Examining the automotive industry in malaysia economics essay

The industry I have chosen is the automotive Industry in Asean in particular Malaysia and to go more indepth I took proton as a good case study what is happening to the Malaysian automotive industry.

Why Malaysia?

Malaysia has a “ strong driving culture” and “ one of the highest penetration rates of cars per capita in the

world” (Bonami, 2005, p. S3), as well as the growing clout of the Association of Southeast Asian Nations (ASEAN) markets, Perusahaan Otomobil Nasional Berhad (PROTON) as an appropriate sample

available at (http://www. proton. com)

Brief introduction about proton

The first national car project by Malaysia was undertaken with the establishment of Perusahaan Otomobil Nasional (PROTON) in 1983. The Proton Saga was produces 1985. Proton nowadays produces a number of car models and variants, including the Iswara, Perdana, Wira, Satria, Putra, Waja and most recently, the GEN-2 and Satria Neo. The latest 104 M. Rosli & F. Kari models, as reported, use Malaysian developed engines through collaboration between Proton and its subsidiary, Lotus (United Kingdom) .

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Political and economic structures, including cultural attitudes relevant to the business;

According to (Rasiah, 2005) Malaysia continues to protect its automobile industry against the

conditions in the Trade related Investment Measures (TRIMs)

agreement of the World Trade Organization (WTO), the inclusion of automotives

under the common effective preferential tariffs (CEPT) under the Association of

South East Asian Nations (ASEAN) Free Trade Area (AFTA) process has brought

increasing pressure for the removal of localization-based tariff protection of

automotives and parts production in the country

Stimulatory and Protective Measures set by the Malaysian government

The development of the Malaysian automotive industry is heavily depending upon

the undivided support of the government. Various stimulatory and protective

measures, such as investment incentives, a local content policy, and tariff and nontariff barriers were implemented to stimulate the development of both local

automotive and parts production. Proton in particular is a unique case because of

its status as the first national project.

To date, the largest shareholders in Proton are still government-controlled

agencies, namely Khazanah Nasional Berhad (42. 7 per cent), the Employees

Provident Fund (12. 6 per cent), and Petronas (9. 8 per cent). Temasek Holdings

Pte. Ltd, a Singapore investment merged as a new shareholder with a 5 per cent

Holding (Rosli. M & KariF 2008).

The government has also provided many incentives under the 1986

Promotion of Investment Act. In particular the Pioneer Status and Investment

Tax Allowance are the two most lucrative tax incentives granted to companies involved

in promoted activities or products that are, from time to time, determined by the

Ministry of International Trade and Industry (MITI).

In order to help to develop national capabilities in the automobile Industry in a sustainable but competitive way, the Malaysian government initially provided protection, allowing Proton(and other Malaysian car manufacturers) to withstand some early environmental downturns (Todd, 1986). For example, import duties were set at roughly 21% on domestic components, as compared to 40% on the equivalent foreign parts. This implies that there was a substantial difference in price between foreign imported cars and proton cars.

Moreover, PROTON cars required excise duties of only 11%, while foreign

branded automobiles were taxed up to 25%. Further, the authorities demanded car assemblers charge a profit margin of 16 to 17% to avoid price wars (Zafar A. & Humpreys J. 2008). This all resulted into that Proton was totally protected in any kind of way of the way to potential success was predetermined in Malaysia.

Economic structure & Cultural attitudes

In Malaysia there is general consensus that the automobile industry

is one of the drivers of world economic growth and has the potential to shape " how we make things . . . , how we work . . . , what we buy, how we think and the way we live"(Womack, Jones, & Roos, 1990, p. 11). Therefore the Malaysian economy has always been heavily depending upon the automobile industry or product which are complementary to that, such as petrol in which Malaysia has one of the biggest oil(Petronas) producing companies in Asia. As mentioned earlier a strong driving culture exists in

Malaysia and owing a car is culturally considered as a status symbol of wealth and prosperity.

Moreover, the plan has been since the 1970's to turn Malaysia into the League of Developed Nations under the visionary leadership of Dr. Mahathir Mohamad, and was introduced in a national development policy document entitled Vision 2020(Zafar A. & Humpreys J. 2008)

This is important, from a economical points of view as Malaysia has not

gone through the usual industrial stages, which implies highly skilled, labor-intensive to mass production (semi skilled, limited products) to multi skilled, mass customization (Simpson, Sykes, & Abdullah, 1998).

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Nature of international trade in ASEAN, now and historically (say ten years ago);

Currently, Asean is near to create an integrated economic community that will free movements of goods, services, investment, capital and skilled labor within the 10 Asean countries. An AEC characterized by a single market and production base allows for economies of scale, investment flows and building business linkages and network to promote further commerce.

The future looks bright for Asean due to fully rebound of the economic crisis. It is expected that Asean private demand picks up, export will increase and social safety will be more enhanced.

However, the Economic Community pillar has introduced at AEC scorecard,

which list down the measures to be undertaken and the achievements to date. Thus, far Asean only has a 75. 5% achievement rate for the 2008/2009 measures. Asean has to do a number of things if it is to achieve its goal of building an AEC by 2015.

This current year exports of Asean are expecting to rise between 4. 9% and 5. 6 % after a 1. 5% growth in 2009.

In the area of services Asean members are close to completing the 7th AFAS package of service commitments covering varying levels of commitments in 65 services

Hub sectors. The service sector of Asean received the highest amount of FDI, accounting for more than 50% of total Asean's FDI.

The sign are good and Asean will see a further increasing growth this year and currently capital flows are increasing, inflation remains low and manageable and Asean currencies appreciate slightly versus the Euro and US$.

History

Since the adoption of the AEC blueprint in 2007, significant progress has been made towards achieving the AEC in 2015.

In Janaury 2010, The Asean-6 achieved zero tariffs covering 99& and for the CLMV 98% and at 0. 5 % tariff rates of the total tariff covering under the common effective preferential tariffs for asean free trade area(CEPT-AFTA).

Also in the same month Asean saw the realization of Asean-China and Asean-Korea free trade agreements and the commencement of the implementation of the Asean- Australia-New Zealand free trade agreements and Asean India free trade agreement.

Since 2000 Asean exports rose from US$68 billion to US$162. 5 billion in 2009. Asean imports of services from the world market has also expanded markedly, of similar trend and magnitutude as exports, increasing two-fold from US$ 86. 6 to US$ 180. 4 billion in 2009

In investment, Asean has witnessed a steady increase in intra-Asean FDI flows accouting for 18. 2% (US$ 10. 8 billion) of total Asean FDI (US$ 59. 7 billion) inflows in 2008, compared with a share of 13. 82% in 2006. For the same period, total FDI inflows increased by 8. 59%.

Source: Asean Roundtable 2010. Achieving the asean economic growth 2015: Challenges for Member countries 29th April 2010. Asean's Readinesss in achieving the Asean economic community 2015. Pushpanathan Sundram

Regional government's attitude towards international trade and investments, both outward and inward;

The ASEAN Free Trade Agreement (AFTA) is a regional free trade agreement among Malaysia, Singapore, Thailand, the Philippines, Indonesia, Brunei, Vietnam, Cambodia, Laos, and Myanmar. The ten participating countries agreed to develop a free trade area that would become a single market with more than 550 million potential consumers (Bonami, 2005). An integrated ASEAN would be the eighth-largest automobile market, with 1 million new car sales each year. With projected growth trends, it has the potential to actually become the fourth largest auto market, with as many as 2. 2 million new autosales annually (" Seeking for Bigger Share," 2002).

The creation of the free trade zone in Southeast Asia allowed PROTON greater access to its neighboring countries. While good news from the marketing front, AFTA would also set the stage for greater future competition for which PROTON was inadequately prepared. (Zafar A. & Humpreys J. 2008)

The protective tariff regime, which imposed rates of up to 300% on imported cars and helped PROTON to gain dominate market share has been phased out. In line with AFTA, all but a few import tariffs will be reduced to between 0 and 5% by 2008 (Shameen, 2005).

The increasing level of international competition puts the Malaysian firm in a very " vulnerable position" (Savage, 2005, p. 20). With plants, contract assembly, and/or joint ventures in Britain, Italy, Iran, Indonesia, Vietnam, and China (Bonami, 2005),

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Although Malaysia's overall automobile sales increased dramatically in 2005, the escalating competition saw PROTON continue its domestic decline (Edwin, 2005). Even

with limited protective barriers still in place, the firm's Malaysian market share had declined from roughly 70% to 45% in the previous five-year period (Burton, 2005).

In response, PROTON is looking to expand its export efforts within the ASEAN region, the " Mediterranean countries . . . , the Middle East, China, as well as India and

Russia to a lesser extent” (Bonami, 2005, p. S5). While this is clearly a reasonable course of action, as exports account for less than 5% for Malaysian automakers versus

the roughly 60% in Japan (Bonami, 2005), production capacity is still comparatively very small.

PROTON, notwithstanding its earlier intentions of a large-scale strategy, is

simply not big enough to gain economies of scale to compete effectively in the export market against giant global competitors (Shameen, 2005).

The company has also been slow to market itself effectively around the world. Recent years have seen the organization neglect its prior efforts at branding, which has led to a “ cheap car” image, even in the domestic market (Savage, 2005, p. 20). According to Rajeev Lochan, general manager, Asia-Pacific, TNS Automotive, “ While the short-term challenge is to provide a promotional thrust to models in its current line-up, the long-term requires PROTON

to invest in revamping its aging product portfolio and reposition its brand to reach a wider base of prospective car buyers” (Savage, 2005, p. 20).

The stakes are very high, as approximately 100, 000 jobs are on the line when considering PROTON and its component supply chain (Burton, 2005).

By signing the AFTA agreement by the Malaysian government PROTON has to find alternative ways how to compete successfully with all its foreign competitors.

Specify potential areas of intra-regional conflicts (if any) and synergies;

As mentioned before Proton is a classic case of a long-protected

national champion that is struggling as the market opens up and a perfect example of intra-regional conflict with its neighboring countries such as Thailand and Indonesia where the car market is liberalised. In 2002 its domestic market share was more than 60%. That has now fallen to 44% after Malaysia reluctantly agreed with its partners in the Association of South-East Asian Nations (ASEAN) to drop import barriers on ASEAN cars to around 20%, from up to 300% previously. And the process is just beginning: Malaysia actually fudged the market opening by simultaneously hiking excise taxes on the imported cars. But by 2008 the country has to do away with such sophistry and cut import duties to 5%

The trouble is that Malaysia's politicians and managers have failed to realise how vulnerable

Proton is, says Graeme Maxton, director of automotive research group Autopolis. The Malaysians see it as a world-class carmaker with great export potential;

the reality is that it is too small to survive in a global market dominated by just a dozen huge carmakers. " Proton is off the scale in terms of economies of scale," says Mr Maxton, " and it will slowly die once the market opens up." Hence, I argue that it is that it is undesirable to pursue such a strategy because on the long term this expensive project(proton and the automotive industry in Malaysia) will impose heavy costs on the government.

The establishment of PROTON has to be attributed to the vision of the Malaysian government. The firm successfully positioned itself as the national car and pride of Malaysia, a symbol of its country's accomplishment on the global stage. I agree that government initiation of a national champion (Donnelly et al., 2002) is certainly a powerful force for the vision and subsequent emergence of a developing country. The conflict which might arise is that Malaysia still is not willing to open up its car market completely to protect its own interest.

This might result into intra-regional conflicts between Asean members. Especially between its neighboring countries because there is sufficient expertise available and this can be applied and used at the Malaysian carmarket (Zafar A. & Humpreys J. 2008). This is the key problem that has prevented the government of Malaysia from signing ant bilateral Free Trade Agreements despite several attemps. For example the partnership with Japan in 2006, is called Economic Partnership Agreement is not compared to a fully eligible fta.

Currently in Malaysia the call for liberalization and subsidies faced by industries (automotive) has remained an obstancle to greater integration in AEC.

Synergies regarding the automotive in Malaysia are not available, futher it is difficult to determine the synergies between other automotive industries such as Thailand and Indonesia because the Malaysian automotive industry is a unique example compared to relative liberased automotive markets(Thailan & Indonesia).

Asean Roundtable 2010. Achieving the Asean Economic Community 2015: Challenges for Member countries. 29 April 2010, Singapore.

Towards an Integrated Asian Economic Community. Where is Malaysia? Rajah Rasiah

Application of suitable management model(s) to analyze findings

According to the literature both models of porter can be applied to the Malaysian Automotive industry, however, Porter's diamond also acknowledges the role the governmental forces and luck can play in national competitive advantage in which the 5 competitive forces is lacking. (Sledge, 2005)

Demand conditions

Demand conditions describe the level of domestic demand that Proton faces. Demand conditions depend both on the quantity of demand as well as the sophistication level of consumers in a home market.

In Malaysia, the demand for cars has been risen steadily due to increasing living standards and consumer expenditure. However, the difference between supply in terms of Malaysian cars and foreign cars is substantial (Due to tariff barriers and special incentives dedicated to Malaysian car manufactures which results in significant higher prices for foreign cars). In fact the Malaysian government can largely influence the demand since most of the Malaysian lack the purchasing power to buy foreign manufactured cars.

Generally, demand conditions are associated with a country's level of economic development.

Malaysia is has been having a sustainable economic growth of an average of 5% per year since the 1980's.

The company has also been slow to market itself effectively around the world. Recent years have seen the organization neglect its prior efforts at branding, which has led to a " cheap car" image, even in the domestic market (Savage, 2005, p. 20).

Thus, the general consensus is Malaysia is that Proton/Malaysian cars are perceived as one of the cheapest car in their segment and this can result that very demanding consumers create an awareness in firms that causes them to focus on the needs and preferences of the consumer.

Also, quantities of demand drive firms to higher levels of efficiency and productivity. Thus, high levels of demand in a nation would drive the firms in that industry to become globally competitive (Sledge, 2005), however this is not applicable yet because Malaysia is still a developing country.

Factors conditions

According to Porter, factor conditions include any factors of production that a firm uses in its businesses. These include the traditional factors of production, this includes manmade structures that facilitate commerce,

Still other factors would be educational and legal systems. Porter classifies these factors into five major categories:

Human resources, physical resources, knowledge resources, capital resources and infrastructure. The more advanced these factors are the more they will enhance the success of businesses located in the country. These factors provide needed inputs and systems that businesses use to gain competitive advantages over their rivals. Without them, firms would have to expend their own resources to provide such structures for commerce and transactions. (Sledge, 2005)

Many of these important factors are still not completely utilized and developed to a certain level. Malaysia automotive industry is lacking most of the important factors such as human resources, knowledge resources many skilled Malaysian labors went abroad due to better labor conditions and highly skilled foreign labor has been brought into the Malaysian automotive industry. In order to expedite the transfer of technology to Malaysia, PROTON was proactive in initiating programs between local vendors and numerous established overseas technical collaborators. By 2002, some 222 collaborative arrangements were in place representing specialized assistance from various regional neighbors (primarily Japan, South Korea, and Chinese Taiwan), as well as Western Europe (Ahmed & Humphreys, 2008)

The Malaysian governments still plays a large role in their own industrial global competitiveness. It has been the initiative of the Malaysian government to set up its own automotive industry and therewith complementary industries will arise(such as car part suppliers). The aimed result was to create an advanced business infrastructure and an emphasis on innovation, however this is still not the case in the Malaysian automotive industry .

Related and supporting industries

This aspect of the model includes the importance of enterprises that indirectly or directly affect the automotive industry. Porter describes these ancillary businesses needed by firms as related and supporting industries. These most often encompass suppliers or distributors that serve the industry at hand. The model proposes that the stronger these industries are the stronger the local industry will be. The underlying assumption is that highly competitive supporting industries will drive the focal industry to be more competitive (Sledge, 2005).

Hypothesis 3: Strong and dynamic related and supporting industries in a firm ' s home market will positively impact the firm ' s global competitiveness.

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simply not big enough to gain economies of scale to compete effectively in the

export market against giant global competitors (Ahmed & Humphreys, 2008)

And according to (ROSLI & KARI, 2008)a research shows that foreign suppliers performed better than local suppliers. Interviews suggest that access to superior technology from abroad is the prime determinant of the inferior performance of local suppliers compared to foreign suppliers. Local firms lack firm-specific advantages that foreign multinational suppliers enjoy

It points to the need for companies and governments to encourage and support ancillary industries to enhance global competitiveness. In both models, this parameter estimate was the second largest and the most statistically significant. This underscores the importance of related and supporting industries in the context of global competitiveness. Without a network, firms can not hope to be worldwide leaders.

Firm strategy, structure and rivalry is the fourth clement in the model. This point on the diamond refers to several key strategic factors that characterize a firm. Strategy describes the types of actions firms utilize to achieve both long-range and short-range goals. These are often either low-cost, differentiation, focus strategies or some combination thereof Other common strategies include growth, maintenance or restructuring activities. Growth

strategies would be associated with higher competitiveness because the ability to pursue growth intemally or extemally would be indicative of overall business health, Stmcture refers to the industry composition.

This describes the degree to which an industry is concentrated or dispersed, competitive or monopolistic, or global or domestic. A more crowded structure would indicate multilevel competition and therefore greater competitiveness.

Rivalry indicates both the number of players and the level of competition among firms in an industry. This could be heated, mid-range, non-rivalries' or somewhere in between. Greater rivalry in an industry would lead a firm to higher levels of competitiveness vis a vis its rivals. Rivalry is thought to be the most comprehensive of the three factors, as it often indicates the underlying strategy and structure of the competitors Thus, a greater number of firm

actions as well as a greater number of competitor responses in the focal industry lead to greater competitiveness of

the firm.

Hypothesis 4: Greater rivalry within a firm s home market will positively impact the firm’s global competitiveness

Make and justify recommendations for possible business strategies to exploit the benefits in this region