

## SECTION 3.0 – CHALLENGES FACING THE MALAYSIAN CONSTRUCTION INDUSTRY

### 3.1. Introduction

In order to continue leveraging on domestic opportunities and competing in the global marketplace, Malaysian construction industry players need to address a number of key strategic and operational challenges. There is a need to take a holistic approach in reviewing the factors impacting the construction industry value chain. Improvements need to be implemented by all parties along the entire construction industry value chain for lasting transformation to occur. Therefore, in addition to contractors, clients, approving authorities, consultants, and other stakeholders must be involved in this transformation.

Enhancement in productivity and quality is vital to build a sustainable local construction industry that is poised to compete with global players. To continuously enhance the level of productivity and quality, the Malaysian construction industry will need to address the following key areas of concerns:

- Inefficient and ineffective methods and practices in contractor's registration and administration procedures, procurement methods and practices, contracting approaches, construction methods, planning submission and building plan approval procedures.
- Inability to attract and develop local workforce for the industry mainly due to the "Dirty, Dangerous, Difficult" image of the industry.
- Difficulty in securing timely and adequate financing at the various stages of construction, and difficulty in repatriating profits/dividends.
- Inability to provide total integrated solutions in foreign projects, unlike Japanese, Korean and German construction companies which could provide total solutions that include financing package and equipment.

### 3.2. Productivity and quality enhancement

While the productivity of the construction industry at present may be sufficient to meet domestic market or regional market needs, it has to improve to compete effectively with global players and increase the benefits to the local market. The ability to enhance efficiency and effectiveness across the industry value chain would also have implications beyond simple GDP contribution. It would enable the various sectors of the economy to

deliver economic and social benefits to the public in a more efficient and effective manner.

Besides productivity, the construction industry in Malaysia should focus on continuously improving quality, one of the key global market differentiators. Although cost is still an important consideration, there is an increasing consumer demand in the global environment for higher quality construction. A study conducted by Standards and Industrial Research Institute of Malaysia (SIRIM) for Department of Standards Malaysia (DSM) in 2002 cited that Malaysia is still catching up to international levels of development in the areas of standards for building and construction materials, and building and civil engineering<sup>1</sup>.

### *3.2.1. ISO9001 certification*

Standard measures of quality are hard to come by for the industry and much of the information is anecdotal. The data that is available however, suggested that more could be done to instil a broad acceptance of quality. One example of this is the number of ISO 9001 certified construction companies in the country.

The percentage of contractors obtaining **ISO 9001 certification** has almost tripled from 2002 to 2004 (from 58 out of 49,438 to 145 out of 62,278). However, this group of companies still represents a minority in the industry (0.12% in 2002 and 0.23% in 2004<sup>2</sup>). While ISO 9001 certification addresses only quality in processes, it does indicate the current level of consideration of quality in the mindset of the Malaysian construction industry.

Various Government entities such as CIDB and the Ministry of Housing and Local Government have been increasing efforts to infuse the value of quality into the industry. CIDB, for example, has launched an ISO 9000 Do-It-Yourself scheme which provides support for contractors pursuing International Organisation for Standardisation (ISO) certification (by providing courses, guidelines, audit and advisory services before third party certification audit).

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<sup>1</sup> Source: "Outcome of the Study on Standardisation Needs for Malaysia", DSM, 2003.

<sup>2</sup> Source: CIDB.

### 3.2.2. *Malaysian Standards (MS)*

The data on quality in products also reinforces the impression that there is further room for improvement. In the area of standards, only a very limited number of the more than 3,000 MS are directly referenced in regulations. As of 31 December 2004, only 25 MS are directly referenced in regulations<sup>3</sup>, while many of the foreign standards quoted in regulations have been revised or withdrawn. In some areas, standards remain to be developed, such as those for lifts, escalators and cranes<sup>4</sup>.

Standards exist for building materials (their use and quality requirements) in more than 200 MS applicable to construction and civil engineering developed by DSM. However, adherence to these standards is voluntary, and of those that are mandated in regulations, many of the standards are revised or withdrawn<sup>5</sup> (regulations are thus in need of updating).

### 3.2.3. *Quality mindset*

Clients and customers need to be **educated** more on the importance of quality in construction and life cycle costing in assessing projects (e.g. energy saving, materials used, etc.), so that they can drive quality improvements through their demand. Presently, the focus of the construction industry is in providing the best possible (lowest) cost, which relegates quality concerns to a secondary factor. Two practices that cause this focus on low cost are budget constraints imposed by clients, and the use of many levels of subcontracting. Clients and consumers of the construction industry place an emphasis on costs, often at the expense of quality. Moreover, industry representatives have noted that clients do not award projects to contractors based on their technical capabilities.

A **shift in mindset** towards the longer term benefits of higher quality, such as lower operating and maintenance costs, higher resale value, and improved safety and environmental profiles, needs to be initiated. The concepts of value management and life cycle costing need to become more prevalent in procurement discussion and decisions, to consider costs over the entire life cycle of a construction project, as opposed to costs at the initial stage only. While life cycle costing will ensure that

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<sup>3</sup> Source: "Outcome of the Study on Standardisation Needs for Malaysia", DSM, 2003.

<sup>4</sup> Note: According to the Ministry of International Trade and Industry, however, it was recently agreed to establish a technical committee on cranes while the technical committee on lifts and escalators is in the process of finalising draft MS for lifts and escalators.

<sup>5</sup> Source: "Outcome of the Study on Standardisation Needs for Malaysia", DSM, 2003.

operating, maintenance, and disposal costs are also considered up-front, application of value management will optimise cost for specified quality levels.

One means of educating the construction community on the importance of quality would be through information sharing on advancements in construction quality.

### 3.3. Inefficient and ineffective methods and practices

#### 3.3.1. Contractor's registration scheme

At present, there are **two major registration centres** for contractors – **CIDB** and **Pusat Khidmat Kontraktor (PKK)**. Contractors registered with CIDB fall within seven grades (G1 to G7) and are graded based on three main criteria: tendering capacity, financial capacity and availability of human resources. Contractors who wish to tender for public sector projects are required by the Ministry of Finance and Public Works Department (PWD) to register with PKK, which is under the Ministry of Entrepreneur and Cooperative Development.

Contractors registered with PKK require a minimum paid up capital of RM1,001, and 100% Bumiputera equity (refer to Table 3.1). Having two registration centres and differing requirements have resulted in unnecessary duplication of human and financial resources. Thus, harmonisation and standardisation of the two registration schemes will be deemed necessary.

**Table 3.1: Comparison between CIDB and PKK's Contractor's Registration Scheme**

Registration Requisites	CIDB	PKK
Financial capacity	Minimum paid up capital is RM 5,000	Minimum paid up capital is RM 1,001 (for electrical contractors) and RM 5,001 (for general contractors)
Bumiputera equity	Not required	100%
Foreign equity	ASEAN countries – not more than 41% Non-ASEAN countries – not more than 30%	-
Track record and performance	Required	Required
Personnel resources	Required	Required
Company status	Registration required with Registrar of Businesses or Companies	Registration required with Registrar of Businesses or Companies or Cooperative Development Department or Farmers' Organisation Authority

Source: CIDB, PKK, Ernst & Young analysis

In addition to having two registration centres, **low barriers to entry** into the industry have swollen the ranks of contractors with many small scale companies (G1 especially). Currently, there are approximately 63,000.00 contractors registered with CIDB<sup>6</sup>, out of which approximately 57% are G1<sup>7</sup> (refer to Table 3.2).

**Table 3.2: Number of Contractors by Grade, 2001 – Jun 2007**

Grade	2001	2002	2003	2004	2005	2006	Jun 2007
G1	21,104	27,085	35,230	39,847	41,340	36,141	35,709
G2	5,841	6,535	7,687	7,916	8,022	6,937	7,119
G3	7,394	8,673	9,784	10,434	10,930	10,043	10,294
G4	1,619	1,808	1,931	2,105	2,197	2,140	2,215
G5	2,115	2,485	2,802	3,039	3,116	2,816	2,887
G6	850	957	1,024	1,132	1,156	1,003	1,043
G7	3,242	3,536	3,486	3,713	3,730	3,736	3,937
<b>Foreign</b>	99	130	135	149	159	48	N/A
<b>Total</b>	<b>42,264</b>	<b>51,209</b>	<b>62,079</b>	<b>68,335</b>	<b>70,650</b>	<b>62,864</b>	<b>63,204</b>

Source: CIDB Construction Quarterly Statistical Bulletin Second Quarter 2007

Generally, the lower ranking contractors, mainly G1, are very much driven by cost and have invested little to build up their specialisation in niche areas. They mainly work as sub-contractors to the larger contractors. In the recent years, with the completion of 'mega-projects' and subsequent economic prudence, local projects were insufficient to sustain the 70,000 odd contractors. Thus, many of the lower ranking contractors have left the industry. CIDB is in the midst of reviewing all its registered contractors and delisting/deactivating those which have not been active for the past three years.

Further, there are plans to tighten the registration requirements for contractors with the objective of raising the standard and professionalism of contractors in the country. This includes plans to introduce accreditation for those who participate in overseas projects. Currently, there are **no restrictions** on who may seek to participate in overseas construction jobs. Should the projects fail, it may create a poor perception of the abilities of the Malaysian construction industry.

<sup>6</sup> Note: Not all registered contractors are active contractors. CIDB is currently in the process of updating its list of registered contractors to determine whether they are active or inactive.

<sup>7</sup> Lowest ranking contractors that can only bid for contracts with a value less than RM100,000.

### *3.3.2. Procure-to-pay (P2P) practices*

Traditionally, public and private sector clients appointed contractors both at the design and construction stage through competitive tender. Selection of the designer and the main contractor has been primarily based on the lowest tender price. This practice has also extended throughout the supply chain with the main contractor competitively outsourcing elements of the job to subcontractors and material suppliers. As a result, some firms have priced work unrealistically low and then sought to recoup their profit margins through contract cost variations arising from, for example design changes, and other claims leading to disputes and litigation.

Although the current public procurement system adopts a holistic framework, it nevertheless **lacks the supervisory and monitoring mechanism** to ensure that projects are progressing smoothly as well as to ensure quality control prevails throughout the construction phase. This is mainly due to lack of manpower in the enforcement unit.

Besides, the existing procurement system **does not provide feedback** to contractors on their performance when bidding for projects. Presently, the bidding exercise does not include **reasons for non-selection**, ranking of contractors, owner's estimation and other relevant information that can help contractors improve their bidding exercise in future projects.

A **fair, open and transparent procurement process** would spur competition among the contractors to offer value-for-money solutions to customers and clients. This in addition to other measures would sift out non-value added contractors and/or subcontractors.

### *3.3.3. Contracting approach*

Quality in the construction industry will have to encompass more than contractors alone. Architects and engineers will have to be involved as well, for of the three contributing factors to quality failures (material faults, construction faults and design faults), 50% of the failures can be attributed to design faults, while 40% are due to construction faults, and only 10% because of material faults<sup>8</sup>.

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<sup>8</sup> Source: CIDB Working Group on Productivity and Quality.

More **partnering** and **communications** in this regard would reduce the inefficiencies that cause additional costs and delays in delivery arising from design changes and rework. Though partnering is not new in Malaysia, pursuing greater levels of integration in the industry will help address the challenges brought about by fragmentation. The Constructing Excellence Report illustrates the different types of partnering, from the traditional construction procurement method to strategic partnering alliances (refer to Figure 3.1). The type of partnering approach chosen will depend on the nature of the project and preference of the clients.

**Figure 3.1: Types of Partnering**

Types of Partnering	Characteristics
Traditional Construction Procurement	<ul style="list-style-type: none"> <li>▪ The traditional construction procurement process involves <b>clear separation</b> between parties in the initial phases of a project.</li> <li>▪ A client will select a designer to draw project plans, which in turn will be passed to individual consultants, contractors, suppliers, and sub-contractors in order to obtain cost bids. The parties with the <b>lowest bids</b> are typically selected to proceed with construction.</li> <li>▪ Communication at these early stages tends to be <b>one-way</b> (from client to designer to contractors), which results in <b>adversarial relationships</b> between clients and contractors, <b>increased costs and delays</b> (through rework and late stage design changes), and a compromise in the level of <b>quality</b> in the pursuit of low cost.</li> </ul>
Design and Build	<ul style="list-style-type: none"> <li>▪ This approach involves <b>collaboration</b> between the consultants, cost consultants and contractors at the design stage.</li> <li>▪ One principal contractor will usually manage the design and cost consultants on behalf of the client.</li> <li>▪ This method enables the contractors to contribute their expertise and comment on the practicality of the design team's design. Thus, reducing the need to do rework at later stage.</li> </ul>
Project Partnering	<ul style="list-style-type: none"> <li>▪ Project partnering is an extension of "design and build", where <b>two or more members</b> of the project team come together on a <b>single project</b> at the design stage, including the client, contractor, sub-contractors and consultants.</li> <li>▪ <b>Partnering agreements</b> are signed, where each partner will agree to share the risks as well as the benefits of costs savings.</li> <li>▪ The combination of <b>expertise</b> and <b>commitment</b> will eventually lead to a more successful project.</li> </ul>
Strategic Partnering Alliances	<ul style="list-style-type: none"> <li>▪ Strategic partnering is a <b>long term collaborative</b> venture between the same partnering teams, usually over several projects and for a specified period of time.</li> <li>▪ It draws on the experience of several projects to engender <b>continuous improvement</b> amongst the partners, through investment in human resources and technology.</li> <li>▪ <b>Further cost savings</b> can be derived through the additional investment from value management over a longer period.</li> <li>▪ This approach may also involve the client using the contractors to service and <b>maintain or operate the project after construction</b>.</li> </ul>

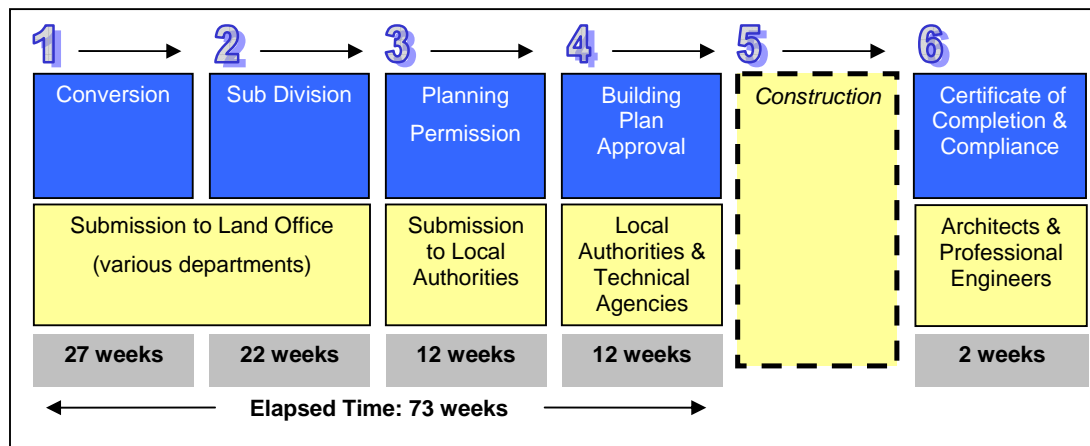
Source: "Demonstrating Excellence", *Constructing Excellence 2004*, Ernst & Young analysis

Implementing alternative methods of construction procurement will require increased attention to **project management**. The prominent project failures were attributed to poor project management which compromised the **quality assurance process** through poor conditions of contract or unsuitable project organisation.

### 3.3.4. Planning submission and building plan approval process

The construction players are currently dealing with 144 Local Authorities and Technical Agencies involved in the planning submission and building plan approval process, resulting in the delay in the submission and approval process. Industry sources pointed out that it takes over 18 months to obtain approval for the building plan as shown in the diagram below. This issue predominantly affects building rather than infrastructure projects, although the latter also faces similar delays with Local Authorities and Technical Agencies.

**Figure 3.2: Planning Submission and Building Plan Approval Process**



Source: Ministry of Housing and Local Government.

Further standardisation and integration of administrative practices through the Ministry of Housing and Local Government's One-Stop Centre (OSC) is currently underway to address this problem.

### 3.3.5. Construction methods

The overall focus on costs has an impact on adoption of technology in the construction industry as well. Cost and budget constraints along with availability of cheap foreign labour have encouraged the construction industry to favour **labour-intensive construction methods** over the use of more expensive technology. This in turn makes

it more difficult for the industry to increase its levels of productivity and quality in the long run.

The use of IBS<sup>9</sup> is still not widespread in the industry. Over the period from 1998 to 2002, less than one-third of completed projects utilised some form of IBS<sup>10</sup>. The two main reasons for the low adoption of IBS in Malaysia are:

- **Lack of integration at the design stage:** IBS component manufacturers are currently involved only **after the design stage**. This lack of integration among relevant players at the design stage has resulted in the need for plan redesign and additional costs to be incurred if IBS is adopted.
- **Poor knowledge of IBS:** According to CIDB's IBS Survey 2003, **clients** and **approving authorities** have poor knowledge of IBS compared to architects and engineers. Familiarity with the IBS concept and its benefits is vital to its success because IBS requires a different approach to construction.

However, there is a definite upward trend in IBS usage over the past few years, which if continued, would help to ease the pressures of labour requirements and boost quality and productivity. In particular, the proposed enforcement of using Modular Coordination (MC) through the Uniform Building By-Laws (UBBL) would encourage **standardisation** and increase the use of IBS components. CIDB has also recently introduced a promotional scheme whereby contractors who utilise IBS in more than 50% of a project are eligible to apply for a levy waiver. However, the waiver of the 0.125% levy is still insufficient to incentivise the use of IBS as the estimated average cost increase in adopting IBS is 10%.

Although **standardisation** would improve the quality of materials and productivity through simplified design and construction, **demand for standardisation** is not present. With IBS usage growing, the MC aspects of IBS will create more demand for standardised dimensions, characteristics and quality in the manufacture of building components. Ratification of the IBS Roadmap 2003 - 2010 by the Cabinet has provided further support in this direction.

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<sup>9</sup> Source: "IBS Roadmap 2003 – 2010", CIDB. IBS is defined as "a construction process that utilises techniques, products, components, or building systems which involve prefabricated components and on-site installation".

<sup>10</sup> Source: "IBS Survey 2003", CIDB.

### 3.3.6. Lack of R&D

In the area of construction R&D, industry participants commented that most companies do not conduct their own R&D but would rather purchase the technology they require. Most construction related R&D activities in the country are performed in academic institutions, but the areas covered usually do not meet the industry needs. The construction industry players have proposed to **develop closer working ties** with academia to link research in labs to shortcomings or opportunities in current practices.

Industry players have also provided feedback that the focus of technology development should be on systems (how to manage the construction process) and on the use of information technology (IT) in construction. The industry can leverage on CIDB's **Construction Industry Research Institute of Malaysia (CREAM)** to undertake research on specific core themes within the construction industry.

## 3.4. Inability to attract and develop local workforce to the industry

The construction sector employs approximately 9% (or 900,000) of the total workforce in Malaysia (refer to Table 3.3). However, there is still heavy dependence on foreign labour especially from Indonesia and the Association of Southeast Asian Nations (ASEAN) region. According to official statistics, around 250,000 of approximately 800,000 construction personnel are foreigners<sup>11</sup>.

**Table 3.3: Employment by Sectors, 2001 - 2005**

Year	Construction	Total Workforce in Malaysia	Construction as % of Total Workforce
2001	846,000	9,535,000	8.9%
2002	905,100	9,542,600	9.5%
2003	942,500	9,869,700	9.5%
2004	890,800	9,979,500	8.9%
2005	904,400	10,045,400	9.0%

Source: Department of Statistic Malaysia ; Yearbook of Statistic 2006

The reliance on unskilled foreign workers in the construction phase of the value chain is related to the earlier issues of cost constraint, and low adoption of technology. Foreign workers are usually **unskilled** when they first arrive in Malaysia. This has impacted the productivity and quality of the construction industry. However, efforts have been put in place to train and accredit them as semi-skilled or skilled workers.

<sup>11</sup> Source: CIDB's record was 250,813 foreign workers as at 30 June 2005.

The construction industry's use of unskilled foreign labour has several effects on productivity. The first of these is the low incentive to adopt more productive and modern methods of construction (i.e. greater use of technology). Unskilled foreign labour is cheaper to employ in the short term than skilled local labour, even if productivity per person is low. This labour preference with its associated low wages is a self-perpetuating problem, for not only does it lower the incentive to migrate to more productive technologies, it reduces the attractiveness of the industry to employ more highly skilled or local labour.

Local workforce is also reluctant to join the industry because unskilled foreign labour, low wages combined with a low emphasis on occupational safety has created an image of a **“Dirty, Dangerous, Difficult”** industry. In 2004, for example, the construction industry has the third highest fatality rate compared to the other sectors (refer to Table 3.4).

**Table 3.4: Accidents and Fatality Rate by Sector, 2004**

Industry	Employment ('000)	No. of Reported Accidents	Share of Reported Accidents	No. of Deaths Reported	Fatality Rate
Agriculture	1,407	5,677	8.2%	62	1.1%
Mining	43	533	0.8%	8	1.5%
Manufacturing	2,972	26,690	38.6%	195	0.7%
Electrical	NA	496	0.7%	10	2.0%
<b>Construction</b>	<b>767</b>	<b>4,445</b>	<b>6.4%</b>	<b>77</b>	<b>1.7%</b>
Trading	NA	12,948	18.7%	143	1.1%
Transport	594	4,151	6.0%	73	1.8%
Finance/Insurance	695	605	0.9%	5	0.8%
Services	2,943	5,295	7.7%	65	1.2%
Public Services	1,042	8,325	12.0%	131	1.6%
<b>Total</b>	<b>10,463</b>	<b>69,165</b>	<b>100.0%</b>	<b>769</b>	

Source: Social Security Organisation, Economic Report 2006/2007 Ministry of Finance

With the Government focused on resolving the problem of illegal immigrants in the near to medium term, a continued reliance on illegal labour would be highly undesirable for the construction industry. Even then, there will always be a need for a small population of legal, skilled foreign workers. Thus, a two-prong approach is required, firstly to train the foreign unskilled labour and secondly, to nurture the desire of the local workforce to join the construction industry.

### 3.5. Inability to provide total integrated solutions

Malaysian construction companies have not been able to provide **total solutions** (including **financing and equipment package**) when competing for overseas projects. In order to compete with the Japanese, Korean and German construction companies in the future, there is a need to develop and enhance value-add in the complementary industries (e.g. building and construction materials, tooling, heavy equipment and machinery). Further, if the Malaysian construction companies can provide **the financial package**, they can then have the bargaining power to stipulate that Malaysian products and services be used in the overseas construction projects.

The Malaysian Industrial Development Authority (MIDA) is giving **the tooling and heavy machinery sector** a boost by designating it as one of the strategic sectors it will promote under the Industrial Master Plan 3 (IMP3). As these complementary sectors grow, they are also able to work alongside the construction companies to provide the equipment package for foreign projects.

### 3.6. Difficulty in securing timely and adequate financing

One of the key challenges expressed by the construction players is **securing timely and adequate financing**. This situation is especially prevalent amongst the small to medium-sized players. Financial institutions, on the other hand, have restrained lending to certain players because of poor credit rating, incomplete loan application information, etc. Further, they are more conservative when assessing borrowings for foreign projects.

The problems in securing financing can be further analysed by the various stages of construction as shown in Table 3.5.

**Table 3.5: Financing Problems Encountered in the Various Stages of Construction (Local or Foreign Projects)**

Stages	Requirements by Clients	Problems Encountered
Pre-Bidding Stage	<ul style="list-style-type: none"> <li>▪ Letter of support from banks.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Difficulty in securing clean letter of support during the bidding stage.</li> <li>▪ Slow processing time.</li> <li>▪ Require feasibility studies.</li> </ul>
Bidding Stage	<ul style="list-style-type: none"> <li>▪ Cashable tender bonds in country of bid.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Time to obtain tender bonds is short i.e. three to four weeks.</li> <li>▪ The Malaysian banks may not have a branch in the country of bid or have correspondent relationship with a local bank.*</li> <li>▪ High costs due to double charge.*</li> </ul>
Execution Stage (Normal Progress Payment Contracts)	<ul style="list-style-type: none"> <li>▪ Performance bonds.</li> <li>▪ Advance payment guarantee.</li> <li>▪ Design guarantee bond.</li> <li>▪ Term loans/ leasing for purchase of equipment.</li> <li>▪ Working capital.</li> </ul>	<ul style="list-style-type: none"> <li>▪ High security requirements, such as back-to-back agreements, collateral and feasibility studies.</li> <li>▪ Banks not willing to issue long-dated guarantees.</li> <li>▪ Cash flow mismatch.</li> </ul>
Execution Stage (“Build-Operate-Transfer” Contracts)	<ul style="list-style-type: none"> <li>▪ Equity funding.</li> <li>▪ Debt funding.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Cash flow mismatch.</li> <li>▪ Country risk issues.*</li> <li>▪ Unavailability of local currency debt, suitable long tenure and non-recourse debt funding.*</li> <li>▪ Require to appoint independent consultant to verify project economics.</li> </ul>
Remittance Stage		<ul style="list-style-type: none"> <li>▪ Difficulty in repatriating profits/ dividends due to restrictions in some countries.*</li> </ul>

Source: Industry participants

\* Applies to foreign projects only

### 3.6.1. Pre-bidding and bidding stage

Contractors feel that financing problems are most severe at the bidding stage. Inability to secure financing at this stage will preclude contractors from participating in overseas bids. During the bidding process, a contractor is required to estimate the project financing costs. In some situations, it is a requirement to submit a **tender bid bond**. Banks however are reluctant to lend because insufficient information are given on projects for the banks to comfortably assess the level of risks involved. They find it difficult to adequately assess the three-Cs of credit (Character, Capacity and Collateral)

for construction companies within the timeframe desired. Banks have highlighted that information provided by credit applicants in the construction industry are typically not sufficient to satisfy review requirements, and that no structured framework exists to reference the past performance of credit applications (e.g. a credit bureau for construction companies).

While feasibility studies to support the loan proposals would facilitate loan approvals, the **high cost** of such studies makes it impractical for most construction companies to provide them.

**Slow processing time** has also been identified as a major challenge: inefficient processing time leads to a stale tender bid (i.e. funds are only available after the deadline for submission of bids has passed). Approximately 32% of respondents to a financing problem survey rated this issue as very critical<sup>12</sup>.

### *3.6.2. Execution stage*

The same financing problem survey revealed that the industry is highly concerned with the **security requirements** outlined by financial institutions. Approximately 61% of respondents rated the problem of too much collateral requested by financial institutions as very critical. Some banks have asked for construction companies to deposit sinking funds equivalent to the amount of loan requested as a prerequisite for loan approval. The impracticality of this requirement lies in the fact that access to such funds would negate the need for a loan in the first place.

For overseas projects, normally the initial working capital required to kick-start the construction project is estimated to be in the range of 10% to 12% of the contract value. At present, there are limited Malaysian bank representatives in overseas markets. As a result, contractors operating in some markets have found raising banking facilities in foreign currencies **difficult** and **costly**.

The norm for the contractors is to either set-up banking lines with **foreign-controlled banks** based in Malaysia which have extensive global network or with the larger Malaysian banks which have relationships with foreign banks based in the countries where the contracts are being pursued. Through these arrangements, the costs are much higher as the contractors have to pay the charges of more than one bank. Only

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<sup>12</sup> Source: "Survey on Problems Faced by Contractors in Raising Finance", CIDB.

the larger construction companies are able to raise the facilities due to their financial capacity and track records with the banks. In addition, for those companies that need to seek funding in the target markets, there may be a need to put in place a suitable equity structure.

There is also a mismatch in the **duration** of the loan vis-à-vis the project duration, especially for “build-operate-transfer” projects. The contractors may face difficulties in loan repayment in the initial years because they may have invested substantially in heavy equipment and machinery at the beginning of the project. Such project will only start to generate returns upon operation of project. Further, they have to secure more projects in that country in order to fully utilise the capital expenditure invested.

Although EXIM Bank also extends **overseas project financing facilities** to the Malaysian construction companies, it imposes limits on the country as well as the company. Besides this, there is a need to address **insurance coverage** requirements as the premium for foreign projects is relatively higher due to the perceived higher risk. Malaysia Export Credit Insurance Berhad (MECIB) was set-up to support Malaysian exports of goods and services and outbound investments by Malaysian companies. Recently, following the restructuring of Development Financial Institutions (DFIs), the Government has completed the merger of EXIM Bank and MECIB as well as setting up of SME Bank<sup>13</sup>.

Companies can also seek funding from the Labuan International Offshore Financial Centre. Currently, funding from Labuan remains relatively low. In 2003, a total loan value of RM 547.2 million was extended to the construction sector - this amounted to less than 8% of construction sector output in Malaysia.

### *3.6.3. Remittance stage*

The local economy will derive financial benefits from the efforts of the contractors who have gone overseas when they repatriate profits and dividends. Due to capital control restrictions in some countries, contractors have encountered **difficulties in repatriating profits and dividends**.

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<sup>13</sup> Source: Bank Negara Malaysia Annual Report, 2004.

Based on the foregoing opportunities and challenges in both local and international markets, the Malaysian construction industry needs to continuously enhance its value chain efficiency and effectiveness to be a total solution provider in the globalised environment. Ultimately, the industry needs to streamline its structure, and ensure that entry requirements and performance of contractors are stringent enough to assess only those players capable of contributing value to the industry.

Last but not least, increased knowledge of construction community will drive or reinforce change in local market for long term sustainability, and will ensure sustainable capabilities across the construction industry value chain. This will therefore enhance ability to compete in the global market, which will eventually increase foreign exchange earnings.

It is envisaged that the CIMP will drive this lasting change in the Malaysian construction industry which will drive up construction contribution to 5% of GDP by 2015.