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The Benefits and Challenges of Palm Oil Plantation in Malaysia – A Study on Foreign Direct Investment

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Abstract

Foreign Direct Investment becomes an integral part of economic growth of a country. This study investigates the issues relating to Foreign Direct Investment in Malaysia, Multinational companies foreign direct investment strategy, motives and benefits of FDIs, capacity and constraint, location strategies and taxation policy in Malaysia for MNCs. Keeping in mind the national interests the policy makers designed the FDI policy which aims FDI as a medium for acquiring advanced technology and to mobilize foreign exchange resources. Even though there is no causal relationship between FDI and Malaysia economic growth still FDI plays an important role in the economic growth of the country.

Key words: *FDI, Economic growth, Plantation industry, Investments*

1. Introduction

Foreign direct investment (FDI) and multinational corporations (MNCs) play a large and growing role in shaping both economic and political world. From a macroeconomic point of view, FDI is a particular form of capital flows across borders, from countries of origin to host countries, which are found in the balance of payments (Denisia, 2010). FDI is the means by which an MNC obtains or expands a subsidiary can take a variety of forms (Singh, 2012). Global FDI flows increased by 35% to $345 billion for the first three quarters of 2013, However, it was 4% below the $1 trillion observed over the same period in 2012 (OECD, 2014).

When multinational corporations enter different foreign markets, it is market failures that attract FDI and give them the advantages in those markets (Denisia, 2010). According to Yang and Huan (2011), the increasing prominence of MNCs in the recent economy has drawn much attention not only from international organizations and national government agencies but also from local citizens.

When the firm has grown rapidly but the domestic market is no longer sufficient, the management chooses to expand to other countries (Iqbal, 2004). It means that the foreign country must provide greater advantages than the home country; so, it lead the company go for FDI. Hymer (1976, cited in Denisia, 2010) found that as MNCs are foreign, they face high costs and risks with their investment in other countries. However, Faeth (2009) mentioned that FDI was motivated by higher profitability as well as low labour costs and exchange risks in foreign countries. The motives of FDI for every MNC are different within different markets, home-countries, and industries. Manufacturing MNCs are attracted raw materials, market, and infrastructure in the host country (Buckley and Casson, 2009), while MNCs in knowledge-based investments are primarily attracted by skilled labour and industry presence (Porter and Rivnik, 2012).

Majority of foreign companies choose electrical, chemical, basic metal, nonmetallic mineral and plastic products, food manufacturing, and scientific and measuring equipment for FDI (Ministry of Finance, 2001, cited in Karimi and Yusop, 2009). In addition, MNC use various methods of FDI including acquisition, equity investment, expansion, Greenfield, joint venture, and partnership (OECD, 2008).

Malaysia is an open and developing economy. As a result, external events such as the oil crises of the 1970s, the downturn in the electronics industry in the mid-1980s, and especially the Asian financial crisis of 1997, put a significant impact to Malaysian until 2000s. Therefore, the government tried to attract FDI to improve the country's economic condition. Malaysian government introduced the Investment Incentives Act 1968 and established of free trade zones in the early 1970s. Following that, Promotion of Investment Act (PIA) was announced in 1986 to allow a larger percentage of foreign equity ownership in enterprise. As a result, the FDI inflow and outflow increased rapidly in Malaysia.

Based on the research of Chowdhury and Mavrotas (2005), there was a strong relationship between FDI and economic growth for developing countries such as Malaysia. However, Duasa (2007) found that there is no strong evidence of causal relationship between FDI and Malaysian economic growth. However, FDI contribute to stability of economic growth in this country.

2. Company's corporate strategies and foreign investment

Johnson & Johnson's operating companies are divided into different business segments including Medical Devices and Diagnostics, Consumer and Pharmaceutical. Therefore, their strategic planning is to remain an impeccable and meeting all expectations of human-care consumers and for its sellers, from pharmaceutical and medical device and diagnostics markets. Johnson and Johnson has actively embraced outsourcing, making it a key component in the company's strategy, enabling it to maintain its competitive edge. When Johnson & Johnson Company considers outsourcing, they look at the business environment including a country's legal framework, regulatory and taxation complexity, and economic and political volatility (Njau, 2012).

About foreign investment with acquisition, Johnson & Johnson (China) Investment Ltd., the branch of Johnson and Johnson that announced and handled the acquisition, is a foreign investment entity established in China by Johnson and Johnson from 1998 (MPO, 2013). In the 2013, Johnson and Johnson invested a reported $1.0 billion in company mergers and acquisitions, which represented 3.98% of its available cash during this period (The New York Times Company, 2013). At the same time, Johnson and Johnson planed to $290 million in a new production base in Xi'an, China (Yang, 2013). In addition, Johnson and Johnson is investing in proven programs to save new-born lives in countries including China, India, Indonesia, Vietnam, Nepal, Pakistan, Uganda, Malawi, Kenya, Ethiopia, Ghana and South Africa (Johnson and Johnson, 2012a).

3. Motives for Johnson & Johnson to engage for FDI:

3.1 Resource - seeking

Availability of natural resources, cheap unskilled or semi-skilled labor, creative assets and physical infrastructure promotes resource-seeking activities. Historically, the most important host country determinant of FDI has been the availability of natural resources, e.g. minerals, raw materials and agricultural products. Johnson and Johnson's demands for low cost resources include raw material and human resource is increasing because their cost of sale and expenses are significant. Base on the chart, even though the sales increased from

2010 to 2012, Johnson and Johnson net earning reduced significantly. Therefore, in order to improve the performance, Johnson and Johnson need to low down their expenses.

Table 1: Johnson and Johnson's Sales and Net Earnings (2008-2012)

TOPIC	UNIT	2008	2009	2010	2011	2012
Sales	U.S. dollars, millions Percentage change over previous year	63,747	61,897	61,587	65,030	67,224
Net earnings	U.S. dollars, millions Percentage change over previous year	12,949	12,266	13,334	9,672	10,853

Source: Johnson and Johnson, 2012b

Sustainability reaches far beyond the walls of any one company, from the raw materials purchased to the external partners that manufacture some of our products. Working closely with our supply chain partners, Johnson and Johnson seeks to ensure the sourcing of raw materials is sustainable (Johnson and Johnson, 2014). Johnson & Johnson's raw materials and supplies increased from 2010 to 2011 and from 2011 to 2012. Therefore, they aim to get the quality material at a cheaper cost to improve their income.

Table 2: Johnson and Johnson's raw materials and supplies (2008-2012)

USD $ in millions	2012	2011	2010	2009	2008
Raw materials and supplies	1,416	1,206	1,073	1,144	839

Source: Johnson and Johnson, 2012b

Johnson and Johnson companies use a tiny fraction of this total — approximately 75,000 tons palm oil or less than 0.2 percent annually. In addition, Malaysia is the second-biggest palm oil producer in the world, and oil palms are an important source of income for the state and thousands of smallholder farms. As a result, Johnson and Johnson can invest to Malaysia to get the raw material supply.

3.2. Market – Seeking

Firms want expand overseas to find new costumers for their goods and services. For every company, new markets bring a chance to maintain competitive advantages and grow within the industry as well as achieve scale and scope economies (Bitzenis et al., 2007). Another motivation for market-seeking occurs when company have saturated sales in their home country, or when they believe investments overseas will bring higher returns than additional investments at home. It is clear that the sale for international market is increasing for Johnson and Johnson, from 52% in 2010 to 56% in 2011-2012. In addition, in 2012, Asia-Pacific Africa took 20% of Johnson and Johnson total sales. Therefore, it encourages Johnson and Johnson to invest on Asia countries such as Malaysia because this is a potential market.

Market-seeking investment is attracted by factors like host country‟ market size, per capita income and market growth (Kudina and Jakubiak, 2008). For Malaysia, the pharmaceutical industry has shown tremendous growth over the last 10 years, consistently between 8 to 10% annually (Naw, 2013). Moreover, the medical devices market in Malaysia is growing rapidly from $0.936 billion in 2009 to $1.091 in 2010 of medical devices sales. Then, it is expected to increase up to $1.692 billion by 2015.

Figure 1: Malaysia's Medical Devices Sales Indicators, 2007-2015 (USD billions)

Malaysia's Medical Devices Sales Indicators, 2007-2015 (USD billions)

	2009	2010	2011f	2012f	2013f	2014f	2015f
Medical devices sales	0.936	1.091	1.253	1.371	1.464	1.580	1.692
Medical devices sales % of GDP	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Medical devices sales % of total healthcare sales	9.70	9.79	9.83	9.93	9.96	10.13	10.27

Source: Business Monitor International, March 2011
f=forecast

Source: Istituto nazionale per il Commercio Estero, 2012

3.3 Efficiency-Seeking

The efficiency-seeking FDI is motivated by creating new sources of competitiveness for firms and it goes where the costs of production are lower. New sources of competitiveness, economies of scope and specialization and low cost of production are some of the efficiency seeking factors of FDI (Wadhwa and Reddy, 2011).

According to the World Economic Forum (cited in Invest in Malaysia, 2013), Malaysia is ranked 3rd globally in terms of its pay-to-productivity ratio, outperforming economies such as Australia (80), Brazil (81), Canada (24), China (16), India (43). Therefore, Johnson and Johnson can low down their cost production in Malaysia because of its high productivity.

Figure 1: Asia Tax Rate (2012)

Emerging Asia Tax Rates			
Country	**Corporate Income Tax**	**Value Added Tax**	**Dividends Tax**
China	25%	17%	10%
India	40% (proposed reduction to 30%)	12.5%	15% (proposed reduction to 5%)
Malaysia	25%	N/A	Zero
Thailand	23% (reduced to 20% for the two accounting periods on or after January 1, 2013)	7%	10%
Vietnam	25% (proposed reduction to 23%)	0%-10%	Zero

Source: China Briefing, 2012

4. Benefits of international diversification

4.1. Risk reduction

Diversified international investment offers investors or Multinational Corporations higher expected returns and reduced risks from exclusively domestic investment. Investing in a variety of assets reduces risk, especially when compared to investing in a limited number of stocks (Riddix, 2011). Moreover, because of different industrial structure in different countries as well as because different economies do not trace out exactly the same business cycle, there are reasons for smaller correlations between expected returns and investments in numerous different countries than between investments within any one country (Johnston, 2014). By choosing many stocks from different industries or sectors, diversification can protect the investors or MNCs from factors that influence each industry or sector. It means that diversified international investment can help the company to share the risk into many countries or segments. Therefore, if the investment in any countries faces losses or any uncertainties, the investments in other countries will not be affected.

4.2. Opportunities

Because of the larger selection of investments in international markets, it brings the company more opportunities. Hence, international diversifications offer the company such as Johnson and Johnson with opportunities to generate profits with growth of international market. The government from many countries is using infrastructure, raw materials and resources in order to improve their economies. Johnson and Johnson will have more benefits from investing in the new markets. The chart below shows that the U.S healthcare expenditures growth rate reduces significantly.

The diversification lets multinational corporations to create opportunities that the home country's markets cannot offer. In addition, access to opportunities in foreign markets can overcome growth challenges, and enhance a companies' performance (Ang, 2007). Specifically, in the latter half of the 1980s and early years of the 1990s, most of the governments of ASEAN gradually liberalized their stock markets, giving foreign investors the opportunity to invest in domestic securities. Therefore, the U.S based companies can have more opportunities to earn more profit in foreign market, especially Asian market.

Moreover, a positive result of international diversification can be an increase in market share for the company. By introducing new products, exploring new regions or targeting new groups of customers in different countries, Johnson and Johnson can expand their customer base. Other than that, international diversification leads the companies to more competition, potential changes in customer preferences and seeing the products or services become obsolete due to new technology (Johnston, 2014).

4.3. Gain from stock and bond

Bonds as well as stocks in an internationally diversified portfolio provide an opportunity to reduce risk for a given return compare to a stock only portfolio. According to a research by Bruno Solnik (1974, cited in Goel and Chaudhary, 2013), an international portfolio of stocks has about half as much risk as a portfolio of same size containing only U.S stocks. Particularly, based on the figure 6, for any given number of stocks, an internationally diversified portfolio typically has less than half the risk of a domestically diversified portfolio. So, the gaining of international stock will be higher than U.S stock.

Furthermore, the benefit from holding bonds comes despite the relatively high exchange-rate risk on bonds. Recently, Cappiello et al. (2006) found that an International Portfolio Diversification of default-free bonds provides a good hedge against domestic bond market declines. As a result, expected gains from international diversification are time-varying. In addition, the expected gains from international diversification are higher for the globally Portfolio Diversification of short term bonds than for long term bonds. On the other hand, holding an International Portfolio Diversification of long term bonds provides little protection against domestic bond market declines (Ahn et al., 2012). Gain from International Portfolio Diversification in term of bonds and stocks bring benefit for multinational corporations such as Johnson and Johnson because they can easily attract more investors when they apply diversification strategy for their business.

5. Financial management capacity and constraints.

5.1. Financial Management

Johnson and Johnson have a healthy cash flow. The company generates positive free cash flow each year from a highly diverse sales base, and often it's a higher figure than net income. The company's free cash flow increased from $11,405 billion in 2011 to $13,819 billion in 2013. It allows the company to take advantage of acquisition opportunities that will augment growth. For example, within the fiscal years from 2010 to 2012, the company brought in nearly $38 billion in free cash flow. Then, the company paid about $18.5 billion in dividends, another $18.2 billion on share repurchases, and about $8.5 billion on net acquisitions (Dividend Monk, 2013).

Johnson and Johnson has a strong financial management in term of liquidity. Current ratio, which measures the ability of a company to pay its current obligations using current assets, for Johnson and Johnson, is significantly higher than the industry. Similarly, quick ratio for the company is also better than the industry overall. It shows that Johnson and Johnson has ability their creditors and repay their short-term debts. At the same time, Johnson and Johnson's debt/ equity ratios reduced from 2012 to 2013 and lower than the industry. It means that the company can generate new funds from the capital market as they use less debt.

Johnson and Johnson also have ability to meet interest payment obligations with business income as their interest coverage ratio increased from 2011 to 2013 with a safe range within the industry average. It can be concluded that Johnson and Johnson have a strong financial position in term of leverage and liquidity.

5.1.1 Johnson and Johnson's constraint financial management

Johnson and Johnson is not strong to generate income and cash flow compare to other competitors in the healthcare industry. Particularly, gross profit margin which indicates the percentage of revenue available to cover operating and other expenditures went down from 70.20% to 67.78% from 2009 to 2012. It was lower than the gross margin ratios with the healthcare industry. Furthermore, the company asset turnover also fell from 0.69 in 2009 to 0.56 in 2013. It shows that company's financial management uses its assets not really efficiency. On the other hand, in term of return on assets ratio, Johnson and Johnson has higher income generated for each $1 of assets the company has, compare to the industry. However, the data shows that the company becomes less profitable as the return on asset ratio is unstable.

Overall, Johnson and Johnson has a weak earnings growth as they cannot maintain the growth rate for earning per share (Figure 7). Moreover, Johnson and Johnson has unstable payout ratio. Since the payout ratio provides an idea of how well earnings support the dividend payments, the company might lose confidence from the investors. It is because the payout ratios of the company was significant lower than in industry and it drop from 64.60 to 54.60 from 2011 to 2012. It can make the company become less attractive to the investors and lead the company to problem in the future.

Table 3: Johnson and Johnson's ratios

	2009	2010	2011	2012	2013	Industry
Profitability ratio						
Gross Margin (% of sale)	70.20	69.49	68.69	67.78	68.67	75.60
Asset Turnover	0.69	0.62	0.60	0.57	0.56	0.5
Return on Assets %	13.66	13.50	8.93	9.24	10.89	7.90
Liquidity ratio						
Current ratio	1.82	2.05	2.38	1.90	2.20	1.60
Quick ratio	1.59	1.34	1.88	1.62	1.34	1.10
Leverage ratio						
Debt/Equity	0.16	0.16	0.23	0.18	0.15	0.35
Interest Coverage	35.93	38.25	22.65	26.89	33.10	12.80
Stock market ratio						
Earnings Per Share (USD)	4.40	4.78	3.49	3.86	4.81	-
Dividend yield	3.00	3.00	3.5	3.50	3.50	3.00
Payout ratio	43.90	44.10	64.60	62.20	56.60	62.00
Free Cash Flow (USD	14,206	14,001	11,405	12,462	13,819	-

Million)						

Source: Morningstar, Inc., 2014

5.1.2 Johnson and Johnson's location Strategies

As Johnson and Johnson Company represent 0.2% of the world's consumption of palm oil, they support the production of sustainable palm oil (Solidaridad, 2013). Johnson and Johnson plans to invest in palm oil plantation in Malaysia through small plantation business, smallholders as well as private estates. In 2013, Johnson and Johnson used their dedicated palm oil fund through many projects to increase the global awareness of sustainable palm oil, increase smallholder yields and optimize land use in Malaysia (Solidaridad, 2013). Therefore, the company has the ability to connect with the smallholders for this investment. In addition, the major private sector holding is 60% palm oil industry in Malaysia (Punch, 2013).

In addition, if Johnson and Johnson chose Penisular Malaysia so that they can get lower cost production. Base on the Figure 8, the government allocated RM7, 500 per hectare to smallholders who plant up oil palms in Penisular Malaysia and RM9, 000 per hectare in Sabah and Sarawak by 2011. It means that, the palm oil planting cost in Peninsular is cheaper. This is an important to be considered because palm trees need to be replanted after some years. This is because the productivity of palm trees decreases after a number of years. Smallholders often work with depleted trees and do not replant when needed because replanting is a large investment. It requires approximately S5, 000 per hectare to replant. Therefore, Penisular Malaysia is a good choice in term of investment cost as the company take it as long-term investment.

Figure 2: MPOB grant to smallholders planting up oil palms (January 2011)

	Peninsular Malaysia	Sabah and Sarawak
Land preparation	RM 2,500 per ha	RM 4,000 per ha
Seedlings	RM 2,000 per ha	RM 2,000 per ha
1st year supply of fertilizer	RM 1,000 per ha	RM 1,000 per ha
2nd year supply of fertilizer	RM 2,000 per ha	RM 2,000 per ha
Total	RM 7,500 per ha	RM 9,000 per ha

Source: Malaysian Palm Oil Board (MPOB), 2011.

However, the oil palm industry in Malaysia is a well-regulated industry with many laws and regulations governing environmental management, forest conservation, and sustainability (May, 2012). Furthermore, Malaysian government is writing a new global standard for its palm oil to ensure quality and address concerns of nongovernmental organizations (Environment News Service, 2013). The Forest Research Institute Malaysia (FRIM) announced that more than 450 hectares Bikam Forest Reserve in Perak, the second largest state in Peninsular Malaysia was cleared for oil palm plantations.

Johnson and Johnson can invest more in Sarawak instead of Peninsular Malaysia to reduce availability of land in peninsular Malaysia, government encourages palm oil private sector to move to Sabah and Sarawak. Moreover, Malaysian Government is continuing an expansionary palm oil production policy based on new land development in Sabah and Sarawak. However, it is reported that the land available for oil palm plantations in Sabah is almost exhausted. Then, The Sarawak state government has grand visions for boosting its current area of 0.9 million hectares to two million hectares of oil palm by 2020 (Malaysian Palm Oil Board 2010). Therefore, Sarawak is the best choice for the company as they need to follow Malaysian government.

5.2 Malaysian government view of FDI

FDI helps boost the growth of economies by allowing for more markets and a larger channel for each market (Graham and Jeffrey, 2005). Malaysia is a developing country and they are in between developed and developing level (Trade Chakra, 2008). To become a developed country, FDI has worked in Malaysian government's favour because it has helped to improve the national economy. Among the Southeast Asian countries, Malaysia has keenly attracted FDI. Particularly, Malaysia has been the most successful Asian country to adopt the FDI because the country combines FDI into the economic development strategy which helps Malaysia to take up to date technology, capital, and skills (Trade Chakra, 2008).

Malaysia's FDI inflows dropped sharply in 2009 because of economic downturn and the global financial crisis. However, net FDI inflow of Malaysia recovered and increased significantly after Global Financial Crisis in 2009. It leads to 25% increase in Malaysian ringgit's (Colombo, 2014). According to Sulong and Harjito (2005), Malaysia attracts more foreign investors by making upgrade the level of national infrastructure and the development of telecommunication. The better the infrastructure of the host country, the more attractive it is to FDI (Wong, 2005). Moreover, Malaysian government offer a tax holiday for up to ten years but only for investments made in new industries (Malaysia, 2012). Other than that, the government offered promotion of investment act that was born in 1986. It allowed 100% of the foreign ownership if a company would export 50% of the product. However, in keeping with long-standing public policies and domestic economic, Malaysian government encourages or requires joint ventures between Malaysian and foreign companies as well as limits foreign equity and employment in many cases (Amerasinghe and Modesto, 2006).

5.3 Capital Budgeting

Capital budgeting is the process of identifying and selecting investment in the long-term assets that will maximize owner's benefits for more than one year (Peterson and Fabozzi, 2011). For every investment projects, capital budgeting tell the investors whether the investment can create value or not. In addition, capital budgeting provides the managers a method to analyze potential business opportunities then decide which investments are worth undertaking. Cash flows are discounted back at the discount rate to cash flows from a project exceeds the cost of the project in present value. If the project has a positive NPV, it should be accepted because it adds value. Free cash flow represents how much real cash available for Johnson and Johnson. Free cash flow used to pay its dividends, make acquisitions, develop new products, invest in new projects and reduce debt. Therefore, free cash flow shows how much the c capacity is to develop further. Johnson and Johnson have a strong cash flow with $13,819 million in 2013 (Table 4).

Even though, the free cash flow is not stable from 2009 to 2013, Johnson and Johnson still can generate enough cash for its investment as all the company's free cash flows are positive.

Table 4: Free cash flow of Johnson and Johnson

	2009	2010	2011	2012	2013
Free cash flow to equity (USD $ in millions)	14,206	14,001	11,405	12,462	13,819
Change rate (%)		-1.44%	-18.54%	9.27%	10.89%

Johnson and Johnson's revenue is expected to grow at 3.64% in the next five years shows that Johnson and Johnson have improving performance. In addition, NWC shows availability of a company's liquid assets. Forecasting NWC shows that Johnson and Johnson has enough assets to finance for FDI even in the case of uncertainties.

Table 5: Johnson and Johnson's forecast of revenue and net working capital (NWC)

	2009	2010	2011	2012	2013	
Revenue (USD $ in millions)	61,897	61,587	65,030	67,224	71,312	
Growth rate (%)		-0.50%	5.59%	3.37%	6.08%	
Average growth rate (%)	3.64%					

	2013	2014	2015	2016	2017	2018
Forecast Revenue (USD $ in millions)	71,312	73,908	76,598	79,386	82,276	85,271

	2009	2010	2011	2012	2013	
Total Current Assets (USD $ in Billions)	39.54	47.31	54.32	46.12	56.41	
Total Current Liabilities (USD $ in Billions)	21.73	23.07	22.81	24.26	25.68	
Net working capital (NWC) (USD $ in Billions)	17.81	24.24	31.51	21.86	30.73	
NWC growth rate (%)		36.10%	29.99%	-30.63%	40.58%	

NWC average growth rate (%)	19.01%

	2013	2014	2015	2016	2017	2018
Forecast NWC (USD $ in Billions)	30.73	36.57	43.52	51.80	61.64	73.36

5.4 Political Risk Management

Political risk is the risk of actions taken by the host country that have negative implications on the performance of the business in the host country. In addition, Malaysia has moderate levels of economic and political risk. At the same time find political risk is significant in both industrialized and developing countries (Baek and Qian, 2011). Overall, dynamic political risk has also significantly improved since 2010 in Malaysia (Marsh&McLennan Companies, 2013).

The Barisan Nasional (BN) coalition's dominance through 52 years in power was dented as it lost control (The Malaysian Insider, 2010). Moreover, uncertainty over the timing of the vote could harm the national economy. The companies hold back on spending during election time (Sithraputhran and Grudgings, 2012). In term of economic reform, Malaysian government is implementing a $444 billion initiative, called the Economic Transformation Program. They aim to propel the country to developed nation by 2020. However, corruption and a perceived lack of judicial independence are damaging investment. At the same time, race and religion are other problems in Malaysian politics.

Malaysia has high political risk for international transaction policy, government stability, religion stability and social stability compare to the world average. Therefore, for Johnson and Johnson, they need to concern on these four areas when they want to invest to Malaysia. However, the company also can have some benefits as Malaysia has low political risk on monetary policy, fiscal policy, labour flexibility and legal system.

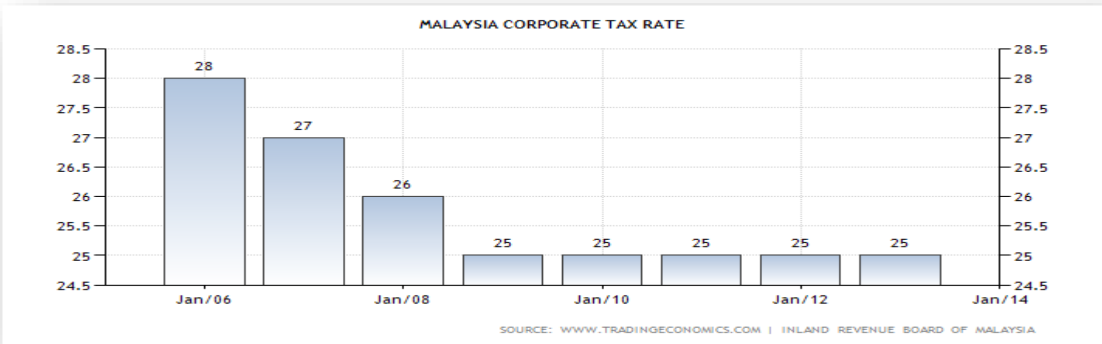
A recent World Bank study indicated that believe that political risk will be the most important constraint on investment in emerging markets more than half of all firms. However, most of those companies do not have any method to measuring political risk and do not integrate it into their approach to risk management. For Johnson and Johnson, in order to manage political risk in Malaysia, they can seek for independent consultants to have statistic about factors affecting the political environment in Malaysia. In addition, Johnson and Johnson risk managers identify the main political risks in the particular states in Malaysia by collecting the data from high-quality political risk consultants, local subsidiaries and partners, the public domain, other companies, industry associations, local organizations, and other sources. Then, risk manager can have a scenario set which provides a basis to define their data requirements. Following that, risk managers should analyze the impact of each scenario on the business.

The company can determine the changes that will affect in the firm's cash flow if one of the events in political risk occurs. If political risk increases, the company can decide not to invest Malaysia or withdraw from the market in which the companies is currently operating, and/or use the "counteractive response", that is, try to gain a competitive advantage based on MNC strengths and the needs of the host government.

5.5 Principles of MNC taxation in Malaysia

Malaysian government applies the same tax rate which is 25% for both local and foreign enterprises from 2008. Profits are only taxed at the company level; so there is no tax for dividend. Moreover, MNC in Malaysia are given 70% exemption of income taxes for 5 years (Bureau of Economic and Business Affairs, 2013).

Figure 11: Malaysian corporation tax rate



Source: Trading Economics, 2014.

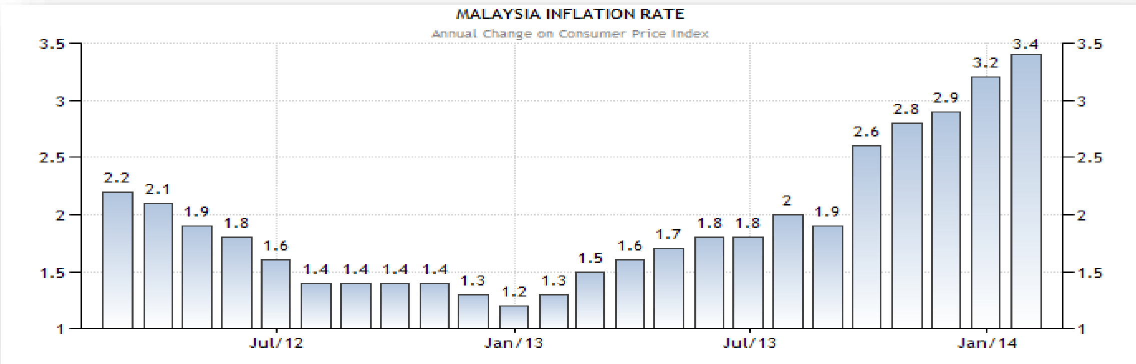
Taxation in Malaysia is attractive for Johnson and Johnson because the tax rate is reduced and remains stably (Figure 11). Therefore, Johnson and Johnson can settle a long-term investment without any uncertainties about taxation in Malaysia. Moreover, taxation principle in Malaysia can helps the company reduce cost and earn more profit as they will pay less tax for the first five years. In addition, they also can get more capital by declaring high dividends to attract more shareholders in Malaysia because Malaysian government avoids double-tax.

5.6 Inflation

The inflation rate is one of the most important economic factors to be considered because it affects the value of a nation's currency. Inflation is defined as a sustained increase in the general level of prices for goods and services. In January 2014, the inflation rate in Malaysia was recorded at 3.40%. Compare to 1.2% in January 2013, Malaysian inflation rate has been increasing significantly (Figure 11). However, the inflation rate is expected to increase further in the coming months (The Star, 2014).

Johnson and Johnson can face some problems when inflation rate increase in Malaysia. Particularly, the purchasing power of customers is reduced as people buy fewer goods and services with the same unit of currency. Moreover, Johnson and Johnson might lower profit then expectation for setting their investment in Malaysia. For example, higher prices for food, transport, petrol and electricity lead to higher cost of manufacturing. In addition, employees also demand higher wages at the time of high inflation. Then, fluctuated inflation rate in Malaysia makes it difficult for Johnson and Johnson to predict the future of prices and returns from investments.

Figure 3: Malaysia Inflation Rate (2012-2014)



Source: Trading Economics (2014)

5.7 Exchange rate

Figure 12 shows the exchange rate between Malaysian ringgit and U.S dollar. Compare to January 2013, Malaysian ringgit has depreciated against the U.S. dollar in January 2014. It means that the value of Malaysian ringgit is reducing. This factor can influence the Johnson and Johnson's FDI in Malaysia. According to Shahrudin et al. (2010), exchange rate is also one of determinants for FDI. He mentioned that when currency value depreciated, it reduces the cost of capital. Then, it leads to higher profit for foreign investors by making a larger investment in terms of the domestic currency. In this case, Johnson and Johnson can get advantage from the exchange rate to get higher return.

Figure 4: Malaysian - U.S exchange rate (MYR/USD)

Source: Trading Economics (2014)

6. Conclusion

There are many benefits and challenges to stand firm in FDI Market. Investing in palm oil plantations in Malaysia, the company can get more land resources, new market and efficiency in the Malaysia. However, Johnson and Johnson need to consider many factors in order to make the investment decision in Malaysia. First of all, the financial capacity and the limitation in the company's financial management is analysed to guarantee that the Johnson and Johnson has enough capital for the investment. As Johnson and Johnson is a foreign company, they have to follow Malaysian policy and regulation for all their actions including setting the location strategy. Then, Johnson and Johnson also have to understand Malaysian political risk, taxation, inflation rate and exchange rate.

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