

**INVESTIGATING THE INTERNATIONALISATION OF MALAYSIAN
CONSTRUCTION FIRMS USING THE INTEGRATED E3R MODEL**

by

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LIST OF ABBREVIATION

| | |
|---------|---|
| AFAS | ASEAN Framework Agreement on Services |
| AIA | ASEAN Investment Area |
| ASEAN | Association of Southeast Asian Nations |
| CEPT | Common Effective Preferential Tariff |
| CIDB | Construction Industry Development Board |
| ENR | Engineering News Record |
| FDI | Foreign Direct Investment |
| GATS | General Agreements on Trade in Services |
| GDP | Gross Domestic Product |
| MATRADE | Malaysia External Trade Development Corporation |
| MITI | Ministry of International Trade and Industry |
| MNE | Multinational Enterprise |
| NIE | New Industrial Economy |
| PSDC | Professional Services Development Corporation |
| SME | Small and Medium Enterprise |
| UAE | United Arab Emirates |
| WTO | World Trade Organisation |

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**MENKKAJI PENGANTARABANGSAAN KONTRAKTOR MALAYSIA
MENGUNAKAN SATU PENDEKATAN MODEL BERSEPADU E3R**

ABSTRAK

Sebagai penandatanganan WTO, pasaran pembinaan Malaysia menjadi semakin terbuka kepada kontraktor asing. CIDB Malaysia telah melancarkan satu pelan induk untuk menerajui penumbuhan industri pembinaan. Tambahan pula, penyertaan kontraktor Malaysia di pasaran antarabangsa menunjukkan satu kecenderungan yang kian meningkat. Tetapi, kajian pengantarabangsaan kontraktor Malaysia adalah terhad.

Kajian lampau juga hanya meninjau pengantarabangsaan kontraktor menggunakan teori tunggal. Kajian ini memeriksanya dengan Model Bersepadu E3R. Model ini terdiri daripada *Eclectic Paradigm*, *Resource-Based View*, *Diamond Framework*, *Network Approach*, *Stage Growth Theory* dan *International Entrepreneurship Theory*. Usahawan adalah watak utama di dalam model ini. Dia membuat keputusan dengan mempertimbangkan tiga faktor utama, iaitu faktor-faktor sumber, faktor-faktor daerah dan faktor-faktor hubungan.

Kajian ini menggunakan pendekatan gabungan dengan triangulasi data. Borang soal selidik dihantar kepada 74 kontraktor antarabangsa. Borang soal selidik yang dikembalikan ialah 14. Tujuh responden bersetuju untuk ditemuduga.

Kajian ini mendapati bahawa kelebihan dalaman firma adalah lebih penting daripada kelebihan peringkat negara semasa pengantarabangsaan. Kontraktor Malaysia perlu mempertimbangkan satu liputan luas faktor-faktor daerah sebelum memilih lokasi luar negeri. Rangkaian-rangkaian perniagaan antarabangsa adalah lebih penting daripada rangkaian-rangkaian perniagaan tempatan. Jarak rangkaian menang atas jurang minda (*psychic*). Kepentingan pengurus atasan firma telah ditonjolkan di dalam kajian ini. Ciri-ciri subjektif pengurus atasan menang atas ciri-ciri objektif.

Untuk implikasi praktikal, pengamal pembinaan perlu unggul dalam subsektor pembinaan tempatan sebelum pengantarabangsaan. Mereka perlu memastikan terdapatnya peluang perniagaan yang berterusan selepas pergerakan pertama. Menjejakkan operasi pertama di kawasan-kawasan yang kurang diberi tumpuan tetapi masih menguntungkan. Perhatian tambahan diperlukan bukan sahaja membangunkan rangkaian-rangkaian perniagaan yang baru bahkan mengekalkan rangkaian-rangkaian yang sedia ada selepas penamatan projek. Membentuk projek usaha bersama dengan rakan kongsi tempatan di negara asing untuk kewujudan pasaran yang pertama supaya mengurangkan kos perniagaan dan mengurangkan liabiliti.

Selain daripada itu, Kerajaan Malaysia perlu mengumpul maklumbalas terkini daripada pengamal pembinaan untuk meningkatkan dan menguatkan kelebihan peringkat negara. Perdana Menteri Malaysia perlu memainkan satu peranan yang aktif dalam mempromosikan Malaysia sebagai satu jenama melalui mengetuai promosi-promosi dan delegasi-delegasi perdagangan, dan menandatangani perjanjian perdagangan antara kerajaan. Kerajaan Malaysia perlu meringkaskan

prosedur memperolehi pembiayaan kewangan dan bertindak sebagai pejamin projek untuk projek-projek luar negeri. Akhirnya, ia perlu terus membentuk konsortium yang dipimpin oleh kerajaan untuk projek-projek luar negeri.

INVESTIGATING THE INTERNATIONALISATION OF MALAYSIAN CONSTRUCTION FIRMS USING THE INTEGRATED E3R MODEL

ABSTRACT

As a WTO signatory, construction market in Malaysia has become more open to foreign construction firms. Malaysian CIDB has launched a master plan to drive the growth of the construction industry. Furthermore, the trend shows the increasing involvement of Malaysian construction firms in international markets. But limited studies have been conducted.

Previous studies investigated the internationalisation of construction firms by applying a single theory. This study examines it with the integrated E3R Model. This model consists of Eclectic Paradigm, Resource-Based View, Diamond Framework, Network Approach, Stage Growth Theory and International Entrepreneurship Theory. The entrepreneur is the key character in this model. He makes decision by considering resource factors, regional factors and relationship factors.

This study adopted the mixed methods with the triangulation of data. Postal questionnaires were sent to 74 internationalised construction firms. 14 of them returned the questionnaire. Seven respondents agreed to be interviewed.

This study found that firm-specific ownership advantages were more important for the internationalisation compared to country-specific ownership advantages.

Malaysian construction firms will consider a wide range of regional factors before selecting overseas locations. International business networks were more important than local business networks. The network distance prevailed over the psychic distance. The important role of top management for the firm's internationalisation was highlighted. Top management's subjective characteristics prevail over objective characteristics.

For practical implications, construction practitioners should excel in their construction subsectors domestically before internationalisation. They should ensure that there are continuous business opportunities after the initial venture. Rooting the initial operation in less focused but still lucrative areas. More attention should be paid not only to developing new business contacts and networks, but also to maintaining the existing one after the project's completion. Forming joint venture projects with local partners in the host countries for initial market presence reduces business costs and mitigates liabilities.

On the other hand, the Malaysian government should gather timely feedbacks from construction practitioners in order to improve and strengthen country-specific ownership advantages. The Malaysian Prime Minister should play an active role in promoting Malaysia as a brand by leading trade promotions and delegations, and signing government-to-government trade agreements. The Malaysian government should streamline procedures for getting financial funding and act as project guarantor for overseas projects. Finally, it should continue to form government-led consortia for overseas projects.

CHAPTER ONE

INTRODUCTION

1.1 Introduction

This chapter starts with the presentation of industry background for this study. The discussion is continued by outlining the problem that initiates this study. The objectives of this study are next presented, followed by definition of terms. Finally, the significance of this study is presented.

1.2 Industry Background

The construction industry is perhaps one of the oldest internationalised economic sectors with more than hundred years of history (Low & Jiang, 2003). Through the colonial expansion as well as the invention of new technology, European construction firms started their cross-border operations in the nineteenth century. From 1859 until 1869, the Suez Canal that connected the Mediterranean Sea and the Red Sea was constructed by French construction firms. Another international project was the railway connecting Ankara and Baghdad, which was constructed by German construction firms. The majority of international construction projects in the nineteenth century were related to military needs such as the preparation of pre-war infrastructures and the post-war reconstruction. The majority of these projects were related to energy and transportation sectors. During that time, American construction firms also started their international ventures, constructing energy and transportation projects around the world. Japanese construction firms managed to obtain their first

project in Korea at about the same time as well. The project was the construction of a railway line (Strassman & Wells, 1988).

In the middle of the twentieth century, many Asian and African countries claimed their independence from their colonial masters. Generally, these newly independent countries were less developed. Their government initiated a wide range of development projects related to infrastructure, mining, and industrial sectors (Strassman & Wells, 1988). This created many construction needs in these countries. However, local construction firms in these countries were not competent to deliver these projects in term of quality and quantity (Ofori, 2000).

North American and European construction firms spotted the business opportunities arising from the development and reconstruction projects in these newly independent countries. Some European construction firms strengthened their position in these newly independent countries, which were mostly their former colonial states. French construction firms expanded their existing operations in the African region. British construction firms increased their involvement in construction activities in the Middle East and Asian regions, including Malaysia (Seymour, 1987). During that time, the international construction industry was dominated by construction firms from developed countries (Ofori, 2003).

In 1970's, construction firms from developing countries started their ventures into international construction. Korean construction firms made their moves into the Middle East region (Chang, 1988). Brazilian construction firms penetrated into neighbouring countries in South America (Verillo, 1988). Turkish construction firms

managed to secure projects in Libya (Oz, 2001). Although construction firms from developing countries were regarded as latecomers, they managed to take over almost 20% of the market share in international construction by early 1980's (Strassman & Wells, 1988).

The booming oil prices contributed to the rapid economic development of the Middle East region in the 1970's. The rapid economic development increased the need for infrastructural construction in the Middle East region. Saudi Arabia became the world's leading oil producer and exporter at that time. The oil wealth enabled Saudi Arabia to triple the total length of paved highways (United States Department of Commerce, 2001). During that time, construction firms from all over the world moved to the Middle East region. Construction firms from developing countries (i.e. South Korea, India, Pakistan, Eastern Europe, China) posed a challenge to those construction firms from developed countries (i.e. United Kingdom, France, Germany). Among these construction firms from developing countries, the South Koreans were the most successful and well known in the Middle East construction markets (Seymour, 1987).

The increasing urbanisation, with the huge population movement, created many construction needs in these Asian developing countries. According to the World Almanac (1997), Asia contributed to more than 50% of the world population and the majority of them live in developing countries by the 1990's. As a result, the construction market in Asia accounted for around 33% of international earnings by construction firms in 1996. According to the Engineering News Record (ENR, 1997), the total value of construction projects was around US\$42.5 billion. The huge

construction demand in Asian region was not only attracting construction firms from developed countries in Europe and North America, but also construction firms from countries within the region as well (i.e. Japan, South Korea).

Bon and Crosthwaite (2001) found that Asian and North American construction firms have an optimistic view towards the Asian construction market. They believed that the Asian construction market would contribute a big share to the international construction industry. Besides, they also believed that the future growth of Asian construction market was very encouraging. Among Asian construction markets, China, India, Vietnam, Malaysia and Russia were predicted to experience the fastest growth rate. The ENR list is referred to just as an indication of the global construction industry. There are several shortcomings of how the ENR compiled its data (Strassman & Wells, 1988). But because there is no alternative source, it is cited in this section.

Over time, intra-penetration of markets among Asian countries increased dramatically. Singaporean construction firms penetrated into construction markets in China (Cuervo & Low, 2003a; Ling et al., 2005) as well as India (Ling & Hoi, 2006). Since the first international venture of Chinese construction firms in 1979, Asian developing countries were their traditional markets (Cheng, 2010). In the year 2003 alone, Chinese construction firms managed to secure half of their overseas contract value from projects in Asia (Tong, 2003).

Asian construction firms now play a more active role in international construction. The latest statistics from the ENR 2010 indicates that 127 out of the top 225

international construction firms are from Asia. Among Asian countries, China leads the export of construction services. Chinese construction firms are indicated in the list. The statistics from the Ministry of Commerce of China showed that Chinese construction firms have undertaken projects in more than 180 countries. From 1976 until 2007, Chinese construction firms have managed to secure overseas projects with contracts' value around US\$386 billion. In the year 2007 alone, the amount was around US\$85 billion. 90% of these overseas projects were located in developing countries in Asia and Africa region (China Ministry of Commerce, 2008).

Interestingly, in term of numbers, Turkish construction firms overtook their counterparts from Japan and South Korea with more international experience. There were 33 Turkish construction firms while only 13 Japanese and 12 South Korean construction firms in the top 225 international contractors list of the ENR 2010. Construction firms from Asian developing countries (i.e. China and Turkey) have become major players in international construction if compared to developed countries (i.e. Japan and South Korea). Another interesting fact is that construction firms from several Asian developing countries, which were not traditional players in international construction, have also made their appearance in the top 225 international contractors list of the ENR 2010. These Asian developing countries are India, Israel, Lebanon, Malaysia, United Arab Emirates (UAE), Kuwait, Russia and Saudi Arabia.

The international construction market is expected to grow progressively. The total annual world construction spending, valued at US\$3.4 trillion, has grown 5.8% since 1998 (ENR, 2000). The international construction output is expected to achieve

US\$5.8 trillion in 2011 (Hazelton, 2009). This indicates that international construction is a huge market for construction firms from all over the globe.

1.3 Research Problem

The Malaysian Construction Industry development Board (CIDB) has foreseen the increasing importance of international markets for Malaysian construction firms. CIDB has launched a master plan to drive the Malaysian construction industry to contribute 5% of the total Gross Domestic Product by 2015 (CIDB, 2007a). Malaysian construction firms have already completed 208 international projects valued at RM6.4 billion in the past two decades (CIDB, 2009a). The majority of overseas projects of Malaysian construction firms were located in the Asian region. Construction firms from other Asian countries were also involved in construction projects in Malaysia as well.

In 2003, Malaysia contributed to around 1% of the total overseas contract value of Chinese construction firms (Tong, 2003). Conversely, the Chinese construction market accounted for nearly 20% of the overseas contract value of Malaysian construction firms in 2003 (CIDB, 2006a). On the other hand, Malaysian construction firms had completed projects with the total amount of RM7.6 billion in India from 1986 until 2009, while another RM7 billion for ongoing projects (CIDB, 2009a). Since late 1980's, Ircon International Limited is the major Indian construction firm that ventured into Malaysian construction market. This firm has completed railway projects with a total contract value of more than RM3 billion, with another ongoing railway project worth more than RM10 billion (Ircon, n.d.).

The implementation of ASEAN Framework Agreement on Services (AFAS) and the General Agreements on Trade in Services (GATS) as well as globalisation trends in the international construction industry have imposed sufficient momentum to move Malaysian construction firms into international construction markets. As a WTO signatory, Malaysia regards WTO negotiations as a good opportunity for local firms to look for greater market access in both the developed and developing markets (MITI, 2004). However, the Malaysian market, including construction, has become more and more open to foreign construction firms. Consequently, the market has become more saturated as its size is small.

Since 1980's, there were many studies about the internationalisation of construction firms from various countries. Previous studies (i.e. Drewer, 1988; El-Diraby, et al., 2006; Strassmann, 1988) examined the internationalisation by using any one of existing theories. The Eclectic Paradigm was used to examine British construction firms (Seymour, 1987), Singaporean construction firms (Cuervo & Low, 2003a, 2003b, 2005), and Chinese construction firms (Low & Jiang, 2006). Erdilek (2008) examined Turkish construction firms by using the Stage Growth Model. The same theory was applied by Kalotay and Sulstarova (2008) to examine Russian construction firms. Nachum (1998), Oz (2001), and Lu, et al. (2009) utilised the Diamond Framework to investigate the internationalisation of Swedish engineering consulting firms, Turkish construction firms, and Chinese construction firms separately.

In the context of Malaysian construction firms, only a handful of studies have been conducted to examine their internationalisation. Awil and Abdul-Aziz (2002)

examined the involvement of Malaysian construction firms in the international market by using the Stage Growth Model. Isa, et al. (2006) conducted a survey to find out their opinion towards international expansion. Abu Bakar (2008) conducted interviews with ten firms, consisting of construction firms, consultancy firms and government bodies that undertook projects in the Middle East in order to find out the challenges abroad. Hanid, et al. (2008) examined two notable Malaysian construction firms to find out their success factors of overseas ventures as well as problems faced in the host country. Juan (2008) observed the behaviour of the Malaysian construction firms in their international expansion in terms of their entry mode and factors that encourage them to venture abroad.

Therefore, it is necessary to initiate a study to look at the internationalisation of firms from a multi-model perspective as it is indeed a complex one (Fletcher, 2001). Examining the internationalisation by using a single theory is insufficient to reflect entire complexity (Burgel, et al., 2001). The international venture of Malaysian construction firms brings significant impacts to both the firm and home country. However, the internationalisation of Malaysian construction firms have not been paid enough attention by scholars as it has not been documented properly. Therefore, this study adds to body of knowledge by using a multi-model theoretical framework to examine the internationalisation of Malaysian construction firms.

1.4 Research Objectives

The main objective of this study is to examine the internationalisation of Malaysian construction firms by using the integrated E3R Model. There are five objectives of this study as stated below:

- 1) To examine resource factors that enable Malaysian construction firms to venture abroad.
- 2) To examine regional factors of host countries that attracts Malaysian construction firms to venture into host markets.
- 3) To examine relationship factors in assisting the international ventures of Malaysian construction firms.
- 4) To examine the characteristics of firm's top management in determining the international ventures of Malaysian construction firms.
- 5) To test the applicability of the integrated E3R Model in explaining the international ventures of Malaysian construction firms.

In this study, resource factors refer to the ownership advantages. These ownership advantages are the combination of the firm-specific and country-specific ownership advantages under the Eclectic Paradigm, the demand conditions and factor conditions under the Diamond Framework, and the Resource-Based View. Regional factors in this study refer to the locational advantages under the Eclectic Paradigm, and the psychic distance under the Stage Growth Model while relationship factors refer to business contacts and networks derived from theoretical frameworks supported by the Network Approach, and related and supporting industries of

Diamond Framework. On the other hand, top management of the firm in this study draws from the International Entrepreneurship Theory.

The multi-model theoretical framework was developed from the Eclectic Paradigm, the Stage Growth Model, the Network Approach, the Resource-Based View, the Diamond Framework, and the International Entrepreneurship Theory.

1.5 Definition of Terms

This study only focuses on construction firms. In this study, the construction firm is defined as ‘the company that carry out and complete construction works involving the construction, extension, installation, repair, maintenance, renewal, removal, renovation, alteration, dismantling, or demolition of civil and structural works consist of building and infrastructure (i.e. road, harbour works, railway, cableway, canal or aerodrome; drainage, irrigation or river control works; bridge, viaduct, dam, reservoir, earthworks, pipeline, sewer, aqueduct. culvert, drive, shaft, tunnel or reclamation works) and mechanical and electrical works consist of electrical, mechanical, water, gas, petrochemical or telecommunication works’. This definition of construction firm is derived from the definition of construction firm under *Lembaga Pembangunan Industri Pembinaan Malaysia Act 1994 (Act 520)*, which was modified from the definition by the United Nations.

This study aims to investigate Malaysian international construction firms. Seymour (1987) defined an international construction firm as ‘a contracting company that works outside the country in which that company is registered (referred to as the

home country)' (p. 9 – 10). Strassmann and Wells (1988) interpreted the international contracting as 'firms from one country building under contract in another' (p. 2). Therefore, this study focuses on Malaysian construction firms that had involved in construction project in the host country and/or are still having project in the host country, without considering the number of project and the number of host country.

1.6 Significance of Research

According to the latest International Trade Statistics 2009, Malaysia was the fifth top exporter in the international construction services in 2007, positioned behind the European Union, Japan, China, and Russian Federation. The total value of Malaysian construction service export was US\$1378 million. The same statistics also indicated that Malaysia was the 21st top leading exporter in the world trade in 2008, accounting for US\$199.5 billion of the total value. For the world trade in commercial services, Malaysia was the 30th top leading exporters, accounting for US\$29.3 billion of the total value in 2008 (WTO, 2009). This infers that Malaysian economy depended more on exports. The dramatic increment in the international construction output, which is expected to achieve US\$5.8 trillion in 2011, offers another source of business opportunities for construction firms (Hazelton, 2009). Business opportunities in the international markets have attracted many Malaysian construction firms to expand their operations abroad. Yet, the internationalisation of Malaysian construction firms is not well documented.

This study may contribute by investigating the impact of the formation of the ASEAN Framework Agreement on Services (AFAS) and the General Agreements on Trade in Services (GATS) under WTO, which allow Malaysian products and services to enjoy non-discriminatory policies in the markets of other members. Active participation in these regional and multilateral, trading agreements is essential for Malaysia as a trading nation which has a small domestic market (MITI, 2004). This accelerates the speed of the liberalisation of the global economy as well as the internationalisation of Malaysian construction firms.

On a practical note, this study aims to provide an insight for Malaysian construction firms, which have no international experience, to better equip themselves prior to their first move into the international market. Furthermore, this study also aims to provide an insight for Malaysian policy makers to draw out a better road map to assist Malaysian construction firms achieve a successful international venture.

On the theoretical side, this study formulates a multi-model theoretical framework to explain the internationalisation of construction firms. The multi-model theoretical framework is tested to determine its applicability by using Malaysian construction firms as a test base.

CHAPTER TWO
THE INTERNATIONALISATION OF MALAYSIAN CONSTRUCTION
INDUSTRY

2.1 Introduction

This section aims to present an overall scenario regarding the internationalisation of Malaysian construction industry. This chapter starts the discussion with the development of Malaysian construction industry. The discussion covers the growth of gross domestic product (GDP) and the construction industry. Then, the trends of inward and outward Foreign Direct Investment (FDI) are presented. The discussion proceeds to the number of Malaysian construction firms, followed by foreign construction firms in the domestic market. After that, the involvement of Malaysian construction firms in the international markets is discussed. The impacts of the ASEAN Framework Agreement on Services (AFAS) as well as the challenges faced by Malaysian construction firms in the wake of the General Agreements on Trade in Services (GATS) are then discussed. Finally, the role of the Malaysian Construction Industry Development Board (CIDB) is presented.

2.2 The Development of Malaysian Construction Industry, 1981 – 2009

This section discusses the importance of the construction industry in the general economy. Then, the discussion focuses on the relationship between Malaysian construction industry and the national economy.

The construction industry contributes a significant percentage in the gross domestic product (GDP) of a country. Its importance is not limited to the size, but also its role in economic development. The construction industry is regarded as a key driver of the national economic growth. The output of the construction industry form a main part of investment goods as well as fixed capital (Ofori, 1988), especially the construction of infrastructure (Todaro & Smith, 2009).

The construction industry also provides the multiplier effect via its backward and forward connection with other sectors (Bon, et al., 1999; Ofori, 1990). Therefore, the construction industry is utilised by governments (i.e. China, Indonesia) as the centrepiece of economic stimulus during the downturns (Hazelton, 2009). The construction industry is one of the important sectors that contribute to the rapid growth of the Malaysian economy. From the annual economic reports published by Malaysia's Ministry of Finance, the construction industry has contributed on average 3.3% to the annual GDP from 1981 – 2009 inclusively (Malaysia Ministry of Finance, 1981 – 2009). This echoes previous studies (i.e. Chen, 1998; Turin, 1969; Wells, 1986) that the value added by the construction industry as a percentage to GDP of developing countries is around 3 – 5%.

Figure 2.1 showed the pattern of growth in percentage of GDP versus the construction industry from 1981 until 2009. The pattern can be divided into five periods: 1) from 1981 to 1987; 2) from 1988 to 1996; 3) from 1997 to 2003; 4) from 2004 to 2009. For the first period (1981 – 1987), the growth of construction industry started to slow down in 1981 due to the sluggish economic activity in the industrial countries worldwide (Malaysia Ministry of Finance, 1981). Malaysia as an open economy was influenced by this phenomenon. This slower external demand contributed to a decline in GDP. This caused a slowdown in construction activities by the private sector, especially housing development and commercial buildings due to low demand, shortages of building materials and cost escalation (Malaysia Ministry of Finance, 1982).

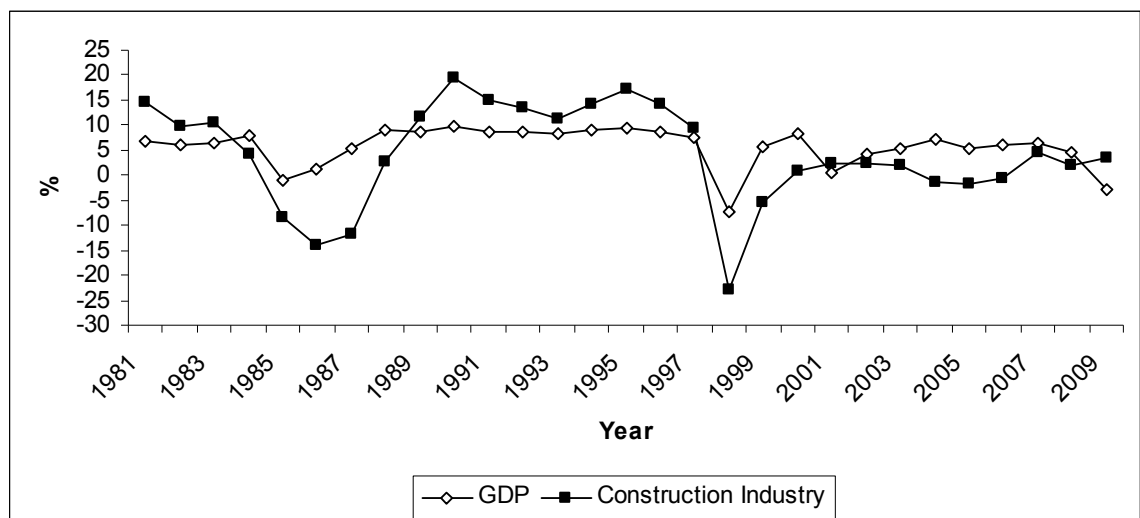


Figure 2.1: The Growth of GDP versus Construction Industry, 1981 -2009
 Source: Malaysia Ministry of Finance, various years

In 1982, Malaysian construction industry experienced slower growth because of the cutting back of public spending by Malaysian government. This delayed the implementation of several infrastructural projects by the public sector. Another reason was the sluggish demand for residential properties. (Malaysia Ministry of

Finance, 1983). Compared to the previous year, the construction industry experienced a marginal increase in 1983 which was contributed by the buoyant construction activities of private non-residential building, such as hotels, office spaces, shopping complexes and factories (Malaysia Ministry of Finance, 1984).

The construction industry faced a decline in 1984 due to the cutback of Malaysian government in public sector infrastructural investment as well as private residential housing started to slacken due to high financial costs and low demand (Malaysia Ministry of Finance, 1985). In 1986, the construction industry experienced a sharp downturn (-14%), following the declining pace in 1985. The severe economic recession in the mid-1980's was the result of several economic problems. These problems included the global recession, tighter international liquidity, the sharp drop in the prices of oil and other major commodities worldwide, the decline in the demand for manufacturing products, and the decline of foreign direct investment (FDI). The Malaysian construction industry experienced further slowdown in residential and commercial buildings as a result of supply exceeding demand (Malaysia Ministry of Finance, 1987). This slowdown continued on into 1987 as public funded projects were reduced due to the cutback in government's expenditure (Malaysia Ministry of Finance, 1988). The financial crisis in the mid-1980's forced Malaysian government to implement greater fiscal discipline and tightened the budget as the Malaysian government had overspent in various extravagances in the 1970's and early 1980's (Jomo & Gomez, 2000).

The second period (1988 – 1996) was kick-started by an economic turnaround in 1988, which recorded a positive growth in the construction industry. This was the

outcome of rapid implementation of several mega-infrastructure projects nationwide by the government to prevent the situation from deteriorating (Malaysia Ministry of Finance, 1989 – 1995). The utilisation of fiscal policy expenditure to increase construction activities was generally used by the government to stimulate the national economy (Donnges, 2009). These mega-infrastructure projects include the construction of phase one of the light rail transit (LRT) in Kuala Lumpur, the Shah Alam Expressway, and the construction of double-track railways between Rawang – Serembam and Kuala Lumpur – Port Klang.

Active construction activities were also triggered by projects related to leisure and hospitality sub-sectors which added new hotels, service apartments, theme parks, retail space and other tourism-related infrastructure facilities, following the promotion of domestic tourism and increasing foreign tourist arrivals. Active construction activities in the residential and commercial sub-sectors also contributed to the booming growth in the construction industry. This booming growth contributed to double-digit growth continuously in the construction industry, from 1989 until 1994. The growth reached the peak with an annual growth of nearly 20% in 1990. This was the highest in the 1981 – 2009 period (Malaysia Ministry of Finance, 1989 – 1995).

According to Malaysia Economic Report (Malaysia Ministry of Finance, 1996), activities in the construction industry remained buoyant in 1995 with a growth of 17% which was the second highest within the period of 1981 to 2009, after six consecutive years (1989 – 1994) of strong growth. The construction industry had spearheaded the national economic growth and contributed to the growth of GDP

with an average of 9% annually in the past seven years. Furthermore, the completion of the North-South Highway in 1994 had improved accessibility to more suburban areas, thus promoting the development of new townships. The growth of the construction industry was further strengthened by investment projects in the manufacturing sector planned by both local and foreign investors in the last two years which had become on-stream, creating greater demand for factory premises and industrial buildings.

The third period (1997 – 2003) started with a slow down in growth when compared to the previous year. This slow down reflected a more cautious sentiment of the Malaysian developers due to increasing supply in the face of the slower demand of high rise buildings especially those related to office and retail space. However, the on-going infrastructural projects managed to keep the growth on the positive side (Malaysia Ministry of Finance, 1998).

In 1998, a deep recession swept over the East Asian emerging economies after the Asian currency crisis in 1997 (Malaysia Ministry of Finance, 1999). The Japanese economy got worse as well. As an open economy, the Malaysian economy, again, was weakened by this financial crisis. The national economic downturn affected the demand and transaction of residential housing which slowed down the construction of existing and new projects. Oversupply of commercial and industrial buildings as well as tourism related facilities caused construction activities in these segments to be sluggish.

Furthermore, the completion of several mega infrastructural projects (i.e. Kuala Lumpur International Airport, Commonwealth Sport Complex) had contributed to a significant slowdown of construction activities as well (Malaysia Ministry of Finance, 1999). The difficulty of getting bridge and end-financing for the construction and purchasing of property made this situation worse. As a result, the growth of GDP was -8%. The situation was even worse in the construction industry which experienced a sharp decline, reaching the lowest point, -23%, in the period of 1981 – 2009.

To prevent the situation from getting worse, the Malaysian government implemented several measures. Capital control measures, such as fixing the exchange rate at RM3.80 per US\$ and reducing interest rates, contributed to the fast recovery of the Malaysian economy (Kaplan & Rodrik, 2001). The strong external trade acted as a recovery engine, assisting the manufacturing industry to achieve 10.4% of growth in the second quarter of 1999. During that time, the drastic fall of the construction industry has been arrested but its expansion has not yet started (Zainal Abidin, 1999). In order to boost up construction activities, the Malaysian government started to privatize several projects and expand government fiscal spending, especially on infrastructural and residential projects (Malaysia Ministry of Finance, 2000). This supported the growth of the construction industry and resulted in a positive growth for four consecutive years, from 2000 to 2003 (Malaysia Ministry of Finance, 2000 – 2003).

During the period of 2004 to 2009, the construction industry faced a soft downturn for three consecutive years, from 2004 to 2006. According to Malaysia Economic

Report (Malaysia Ministry of Finance, 2004 – 2006), this was due to the slowdown of civil engineering sub-sector with the completion of the majority of infrastructural projects and a smaller number of new contracts awarded by Malaysian government. The supply of residential housing and commercial buildings was more than the demand, together with the increasing prices of materials and transportation. It weakened construction activities in these sub-sectors.

After three consecutive years (2004 – 2006) of negative growth, the construction industry, finally, managed to post a positive growth of nearly 5% in 2007, mainly due to increase civil engineering activities. This expansion was also supported by the increase in construction activities related to commercial buildings due to the good performance of the national economy (Malaysia Ministry of Finance, 2008). Although the national economy was affected by the financial turmoil precipitated by the United States (US) sub-prime mortgage crisis and mounting inflation worldwide, triggered by high commodity prices, the construction industry suffered only a marginal decline in 2008. The construction industry still posted a positive growth because of the higher civil engineering works, special trade works and residential activities (Malaysia Ministry of Finance, 2009a).

As said by Ministry of Finance (2009b), the Malaysian GDP experienced a negative growth in 2009, continuing to be affected by decline in exports due to the global financial crisis in the previous year. However, the construction industry still managed to achieve a marginal growth when compared to the previous year. This was due to two economic stimulus packages introduced by the Malaysian government. The first economic stimulus package of RM7 billion was announced at

the end of 2008 and commenced in the first quarter of 2009. RM4.1 billion, accounted for more than half of the allocation of the first economic stimulus package, was channelled into construction-related activities. This package increased construction activities especially civil engineering works involving new infrastructural project and upgrading works as well as the construction of low and medium costs houses. The second economic stimulus package of RM60 billion was allocated for 2009 and 2010. Around RM3.7 billion was allocated to construction-related activities such as the upgrading of infrastructure, improving educational facilities, and providing basic amenities to rural areas. Through the two economic stimulus packages, the Malaysian government hoped to exploit the important role of the construction industry as a multiplier in mitigating the current economic downturn.

The boom and bust growth of the construction industry was linked closely to the ups and downs of Malaysian national economic wave pattern (see Figure 2.1). The short-term national economic growth is influenced by the construction industry. Yet, the national economy has a long-term effect on the construction industry (Zheng & Liu, 2004). The construction industry boomed when the economic growth strengthened however it plunged when our economy weakened. The construction industry grew at a faster rate than the national economy during rapid economic growth. However, the construction industry experienced greater declines and remains in recession longer than the national economy as a whole during the economic downturn.

For the past three decades, the development of the construction industry at home had a significant impact on Malaysian construction firms. The rapid economic

development created many chances for Malaysian construction firms to get involved in various types of construction works. These construction works consisted of building construction (i.e. residential and commercial buildings), infrastructural construction (i.e. highways, railways) and oil and gas related construction. Over time, Malaysian construction firms developed their knowledge and skill via learning by doing. They also gathered sufficient experience in the related fields. As a result, Malaysian construction firms have become more confident in performing their tasks.

Other than that, the boom and bust growth of the construction industry for the past three decades provided Malaysian construction firms with a chance to undergo both the best and the worst scenarios. During the booming periods, Malaysian construction firms learnt how to handle many on-going projects simultaneously. They have to ensure that the projects were completed on time and with good quality. Conversely, Malaysian construction firms need to have a good financial plan to assist them to weather the challenges during the bust periods. Conclusively, Malaysian construction firms managed to develop their firm-specific ownership advantages after undergoing the ups and downs in the construction industry.

2.3 The Trend of Malaysia Inward and Outward FDI, 1981 – 2009

According to United Nations Conference on Trade and Development (UNCTAD), FDI refers to ‘an investment made to acquire lasting interest in enterprises operating outside of the economy of the investor’. Purposes of FDI could be to search new markets for future’s growth, to diversify risks, and to look for cheaper resources (Ahmad & Kitchen, 2008). As one of the most open economies in the world, the

development of the Malaysian economy has been closely incorporated with the global economical and financial system. Several studies (i.e. Alfaro, et al, 2004; Domarchi & Nkengapa, 2007) have indicated that there is a positive relationship between inward and outward FDI and the economic growth of a country. Malaysia also experiences, not only significant trade expansion, but also a lot of investment flows, both inward and outward FDI. This has a significant impact on the economic growth in Malaysia as well as the transformation of the economy, especially the emerging of new industries, the increasing of production capacity, employment, trade, and technology capacity (Bank Negara Malaysia, 2009).

This section discusses the trend of inward FDI, followed by the trend of outward FDI in Malaysia. Figure 2.2 shows the trend of Malaysia inward and outward FDI from 1981 to 2009. The trend of Malaysia inward FDI from 1981 to 2009 can be divided into three main waves: 1) 1981 – 1985; 2) 1986 – 1997; 3) 1998– 2009. The first wave of FDI (1981 – 1985) was less than RM5 billion on the average each year (Malaysia Ministry of Finance, 1981 – 1985). Although the amount was small, it accounted for 12% of the annual GDP of Malaysia during that period. During the first wave, the majority of foreign investors participated in import-substitution industries as well as manufacturing industries involving consumer and intermediate goods (i.e. electrical household appliances, electronic components). This wave of inward FDI contributed to the transformation of economy from primarily an agricultural industry to a manufacturing industry. The economic development of Malaysia had benefited from the consistent flow of inward FDI during the 1981 – 1985 period.

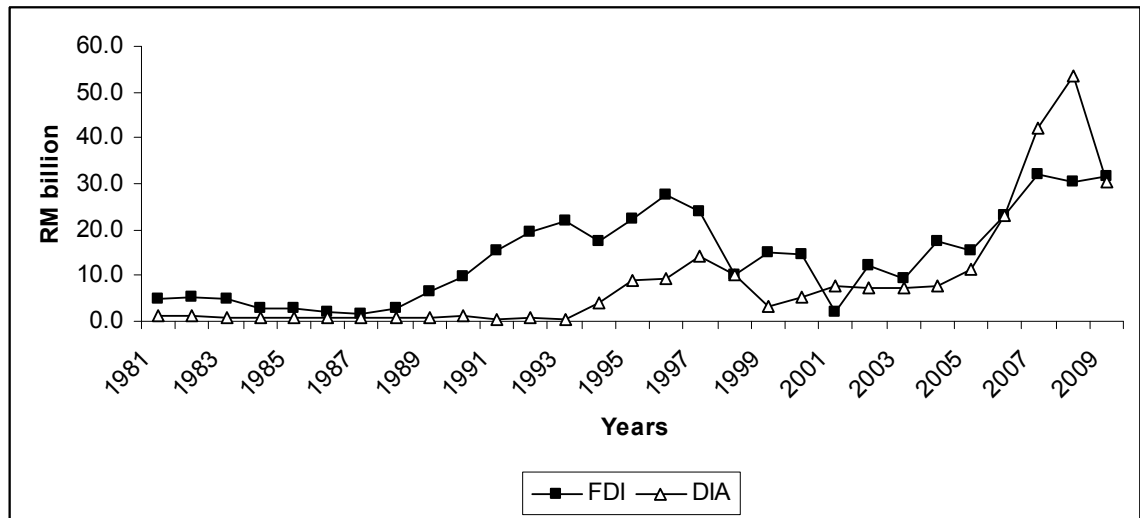


Figure 2.2: The Malaysia Inward and Outward FDI, 1981 - 2009
Source: Bank Negara Malaysia, various years

As the Malaysian government had foreseen the positive impact of inward FDI towards the national economic growth, the industrialisation process was initiated to create an encouraging investment environment for international investors. As a result, the liberalisation of foreign equity ownership was enforced in 1986, followed by the introduction of the Promotion of Investment Acts in the same year (Bank Negara Malaysia, 1986 – 1992). This started the second wave (1986 – 1997) which enabled Malaysia to enjoy seven consecutive years, from 1986 to 1992, of positive growth in FDI inflows.

The Promotion of Investment Acts offers a wide range of fiscal incentives to attract international investors to channel their capital into Malaysia. The appreciation of Japanese Yen as well as the currencies of New Industrial Economies (NIEs), together with the shortage of manpower and the high production cost, had boosted the inward FDI of Malaysia (Bank Negara Malaysia, 1986 – 1992).

Investors from NIEs (i.e. Hong Kong, Singapore, South Korea, Taiwan) reallocated their production to developing countries, including Malaysia, due to the decline of their comparative advantages in manufacturing locally (Aminian, et al., 2007). The manufacturing industry of Malaysia received the highest FDI compared to others. Foreign investors had channelled their capital into various sectors such as electronics and electrical, chemicals, and food manufacturing. As a result, the inward FDI of Malaysia achieved its peak in 1992 – 1993 with the total amount around RM22 billion. The inward FDI accounted for 8.7% of the Malaysia GDP (Bank Negara Malaysia, 1992 – 1993).

The second wave of inward FDI, created many construction needs especially the construction of factories, this has contributed to the growth of the Malaysian construction industry (Bank Negara Malaysia, 1994 – 1997). It was believed that the combination of inward FDI and the local stimulus packages contributed to nearly 20% of the annual growth of the construction industry in 1990 (see Section 2.2). Other than obtaining many job opportunities and construction experiences, Malaysian construction firms have the opportunity to work with foreign multinationals. The established relationships between foreign multinationals and Malaysian construction firms have a significant impact on the internationalisation of Malaysian construction firms.

As said by Bank Negara Malaysia (1994 – 1997), the second wave of inward FDI was moderate, thereafter, but still achieved a high level, of around 6.6% of GDP in the period 1994 – 97. The majority of foreign investors channelled their capital into the manufacturing industry, which accounted for around 65% of the total inward