CHAPTER 6

CONCLUSIONS

6.1 Introduction

The Malaysian economy has grown rapidly in recent years. For the past eight years (1987-1994), the average annual growth rate of the economy has been around eight per cent. Full employment was achieved in the early 1990s and at present the economy faces labour shortages. Within this scenario of sustained growth, the country now faces a new threat, namely, rising inflation.

Together with rapid growth, the Malaysian economy also underwent significant structural changes since Independence. By 1992, the manufacturing sector's share in the country's GDP had risen to 32 per cent from 9 per cent in 1960. With the increasing importance of manufacturing activities in the economy, it is thus not surprising that in the early 1990s, the country's central bank, Bank Negara Malaysia, suggested that the market structure in the manufacturing sector could have exacerbated inflationary pressures in the country. At present, there has been no empirical studies that have examined the link between market structure and inflation in Malaysia. In view of this, we have studied extensively, the relationship between market structure and profitability performance in Malaysia and we have extended further to examine the link between market structure and inflation.

The first section of the study examined the link between market structure and performance using the SCP framework. The second section conducted an empirical analysis of market structure and inflation. Previous empirical studies on SCP, including those conducted in Malaysia, have all supported the influence of market structure on conduct and performance in the manufacturing industry. The empirical relationship between market structure and conduct and performance was re-examined to ensure data consistency between the micro (first) and macro (second) segments of this study. This study found that even though the manufacturing industries in Malaysia have become more competitive in recent years, at least one third of the industries still regarded as being concentrated.

Among the conventional determinants of market structure such as market concentration, minimum efficient scale, absolute capital requirements, capital-output ratio, advertising intensity, growth rate of industry and international linkages (exports, imports, and direct foreign investment), minimum efficient scale, absolute capital requirements and capital-output ratio are important elements of market structure in Malaysian industries. The variation in the concentration ratio itself can be explained by economies of scale only. The significant impact of absolute capital requirements on profitability suggests that the industries which are more capital intensive tend to yield higher profitability. Market concentration has an insignificant impact on price-cost margins when the low value-added industries are not excluded from the sample. However, it becomes significant in high value-added industries.

Economists suggest that firms which acquire more market power are able to raise their prices easily but not all the empirical studies reach the same conclusions. There are many arguments concerning the link between market structure and inflation. Studies on market structure and the rate of price adjustment showed a positive and significant influence of market power on inflation.

The findings from this study indicated a positive relationship between market concentration and the rate of price adjustment in Malaysian industries although it is not statistically significant. This could be due to the effect of the data aggregation when the data used was reclassified from twenty-eight three digit SIC industries into seven one digit SITC industries.

6.2 Suggestions for Future Studies

The findings of any empirical studies are heavily dependent on the quality of the data used. In this respect, future research in this area can only be improved if a more complete set of data is made more accessible and available. For instance, at present the reclassification of data from the SIC to the SITC or vice versa are based on the researcher's discretion. The absence of a standard classification table to harmonize between the SIC and the SITC grouping perhaps might explain the differences between the findings of this study and other empirical studies such as Gan and Tham (1977), Lall (1979), Rugayah (1992) and Zainal and Phang (1993).

Furthermore, the problem of data inconsistency can be alleviated if market variables such as the Herfindahl index, n-firm concentration ratio and MES can be prepared and published by the Department of Statistics. This is practised in some developed countries such as the US and the UK. Due to this problem, many of the previous empirical studies have adopted different market variables hence rendering these results to be almost non-comparable.

New administrative guidelines imposed by the Department of Statistics could also hinder future empirical work in this area. For example, at present, the Department has disallowed direct compilation of data at their premises. All data are now compiled by the Department's staff upon request to do so. At the same time the Department of Statistics' compilation is very time consuming. This would worsen the time and financial constraints (due to the very detailed data and tedious tabulation required), making empirical work in this area difficult and expensive.

6.3 Policy Implications

As discussed, in the first segment of this study, market structure influences market performance in the manufacturing industries in Malaysia. In the second section, a less dominant link between market structure and inflation has been found. Eventhough the empirical findings in the study does not support the argument that more concentrated market could exacerbate inflationary pressures in the economy, policies are still needed to ensure a competitive economic environment in the country. This is because competition is virtuous ideal even without taking into account of its impact on alleviating inflationary problems.

Boner-Krueger (1991) places a strong emphasis on the need for antitrust policies and institution(s) within an appropriate regulatory antitrust framework to ensure efficient functioning of markets. In this view, antitrust laws can be crucial to promote an open and competitive environment.

In Malaysia, there is no implementation of antitrust laws but there is a need to have this policy because a non-competitive market can be threatened by collusive behaviour (e.g. price fixing). To check this, Malaysia can implements its own competition policy which can monitor the level of market concentration in its industries.

The empirical results seem to suggest that large firms earn a bigger profit than small firms, hence, Malaysia should perhaps consider some form of merger control policies to encourage more competitive markets. Such policies can be used to check mergers or equivalent contracts that would significantly raise concentration in the market. In addition to merger control policies, the implementation of de-monopolization policies may be able to lower concentration in currently concentrated markets.

Since absolute capital requirements is high, new firms may find it more difficult to enter the industries. Therefore, in order to make the market more competitive, credit facilities such as loans and funds for instance, could be made more available to new and smaller firms. In addition, their entry into the markets can also be improved through the liberalisation of licensing and tax relief. Exit policy should also allow firms to leave the industry even with huge outstanding loans.

High capital-output is also seen to be another important element of market structure. Our findings show that industries with high physical capital appear to obtain large profits. However, it can be argued that other similar industries with low capital input can still achieve reduction in real costs and obtain high efficiency and net-returns if they possess skilled and adaptable manpower resources to match changing production processes. In this context, human resource development programs are considered essential elements to influence market competition.

Price Commission could help to administer price control if concentrated market speeds the rate of price adjustment. For firms reaching above a certain predetermined threshold size, they may be required to pre-notify the Commission of their intention to raise prices. During the pre-notification period the Commission can investigate the proposed increase and determine whether it is justified under the allowable cost rule[1]. A proposed price increase by firms will be checked by the Commission to see if the new prices exceed the 'reference profit margins' and are justifiable. The benchmark of reference margin can be defined in terms of the ratio of profits to revenue realized by firm in the years before the introduction of control. Restricting the growth margins in this way may be able to result in efficiency gains being translated into lower prices. But such a system of controls may weaken the incentives to reduce costs because firms will not be able to gain extra profit even if they successfully

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1 Allowable costs comprise labour, material, fuel and certain fixed costs per unit of output.

reduced the production costs. However, direct profit control can be viewed as complementary to an anti-inflationary policy because labour unions, at least in Malaysia, may accept lower wage settlements in view of restraints of prices, and hence reducing the rise in unemployment to accompany a deflationary policy.