Chapter 1
Introduction

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1.1 Market Summary

Malaysia is a member of the Association of South East Asian Nations (ASEAN), a regional trading block with combined annual vehicle sales of 1.5 million units (1996, pre financial crises). Before the beginning of the current economic crisis in 1997, Thailand was the largest automotive market within the ten-nation ASEAN, with Indonesia ranking second, followed by Malaysia and then the Philippines. For 1997 and 1998, Malaysia was the largest vehicle market, followed by Thailand, then the Philippines and Indonesia (Vehicle sales in 1998 for the entire ASEAN market were down 73 percent compared to the pre crisis levels of 1996) The other ASEAN nations include Brunei Darussalam, Burma (Myanmar), Cambodia, Laos, Singapore and Vietnam.

1.1.2 Overview of Industry Performance

The motor vehicle industry is one of the most important economic sectors of the country. In 1997 the ex-factory value of cars sold alone exceeds RM11billion. It is also one of the most sensitive to changes in economic environment and other economics factors. Given its size and the impact of the rest of the economy, in the West, the control of cars sales is often used as a means of macro-economic management. In this country, the government faces a serious dilemma is trying to control the car industry. On the hand, excessive demand for cars can lead to various economic ills but on the other hand a tight control on car sales can damage Proton and Perodua and hence the ambitions of the government to create a national car industry.

In Malaysia, the motor vehicle industry can be divided into two major related segments- assembly and distribution. Proton is the nation's leading car assembler and Edaran Otomobil National (EON) is the largest car distributor. Most of the other major motor companies double as both assembler and distributor of motor vehicle of the same make. Owing to the small size of the market, not all makes of cars sold locally are assembled here as well. Those makes with minor market position generally try to garner a reasonable market share before they attempt to assemble locally. Among the latter are such makes as Alfa Romeo and Kia. In addition, almost every listed motor company is involved in more than one business activity. Proton also manufacturers motor vehicles parts. EON has diversified into banking, auto parts manufacturing and stock broking; Tractors Malaysia (TMB) and UMW are also involved in heavy equipment; Tan Chong has diversified into auto parts manufacturing and heavy equipment. Oriental is a diversified group, which is the sole listed corporate vehicle of the family of the late, Tan Sri Loh Boon Siew, the well-known Penang entrepreneur. The company is surprisingly complex as it is involved in a wide range of activities. Very roughly, Oriental can be divided into four main parts – Honda cars and motorcycles in Malaysia, Honda cars and motorcycles in Singapore and Brunei, parts manufacturing and non-motor related activities. For 1997 (pre-crisis period), Honda is Malaysia's fourth best-selling passenger car with a 6.4% market share and is the best selling passenger car in the non-national car segment. In addition, Oriental owns several hotels/properties in Australia (Sydney and Melbourne) and New Zealand. Therefore, during the crisis these motor companies already plan ahead to diversify their business in order to minimize adverse impacts.

DRB-HICOM is the most powerful player in the local motor vehicle industry and it has a hand in almost every national motor vehicle. It controls virtually all the existing national vehicles[1]. In recent development (end 1998), Petronas is negotiating with HICOM to acquire the latter's 27.2% interest in Proton. The price to be paid by Petronas for the Proton stake has not yet been determined. It was reported that Proton need funds urgently for its research into new car engines. Proton's best selling model, Iswara, is more than 10 years and a new engine is overdue.

1.2 Financial Crisis

It has been said that Asian Crisis stands out as one of the major crisis of the century, especially for those countries that are experiencing the turmoil. The financial crisis which erupted in Asia in mid-1997, led to sharp declines in growth, currencies, stock markets, financial systems and other asset prices of

[1] Cars, commercial vehicles trucks and motorcycles

a number of Asian countries. This research will focus on the impact of the crisis on our National Automotive Industry.

The crisis in South East Asia did not come as a complete surprise[2]. Countries, which suffer from this crisis, should take this as lessons even though the crisis unfolded against the backdrop of several decades of outstanding economic performance in Asian countries.

The preceding brief account of the crisis up to mid-1998 suggests that the main factor behind it was the volume and the nature of the flow of foreign capital to the countries involved. In addition to its severe effects in Asia, the crisis has put pressure on emerging markets outside the region. The issue now is how to strengthen prudential regulations and the structure of financial institutions in developing countries; and how to establish an international regime for the flow of private capital, which will do more good than harm. There is an important question of devising a more stable exchange rate system. Both developing countries and the advanced economies need to find a middle way between the rigidities of fixed or pegged rates, where adjustments become synonymous with crises, and the excessive volatility of freely floating rates. This crisis highlighted difficulties, which arise when smaller countries peg or stabilize their currencies against a major national currency, such as the United States dollar.

[2] In its analysis of east Asia, the United Nations Conference on trade and Development (UNCTAD's)

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The Asian crisis has once again highlighted the importance of a sound macroeconomic policy framework and the danger of unsustainable large account deficits. So, it is important to ask what lessons should be drawn from the Asian crisis, while not falling into the trap of assuming that future crisis will necessary follow the same pattern. The financial crisis has multiple causes; and whilst most of these factors continually reappear, their relative importance varies from case to case.

The damage due to exchange rates of some of the Asian Currencies are illustrated in Graph 1.1

Graph 1.1 Asian Currencies: Thailand, Indonesia, Philippines, Korea, and Malaysia

Source: Dao Heng Bank, Asia Research; Datastream

Malaysia experienced a currency crisis from mid-1997[3], which in turn precipitated a financial crisis and eventually led to a severe recession in 1998 after almost a decade of rapid economic growth and industrialization. The table 1.1 shows the fluctuations of exchange rates before and after the crisis.

Table 1.1 The Exchange Rate: Malaysia Ringgit

(Vis-à-vis US $)

Year	1997 I	1997 II	1997 III	1997 IV	1998 MAR	1998 JUN	1998 SEP
Malaysia (RM)	2.4857	2.5081	2.7771	3.4818	3.7450	3.9967	3.8000

(Note) 1998 (Sep): Market rate (Sep.3.1998)
(Source) IMF 'International Financial Statistics August 1998'

Malaysia's experience is different from those of other East Asia countries in four aspects as below[4];

a) Although prudential regulation and supervision had weakened with growing financial liberalization, especially since the mid-1980s, the situation in Malaysia was not as bad as elsewhere in the region.
b) Although the Malaysia, banking system contributed to asset price inflation by lending for property and share purchases, Malaysian banks and corporations were allowed far less access to foreign borrowings than their

[3] As illustrated in data Table1.1 The Exchange Rate: Malaysia Ringgit
[4] *From Financial Liberalization to crisis in Malaysia*-Chin kok Fay and Jomo K.S

counterparts in other crisis economies in the region. Unlike in the other economies, foreign bank loans did not figure as significantly in the Malaysia crisis; instead, capital market flows, especially those into and out of stock market, figure more prominently.

c) As a consequence of its reduced exposure to private bank borrowings from abroad, Malaysia was not in a situation of having to go cap in hand to the International Monetary Fund (IMF) or to others for emergency international credits facilities.

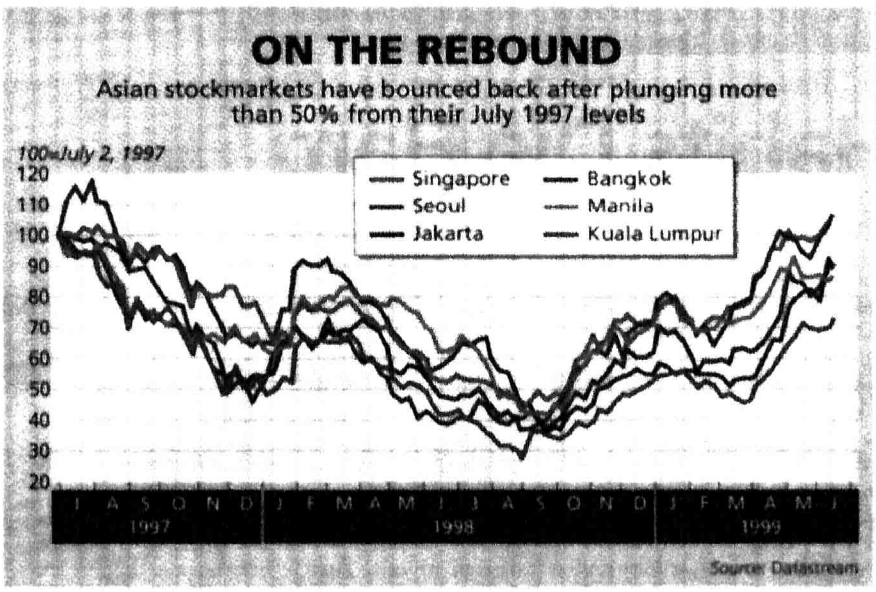
d) For most of the second half of 1997, and again from mid-1998, the Malaysian authorities deliberately pursued unconventional measures in response to the deteriorating situation, with rather mixed results. Table 1.2 summarizes the process of the crisis that had led to a recession in Malaysia in 1998.

Table 1.2 The diagram below show us the outline how currency crisis led to recession in Malaysia.

CURRENCY CRISIS →	FINANCIAL CRISIS →	RECESSION
• After Thai Baht was floated on 2 July 1997, the Ringgit was under strong pressure. • Imported inflation was inevitable due to the massive Ringgit devaluation. • Additional funds probably encouraged greater investment in activities, which is not adding to productive capacity. • Malaysia had maintained large current account deficits and worsening savings-investment gaps. (was financial by net capital inflows or foreign savings) • Almost all-international competitive non-resource based industrial capability is foreign-owned. • Misallocated public investments in education and training as well as limited indigenous internationally competitive industrial capabilities. • Much of the downward pressure on the Ringgit was included by regional developments as well as by adverse perceptions of the regional situation.	• The financial crisis can be traced to financial liberalization and its consequent undermining of national monetary and financial regulation. • The depreciated Ringgit increased the relative magnitude of the mainly privately held foreign debt as well as the external debt-servicing burden. • Loss of investor confidence led to sudden and massive capital outflows, credit crunch. • Finance interests favored certain policies, including selective financial liberalization, which led increase lending for unproductive purposes, asset price inflation, massive reversible short-term capital inflows and an overvalued currency. • The break down of non-performing loans by sector reflects the uneven impacts of the recession. • Difficulties in recovering loans have constrained the financial system and economy activity.	• ↓ Growth reduced foreign demand, especially from East Asian region. • Business failures, growing unemployment and reduced incomes exacerbated contractionary tendencies. • Tighten monetary policy from late 1997 exacerbated deflationary pressures due to government spending cuts. • The greater depth of the KLCI falls. • Greater uncertainty and reduced confidence in the Malaysian investment environment. • Limited price competitive effect due to other devaluation in the region and reduced commodity prices as well as agricultural output. • Stricter prudential regulation that limited the vulnerability of the Banking system. • The political fall-out from 1997-8 crises has greatly politicized subsequent analysis and interpretation of the crisis.

The following diagram illustrates us the situation of stock market in selected Asian countries:

Graft 1.2 ASIAN STOCK MARKETS



Source: Dao Heng Bank, Asia Research; Datastream

The Malaysian stock market increased in relative significance as a resource of corporate finance, particularly at the expense of domestic and foreign bank loans, and emerged as a more important source of funds than the commercial banks from the early 1990s. Although the Malaysian stock market has emerged as more important funds than commercial banks since 1990, funds thus mobilized during the stock boom did not necessarily go to productive investment. By 1993, the Malaysian stock market had gained a reputation as a kind of casino, with active trading fuelled by heady optimism, sudden interest from foreign institution investors, and a frenzy of speculation about corporate take-overs[5]. The KLSE Composite Index (KLCI) almost doubled to 1275 (1993) points before crashing to 971 points (1994).

According to some stock market analysts, by early 1997, over a quarter of stock in Kuala Lumpur Stock Exchange was in foreign hands with another quarter held by Malaysian institutions and the rest constituting 'retail trade' by individuals. While most Malaysian shareholders only operate within the Malaysian Stock market, foreign institution investors see the Malaysian market as only one of many different types of financial markets in a global financial system including many national markets. Although always in the minority, foreign investment institution made the stock markets in the region, shifting their assets among securities markets as well as among different types of financial investment options all over the world.

When the crisis hit Malaysia, besides currencies the stock markets faced very strong stress among the South East Asian countries.[6] The greater efforts of the Malaysian authorities to revive the Kuala Lumpur Stock Market, as has been the case since the mid-eighties, is truly exceptional, even by the standards of newly emerging markets. After announcing a domestic led economic recovery strategy, efforts to revive the stock market have been justified in terms of their expected positive wealth effects, besides reversing the adverse effects of the asset price deflation for the viability of the financial system.

[5] Asian Wall Street Journal, 26 March 1996

Capital controls have allowed the Malaysian authorities to pursue an expansionist monetary policy with limited adverse effects for the time being. The controls helped them to lower interest rates and to increase money supply (M1) in order to increase liquidity, stimulate production and fuel the KLSE upturn. This cannot go on indefinitely as it is likely to raise domestic inflation and external pressure on the ringgit peg. The Ringgit peg has actually affected the export and import of national cars in Malaysia, further discussion on this issue will be included in Chapter Two.

However, foreigners locked in until 1 September, 1999 have withdrawn their funds from the banks, offering low interest rates, to take advantage of the stock market upturn. With political support from the middle and propertied classes desperately needed by the regime with its credibility significantly eroded by the political crisis since mid-1998, efforts to boost the stock market are considered crucial for electoral success.

[6] This can be proven by the diagram B above

1.3 Methodology of the Study

The research methodology chosen is desk research using mainly secondary data. The sources are of data from Universities, Bank Negara Malaysia (BNM annual report), Statistics reports (DOS), and the Malaysia Motor Trader Association (MMTA). Besides that, primary data on the performance of the industry were obtained through interviews with the management team, company executives and the agents to get additional information. Basic statistical tools like the mean, average and percentage were used to analyze the data collected.

1.4 Objective

The general objective of the paper is to study the economic impact of Proton while the specific objectives are: -

- examine the growth of the Proton in the Malaysia context.
- The contribution of the Proton.
- The effects of financial crises on Proton.

1.5 Hypothesis of the Study

Hypothesis 1: Factors of Total National Cars Production in Malaysia

Other passenger cars (PSC), Price (PRC), Population (POP) and Gross Domestic product (GDP) will influence Total car production (TCP).

Dependent variable: TCP.

Independent variable: PSC, PRC, POP, and GDP.

Hypothesis 2: Factors of Price of National Cars

Population (POP), Total car production (TCP), Passenger cars (PSC) and Gross Demand (GDP) will influence Price of National cars Malaysia (PRC).

Dependent variable: PRC.

Independent variable: POP, TCP, PSC, and GDP.

1.6 Organization of study

This study consists of five chapters. Chapter I will serve as an introduction of the study which gives a general overview of the Proton and the financial crisis. The objectives, scope and significance, as well as the methodology of this study will also be discussed. Chapter II will review the activities of the automotive industry before and after Proton. Chapter III will discuss on the hypothesis and the comparison between Proton and others passenger cars in Malaysia. Chapter IV will discuss the results of the hypothesis and the contribution of this industry to the country. Finally, Chapter V concludes the study by summarising the findings, suggestions for improvements to the industry, and challenges in the next phase of development.

1.7 Limitation and problems

The results of the research contained herein has been achieved through extensive research and the compilation of data and information obtained from various books and authoritative bodies. It is undeniable that there are limitations in the findings, analysis, assumptions and conclusions set out in this research.