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Pains and gains of venturing abroad

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THE Malaysian economy has grown more in the last 15 years than it did in the first 52 years of independence.

Since 2010, the national gross domestic product has increased by over RM1 trillion, reaching nearly RM2 trillion last year.

It was not an overnight success, however, for the nation's supercharged growth. The momentum accelerated in the 1980s, when Malaysia became a factory for the world and eventually evolved into a service-oriented economy.

As the economy expanded, so did business opportunities.

Malaysia has produced some of the largest companies in the world in their respective industries.

Top Glove Corp Bhd is a major glove manufacturer, while Karex Bhd is among the biggest condom manufacturers.

IHH Healthcare Bhd, in which Khazanah Nasional Bhd has a major stake, is among the world's top-10 largest private healthcare groups.

SD Guthrie Bhd is the world's second-largest listed palm oil company by assets.

Aside from these examples, there are other companies like Tenaga Nasional Bhd, Gamuda Bhd, YTL Power International Bhd, and HSS Engineers Bhd that thrive on foreign contracts.

While Malaysia has played a significant role in the growth of their companies, their global footprint allows them to operate on a bigger stage today.

For Gamuda, which recently announced its ninth Taiwan project and a deal to co-develop Australian renewable energy projects, overseas operations generated two-thirds of its revenue in the first nine months of its financial year ending July 31.

It is no surprise that Gamuda, led by its strong foreign exposure, is the largest listed construction firm in Malaysia, with a market capitalisation of nearly RM30bil. This is nearly triple the size of the second-largest construction company on Bursa Malaysia – IJM Corp Bhd.

Also, a diversified revenue base reduces the risk of over-reliance on the Malaysian economy.

Ng Zhu Hann, chief executive officer of fund management company Tradeview Capital, says Malaysia is a good market to build a business base, although the target has to be long-term growth.

"There are still a lot of opportunities for small and medium enterprises.

"Tradeview Capital is able to build a good base because we started out in Malaysia instead of a market with more competition. But, to grow further, we have to venture out," he tells *StarBiz 7*.

Fund managers and analysts say that companies with a strong exposure overseas often carry a premium on valuation compared to their peers.

However, Mohd Redza Abdul Rahman, director of research at BIMB Securities Research, says a premium only makes sense when execution is demonstrated through revenue growth, increased earnings margins or international recognition.

Companies with meaningful revenue abroad have access to faster growing end markets, thus, the ability to consistently outpace domestic sales growth.

- A global footprint allows successful companies to operate at a big scale today
- A diversified revenue base reduces the risk of over-reliance on the Malaysian economy

"Then there are diversification benefits where broad geographic footprints are able to smooth out local business cycle swings, reducing overall earnings volatility and making cash-flows and profitability more predictable.

"Furthermore, businesses operating across multiple jurisdictions can benefit from economies of scale that can lead to shared procurement, cross-selling opportunities, and most importantly, a global brand premium."

That said, global exposure is not without risk.

Before assigning a premium, Mohd Redza said the complexities of running a business overseas must be considered.

"Country specific hurdles, especially in the different regulatory regime, tax structures and governance standards could stress the management out easily.

"Expertise and knowledge to deal with these complexities, will ease the ability to steer the ship in foreign waters," he adds.

Also, mergers and acquisitions or joint ventures abroad have their own pitfalls. A high valuation could lengthen the break-even period and investors might not have the patience to wait.

Cultural misalignments could also result in operational difficulties, no matter how nice the financial projections are.

Classic examples of Malaysian companies losing money abroad are Axiata Group Bhd and IJM Corp Bhd, as well as Eco World International Bhd.

Axiata, which has Khazanah Nasional Bhd, the Employees Provident Fund and Permodalan Nasional Bhd as some of its largest shareholders, walked out of Nepal and Myanmar at a loss.

In the case of Nepal, Axiata complained about unfair taxation and unfavourable foreign investor protection.

As for the conflict-stricken Myanmar, Axiata cited worsening macroeconomic parameters and business conditions.

Investments in risky frontier markets piled pressure on Axiata's cash flow. The money would have been better invested in lower-risk markets.

IJM had a bad experience in its Indian operations where bureaucracy was a major issue.

The construction giant had to dispose of its stake in an Indian highway concession at a loss.

Eco World International has had a tough time navigating the British property market, as weak demand left the property developer with many unsold units.

Ironically, the company which had a mandate to build properties abroad except for Malaysia, is now looking to venture into Malaysia.

Fund manager Danny Wong of Areca Capital cautions that foreign contracts and deals may not necessarily offer fatter margins than Malaysia.

"To venture abroad, companies must be resourceful. This means there must be good management, vision, understanding of how local regulations work and ample talent to implement the projects.

"We wish to see more companies grow beyond Malaysia, but it really depends on the mandate for us to consider these companies for investments. A premium always comes with risks," says Wong.

Tradeview's Ng tells says that a successful venture abroad partly depends on the type of sector and how localised it is.

"A technology or semiconductor company, for example, is not as localised and it can serve various global customers with a presence in Malaysia.

"It is tougher to venture into a more localised sector such as real estate where there is more influence of local systems and regulations. The length of time for investment returns may also be longer, which is a risk," according to Ng.

Mohd Redza of BIMB Securities Research says it is "definitely encouraging" that Malaysian corporates are no longer simply "domestic champions" but have built substantial, diversified revenue engines abroad.

However, not all ventures are successful, considering that regulatory and market fit matter as much as scale and the fact that macro-cycle timing can make or break ventures.

"But having the courage to venture overseas is important to send a powerful signal for stronger partner buy-in – commitment shows you're in it for the long haul as well as showing readiness for a steeper learning curve.

"By co-owning an overseas asset outright, you accelerate on-site problem solving and enhance skill sets without depending on second-hand reports," he points out.