

**THE APPLICATION OF THE INTERNATIONAL TRADING
AND INVESTMENT THEORIES ON INTERNATIONAL
AUTOMOBILE BUSINESS:
LESSONS FROM 2 CASE STUDIES; PROTON AND TOYOTA**

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**MASTER OF BUSINESS ADMINISTRATION
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ABSTRACT

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In the 21st century, there are many domestic companies who have strived and try to enter the foreign market. All the existing multinational company would face challenges from this development. Some of the challenges that these multinational companies would face includes technology and financial.

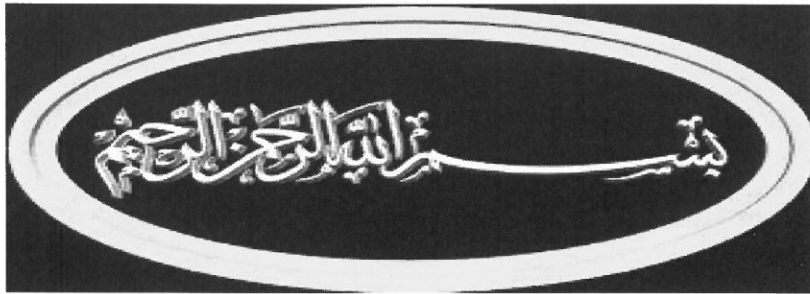
Several theories includes mercantilism theory that was used widely in 17th century, absolute advantage theory that explains how free trade will affect the trade flow, comparative advantage theory, Heckscher-Ohlin theory, product life cycle theory and other international investment theories have been used to study and understand international investment.

Thus, this paper will look into those theories as compared to the roles of technology and financial in the international automobile business. Automobile industry (Proton Holdings Bhd and Toyota Motor Company Ltd.) will be the focus of this study. These two companies will be examined on their trade and investment theories as compared to their worldwide performance based on technology as well as their financial strength.

In summary, Proton has been very successful in domestic market with strong support and privileges given by the Malaysian government. The international component in Proton still remains uncertain, as they were not able to compete with those players in the international ground.

Toyota on the other hand, has achieved the highest standard in performing the organization's objective in becoming the market leader in automobile industry. However, they are having stiff competition with their rivals in the market and the biggest challenge posed for Toyota would be to maintain their highest product quality. The next toughest challenge would be to keep their consumers' confidence level at the very highest level to ensure continuity in their future sales.

ACKNOWLEDGEMENT



ALHAMDULILLAH; Thanks to Allah S.W.T by given me His blessing and willing to me to complete this Project Paper.

This Project Paper was prepared for the completion of my Master's Degree of Business Administration majoring in International Business. The completion of this Project Paper would lead me to the degree of Masters of Business Administration (MBA) majoring in International Business under School of Management (SOM).

Firstly, I would like to express my sincere thanks to my beloved wife; Zuriahati Zainal and 3 children (Nur Aimi Qistina, Mohammad Aimi Wafiq & Nur Aimi Maisarah) for their cooperation, understanding, encouragement, constructive suggestions and full of support for the completion of my Project Paper.

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DECLARATION

This declaration is to clarify that all of the submitted contents of this project are original in its figure, excluding those, which have been admitted specifically in the references. All the work process involved is from my own idea and creativity.

All contents of this project have been submitted as a part of partial fulfillment of Masters of Business Administration.

I hereby declare that this project is the work of my own excluded for the references document and summaries that have been acknowledged.

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CHAPTER 1

INTRODUCTION

1.1 Background of the Study

International business is becoming increasingly popular for the last decades. Multinational organizations that traded around the globe and placed their products in each and every corner of the world are the most profitable organization in the world. To put the scale of international trade into context, the combined revenues of the top 200 organizations constitute one quarter of the world's Gross Domestic Product (GDP). Their total revenues approach USD10 trillion with around 20 million employees.

The statistics of foreign direct investment has shown an increasing numbers decade after decade. In 1967, the overall shares of foreign direct investment received by other countries is about USD105 billion but the figure has doubled in 1973 and doubled again in 1980. The development of trade and international investment portrays the economic power, politics and technology as a motivator to global market and industry.

The gradual removal of trade barriers and capital movements has stimulated greater flows of exports, imports and foreign direct investment. Multinational organizations have been the innovator in the new economic market by providing new products and exploiting technological advancement to operate efficiently across international boundaries.

Trade is defined as voluntary exchange of goods, services, assets or money between one person or organization and another. It has been popularized long time ago; as part of the exchanging needs for continuity of living. International trade on the other hand is a trade or transaction between residents, organizations or any entities between two countries.



International trade is not limited to commodities that some countries produce and other do not. In some scenarios, countries do import goods that they themselves could produce more cheaply than the countries from which they get them. For example, Britain could raise dairy products more cheaply than Denmark but Britain nevertheless imports part of its supplies from that country and devotes its main energies to producing machinery, electrical equipment, motor vehicles and other manufactures, because its advantages over Denmark in producing these things are greater than its advantages in producing dairy products. This strategy is known as the principle or the law of comparative costs or advantages of international trade.

The theory of international investment explains international capital movements in the context of international production and trade. International investment creates international production and is integrated via international trade. Knowledge, know-how and technology are generally transferred between countries along with financial capital. International trade, financing and investments have grown at an extremely rapid pace in recent years and becoming multinationalized.

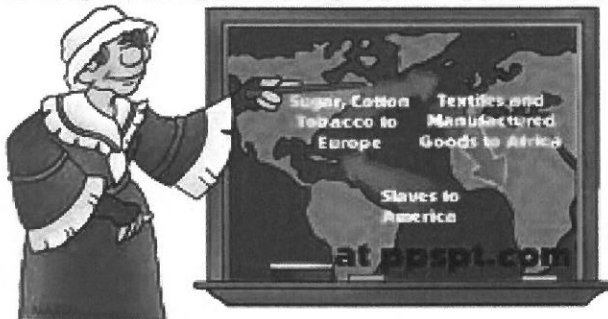
1.2 Theory of International Trade

International trade theories are divided into few theories that have been developed to support the international trade itself.

i) Mercantilism

MERCANTILISM

in the Thirteen American Colonies



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was the first international commerce theory founded in England in the middle of 16th century. At that time, silver and gold were the source of wealth for each country and had a big role in the international trade transaction. They were the main currency in the trading business among the countries. A country would get gold and silver through exporting product to the other countries, while the gold and silver would flow out through imported products. The main concept of mercantilism was a country should get the trade surplus in the balance of payment account because the trade surplus would result to the inflow of gold and silver and the country would get more wealth and prestige.

The theory belief that national prosperity is the result of a positive balance of trade that is to maximize exports and minimize imports. Mercantilism

ii) Absolute Advantage



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Theory of absolute advantage was founded by Adam Smith, a Scottish economist, in his book entitled *An Inquiry into the Nature and Causes of Wealth of Nations* (1776). Smith disagreed with the mercantilism trade nature and proved that it would only give bad impact to the economy and the nation.

Smith then suggested that the free trade system among the countries would increase the profit of the countries. According to Smith again, free trade would determine the level of products or services that should be imported or exported by a country. He developed a theory known as absolute advantage theory. This theory suggested that a country should export the products that could be produced efficiently (absolute advantage) compared to other countries and import the products by other countries that are produced more efficiently than their own country. In other words, the country should be specialized in producing the products productively and efficiently before exporting them to the other countries. On the other hand, that country would import products that they cannot

produce productively and efficiently. By specializing and exporting, the countries will increase the total products produced and the world services.

iii) Comparative Advantage



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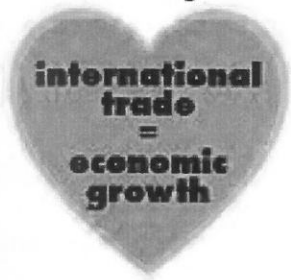
David Ricardo, a British economist, introduced the theory of Comparative Advantage in early 19th century. According to Ricardo, the country in the above situation has to produce and export the products or services that can be produced more productively in relative compared to other countries and also import

the products or services that can be produced more efficiently and productively compared to the country.

The difference between the two theories lies in the concept of absolute theory, which is based on absolute productivity difference, while the comparative advantage theory focuses on relative productivity difference between countries. This distinction happens because comparative advantage theory uses opportunity cost concept to identify which product should a country specialize.

iv) Heckscher – Ohlin

Heckscher-Ohlin Theory:

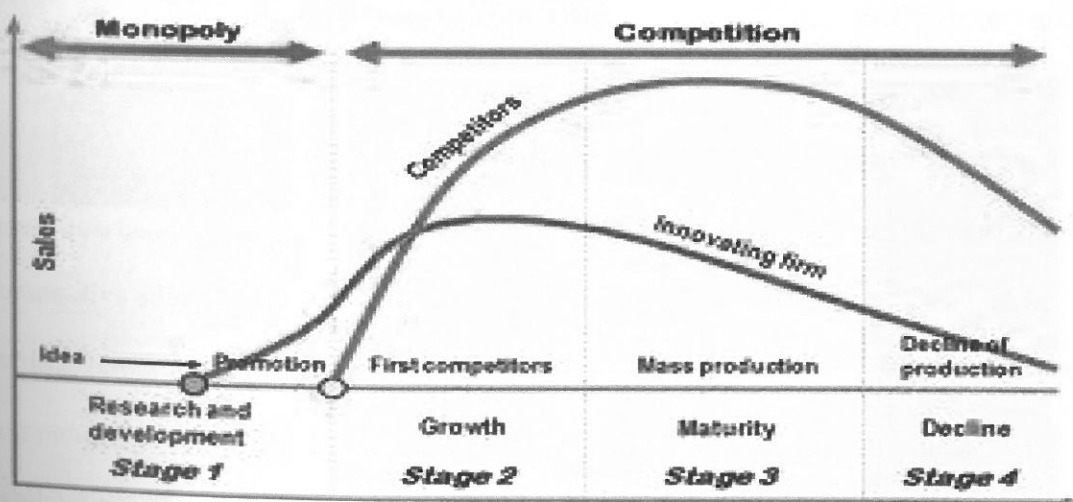


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Heckscher – Ohlin theory was introduced by Swedish economists, Eli Heckscher (in 1919) and Bertil Ohlin (in 1933).

They gave the different points in explaining a country's comparative advantage. According to them, comparative advantage is a result of the difference in production factors of a

country. Heckscher and Ohlin defined endowment factor as natural resources such as soil, labor and capital. Each country has different natural resources and the difference affects items production cost. Having many factors will cause to low input cost. Heckscher-Ohlin theory suggests that the country that has high endowment resource will export products that use that resource and import products that use endowment resource that the country does not have. Unlike Ricardo, Heckscher-Ohlin explains that the international trade pattern is determined by a country's endowment resource difference, and not the difference in productivity.

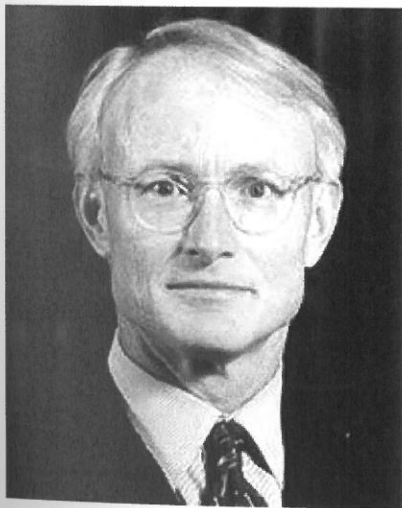


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v) Product Life Cycle

Raymond Vernon, the inventor of this theory, has tried to describe the International Trade Pattern through the Product Life Cycle Theory. This theory is focuses on the product and not the firm's productivity or endowment resource. This theory; which was developed in the mid-1960s has found that; most of new products are produced by firms in America and other developed countries and are sold there. Vernon gives a comment that wealth and the size of market in developed countries, give big incentive to the firms to produce new products. Moreover, expensive labor cost has caused the firms in America to develop innovation processes to reduce the cost.

vi) Competitive Advantage of Nations Theory



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Michael Porter of Harvard Business School has presented a research in 1990 on how to determine the success or failure of a nation in international competition. He introduced the Competitive Advantage of Nations Theory that concentrates on the firm strategy, structure and rivalry as well as the presence of strong competitors at home serves as a national competitive advantage. The theory also looks at conditions of other factors such as labor, natural resources, capital, technology, entrepreneurship, and know how. The other component in this theory is looking at the related and supporting industries; the availability of clusters of suppliers and complementary firms with distinctive

competences. Demand conditions at home are mainly focusing on the strengths and sophistication of customer demand.

Classical Country-Based Trade Theories

- Mercantilism
- Absolute Advantage
- Comparative Advantage
- Comparative Advantage with Money
- Relative Factor Endowments

6-7

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1.3 Theory of International Investment

Many organizations are entering into international investment to get their balanced gaining rate in the international market. The internationalization will give the organization more market penetration as well as opening up new business ventures and opportunities. In the world of borderless, the internationalization process has evolved to be at cross-border transaction with all stages of domestic focus, pre-export stage, experimental involvement, active involvement and committed involvement by the organizations and also the home and receiving countries.



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There are basically 4 main theories on international investment:

i) Firm Specific Advantage

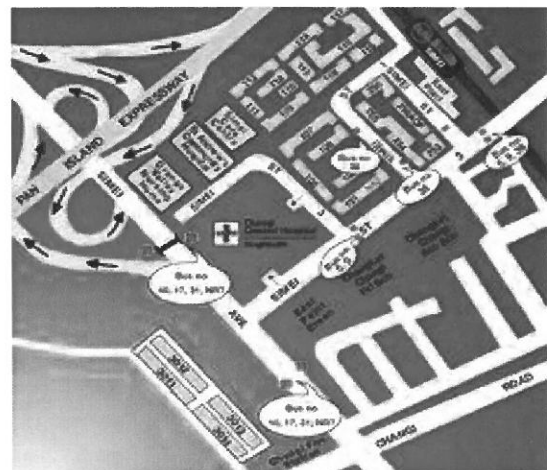
The theory of Firm Specific Advantage describes that a company should have specific advantage, even if it is small but exclusive, to enable it to invest and compete competitively in international market. The firm specific advantage will enable a company competes with local and international companies and producing larger profits compared to other competitors in international market. By investing in the international market, a multinational company will normally go through a new environment and will compete with the local companies as well as other multinational companies in the countries. The

firm specific advantage consists of intangible assets such as expertise in management, marketing, basic technology utilities and also tangible assets such as source of capital, modern machine, etc. Having this specific advantage has become a pre-requirement for a company before it takes any initiative to invest in international market.

ii) Location Specific Factor

Location-Specific factors come from a certain location (countries) and usually this advantage is the specific elements that place have. Some of the factors are:

- No trading ban that limits the import
- Skilled labor and cheap labor
- Wealth of natural resources
- Near the consumer
- Good transportation and communication
- Free from government interference
- Differences in culture



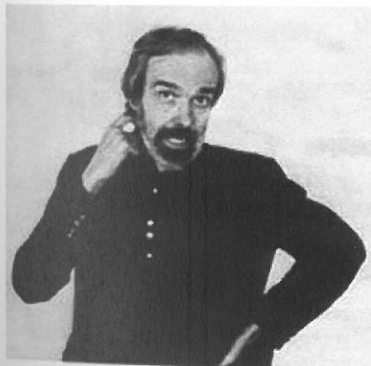
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iii) Internationalization Advantage

Internationalization advantage has suggested that foreign direct investment would happen when the transaction cost such as negotiation, observation and enforcement of the contract cost with the second company are high. In this situation, the organization would have higher profit using their own factors then letting or selling the factors to the second

party through licensing contract and franchise; if the local transaction cost to produce own product are high, a multinational company can invest in foreign countries. The internationalization advantage enable the organization to cross-subsidy the product or its operation to evade technology cost and to control the input supplies, sales condition and many others. The advantages of internationalization answered the question on why organization chooses to enter foreign market through foreign direct investment. The company has to make decision whether it is more profitable to handle the foreign factory by themselves or give the tender to the foreign company to produce the product, whether through franchising, licensing or agreement.

iv) Dunning Eclectic Model



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John H. Dunning has produced the eclectic model that combines the ownership advantage, locations advantage and the internationalization advantages to create a model of direct investment. The term eclectic are chosen because:

- (a) It describes the main theory that has been deferred since 1960 like the industrial organization, and the location of international trade without being tied down to any doctrines.

(b) It includes all type of foreign direct investment including the tender oriented investment.

(c) From Dunning's perspective, the eclectic term includes all types of foreign incorporation including exportation and licensing as a direct foreign investment and stated that the preferable method are based on the real benefit that the company can gain.

According to the Dunning Eclectic Model, a direct investment exist when there are three condition:

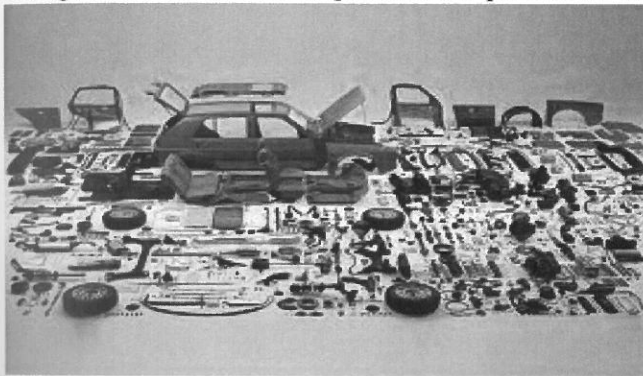
1. Ownership Advantage – the organization has to have a unique competitive advantage to help the organization to cover its weaknesses when competing with the foreign organization. This competitive advantage maybe comprised of tangible assets such as the natural endowment resources, manpower and the financial asset as well as the intangible assets such as communication technology, management, marketing and entrepreneur skill, etc.

2. Location Advantage – in international trading, the profits are bigger if production was done in the foreign location compared to domestic location if the location provides advantages in trading and investments.

3. Internationalization Advantage – the organization would receive advantages from controlling the foreign sales than giving contract to foreign company that giving the services. Controlling own production is more important as it is dangerous if the second organization has access to the organization technology.

1.4 International Automobile Business

The automobile business is a global industry that has been at the heart of the manufacturing changes in much of the developed countries and regions throughout most of this century. In the world of borderless today, the environment of wholesale realignment of markets, production processes and organizational structures, policy-



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makers must understand the degree and direction of change. The automotive industry provides significant insights into current and future directions for the entire economy.

The cyclical nature of an automotive industry has contributed directly to the industry's disproportionate impact on economic activity. As an example, the United States of America automotive sector directly contributes approximately 4 percent of total output as measured by gross domestic product (GDP). However, the automotive sector accounted for more than 40 percent of the change in GDP on quarterly basis.