

Issues regarding the Malaysian construction industry

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Ladies and Gentlemen:

Issues affecting the Malaysian construction industry are not only multifarious but also complex. To remain focus this paper will discuss issues pertaining to the construction industry in the context of its development, the raison d'être of the Construction Industry Development Board (CIDB) when established by parliamentary statute in 1994.

CIDB began operations in earnest beginning 1996. The need to establish a statutory body to manage development of the construction industry was mooted in the wake of numerous accidents and quality deficiencies in the construction industry, amongst which included the infamous collapse of the Highland Towers, the landslide at Gua Tempurung, and the many grouses voiced by a large segment of dissatisfied final-purchasers of the construction industry product. CIDB was also tasked with exporting construction services as well as profiling the construction industry by developing and maintaining a database of vital statistics describing the industry. The need to subject the construction industry to managed-development rather than merely leaving it to random development was also driven by the continual increase in the government's development expenditure. The Treasury's Economic Report recorded a Government development expenditure of RM2,151 million in 1975, while in 2007 the figure was estimated to be at the current value of RM40,870 million. Without discounting, this shows a development expenditure increase of about 1900 percent over a period of 32 years, a large part of which was spent on physical projects that had to be constructed. The Government's investment in

development underscored the dire need to nurture a construction industry that is capable of further improving the national economy.

The tools accorded to CIDB to imbue transformation in the construction industry came in the form of legislative power to register contractors, the responsibility to advice state and federal governments and to propose incentives or legislations and policies that can tweak the market forces to move in certain predetermined direction. CIDB's activities are funded via levy collected from projects implemented in Malaysia. Although CIDB is not equipped with wide ranging powers to effect changes in the construction industry, nothing prevents it from piggy-back on the powers of other government departments that may be delegated to CIDB. However, the spirit of Act 520, the Act that was enacted to establish CIDB, gave preference to promotion and encouragement as the prime modus operandi.

Ladies and Gentlemen:

The construction industry has been with us since time immemorial and originated just like many other trade and business based on demand created by the market. As a result when CIDB came into being it was tasked with the transformation of an industry that is steeped with entrenched norms and practices acquired over years of experience. Therein lies the first issue that CIDB had to handle, one that is as much difficult as it is sensitive to many people and organizations already historically part and parcel of the industry. To garner support for CIDB's programme of change, CIDB must tread with care and with as much diplomacy as possible. This was achieved through consultative approaches with attention given to secure approval from captains of industry and organizations already empowered to manage various aspects of the construction industry.

The world, however, keeps changing and change is not going to wait for us to be ready to take effect. Traditional practices soon became obsolete when

environment, client's expectation and technology begin to change. For an entrenched industry such as construction the resistance to change can be a daunting task and must be addressed with patience, a deep understanding of the industry, and vast amount of knowledge. This can only be achieved by keeping ahead of development in the construction field occurring all over the world.

Ladies and Gentlemen:

In addressing the development needs of the construction industry one is tempted to conclude that by focusing development efforts on the construction resources then the industry will automatically improve. The three major divisions of construction resources are namely human capital, technology, and business and management skills. Although it cannot be denied that the efficient utilization of resources is a necessary condition for a more productive construction industry, it is insufficient to deliver the full benefit of any improvement in the resources. The seamless integration of these resources into the value chain as well between each other is also a prerequisite for efficiency and productivity. As an example, consider the case of a worker certified to be skilled in a number of trades in construction. Such workers, after having undergone numerous skills training courses and obtained certification would naturally expect to be better rewarded when employed in a project. A contractor, on the other hand, when bidding for a project, must maintain a price that is competitive vis-à-vis his contemporary. At the same the quality level of the workers are not specified in the tender. As such contractors can opt to employ skill workers to undertake the job during construction, or he can choose the cheaper route of hiring cheap foreign labour with no skills certification but able to do every kind of job offered to him at site. Most contractors opt for the latter resulting in lack of demand for the skilled worker. In such cases, all efforts at developing a construction resource, i.e. the worker, would have gone to waste. For tenders to be evaluated on a level playing field it may be necessary to compel the use of skill labour as a condition of the contract. A more all-encompassing approach is to allow only skilled workers to

work in the construction industry as practiced in countries such as Australia and UK.

Ladies and Gentlemen:

In pursuing development of the construction industry the criteria for development must, in the final analysis, contribute positively to the industry's productivity, quality and competitiveness. Issues affecting construction industry similarly must be those that are barriers to these three criteria. In addressing the issues faced by the construction industry, and the issues are countless, it is convenient to broadly identify two types of issues:

- (a) Structural issues, and
- (b) Operating issues

(a) Structural issues

A crowded, over-controlled, highly competitive, low profitability industry

The construction industry is as wide as it is deep in structure. The Malaysian construction industry, just like the construction industry in most countries, is a fragmented, highly labour-intensive industry but unable to attract local workforce to its fore. Its value chain is acted upon by numerous professions including, but not limited to, architects, engineers, quantity surveyors, land surveyors, project managers, landscape architects, interior designers and planners. The development of projects is subjected to strict administrative supervision by a host of Government Departments and Statutory Bodies and includes the numerous local authorities, Fire Departments, Department of Safety and Health, Department of Environment, the Public Works Department. It must interact with numerous utility suppliers including the Water Supplier of each State, the Sewerage Department, and Telekom Malaysia. Clients and purchasers must

interact with financial institutions to obtain financing while contractors must secure bridging finance and mitigate risks via insurance coverage. A project is managed by a main contractor and supported by between 20 to 50 subcontractors. It has been quoted that as many as 140 trades and industries are involved in the supply chain, while hundreds or even thousands of workers are needed during the construction stage of a project. Matters are made more complex by the fact that the procedures for project development have to undergo processes involving the private sector that overlaps with approval processes of public officials each with differing priority.

In managing the construction industry one can easily be intimidated by its sheer size and complexity. But the construction industry became what it is not out of choice but was driven to it when new demands were imposed upon it by society, or by authorities representing the interests of society. Society expects construction to provide development, but it must be done without risks to workers health and public safety, without harming the environment, without incurring undue waste, without inconveniencing or harassing the neighbourhood, without sacrificing the needs of future generations, without contravening any laws or regulations and without profiteering from the effort. Worst, the constraints grow with the growth of knowledge as we discover our limitations in every field. To address and overcome these constraints new expertise are required. Hence the burgeoning structure of the construction industry.

The labour dilemma

This is one of the most pressing issues faced by the construction industry. The construction industry is a labour-intensive industry. Malaysia has for many years now been dependant on immigrant labour to fulfill our demand for construction work force. As the country becomes more developed, and the economy is driven by higher value-added activities, and when transformation into a knowledge economy takes root, the availability of human resource pool to serve the needs of

the construction industry diminishes. This is aggravated further by the fact that more Malaysians are entering the work force later in life due to the availability of educational opportunities provided by the many public and private institutions of higher learning that mushroomed since the end of the 21st century. CIDB, via its subsidiaries Akademi Binaan Malaysia, in conjunction with other public and private skills training institutes have been sponsoring training programmes for youths as well as for construction workers. However, the impact of locally-trained labour on the construction scenario is rather low. There are a number of reasons why our construction industry is unable to attract local workforce to the industry and tend to loose the good ones to our neighbours. These are listed below:

- i) the high economic growth of Malaysia offers numerous employment choice to Malaysians at wages comparable to or even better than that offered by the construction industry, in working conditions that are not as hazardous, difficult and uncomfortable as found in the construction industry. Even when wages are lower, working in an air-conditioned office can offer greater incentive than working under the hot sun for eight hours.
- ii) Highly skilled Malaysian workers can easily gain employment in Singapore and are paid higher wages in Singapore Dollars.
- iii) Singapore provides special incentives to attract skilled Malaysian workers¹. Skilled Malaysian workers are offered three-year work permits with possibility of permanent residence. Unskilled Malaysians workers are given two-year work permits renewable for another two years. For skilled workers, a further two-year renewal is possible. For Malaysian workers on three-year work permits, employer pays CPF of 20 per cent while employee pays 20 per cent.

- iv) The demand for unskilled labour is greater than for skilled labour due to the labour-intensive nature of the industry.

Singapore Foreign Workers Policy allows companies in Singapore the flexibility to hire foreign professionals and workers. This is done in order to help keep the overall cost of production down and make their operations in Singapore viable.

Given these conditions any effort at enhancing the skills of our labour force will only benefit our neighbour. Yet dependency on foreign brings with it numerous negative effects among the salient ones being outflow of funds due to repatriation of wages, lowering of productivity due to lack of skills, and various social and health problems.

¹ *Construction Working Group Report, Economic Review Committee, Ministry of Trade and Industry, Singapore.*

Construction unable to capitalize on globalization via offshoring.

If we consider the economic development of most developed countries we will see the trend that the higher value-added goods and services will in time push out the lower value-added ones. Low value-added manufactured product such as textiles, consumer electronics, and even automobiles, will then have their production operations 'offshored' to other lower-cost countries simply because the added-value created in the home country just cannot sustain the production operations in that country. While production may be offshored, the R&D, marketing, and design functions may still be retained as they provide higher value-add.

Construction is another traditional industry with low value added. In Singapore, for example, where construction can be considered more productive, the Nominal Value Added was 3.7, 3.7 and 3.8 percent for 2005, 2006, and 2007². This

compared poorly to manufacturing that recorded Nominal Value Added of 27.3, 27.7, and 24.1 percent for the same years.

But construction cannot be 'offshored' notwithstanding its low value-added. This presents a special challenge to the economy. How do we effectively manage a low value-added industry in an environment where high value-added economic products are driving it? The low productivity will also be a drag to the other sectors.

Such a situation has forced some developed countries to continue their dependency on the cheaper immigrant labour. But this approach does not solve the problem as sooner or later the cost of immigrant labour will catch up with the local due to rise in the cost of living. Another alternative is to enhance the value added on construction by making it capital- and skill-intensive and supported by R&D. However, this entails high wage labour and will result in higher cost of construction. Whether this cost will commensurate with the productivity of the construction industry, and whether the higher production cost can contribute positively to the other sectors in the economy is the determining factor whether such an approach will succeed.

² *Economic Survey of Singapore, MTI*

The quest for productivity

The productivity of the construction industry has a strong bearing on the competitiveness of the country's manufacturing sector. When productivity is high then infrastructure services and factors of production are competitively priced. This can be achieved through competition on an equitable basis and an adequate supply in order to promote efficiency, lower cost and raise standards. A productive construction industry that can produce cost-effective projects will in turn attract foreign investment into the country. The productivity of the

construction industry in Malaysia has consistently been low. This is not only detrimental to the industry but construction, being a sector of the economy, is dragging down the nation's productivity.

In Malaysia, the percentage change in labour productivity was 0.42 and 2.34³ percent for 2006 and 2007 respectively. This compares favourably with the Singapore figures of -2.6 and 7.6⁴ percent for the same years.

From the trends in both Singapore and Malaysia it can be seen that, rather than resulting from high capital intensity, higher productivity is a result of more projects. It appears to indicate that productivity gains are, as yet, not gained through doing things more efficiently using technology, but through maximising the reserve capacity of labour. For a country like Singapore with a small construction workforce it is prima facie evidence of an effective policy on the mobility of foreign workers. For Malaysia, the issue is more complex as the productivity level is not consistent for all parts of the country, or between highly urbanized areas and remote areas.

³ *National Productivity Report 2007, Malaysia Productivity Corporation,*

⁴ *Economic Survey of Singapore 2006, MTI Singapore*

Economic dependence on construction driven project to decline

Malaysia's domestic demand is dependant on a few domestically generated activities that includes activities supported by construction. Mature economies as found in Europe, the US and Japan have lower dependency on construction to drive their economies. The infrastructures of these economies are fully developed and may not need further development for the time being. Construction is limited to properties and their supporting utilities. Malaysia will also reach a stage when the role of construction will not be as prominent as it is now in driving the economy. The construction industry must prepare itself for

such an era by moving into the maintenance and facilities management field, and securing projects in foreign markets. The construction industry cannot expect the Government to sustain it on a long-term basis by pursuing a deliberate policy of offering infrastructure project. Sooner or later public spending on infrastructure will be reduced and will then force the small and inefficient construction firms to exit.

(b) Operational Issues

Facing the threat of global financial crisis

This would be the most urgent issue facing the construction currently. Although the official view subscribe to Malaysia being able to weather the financial crisis, the construction industry is not expected to come out of it unscathed. We should at least take steps to prepare our construction industry to face the crisis and to undertake any mitigating role.

The global financial crisis, triggered by the subprime fiasco in the US in July 2007, is already taking its toll on the developed countries by virtue of the closely intertwined economies of these rich countries. However, since the middle of this year (2008), there are signs that the Asian economies are beginning to feel the impact of the crisis as it transcends the global economies. This is unavoidable as the global economy is all closely interlinked. The only difference will be the severity of the impact depending on a country's exposure to the American asset bubble. Nevertheless, our real economy cannot escape the adverse impact on the real economies of these developed nations. Malaysia's major markets including Japan and Singapore are experiencing slowdown due to weakening demand in developed economies. The US and EU, another major market for Malaysia, are already up to their neck in the crisis. Malaysia's commodity prices have dipped substantially as a result of weak demand. Revenue from export of

petroleum will take a beating as oil price drop below US50.00. Tourism is also affected by the slowing regional economies.

The slowdown in Asian economies is likely to continue into 2009 and perhaps into 2010. The construction industry will be affected both domestically and overseas. Domestically, however, the public sector is expected to again utilize the construction industry to rejuvenate the economy, as happened during previous economic slowdown. However, it is doubtful if a supply-push strategy can jump-start the economy afflicted by dwindling demand resulting from loss of purchasing power. A demand-pull strategy will more likely work better but may be hard to achieve if global recession sets in. If the construction industry is called upon to rejuvenate the economy then the Government must focus on implementing projects that not only provide the multiplier effect but, more importantly, must have relevance to and be able to enhance economic activities in the country.

As for the construction export market the impact will vary with each market. As almost none of Malaysian contractors are in the developed countries they are shielded from the direct impact of the subprime crisis too. However, countries such as India, the largest foreign construction market for Malaysia, will have to face serious consequences over the fallout in US due the close interlink between the two economies. Notwithstanding the economic crisis, India cannot default on its investment in infrastructure as this will lead to dire consequence on its already overworked and overutilised and underdeveloped infrastructure, faltering its economy. Pakistan, another construction market for Malaysia is already receiving aids from IMF. Whether the aid will be used for development, and whether development in Pakistan will be opened to international contractors will determine whether it still remains an attractive market to Malaysian contractors. Cash-rich Middle-Eastern countries, although still susceptible to the global economic downturn, still retain potential as an attractive construction market given that they have sufficiently large reserves to weather the economic storm.

Limited choice of domestic project to gain experience and build competitiveness

Malaysian contractors gain a foothold in India by initially constructing highways. That Malaysian contractors were able to perform this undertaking was the result of their experience in constructing world-class highways in Malaysia. Similarly, we were able to construct dam projects because Malaysia has abundant dams constructed by Malaysian contractors. Unfortunately, lately there is a dearth of such large scale projects or projects that require specialized knowledge, such as the construction of a incinerator or a nuclear reactor. Even if there are such projects, like the Penang Second Link, or the Double- Tracking Railway Line, the challenging portions are unfortunately given out to foreign contractors. This is lost opportunity to Malaysian contractors. Every new project provides new opportunity to Malaysian contractors and consultants to gain experience, a major factor when bidding for new projects. Under the previous Prime Minister there were ample opportunities to embark on intellectually challenging projects. From the construction perspective it was a time when we build the world's tallest building, a sophisticated international airport in record time, the North-South Highway that revolutionized our economy, the world's first dual-purpose tunnel, high speed dedicated rail link, complex urban transportation, F1 circuit, a whole new super-standard, environmental friendly and socially-soothing city, the biggest hydroelectric dam with submarine cable and many more. All these projects are source of experience for Malaysian consultants and contractors which gave us advantage when entering foreign markets. These loss opportunities of today will be a handicap for us in future.

Overseas market: lack of strategy to remain competitive.

Malaysian contractors have successfully penetrated around 56 countries around the world. We capitalized on India's hunger for infrastructure and turned it into biggest construction market. Our presence is felt in the Middle-East. We are in

most Asean countries. We have projects in Bosnia-Herzegovina and in many other countries.

We may be good at securing projects. However, few Malaysian contractors have the stamina to maintain their lead. Our ability to secure project may be due to our experience in undertaking similar project at home, or due to our capability in project management, or our financial capacity. But these are easily-emulated competitive advantage. Sooner or later the host nation contractors will be able to emulate our contractors and provide equivalent construction service to their citizens.

In order to maintain our lead it is imperative that we build our competitive advantage on high value-added activities or procedures that are not easily emulated. This would include but not limited to developing sophisticated software for use in project development, employing specially design machineries to enhance productivity and simplify construction process, use of new patented materials and equipment and minimizing dependency on human labour at work sites. To develop competitive advantage like these require investments in R&D. As it stands, not many Malaysian contractors invest in R&D. As such, any gain in advantage secured during entry into market is soon lost to the local construction industry.

Petrol price pegged to global market price

After the roller-coaster fluctuation of the price of petrol we have now almost reached back to square one with the price of petrol almost at the level it was before the global jump in oil price this year. More importantly the Government has successfully eliminated all subsidies on petrol.

Subsidizing petrol has always been a bane among economist as it tends to distort the economy and does not reflect the true value of economic activities.

Providing subsidy across the board also result in missing the real target group that is supposed to benefit from the subsidy. As such, the Government's move to remove subsidy from petrol is a step in the right direction and will, in the long run, benefit the economy and make it more competitive.

However, the impact on the construction industry, particularly the contractors, is still unclear. This is because when petrol was subsidized the price of petrol did not fluctuate widely as there is some slack that can be absorb by the subsidy. With the removal of the subsidy we can expect the price to fluctuate in tandem with global fuel price.

Given the uncertainty in the world today, it is most likely that the price of petrol will also fluctuate with the global risks. Contractors, on the other hand, consider uncertainty a bigger enemy than high prices. This is because a contractor is bound by his bid price. Where there is no fluctuation clause included in the contract, the contractor is expected to bear the cost of any changes in price. In a situation where price is unstable and unpredictable the contractor is put in a difficult position. To price for the risk of fluctuation will lead to higher tender price. Not pricing the risk may result in a tender price too low to be implemented during the construction stage. Worst still, an unstable fuel price may lead to an unpredictable prices for everything else. In such situation, contractors cannot commit themselves to any fixed price over too long a period.

This issue should be resolved by providing an equitable remedy in the condition of contract to those bearing the cost of the project.

Conclusions

The issues faced by the construction industry are many and varied. Realising this, CIDB, in conjunction with industry practitioners and institutions, developed the Construction Industry Master Plan 2006 – 2015. Most of the common issues,

both structural and operational, have been considered, and actions are being undertaken to address and resolve them. However, issues developed over time due to unprecedented and unexpected changes in the world we live in. Issues also develop because our assumption was erroneous or because we lacked understanding of the real situation. In order to keep the Construction Industry Master Plan relevant, it is continuously reviewed and updated. Hopefully, in so doing we are able to reconcile, more accurately, what we perceived to be the needs of our client, stakeholders and country, with what is reality.