

Conducive Business Environment to Regain Competitiveness for Sustainable Firm Growth in Special Economic Zone of Batam, Indonesia

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Abstract

The declining competitiveness of Batam has significant impact on Batam firms' growth. Lack of supporting infrastructure, and lack of good public governance i.e., the dualism power of local government (PemKot) Batam and local authority (BP) Batam has caused the declining competitiveness and declining firms' growth in Batam. Good supporting infrastructure, good public governance, productive manpower and good research and development institutions in Batam as part of conducive business environment is critical for regaining competitiveness that impacts firms' growth in Batam. It is urgent to transform Batam from the status of Free Trade Zone (FTZ) to Special Economic Zone (SEZ) in the near future which has proven to be a powerful engine for regional economy growths and excellence, and to be able to compete in a highly competitive business environment of ASEAN Economic Community (AEC) that has been realized recently.

Keywords: competitiveness, firm growth, good public governance, business environment, SEZ

1. Introduction

Competitiveness of Batam has declined due to lack of conducive business environment in Batam. Firm growth in Batam has been stagnant or even declined sharply from the year of 2010 up to 2017, there has been eightytwo (82) foreign direct investment firms moved out from Batam. The main reasons for the move are unconducive business environment, the government and officials are inconsistent in interpreting/implementing laws/regulations, and labor forces and labor union that has tendency to strike frequently (Kompas, 19/4/2017 and PemKot Batam 2017).

Unconducive business environment, lack of research and development institutions in Batam firms has impact on competitiveness and firm growth in Batam. The products or services as firms' output cannot compete internationally. Innovative products or innovative processes are very important in a highly competitive business environment of ASEAN Economic Community (AEC) that has been implemented since the end of 2015.

Based on the data that researcher got from local authority of Batam (BP Batam) indicated that private investment growth in Batam, Riau islands for these past five years from the year 2011 up to 2015 has been stagnant (BP Batam, 2016). In previous research, researcher found that firm growth of electronic industry in Batam has decreased significantly in the past decade. In Tjong et al (2012), it was found that investment has fallen from 45 percent for the year of 1998 to 30 percent for the year of 2007 because of growth barrier for firms. The growth that was stagnant also confirmed by previous Indonesian economic coordinating minister Chairul Tanjung. He said investment growth and economy growth in Batam has been relatively stagnant since the year of 2009 even though Batam has been granted special incentives/ facilities to be developed into industry city (Kompas, 6th June 2014).

In ASEAN SME Expo in 2014 held in Batam from 31st May 2014 to 2nd June 2014, Deputy head of Indonesian Kadin division of SME and cooperation, Erwin Aksa said firm growth in Batam has been stagnant or declined. Another major problem that has caused declining competitiveness and impede firm growth is man power issues. Manpower in Batam has tendency to strike and has been unproductive. The explanation about economy and industry indicators in Batam from the year 2008 up to June 2014 is as follows.

From macro economy indicators in Batam in table 1, researcher found that economy growth in Batam was relatively stagnant in almost past ten years from 2008 to 2015. Batam regional earnings only increased a little in the past few years from 606.34 billion rupiah for the year 2013 became 779.94 billion rupiah for the year 2014 and 845.31 billion rupiah for the year 2015. Gross domestic regional product Batam these past few years was 96.49 trillion rupiah for the year 2013 and 2014 became 108.72 trillion Rupiah, inflation increased from 2.02 % in the year 2012 to 7.81 % in 2013 and economy growth level decreased from 7.40 % in 2012 to 7.00 % in 2013, and to less than 5 % in 2017 (BP Batam, 2018).

Tabel 1 Indicator of Economy and Industry of Batam from the year 2011-2015

Indicators	units	2011	2012	2013	2014	2015
Regional Income	billion rupiah	335.41	409.98	606.34	779.94	845.31
Product Domestic	trillion rupiah	74.18	83.75	96.49	108.72	108.72
Regional Bruto						
Growth of Economy	Percent	7.83	7.40	7.00	7.99	7.99
Inflation	Percent	3.76	2.02	7.81	7.61	4.73
Electricity	Million Watt	371.66	509.63	509.63	502.42	538.95
Road	Kilometer	437.74	438.46	438.46	438.46	438.46
Man Power	person	313,544	330,592	330,592	330,592	350,674

Source: Development Progress of Batam, BP Batam 2017

Manpower has been stagnant, Growth of economy has been stagnant. Electricity increased a little, also infrastructure like electricity supply have declined from 509.63 million watts in 2012 to 502.42 million watts in 2014, became stagnant in these past three years. About five hundred million watts from the year 2012 to the year 2015. Electricity is a very important input for firms in Batam especially manufacturing companies. Without affordable price and uninterrupted access to the supply of electricity, firms cannot operate well. Road infrastructure is stagnant, no development of road from 437.74 kilometer in 2012 to 438.46 kilometer in 2014. Information technology like internet connection and internet speed also not enough in Batam. To do regional and international business transaction needs sufficient information technology. Good policy/regulation regarding man power, public governance, and sufficient infrastructure is crucial to create conducive business environment that could increase competitiveness and firm growth.

Lack of good policy/regulation, and lack of innovative products and innovative processes has caused export from Batam to decline as shown in the figure 1 below:

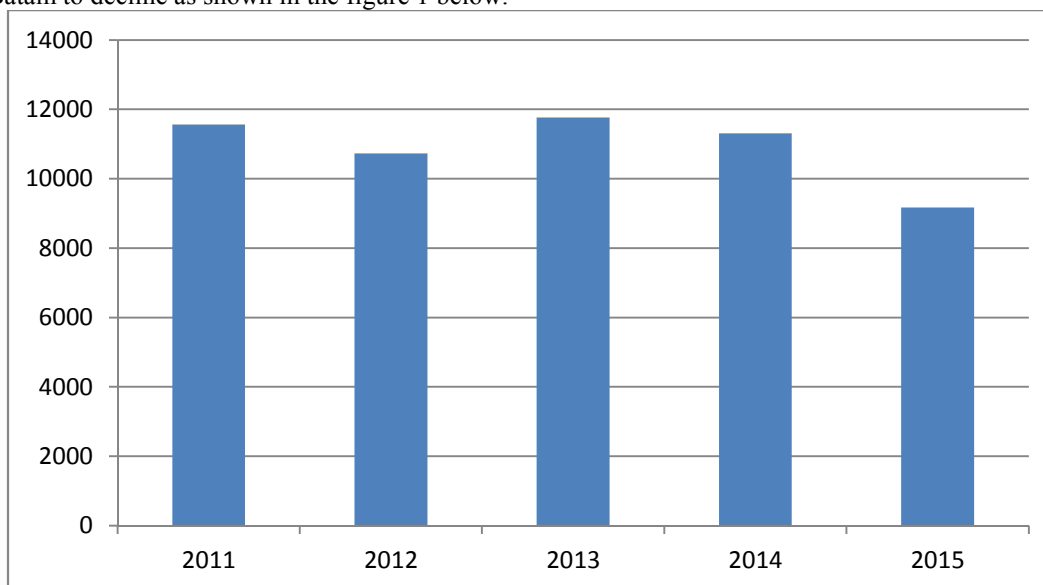


Figure 1 Export of Batam 2011-2015

Source: BPS, 2016

Value of export from Batam in December 2015 was US\$636,03 million or declined about 4,85 percent compare to the export in November 2015. Compare to the export in December 2014, export in December 2015 declined about 28,24 percent. Export from the city of Batam with the highest value from the port of Batu Ampar was US\$258,42 million which contributed about 40,63 percent from total export of Batam city. During the month of December 2015 oil commodity export was US\$111,21 million, increased about 3,34 percent compare to November 2015. Export of non-oil in December 2015 was US\$524,81 million or declined about 6,42 percent compare to November 2015. The decline in export was due to business environment in Batam which is unconducive, lack innovative or competitive products or services from Batam (PemKot Batam, KADIN Batam, 2017). Another reason is firms could not meet the orders of customers because of the tendency to strike by the labor forces/labor unions of the firms in Batam demanding raise in minimum wages (PemKot Batam, 2017).

Besides the business phenomena in Batam found above by researcher, there is also theoretical phenomena found by researcher as follows. From previous research, author can conclude that there are two contradictive theories which are: Demirguc et al (1998) found that active capital market and good and consistent legal system are important factors for firms to get external financing or better access to finance and cause firms to grow faster. These findings supported the research of King and Levine (1993), and Levine and Zervos (1998) and other previous research, causes economy growth and firm growth to be greater and faster.

Allen et al (2005) found different results. Financial system and legal system in China is still considered bad, however the economy growth in China is one of the fastest in the world. Firms with good reputation and good relationships with local government gets access to finance easier and grow faster. The growth is not due to the legal system or financial system of the country. This finding is contradictory to the finding of Demirguc et al (1998), King and Levine (1993), and Levine dan Zervos (1998) as discussed above.

Based on empirical and theoretical phenomena above, internal factor and external factor as discussed above there exist research gap. Researcher found research gap about key factors of competitiveness that is internal factors from the firm like value chain activities, innovation and firm growth which has not been done before and also external factors such as business environment, man power, governance, and infrastructure that impact competitiveness and firm growth in Batam.

The novelty of this research is examining the effect of key competitiveness factors on sustainable growth of firms in Batam. Competitiveness has positive and significant impact on firm growth (Tjong et al, 2012).

The population in this research is manufacturing and non-manufacturing firms in Industrial Park of Batam. Sampling method is purposive sampling

2. Literature review

2.1 Firm Growth Theory

The early contributions in firm growth theory focus on empirical validation about Gibrat's Law, known as the Law of Proportionate Effect. In the simplest form, the law predicted that the level of expected growth did not depend on firm size. From regression results, it was found that the growth level in modern economies had negative weak relationships with firm size to reject Gibrat's Law (Mansfield (1962), Evans (1987), Hart and Oultan (1999)). Besides firm size, other factor that has been investigated was firm age. But the result showed that firm age did not affect firm growth (Evans, 1987).

Demirguc et al (2008) found that firm size, and access to finance affected firm growth. La Porta et al (1999) found that legal system, and financial system affect the economic growth of a nation. Allen et al (2005) found that good relationships with local government, not the legal system or financial system, affected the growth of economy of a nation. Other previous research on competitiveness and firm growth was Porter (1990) as explained below.

Porter (1990) and Best (2001) explain the concept of cluster. An important feature in Porter (1990), a competitive cluster in geographical space were critical sources and competencies that provide a certain region with key position within economic activities, to make this region have a competitive position in global market. This concept has gained significant attention especially because of the emphasis in productivity improvement and innovation in a firm that implement this concept, and in establishing new firms. Other researches on competitiveness theory is as follows.

2.2 Competitiveness Theory

According to Klepper (1996), a new firm enter an industry goes through a process called product life cycle (PLC). The process will go through the stages of Introduction, growth, maturity, and decline. At first when a new firm enters an industry, there will be a lot of new different products, new different processes. Firms have competitiveness and experience growth. A portion of the free cash flows from net income will be reinvested in to the firm for research and development (R & D) depend on firm size. But Hao Ma (2000) look at competitive advantage as a relational construct. Competitive advantage has three characteristics: (1) Competitive advantage does not equal to superior performance, (2) Competitive advantage is a relational construct, and (3) competitive advantage depends on specific context. In Hao Ma (2000) there are three possibilities about competitive advantage: 1) Competitive advantage with superior performance, 2) Superior performance without competitive advantage, 3) Competitive advantage without superior performance.

To improve competitiveness in maturity stage of PLC, a firm needs a strategy. There were two approaches in previous researches about strategic management. The first one was structural approach (Porter, 1980) and the second was resource-based view (RBV) (Barney, 1986, 1991). There were two types of competitive advantage which were: cost leaderships and differentiation implicitly equate competitive advantage with profitability or performance (Porter, 1985). One important external factor of competitiveness is governance as explained below.

2.3 Governance Theory

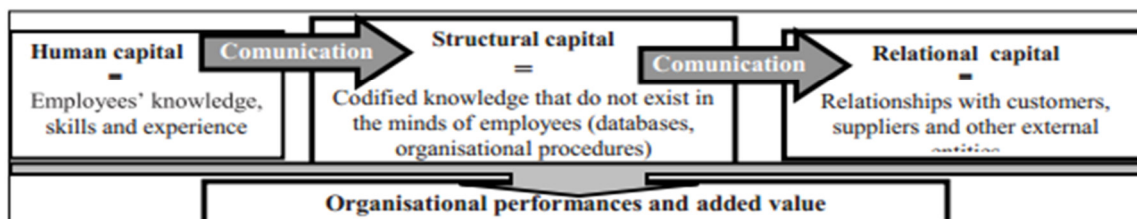
According to the definition of World Bank, governance as cited by Mardiasmo (2009) is as follows: “The way state power is used in managing economic and social resources for development of society”. La Porta (1999) found the legal system affected the growth of the economy of a nation. ASEAN Economic Community (AEC) is also trying to achieve the goals for the prosperity of the regions. In talking about governance, there is always a conflict of interest between principle and agent as explained by Agency theory below.

2.4 Agency Theory

Jensen and Meckling (1976) was the pioneer of this theory, to separate ownership problem and control. To run a company/a nation, a manager/executor normally acts for his/her own interest. Separation of ownerships by owner and control by manager/executor could create a problem that manager/executor acts on his/her own interest. To act on his/her own interest cause a conflict of interest between manager/executor and owner of a firm/a nation (adverse selection & moral hazard problems). Other important external factor of competitiveness is man power as explained below.

2.5 Man Power Theory

Manpower is essential element in competitiveness (Porter, 1990). Manpower who are competent, professional can work efficiently and effectively are intellectual capital of firms (Sumedrea, 2013). Manpower is an asset of a company. Manpower theory deal with intellectual capital. In intellectual capital there is human capital and structural capital. The growth and success of an organization depends on its man power, it means the success of a firm very much depend on how to develop its human capital. The business nowadays is dynamic and compete globally, man power who has knowledge and skills becomes valuable asset of a firm (Sumedrea, 2013). The way a firm executes its strategy relate to how a firm manage its human resource (Hambrick et al,1989). But there is still very little research done on the relationships between human capital and firm’s performance. Some researchers have done based on behavior in order to achieve certain goals for its performnace (Snell et al, 1992). And it has to do with reward and compensation for the employees (Finkelstein dan Hambrick, 1996). There are three functions in human resources management, they are: compensation, selection, and development (Tichy, Fombrun, and Devanna, 1982). Koch and McGrath, 1996 found a positive and significant impact of excellent planning, recruitment, and development on the productivity of a firm. A firm with human capital who has high productivity, and know how or skills that can not be easily replicate by competitors becomes a valuable asset of a firm and can give an added value to the firm (Barney, 1991). Below is a diagram that shows intellectual capital of a firm.



Source: Sumedrea, 2013.

Finally, researcher also investigate infrastructure as other important external competitiveness factor that affect firm growth as explained below.

2.6 Infrastructure theory

Infrastructure affects firm growth (Porter, 1990). It is also an important element in determining competitive advantage model of Porter. The growth of a sector will drive production expansion through multiplier effect to the whole sectors of an economy. In the beginning, the initial multiplier effect will be limited, i.e, initial multiplier effect in manufacturing sector. Although it is limited the multiplier effect still can drive other sector to grow through backward linkage and forward linkage. The growth of other sector can happen due to innovation and development of new products or new process. The multiplier effect will be bigger if there is an activity of developing of new infrastructure followed by developing local transportation or other public infrastructure and other sector that support a growth of the economy. Because development of infrastructure can drive and expedite the economic growth of local region (parikesist, 1999). There are two economic benefits from developing infrastructure locally, economic growth benefit for local region and distribution benefit which have been examined empirically by Parikesist, 2000. Infrastructure such as roads, internet connections, electricity supply are still not sufficient in Batam compared to neighboring countries like Malaysia, and Singapore (BP Batam, 2017).

3. The Method

3.1. Qualitative Research

In-depth Interviews were conducted together with data collection of the survey. The aim of these interviews is to gain more insight on investors' perspectives about Batam

3.2 Quantitative Research

Field survey based on a structured questionnaire to selected companies in existing business clusters in Batam-SEZ

4. The results and findings

4.1. Population

All firms in Industrial Park Batam,

4.2 Sample

Manufacturing firms in Industrial Park Batam.

Profile of Responding Companies in Batam Sector

Table 2 classified the surveyed companies by sector, namely, manufacturing and non-manufacturing sector. About 67 % of the surveyed companies are from the manufacturing sector.

Table 2 – Sector

Industry sector	Frequency	Percent
Manufacturing	100	66.7
Non-Manufacturing	50	33.3
Total	150	100.0

4.3 Company Size (by Number of Employees)

Table 3 shows that about 70% of the companies surveyed have 100 or more employees. **Table 3** shows companies in Batam by size.

Table 3 - Company Size (by Number of Employees)

Number of employees	Frequency	Valid Percent
Less than 20	21	14.0
20 to 49	17	11.3
50 to 99	16	10.7
100 to 199	18	12.0
200 to 499	27	18.0
500 to 999	23	15.3
1,000 to 4,999	25	16.7
5,000 to 9,999	3	2.0
Total	150	100.0

4.4 Ownership Type

Table 4 shows that about 62 % of the company surveyed are fully foreign owned companies.

Table 4 – Ownership type

Types	Frequency	Percent
Foreign owned company	93	62.0
Local / state owned company	35	23.3
Joint-venture with foreign majority shareholder	14	9.33
Joint-venture with foreign minority shareholder	8	5.37
Total	150	100.0

More than fifty percent are foreign owned companies

4.5 Whether located in Industry Park

Tables 5 show that 68.7% of all the survey respondents are located in industry parks. Of these companies located in industry parks, 66.7% are manufacturing companies and 33.3% are non-manufacturing companies. Of those manufacturing companies located in industry park, 53.3 % are medium-sized companies (200 to 999 employees). Of those non-manufacturing companies located in industry parks, 45.5% are medium-sized companies (20 to 99 employees). In addition, 62 % of those companies located in industry park are foreign-owned.

Table 5 – Whether located in industry park

	Frequency	Percent
No	47	31.3
Yes	103	68.7
Total	150	100.0

4.6 Financial Performance of Companies in Batam

Financial performance is measured by revenue growth rates as shown by table 6 below.

Table 6 shows the revenue growth rates (unweighted) of Batam companies by sector. On the whole, Batam companies estimated that, on average, the revenue growth rate for the last 3 years is about 11.5% per annum whereas the expected revenue growth rate for the next 3 years is 15.2%. The revenue growth rates should be interpreted with caution as it is unweighted by the size of the companies. Smaller companies with smaller total sales revenues indicating huge positive or negative growth rates would bias the average growth rates.

Table 6 - Revenue growth rates by sector

	Sector	Estimated Growth Rate	Expected Growth Rate
Mean	Manufacturing	15.72	15.93 *
	Non-Manufacturing	21.05	27.91 *
	Total	15.73	21.20
Minimum	Manufacturing	-10 (n=2)	0 (n=3)
	Non-Manufacturing	-5 (n=1)	0 (n=2)
	Total	-10 (n=3)	0 (n=5)
Maximum	Manufacturing	100 (n=1)	100 (n=2)
	Non-Manufacturing	70 (n=2)	81 (n=1)
	Total	100 (n=3)	100 (n=3)
N	Manufacturing	100	100
	Non-Manufacturing	31	31
	Total	131	131
Std. Deviation	Manufacturing	18.32	20.137
	Non-Manufacturing	21.997	22.358
	Total	19.875	21.457

* Statistically significant difference between groups at 5% significance level

4.7 Competitiveness at the firm level (Practices of innovation and R&D collaborations)

Practices of innovation and R&D collaborations can be seen as a way for companies to enhance their level of competitiveness. Table 7 showed that the most common practice of innovation and R&D collaborations among manufacturing companies is using technology licensed from a foreign-owned company (indicated by 81.4% of manufacturing companies).

For non-manufacturing companies, the common practices are conducting their own R&D at Batam SEZ (50%), and using technology licensed from a foreign-owned company (47%).

Table 7 – Practices of innovation and R&D collaborations

Practices of innovation and R&D collaborations	Those indicated “Yes”			
	Manufacturing		Non-Manufacturing	
	N	%	N	%
Use technology licensed from a foreign-owned company	72	72	17	34
Conduct own R & D at Batam SEZ	32	32	21	42
Conduct own R & D at another location of the parent company	27	27	11	22
Collaborate with companies from Indonesia in R & D	17	17	12	24
Collaborate with companies from the investing country in R & D	23	23	7	14

From the above table, less than 50 percent of companies conduct own R & D at Batam SEZ.

4.8 Competitiveness of Batam as a whole (Perceived importance and satisfaction with Batam on competitiveness factors)

Table 8 - Importance of Composite Competitiveness Factors by sector

Competitiveness Factors	Manufacturing	All Sectors
Man Power Factor	4.81	4.77
Governance Factors	4.72	4.69
Business Environment Factors	4.30	4.32
Overall Competitiveness Factors	4.59	4.55

Notes:

1=Not important; 2=Somewhat important; 3=Moderately important; 4=Quite important; 5=Very important

The following tables show satisfaction with Batam on composite competitiveness factors by sector.

Table 9 - Satisfaction with Batam on Composite Competitiveness Factors by sector

	Manufacturing	All Sectors
Man Power Factor	2.71	2.72
Governance Factors	2.98	2.91
Business Environment Factors	3.29	3.28
Overall Competitiveness Factors	3.01	2.97

Notes: 1=Not satisfied; 2=Somewhat satisfied; 3=Moderately satisfied; 4=Quite satisfied; 5=Very satisfied

From Table 8 & Table 9, in general, manufacturing companies attached higher importance to manpower and labor factors (statistically significant) compared to non-manufacturing companies. There are no statistically significant differences in the mean importance ratings attached to other factors between manufacturing and non-manufacturing companies.

Manufacturing companies are generally more satisfied than non-manufacturing firms; specifically,

Manufacturing sector attached greater importance to governance factors than non-manufacturing sector. (statistically significant) and low satisfaction (mean scores: 2.91-2.98)

Generally, manufacturing companies attached relatively lower importance to business environment factors, compared to other factors (mean scores: 3.3-4.4)

4.9 Governance

From the above results we can conclude that most firms in Batam are not satisfied with governance factor with perceived satisfaction of 2.98 for manufacturing sector and 2.75 for non-manufacturing sector but perceived as very important factor 4.72 for manufacturing sector and 4.60 for non-manufacturing sector.

4.10 Man Power

From the survey of manufacturing respondents, it is found that firms are very dissatisfied with labor unions and labor regulations with score of 2.73 and 2.82. The labor in Batam's firms have a tendency to strike to ask for wages increase. Firms become unproductive, cannot meet the order of customers. It is one of the main reasons that caused exports from Batam has declined significantly these past few years. It has a significant impact on competitiveness and firm growth of Batam as indicated in table 10 below.

Table 10. Satisfaction with Man Power And Labour Factor

	Manufacturing
Manpower and Labour Factors	
Labor regulations (min. wage, layoff and retrenchments)	2.82
Labor costs (wages, salaries, bonuses, social payments)	3.03
Availability of technical expertise and skilled workforce	3.18
Availability of adequately educated workforce	3.11
Labor unions have very weak bargaining power	2.73

Source: processed by researcher

4.11 Physical Infrastructure

Table 11. Satisfaction with Physical Infrastructure Factors

Manufacturing	
Physical Infrastructure Factors	
Access to land	3.39
Affordability of electricity supply	3.30
Access to uninterrupted electricity supply	3.18
Access to clean and portable water	3.31
Access to air transportation and logistics infrastructure	3.34
Access to land transportation and logistics infrastructure	3.16
Access to sea transportation and logistics infrastructure	3.61
Quality of telephone connection	3.80
Quality of internet connection	3.63

Source: processed by researcher

From the above table 11, it can be analyzed that firms in Batam are dissatisfied with electricity issues and land transportation issues with scores of 3.18 and 3.16. Manufacturing firms in Batam are dissatisfied with the issue of access to uninterrupted electricity supply and also dissatisfied with the issue of access to land transportation and logistic infrastructure. Uninterrupted electricity supply is mandatory for operating manufacturing firms in order to produce, and to meet customers' orders. It is a big problem to access to uninterrupted electricity supply. Firms become inefficient, unproductive, and cannot meet customers' order. It is also one of the main reasons for export declining from Batam in these past few years. Below table 12 shows internal or firm level competitiveness factor.

4.12 Firm Level or internal competitiveness

Table 12. Satisfaction with Internal Competitiveness Factors

Manufacturing	
Internal Competitiveness Factors	
Upgrade machinery and equipment	3.32
Develop new markets	2.33
Develop a major new product and/or service line	1.64
Upgrade an existing product and/or service line	1.60
Add quality R &D institute or Add other value-chain activity	2.72

Source: processed by researcher

From the above table 12, it can be observed that firms are very dissatisfied with the issues of upgrading an existing product and/or service line or developing a major new product and/or service line with scores of 1.60 and 1.64. Firms' products and/or services cannot compete internationally or globally. This is due to lack of good quality research and development institutions in manufacturing firms in Batam. Firms cannot innovate or upgrade an existing product and/or service line or develop a major new product and/or service line. Firms loose competitive advantage. Their products and/or service cannot compete internationally or globally. This is also one of the main reasons why exports from Batam has declined significantly.

5. Conclusin

External competitiveness factor in Batam such as lack of good policy/regulations regarding man power, governance, infrastructure, have caused competitiveness to decline significantly. The firm growth of Batam has been stagnant for the past ten years eventhough Batam has been given incentives by government to be developed into industry city. Man power, and governance is perceived to be very important but the firms in Batam are very dissatisfied with these issues. About 30 percent of companies in Batam have removed their operations to other more competitive region like China, Vietnam, and Malaysia. Dualism authority problem between government of Batam (PemKot Batam) and local authority of Batam (BP Batam) needs to be resolved urgently to create conducive business environment to improve declining competitiveness and firm growth. Conducive business environment in firm level, internal competitiveness factors such as research & development institutions to develop innovative products and innovative process is critical to create sustainable firm growth. Innovation or other value chain activities impact firm growth significantly. Firms should cooperate with government to create synergy, to improve business environment to regain competitive advantage and sustainable firm growth. Local and central government should have good coordination and deregulate policy/regulations regarding man power, also to eliminate dualism or conflict of power between local government (PemKot Batam) and local authority of Batam (BP Batam) to create conducive business environment to regain competitiveness for sustainable firm

growth. It is urgent to transform Batam from FTZ to SEZ status.

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