Chapter 8

Privatization, liberalization and globalization

Delayed Implementation of AFTA and WTO agreement

At the Fourth ASEAN Summit in Singapore in 1992, the ASEAN heads of government announced the goal of creating an ASEAN Free Trade Area (AFTA) whereby tariff rates levied on a wide range of products traded within the region be reduced to between 0 and 5%. One of the sectors that would undergo immediate liberalisation is the automotive industry where tariff rates, quantitative restrictions and non-tariff barriers would be brought down by a maximum of 20% by 1998 and to between 0 and 5% by 2003. Current import duties are 170% and above. In line with WTO (World Trade Organization) commitments, Malaysia also agreed to phase out local content restrictions by 2000.

However, due to the economic crisis, several ASEAN countries including Malaysia have requested for a time extension before AFTA and WTO agreement take effect. This is to allow companies that were hit badly by the crisis would have some time to recover and to make adjustments prior to full liberalisation. Nevertheless, the concern posed by several key players in the domestic automotive industry is that car assemblers and manufacturers are not fully committed, much less ready to the opening of the domestic markets. As such, they will use the 1997-1998 recession as a delay tactic against full liberalisation.

Historically, tariffs have been used extensively by the Government as a means of regulating the imports of goods into Malaysia. In a report by the United State Trade Representative Office 1998 Foreign Trade Barriers Report, it commented that “Malaysia maintains several measures to protect the local automotive industry, including high tariffs and an import quota and licensing system on imported motor vehicles and motor vehicle parts”. The report also mentioned that Malaysia maintains local content requirements of 45% to 60% for passenger and commercial vehicles and 60% for motorcycles.
the other hand, the Malaysian Motor Traders Association believes the delay in implementing AFTA will slow down the domestic auto industry’s drive towards higher competitiveness. The delay will certainly prevent the industry from learning the lessons of full competition, while at the same time, keeping vehicle and vehicle components’ prices at high levels. Consumers will also have very limited choices, unless they are willing to pay high tariffs and duties for imported cars. Such a delay also prevents economies of scale from being exercised earlier, thus causing the domestic automotive assemblers and manufacturers to lose out in their competitive advantage against countries that are more prepared. (Smartinvestor issue 107)

Subsidies and competitive advantage

For the AFTA framework, tariffs and subsidies would be phased out by 1st January for certain industries such as the automotive sector. However, the unforeseen 1997-economic crisis that swept ASEAN gave an eleventh hour reprieve for the automotive sector.

The Malaysian automotive industry has now been granted extra time to adjust to the new economic environment. But the delay is not forever, it will end in 2003. In the meantime, reliance on subsidies is a cause for concern. Subsidies are viable in the short-term to help start an infant industry. Tariff and subsidy protection can also encourage domestic competition, which will prepare domestic companies for international competition.

However, the argument against most subsidies is that subsidies do not provide the incentives to be cost competitive and innovative. Invariably, companies that are used to a subsidised environment that they operate in have problem adjusting to a market-led environment. Having failed to grow out of that protective framework, they remain sub-optimum efficiency and productivity that is below international standards.

As a result of this artificial protection, domestic automotive companies remain untested and unproven against international competitors, be it in terms of production levels, supply processes, marketing strategies, customers relationships or dealer networks.
Moreover, high import tariffs and custom duties prevent consumers from enjoying lower prices on foreign cars because of the price advantage of local cars. In the long-run, if the local industry is unable to compete in a non-tariff, free market environment, customers will end up bearing the burden of inefficiency and higher costs. Although the price of a locally manufactured vehicle in Malaysia is considered affordable, it is still prohibitively high. In Malaysia, for example, the price differential for a 4-cylinder sedan is generally two to three times the global price of a similar car. Naturally consumers are not losing end.

One of the key aims of the national car policy is to develop as much local content as possible so that when this critical mass is attained, it could not only support national car manufacturers but also supply to other car assemblers in the country and around the region. Opening up the domestic car industry would enable this critical mass to develop earlier, thus creating economies of scale at very competitive levels.

Mentioned by Aishah Ahmand, chairman of Malaysian Motor Traders Association, you have domestic protection, as compared to other ASEAN countries who do not. Our products are more expensive for assemblers as well as for consumers. We need our vehicles priced more competitively. Many players in the industry believe that if we do not have a leading edge and when we open up, we will lose our competitiveness."

In a competitive market also acts as a catalyst to encourage foreign car manufacturers to set up base in the region to tap into the growing demand for different types of vehicles. “Several manufacturers from other parts of the world like General Motors or Volkswagen, have setup manufacturing facilities in Thailand to cater for that growing demand. There will be a critical mass because about 120,000 units of vehicles are exported each year,” says Aishah.

Protectionism and tariffs also have the tendency to shield local players from the rigours of the market place where firms compete with each other on a level playing field. In the
absence of a scarce R&D skills or technology transfer, domestic players would lose their edge not only in the primary industry but also in secondary areas as well. Although competition could easily wipe out small players, it is not the tendency of the market to wipe them out. In developed mature markets like Europe or North America, national car brands like Saab, BMW or Lotus coexist comfortably with giant counterparts like Ford, General Motors, DaimlerCrysler or Volkswagen. As quoted by Ford Malaysia’s Managing Directory Richard Canny, “It is a two-way strategy that will complement each other. Look at the European union where there are many national car companies despite the common market. We maintained our presence there and these companies continued to survive because they have become more productive and efficient. Our supplier network extends to the whole of Europe and we all complement each other.”

The secret to the survival of some of these smaller firms lies not so much in protection and subsidies as in creating niche markets – through high-tech engineering or clever marketing. This helps explain why Lotus and BMW continue to enjoy healthy sales because customers recognise their superb engineering and sexy marketing appeal (“the ultimate driving machine”) respectively.

One strategy for Malaysia is to become specialists in certain complex components. By doing so, specialists can even venture out to become contract suppliers to other car components, either in the region or to the global markets. This concept, says Richard Canny, has worked in Latin American and will also work in ASEAN because specialization has created an economic balance, helped raise productivity and create natural competitive advantages for different countries. “Malaysia is very strong in electronics and there is no reason why these companies could not supply electronic at a global level. You can also go into product development because you already have a natural volume base in the national car projects.” (Smart Investor Issue 107)
Component sourcing

To ensure that such a strategy succeeds require a viable and comprehensive supply chain mechanism that encompasses relationship with components suppliers, dealer networks and logistics providers. Much of the components source from local components suppliers are of low value and low-tech, i.e. components that require a relatively low depth of manufacturing, such as tyres, glass, wiring and simple electronics. According to Richard Canny, it is much harder to source for deeply integrated components such as power trains, chassis sets, complex electronics or braking mechanisms. There are not many suppliers that are capable of supplying these complex units to car manufacturers and assemblers. This investment is not profitable due to low volume of demand and absence of critical mass of assemblers/manufacturers, either within ASEAN or in the Asia Pacific region. Furthermore, components suppliers in Malaysia are a “fragmented market” because there is no one that can handle a complete sub-assembly operation. As a result, car assemblers have to source from multiple suppliers. This leads to inefficient, unproductive and defeats economies of scales. There is no depth in suppliers’ manufacturing to provide value-added services.

“If you take Malaysia as a single market, it ranks number 25 world-wide but if you take the whole of ASEAN as a single market, the region ranks number eight. There is thus a great incentive to combine the fragmented market together and create a single market,” stress Canny. “We need to move to AFTA as quickly as possible to achieve a higher rate of productivity. This will not only improve the bottom line of Malaysian car manufacturers when AFTA comes into effect but will have that mobility to increase volume according to demand.” Higher productivity also has an interesting side effect: a multiplier effect on skill sets. From just manufacturing/assembly, automotive employees would have the chance to venture into new areas like tooling, product design or marketing strategies. (Smartinvestor issue 107)