

FDI, SMEs, and the shortage of skilled workers
By Quah Boon Huat

FDI is not too much of a good thing, only if there is an adequate supply of skilled workers to meet the staffing needs of homegrown SMEs.

Foreign Direct Investment (FDI) represents the transfer of assets like capital and technology, and access to export markets, skills and management techniques. It is therefore widely regarded as having a stronger positive impact on economic development and growth than any other capital flows.

Malaysia's export-led manufacturing boom has been largely the result of manufacturing FDI inflows. According to UNCTAD's inward FDI potential and performance indices, Malaysia is considered to have high FDI potential and to have performed well in recent years.

So when the UNCTAD World Investment Report 2006 revealed that Malaysia's inward FDI dipped 14% in 2005, the only ASEAN country to register a decline, there was much public debate about whether Malaysia's investment climate has become less attractive.

But is Malaysia depending too much on FDI for its economic prosperity? Have we been serious enough about developing homegrown entrepreneurship, especially small and medium-sized enterprises (SMEs)? These questions come to mind because FDI inflows have effectively served as a substitute for domestic entrepreneurship in Malaysia. There is no world-class Malaysian company to rival the big multinationals in manufacturing that have put Malaysia on the world map.

Forget government-sponsored heavy-handed import-substituting heavy industries model of industrial policy in which preferential allocation of capital is given to large companies. It has not worked well in Malaysia.

A different model of industrial policy is being credited for the spectacular growth of Taiwan's homegrown computer and semiconductor firms. The quasi-governmental Industrial Technology Research Institute provides development initiative and engineering support, while SMEs take care of commercialisation. The Taiwanese government did sponsor the development of a venture capital industry though it exercised great restraint when it came to capital allocation.

SMEs have an important role to play in the Malaysian economy. However, their share of total exports is about 20% lower than that in the Philippines, Hong Kong, Taiwan and the US. And despite making up 99.2% of total business establishments in Malaysia, SMEs only accounted for 47.3% and 43.5% of total value-added and output respectively in 2003. By comparison, SMEs in Korea contributed about 50% of total value-added, while Japanese ones contributed 55% towards GDP.

The long-term competitiveness of SMEs critically depends on, among other things, an adequate supply of skilled labour. However, skilled labour, an important factor of production in the knowledge-based economy, is becoming scarcer by the day in Malaysia.

The increasing demand for skilled labour, due largely to Malaysia's success in attracting huge manufacturing FDI inflows, is creating a situation in which the demand-supply gap for skilled labour is proving difficult to fill. As a result, the much touted spillover effects from inward FDI through backward linkages is likely to continue to be very muted, because SMEs, constrained by the shortage of skilled workers, are unlikely to have the capacity to fully reap the benefits.

And considering the difficulties that SMEs have in attracting the best workers in the first place, SMEs will continue to be plagued by problems related to the shortage of skilled workers. The situation is likely to get worse. This is an especially critical issue in the case of SMEs that cater to the outsourcing needs of MNCs.

Theoretical occupational choice models suggest that FDI tends to crowd out domestic entrepreneurs through their selections in product and labour markets. However, there are empirical studies suggesting that in the long run, this crowding-out effect may be moderated or even reversed because of learning, demonstration, networking and linkage effects.

However, if nothing is done to ensure that there is effective human resource policy implementation to tackle the critical issue of skilled labour scarcity, there will be no end to the crowding-out effect that accompanies FDI inflows. Things will get worse for Malaysian SMEs as the economy moves up the value chain, unless the domestic supply of skilled labour can keep pace.

The writer is a research fellow at the Malaysian Institute of Economic Research.