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Malaysia must get its innovation strategy right

Go for a few deep Vs, the technology sectors where we can make global impact

R B Bhattacharjee

KUALA LUMPUR: The Malaysian economy cannot be an "aircraft carrier economy" like China or India, and it should reposition itself as a niche intellectual capital service economy, or a kind of "luxury speedboat economy" — small, deeper but of high value.

A prime example of the new asset class that the country can develop is Islamic finance, said Zaid Hamzah, a consultant for the national intellectual property development policy.

"The biggest challenge the country faces in the coming decade is value creation," Zaid told a brown bag lecture entitled "Repositioning the Malaysian Economy as the Niche Intellectual Capital Service Economy" organised by the Malaysian Institute of Economic Research last Wednesday. "The innovation-driven economy must be built by sequencing the development of strategic skills sets, value engineering and commercialisation of intellectual capital."

Zaid calls his commercialisation strategy the short Ts, deep Vs model: "Short Ts are innovations that Malaysia can make that do not have world renown or global impact. The deep Vs are the few technology sectors where Malaysia can have a global impact. The challenge is for Malaysia to come up with many Ts and a few Vs. You cannot fight on all fronts. The innovation space is so complex and wide, it would not be sustainable."

"Leveraging on Islamic finance as a type of intellectual capital can fundamentally change how value is created at the economic level," Zaid, who has written six books on law, technology and innovation, said.

Considering Malaysia's ambition of moving towards a new knowledge-based, innovation-driven economy, and that for the last three decades, it has wanted to be a global hub for Islamic finance, the country needs to sharpen its understanding of the field.

"Right now, the main hub for Islamic finance, other than Bahrain in the Middle East, is in London," said Zaid. "The UK government has been pushing Islamic finance as the new value driver. The competition will go on. Religious belief makes no difference, because the proponents, book runners and advocates of Islamic finance on a global basis are not Muslims.

"Investment money goes in where investors think the yield is higher. If Islamic finance is more entrepreneurial, risk-taking, gives a higher yield, has all the safeguards such as being speculation-free, with all the basic features of Islamic finance, then it makes a good investment case."

Given that Islamic finance is one of Malaysia's competitive advantages, it makes sense for the country to focus on this and create innovative instruments, he said. For example, Malaysia should marry Islamic risk capital with the innovation drive. Although private sector investment in the innovation drive has increased in the last five to seven years, it is still led by government.

Zaid noted that Malaysia has invested much resources in hard infrastructure development in the past few decades. It now must focus on creating the soft economic infrastructure to support the innovation economy. This involves developing expertise at three levels — strategic, operational and technical. Technical issues include intellectual assets as a class to create, for example, musharakah-based financing to service deals based on joint enterprises with profit-loss sharing.

However, although the Malaysian government has spent billions on developing intellectual capital in the last decade, the yield has not been up to expectations, by the admission of the ministry of science, technology and innovation, Zaid said.

But budgets mean little in an innovation-led economy. Under the 10th Malaysia Plan (10MP), the budget for innovation investment, through a Mudarabah Innovation

Fund is just under RM1 billion over the next five years. In comparison, Microsoft, of which Zaid is a former director of intellectual property, spends US\$10 billion (RM31.3 bil-

lion) per year, while GE and others spend much more.

"But should Malaysia be worried?" asks Zaid. "Many studies have shown that there is no correlation between the size of innovation investments and the yield.

"It's the yield that's important," he asserted.

In view of this, Malaysia should focus on several niche areas where it can extract the highest value with the least amount of resources, within the shortest possible time.

The World Bank, in a study commissioned by Malaysia, has suggested that it should specialise its economy, and to do this, it has to deepen its specialisation, said Zaid.

Illustrating the issue, Zaid said Malaysian lawyers are underpaid internationally because the legal services market here has not grown as dynamically as it could. Allowing competition would change that, he said, noting that Bank Negara has allowed five international law firms to provide Islamic finance services.

To make the economy more specialised and sophisticated, Malaysia has to go for higher value, said Zaid. Outlining the task ahead, he said the elements of an intellectual capital service economy are service, intellectual capital, investment in innovation, and return on innovation investment (ROI2).

Ironically, although Malaysia has been focusing on Islamic finance for over 30 years, international Islamic finance services are provided worldwide more by English and American law firms than Malaysian law firms, Zaid said. For example, Allen and Overy, a top UK law firm with an office in Singapore, has an annual turnover of £1 billion (RM4.81 billion).

"Lawyers provide valuable services, and clients expect those who charge higher prices to provide superior services," said Zaid.

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In the last sukuk deal put together by Khazanah worth RM3.6 billion and issued in Singapore dollars in Singapore, the governing law was English law. "For now, it cannot be Malaysian law, because the confidence level is not high enough," said Zaid, noting however that Bank Negara has declared the intention of making Malaysian law the governing law of choice.

Another irony is that "despite Malaysia's focus on Islamic finance over the last two decades, the people teaching this subject are in London, New York and more recently, in Hong Kong and Singapore, not Malaysian lawyers," said Zaid.

"American and English law firms are teaching sophisticated Islamic finance structuring," he said.

The reason they command a premium for their services is that their

client base determines what law they want to govern their investment.

According to Zaid, a senior banker who helped set up an Islamic bank in Malaysia said Middle Eastern investors who came to Malaysia asked whether the environment is right to invest millions of US dollars into the economy. "The safeguards for investments here are still not at the level of say, a REIT fund in the UK," said Zaid.

Ironically, the intellectual capital that is being created in the country today is not being appropriately valued.

"Intellectual capital is being created by the 14 or so research institutes in the country. Some of them are world class, but not very familiar to many Malaysians. The Forest Research Institute of Malaysia R&D unit, for example, is one of the best in the world," Zaid said.

The challenge at the policy level is to find the points of value calibration, said Zaid. This means finding the single factor that can maximise or accelerate economic yield.

At least seven of about 10 niche economic areas — including high value manufacturing, medical tourism, Islamic finance, biotechnology, green technology and ICT — have been activated, he said.

Only a few accelerating factors remain to be tapped, and the challenges are at the micro-economic rather than macro-economic level, said Zaid.

"What matters is how you leverage on existing small asset class to reap higher returns," he said. "If Malaysia has world-class patents on palm oil, rubber research, marine technology, etc, it's about tapping their yield."