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# Integrating Business Opportunities in Contiguous Economies: Perspectives from Singapore's Gambit in Indonesia

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# Pan Pacific Conference Proceedings

## Integrating Business Opportunities in Contiguous Economies: Perspectives from Singapore's Gambit in Indonesia

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### ABSTRACT

The idea of exporting Singapore's expertise in infrastructure development took hold, in the early 1990s, as part of a larger regionalization strategy. Singapore's positive reputation with multinational corporations for the efficiency of its industrial infrastructure underscored this strategy. This paper<sup>1</sup> revisits the debate on the attractiveness of the low-cost investment enclaves for multinational investments, with *new evidence* from Batamindo Industrial Park. Evidence from on-site surveys is presented. This paper concludes that, while the project's progress to date has been largely overshadowed by socio-political uncertainties in the host environment, its future outlook remains promising.

### INTRODUCTION

Singapore has, over the last four decades, risen to be Southeast Asia's premier world-city, as well as an important base for multinational manufacturing. However, given the inherent confines of a city-state, it has also been driven to hone its ability to leverage global resources to ensure sustained economic growth. Since mid-1960s, the Singapore government has been very aggressive to woo foreign Multi National Companies (MNCs) to fuel the city-state's economic development. However, rising business costs in the 1980s made it imperative for Singapore to redistribute its labor-intensive activities to neighboring areas, and forge important linkages with low cost production environments in the immediate region.

### SINGAPORE-RIAU 'ALLIANCE'

Against this backdrop, it had long been recognized that the Singapore-Indonesia border zone, notably the nearby Riau islands of Batam and Bintan, were capable of attracting labor-intensive industries, and activities with extensive space requirements that are closely linked with Singapore-based activity. However, it was not until 1989, when Indonesia was prepared to extend foreign investment concessions to

kick start Batam's development, that Singapore renewed its interest in participating in the development of these islands.

The strategic thrust of the flagship project was to present investors with a packaged choice to locate the activities along their value chains in the contiguous areas, viz, Singapore can support business operations dependent on advanced technology and sophisticated services, while low value, labor-intensive industries can be located in the Riau islands. Such specialization, as provided by both Singapore and Riau, is designed to enable investors to retain activities in close proximity while making use of contrasting environments i.e. complementary specialization in national border territories [2].

### Batamindo Industrial Park

Batam Industrial Park started with a joint venture between two Singapore government-linked companies and Indonesia's Salim Group. The Singapore partners contribute design, physical development, management and marketing of the Park while a Salim subsidiary, has responsibility for labor recruitment.

The Park was conceived as a self-contained industrial township with its communication and business linkages through Singapore rather than through Indonesia. Self-containment, in this context, has resulted in an investment enclave offering facilities close to conditions in Singapore, in marked contrast to the conditions immediately outside the Park.

### EMPIRICAL FINDINGS

The use of secondary data from official publications, press report, etc is insufficient. The success of the Park hinges in large measure on its ability to harness the micro-economic processes of specific firms and industries operating in a global environment. Thus, to obtain primary data on the differential impact of various pull factors on firms' investment decisions, along with the differential impact of different types of constraints on their operations, we applied the questionnaire developed in Yeoh, et al [6] to the tenants in BIP.

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## Statistical Treatment of Survey Results

The (cumulative) *logistic* distribution function, estimated by the maximum likelihood, takes the following form:

$$P_i = \frac{e^{Z_i}}{1 + e^{Z_i}} \quad (1)$$

Where:

- $P_i$  is the probability of firm  $i$  choosing the factor in question,
- $Z_i$  is a linear function of the firm attributes defined as  $Z_i = \alpha_0 + \alpha_1 F + \alpha_2 L$  – with  $F = 1$  if wholly foreign-owned, 0 otherwise;  $L = 1$  if large (> 500 employees for BIP), 0 otherwise;  $\alpha_0$  = constant term;  $\alpha_i$  = coefficient of independent variable

## Profile of BIP Respondents

There were 27 respondents in this survey, of which 12 were Singaporean ventures while 15 were wholly foreign-owned. The majority of respondents were involved in the manufacture of intermediate products, 7 were involved in the manufacture of consumer products, and another 5 were providers of industrial services. 14 of the BIP tenants employed more than 500 workers. There were 7 respondents with sales turnovers of less than US\$ 5 million, 14 respondents with turnovers between US\$ 5 million and US\$ 50 million, and the remaining had turnovers exceeding US\$ 50 million.

## Factors Influencing the Respondents' Decision to Invest in BIP (Table 1)

Singapore leverages on its infrastructure development expertise and the low-cost labor available in the host environments to market its industrial parks. It supplements these purported advantages with its political commitment to the Parks, as demonstrated by the many bilateral agreements between the GLCs and host governments or politically-linked business conglomerates. Furthermore, there is a host of investment incentives that entice multinationals to locate their lower value-added activities in these self-contained enclaves.

Not unexpectedly, the reliable and efficient Singapore-styled infrastructure was the Parks' main draw, with 85% of the BIP tenants surveyed citing it as a pull factor for them to locate in the Park. Political commitment from both the Singaporean and Indonesian governments were a major consideration for wholly Singapore-owned or joint-venture companies, when compared to the foreign-owned companies. This is suggested by the negative and statistically significant  $\alpha_1$  (= -2.800 and -2.089). This is not unexpected, considering the high uncertainty avoidance of the Singapore culture. Large companies

in BIP were also more likely to choose political commitment from Singapore government as one of the pull factors, indicated by positive and statistically significant  $\alpha_2$  (= 2.548), because of the symbiotic relationship between MNCs and Singapore Economic Development Board (SEDB). As well, SEDB was active in encouraging leading MNCs in Singapore to use the Park. The SEDB controls access to a wide range of taxation concessions and regulatory permissions in Singapore and has great influence over investors who perceive cooperation with the EDB may bring business advantages [3].

TABLE 1 Factors Influencing Respondents' Decisions to Invest in BIP (by Maximum Likelihood Estimate/Binary Logit)<sup>w,φ</sup>

Variables	$\alpha_1$	$\alpha_2$
Political commitment from the Singapore government	-2.800 (0.029)**	2.548 (0.039)**
Political commitment from the host country government	-2.089 (0.097)***	1.458 (0.175)
Investment incentives	0.283 (0.804)	0.017 (0.988)
Competitive labor costs	-1.583 (0.201)	0.894 (0.403)
Reliable infrastructure facilities	0.035 (0.975)	1.355 (0.277)
Availability of skilled/educated labor	-0.899 (0.307)	0.209 (0.806)

Note: <sup>w</sup> "forced-entry" regression method is used.

<sup>φ</sup> p-values in parentheses are for 2-tailed tests.

\* Significant at 1% level

\*\* Significant at 5% level

\*\*\* Significant at 10% level

Source: Questionnaire survey

## Major Constraints on the Respondents' Operations in BIP

BIP is now an established industrial estate development, but our study alludes to some emerging constraints which have undermined the attractiveness of the Park. The 'cheap' labor resources which drew companies to Indonesia proved to be mere perception rather than a reality in BIP, as 'rising labor costs' is the main constraint faced by the majority (78%) of the BIP tenants surveyed. Low labor productivity exacerbated the difficulties faced by the tenants, which perform predominantly labor-intensive activities in BIP. This is further documented by constant lamentations of industrial relations problems during our interviews with the tenants, and which are substantiated statistically by 63% of the BIP tenants.

The Singapore-styled infrastructure, though reliable and efficient, also proved to be costly, as facilities such as the power plant, waste-treatment system and water supply are independently managed. This resulted in high overhead costs, where 74% of respondents cited it as a constraint they faced.

'Impact of host government regulations' and 'competition from overseas industry competitors' are constraints faced by 89% and 78% of the surveyed BIP tenants respectively. The government's control over the operating environment and the economic landscape shaped by overseas industry competitors has proven to be very stifling for the operations of the tenants in BIP. Populist measures before Indonesia's general elections due on April 2004, further accentuate the reluctance of investors to pour money into the country in the immediate future.

## DISCUSSION

Issues pertaining to the scale and character of development of the Park, viz, BIP's resemblance to a Japanese investment enclave [1], its surrounding environment and the tensions of squatter settlements, and the limited impact of BIP on the transfer of low value operations from Singapore have been taken up in other papers [4] [5]. These challenges persist.

Initial promotion of BIP had talked about it making a significant contribution to the upgrading of the Singapore economy by managing the outflow of MNC investment, and stimulating Singapore's role as a regional headquarters. In reality, while specializing and creating niche sectors are commendable, BIP's "industry-cluster" strategy effectively hedges the success of the Park to the highly volatile electronics sector, and issues such as the long-term sustainability of the park adopting such a low-cost, electronics-enclave strategy arises.

The mushrooming of other industrial parks on the island, some within close proximity to BIP, has weakened the Park's competitiveness. The premium placed on the Park's one-stop support service, and self-sufficient operating environment, is increasingly called into question following the spawning of competitor parks backed by prominent Indonesian politicians which match BIP standards.

Competition is not limited to within Indonesia. With minimum monthly wages, Indonesia was priced out of the competition for similarly-skilled labor from Bangladesh, Vietnam, and Sri Lanka.

## CONCLUSION

From our empirical studies, the consensus is that the political climate created by the Singapore and Indonesian governments, the factor conditions, infrastructure and the proximity to Singapore are the main determinants that shape the competitive

environment in the Park. The tenants were able to tap into the low-cost environments of the Park, as well as leverage on Singapore's infrastructure, management and expertise. These results lend support to rationalization theories, and affirm the agglomeration economies suggested by location theory. The survey results also highlighted the impact of government policies/regulations on the respondents' operations in the Parks.

BIP's management maintains that the intense competition amongst industrial parks for investors' dollars, in fact, indicates the attractiveness of Batam as an investment location, and reflects the (Singapore) government's long-term vision of twinning the two contiguous (Singapore-Riau) economies.

Official commitment to the projects remains, as is the acceptance of an extended time horizon to meet targets. Its management has been taking up key leadership positions in its representation to the relevant authorities to create a better environment for investors, on the one hand, and its endorsements of the *location advantages* of the island to potential investors, on the other. BIP's management envisages an important role in shaping the industrial character of Batam, and in redistributing the economic benefits back to the Singapore economy. Be that as it may, our study contends that, the economic 'theorization' and business 'optimism' that underscores this transborder initiative has been overshadowed by the political nuances that radiate from the host environment and, one must be tampered by the economic realities of Asia's new 'powerhouses' – China and India!

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