

INTRODUCTION

In the last decade, the Indonesian economy has continued to run on a high-growth track, led by manufactured exports. For this period, a new variety of manufactured exports has appeared from labor-intensive industries, resource-based industries, as well as relocated industries by overseas multinationals, following the long-established exports like textiles, garments and plywood. The early manufactured exports producers in the latter industries have started to prepare for a competitive international environment. In the meantime, domestic-oriented industries have succeeded in deepening their backward linkage, supported by emerging purchasing power and continuous foreign capital inflows. The new entrants from this import-substitution type of industry, such as upstream petrochemical, assembly and component manufactured for heavy machinery, have also joined a list of expansive investments. All these types of industry, as Indonesia moves toward the era of trade liberalization, have come to face challenges to reinforcing their respective industrial competitiveness, either in overseas markets or in domestic markets.

After mid 1997, however, the Indonesian economy encountered the steepest fall that has ever been experienced in the last three decades, triggered by a furious depreciation of Rupiah. A set back of growth and stagnation of productive activities in a certain period of time will be unavoidable. Serious restructuring of the expansionistic banking sector and of debt-swollen businesses should be undertaken. Nevertheless, from the viewpoint of industrial development, the economic crisis means neither that the accumulation of capital and industrialists' capabilities over decades are nullified nor that all industries will plunge into the long-term downward trends. What is crucial is for industrialists to sustain efforts in this hard time to obtain competitive advantages to cope with challenges in the coming liberalization era.

The aim of the book is to analyze the main trends of the changing industrial structure by an in-depth industry-wise analysis in order to assess the competitive advantages to be enhanced and the disadvantages to be overcome by Indonesia's manufacturing industry. In the last year's volume of this 2 year series of industrial analysis, the focus was on the patterns of industrial development in the long historical perspective, covering 5 industries; the textile and garment industry, palm oil industry, motorcycle industry, machinery industry, and petrochemical industry. In this year's volume, in depth industrial analysis has special focus on corporate strategies

that have responded to the challenges of changing domestic and international environments of the industry. What challenges the industrialists face, how they see business opportunities in the challenges, and how they are reforming themselves to overcome the existing weaknesses and to cope with the new conditions, are the major questions posed. The 5 industries selected in this book is textile and garment industry, pulp and paper industry, pharmaceutical industry, steel industry, and machinery component industry. The former two represent export-oriented industries, older and newly evolving industries respectively. The latter three represent domestic-oriented industries with high imported contents, which face challenges in finding export possibilities as well as domestic industrial linkages.

Chapter 1 looks at the structural changes and corporate responses in the Indonesian textile and garment industry. The industry has been facing greater competition in the domestic as well as overseas markets due to tariff reductions and the phasing out of bilateral quotas as captive markets. Increased open trade leads the structure of this industry to greater integration and specialization. Specialization in polyester products has advantages in the long run because of the continued import dependency on cotton. Case studies show a cooperate response to increasing competition and rising real labor costs. One case shows an evolution of corporate strategy from high export-orientation with low end products to medium end branded products, and then to a focus on domestic market including the development of their own brand. Another case illustrates the importance of upgrading and integrating capital capability, and of transforming family-owned businesses to professionally managed businesses.

Chapter 2 analyzes the internationalization process of the Indonesian pulp and paper industry. This industry has now emerged as a competitive export industry with dominant players in the Asian region. The process has been driven by comparative advantages of the industry in abundant low-cost forest resources, and by the players' advantages in vertically integrated asset concentration. The focus of corporate strategy for upgrading business capability is on the institutionalization of their family businesses in the global market place, making use of international market status, international strategic alliances, hiring of expatriates, and internal skilled labor mobility.

Chapter 3 describes the heavy challenges faced by the Indonesian pharmaceutical industry. The major challenges are dependency on imported raw materials due to lack of domestic upstream industry, dependency on foreign patented products due to lack of research and development,

withdrawal of long-enjoyed protection, and the increased burden of debt and import costs after the monetary crisis. Case studies indicate that survival strategies for domestic companies are strategic alliances with foreign companies in the short run, making use of their domestic distribution networks and access to traditional natural resources. In the longer run, drastic mergers are unavoidable. Exploring export opportunities with decreased imported components is crucial.

Chapter 4 is an analysis of the competitiveness of the Indonesian steel industry. While the potential advantages of this industry lie in the large domestic market and local availability of raw materials and energy, the future still depends highly on national producers' capabilities to compete against increasing imported products in quality and prices and their optimal use of processing technologies of raw materials. To optimize the domestic market potentials, *PT Krakatau Steel* in the most upstream segment is entering into a strategic venture with Korean steel companies, and the *Bakrie Group* is widening its coverage of products.

Chapter 5 focuses on the Indonesian machinery component industry as a newly developing segment of the material process industry. Although the economic size of the industry is still small in the international perspective, the accumulation and spacial concentration of component manufacturers have proceeded in the last decade, from which subcontracting networks have emerged. The development of such networks is crucial, because they have potential for connecting the large-scale modern sector and the small-scale semi-modern sector, as well as the assembling industry and the material industry. Case studies show that the emerging subcontracting networks are of a very flexible nature unlike the Japanese equivalent, and also that the dynamics of business orientation has worked to evolve the networks, especially among the private industrialists, either business groups with large assemblers, or subcontractors themselves in the middle and lower strata.

Each chapter did not attempt to reflect a common, collective perception on the changing industrial structure of Indonesia's manufacturing industry, and each chapter has a differing weight in terms of analysis on impacts of the on-going economic crisis. Despite this fault, the attempt of this in-depth industry-wide analysis is expected to open up a new sphere of understandings on the changing nature, challenges and opportunities of the Indonesia's manufacturing industry, especially from the standpoint of manufacturers, a prime source of development dynamism.

Editor