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**JOINT VENTURE INVESTMENT IN  
OIL PALM PLANTATION  
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# JOINT VENTURE INVESTMENT IN OIL PALM PLANTATION IN INDONESIA

## EXECUTIVE SUMMARY

*Austral Enterprises Berhad (AEB) is a Malaysian public listed company and the plantation arm of Island & Peninsular Berhad. AEB initiated a move to expand its plantation activities beyond the borderline of Malaysia in late 1994, taking advantage of Indonesian Government's deregulation to attract foreign investors' participation in the country's economic development especially in their lesser developed provinces.*

*A joint venture company PT Mitra Austral Sejahtera (PT MAS) was formed to operate the plantation business in Indonesia with AEB holding a 65% stake. The balance of 35% equity is held by an Indonesian company PT Ponti Makmur Sejahtera (PT PMS). AEB's stake is via capital injection, the management and expertise in developing and managing the plantation whilst PT PMS participation is providing the land free from encumbrances, maintaining liaison and co-ordinating with the locals/government agencies and a participative cash injection towards the project. PT PMS holds the right for a 30,000 ha land concession for plantation development in the regency of Sanggau, Kalimantan Barat, Indonesia.*

*This paper discusses the strategic approach, successes and drawbacks experienced by AEB in the course of plantation development on a joint venture investment in Indonesia. An introduction on the plantation industry was also made to create awareness about its history and the current economic impact of Malaysian palm oil industry.*

## 1.0 INTRODUCTION

### 1.1 THE PLANTATION INDUSTRY

Hans Ruthenberg in his book "Farming Systems In The Tropics" has defined plantation as "any land planted with perennial crops". Any holding largely planted with such crops is an estate (a minimum area of 100 acres as classified by Malaysian Government Authorities) and operated by a planter or manager with a large number of paid workers. Ruthenberg then classifies plantations according to their cropping and exploitation systems as follows in three main groups:-

- perennial field crops : e.g. bananas, pineapple, sisal, sugar cane
- shrub crops : e.g. coffee, tea
- tree crops : e.g. cocoa, coconuts, oil palm, rubber

The late Edgar Graham, a Director of Unilever in a book entitled "The Modern Plantation In The Third World" brought out some of the principles behind the management of plantations and pointed out that it was the management system and concepts which are important, not the categories of crops which can be grown by that system.

His salient features for plantation estates were:-

- a corporate type of organisation



- large labour force
- extensive land areas
- skilled management
- close supervision for a system of detailed routine

Graham considered that the best examples of the plantation estate system were with oil palm and rubber. In his view "most of the characteristic features of the modern plantation, particularly in the management and supervisory structures and the techniques of training of labour, arise from the methods originally conceived from around the beginning of the twentieth century in the rubber industry, developed and improved continuously since that time and proven in the oil palm industry".

The early plantation industry had its origin in America and the Caribbean in the 18th Century but the modern plantation industry really got underway is with the rubber boom at the start of the 20th Century in the Far East region especially in Malaysia and Indonesia.

In broad terms, although there are variations from country to country, one can divide the modern plantation industry into three periods; the pioneer, the expansion and the consolidation periods.

The pioneer period in Malaysia can be taken as 1900 - 1940 when the British brought rubber from Brazil, the expansion period as 1960 - 1990 and are now generally in a phase of consolidation although large expansion continues in Indonesia.

The first large rubber estates came into existence in 1902 located mainly in Sumatra's East Coast and the province of Aceh, while the first Java estate was planted in 1906 in West Java. On the first native rubber in Peninsular Malaysia was planted at the same year as Sumatra whilst in Sabah in 1908.

The total rubber plantation remained small at less than 10,000 hectares in the Far East until 1910 when the world price became so attractive as to induce large-scale investments.

The combination of increasingly attractive rubber prices and a series of disasters in the culture of tea (the break in the world market price), coffee (the outbreak of the *Hemileia* rust), cocoa (the non-suitable climate and intensive pest management) and tobacco (limited suitable land) forced small plantation owners to an immediate consolidation and conversion of their estates to rubber crop in an effort to save their investments.

The decline in the world demand and unattractive price of natural rubber due to substitution of synthetic rubber has then caused another crop conversion of rubber estates to oil palm estates.

After 1970, where marked reduction of Malaysia's rubber production, the oil palm industry have had an impact and the developments over the last 30 years include:-

- underplanting
- advanced planting material
- improved seed materials
- water management
- fertilising in relation to soil type
- mechanisation of fertiliser application
- introduction of pollinating insects
- improved harvesting organisation including mechanisation of collection
- mechanisation of herbicide application and greater range specificity of herbicides
- integrated control of pests
- reduction in processing labour requirements
- improved image of palm oil
- expansion of markets for palm oil

Graham interestingly links the oil palm to the "striking adaptation of a management system and technology to a desired social pattern in the achievements of FELDA which has succeeded in combining plantation

methods with a system of smallholdings and has thereby played a large part in the enormous increase in production in Malaysia”.

This leads to another change, the development of smallholder institutions such as FELDA including FELCRA and RISDA in Malaysia, ORRAF in Thailand, PCA in Philippines, the Nucleus Estates System in Indonesia, Cote d'Ivoire, Kenya and Papua New Guinea and CEPLAC in Brazil.

Among the institutions, the most successful in terms of production have been those like FELDA and the Nucleus Estates System using the plantation estate corporate management system.

Management systems of the corporate management type are the most efficient for tree crops. Progress was made in moving away from the old Agency House administration to a corporate management which also is consumer rather than production oriented.

The successful expansion of oil palm industry is at the expense of conversion of rubber and cocoa crop. Finally, a most important change was the development of downstream activities in the 1980's, particularly in Malaysia.

Up until 1987 in Malaysia, agriculture has been the dominant economic sector where in 1960, rubber together with tin contributed 60% to the nation GDP whilst in 1970 agriculture's contribution was 29% compared to

manufacturing of 14%. In 1980, agriculture contribution to the nation's GDP is 23% followed by manufacturing at 20%. By 1990, manufacturing contributed 26.9% as compared with 19% by agriculture.

By year 2000, agriculture contribution is projected to decrease to 13% as compared to 37% by manufacturing. By year 2020, manufacturing is projected to increase to 39% as against a mere 6% from agriculture. This conforms with the history of development which demonstrates that as a country industrialises, it is without fail that the agricultural sector become less desirable area of employment and economic concentrate.

## 1.2 THE OIL PALM HISTORY IN MALAYSIA

The introduction of the oil palm in South-East Asia region began with four seedlings : two from Mauritius, Africa and two from Amsterdam, which were planted in Java in 1848 at the Botanical Garden in Bogor (then called Buitenzorg).

In 1870, seedlings derived from these palms were planted in the Economic Garden, Singapore. In 1878, more seedlings were taken back to Bogor to be raised.

In 1911, palms from Deli (now near Medan, Sumatra) known as Deli Dura, were brought to Malaysia and planted as ornamental plants at Rantau Panjang, Kuala Selangor. Seeds from Rantau Panjang were thereafter

planted at Tennamaran Estate, Selangor in 1917 by Henry Fauconnier. This marked the beginning of the initial commercial planting of oil palms in Malaysia.

Development however was slow and it took another 50 years before the pace quickened when the Malaysian government embarked on a massive agricultural diversification programme to ease dependence on rubber which price is no longer economically favourable.

The advantage of oil palm is that it yields more oil than any other oil-bearing plant. Per hectare oil production of the oil palm is about 5 times and 9 times greater than those of groundnut and soyabean respectively. An average Malaysian plantation on maturity yields an equivalent of 3.7 tonnes of crude palm oil per hectare per year.

Rapid technology advances and research developments in the Malaysian palm oil industry have resulted in a wide spectrum of uses for palm oil. Through the processes of refining and fractionation, various palm oil products can be made which possess the characteristics required for many different uses. In addition, Malaysian palm oil refiners are able to supply products tailor-made to consumers' specifications by means of double fractionation, hydrogenation and inter-esterification or by blending with other vegetable oils.

The fast expanding oleochemical industry has further diversified the uses of palm oil into the production of fatty acids, glycerol, methyl esters, etc. which are starting materials for the manufacture of numerous items for industry and home. Malaysian palm oil today is widely used in both edible and non-edible applications.

In 1996, the world production of 17 major oils and fats was 96.3 million tonnes (APPENDIX I ) an increase of 2.4 million tonnes over 1995 production of 93.9 million tonnes. The oils and fats industry is dominated by soyabean which production is 20.1 million tonnes or 20.9% of total oils and fats production. Palm oil is second with 16.1 million tonnes (16.7%), followed by rapeseed oil (11.9%) and sunflower oil (9.7%).

In year 2000, the consumption of oils and fats is expected to be 107 million tonnes compared to 96.2 million tonnes in 1996. Palm oil is an ideal candidate to cater to the increased demand. It is the cheapest vegetable oil (APPENDIX 2) and the attractiveness of price cannot be under-estimated on under developing countries seeking to improve their current dietary intake of only 8 kg oils and fats per annum to about 30 kg per person of that in developed countries.

Palm oil production is expected to reach 17 million tonnes in 2000 with 14.4 million tonnes exported. Malaysian production is then expected to reach

8.6 million tonnes and the country will supply 10% of the world's oils and fats in export versus 7.6 % now.

### 1.3 MALAYSIA'S COMPETITIVE EDGE

Palm oil, though produced and used in Africa for centuries, was insignificant in the world's oils and fats market until Malaysia started producing and exporting it on a large scale in the 1970's.

Malaysia's ability to produce and consistently export large quantities of high quality palm oil has made it as one of the major oils in the world vegetable oil market. In 1996, 86% of the 8,385,886 tonnes of production was exported.

Today, the oil palm is an established plantation and smallholder crop in Malaysia, playing a prime role in the nation's economy. Up to end of 1995 (as per Ministry of Rural Development data) there was a total of 2,960 estates of which 760 were big estates and 2,200 were small estates.

In 1996, the distribution of oil palm planted area by category is as follows:-



<u>Category</u>	<u>Hectares</u>	<u>Percentage</u>
Private Estates	1,318,778	50.42
Govt. Schemes:		
FELDA	683,538	26.14
FELCRA	134,059	5.13
RISDA	39,685	1.52
State Schemes	197,922	7.57
Smallholders	241,287	9.22
	-----	-----
<b>T O T A L</b>	<b>2,615,269</b>	<b>100.00</b>

Source : PORLA

Also in 1996, there are 290 operating palm oil mills, 41 refineries, 35 kernel crushing plants and 13 oleochemicals plants in the country.

Malaysia will continue to exploit this leading advantage as part of its economic development as well as contributing to the world supplies of edible oils and fats.

Within a span of last thirty years, the sector has progressed from being a mere exporter of primary commodities (both rubber and oil palm), where more than 80% of the commodities were exported raw, now have reached a

maturity level, with 72% currently being exported in semi-processed and finished products whilst only 28% were in form of raw material. This is the success story of Malaysia.

The plantation industry in this country possesses a unique experience of growth, strength and expertise that was exploited to advantage. The established management system is among the most advanced in the world with a proven track record of nearly 100 years. With the Research and Development facilities coupled with the supporting technical and marketing services, these scientific knowledge and skills have been fruitfully exploited over the years as reflected by the achievements in the natural rubber and now the oil palm industry.

The oil palm industry has developed from mere expansion of hectareages into consolidation and from mere production of volume to value-added downstream manufacture.

This advancement was also made possible by the cess payments on every tonne of crude palm oil produced by Malaysian companies. A rate of RM7.25 per tonne was paid to PORIM for R&D purposes whilst RM3.75 per tonne was paid for regulatory purposes to PORLA out of which RM2.75 will be given by PORLA to MPOPC for marketing enhancement purposes.

1996, the primary commodity sector earned some RM34 billion in export earnings or 17% of the country's total export receipts out of which oil palm products contributed RM11.7 billion (APPENDICES 3 & 4). In 1995, palm oil and its products brought in RM13 billion, which is higher than that earned by petroleum, LNG and petroleum products of RM12.3 billion. This shows that the golden palm oil is worth more than the black oil.

The palm oil commodity gross sales proceeds practically equal net sales proceeds as there is effectively no import of components parts unlike manufacturing. This is a vital role in helping the country to improve its current account deficit.

The plus factor for palm oil is that it is a renewable resource. The success of palm oil bears testimony to our capability in managing our limited resources and yet be competitive globally.

The Kuala Lumpur Commodity Exchange (KLCE) Crude Palm Oil (CPO) Futures Market is also the only CPO futures market in the world. It is right in the centre of the palm oil production region in the world i.e. South-East-Asia. The region currently accounts for about 80% of the global palm oil production and 70% of its exports.

#### 1.4 INDONESIA AS A COMPETITOR

In spite of the impressive performance, the plantation industry in Malaysia is not without its challenges. At this point, is the continuous dependence on foreign labour. As the quest for industrialisation had begun to accelerate, rural-urban migration of workers follows a similar trend experienced in developed countries. To fill the job vacancies and demand for workers, the government has allowed the importation of foreign workers from neighbouring countries to work in plantations.

The most critical success factor in the plantation industry is still producing efficiently at low cost. Malaysia is slowly losing its competitive advantage due to rising costs of labour. Scarcity of labour and suitable land which if available is expensive have compounded to the increase in production cost for each tonne of crude palm oil at RM700 compared to an equivalent of RM300 per tonne when produced in Indonesia. This competitive cost of only 43% than that of Malaysian cost of production is a major factor for Malaysian plantation companies to expand into Indonesia.

In November 1996, the Indonesian Government has frozen application of Malaysian investors and licence i.e. *Penanaman Modal Asing* (PMA) in investing oil palm plantation in Indonesia due to the already big investment by Malaysian companies, hence this negative reaction recently. Nineteen

Malaysian proposals were known to be caught at different stages of acquiring the final clearance for PMA, inhibiting further Malaysian investment.

Out of 5.5 million ha of total land area approved for oil palm plantations, 1.6 million ha involved approved Malaysian investors which constituted 27%. This also formed 73% out of the total of 2.2 million ha approved for foreign investors in Indonesia. A total of 41 Malaysian companies were identified to have investment interest in the Indonesian oil palm plantation industry todate.

Prior to 1985, the oil palm holdings in Indonesia were dominated by government owned plantations with only a handful of foreign private companies. According to the Indonesian Directorate General of Estate, the area planted has increased from 0.6 million ha in 1985 to 2.0 million ha in 1995.

The plantation area by category of producers is as follows:

<u>Year</u>	<u>AREA (HA)</u>			
	<u>Smallholders</u>	<u>Government</u>	<u>Private</u>	<u>Total</u>
1985	118,554	335,195	143,603	597,352
1995	658,536	404,732	961,718	2,024,986

Source : Indonesian Director General of Estate

Indonesia is the second largest palm oil producer after Malaysia. More significantly, its share of the total palm oil production has been rising tremendously since 1990. The Indonesian palm oil production which was only 1.24 million tonnes in 1985 has increased to 4.48 million tonnes in 1995 and 4.97 million tonnes in 1996.

The Indonesian government, keen on reducing the dependence on petroleum based export revenues, encouraged export oriented growth in other sectors which was classified as non-oil and gas sector. Oil palm industry was one industry considered worthy of support.

Some favourable deregulations were made regarding land use for promoting foreign investments for plantation development. Various incentives have been provided by the government to foreign companies to invest in Indonesia. These include incentives such as the Right to Utilise Land (HGU or *Hak Guna Usaha*) with a lease period of 30 years extendable

automatically by 30 years (60 years total i.e two economic cycles for oil palm) and renewable thereafter.

This Act was instrumental in attracting quite a number of foreign companies particularly from Malaysia, who invested either alone or in joint ventures with Indonesia partners, bringing with them a wealth of expertise and the much needed foreign capital to the country.

The Indonesian oil palm industry is forecasted to sustain its present growth in future. Planted area is expected to grow 11.4% per annum during the period of 1997-2005 to reach 4.6 million hectares in the year 2005. Expansion is on going in Indonesia as compared to declination if not the consolidation phase in Malaysia.

The comparison between Indonesia and Malaysia palm oil status and their growth is as APPENDIX 5. The graphical comparison in palm oil production is charted as APPENDIX 6.

Concurrent with the expansion in planting area and the large immatured area coming into production (maturity period of 3 years after field planting), CPO output is projected to increase by 12% per annum and to reach 11.7 million tonnes in the year 2005. By this time, Indonesia will surpass Malaysia as the world's largest palm oil producer.

Export is projected to increase by two folds to 5.8 million tonnes also by the year 2005. However, it is still lower than the forecast exports of Malaysian palm oil at 8.7 million tonnes due to higher consumption by Indonesian domestic market. This export forecast pattern is as per APPENDIX 7.

By the beginning of the next century, the success story of Malaysia in the oil palm industry will be repeated in Indonesia only that our Malaysian companies will have a 27% share contribution recognised as their output.

## 1.5 AEB COMPANY PROFILE

AEB has an authorised capital of RM200 million with a paid-up capital of RM144.8 million currently under planning to double by 1998 through rights issue. Being the plantation arm of its parent company i.e. Island & Peninsular Berhad (I&P) who holds a 55% equity stake in AEB. I&P itself is being controlled by Permodalan Nasional Berhad (PNB) who holds a 60% stake of I&P's shares. The factfile about AEB details is attached as APPENDIX 8.

The principal activities of the company are oil palm cultivation and processing of oil palm products, as well as a small portion of rubber. Cocoa production however, has been discontinued since 1995 due to uneconomic cost of production and was replaced with oil palm.