

ON
exhilarate

PIX BY RAZALI MOHAMED

Challenging Road

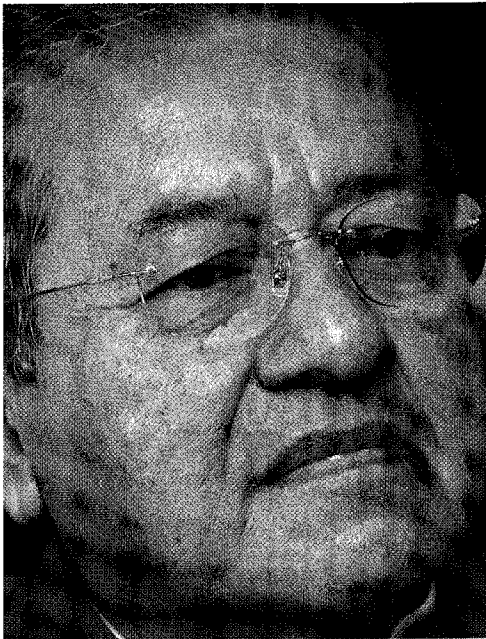
CEO Mahaleel: Leading Proton to new phases of development

Perhaps at more than any other time in its 20-year history, Proton is facing issues that could have a significant bearing on it. How will it ride out the bumps?

Stories by Clarence Y K Ngui

WHEN the first model of the Malaysian-made Proton Saga rolled out in 1985, it was a historic moment for the nation. The Saga, based on the Japanese Mitsubishi Lancer, marked the nation's ascendancy to the ranks of less than a dozen car-manufacturing countries.

While many Malaysians saw the event only as the making of an affordable passenger car, former Prime Minister Tun Dr Mahathir Mohamad saw more. For him, the Saga represented a grand vision of making Malaysia a centre of automotive design, engineering and manufacturing.



Dr Mahathir: *The nation stands proud*

To date, Malaysia has invested more than RM20 billion in developing infrastructure and support services for the national automotive industry. Some 350 automotive parts and component makers have been established and Proton and its vendors directly employ more than 100,000 trained personnel.

With Proton Holdings Bhd celebrating its 20th anniversary this month, it can be said to have come of age. It is no longer the new kid on the block and has long moved beyond the assembling of licence-built Mitsubishi Lancers and the French Citroen AX.

The national car company has acquired

its own designing, engineering, manufacturing and testing capabilities. Since 2003, Proton has been launching home-grown models such as the Waja, Gen-2 and more recently the Savvy.

'It is a very considerable feat,'

of automotive companies that can build a car from scratch to full-road worthiness. 'The nation stands proud,' he says.

But, with all its successes, Proton is also at a crossroads. While once every eight out of 10 new cars on Malaysian roads were Protons, now that figure is closer to four.

Do you know how much spin-off was created from the automotive industry? Most countries have a 40-year protection period for any new industry. The Malaysian auto industry is only 20 years old. – Dr Mahathir

says Dr Mahathir, now Proton advisor, in an exclusive interview with *Malaysian Business*. He believes Proton is one of a handful

Will Proton's market share continue to slide or can the Waja, Gen-2 and Savvy address the problem?

Proton's eroding market share is not its only predicament. There has also been much speculation over the position of its chief executive officer, Tengku Tan Sri Mahaleel Tengku Ariff. At the time of writing, his position seemed secure and it was business as usual for him.

He refused to comment on the controversy, saying that he did not want to stir up any more excitement (*see interview with Mahaleel on page 33*).

Creating an engineering base

Without doubt, Malaysians now have a wider choice. For instance, the Proton Waja now finds itself priced competitively against rivals such as the Hyundai Accent, Kia Spectra and Hyundai Getz.

But are Malaysians paying a higher price for their cars?

Mahaleel says Proton is already selling at very competitive prices. 'The Gen-2 is a much superior car to the Wira, but we are still selling at almost the same price.'

Dr Mahathir says it is disappointing when people do not see the complete picture. 'Do you know how much spin-off was created from the auto industry?' he asks. 'Most countries have a 40-year protection period for any new industry they're trying to nurture. The Malaysian auto industry is only 20 years old.'

For him, the pride of having a successful automotive sector naturally comes at a cost. But he believes that in the long run, it is Malaysians who would gain.

FACT FILE

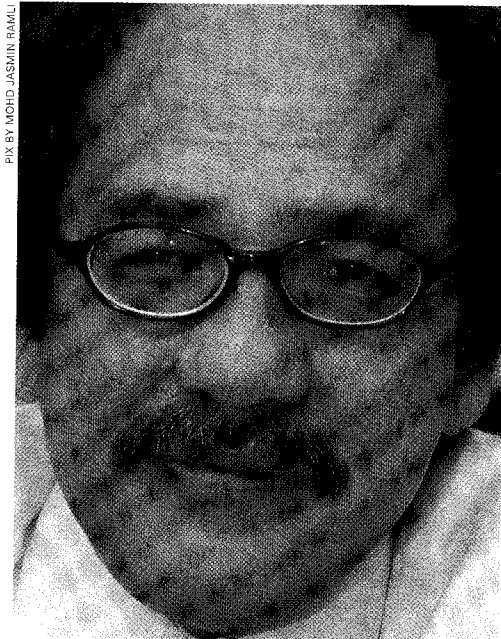
PROTON HOLDINGS BHD

PAID-UP CAPITAL	
RM549.21 million	
BOARD OF DIRECTORS	
Datuk Azlan Hashim (Chairman)	
Tengku Tan Sri Mahaleel Tengku Ariff (CEO)	
Datuk Abdul Majid Hussein	
Tan Sri A Razak Ramli	
Badrul Feisal Abdul Rahim	
Abdul Jabbar Abdul Majid	
Datuk Seri Mohamed Daud Abu Bakar	
Md Ali Md Dewal	
HIGHEST-PAID DIRECTOR	
Above RM600,000	
SUBSTANTIAL SHAREHOLDERS (AS AT AUG 6, 2004)	
Khazanah Nasional Bhd	34.81%
Employees Provident Fund Board	12.6%
Petroleum Nasional Bhd	9.85%
LATEST RESULTS	
Net profit of RM810.1 million for the year ended March 31, 2005	

**OVER
ORY**

Proton's new generation Gen-2 is powered by the Lotus-designed Campro engine





PIK BY MOHD JASMIN RAMLI

Wan Mohd: *We must not be impatient*

'We must not be impatient,' says Proton Vendors Association president Dr Wan Mohamed Wan Embong. He believes that if the South Koreans and Japanese paid a price for their successful automotive industries, why are Malaysians not willing to make the same sacrifice? 'Do you know how much the Japanese and South Korean governments were willing

to subsidise their automotive industries?' he asks.

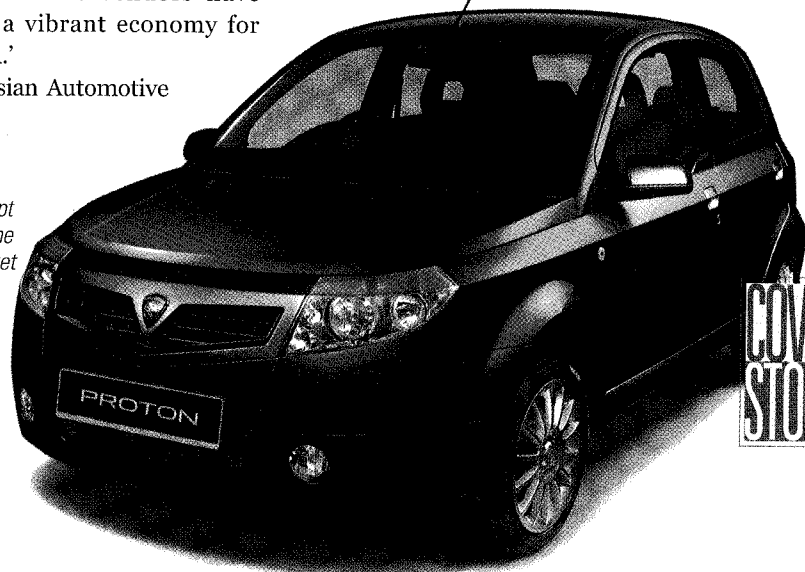
So, are Malaysians prepared to pay to support a national car manufacturer like Proton?

Wan Mohamed says it will be almost impossible for Proton to make an about-turn. 'There is so much at stake. Without Proton, it would be almost impossible to support the local auto-parts industry,' he says.

'We are looking at spare-parts, ceramics and audio-visual manufacturers. They might lose everything. You cannot deny that Proton and its vendors have created a vibrant economy for Malaysia.'

Malaysian Automotive

The Savvy is Proton's attempt to break into the small-car market



COVER STORY

THE THAI EXPERIENCE

EMERGING as the 'Detroit of Southeast Asia', Thailand's automotive industry is the region's largest. The global big boys, General Motors, Ford-Mazda, Honda, Toyota, Nissan, Isuzu and Mitsubishi, all have manufacturing plants in the kingdom. Together with 1,800 component manufacturers, the industry provides employment for some 300,000 people.

Unlike Malaysia's concentration on the domestic market, Thailand exports some 40% of its production to more than 139 countries. In 2003 alone, it netted some 138 billion baht from exports of completely built-up (CBU) vehicles and autoparts. For the record, after the United States, Thailand is the world's largest producer and market for one-tonne pick-up trucks.

Looking back, both Thailand and Malaysia had a single vision in creating a vibrant automotive industry. However, in realising their aims, they both took different paths. Thailand went the assembling way while Malaysia created its own national car project, Proton.

Proton Holdings Bhd's advisor, Tun Dr Mahathir Mohamad, eschews the assembling path as a 'screwdriver industry'. He says, 'With assembling you will not have the technology for designing, manufacturing and testing.'

Nonetheless, it appears Thailand's path has its merits. Bangkok is Southeast Asia's automotive engineering and

manufacturing hub. Perhaps, by not creating a domestic player that could rival foreign car-makers, Thailand opened the way for the entry of the big operators.

To date, Thailand has attracted more than 200 billion baht in investments from Japan and the US. Early this year alone, Nissan Motor Co announced it would transfer its pick-up manufacturing to Thailand with a 29-billion baht investment, while Japan's No. One car-maker Toyota will expand its current manufacturing plant with another 18-billion baht investment.

Is Thailand's effort on assembling paying off? 'Assembling requires a certain level of technological expertise. It is possible for manufacturing to follow suit,' says Malaysian Automotive Association president, Datuk Aishah Ahmad. For her, assembling is the precursor to a vibrant automotive industry.

However, the Thai experience shows that the bulk of players in its automotive industry are the Japanese. In fact, since 1997, half of the Thai-owned manufacturers that provide top-tier parts to the industry have been replaced or bought out by Japanese companies.

So, is this an indication that the Thai move is flawed? Perhaps, it all boils down to what come first: national pride and a handful of companies, or the economy at large with its job opportunities and foreign investments. **mb**

SAGA TO SAVVY: PROTON'S 20-YEAR JOURNEY FROM ASSEMBLER TO FULL-FLEDGED CAR MANUFACTURER

1985-1995: THE START-UP YEARS	1996-2005: THE ROAD TO INDEPENDENCE
<p>Proton's Start-up Focus To master vehicle assembly</p> <p>Investment into basic automotive manufacturing infrastructure</p> <p>Manufacturing Infrastructure 1991: Opened an engine parts and transmission assembly facility 1994: Opened a casting plant for engine and chassis parts 1995: Proton's assembly and manufacturing plant in Shah Alam is limited to 230,000 units per year</p> <p>Developing Local Industry Vendors produce components according to specifications and design by Proton 1985: First Saga rolls out at 18% local content 1985: Proton cars have only 228 locally sourced components 1990: Proton cars have some 1,200 local components from 110 home-grown vendors</p> <p>Employment 1990: Proton's initial 1,000 employees grow to 2,509</p> <p>Business Viability 1985: Critics dismiss Proton as a non-economically-viable project 1995: Proton's cash reserves surpass RM500 million</p> <p>Vehicle Sales 1985: 16,600 units sold on turnover of RM172 million</p> <p>Export Sales 1986: First exports comprise 25 cars to an Asian country 1995: In a bid to go international, 20,836 units are exported, with discounts</p> <p>Models Early Proton cars were based on Mitsubishi models Saga, Iswara, Wira, Satria, Putra, Juara and Perdana Intellectual property, design and engineering rights were not Malaysian</p> <p>Engine Proton did not have the capability to design and engineer its own engine. All engines were sourced from Mitsubishi</p> <p>Quality Critics of the National Car Project dismissed Proton cars as having poor quality</p>	<p>Proton's Upgrading Focus To achieve fully independent, world class design-and-build capability</p> <p>Investment into advanced R&D engineering capabilities and infrastructure</p> <p>Knowledge Infrastructure 1996: Acquisition of Lotus Group International 2004: Acquisition of MV Augusta Motor Spa 2004: Operations begin at new manufacturing facility in Tanjung Malim. Capacity is one million cars p.a.</p> <p>Developing Local Industry Proton's vendor development programme has created expertise in advanced manufacturing 2002: Local content purchase amounted to RM3.69 billion 2005: New-generation Proton cars like Waja, Gen-2 and Savvy have more than 90% local content 2005: Over 5,000 local components supplied by 247 vendors and 3,000 sub-vendors</p> <p>Employment 2005: Proton employs 9,500 employees worldwide and indirectly creates 100,000 jobs via vendors and sub-vendors</p> <p>Business Viability 2005: Cash reserves close to RM3 billion. Proton has also formed strategic alliances with companies such as Volkswagen SA</p> <p>Vehicle Sales 2004: 152,500 units on turnover of RM5.26 billion 2004: Set up Proton Commerce Sdn Bhd to provide car financing</p> <p>Export Sales 2003: 7,338 units 2004: 17,243 units</p> <p>Models 1997: Collaborated with Lotus to modify and build variants such as Satria GTI, Perdana V6 and Arena New generation models such as Waja, Gen-2 and Savvy are engineered and built by Malaysians. Intellectual property, design and engineering rights are Malaysian</p> <p>Engine 2004: Introduced 1.6-litre Campro engine, the first commercially viable Malaysian engine</p> <p>Quality Proton receives ISO 9001:2000 certification. Proton meets European specifications. Savvy becomes first Malaysian car certified by TUV</p>

Source: Proton Holdings Bhd.

But at least Proton seems to be on the right track. For example, within 12 years of rolling out its first car, it acquired the capacity to design its own platform and

models. 'How can you compare Proton with other companies that have more than 50 years of designing capabilities?' asks Mahaleel.

Perhaps, for now at least, Proton must depend on its various strategic alliances to achieve economies of scale. This best answers why the Proton Savvy sources its engines from Renault. 'If we manufactured engines for only 50,000 units, the cost would be sky-high,' says Dr Mahathir.

Even without full economies of scale, Proton is a profitable company. For FYE March 31, 2005, it recorded a net profit

What Proton lacks in economies of scale, it makes up in low cost of creative engineering... We have among the most competitive pricing for fuel and personnel costs in Malaysia.
— Mahaleel

of RM810.1 million on the back of revenue of RM8.5 billion. Amazingly, according to Mahaleel, Proton has never incurred a loss, even during the financial crisis of 1997/98.

What Proton lacks in economies of scale it makes up in its low cost of creative engineering. Says Mahaleel, 'The cost to fully developed and test a car in Malaysia is much lower than in Europe, Japan or the United States. We have among the most competitive pricing for fuel and personnel costs in Malaysia.'

Perception of quality

Among Proton's biggest hurdles today is how to address the adverse perception of its quality. With more than two million vehicles sold, perhaps it is not surprising that Proton would have a numerically higher number of complaints.

'All cars have problems. But we have reduced our defects from 15 defects per car in 1996 to four or five defects currently,' says Mahaleel.



Aishah: Proton has come a long way

'Do you think other cars do not have a quality problem?' asks Wan Mohamed. Interestingly, he owns a spanking new Mercedes Benz S-class and he recently forked out some RM20,000 for repairs. 'I'm not complaining that my Mercedes has faults,' he says.

Wan Mohamed says Malaysians have to look beyond quality, at least for the short time-frame. 'This is not only about Proton. It is about the creation of a whole new industry in Malaysia. We are developing a community of component manufacturers.' (See box story on Proton vendors on page 30.)

For him, every stage of development will have to come with some lessons learnt. 'The vendors will improve but we need time,' he says.

Soon, Proton will phase out models more than a decade old. Dr Mahathir confirms that the Iswara model (a variant of the original Saga) is at the end of its product cycle.

FIVE-YEAR FINANCIAL HIGHLIGHTS

FYE Mar 31 (RM mil)	2005	2004	2003	2002	2001	2000
Revenue	8,496.8	6,470.3	9,268.0	10,307.7	8,301.2	6,496.7
Profit Before Taxation	779.9	592.0	1,360.0	1,511.8	378.3	141.3
Profit After Taxation	810.1	521.1	1,117.8	1,185.0	278.6	86.0

A CAR FOR RM11,000?

CAN you value a brand new compact car at RM11,000? Apparently you can, if you consider at least three Korean models that were declared at RM11,000 or less each upon entry at Port Klang.

'This is unfair practice,' says Proton Vendors Association president Dr Wan Mohamed Wan Embong. According to him, the same cars have landing prices of almost twice the value in Singapore. 'Why are they grossly under-declared in Malaysia? This under-declaration causes much injury to the national car manufacturers and their vendors.'

For Proton Holdings Bhd's CEO Tengku Tan Sri Mahaleel Tengku Ariff, it is the Government that would ultimately be the biggest loser.

Mahaleel has a point government revenue-wise, but its effect on Proton sales is doubtful. Even if these cars were declared at RM11,000 at Port Klang, it does not mean they are sold to the Malaysian public at that price. Their on-the-road prices are between RM48,000 and RM72,000. Surely this puts them beyond the price range of many of the national cars.

Furthermore, the Government would gain additional revenue if the lower prices drove up demand for the cars.

Malaysian Automotive Association (MAA) president Datuk Aishah Ahmad says such a RM11,000 compact car is not an impossibility. She says the Korean manufacturers have a production capacity of more than three million and that the cost of production can be reduced drastically due to economies of scale.

But Mahaleel believes there is more to that. 'If we can accept RM11,000 as a

declared price, it is tantamount to saying cheating is alright,' he says.

Proton's advisor Tun Dr Mahathir Mohamad asks, 'Do you think you can manufacture a car at such low prices?' For him, if Proton is to compete and win, it has to do so in an environment of fair competition. It is believed that the earning gains from this under-declaration are used to pay for higher trade-in prices.

Dr Mahathir's concerns also lie beyond the RM11,000 issue. It is over the distribution of Approved Permits (AP), which a company needs before it can import completely-built-up (CBU) cars into Malaysia.

He claims that of 67,000 APs given out in 2004, 54,400 were to 20 companies and the remaining 12,600 to 92 companies. 'This is not in line with the Bumiputera policy,' he says. 'Small number, big opportunity, big number, small opportunity.'

The award of APs come under the purview of the Ministry of International Trade and Industry. At the time of writing, our questions faxed to its Minister, Datuk Seri Rafidah Aziz, went unanswered.

According to media reports, obviously Rafidah sees the issue differently. She is quoted as saying that the AP system is keeping the national car-maker Proton alive. 'If you open (the floodgates) of APs today, Proton will die,' the reports quote her.

Rafidah, on the instructions of the Cabinet, has since replied to Dr Mahathir's allegations. For now at least, Prime Minister Datuk Seri Abdullah Ahmad Badawi considers the issue closed. **mb**

This is not only about Proton. It is about the creation of a whole new industry in Malaysia. We are developing a community of component manufacturers. – Wan Mohamed

Proton's export potential

While Proton can improve its market standing locally, the long-term

determinant for its sustainability will be its export potential. Can it widen its external market?

The late 1990s and early 2000s saw Proton having a tough time exporting its models. 'It was difficult,' says Mahaleel, 'but the Iswara and Wira still managed to penetrate competitive markets such as the United Kingdom. Even with the old Saga, we did not do badly.'

In the 1980s, the rationale behind Proton's exports was the acquisition of

KEEPING THE VENDORS ALIVE

WITH 70% of Proton parts sourced from vendors, the fortunes of Proton depend on the vendors, whose pricing and quality can make or break Proton.

Is that something that comes with the turf? Proton Holdings Bhd's advisor, Tun Dr Mahathir Mohamad, obviously thinks so.

'If we want to develop an automotive engineering capacity in Malaysia, we must be prepared to accept the constraints,' says the former Prime Minister.

He says Malaysia's component manufacturers are still relatively new and some have yet to achieve full economies of scale. This means Proton, at times, has to pay for either late deliveries or higher prices.'

But, after 20 years, aren't these component-makers taking too long a time to become more competitive? Proton Vendors Association president Dr Wan Mohamed Wan Embong believes it is still too early. 'We are still a very young industry. Malaysians are an impatient lot.'

He says if the South Koreans and Japanese were willing to protect their automotive manufacturers, why are Malaysians lacking a similar sense of patriotism? He fears if protection is lifted, Proton would try to reduce costs by sourcing cheaper components from foreign vendors, putting the local vendor system

in jeopardy.

Wan Mohamed says a lot is at stake. For example, Proton vendors support a direct employment of 50,000 people and more than RM13 billion in investments.

WHAT PROTON VENDORS WANT

1. Introduction of the Vehicle End of Life policy;
2. Approval of new assembling licence to be granted only if applicants can bring in added-value services such as R&D. The country of origin should also reciprocate to allow similar facilities for Proton and Perodua;
3. CBU passenger cars that compete directly with Proton and Perodua must not be allowed;
4. CBU passenger cars older than five years should not be imported;
5. A review of the Afta policy especially with regard to the 40% Asean content;
6. Rebate/discount on excise duty for Proton and Perodua should continue indefinitely;
7. Declared price of imported vehicle for custom clearance must be based on open market value in the country of origin; and
8. Provision of special incentives for national car manufacturers and local vendors.

is unfair competition,' he says (*see box story on the AP controversy on page 29*).

Wan Mohamed shares Dr Mahathir's concerns. 'Do you think there is perfect free trade? he asks. 'Why is Malaysia opening its market when our neighbours are imposing a barrage of tariffs and restrictions on Malaysian-made products?'

'If foreign makes have an easy access to Malaysia, Proton should also have equal access to markets such as China, Japan, South Korea and Thailand. Why are these markets creating barriers to Proton's and Perodua's entry?' (Perodua is Malaysia's second national car project.)

However, MAA's Aishah believes liberalisation of the Malaysian automotive market is a natural progression. 'Things change. Proton must be able to make the necessary changes,' she says.

A new Proton in the making?

'We are changing with the times,' says Mahaleel. 'For example, Proton buyers now have a wider choice of which distributor to buy their cars from. If they do not like Edaran Otomobil Nasional (EON), they can buy from Proton Edar.'

Continues on page 35

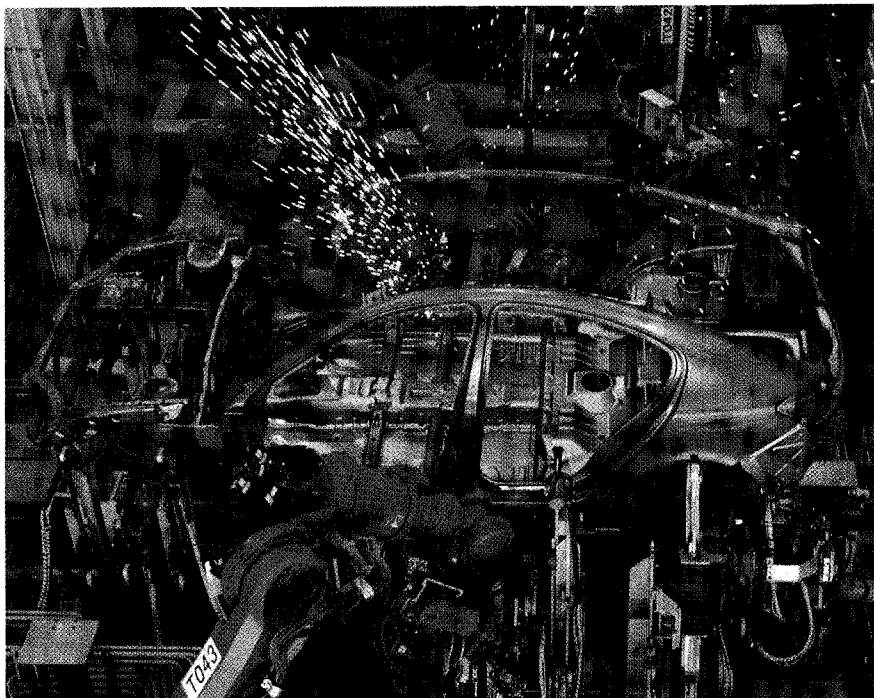
market share. Dr Mahathir says Proton made losses on each car sold abroad then. Obviously, it was not a policy the company could implement indefinitely.

Proton later changed this and started exporting its cars at a profit. In 1997, it shipped out 27,000 cars. However, the exports were not managed by Proton but by its then parent company, DRB-Hicom Bhd.

Afta and fair competition

Both Dr Mahathir and Mahaleel are requesting a fair deal for Proton. 'If you must compete, it has to be on a level playing field,' says Dr Mahathir. 'If other car companies need only 40% local content, Proton can also do likewise, but what about the vendors and the economy at large?'

And that's not the only problem. Dr Mahathir claims that Proton's loss of market share is partly caused by the under-declaration of its competitors. 'It



Making the Gen-2 at Proton's new state-of-the-art plant in Tanjung Malim

CHRONOLOGY OF EVENTS

PROTON advisor Tun Dr Mahathir Mohamad, International Trade and Industry Minister Datuk Seri Rafidah Aziz, and Proton CEO Tengku Tan Sri Mahaleel Tengku Ariff were among various parties making public statements on the Proton issue recently. *Malaysian Business* runs a time-line:

JAN 2005: Proton's chairman Datuk Abu Hassan Kendut resigns after Dr Mahathir appeals to extend Mahaleel's contract as chief executive. Datuk Azlan Hashim replaces Abu Hassan.

MAY 31: Rafidah tells the media that it is the AP system that is keeping Proton alive.

JUNE 1: Prime Minister Datuk Seri Abdullah Ahmad Badawi tells Proton to compete and not expect indefinite government protection.

JUNE 27: Mahaleel gives controversial interview to *Oriental Daily* in which he reportedly criticises the Government over its unfair treatment of Proton.

JUNE 30: Proton's board calls for an emergency meeting. Azlan asks Mahaleel to explain his media interview.

JULY 4: Azlan meets Dr Mahathir over Proton's emergency meeting.

JULY 5: Dr Mahathir calls a Press conference to explain Proton's position.

JULY 6: Rafidah declines to comment on Dr Mahathir's remarks on APs and other alleged unfair practices.

JULY 7: Opposition leader Lim Kit Siang calls for an emergency parliamentary debate on Mahaleel's allegation of the Government's unfair treatment of Proton. The motion is denied.

JULY 7: Cabinet requests Rafidah to reply to Dr Mahathir's allegations.

JULY 8: Abdullah says Dr Mahathir has received Rafidah's letter. The Cabinet considers the matter closed.

He insists that all Proton foot soldiers at its retail outlets have also changed. 'I'm sure no Proton salesman would today force you to buy accessories.'

Aishah believes what Proton needs now is to regain a strong branding position.

Dr Mahathir however believes in looking beyond Proton's immediate woes. He says in the long term, the company is planning to make a hybrid car. But progress is slow due to constraints such as limited funds for research and development.

The Volkswagen alliance

With British sports car-maker Lotus and Italian motorcycle-maker MV Augusta in its stable, Proton's drive forward might come largely from its strategic partnership with Volkswagen SA (VW) of Germany.

Aishah believes this tie-up can herald a new development for the national car company. 'Perodua has benefited from its

partnership with its Japanese partner, Daihatsu Motor Co. I believe Proton will also benefit from this partnership,' she says.

Mahaleel believes Proton's joint venture with the German marque would be a win-win situation. 'We can tap their technological experience while VW will gain an immediate base in Malaysia,' he says.

The question remains whether Proton's main shareholder, Khazanah Nasional Bhd, would take the bold step of selling Proton's shares to VW.

Dr Mahathir cautions against an outright sale. 'You can sell Proton like how they sold Skoda or

Seat, but what will happen to Proton and its vendors?' he asks.

All said and done, these days Proton has a lot of thinking to do. Twenty years after its inception, things are still not all assured. On the contrary, they have become more challenging. Will Proton rise to them? **mb**

With Lotus and MV Augusta in its stable, Proton's drive forward might come largely from its strategic partnership with Volkswagen.