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AFTA: The Upcoming Challenges to the Malaysian Automotive Industry

Proton and Perodua will face threat of AFTA if they are not prepared by the year 2005. The government has helped them by deferring the AFTA from 2003 to 2005. So now it is up to the local manufacturers to come out with their own remedies to face AFTA. No car manufacturing can escape from liberalization of car industry in this region. Is Proton ready for this kind of threat? What actions have they taken to face these challenges? What measures they should take to improve the competitiveness of the auto industry? These questions will be discussed in this chapter.

5.1 AFTA and Its Implications for Malaysian Automotive industry

In January 1992, at the Fourth ASEAN Summit in Singapore, the ASEAN heads of government formally agreed to establish an ASEAN Free Trade Area (AFTA) and signed the Singapore Declaration and the Framework Agreement on Enhancing ASEAN Economic Cooperation. There are six original members of AFTA: Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore and Thailand. Now AFTA has 10 members including 4 new members - Vietnam (joined in 1995) Laos and Myanmar (joined in 1997) and Cambodia (joined in 1999).

The ASEAN Economic Ministers (AEM) signed the Agreement on the Common Effective Preferential Tariff (CEPT) Scheme for AFTA, which represents the main mechanism for the realization of AFTA. According to the CEPT Agreement, the countries of ASEAN would reduce intra-regional tariffs

on all manufactured items including capital goods and processed agricultural products and remove non-tariff barriers over a 15-year period starting January 1, 1993. However, in view of the economic challenges, the AEM Meeting on 22-23 September 1994 in Chiangmai, Thailand agreed to shorten the time frame for the realization of the AFTA from 15 to 10 years, finishing by 1 January 2003 instead of 2008, and to include unprocessed agricultural products into the CEPT scheme.

In efforts to strengthen the rules and disciplines of the CEPT Agreement, in November 1996, ASEAN adopted a dispute settlement mechanism¹ covering all economic agreements. The provision on emergency measures under the CEPT Agreement has also been strengthened to make it consistent with the WTO Agreement on Safeguard Measures. A Protocol on Notification Procedures has been established to provide advance warning of actions or measures that can have an adverse effect on concessions granted under an existing ASEAN agreement. These protocols represent the evolution of ASEAN economic cooperation towards a more rule-based system.

5.2 Objective of AFTA

The ultimate objective of AFTA is the following:

- i) to increase ASEAN's competitive edge as a production base geared for world market, that will be realized through the elimination of

¹ largely patterned after the WTO mechanism

intra-regional tariffs and non-tariff barriers, allowing manufacturing sectors become more efficient and competitive.

- ii) With the larger size of the market, investors can enjoy economies of scales in production. Foreign direct investments will be attracted into the region, which will in turn stimulate growth of supporting industries in the region for many foreign direct investments.

5.3 Recommendation

Proton has already started preparing for AFTA. But is it enough? Sales have been projected to drop significantly for Proton once AFTA is implemented. One of the measures taken by Proton is in R & D sector. They have come up with first Malaysian design car. This is a milestone in Proton, which was realized using latest technology like Rapid Prototyping and commitment by the employees. Proton is also doing research and development with Lotus engineering and Petronas-Sauber Formula 1 team to come up with own engine. This moves in R & D sector is very important for them. Now they can show their own identity to the world rather than copying prototype of Mitsubishi cars. They have changed to a new logo that will give them more precise identity. Perodua still lack in this field, they still come out with Daihatsu prototype cars to manufacture in Malaysia.

Local manufacturers have to come with their own identity or brand if they want to penetrate the ASEAN market. In order to have own identity, they need to come out with their own model that is not available from other auto manufacturers. Daihatsu have already manufacturing base in Indonesia. So

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for Perodua it will be difficult task to penetrate the ASEAN market. Definitely their sales in Malaysia will drop in 2005. So to compensate that, they better penetrate other ASEAN countries.

Another significant matter that need action be taken action is cost competitiveness. Cost control is very important. The cost of Malaysian cars is very high compared to the actual price of foreign car without tax and tariffs. Even Datuk Seri Rafidah Aziz has urged Proton to cut cost of local production. If they want to be global distributor then their price should be competitive with car giants. Even though their capacity is small compared to other car giants they have to cut the cost to challenge them. Proton has informed that the new model Proton WAJA parts are 90 percent locally made. This is a good sign for local part manufacturers. However are the local parts cheap compare to foreign suppliers. Proton should get alternative choice to reduce cost. They can buy some parts from other countries that are significantly cheaper than local parts producer.

Quality of parts is also another main issue on national car quality is not even par with quality of foreign cars. Quality is very important because most consumers will look at the quality of the car before purchasing them. They should improve their quality and should be strict in quality control. Even to maintain local sales Proton will have to maintain quality and upgrade them to be higher than foreign cars. Proton car owners knew the quality of Proton cars before they buy the car. They didn't consider the quality because the cost was more important to them.

Finally before penetrating other ASEAN countries, local manufacturers must have a well planned marketing strategy to sell the car in the ASEAN region. They should come up with some partnership with these ASEAN countries to market their cars. Local distributors in ASEAN countries are more reliable and trusted since they know their market well. The collaboration should enhance the marketing strategy and method to penetrate ASEAN. R&D with own design, cost control, quality control and marketing are the four main items that local car manufacturers should concentrate on. They should use all four management principles, which is planning, controlling, organizing and leading to implement these tasks. The principles are very important to implement their plans and run them successfully.

5.4 Conclusion

The Malaysian automotive industry has thrived under the protection and support of government policies. Beginning with import-substitution policies to promote domestic assembly and local content in the mid-1960s to early-1980s period, there was a drastic restructuring of the industry when the first state-led NCP started in the mid-1980s. Thus, from a fragmented and inefficient base in the 1960s and 1970s, the industry shifted to manufacturing automobiles and component parts in the mid-1980s and 1990s. Like the NCPs, the automotive component parts industry has also developed and grown under the government policy of increasing local content and promoting industrial linkages.

The advent of the economic crisis in mid-1997 interrupted a decade of growth for the local automotive industry. The crisis also exposed several weaknesses in the structure and policy framework governing the automotive industry. Higher tariff rates on imported vehicles coupled with preferential duties accorded to national cars have undoubtedly boosted the domestic industry. They have however also led to inefficiencies due to the lack of competition under a protectionist regime. The crisis has also exposed the dangers of relying almost entirely on the domestic market for automotive sales.² To enjoy economies of scale in their production operations, manufacturers and assemblers would have to develop export markets in tandem, as the size of the domestic market is limited. This would not be easy but is deemed necessary at the present stage of industry's development.

The real test for the Malaysian automotive industry will come when domestic protection is lowered and eventually removed, as a consequence of market opening measures under the AFTA and WTO initiatives. The potential influx of foreign competition as a result of liberalization may pose serious threat to the future development of the local automotive industry. Market opening measures are expected to have far reaching implications on the national cars' abilities to retain their lucrative domestic market shares and would thus compel them to increase their exports in a highly competitive environment. Even if liberalization efforts are delayed, the local industry must strive to be more internationally competitive. Efficiency should also be enhanced so that the domestic car prices can match, if not undercut imported

² Lessons from the Malaysia Financial crisis & through road ahead for Proton. (HF1008 UM 2000 KHO)

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prices, even in the absence of government support and protection. Otherwise, Malaysia would not optimally utilize its economic resources, and domestic consumers will continue to shoulder the burden of the industry's inefficiencies.

Lastly we can say that AFTA is a threat to local manufactures but it is an opportunity to many new Malaysian companies. They can actually negotiate with foreign giants to invest in Malaysia and open up joint venture companies. With joint venture it would be a win-win situation where both local and foreign companies can benefit from the project. Honda Motor Corporation just formed a joint venture project with DRB-HICOM and Oriental Industries in July 2000. Both local companies have 51 percent share while HONDA has 49 percent. DRB-HICOM is actually a parent company for Proton but they are planning to sell the stakes to PETRONAS. This is because their debts are very high. Now they have formed an alliance with HONDA so that they are not out of the car industry. This is considered a good move because this joint venture project will benefit all parties involved. Some other companies can follow this footstep to form a joint venture company with other auto giants like Toyota, Ford, Volvo and others. If they don't offer themselves then Thailand will grab these entire joint venture project and gain most from AFTA.