PART THREE: AN AUSTRALIAN INVESTMENT PERSPECTIVE

THE AUSTRALIAN AGRIFOOD INDUSTRY[1]

The Australian food industry is broad based and world competitive. The value of Australian food exports in 2003-04 was A$21.1 billion, about the same as Indonesia's **total** exports. The industry has performed well – food exports have grown by an average 6% each year in the ten years to 2002.[2]

- Australian food products account for 22% of Australian merchandise exports and represent a 2.7% share of world food trade.
- The processed food industry is a major employer, representing about 17% of the total manufacturing workforce.
- In GDP terms, 22% of manufacturing sector turnover is from processed food and beverages.
- The Australian industry is a mature sector of the Australian economy, projected to grow at 2.7% per year, against forecast GDP growth of 3.6%.[3]
- Meat, grains, milk and seafood accounted for 73% of Australian farm and fish production in 2002/3 – valued at A$28 billion.

While Australia has a strong export trade in agricultural products, this is not, however, reflected in foreign investment, either by product category or by export destination. Australia, with its 3% of global trade in foodstuffs, is a relatively small player in overseas investment in agrifood.[4]

ENGAGEMENT IN OVERSEAS MARKETS

Australian outward FDI in the agrifood sector is modest compared with mining and other secondary industries such as building and construction. Moreover, Australia is itself a major destination for FDI, and overseas-owned companies dominate the Australian food industry. Recent developments with takeover offers indicate this trend is likely to continue.

In the major sectors of grains, meat and dairy, Australian companies are large exporters, well-experienced and embedded in international markets. For a variety of reasons, however, this has not translated into a large offshore investment presence, other than bilateral engagement with New Zealand.

Major outwards foreign investments include, however:

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[1] The perspective covers the entire agrifood industry from agricultural raw materials to processed food products.
[2] Data in this section is derived from the National Food Industry Strategy website.
[3] IBIS forecasts.
[4] NFIS data, 2002.

- Brewing
- Wine
- Biscuits (Arnott's/Campbell Foods)
- Fruit juices – Berri in China and Indonesia.

The Burns Philp group previously had major offshore investments in spices and yeast manufacture, however the company sold its yeast and bakery ingredients group to Associated British Foods plc in 2004.

In Indonesia, Burns Philp is represented through the activities of their Goodman Fielder subsidiary (Meadow Lea margarine). This is a joint venture with the PT Sinar Mas conglomerate.

The Berri group has a JV in Indonesia producing fruit juices and Arnott's manufactures biscuits in Indonesia. The San Miguel group of the Philippines recently took a 50% stake in Berri and have announced that they plan to expand beverage production in Indonesia.

MNCs such as the Mars group use Australia as a regional Asia Pacific base, and draw on a variety of Australian resources for their offshore operations in the region.

WHY AUSTRALIAN FIRMS INVEST OFFSHORE:

For Australian companies, the key factor driving offshore investment is access to larger markets. Factors such as foreign taxation benefits, labour issues, tariffs and access to lower priced inputs are also critical. Survey data[5] demonstrates, however, that *access to global markets* is the primary driver of offshore investment by Australian companies.

The perceived benefits for most Australian companies generally are:

- availability of a larger customer base
- expanded marketing options – and increased scale of operations
- increased availability of skilled foreign staff
- better access to production technologies
- in certain cases, (especially food, building materials and service delivery) a local presence is sometimes mandated to effectively service foreign markets

During 2003, Australian direct investments held offshore by Australian companies were estimated to total A$169 billion. The Australian level of direct investment abroad for calendar year 2003 by Australian companies is listed in Table 26.

TABLE 26: AUSTRALIAN FDI, CALENDAR YEAR 2003.

COUNTRY	VALUE A$ MILLIONS	% OF TOTAL
USA	78,026	46.0%
United Kingdom	34,280	20.2%
New Zealand	21,819	12.9%
Bermuda	4,717	2.8%
Hong Kong	3,400	2.0%

[5] Austrade; Productivity Commission survey 2001.

(SAR China)		
Netherlands	2,267	1.3%
Singapore	1,805	1.1%
Indonesia	439	0.3%
Malaysia	263	0.16%
Thailand	204	0.12%
TOTAL	169,455	100.0%

Source: ABS – International Investment Position: Supplementary Country Statistics Cat 5352 Table 5c

These figures do not include portfolio investment.

It is difficult to draw precise conclusions from these country-based statistics, beyond the obvious judgment that Australia's investment stock in Indonesia at the present time is at a low level compared to more traditional markets in the USA, UK and New Zealand. The statistics also require careful interpretation, as investments may often be made via third countries, and movements of capital offshore and repatriation of funds are not easily captured in official statistics.

Foreign Investment in Australian Agrifood Industries:

The propensity of the Australian agrifood industry to invest offshore is lower than other major manufacturing sectors. Some of the contributing factors are:

- the high degree of foreign ownership of the Australian industry
- industry fragmentation (e.g. the dairy industry is organised in cooperatives of small scale dairy farmers – although this situation is now rapidly changing with considerable consolidation of holdings), and
- a long history of concentrating on merchandise exporting.

A 2004 estimate[6] indicated that multinationals owned 23 of the top 50 food and beverage companies in Australia, accounting for one third of total output. More recent takeover activity by MNCs is expected to result in an even higher figure in 2005.

Interestingly, the Australian industry has a high export intensity that is not reflected in investment. In the food sector, being 'inside the market' and closer to the customer has important advantages in gaining and maintaining market share.

Some Australian executives interviewed[7] commented that Indonesia's raw material processing sector was not internationally competitive, with the exception of plantation crops such as cocoa and palm oil. Infrastructure impediments such as lack of an efficient cold chain were also mentioned as inhibiting corporate decisions on investment.

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[6] Nigel Gerrard, Managing Director of SPC Ardmona and Chairman of the National Food Industry Strategy (NFIS) Ltd, speaking at the opening of the Annual Outlook Conference of Australian Bureau of Agriculture & Resource Economics (ABARE) in Canberra on 2 March 2004.
[7] Bayliss Associates interviews, December 2004.

For SMEs however, the opportunities for engaging in investment-related activities in foreign markets has changed. Companies with specialised products, services or strong brands are prepared to engage in business activities that may be classed as 'investment' although the financial commitment may be relatively low. This usually stems from the need to be a 'market insider' to achieve the business's objectives. One example would be the secondary tier franchises such as Dôme, La Porchetta and Gloria Jean's, which require deeper relationships with local partners and allies.

> *A frequent comment about Australian outwards investment is that Australian equity markets emphasise shorter-term returns in the FMCG sector. Shareholders and analysts are often described as impatient with foreign ventures that have longer lead times and variable profit performance during the establishment phase. While there may be considerable truth in this comment, Australian equity markets and analysts have also been receptive to companies which have well-founded investments and a sound strategy.*

A Perspective on Australian Investment In Indonesia

Australian investment in Indonesia had its origins in 1959 in the automotive industry, when General Motors Holden shipped CKD (completely knocked down) Holden packs to Indonesia for assembly in Surabaya. Assembly of Holdens continued through the 1960s and 1970s and Holden Kingswood and Torana taxis were a common sight on the streets of Jakarta during this period. The Holden Commodore was also assembled in 1981.[8]

During the 1960s a range of Australian investments commenced operations in Indonesia. Building and construction activity attracted many Australian companies during this period. The following is a listing that is representative of some of the Australian companies that have invested in Indonesia over a 40 year period:

- Steel drums and water heaters (Rheem)
- Dairy Products – Australian Dairy Corporation
- Consumer goods – Kiwi
- Engineering consultancy services (Meinhardt and others)
- Surveying and cartography (Arman & Larmer and others)
- Contracting services (Thiess and others)
- Steel building products, corrugated sheets – BHP Biliton group
- Industrial gases – CIG
- Glass containers – AGM
- Concrete pipes and structures – Hume, Monier
- Ready mixed concrete – CSR, Pioneer
- Mining – CSR, CRA and others
- Advertising and public relations (technical advisory arrangements).

The Australian presence increased in the 1970s in these sectors, as well as many others, including:

[8] Data from GMH Corporate Communications, February 2005.

- Banking – representative offices and investment vehicles
- Oil and petroleum services
- Engineering – Walkers Ltd
- Engineering consultants and contractors – a large expansion in this group
- Mining and mining services and equipment
- Building products – James Hardie
- Legal and accounting services (technical advisory arrangements)
- Packaging – ACI
- Foundry products - Tubemakers
- Fire protection – Wormald
- Consumer goods – Reckitt + Colman
- Portable buildings – ATCO
- Pharmaceuticals (Australian branches of MNCs)
- Steel structures – Transfield
- Building and construction – Frankipile, L+M.

The 1980s saw the spread of industries expand, notably mining and services became more prominent:

- Mining – CRA and many others – coal, gold, nickel and copper
- Contract mining services
- Shipping and marine services
- Packaging materials
- Consumer goods
- Insurance – QBE
- Service industries – management and financial services
- Aviation
- Livestock services
- Plastics processing
- Transport equipment
- Welding equipment
- Management consulting
- Yeast production – Burns Philp
- Architectural services
- Health services
- Telecommunications
- Banking – ANZ, CBA

The 1990s saw the greatest increase ever recorded in new investment, with about 400 companies listed in the Austrade Directory of Australian Business in Indonesia in 1995.

The 'boom' period from 1991-1996 resulted in an influx of small and large companies, but was noted for the high number of SMEs who 'discovered' Indonesia, by then an overheating economy.

Much of this growth in interest from Australia was spurred by the massive 'Australia Today Indonesia 94' integrated country promotion, which saw 12 Australian Ministers visit (including Prime Minister Paul Keating), as well as virtually all state premiers and many state ministers. The business conference attracted 600 Australian CEOs and senior executives.

The wave of new investment expanded to include almost every service available in Australia as Indonesia ramped up double digit growth and consumer demand reached levels well above the previous decade.

Major investments included Telstra's contracts in Central Java as well as investments in packaging (AMCOR), plaster board production by Boral and CSR and coated steel by BHP. But there were many more:

- Automotive products
- Construction and financial services – Lend Lease
- Beverages – Coca Cola Amatil
- Insurance - AMP
- Food processing – Berri, Arnott's, Goodman Fielder
- Golf course design
- Landscaping services
- Interior design
- Public relations
- Concrete products
- Salt refining and processing
- Electrical products – insulators, transmission equipment
- Management consulting.

This business expansion in 'overdrive' came to an end abruptly in 1997, with the onset of the Asian financial crisis. First to go were the companies servicing the 'luxury' market such as resort design and construction.

With so many of the Indonesian conglomerates carrying heavy levels of debt, a flurry of M&A and corporate restructuring activity took place in Indonesia and the South East Asia region, which took several years to work through. Indeed, the Indonesian Bank Restructuring Agency (IBRA) only completed its mandate in 2004.

The ensuing period resulted in many Australian companies disinvesting, selling their assets, merging or heavily downsizing to 'hang in' during the hard times.

The communal violence that accompanied the fall of the Soeharto New Order government in May 1998 provided a severe jolt to the expatriate business community, who had previously been largely immune from periods of social unrest. Australian boards applied stringent standards to an ongoing presence in Indonesia and the safety and welfare of expatriate staff and their families was a major consideration.

1998 changed the atmosphere of a 'comfort zone' for expatriates, albeit that there were no Australian casualties at that time. Australians nevertheless faced many situations of increased risk and danger, and this has impacted corporate investment decisions in Australia.

The events of 1998 have been exacerbated by terrorist incidents on 11 September 2001 and have been followed by the Bali bombings (October 2002), the J.W. Marriott bomb (August 2003), as well as the Australian Embassy bombing in September 2004.

While Australian corporate decision makers are increasingly positive about the democratic elections of 2004 and the actions being taken by the SBY government, unpredictable terrorist events will continue to impact on investment decisions, particularly where expatriate Australian staff and their families are involved.

Since the market shake-out of 1997/98, a strong core of Australian companies have continued to conduct a broad range of business operations in Indonesia and for most, 2004 has been a good year as sustainable economic growth returned and the elections provided a strong boost to business and consumer confidence.

VIEWS FROM THE BUSINESS COMMUNITY

Richard Martin, Managing Director of IMA Asia, advises a wide range of Australian and international companies on business strategies in Asia. IMA is an affiliate of the Economist Conferences Group.

Richard Martin observed that, in terms of investment in Asia, Australia's focus is overwhelmingly on China. He suggested that, in general terms, China probably represented around 70% of Australian companies' current investment interests in Asia, India some 15% – with other Asian markets taking up the rest. Not all that interest of course is expected to translate into actual investment, but China is seen very much as the essential strategic play for most major international companies. Its importance in investment terms dwarfs the rest.

Whilst investment in China is seen as strategic, other developing markets in Asia are viewed more in 'frontier' terms – and not considered critical to forward planning. Indonesia, Martin observed, is likely to remain a frontier market for the next five years, 'or at least until there is a sufficient run of data to demonstrate that reform is going right.'

'Until then it will continue to be difficult to get an Indonesian investment proposition past your board and your banker.'

Nevertheless there are strong indications that Indonesia is starting to come right. Much depends on the incoming administration of President Susilo Bambang Yudhoyono.

Richard Martin summarised 'Companies can do well in Indonesia, but they require capable managers on the ground, often of the old school, who can manage a low asset business with variable cash flow and have an innate understanding of risk and return.'

One of Australia's top corporate lawyers, with many years' experience in Indonesia, remarked that following the financial crisis of 1997/98 up until the election of the SBY government, there had been a marked reluctance among major Australian companies to consider investment in Indonesia. He noted that corporate concerns centred around uncertainty in the administration of commercial law, opacity in government decision-making processes, increasing concern at Australian board level with governance issues in Indonesia and apprehension that regional autonomy policies were adding a further layer of cost, regulation and uncertainty to business operations.

'There are a range of positive signs emerging and the business community is waiting for concrete decisions on the legal environment as well as clarity in policy direction. Outstanding legal cases that have clouded perceptions for foreign investors must be resolved quickly, and the government is clearly making a concerted effort to do so.'

'The Australian Government's supportive role is also key to reinvigorating bilateral investment deals. John Howard has taken a strong stand in supporting the recent Indonesian infrastructure summit and emphasising the importance of new investment in Indonesia and the Australian business community is taking notice. The timing is right for Australian companies to reassess Indonesia's investment potential. The economy is on an up-tick and equity markets in Indonesia are strong.'

'Other countries such as Singapore, Malaysia and China have been active for some time in investing in Indonesia. Australian, as well as other overseas banks and financial institutions have been looking at investment opportunities. They recognise the potential and that current settings are improving. We need some high level exchanges of business and government leaders to work on identifying and defining tangible new investment deals, and accelerating the regulatory steps needed to improve the investment climate. The Indonesians appreciate what has to be done and are looking to Australia for a positive approach to the improving environment for deeper business engagements.'

Washington H. Soul Pattinson and Company Limited (WHSP), through its subsidiary, KH Foods Limited (formerly Keith Harris & Co.), has positioned itself strategically in the Indonesian food additives market. WHSP has consolidated its relationship with the flavorings and additives company PT Jutarasa Abadi in Jakarta, to provide an efficient, low cost manufacturing base for the South East Asian region.

Mr. Robert Millner, Chairman of WHSP, notes that Indonesia offers considerable potential as a manufacturing base for its Asian operations. Millner emphasised, however, that the key to success in Indonesia is the selection of a suitable local partner. 'The right partner is basic to any long-term strategy,' Millner said. Moreover by establishing a local low-cost, manufacturing operation in Indonesia, whilst supplying core ingredients from Australia, a company can gain access to food processors servicing that lower cost end of the market.

'These are often companies unable to afford imported ingredients. Local manufacture can unlock the considerable, untapped demand of efficient, low-cost food processors in the Indonesian market.' Millner said.

Mr. Millner also noted that the new government of President Susilo Bambang Yudhoyono was sending the right messages to the international investment community, and that the President knew what was needed for an investment-led recovery. Millner stressed, however, that the foreign investor looked for concrete action to support policy initiatives.

One of Australia's leading agribusiness investors with a high exposure in Asia also shared his experiences. Some of the highlights were:

'In 1997/98 nearly everyone got burnt in Indonesia. But it also opened M&A and other opportunities. The Indonesian domestic market is huge, particularly in the major cities, especially Jakarta, where there is an increasingly sophisticated middle class. Distribution capability is always problematic, particularly for fresh, chilled and frozen product.'

'The Indonesian retail sector is now more sophisticated, but improved retailing skills are not evident outside Jakarta. Food processing companies wanting to buy into the market or operate in Indonesia are finding it difficult to find distributors with good discipline in the cold chain.'

'If investing in Indonesia – the cheapest thing is labour. But to make food products, labour is rarely more than 10-15% of variable cost. Labour costs in Indonesia are about 1/6th what they are in Australia – but because Indonesians don't have the same skill level, it is not comparing like for like. Labour saving is also not a direct comparison – as there has been not enough investment in skilling the Indonesian workforce in quality standards. It is not at all apparent what you need to do to compensate for skills development.'

This CEO reflected that there were three primary factors attracting investment to Indonesia:

- availability of local raw materials
- size of the Indonesian market
- labour costs

He noted that Indonesia was nevertheless finding it hard to compete with Vietnam, Malaysia, India and China.

'You need to find solid JV partners who have good connections. Connections are always important – but these days' commercial skills and market savvy rank higher. I need someone who understands the dynamics of my industry and has a vested interest in ensuring a project will work – plus a financial commitment.'

EMPLOYMENT IMPLICATIONS OF FOREIGN DIRECT INVESTMENT

The Australian Productivity Commission (PC) undertook the most recent survey of the employment implications of Australian companies investing offshore in 2002.[9] While levels of investment have changed since that time, the research findings on economic linkages remain substantially valid. The survey was based on interviews with 200 companies.

The Commission found that market-related factors are the major drivers for outwards investment, particularly access to overseas markets. Very few respondents reported a fall in their domestic activity as a result of outwards investment, while many reported an

[9] Australian Productivity Commission, *'Offshore Investment by Australian Firms',* 2002.

increase. The PC survey reveals that

'The establishment of offshore operations typically does not reduce or displace local activity of investing firms. Indeed, the survey suggests that FDI is more likely to complement, rather than substitute for, domestic operations.'

The Commission also noted *'While a majority of respondents indicated that their offshore operations had had no impact on their production and employment in Australia, those who considered that it had led to higher employment and production outnumbered by two to one those who considered that it had resulted in some contraction in activity.'*

Many companies also indicated that their offshore investments had:

- increased profitability, and
- lifted exports.

Both these factors have positive collateral benefits in employment creation. The perception that a company's overseas investment impacts negatively on their exports is not borne out by experience – or statistics. Indeed, at a time of historically high growth in outwards FDI from Australia, exports also grew strongly, as did the share of manufactured products in Australia's export mix.

The Productivity Commission survey indicated that over 90% of 90 Australian companies with offshore investments reported that their offshore activity had either not changed, or had led to an increase in their Australian production, exports and employment over the previous 5 year period.

Outwards investment has been strongly associated with forging new growth opportunities, rather than substituting for, or replacing, operations in Australia. Offshore investment also provides other opportunities, often stimulating research and development to support the company's products in offshore markets and under local manufacturing conditions. Other benefits flowing from FDI include:

- better risk management and achievement of economies of scale in the provision of financial services
- a global outlook and an improved ability to service clients in other overseas markets
- economies of scope through access to a larger portfolio of development opportunities.

The range of investment opportunities examined in this report will be either employment-neutral or in fact add to a company's employment, as a result of some of the positive factors which complement an offshore investment.

THE SINGAPORE CONNECTION

Indonesia and Singapore have many longstanding trading and investment links, strengthened by Singapore's role as a regional trading and financial centre and it geographic proximity as one of Indonesia's immediate northern neighbours.

Singapore's level of commercial engagement in Indonesia has grown appreciably in recent years, and it is now one of the largest foreign investors in the country. Agrofood is of special interest in that investment mix – notably estate crops such as cocoa and palm oil.

There are also long-standing family linkages between the ethnic Chinese communities of Singapore and Indonesia, and many of the larger Indonesian family companies have significant investments in both countries.

A range of Singapore government agencies and government-linked companies (GLCs) are also active in Indonesia, including the Government of Singapore's investment arm, Temasek Holdings.

Singapore's Economic Development Board has provided strong support to projects in Indonesia for the production of leafy green vegetables for the Singapore market as well as pig farming on Pulau Bulan, with the output of those farming operations exported to Singapore.

The Government of Singapore, through its export promotion arm, International Enterprise Singapore, has established Network Indonesia an industry grouping to foster connections and business linkages between companies that have an interest in the Indonesia market. It aims to cultivate a fraternity of Singapore-based companies and entrepreneurs interested in business opportunities in Indonesia, and assist them to share timely information, ideas, opinions and experiences.

Australian companies contemplating investment in Indonesia may find value in exploring business links with Singapore-based companies already in Indonesia. Singapore companies with food-related interests are always interested in new technologies for agrofood processing and Australia is seen as an important source of that expertise.

Associations with Singapore companies in the agrifood sector could spread the risk of investment and open new lines of finance. The Government of Singapore is actively supporting ventures in Indonesia, and would be pleased to assist in putting appropriate parties together.

Finding the right commercial links does take time, but there are a number of Australian and Singapore government agencies that can offer advice, as well as many private sector business and financial advisers who could provide assistance as well. These include:

- Austrade http://www.austrade.gov.au
- The Australia Singapore Chamber of Commerce & Industry http://www.ascci.org.au

- Department of Foreign Affairs & Trade http://www.dfat.gov.au
- International Enterprise Singapore http://www.iesingapore.com

  Association with a Singapore partner may also provide an Australian company with broader regional focus and access to other ASEAN markets as well.

As Indonesia's economy recovers, the level of Singapore investment in Indonesia is forecast to increase substantially. The two countries recently signed an Investment Protection Agreement – a key element in the bilateral business relationship.

Singapore is keen to add value to Indonesian agricultural commodities and its strong international trading and transport links can facilitate investment.