CHAPTER 5

STRATEGIC ANALYSIS OF THE MALAYSIAN PALM OIL INDUSTRY

The background, problems, issues and strategies of the Malaysian palm oil industry has been reviewed in the previous chapters. This chapter will attempt to analyse the strategic position of the industry in terms of the competitive rivalry within the industry; its strength and weaknesses as well as the opportunities and threats that exist in its environment.

The analysis will make use of two strategic analysis concepts developed by Micheal Porter.

5.1 Structural Analysis of the Malaysian Palm Oil Industry using the M. Porter's five competitive forces model.

The competitive rivalry within the palm oil industry can be more clearly seen by analysing the five competitive force facing the palm oil refineries. The position of the refineries is central to the industry as they are the major buyers and exporters of palm oil. As such any weaknesses in their competitive position against the foreign buyers/importers and substitutes is a weakness to the Malaysian palm oil industry as a whole.
5.1.1 Threat of new entrants

Entry into the refining sector is difficult. This is because it is unlikely the government will issue new refining license as current refining capacity is now in excess of the crude palm oil production. In 2001, Malaysia's total refinery capacity is 14.5 million tonnes. This exceeds CPO production in the same year of 11.8 million tonnes by 2.2 million tonnes.
5.1.2 Bargaining power of suppliers

The higher refining capacity in the industry against the availability of the supply of crude palm oil, has created a situation where demand exceeds supply in the local crude palm oil market. This situation together with the fact that the supply of the crude oil is dominated by few large plantation companies, gives suppliers strong bargaining power. The problems, in terms of cost and transportation, of importing crude palm oil into the market also helps to add strength to the suppliers power, as refiners switching to import crude palm oil is relatively high.

5.1.3 Bargaining powers of buyers

As mentioned earlier, there are large number of refineries in this countries. The large number of refiners give ample choice of suppliers for buyers to choose. The buyers of palm oil are therefore in a very strong position bargaining position.

5.1.4 Threats of substitutes

Threats of substitutes are high. Palm oil faces competition from at least 16 other major edible oil and fats in the international markets. It has to compete with soybean and other subsidised oil, as such its price performance is currently limited by the supply and availability of the other edible oils.
5.1.5 Intensity of rivalry

The refining sector as we have analysed is faced with high intensity of rivalry. The rivalry is the result of high threat from substitutes, poor bargaining position against foreign buyers and local suppliers and high exit cost. The high cost of investments have made exit out of the industry difficult and expensive.

In summary, the above analysis has identified the following weakness in the structure of the Malaysian palm oil industry. Producers/plantation companies are in a strong position against refineries and the refineries are in a weak position to compete against other producer countries and edible oils and fats in the world. The position of the refineries does not give them the strength to market and promote the oil aggressively in the international market. This is because marketing of palm oil overseas require large amount of financial resources and a strong bargaining position against international buyers.

There is a need for strategies to strengthen the position of the Malaysian palm oil industry. The recommended strategies is shown in chapter 6.

5.2 SWOT Analysis; i.e. Strength, weakness, opportunity and threat of the Malaysian Palm Oil Industry

Before determining the policy directions and strategies to adopt, we apply the value chain to the palm oil industry. The traditional SWOT analysis focuses on the strength, weaknesses, opportunities and threats in an industry and it provides a framework for assessing the usual parameters prior to making business decisions.
2.1 Strength

Palm oil is a versatile raw material. As can be seen from the palm oil utilisation chart earlier, palm oil is a versatile raw material. It has wide applications and can be used in the manufacture of both edible and non-edible products. In food use, palm oil can be used to produce frying/cooking oils, shortenings, margarine, vanaspati, and cocoa butter equivalents. In non-food applications, palm oil is used for soap making and oleochemicals.

1) Strong research and development capabilities

Malaysia has strong R&D capabilities in palm oil. Due to its economic importance, great emphasis has been placed by both the private and public sector in research and development work on palm oil. Since inception, MPOB has contributed significantly to improving the quality and production yield of oil palm and has helped in the technical promotion of the oil. The work of MPOB is well known throughout the world. MPOB has also collaborated with nutritionists and scientists around the world to research into the nutritional and health aspect of the oil.

ii) Palm oil price is attractive

In the international market, palm oil is economical compared to other vegetable oils. Although to the dislike of the industry, the low price is a strength, in the sense that it is more price competitive and would be more attractive to consumers to switch to palm oil. (See Appendix 6).

iv) Malaysia has well developed infrastructure

Malaysia has well developed infrastructure. It has good transport system and port facilities to support the industry. It's mills and refineries are equipped with up to date technologies which help to increase productivity and reduce production cost. Being the pioneer in the industry and having been in the business for more than 30 years, Malaysia has the advantage of being the first to move down the learning curve.
5.2.2 Weaknesses

i) Weak industry structure
The weakness in the Malaysian palm oil industry structure has been analysed earlier. The weaknesses has led to the conflict between the producers and refiners. This has resulted in a number of problems in the industry. The conflict has also given the buyers a stronger bargaining power. The weak position of the refiners and exporters has resulted in them having to accept a lower price for their products.

ii) Lacking in product image
Palm oil is sold mainly on price and is used as a substitute to other vegetable oils and fats. It is used mainly because of its low price. Only when palm oil price is consistently low over a long period of time, consumption for this oil will increase as users will find it more economical to switch to palm oil. In the lesser developed countries like India, Pakistan and China, palm oil is imported mainly because of its price competitiveness and as a substitute or supplement to oils and fats produce at home.

Since palm oil has little or no image, it has made it easier for the anti-tropical oil campaigners to create an adverse image for palm oil. As consumers become more affluent and health conscious, a positive product image is needed to ensure continued demand.

iii) Limited promotion budget
Promoting palm oil in the international market requires a large sum of money and resources. Malaysia, as a small developing country will not be able to match Europe and United States in spending in the promotion of its oil. Moreover the low margins offered to refiners and exporters does not give them the profits for extensive promotion efforts.
iv) Lack of information to develop best practise for the industry

Existing plantation company will not be able to know whether it is performing well in the industry. This is because it is difficult to obtain industrial benchmark for comparision. Existing performance indicators disseminate to the industry by different plantation companies are not the same as each company has their own approach to derive the numbers.

5.2.3 Threats

i) Increasing competition from other vegetable oils

The rapid increase in production of world vegetable oils and the increasing dominance of palm oil in the international market, have made other vegetable oils producers adopt a more aggressive attitude towards protecting their declining market share. Some of the tactics used are the labeling of oils and fats aimed at restructuring the import of tropical oils and the oilseed subsidy of European Union. These efforts have made it difficult and costly for the Malaysian palm oil industry to gain market share.

ii) Increasing competition from other palm oil producing countries

Malaysia can expect increased competition from other palm oil producing countries, especially Indonesia, as production acreage in these countries increase. According to Oil World's forecast world's production of palm oil will increase from average annual production of 10.10 million tonnes in 1988/90 to an average annual production of 17.50 million tonnes by the years 1998/2002. Indonesia will record a growth rate of about 131% and Malaysia 57%.
The forecasted growth is tabulated as follows:

**Growth in the World's production of palm oil from 1988/90 to 1998/02**

*(million tonnes)*

<table>
<thead>
<tr>
<th>Year</th>
<th>Malaysia</th>
<th>Indonesia</th>
<th>Others</th>
<th>World's total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1988/90</td>
<td>5.69</td>
<td>2.19</td>
<td>2.22</td>
<td>10.10</td>
</tr>
<tr>
<td>1998/02</td>
<td>8.96</td>
<td>5.06</td>
<td>3.48</td>
<td>17.50</td>
</tr>
<tr>
<td>Absolute increase</td>
<td>3.27</td>
<td>2.87</td>
<td>1.26</td>
<td>7.40</td>
</tr>
<tr>
<td>% Growth</td>
<td>57%</td>
<td>131%</td>
<td>57%</td>
<td>73%</td>
</tr>
</tbody>
</table>

*Source: Oil World*

As can be seen from the above, the competition from lower cost producer like Indonesia can post a serious threat to Malaysian exporters.

lii) Increasing emphasis by importing countries to strive for self-sufficiency in edible oils.

There is an increasing trend for developed and developing countries to strive for self-sufficiency in edible oils and fats. For example, the European Union, through its oilseed subsidy has been able to achieve self-sufficiency in rapeseed and sunflower oil. EU is now a net exporter of these oil. India, one of the largest consumers of edible oils and fats in the world has been encouraging domestic production and cultivation of oilseeds so as to reduce foreign exchange payments.
5.2.4 Opportunities

i) Increase in world consumption

The world consumption of edible oils and fats is forecasted to increase with population growth and increase in consumption per capita. The world's population is forecasted to increase from 6.0 billion in 2000 to 7.4 billion in year 2020. 39.3% of this population will come from China, India and Pakistan. The current consumption per capita of edible oils and fats in these countries is about 13.5 kilogram per head, and this is significantly lower than the estimated 46.7 kg. per head consumed in EU and 49.37 kg in USA. According to Oil World's forecast, the current world average consumption per capita is estimated at 18.25 kilogram per head is expected to increase to 23.81 kg. in year 2020. The increase is based on the fact that as developing countries progress, its people will have more wealth to consume larger amounts of oils and fats. Together with the population growth, the current world consumption of edible oils and fats, according to Oil World's forecast will increase from 110.529 million in 2000 to 171.988 million in the year 2020.

Growth in consumption of palm oil over the same period will increase from 19.8 million tonnes to 40.63 million tonnes, of which Malaysia will produce 15.4 tonnes. (See Appendix 5).

ii) Increase in health consciousness among consumers

The switch from animal oil and fats to vegetable oils is expected to continue as consumers become more health conscious, and become more aware of the harmful effects of consuming large amounts of animal fats which is high in saturated fats. This switch provides an opportunity for palm oil which has been found to be nutritious, with high content of vitamin E. Palm oil is also known for its stability as frying fats and need not be hydrogenated before being used.
iii) Increased in non-edible uses

The use of palm oil in non-edible products such as in the making of soap and oleochemicals has been on the increase. This is evident by the increased in the number of oleochemicals plants in the country.

5.3 Conclusion

From the above analyse, it is clear that Malaysian palm oil industry structure is weak. The industry is also faced with the problem of lack of product image and promotional budgets. Increasing competition from other low cost producers, like Indonesia, is a major threat to Malaysia. Malaysia does have strength and advantage over other producers. Its research and development capabilities and good infrastructure are its major strength. The uses of palm oil is wide and varied, there is potential for palm oil to increase its market. Opportunities lie in the growth in both edible and non edible use, as world population increases and developing countries becomes wealthy.