

CHAPTER 6 - PROPOSED STRATEGY FOR MALAYSIAN PALM OIL INDUSTRY

The cultivation of oil palm and the development activities have gained momentum over the years making Malaysia among the leading the leading players in the world's fats and oils market. Indonesia ranks second and between the two, they account for over 80% of the world's output and 19% of the total global fats and oils market.

Malaysia has to intensify efforts to overcome the current issues faced by the industry to strengthen its position in the oils and fats industry. This chapter will discuss some of the strategies that could be used by the industry.

6.1 Strengthen the industry structure

Local firms should operate as a team rather than rival each other in search of profits so as to give them strength and comparative over foreign competitors. Structural integration will help to reduce the fragmentation within the industry and enhance its bargaining position, by removing some of the wasteful competition in the industry. The integration proposed is for the producers to integrate forward and for the refiners to integrate backward into the plantations and milling sector. The integration will unite the producers and refiners into one, thus strengthening their position against international players.

Forward integration

This strategy may appear unsound to the producers as refining margin is low. However, producers namely the larger plantation companies should take a longer view.

Although producers will have to make some short term sacrifices in terms of profit loss, the longer-term prospects appear to be more advantageous. Some of the advantages of forward integration to producers are:

-) they can achieve a better economy of scale as their plantations, mills and refineries can share the same administrative, engineering and other overheads. If the refineries are built near the source of crude oil, there is an additional saving on transportation and handling cost
- i) they can better control of their crude and thus can ensure a higher quality output to their customers
- ii) they can assure their customers of prompt delivery and consistency of supply

They allow better quality, delivery and consistency of supply. This will allow producers the opportunity to differentiate their products and thus obtain a better price.

Backward integration

Refineries should integrate backward i.e. to go into plantation and milling. The advantage of backward integration for refineries is more obvious, in the sense that for long term survival as the milling and plantation sector is more profitable. Besides, with the integration they can secure the consistent supply of raw materials (i.e. crude palm oil).

By integrating backwards, the same advantage of economy of scale, quality and delivery as discussed earlier for forward integration will apply.

6.2 The government need to play a proactive role in the integration process

The government needs to play a supporting role by encouraging such integration by providing some form of incentives and assistance for producers and refiners to integrate. The incentives could take the form of a preferential financing scheme or special tax incentives. A coordinating body should also be set up to facilitate the integrating process.

6.3 Need to continue with diversification into further downstream processing

To achieve continued market growth and increased market demand, the Malaysian palm oil industry, following Ansoff's Product-Market Expansion Matrix, should continue to promote new product development and diversification into related downstream products. The current trend of refiners diversifying into further downstream processing of higher value added specialty fats and oleochemicals should be further encouraged. Currently, these products command a higher value and a higher profit margins for refiners. The diversification should not stop at oleochemicals, Malaysia manufacturers should go further into the manufacturing and exporting of soap chips, detergents and other palm based products. The diversification is also in line with the Malaysian government's policy of further industrialisation in the country.

Joint-venture with foreign interest who have technological know how and the market for these products should also be encouraged. These foreign partners with their investments in Malaysia will help to widen the market for the palm oil products, in that they will help to market the products to their customers, who would otherwise be difficult for the Malaysian exporters to penetrate; and they would also use the products themselves for further processing overseas.

6.4 Need to develop a strategy of setting up repacking and distribution facilities overseas

The Malaysian palm oil players should be encouraged to set up repacking and distributing facilities in consumer countries. Joint ventures with local agencies or distributors who are familiar with local market and trading conditions will be a suitable entry strategy. Processed palm oil could then be exported from refineries in Malaysia to these repacking and distribution centers worldwide. This strategy will help to maintain most of the value added activities within Malaysia, and at the same time penetrate the market of the consumer countries and those of the neighbouring countries.

6.5 Relationship management

Another area where the Malaysian palm oil industry must develop is its relationship with the buyers. Relationship building is a must for successful marketing, in today's competitive marketing. According to Thomas Levitt (1980), relationship helps to determine the buyer's choice the next time around. Repeat orders will go to those sellers who have done the best job of nurturing relationships with their buyers. Also, by keeping physically close to buyers, suppliers will learn about the needs and supply what the buyers want instead of trying to get the buyers to buy what they have.

Traditionally, most of Malaysia's palm oil sales are done through brokers, trading houses, or selling agents, without the exporters really knowing whom the final buyers are. This has put Malaysian exporters at a disadvantage and over dependent on middlemen. In order to expand their market there is a need for Malaysian exporters to know and meet the final buyers. Industrial buyers are unwilling to risk trying out new supplier each time they need the oil. They will go back to their suppliers whom they know and those who will supply what they promise. Buyers may even be willing to pay a higher price for the reliability of supply. As such, it is important for the Malaysian exporter to build and manage relationship with buyers to ensure repeat orders.

Once the bond between the suppliers and buyer is established, it is very difficult for other suppliers to penetrate. It is only when the existing suppliers are not performing as expected or when there is a new task or a problem with the existing supplies that the buyers will start to look for new suppliers. Therefore, to penetrate the soybean market there is a need for Malaysian exporters to sow the seed of recognition of a problem of using other soft oil in the buyer's mind. This can be achieved by promoting the benefits of using palm oil compared to other oils and educating potential users on the value and savings that they can achieve by switching to palm oil. The promotion could be in the form of advertisement, seminars, and press releases in consumer countries and visits to factories overseas.

6.6 Need for technical-sales personnel

In order to achieve the abovementioned market penetration strategy effectively, there is a need for more technical-sales personnel. Personnel visiting potential and existing customers overseas must have the technical knowledge about edible oils i.e. not only of palm oil but also of other competing oils. This is because they must be able to explain what palm oil can and cannot do compared to other edible oils; and must be in a position to advise potential users to switch from other edible oil to palm oil. Ability to give technical advice and recommendations can make the difference in concluding a sales and starting a relationship with the buyers.

Although MPOB has set up various Technical Advisory Service (TAS) teams to help promote the oil, there is a need for private sector to play a more active role. There is also a need to train and update our sales personnel on the latest development on palm oil.

6.7 Need for continue with the effort of improving bilateral relationship with consumer countries

Building relationship at the firm to firm level is important but equally important is the building of relationship with the government of importing countries. The government can act as an important influence to the purchase decision of the buyers. The tariff imposed and the government regulation on the use of imported oils and palm oil can play an important role in determining the extent palm oil can be sold to the country. Also, as has been noted earlier much of the imports from less developed countries are done through state or government agencies. It is therefore important for the Malaysian government and industry to maintain close relationship with these agencies so as to ensure that they will continue to buy from Malaysia.

6.8 Need to set up marketing or trading offices overseas

To assist in developing and maintaining close relationship with consumer countries, the Malaysian palm oil industry should encourage its member to set up marketing or trading offices overseas, especially in countries with high potential. Other than promotional activities these offices could monitor the relationship with consumer countries and collect market information for Malaysian exporters, so that prompt action can be taken.

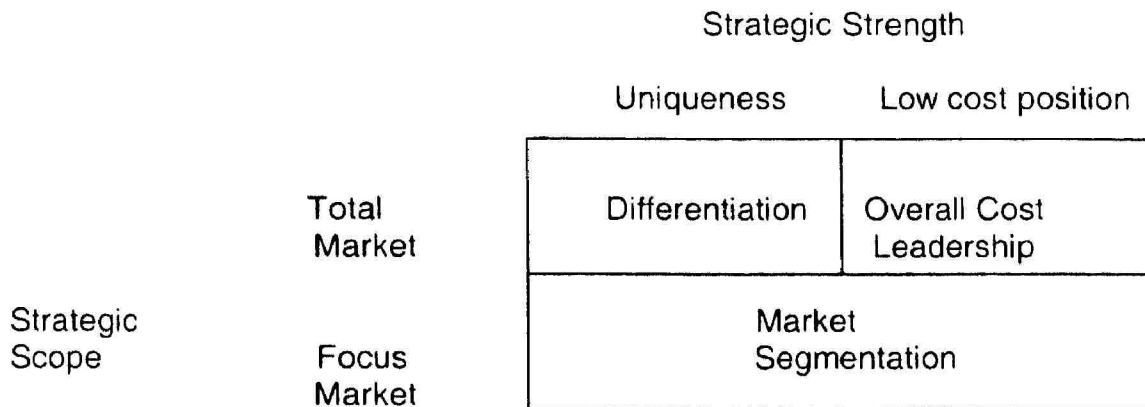
These offices can also assist existing customers with their problem and keep them informed of the latest development in palm oil. They can also act as importing agents for the consumers or provide them with link to Malaysian exporters.

These offices could take part in counter trade activities i.e. importing palm oil from Malaysia and exporting local material and goods sought by Malaysian importers. This is an important activity as it will reduce exporters' foreign exchange risk and reduce importers' cost of imports by cutting out middlemen.

6.9 Need for differentiation strategy

One of the weakness of the industry is that palm oil has been sold based mainly on its price. The oil is used as a substitute for other vegetable oils due to low price. With the increasing volume of production, the pressure on price will be even greater. Due to this trend the Malaysian palm oil industry has been competing on low cost strategy. Much of the research and development efforts have been concentrated on improving production yields and process efficiencies so as to reduce cost.

According to Micheal E. Porter's concept of three competitive strategies, price premiums can be obtained by applying the differentiation strategy.



Theodore Levitt (1980) argues that there is no such thing as a commodity. All goods and services can be differentiated, even the commodity that seems to differ from competitors' offerings only in price. Malaysian palm oil can adopt the differentiation strategy.

Differentiation can be achieved through different means. In the case of palm oil it can be achieved through promoting product uniqueness, quality, reliability and availability of supply, technical support and a good overall image.

6.10 Product Uniqueness

Much research and development has been done by Malaysian Palm Oil Board (MPOB) on the technical qualities and uses of palm oil. Their research were made in the nutritional, technical and health aspects of palm oil. Through extensive research palm oil has been found to be nutritious, has a high vitamin E content, it reduces cholesterol and protects the body from the harmful effects of free radical damage associated with diseases such as cancer, aging, circulatory conditions, arthritis, cataract and air

pollution. It can be used in its natural state for deep-frying without having to be hydrogenated. Palm oil should capitalise on its strength as a versatile raw materials. It has wide applications in food use and in the manufacturing of soap and oleochemicals.

These qualities and uniqueness should be aggressively promoted so as to create consumer awareness. However, product uniqueness alone does not lead to differentiation unless it is valuable to the buyer. Therefore, in order to bring the value of uniqueness to the users, there is a need to educate potential customers and assist them to improve the value of their products or to lower their production cost. This as discussed earlier calls for the need for more technically skilled sales personnel.

6.11 Quality

The ability to supply quality products constantly will help to differentiate and add value to our product. All aspects of quality from planting to harvesting to collection of fruits to milling, refining, transportation, shipment and storage up to the factories of the buyers has to be looked into. Malaysia is known to have done well in the first stages i.e. planting, harvesting, milling and refining. However, there is still a need to improve transportation, storage and shipment to ensure consistent quality.

6.12 Reliability and availability

The importance of reliability and availability has been highlighted earlier, however there is a need to re-emphasis that most importers of palm oil are industrial users. These buyers have to be assured of the reliability and availability of supply to keep their plants running. Malaysian exporters must assure their buyers of reliability and availability of supply. Unless they can give the buyers this assurance, it will be difficult to convince them to use palm oil in the first place.

6.13 Technical support

As discussed earlier, the provision of technical support service will help the industry to further differentiate itself from competitors. By providing technical support services, buyers will have more confidence in using palm oil products. Also, by assisting them with their technical problems, a closer relationship can be built with the buyers. The industry's ability to provide such service will also help to enhance its reputation.

6.14 Image and identity

It has been said that palm oil has little or no image in the international market. It is being sold as a commodity and used as a substitute for other oils due to its price attractiveness. In order to differentiate Malaysian palm oil with other edible oil, there is a need to build an image of palm oil. A preference to use palm oil must be created based on its quality and properties; and not on price.

Malaysian palm oil has also to create an identity for itself so that users can differentiate it from the palm oil produced by other countries. Although branding is a possibility, it will be a very costly affair. However, as an alternative, Malaysian exporters can start off by using the word "Malaysian" in their product description. For example, instead of just stating "RBD Palm Oil" they should describe it as "Malaysian RBD Palm Oil". This has not been practised at the moment and should be encouraged.

In summary, the Malaysian palm oil industry must create a good image not only for the product itself but also for the industry as a whole. Its members must conduct their business in the most professional manner and must fulfil all contractual obligations.

6.15 Market Focus/Segmentation Strategy

For more effective market and promotion program, the Malaysian palm oil industry should apply the market focus or market segmentation strategy. In marketing palm oil to the world, different strategies will be required for different parts of the world. Different countries or regions will have their own unique characteristics and requirements.

With its limited resources it would be better for the Malaysian exporters to focus on certain markets or industry or even selected potential user companies to promote their products. By focusing on selected markets the exporters will be able to serve its market more effectively and efficiently, thus achieving differentiation through better service or low cost through less inefficiency.

The market for palm oil can be segmented according to:

- a) food use and non-food use,
- b) developed and developing economies

The potential of each of these segments should be evaluated. The segments with the highest potential in terms of market growth and profitability should be the focus of the Malaysian palm oil exports.

6.16 Develop statutes to regulate the disclosure for plantation companies

Currently there are no specific statutes that regulate the disclosure for plantation operations. (Tan Liong Tong, 1997). As such, it is difficult for plantation companies to have proper benchmark as a guide to improve their operations and make it more competitive. The information shortfall should be evaluated by the accounting bodies in the country and a proper recommendation should be send to the government for implementation.

To conclude, this study has attempted to make some recommendations that can be useful to the industry in overcoming some of the problems. It is the author's hope that the study could benefit the industry in some small way.