

Manufacturing Sector Brief
INDONESIA



COUNTRY OVERVIEW

Indonesia is the largest member country of the Association of Southeast Asian Nations (ASEAN) in terms of land size and population of over 270 million people (in 2020). It is also the world's most populous Muslim-majority country and potentially a large consumer base for 'Halal' certified products. Based on 2020 population census, those age 39 years and lower make up more than 55% of the population.

Indonesia's economy is 66% of the whole ASEAN economy with GDP growth between 5.1% and 5.3% annually. Economic development in Indonesia has been impressive and prior to COVID-19 the country was on track to qualify as an upper-middle-income status economy (World Bank, 2021). The country is endowed with vast and rich natural resources supporting various forms of agriculture. Thus, its economic growth potential is centered around manufacturing, agriculture, marine, infrastructure, and tourism industries. Further, Indonesia has also adapted with global technology, in particular digital technology.

Indonesia's economy sees increased economic growth potential with the signing of the Regional Comprehensive Economic Partnership (RCEP) along with other trade agreements (OECD, 2021).



MANUFACTURING SECTOR OVERVIEW

Indonesia is courting investors to the country, as it aims to be in the top 15 manufacturing hubs in the world by 2023 and its growing middle class provides the much-needed leverage to accelerate growth in the manufacturing sector.

Powered by 15% of the national workforce, Indonesia has registered USD 8.9 billion in investments from January to September 2019. The health and social services, information and communication, agriculture forestry and fishery, water supply and waster treatment, finance and real estate all experienced positive growth in 2020.

● GDP Composition in 2019 and 2020

Sector	2019
Services	44.2
Industry	38.9
Manufacturing	19.7
Agriculture	12.7

According to the UN Comtrade Database, Indonesia's trade statistics showed imports surpassing exports by USD 3.72 billion in 2019.

• Total Exports (2019)	\$167,002,880,981
• Total Imports (2019)	\$170,727,343,535
• Trade Balance (2019)	(\$3,724,462,554)

Table 1: Indonesia MSMEs by economic sector 2016

● Item MSMEs by sector (% share)	2010*	2011	2012	2013	2014	2015	2016**
Agriculture, forestry, and fisheries	50.0	49.6	48.8	--	--	--	--
Manufacturing	6.2	6.4	6.4	--	--	--	16.7
Transportation and communication	6.5	6.5	6.9	--	--	--	7.3
Construction	--	--	--	--	--	--	0.9
Wholesale and retail trade***	29.4	29.6	28.8	--	--	--	63.5
Other services	6.3	6.4	6.9	--	--	--	10.7
Others	1.6	1.6	2.1	--	--	--	0.9

* The Ministry of Cooperatives and SMEs revamped data, tracked back to 2010. Annual sectoral data were also revamped but not available after 2013 as a survey of the business sector was stopped.

** Sectoral data in 2016 are based on the Economic Census 2016 (only for non-agriculture sectors). Wholesale and retail trade includes hotel and restaurant.

(Source: ADB Asia SME Monitor 2020 database)



SUBSECTOR/SEGMENT

Investors can have good opportunities in the machinery and equipment manufacturing subsector, which is slated to grow at 8% annually, fueled by the rapid development in agribusiness, energy, mining, and construction in Indonesia.

The main areas of manufacturing include textiles and garments, food and beverages (F&B), electronics, automotive, and chemicals, with the majority of manufacturers in this sector comprising micro, small, or medium-sized enterprises (MSMEs).

Textile and garments are mainly exported to the United States and increasingly to the Middle East. Indonesia enjoys low tariffs on textile and garment exports to the US and the European Union under the Generalized System of Preference (GSP). Indonesia aims to become a leading textile and garment manufacturer for export market.

The automotive sector is another key manufacturing sector, with the leading brands such as Toyota, Daihatsu, Honda, and Mitsubishi. The large and growing middle class population continues to make Indonesia an attractive market for automotive sector in Southeast Asia. It has a well-developed capacity for MPVs and SUVs but not for sedans because the government's tax system does not encourage the production and export of such vehicle.



GEOGRAPHICAL PRESENCE

Investment in the manufacturing sector should be targeted at the country's main manufacturing hubs located in the provinces of West Java, Central Java, East Java, and Banten, where logistics and infrastructure are the most developed with easy access to seaports. Indonesia's manufacturing sectors carries some heavy weights such as:

- Busana Apparel Group - one of the largest garment manufacturers and exporters;
- Sampoerna - Indonesia's largest tobacco company with about 35% of the Indonesian tobacco market and one of the largest Indonesian companies on the Indonesia Stock Exchange (IHSG) in terms of market capitalization;
- Indofood - Indonesia's largest food processing company and the world's biggest producer of instant noodles. Indofood has operations in each stage of Indonesia's food manufacturing, from the production of raw materials, processing, and to consumer end products;
- PT Charoen Pokphand Indonesia Tbk - manufactures and distributes animal feeds, woven plastic bags, and poultry equipment and also processes chicken; and
- Indah Kiat Serang - pulp and paper manufacturing (bleached hardwood paper pulp, full range of paper, tissue, packaging, and stationery).



BRIEF PROFILE OF MSMES IN THE SECTOR

MSMEs account for around 99% of existing business enterprises in Indonesia and employ more than 95% of the total workforce across the country. The food sector is the largest manufacturing sector by number of firms (24.5% of the total), employment (16.4% of the total), and value added (18.4% of the total).



POLICIES AND REGULATIONS

Investors should look out for various incentives and tax relief programs put in place by the Indonesian government to promote investment in the manufacturing sector. Many of these incentives have been outlined in the Indonesian Master Plan of National Industry Development 2015-2035.

Specific manufacturing subsectors that prioritized to enjoy such incentives are food and beverages, automotive, textiles, electronics and chemicals. The Indonesian government's implementation strategies for the Master Plan of National Industry Development 2015-2035 is by embracing Industry 4.0 or the Making Indonesia 4.0 strategy. Investors in high-end technologies to support growth in high-technology manufacturing may see several exciting opportunities for investments in artificial intelligence, robotics, and genetics research by 2030.

Scaling up e-commerce expands market access opportunities for MSMEs. Indonesia's Nexticorn program, which was launched in May 2018, aims to link local start-ups with financial backing for the growing portfolio of start-ups valued at over approximately USD 1 billion in the country. These efforts drives both domestic and foreign investments in Indonesia.

Investments in Indonesia is further facilitated by several incentives such as:

- **simplified business licensing**
with online one-stop service for integrated submission system (pelayanan satu pintu)
- **eased foreign investment restrictions**
ease rules in some of its startups by minimum investment requirements exemption
- **relaxed labor laws**
immigration law relaxations for foreign personnel including a 'fairer' approach to hiring and firing
- **streamlining of corporate tax regulations**
for example, business in an Special Economic Zone (SEZ) are categorized according to two types of tax: badan usaha (business entities) and pelaku usaha (businesspersons). Both of which are eligible for 100% reduction in corporate income tax as long as their investment are in SEZs and with a minimum value of IDR 100 billion (USD 7million) for a period of 10 years



INVESTMENT AND MARKET ENTRY OPPORTUNITIES

Investment opportunities in agriculture, manufacturing, tourism, and natural resources are rife in Indonesia's 11 Special Economic Zones (SEZs) across the country. The SEZs continue to attract increasing investments. Up to October 2019, the total investments SEZs of Indonesia have achieved is over USD 6 billion, especially in Sei Mangkei, TanjungApi-Api, Maloy, Palu, Bitung, and Morotai.

Being a country with the largest Muslim population, Indonesia is a major market for Halal-certified products. With the 2019 Halal Product Law, there is a ready market for Halal-certified products in and outside Indonesia. Investors should take note of the Indonesian government strategy to tap into high-value niche market for sharia-compliant food and beverages and consumer goods especially in Islamic countries.

Indonesia presents a clear growth opportunity to investors based on understanding all partnerships to be mutually benefitting business, employment market and the public sector in terms of revenue.



ISSUES AND CHALLENGES

Although Indonesia's investment climate is changing to favor more investments, the government continues to further improve and facilitate launching new projects, securing raw materials from overseas, and setting up a business or facility in some localities (where the government of Indonesia continue to enhance governance, transparency and local government service excellence). The vast archipelago of over 17,000 islands results in businesses facing rules and regulations that vary depending on their locality.

Investors or foreign manufacturers with robust international value chains may face cumbersome import license requirements and hefty import duties. This may pose obstacles to the development of high value-added manufacturing sectors, such as automobiles, mobile phones, and technology-intensive products.

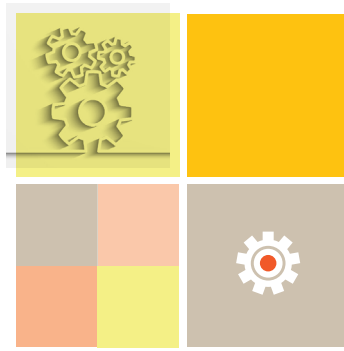
Public-private partnerships with foreign investors or its large manufacturers may be able to link over 99% of manufacturing firms who are MSMEs with the global value chains. Investors may need to take into account the lower labor productivity as compared to its ASEAN peers, which may slowdown adoption of high technology in the manufacturing sector.

Investors may need to consider engaging domestic MSMEs to support investments in manufacturing and facilitate transfer of technologies and upskilling of the workforce. Foreign trade delegations may consider policy support to incentivize human resource development and favorable tax policies for MSMEs to improve their competitiveness and value addition. With more efficient coordination across multi-agencies in the roll-out of more than 50 incentives for the manufacturing sector, investors may find a compelling case to increase their stake in this sector in Indonesia.



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