



 KCS Country Risk & Threat Advisory

KCS Group Europe  
Risk & Threat Advisory paper

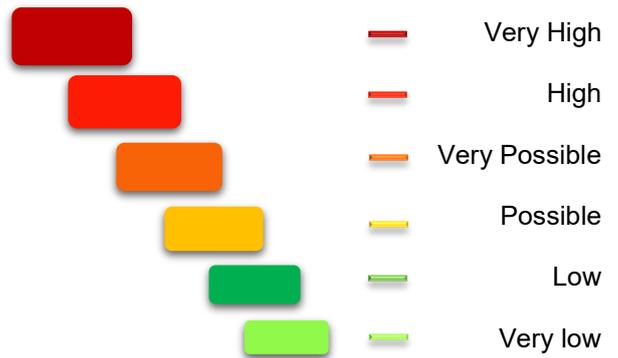
Political Risk Advisory Briefing: Malaysia  
June 2019

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<b>Country:</b>	Malaysia
<b>Population:</b>	31.62m
<b>Source:</b>	Trading Economics

**Malaysia has a risk rating of 3: Possible**

- 6 Very High** The assorted threats described in the report are almost certain to have a derogatory effect.
- 5 High** The threats are extremely likely to negatively affect the business.
- 4 Very Possible** There is a strong likelihood of problems arising in this country.
- 3 Possible** There is a fair chance of problems arising in this country.
- 2 Low** There is a low likelihood of any threats impacting business.
- 1 Very Low** There are virtually no impediments to successful business in this country.



## Politics

Malaysia has never quite escaped the tit-for-tat political backbiting that has characterised its political landscape and the present day is no exception. However, the problem for the new Prime Minister, Mahathir Mohamed, is that much is now coming from within his own coalition, not least the People's Justice Party (PKR), when the coalition has not even been in power for a full year.

Former PM Najib Razak and his United Malays National Organisation (UMNO) are facing too many legal actions to be key players in political plotting, for good or ill. Razak himself is personally on trial for his role in the infamous 1MDB scandal.

Already considerations are being given to Malaysia's long-term political future. Nurul Izzah, daughter of PKR leader Anwar Ibrahim, is seen as a future PM but continues to make public pronouncements about Mohamed being a *'former dictator'* and of his actions during his first term – this despite the pact Ibrahim has with Mahathir, and that Ibrahim is forced to re-assert his support for the PM each time an attack occurs. This in-fighting could have serious consequences the longer it lasts. However, Ibrahim himself knows that Mohamed's time (he is 93) is limited and so must place himself ready for one last shot at becoming PM when the moment arises, even to the extent that he must break with his daughter to do so. The real purpose of the designed uproar over Izzah's comments was, in fact, to detract from the internal problems facing the party and refocus the media attention on her father. His message has been lost of late, especially given that he will not be in a position to lay claim to any of the new reforms meted out by Mahathir if he does eventually become Prime Minister. Already suffering in popularity since his conviction for a sodomy charge, Anwar is unlikely to have a shot in 2023 as the real threat to his becoming the next prime minister is actually from within his own party, as younger, more ambitious PKR politicians increasingly see him as a spent force.

There is a chance that the factionalism will override any genuine political efforts to move the country forward. Already, Izzah was part of a faction that split from the Malaysian Islamic Party (PAS) to join the PKR, and Ibrahim was likewise part of a splinter group that left the UNMO group in order to help form PKR. How many more splits and uneasy alliances can Malaysia take?

No matter which way one looks, the optics for Anwar are not good. Regardless of the necessity for the Pakatan Harapan coalition, without which Mahathir would not be PM today, or the fact that PKR is the largest party in it, the public see the 93-year-old man as the saviour of Malaysia. They have already forgiven him for his past actions, as long as he continues with the reforms necessary to stop another kleptocracy. However, Mahathir knows he does not have forever and with the spectre of a handover looming at some point before 2023 and the next elections, much will depend on who his successor is and whether they will continue the self-proclaimed '*war against corruption*'.

### **Economy**

Malaysia is considered to have one of the more '*resilient*' economies in south-east Asia, with the International Monetary Fund in March 2019 praising the country for above-average growth, a drop in inflation and slowly increasing incomes over the past year. As outlined by the World Bank, in the key metrics of openness (130% trade-to-GDP ratio), growth (average of 5.4% since 2010), extreme poverty (less than 1%) , Malaysia is seeing solid progress.

Malaysia has also successfully diversified into manufacturing, high-tech and infrastructure industries, moving away from the predominantly agricultural society that it was at the time of independence. This is a bonus for any incoming industry: the diversified economy means that the country is more open to opportunities of various kinds.

Clearly with a strengthening economy, the instances for corrupt practices and deals will increase and great care must be taken both by Malaysian authorities, and outsiders/investors, that these are not allowed to characterise the economy as a whole. Malaysia must also tackle the twin problems of predictions of a slight stagnation of growth, and of the brain drain to neighbouring countries (not least Singapore): one in ten Malaysians are emigrating to work abroad at a rate that is double the global average. Whether this is down to structural problems in Malaysia itself, or just better standard of living/higher wages elsewhere is debatable, but certainly Malaysia needs to encourage more citizens to remain as this will in turn improve the performance and diversity of the economy.

Malaysia is also on the cusp of experiencing what might be termed a '*digital boom*', with the digital infrastructure slowly being put in place to allow business to adopt technology to streamline and improve their businesses. However bureaucracy and red tape surrounding connectivity is still stymying the true ability of this industry to help Malaysia flourish.

The short-term requirement is now to tread the fine line between positive spending projects and infrastructure improvements, and the diverting of money into private purses, whereas the long-term growth must be focused on key diversity indicators, improving education and knowledge rates (the *'brain drain'*) and ensuring that the growth is not side-tracked by a recurrence of the East Asian financial crisis of 2008.

### **Corruption**

In recent months it has been impossible to separate Malaysia from the 1MDB scandal. This sequence of events, which has reached all the way up the former PM Razak himself, has seen almost \$3.5bn USD be allegedly channeled into private bank accounts and a network of criminal largesse at the expense of Malaysian infrastructure and development, spread around the globe.

However this is far from the only issue. Ibrahim has publicly stated that the people of Malaysia need to stop *"idolising robbers"* – certainly a dig at Razak specifically, but also a comment in general on the practices of former administrations. Nothing is quite as top-down as corruption and the former government must be held accountable for the billions lost in deliberate fraud, mismanagement and nepotism.

While it is gratifying that such high-profile politicians are publicly speaking about the corruption problem, words without action are meaningless. There is some sign that Malaysia is looking to be a regional leader in anti-corruption drives. Although the Asian region as a whole (according to Transparency International) sees one in four paying some sort of a bribe or facilitation payment, and problems of ineffectual leadership are present across the whole continent, Malaysia is still considered to be the second *'cleanest'* country for business in south-east Asia, behind Singapore<sup>1</sup>. Surely this should be a good thing?

Sadly there are matters specific to Malaysia that mean the sweeping away of corruption may only be skin deep. Politics is considered by barometers and surveys to be the most corrupt institution in the country: not good, when politicians are ultimately responsible for the laws and decisions on which businesses depend. There is little coverage of incidents when politicians are arrested or charged (largely perhaps because this happens so infrequently) and little real punishment. While the Malaysian Anti-Corruption Commission Act criminalises bribery of all sorts, in practice payments and gifts are still expected.

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<sup>1</sup> Source?

Malaysia also plays host to a relatively unique system informally known as the *'revolving door'*, whereby officials revolve between the public and private sectors, muddying the waters as far as the public-private split of business is concerned, and giving rise to potential dark links between political entities and the wider business community (indeed, Malaysian political bodies themselves are permitted to own private enterprises without restriction).

With such low distrust of politicians and the political system, and proven instances where the system allows for corrupt officials/practices to exist with impunity, Malaysia still represents a complex and difficult environment for the unprepared investor.

### **Business environment**

The Malaysian business environment is predominantly focused on construction, finance, automotive and electrical sectors: for the most part, these are clearly manufacturing industries where there is a clear need for foreign partnerships to work with domestic producers. High-tech electrical products are a particular export, accounting for just under \$70bn of outward trade per year, but equally the country is a keen importer of metals and plastics products, petroleum and machine/electricals.

Malaysia also has a strong oil economy, producing just under 350,000 barrels per day, although the degree to which the economy remains reliant on these exports could be a long-term cause for concern. The country continues to develop new fields and wells, but (unlike other nations) there is a publicly acknowledged need to diversify away from this.

Malaysia is certainly moving in the right direction in terms of openness, expansiveness and attractiveness to foreign involvement and investment. Over 2018, it made advances in key areas including Starting a Business, Dealing with Permits, Trading, and Resolving Insolvency. Cumulatively this has pushed Malaysia up the World Bank's 'Doing Business' ranking to fifteenth in the world.

Starting a business remains on the whole a weaker area for Malaysia, compared to neighbours, and remains a slower process (with the possibility of hastening decisions by paying bribes – bringing us back to corruption).

The key is that an incoming business should be able to fit with the innovative and '*advancing*' style that the government is pushing for, be it in terms of the product offered or the manner in which work/research is carried out. Such ventures are likely to receive the most approval and support.

### **Criminality/Terrorism**

Islamist terrorism in south and east Asia, while not at the levels of public awareness as groups operating in the West, is a very real threat and cannot be ignored. Despite being a majority-Muslim country, Malaysia has been targeted frequently by Al-Qaeda and affiliates – although the majority are stopped by security services, lone wolf attacks (such as the grenade attack on a Puchong nightclub) will still occasionally succeed.

Militants in Malaysia tend to operate a decentralised structure, where small cells or even lone individuals recruit and plan largely independently of each other – there is also a large degree of online radicalisation which leaves the authorities with an uphill struggle in identifying the true nature and extent of the threat. While there is no open Al-Qaeda or Islamic State presence, the number of individualistic groups (such as Jamaal-e-Islamia and Kumpulan Mujahadin Malaysia) mean that the threat is localised and specific.

The degree to which such terrorism would target business specifically, is debatable. From the incidents recorded and prevented so far, the focus seems to be on mass casualties and spreading fear rather than deliberately destabilising the business sector.

The bigger issue would be the networks created across the whole south-east, taking the Philippines and Indonesia into account as well and building up cells on a regional basis.

## GREY AREA DYNAMICS INDICATORS

Over the years, KCS has made it their business to find workable solutions to impossible problems. To do this, KCS has sought to establish clearly the intelligence gap between perception and reality.

In today's market where terrorism, organised crime, cybercrime and government sponsored cyber espionage and war appear to confront us daily, we need reliable tools to identify the risks well in advance. It was for these reasons that KCS created and developed the analysis of risk by Grey Area Dynamics or GAD's, as they are often referred.

GAD's are all the risks, weakness and threats that will, at one time or another, interfere, disrupt or at worst close down businesses. In the projects and work in which KCS have been involved in all over the world, it has been evident that the GAD's identified, can and do kill. This method of risk assessment and measurement goes well beyond standard due diligence and is a collective description of factors, which can be passive and non-passive, legal and illegal. Because GAD's are difficult to quantify or assess from a purely economic viewpoint, these considerations do not normally feature in most credit ratings, investment and banking reports, which focus only on sovereign risk.

The main categories of Grey Area Dynamics relevant to this report that are usually encountered are:

### Passive/Legal

- Language & Dialects – ethnic languages endure particularly in the outlying regions, but English is widely taught and is the language of business.
- Cultural & Local sentiment – while Malaysia as a whole is very welcoming to foreign business and investment, it is not permitted to conduct service/consulting jobs as a foreigner without being registered as an official Malaysian company.
- Pressure Groups – confined to local political/religious sentiment and not a real threat to foreign business.

### Non-Passive/Legal

- Absence or effectiveness of Legal Safeguards -
- Overt and disguised/beneficial ownership – serious concerns persist over the degree to which political entities can control private companies and the extent to which these can corner the market.
- Bureaucracy and Local Government – the government is aware of the need to reduce 'red tape' but bureaucratic obstacles, both necessary and opportunistic, remain.
- Public or Media hostility – Malaysia's press is considered 'partly free' and exposing political corruption is traditionally frowned upon but buoyed by 1MDB, incidents are now beginning to be reported.

### Passive/Illegal

- Bribery & Corruption, Vested Interests and Cronyism – very prevalent throughout business and civil society.
- Patronage – the political economy relies on patronage and this may bleed over into business, and the selected politicians will have significant influence on business practices/ventures
- Product diversion – no significant problems in this area.
- Parallel Trading – forbidden under Malaysian law but in practice there is no strict system to pick up on and prevent it.
- Hidden Barriers to entry – likely to be confined only to requests for facilitation payments etc.

### Non-Passive/Illegal

- Counterfeit & Fraud – counterfeiting is seen at the product level at an alarming rate across south-east Asia and this could affect products exported from Malaysia.
- Unfair Market Competition, Ethics and Corporate Espionage – the Anti-Trust and Corruption Acts prohibit actions that restrict competition in Malaysia and investigations have been enacted against some offenders – but no guarantees all will be caught.
- Organised Crime – human trafficking is a serious concern but little indication that OCGs are operating a wide network across Malaysia.
- Kidnap & Extortion – occasional isolated incidents but predominantly this is not a problem.
- Religious Extremism, Terrorism – strong threat from IS-affiliated local groups and lone wolves.
- Civil Unrest – No significant protests/unrest since election day in 2018 and unlikely to recur again in the short-term.

For a risk assessment to be thorough, it must encompass the potential for a broad array of economic, political and business situations that might affect a business venture. Evaluations limited just to political issues or financial factors may be completely misleading.

The degree of severity of a risk portfolio will also depend on the origin of the investing entity; for example, European companies often face different risk profiles to American corporations considering the same investment opportunity.

Grey Area Dynamics pose a challenge of diagnosis<sup>2</sup>. The key to avoiding problems before they occur or solving them after they have begun to take a toll on performance, lies in their early identification and evaluation. Ignoring the impact of GAD's can be a costly business.

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<sup>2</sup> KCS Group Europe won the European Service Provider of the Year, 1999-2000 at the European Risk Management Awards magazine International Risk Management for their work on GAD's. In 2004, the company won an award for Product of the Year from StrategicRisk.