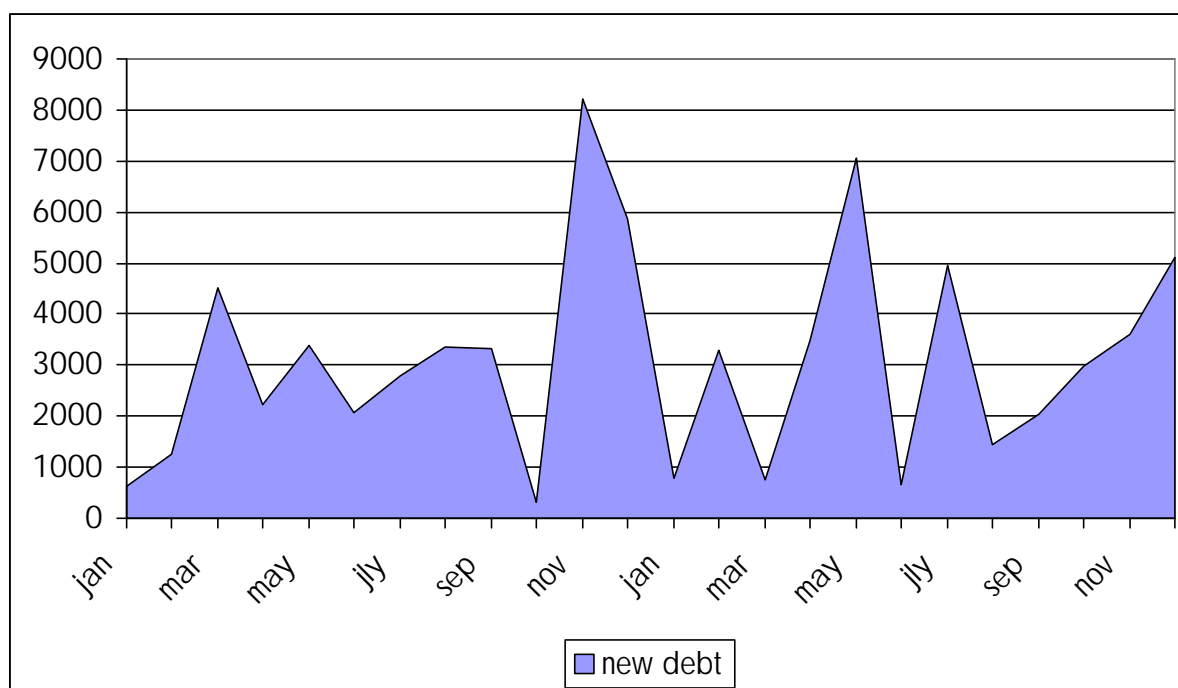
In response to a more diverse capital market comprising both equities as well as debt instruments, policy guidelines were put in place. Guidelines governing the issuing of private debt securities was introduced way back in 1989 and by 1993, the Securities Commission had been established to ensure a proper regulatory framework and authority to oversee the growth and development of the country's capital market. But the really exciting event that will shape the financial landscape over the next decade is the introduction of the Capital Market Master Plan in 1999. In this connection, the Securities Commission Act (1993), the Companies Act (1965), the Banking and Financial Institutions Act (1989), the Futures Industry Act (1993) and the Securities Industry (Central Depositories) Act 1991 were amended making the Securities Commission the sole regulator for fund raising activities for business companies. Apart from the policy framework, the FAST, BIDS and RENTAS systems make up the infrastructure in which the capital market can effi-



ciently function.

The Fully Automated System for Tendering (FAST), which was implemented in 1996 enables tender announcements, bids submission, processing of tenders to be done electronically. Not only will this increase efficiency but it also avoids possible disputes that arise from tender bids. The Bond Information and Dissemination System (BIDS), established in 1997, is an important supplement. This is a centralized computer data base for Malaysian debt securities containing information on terms of issue, real-time prices, trading performance. Finally, the real time gross settlement system called RENTAS was introduced in 1999, replacing the former SPEEDS settlement protocol that existed since 1990 as an automated scripless book entry system for confirming trade, cash settlement and transfer of securities.

Fig.2: New Issues of Private Debt Securities (2001-2002) RM Million



Source: Bank Negara Malaysia

Unfortunately, despite the critical role that it plays in the financial system within the country's economic system the private debt securities (private bonds) market has not kicked in. Over the same two year period, as shown in Figure 2, there appears to be little capital accumulation of private debt securities. The volume of securities issued varies from month to month and therefore we look for the area under the curve over several months for an indication for the volume of money raised as debts by business firms. In Figure 2, the area under the curve for 2001 amounted to RM37.9 billion. The amount for 2002 was RM36.2 billion or about a 5% decline. It appears that either business firms remain generally reluctant to fund its activities through debts or that the market still prefers to put its monies into equities, evident by the fact that market capitalization had increased while debt securities declined. Maybe both.

Getting people to give you money to conduct business is an agency problem. You can sell them stocks or you can borrow and pay your bondholders a modest fixed annual income. Theory has taught us that you need to do both since business funded solely on equities also meant that shareholders take all the risk. Funding further expansion by issuing yet more stocks also means that stakes held by previous stockholders become further diluted. Beyond a certain point it will be difficult to generate enough confidence for funds to expand via selling more stocks. Taking on debt on the other hand serves to discipline the business so that more careful investment decisions are



made vis-à-vis cost commitments against potential revenues. The risk is more evenly distributed and profits accumulated help to expand the stakes held without more stockholders coming onboard.

Conclusion

In the development of the economy the expanding middle-class, needed to transform society from its manufacturing base and onto a tertiary staged service oriented economy, does not merely play the part as domestic consumers. The real sector, comprising industries and business firms, needs to fund private investment projects. Initially, public listing and issuance of shares will be able to put middle-class wealth in the hands of entrepreneurs, as has been the case in Malaysia. Despite uncertainties in the economy over the past two years there has been evidence of monthly year-on-year increase of market capitalization in the KLSE. But understanding that beyond a certain point greater confidence by investors, as an agency relationship, on the share market can only be achieved through a more balanced capital market comprising both debts securities as well as equities, many policy reforms have been taken through government initiatives to foster further growth of the private debt securities market. Many innovations have been introduced over the past ten years aimed at more transparency and greater efficiencies through automation. For the next decade, a capital markets master plan has been formulated. Unfortunately, performance numbers show that the intended policy effects have yet to kick in. Watch this space for progress reports. **§ Chan Huan Chiang**

Reference:

Oliver Hart (1995), *Firms, Contracts and Financial Structure*. Oxford University Press



(Continued from page 8)

The ferry service does not only need to adopt a new look but also have fun activities and a variety of food items on board to attract tourists. Moreover, the destroyed areas of the ferry terminal in Butterworth can be converted to a ferry museum - with exhibits on the ferry service dating back to its maiden days and tracing its evolution. To make it more interesting, some of the wrecked parts should be left untouched - with a few modifications to ensure public safety.

Conclusion

The public and the private sector have long worked together to promote tourism in the state. A third component can be added to this synergistic alliance. Community-based organizations can provide a lot of input which can help to boost the tourism sector. For instance, environmental groups would have knowledge of how to protect and preserve nature as well as conduct educational programmes. Their contributions can enhance the eco-tourism products.

A better databank is needed for up to date statistics on the respective sectors, such as eco-tourism, medical tourism, education tourism as well as silver-haired programmes. This is essential for the purposes of planning and performance monitoring

Delays in creating new products due to various types of glitches - with promises remaining promises would only result in the dwindling of repeat arrivals or even new arrivals as new and attractive destinations are coming up all over the world all the time.

Penang cannot afford to miss the boat! **§ Tan Pek Leng & Fatimah Hassan**

Acknowledgement:

Bayan Baru Travel Sdn Bhd; Friendship Holidays Sdn Bhd; Holiday Tours and Travel Sdn Bhd; Sunrise Tours and Travel Sdn Bhd;



Tourism in Penang: The Pearl Lacks Lustre

At the risk of stating the obvious: tourism in Penang is heading for troubled waters. This was the message that resonated during the Penang Tourism Forum held in October last year. It might have been out of desperation or exasperation, but tourism industry players came out in numbers to voice their strong views on what ails the tour and travel trade. The problems are not all new, although some more challenging ones have emerged of late. Sadly, not many new solutions were suggested. Was it in part because the same people have remained as the leaders of the trade associations for too long? Their faces were far too familiar, they had been seen in the same kinds of forums for too many years past, what they say have been heard many times before. Penang's tour and travel industry needs a massive injection of new blood, adrenalin and creative juices.

As one agent succinctly put it, many clients' reactions to a promotion package to Penang is: "Seen it all, Done it all".

What then needs to be done to polish up our act?

For a start we have to arrest in the decline in tourist arrivals, although keeping in mind the carrying capacity of the state. As Table 1 shows, although domestic arrivals have been boosted, they were not enough to make up for the reduction in international visitors.

Table 1: Estimated Total Visitor Arrivals for Penang in 2000, 2001 and 2002

	2000	2001	2002
Total Visitor Arrivals	3,785,492	3,469,943	3,425,308
Domestic Visitor Arrivals	1,434,701	1,544,125	1,640,723
International Visitor Arrivals	2,350,791	1,925,818	1,784,585

Source: DCT Consultancy Services Sdn Bhd

It is undeniable that a substantial part of the decline in international arrivals can be attributed to the September 11 attacks and subsequent terrorist activities: the Afghan war, deterioration of the Israeli-Palestinian conflict, the Bali bombings, the incident in Zamboanga and the McDonald's bombing in Sulawesi, etc. With the war in Iraq and the conflict in North Korea threatening, the times can't be getting better.

However, externalities alone cannot be blamed, the weaknesses within have to be confronted and overcome.

New Markets

One obvious trend that has occurred over the past few years is a gradual shift in the market mix of international arrivals as seen in the Table 2.

The drop in traditional markets like United Kingdom and Australia are due, in part, to travel advisories and fear of traveling after the series of "terrorism-related" incidents mentioned earlier. The drop in arrivals from the Netherlands merits special concern. Arrival numbers rose dramatically, with Netherland's share of the market increasing from 0.2% in 1999 to 5.5% in 2000, and it was made possible by the Martin Air chartered flights to Penang which brought about 250 visitors per week. The arrivals were adversely affected by the cessation of the chartered flight, resulting in the continued decline in Netherland's share of the arrivals, at 3.1% in 2001 and 2.0% in

Table 2: Market Mix for 2000, 2001 and 2002

	2000 (%)	2001 (%)	2002 (%)
Malaysia (Domestic)	37.9	44.5	47.9
United Kingdom	11.7	9.2	8.3
Japan	6.4	5.8	5.9
Singapore	5.9	6.2	5.7
Australia	7.5	6.3	4.8
Indonesia	4.7	4.5	5.0
USA	2.9	2.2	2.3
Netherlands	5.5	3.1	2.0
Thailand	1.7	1.9	2.0
Middle East	2.5	4.2	5.3
Germany	1.6	1.3	1.2
Mainland China	1.0	1.3	1.7
Hong Kong	1.8	1.9	1.5
Taiwan	2.0	1.8	1.3
Others	6.9	5.8	5.1
Total	100.0	100.0	100.0

Source: DCT Consultancy Services Sdn Bhd

2002.

The influx of the Middle East visitors is due to promotional activities like the Dubai travel mart. They may also have been diverted from Western destinations which have not been showing them much welcome or hospitality. The share of arrivals from the Middle East to Penang has been on a steady upward trend: from 2.5% in 2000 to 4.2% in 2001 and 5.3% in 2003. This group has found Malaysia, especially Penang conducive for family holidays and the easy availability of halal food is a definite plus. And as result, a few restaurants serving Arabian cuisine have also emerged.

The Chinese market is also a growing one – with greater liberalization and higher spending power more and more visitors from China can be expected to venture overseas in search of rest and recreation. Penang is well-poised to tap this gigantic market. The share of Chinese tourists to Penang has already grown from 1% in 2000 to 1.7% in 2002.

Since Penang has become a popular destination among Middle Eastern visitors, with niche markets like honey-



moons, wedding anniversaries, family reunions and long-stay silver haired programmes, training sufficient Arabic speaking tourist guides who can cater to them competently is an urgent issue. This applies similarly to other potential new markets. There is a need to understand the culture, way of life and habits of these groups of tourists to make them feel welcome and comfortable. Well-trained foreign language guides are in dire shortage.

Another new market segment that the state can focus on is the disabled community, who have an equal right to travel but are often prevented from doing so. Penang has made a start with projects like making Gurney Drive accessible to the disabled. Facilities for the disabled are equally relevant for the elderly and this provision of them ties in well with the silver-haired programme.

While shifting focus to new markets, needless to say, the traditional Western market should not be forgotten either.

Product Focus

Penang has suffered from the lack of a clear identity. The old image of sun and sea no longer sells and no definite new image has emerged. Although, focusing on niches has been oft repeated, the tendency is still to sell everything all at once, an unwillingness to let go that is reflected in the "multi-faceted" tagline. In end tour promoters are not sure what to associate with Penang and potential visitors have no clear image to cling to.

Heritage and Culture Tourism has long been touted as the new focus, but even there efforts seem lackadaisical – what has happened to the World Heritage Listing? Are enough efforts being put into conservation? Have enough tourist guides become well-versed with the state's heritage and living culture?

Silver Haired, MICE, Cruise, Medical, Education, Sports & Recreation – how many "niches" can we incorporate? What is the essence of a niche? We can't afford the Jack of All Trades syndrome.

Essential Links

The state needs to either resolve the air travel problem it faces due to cessation of direct flights or tie up with Kuala Lumpur in promoting Penang as the next stopover. Direct flights are very important for travel agents to convince their counterparts to lure visitors to Penang, otherwise they might find it too bothersome to make their way here. It was highlighted recently that more flights east are in the offing, with landing points in China to be increased from six to 11 and five other destinations to be added by 2005. Chartered flights such as Martin Air had proven fruitful and similar initiatives should be revived and extended to other countries in order to attract more arrivals.

Penang is surrounded by waters but very few water related tourism activities are being carried out. The idea of having water taxis, which had been proposed years back, would bode well for the state in attracting inbound as well as domestic arrivals. Besides that cruises would also be an attractive package.

Trishaws can be means of public transportation within the inner-city of George Town –they can help reduce traffic pollution in the city! This will compliment the free shuttle bus service provided by the municipal council. Since the free shuttle service has designated routes, the trishaws can ferry passengers from these routes to explore other parts of George Town. This will generate income for the trishaw peddlers as well as bring in revenue for the tourism sector. Remember the trishaw and the ferry service were the Penang trademarks of yore. There should be a campaign to encourage the public, in general, to use the trishaws as means of transport along certain roads and alleys that are cordoned off to motorized vehicles. However, due to the hot climate, more trees should be planted along the roads to provide shade.