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So far, car maker Proton hasn't had to worry about competition, but all that may soon change.

INDUSTRY

Bumpy Road Ahead

Falling tariffs and mergers in the global car industry may force Malaysia's Proton to look overseas for help

By Sadanand Dhume in Kuala Lumpur

To the casual observer, rush hour in Kuala Lumpur is no different from rush hour in any other large Asian city. Jammed bumper to bumper, traffic thickens the air with exhaust fumes. But there's one difference: Most of the people haltingly making their way home aren't driving Japanese, Korean or American cars, they're behind the wheels of Malaysian-built Protons.

For 15 years, sky-high import tariffs have protected Perusahaan Otomobil Nasional, or Proton. But the road ahead looks bumpy. A looming free-trade agreement threatens to tear down the tariff walls that have kept more-efficient competitors at bay. Meanwhile, global car makers continue to slash costs and improve their competitiveness by relentlessly pursuing alliances and mergers.

Analysts say consolidation and lower tariffs will eventually force Proton to embrace a foreign partner if it's to survive. Therein lies the catch. Proton is no ordinary car maker: It's a symbol of national pride, evidence of Malaysia's march toward industrialization and a pet project of Prime Minister Mahathir Mohamad. As a result, the Malaysian government is unlikely to countenance a foreign takeover.

Cash-rich petroleum giant Petrolim Nasional, or Petronas, is set to formalize buying a 27.2% stake in Proton within six months; but that will provide only a little breathing room. "In the next four years, there won't be that many players left," says Lai Tak Heong, head of research at SG Securities in Kuala Lumpur. "I think somebody serious about using Proton as a base for this region will take a meaningful stake of at least 20%."

For now, the future doesn't look bright. Tariffs protecting Proton range from 42% to 300%. But a proposed free-trade agreement by the 10-member Association of Southeast Asian Nations threatens that. Maximum tariffs were due to come down to 20% by January 1 this year, and to 5% by 2003.

Malaysia has fought hard to exclude cars and car parts from any deal, but the days of protectionism are numbered. "Ultimately, we'll have to bring down tariffs," concedes a Malaysian government official familiar with the Asean trade talks. "It will be driven by our commitment to Asean and the fact that Malaysia is a small domestic market."

Adding to the pressure on Proton is the warp-speed consolidation of the global car industry. Analysts say that in three to five years, once the mergers, acquisitions and alliances settle, the world will be domi-

nated by four or five giant car firms. Each will benefit from economies of scale, huge research and advertising budgets and the ability to share parts and manufacturing processes among different brands.

Proton's financial position is already shaky. Sales fell 40% from a year earlier to about 4.1 billion ringgit (\$1.1 billion) in the year to March 31, 1999; profits were down 85% at 67 million ringgit.

SG Securities predicts a loss of 47 million ringgit for the financial year just ended. Analyst Vincent Khoo attributes the red ink to a strong yen—30% of Proton parts are imported from Japan—and to the fact that the government hasn't allowed a price hike for more than two years. Khoo expects that a stable yen and an expected 7% price increase will allow the company to return to profit in the coming financial year.

Despite its problems, Proton is unlikely to be swallowed whole by a foreign giant because it's an important symbol of Malaysia's aspirations. Its favourite-child status has also ensured that it hasn't faced real competition at home. Stephen Hagger, head of research at Credit Suisse First Boston in Kuala Lumpur, says Proton has been hampered by rules requiring it to buy locally made parts, even if they're not the cheapest. Analysts say this has benefited vendors with ties to the ruling party.

Technically, Proton already has a foreign partner: Mitsubishi Motors, in which the German-American giant DaimlerChrysler recently acquired a 34% stake, owns 8% of the company. But analysts say this isn't enough incentive for Mitsubishi to share with the Malaysian car maker the new technology it needs.

For now, it looks as though Proton will remain Malaysian. At a press conference on March 10, the company's chief executive, Tunku Mahaleel Ariff, said Proton wasn't for sale, but was open to acquiring international technology and know-how.

It remains to be seen just how "open" that is. Larry Prein, Ford Motor's Detroit-based manager for the Asia-Pacific region, says one option would be for Proton to sell a larger stake to a foreign car company, enabling it to "get some of the advantages of having a larger partner without having foreign management."

Lai of SG Securities agrees. If Proton were to tie up with an international company, he says, the Malaysian company could make cars on its partner's behalf for the Asian market. "You have the Asean market to talk about, not just Malaysia." ■