

# PROSPECTS FOR AUSTRALIAN INVESTMENT IN THE INDONESIAN AGRIBUSINESS AND FOOD PROCESSING SECTOR

## EXECUTIVE SUMMARY

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For the Government of Indonesia's President Susilo Bambang Yudhoyono<sup>1</sup> capital investment is a cornerstone of recovery and future development. Fresh efforts are now underway to redress the structural impediments that have slowed investment in the past. No sectors are more important to the President than food and agriculture development and there is strong encouragement from both the Australian and Indonesian Governments for Australian agrifood<sup>2</sup> companies to review Indonesian investment opportunities that are a natural fit with Australian capability.

- Indonesia offers a market base of some 220 million consumers, with GDP currently growing at a rate of 5.4% per year,<sup>3</sup>
- Australian food and beverages are particularly well recognised in Indonesia and enjoy favoured positioning in the market.
- There is strong complementarity between the food and beverages Australia produces and Indonesian consumer demand.
- The latest data on investment approvals in Indonesia demonstrated an improved investment outlook. After falling more than one-third to US\$10.28 billion in 2004, foreign direct investment approvals in the first three months of 2005 were US\$4.28 billion – an increase of 173% over the same period in 2004.<sup>4</sup> Recent reports also indicate that domestic investment is on the rise.<sup>5</sup>
- The Australia-Indonesia business climate is positive and there is a growing awareness that the Indonesian economy is now back on track.
- Moreover from the perspective of an Australian investor, the Australian dollar to Indonesian rupiah exchange rate is currently at an historically favourable level.

This report, prepared under the auspices of the Australia Indonesia Working Group on Agriculture and Food Cooperation (WGAFC) and the Working Group on Trade, Industry and Investment (WGTII), focuses on 10 market sectors and profiles opportunities in these sectors. It examines the techniques Australian and Indonesian companies have adopted to create successful new business.

Indonesian firms contacted for the preparation of this report expressed solid interest in working with Australian companies. Australian agrifood expertise is well recognised and, combined with Australia's reputation as an exporter of quality food products, provides a firm basis for new business engagements.

**Clear Signs of Recovery.** Although investment surveys for 2004 ranked Indonesia's performance below that of its Asia Pacific competitors, there are now signs of renewed confidence. This improved sentiment has resulted from perceptions that the administration of President Susilo Bambang Yudhoyono would have the resolve to implement structural changes necessary for an investment-led recovery.

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<sup>1</sup> Popularly known as SBY.

<sup>2</sup> The terminology 'agrifood' is used throughout the report to refer to the full spectrum of the food and agricultural sectors, and includes any food or beverage product, or ingredient in a food or beverage product, from the raw and unprocessed state to that of a highly processed finished product.

<sup>3</sup> Economist Intelligence Unit – Quarterly Economic Survey, 22 March 2005.

<sup>4</sup> BKPM – Indonesian Capital Investment Board.

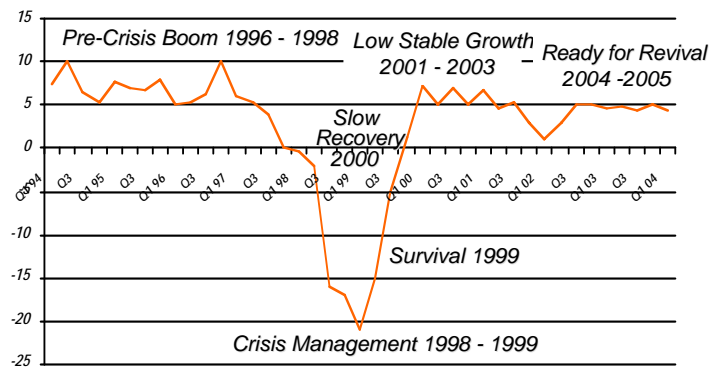
<sup>5</sup> New York Times, 18 February 2005.

*"My government is adopting what I call the triple track strategy," President Susilo Bambang Yudhoyono said recently.<sup>6</sup> "First, to promote growth through export and investment; secondly, to promote employment by stimulating the industrial sector and thirdly, to reduce poverty by promoting agriculture and rural development."*

The 1997/98 Asian Crisis battered Indonesia's economy. Although recovery has been slow, 2004's economic performance has been sound and projections for 2005 and beyond are positive.

**Strong commitment by political leaders.** President Susilo Bambang Yudhoyono and Prime Minister John Howard have both identified renewed investment in Indonesia as key to economic recovery and development. The President sees agrifood as a particularly critical growth sector.

### Indonesia: Real GDP Growth (%/year)



Source: KADIN Revitalization of Industry & Investment Report, with attributed commentary from the Indonesian Minister of Trade, Dr. Mari Pangestu - 200

**Investment opportunities take many forms.** This report examines Indonesia's attractiveness as a foreign investment destination in the broadest sense. It examines greenfield, as well as other investment models for the agrifood sector:

*Mergers and acquisitions*  
*Multi-partner investments with third countries*  
*Licensing & Technology agreements*  
*Brand building & marketing arrangements.*

For small and medium sized enterprises (SMEs), there are often considerable resource constraints that limit investment offshore. This report recognises these and examines investment techniques particularly suitable for SMEs.

**Indonesian agrifood companies must be internationally competitive.** Competition in the global food industry dictates that opportunities must be of world class to attract investment. Indonesia must compete for foreign direct investment (FDI) against all comers. China, India, Thailand, Malaysia and Vietnam are all attracting significant amounts of FDI in agrifood, and Indonesia must establish its own case to attract similar capital inflows.

<sup>6</sup> State Visit to Singapore, 16<sup>th</sup> February 2005.

**What do Australian industry leaders say?** This report includes comments from existing and prospective Australian investors as well as business advisers. A great number of CEOs today recognise the potential Indonesia offers for agrifood investment.

A précis of some of those commented is as follows:

*"Timing is right for Australian companies to reassess Indonesia's investment potential. The economy is on an uptick and Indonesian equity markets are strong."*

*"We need to unlock the potential of 220 million consumers to the near north of Australia. After China, Indonesia is the most exciting and promising growth play for Australian agribusiness companies."*

*"Establishing a manufacturing operation in Indonesia with core ingredients from Australia, means our company can get access to food processors servicing high volume markets."*

**Investment underpins merchandise exports:** Australia is an experienced exporter of food and agricultural products to Indonesia. Many Australian companies, however, continue to limit their engagement with Indonesia to direct export, waiting to be convinced that investment will yield a better return.

There is, however, also concern that low levels of supporting in-country investment will come at a cost to long-term market development. As the Reserve Bank of Australia Governor, Mr Ian McFarlane noted in March 2005, "One of the major characteristics of the development of Asia over the past decade has been the increase in cross-border interdependence of production."<sup>7</sup> Implicit in this cross border interdependence is the need to back export performance with strategic investments.

**Australian's agrifood industry structure is changing.** The Australian food processing industry has been undergoing major rationalisation, and this has been a factor restraining its focus on offshore expansion. Meanwhile domestic and traditional export markets have been strong, similarly limiting the need to consider other growth strategies.

**The need to understand Indonesian markets.** The Indonesian food market is also undergoing constant change. Understanding Indonesian consumer behaviour before and after 1997/98 is imperative in structuring business models for the future.

**The role of governments.** Australian federal and state governments have devoted considerable resources to the analysis, support and development of food exports to Asia. These promotional efforts have been successful in creating interest and providing a strong depth of information.

**The scope of the study.** Meetings were held with over 120 Indonesian companies, organisations and government agencies. The aim was to interview as extensively as possible prospective investment partners as well as key facilitators and regulators of investment transactions.

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<sup>7</sup> Australian Financial Review, 31 March 2005.

The following 10 agrifood sectors were analysed:

- *Fruit*
- *Poultry*
- *Beef*
- *Dairy*
- *Bakery Products*
- *Baby Food*
- *Confectionery*
- *Snack and convenience foods*
- *Beverages, and*
- *Food ingredients*

Interviews were conducted with Australian and Indonesian companies in each of these 10 sectors were analysed against Australian, Indonesian and global market settings.

The Indonesian food sectors were examined for:

- *Growth potential*
- *Scale of operation*
- *Foreign investment*
- *Competitive pressures*
- *Australian advantage*

In each of the sectors, investment attractiveness was tested against the following criteria:

- *Ease of entry*
- *Capital requirement*
- *Sales potential*

In assessing investment prospectivity subjective entry factors were also considered. A range of investment alternatives was identified in each sector to provide a practical blend of investment entry models.

*The end result was a matrix of investment attractiveness for the 10 agrifood sectors, with commentary on specific business opportunities in each sector.*

Good market openings are reappearing and some Australian companies and a broader range of international groups are developing them. Australian companies active in Indonesia are translating these new dynamics of the food market to build profitable ventures.

'Staying away until things get better', however, does not make eventual market entry any easier, as existing players consolidate their own market presence. The Indonesian food market is undergoing fundamental changes. Gaining first-hand experience and knowledge is critical to developing a long-term business strategy.

**Some key messages for investors.** The agricultural sector in Indonesia will always have sensitivities to foreign investment. Complex issues of smallholder communities, land ownership, co-operative marketing and a long history of government intervention mandates a well-considered and long-term strategy.

The food-processing sector does not have the same complexities, although local raw material supply may pose particular challenges.

**Conclusions and recommendations.** The report provides a review of the Indonesian agrifood sector, as well as an analysis of the Indonesian investment climate and methods of investment market entry. Suggestions for business programs and investment promotion have been provided.

The view from Indonesian companies and agencies was:

- Renewed levels of confidence in the political and economic environment.
- Strong consumer demand is fuelling new domestic investment and finance is readily available to add new manufacturing capacity.
- Sustained recognition of Australian expertise and skills.
- Willingness to work with Australian companies in a variety of business models.

Some Indonesian companies queried why Australian business engagement was not higher, and often were not familiar with the full extent of Australian agrifood expertise.

From the Australian side, company views varied, however common themes were:

- There is recognition that Indonesian business conditions are improving, with a growing awareness that the economy is getting back on track.
- Indonesian investment settings have to improve to attract new capital; of particular concern are governance issues, legal and administrative unpredictability and a pervading sense of uncertainty.
- Other countries are presenting a much more favourable investment climate. Indonesia is considered to have fallen behind in attracting FDI as a result of political uncertainty and poor governance factors.
- Australian companies are generally familiar with the Indonesian environment and many see Indonesia as a critical element in their future strategies.
- There is a strong 'wait and see' element in assessing the performance of the SBY government and its ability to create durable economic reforms.
- Across the board there is considerable belief in increased two-way engagement of Australian and Indonesian business leaders.

High-level visits, conferences and investment workshops can deliver impact. Companies listen to industry leaders and are more likely to act as a result of an interaction at senior executive level. Putting business leaders together is a powerful catalyst.