Can the Decline of Batam’s Shipbuilding Industry be Reversed?

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EXECUTIVE SUMMARY

• Batam’s shipbuilding industry is the largest in Indonesia. Yet, it has not benefited from President Jokowi’s maritime plan that aims to promote connectivity within the archipelago.

• This is partly due to Batam’s status as an export processing zone, which has prevented it from catering to the domestic market.

• Batam’s shipbuilding industry was driven by a combination of government policies (duties exemption and cabotage measures) and high commodity prices. It is currently suffering from overcapacity, what with the sharp decrease in oil prices that deflated the need for offshore activities reducing demand for offshore support vessels.

• In order to reverse the prolonged cyclical downturn, Batam’s shipbuilding industry needs to find new ways to revitalize its competitiveness, and this may be best done in specific niche markets such as ship repairing and maintenance services.

• One important policy option that can have immediate effect is for Batam’s shipbuilding firms to be allowed access to the domestic market, at least until global conditions improve.

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INTRODUCTION

Indonesia, with more than 17,000 islands and a coastline reaching around 95 thousand km, has long held the wish to develop its shipbuilding industry onto the world stage\(^1\). Confidence in the industry’s future received a boost with the election of President Joko ‘Jokowi’ Widodo in October 2014. Jokowi has vowed to turn Indonesia into a global maritime fulcrum\(^2\).

One of the locations that has come to be regarded as a centre for shipbuilding in Indonesia is Batam, a major island in the Riau Islands Province. Batam has experienced significant development since the early 1970s, thanks to its close proximity to Singapore and to its status as a Free Trade Zone (FTZ) area. It is undergoing a difficult period at present, however, due to the prolonged cyclical downturn in the global economy.

THE RECENT HISTORY OF THE GLOBAL SHIPBUILDING INDUSTRY

Over the last four decades, the world’s shipbuilding industry has been dominated by three Asian countries—Japan, South Korea and China. These three control around 80 percent of world orders\(^3\), and dominate the four main market segments: tankers; bulk carriers; container ships; and offshore vessels. Between 2010 and 2014, they built 86 percent of tankers, 94 percent of Liquid Natural Gas (LNG) carriers and 95 percent of bulk carriers in the world\(^4\).

The competition between them has also been profound, with each being market leader at different points in time. In the early 1960s, Japan, supported by its industrial conglomerates, was leading the global shipbuilding industry. In the 1990s, South Korea emerged as the new market leader. Its strong shipbuilding industry was the result of heavy government support combined with the availability of a skilled, hardworking and cheap labour force, as well as a favourable exchange rate. In 2003, South Korea met 44.8 percent of the world’s market orders, bypassing Japan, whose share was then down to 28.2 percent. In the early 2000s,

\(^{1}\) The 2012-2025 Ministry of Industry Road Map sets some targets for the development of shipbuilding industry, including the plan to produce vessels with a capacity of 200,000 tonnes deadweight by 2020.


China took over the top position. In 2012, China was catering to 40 percent of global orders against 28 percent by South Korea and 17 percent by Japan\(^5\).

Given their long history in the industry, Japan and South Korea offer superior technology and reliability in comparison with China. However, following massive investments since 2008, China has been quickly catching up and it can now produce better ships to cater for more complex segments such as ultra-large container ships of 12,000-14,000 20-foot equivalent units (TEU) and LNG containers\(^6\).

Within Southeast Asia, Indonesia, Malaysia, the Philippines, Singapore, and Vietnam are the countries that are competing to promote their maritime and shipbuilding industries. In order to achieve their goal to be part of world’s leading ship exporters, they invite investment and participation from foreign multinationals. For instance, Japan-based Tsuneishi Heavy Industries, South Korea-backed Hanjin Heavy Industries Corporation and Singapore-based marine and offshore company Keppel have all played major roles in boosting the Philippines shipbuilding production, making the country the world’s fourth largest shipbuilder today\(^7\).

At the same time, South Korea-conglomerate Hyundai has been a player in the development of the shipbuilding industry in Vietnam, the world’s fifth largest shipbuilding nation. The Hyundai-Vinashin yard, a joint venture between Hyundai and a Vietnamese state-owned enterprise, has been one of the key producers of medium-sized bulk carriers and product tankers. Other big foreign shipyards in Vietnam include Strategic Marine (Australia) and STX Europe.

Likewise, international shipbuilders such as the Norwegian Aker and the Danish Maersk Lines have invested in offshore facilities in cooperation with local suppliers in Malaysia. Through this cooperation, Malaysia has built its capacity in terms of new and advanced technology for building complex small- and medium-sized vessels, cruisers and offshore vessels.

Singapore is one of the leading ship repair and ship conversion hubs in the world. It has built up a strong reputation in rigs and offshore structures building and in Floating Production, Storage and Offloading (FPSO) unit conversion\(^8\). In terms of shipbuilding, Singapore serves a niche market of customized and specialized vessels such as offshore supply and support vessels. The Singaporean shipbuilding industry is controlled by two big


\(^8\) Maritime sector developments in the global markets, SmartComp Research Report No 3, October 2013
shipyard groups, SembCorp Marine Ltd and Keppel Offshore & Marine. Both cover the entire value chain from ship repair to rig building and offshore production. These two are also actively involved in overseas projects.

Indonesia has approximately 250 shipyards all across the archipelago, 115 of which are located in Batam. The big shipyards in Batam are foreign-owned and managed. Most are Singaporean companies or are linked with a Singapore partner (see Appendix 1: List of shipyards in Batam).

The shipbuilding and shipyard industry in Batam is concentrated in Tanjung Uncang (Nanindah, Batamec, ASL), Kabil (Anggrek Hitam, Labroy), Sekupang (Bandar Victory, Cahaya Samudera), Batu Ampar (McDermott, Bintang Intipersada), and Sagulung (Sentek, Citra, Patria Maritim) (see Figure 1).

**Figure 1: Locations of key shipyards in Batam**

There has been a trend of Singaporean shipyards relocating to Batam after the signing of an economic cooperation agreement between Singapore and Indonesia in 2006. Several factors contributed to this. The first was Singapore’s policy to relocate its shipyard industry due to
land limitation, high labour costs, and environmental concerns. Second, as an FTZ, Batam offers import-duty exemption, which was of great help to industries that rely on imported materials, parts and components. The third factor was the implementation of the national-flagged ships (cabotage) policy under the Law No. 17/2008. The law requires all vessels operating in Indonesian waters to be domestically owned (flying the Indonesian flag). The cabotage policy has benefited the shipbuilding industry, which can be seen in the increase in national-flagged vessels for domestic maritime transportation and in the amount of cargo delivered by the national fleet. The Indonesian commercial fleet more than doubled between 2005 and 2014, growing from 6,041 vessels to 13,224 vessels.

The shipbuilding industry in Batam received another boost when offshore activities jumped in response to the record high oil prices in 2011-2013. Due to its strong linkage to Singapore’s marine and offshore industry, Batam’s shipbuilding industry has come to specialise in building offshore support vessels that carry out high-sea operations for oil and gas explorations.

**Figure 2: Employment trend in Batam**

Source: BP Batam and BSOA

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During its golden period in 2011-2013, Batam’s shipbuilding industry produced on average 200 tugboats and more than 700 barges per year to cater demand from offshore and mining industries. However, after the sharp drop in oil prices in the second half of 2014, the industry has been struggling to find orders. Currently, the industry only produces 2-3 tugboats per year and barely covers its operational costs. During the golden period in 2012, around 250,000 workers were employed in the shipbuilding industry in Batam. This number has been declining rapidly and currently, only around 11,000 workers are employed in this industry in Batam (Figure 2).

**CHALLENGES FACING BATAM**

Overall, both external factors and internal regulations contributed to the rapid development of the shipbuilding industry in Batam. Data from the Batam Shipyard Offshore Association (BSOA) show that the number of shipyard companies in Batam grew from 33 in 2006 to 115 companies in 2015. Moreover the number of supporting industries increased from around 80 companies to more than 100 in the same period.

No doubt, great exposure to external conditions laid the ground for rapid growth, but this also made the industry vulnerable to external changes as well. The sharp fall in international oil prices since the second half of 2014 quickly led to huge drops in orders (Figure 3).

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The oil price level is strongly tied to the level of demand for offshore support vessels. As most shipyards in Batam focus on building and repairing offshore support vessels, the low oil prices has an adverse effect on demand for offshore projects and new vessels. What has made matters worse is the huge oversupply of offshore vessels, tugs and barges which came in the wake of widespread speculation during the period of high oil prices.

Currently, many shipyards in Batam are standing idle. Some have cut jobs and even closed their docks. According to BSOA, less than 30 percent of the 115 registered shipyards in Batam are currently active. The surviving shipyards rely on the ship repair and maintenance business. A few benefit from government projects. PT Anggrek Hitam for example received an order from Pertamina to build two oil tankers; while PT Palindo Marine and PT Citra Shipyard received an order from the Transport Ministry for five and for two navigation vessels, respectively.

In mid-2014, the Indonesian government decided to ban raw mineral exports, including nickel, bauxite, gold, silver, tin and coal. Riau Island Province is one of the biggest producers of nickel and bauxite, and the export ban on raw materials significantly affected the demand for barges and tugboats.

As orders from the private sector drop more and more, the industry seeks government projects. However, Batam is at a disadvantaged by its FTZ status. As a FTZ, Batam benefits from free import duty for goods. However, its products have to be re-exported and not sold

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*Source: FRED Economic Data. Accessed 13 January 2017*

*Interview with BSOA, Batam, 3 June 2016.*
domestically. If they are sold domestically, import duty as well as a 10 percent value-added tax will be levied on them, making them 20 percent more expensive.

As an export-oriented zone, Batam is designed not to compete with other industrial areas in Indonesia. Such a regulation was not an issue under bullish global economic conditions. However, the situation has changed dramatically since the second half of 2014. Export markets have shrunk and at the same time the domestic market that ought to be its natural outlet is strictly closed to it. An interview with some BSOA members reveals their wish to gain access to the government’s maritime projects. They deem that the government has been unfairly prioritizing shipbuilding companies in Java which are members of the Jakarta-based shipbuilding and offshore association (IPERINDO).

Whatever the case, there are some structural problems facing the shipbuilding industry in Batam. First, the industry is highly dependent on imported components, such as engine, propeller, boiler, seawater treatment, navigation equipment, etc. These imported materials account for around 70 percent of total production costs. Some managers note that locally produced components are more expensive than imported one. This is partly caused by the high transport and logistic costs in Indonesia. When a company orders from Singapore, it will receive the purchases within a day. However, if it orders from Jakarta, delivery can take from one to two weeks.

Second, a rapid increase in minimum wages has made Batam lose some of its competitiveness to Vietnam and the Philippines. Due to a regulatory environment that is tilted in favour of labour, the industry had had to face a significant increase in minimum wage (Figure 4). Moreover, the negotiation of minimum wage has been perceived as politically-motivated and are often marked by disruptive labour demonstrations (sweeping raids) and threats being made to the management by militant unions. It is important to note that the minimum wage in the shipbuilding industry is 20 percent higher than Batam’s minimum wage (electronics and hotel business have the second and third highest sectoral minimum wages).

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14 Interview with BSOA, Batam 3 June 2016.
15 Interview with PT Patria Maritim, Batam 2 June 2016.
For firms, labour demonstrations have become a routine risk that they need to consider when receiving orders. As a common practice for avoiding labour pressure, the industry has taken to using subcontractor services to obtain their construction workers. While this helps firms avoid dealing with labour directly, they don’t enjoy loyalty from the workers. There have been many cases of companies losing their workers at a crucial time since contract workers can easily move to other projects that offer higher wages.

In 2010, industrial relations in Batam suffered a severe blow following massive labour unrest involving the PT Drydocks World Graha shipyard in the Tanjung Uncang area. Growing resentment against discriminative treatment between foreign and local workers triggered local workers to commit vandalism and assault Indian workers. At that time, Drydocks was employing 200 foreign workers and 10,000 local workers. The latter are mostly poorly-trained and low-skilled and thus get much lower salaries and benefits. This incident has shaken foreign investors’ confidence about business climate in Batam.

Finally, the shipbuilding industry is also struggling to find a long-term financing. The interest rate in Indonesia is relatively high compared to that in neighbouring countries, and can reach 12-14 percent per annum. And since 2015, the banking sector has put the brakes on new credit to the sector in light of the perceived risk. And so, companies are now struggling to maintain a healthy cash flow.

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CONCLUDING REMARKS

Since the global environment is expected to remain uncertain, the shipbuilding industry in Batam needs to focus now on internal restructuring and business consolidation. Demand is expected to return eventually, but this will take some time. To survive, the industry must secure long-term financing, and currently the government should play the role as lender of last resort. The industry is expected to continue restructuring its assets and debts, cutting jobs, diversifying its services, or shifting to other sectors. At such a time, the government would do well to provide more incentives for the industry to undergo restructuring, for there is real fear that it will become a sunset industry.

During the current cyclical downturn, businesses have been able to survive through repairing and maintenance activities. Some firms tap into government maritime projects. However, this will not be sufficient for the whole industry’s needs. Allowing Batam to cater for the domestic market will require a clear decision from the central government.

Going forward, Batam needs to continue revitalizing its core competitiveness, i.e. its close proximity to Singapore and its relatively cheaper labour. The latter needs to be complemented with investments in education and training to improve skills and productivity. Batam’s authorities must seriously revisit its land use policy, given the huge amount of idle land in Batam. It must actively promote foreign investment and help foreign-based companies to collaborate with local companies. The collaboration can be done in shipping, shipbuilding, port development or port management. Experienced multinational companies can offer funding and knowhow to help local firms upscale and modernize their operations. Specifically, the shipbuilding industry in Batam should work to provide the best support possible for the government’s maritime industry.
## Appendix 1: List of select shipyards operated in Batam

<table>
<thead>
<tr>
<th>Company</th>
<th>Products &amp; services</th>
<th>Ownership</th>
<th>Land area</th>
<th>Year of establishment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 McDermott</td>
<td>Designs, engineers, fabricates &amp; installs marine pipelines &amp; offshore structures for development, drilling &amp; production &amp; subsea production systems</td>
<td>USA</td>
<td>110.1 hectare (Batu Ampar)</td>
<td>1970</td>
</tr>
<tr>
<td>2 DDW-PaxOcean (Pertama, Graha, Nanindah)</td>
<td>Rig building, ship building, ship repair and conversion service</td>
<td>Singapore (Kuok Ltd)</td>
<td>54.6 hectare (Tj. Uncang)</td>
<td>1993 (In 2012, Pacific Carriers (PCL) acquired majority share of Drydocks World)</td>
</tr>
<tr>
<td>3 Nexus Engineering Indonesia</td>
<td>Ship building, ship conversion, offshore construction and turnkey engineering services</td>
<td>Singapore (Beng Kuang Marine Ltd)</td>
<td>32.8 hectare (Kabil)</td>
<td>1993</td>
</tr>
<tr>
<td>4 Sentek</td>
<td>Ship building and repair of tugboats, oil barges and deck cargo barges, floating docks, chartering service of barges, and launching service</td>
<td>Singapore (Sentek Marine &amp; Trading Pte Ltd)</td>
<td>Tj. Uncang</td>
<td>1993</td>
</tr>
<tr>
<td>No.</td>
<td>Shipyard Name</td>
<td>Types of Services</td>
<td>Location Notes</td>
<td>Year</td>
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<tr>
<td>5</td>
<td>ASL Shipyard Indonesia</td>
<td>Offshore support vessels, dredger, tugs, barges and tankers</td>
<td>Singapore (ASL Marine Holdings Ltd)</td>
<td>1996</td>
</tr>
<tr>
<td>7</td>
<td>Bandar Victory Shipyard</td>
<td>Ship building and ship repair</td>
<td>Private national company</td>
<td>1997</td>
</tr>
<tr>
<td>8</td>
<td>Bandar Abadi Shipyard</td>
<td>Ship building, ship repairing, ship conversion and steel fabrication</td>
<td>Private national company</td>
<td>2005</td>
</tr>
<tr>
<td>9</td>
<td>Patria Maritim</td>
<td>Barges, offshore supply vessels and tug boats</td>
<td>Private national company, subsidiary of United Tractors and Astra International group</td>
<td>2005</td>
</tr>
<tr>
<td>10</td>
<td>Marcopolo Shipyard</td>
<td>Dry-docking, repair and conversion of ships, ship building, tugs and barges, AHSTS, offshore fabrication and installation</td>
<td>Singapore (Marco Polo Marine Ltd)</td>
<td>2005</td>
</tr>
<tr>
<td>11</td>
<td>Citra Shipyard</td>
<td>Barges, CPO, SPOBs and tug boats</td>
<td>Private national company</td>
<td>2006</td>
</tr>
<tr>
<td>No.</td>
<td>Company Name</td>
<td>Industry Products</td>
<td>Ownership Type</td>
<td>Land Area</td>
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<tr>
<td>12</td>
<td>Anggrek Hitam</td>
<td>Floating cranes, accommodation barges, work barges, tug boats, supply vessels</td>
<td>Private national company</td>
<td>2.8 hectare (Kabil)</td>
</tr>
<tr>
<td>13</td>
<td>Cahaya Samudera</td>
<td>Shipbuilding and ship repair and maintenance</td>
<td>Private national company</td>
<td>5.7 hectare (Sekupang)</td>
</tr>
<tr>
<td>14</td>
<td>Labroy Shipbuilding Engineering</td>
<td>Offshore supply vessels, tankers, cement carriers and rigs</td>
<td>Singapore (Labroy Shipbuilding &amp; Engineering Pte Ltd)</td>
<td>19 hectare (Kabil)</td>
</tr>
</tbody>
</table>

Source: Author’s compilation from various sources