

Potential business opportunities in east timor



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To begin, the aim of this audit is to examine the potential business opportunities in the country East Timor. More specifically, this research focuses on the potential of business in exporting agricultural goods like copra and coffee from East Timor. The research will analyze East Timor's 1) Cultural Environment; 2) Political and Legal Environment and; 3) Economic Environment.

In addition, using theories and concepts of International Trade the research will characterise the government's attitude to international trade, both outwardly & inwardly.

Finally, based on the dept of research and understanding, I will conclude with some few recommendations for East Timor's current International Trade Strategy.

Analysis of East Timor's Business Environment

The research will analyze East Timor's business environment in three environments namely 1) Cultural environment; 2) Political and Legal environment; and 3) Economic environment.

Cultural Environment in EAST TIMOR

Languages

Tetum and the Portuguese are the official language for East Timor. English and Bahasa Indonesia is officially used in everyday business. In East Timor there are 16 indigenous languages including Tetum, Galole, Mambae, and

Kemak are very well spoken by significant numbers of people. (U. S. Department of State 2010)

Ethnic groups

The breakdown of ethnicity are as follows Austronesian (Malayo-Polynesian), Papuan, small Chinese minority. (Central Intelligence Agency)

Religions

The breakdowns of religions are as follow: Roman Catholic 98%, Muslim 1%, Protestant 1% (Central Intelligence Agency 2005)

East Timor culture

East Timor has a mixed culture of Malay and Pacific Islander culture. The Timorese peoples reflect the geography of the country on the border of those two cultural areas. During the Portuguese influence from the centuries of colonial rule resulted in a substantial majority of the population identifying itself as Roman Catholic. Some of those who consider themselves Catholic practice a mixed form of religion that includes local animist customs. As a result of the colonial education system and the 23-year Indonesian occupation, approximately 13% of Timorese speaks Portuguese, 43% speak Bahasa Indonesia, and 6% speak English, according to the 2004 census. (U. S. Department of State)

Political and Legal Environment in EAST TIMOR

The Head of state of the country East Timorese republic is the president, who is elected by voting system for a five-year term and whose role is largely

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symbolic, though he is able to elect some legislation. In the further following elections, the president appoints as prime minister the leader of the majority party or majority coalition. Become the head of government the prime minister presides over the Council of State or cabinet.

The unicameral Timorese parliament is the National Parliament or Parlamento Nacional, whose members are elected by voting system to a five-year term. The number of seats can vary from a minimum of 52 to a maximum of 65, though it exceptionally has 88 members at present, due to this being its first term of office. The Timorese constitution was modelled on that of Portugal. The country is still in the process of building its administration and governmental institutions.

(SOURCE: East Timor Government website)

One of the main problems with East Timor is corruption according to Transparency International Corruption Perceptions Index, the country ranks poorly at 111. With a low confidence range of 2.3 – 3.0, it is not easy to attract foreign direct investments into the country. Also the neighbour country Indonesia also lacks in corruption and it holds the 130th rank in Corruption Perception Index. With corruption the cost of business will be higher as more monies have to be paid out to the stakeholders when running business in East Timor.

Transparency International Corruption Perceptions Index

Explanatory notes*

* CPI Score relates to perceptions of the degree of corruption as seen by business people and country analysts, and ranges between 10 (highly clean) and 0 (highly corrupt).

** Confidence range provides a range of possible values of the CPI score. This reflects how a country's score may vary, depending on measurement precision. Nominally, with 5 percent probability the score is above this range and with another 5 percent it is below. However, particularly when only few sources are available, an unbiased estimate of the mean coverage probability is lower than the nominal value of 90%.

*** Surveys used refers to the number of surveys that assessed a country's performance. 12 surveys and expert assessments were used and at least 3 were required for a country to be included in the CPI.

Source: Transparency International 2006

Economic overview

East Timor is one of the poorest countries in the world and also in Asia-Pacific region. It was ranked 158 out of 179 countries in the 2008 UN Human Development Indices. The US Central Intelligence Agency (CIA) reports that in 2001 East Timor's GDP was estimated at \$415 million. The per capita GDP was estimated at under \$500. The annual growth rate of GDP was forecast at -2% in 2003. The average inflation rate was estimated at 3% in 2001. The CIA defines GDP as the value of all final goods and services produced within a nation in a given year and computed on the basis of purchasing power parity (PPP) rather than value as measured on the basis of the rate of exchange. It was estimated that agriculture accounted for 25% of GDP, <https://assignbuster.com/potential-business-opportunities-in-east-timor/>

industry 17%, and services 57%. While East Timor has made significant progress in building an institutional framework to support economic development and promote macroeconomic stability, East Timor's economic performance since independence has been fragile. Growth contracted following the reduced international presence after 2002, before increasing in 2004 (0.3 per cent) and 2005 (2.3 per cent). The economy contracted sharply again in 2006 (-3.4 per cent) following the violence of that year. With UNMIT's establishment and the return of a significant number of international personnel, East Timor's economic growth rate increased sharply in 2007 (19.8 per cent). In 2008, IMF forecast 2.5 per cent growth with 4 per cent inflation.

(Source: Central Intelligence Agency)

East Timor – Trade

The East Timor is one of the poorest nations in the world, but they generate most of their revenue from trading. The country East Timor generates nearly more than half of the revenue by exporting goods. The major export goods or commodities are coffee, coconut, sandalwood and marble. In 2007-08, East Timor has good relations with Australia in trading and it ranked as Australia's 91st largest goods trading partner, with total merchandise trade valued at \$37 million. In turn East Timor imports from Australia were valued at \$33 million with major items including refined petroleum and motor vehicles. Exports of East Timor were valued at \$4 million to Australia, particularly the commodity coffee. In July 2003, East Timor and Australia extended preferential duty-free access and quota-free access between the two regions. East Timor has been steadily improving its trade balance, reflecting the

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contribution of petroleum development. Excluding hydrocarbons, coffee accounts for around 90 per cent of merchandise exports, and this could increase as world coffee prices rebound.

Please refer to appendix 1- About East Timor's Trading Fact Sheet with Australia

(Source: Australian Government website on Foreign Affairs and Trade)

The nature of Advantage

Advantage in the context of International Trade Theory can be classified into five categories and defined by Daniels, Radebaugh and Sullivan (2004) as 1) Natural advantage by means of climate, soil and etc; 2) Acquired advantage through the processing of one of the basic factors of land, labour and etc; 3) Comparative advantage against another nation's endowment of assets; 4) Country size as a proxy for the range of natural factors such as climate, soil, minerals and etc, size of population that provides opportunities to process materials and create markets and lastly; 5) Factor proportions that suggest their optimum utilisation in production.

According to Daniels, Radebaugh and Sullivan (2004) Framework, the evolution of International Trade Theory is depicted as below:

Apart from Porter's Competitive Advantage of Nations theory, I have chosen to relate Comparative Advantage and Factor Proportions theory.

1). Comparative Advantage:

According to David Ricardo's comparative advantage of the country of East Timor, the two industry we are going to discuss, they are Agricultural and Petroleum Industry.

The agricultural industry is the industry which contributes majorly in the revenue from exports. East Timor mainly relies on its natural commodities as sources of its export. Coffee is one of the major item for East Timor export. East Timor is one of the minor coffee producing country of the world even though the Arabica variety finest coffee types are the best that attracts buyers to East Timor. The production of coffee in East Timor is about 10, 000 tonnes per annum. Coffee generates revenue per year of around \$20 million. Moreover the East Timor government has lifted the tax on coffee export which is sure to boost the coffee trade. Main revenue generating other export commodities of East Timor are sandalwood and coconut. Sandalwood especially grows in the hilly areas of East Timor and is a main export item. East Timor is being island best suitable for planting coconut trees, so the follow growing coconut trees near its shores. The coconuts are exported to different countries. So the agricultural industry is having the comparative advantage then petroleum industry.

(Source : Maps of world dot com)

Comparing with petroleum industry East Timor is beneficial from the commercial exploitation of its petroleum reserves. The most heavily petroleum-dependent country in the world, East Timor's economy is one among them. The Government of East Timor is planning to use its oil

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reserves and generate revenue from the industry and make them support in long-term economic development, economic diversification and poverty reduction. East Timor has established an internationally-acclaimed Petroleum Fund to manage its petroleum revenues transparently and sustainably. As at 31 December 2008 the fund had accumulated savings of around US\$4.2 billion. But the petroleum industry need very technically sound employees and huge investment to run, so they made collaboration with Australia but East Timor gets very less from the actual return. So currently they need to focus on technical support and huge capital, then they the start the petroleum exploration plan by its own and definitely it will give better revenue. So now, the agricultural industry is having the comparative advantage then petroleum industry.

(Source: Australian Government website on Foreign Affairs and Trade)

Please refer to appendix 2- About East Timor's Oil: Blessing or Curse?

2). Heckscher-Ohlin Factor Proportions Theory

€This theory suggests that each country has important factor endowments and as a result will tend to export products which make use of factors that are abundant there. The country will tend to import products that are locally scarce (Daniels, et al. 2004).

Details

Heckscher-Ohlin Factor Proportions Theory

Major Exports

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coffee, sandalwood,

marble, potential for oil

and vanilla exports

Major Imports

food, gasoline, kerosene

and machinery.

Total Exports

\$10 million

Total Imports

\$202 million

Source: Trade key website

Summary of EAST TIMOR current trade position using the extended form of Porter's Diamond of National Competitiveness

Source: (Dunning 1993)

According to Porter (1994), there are four principal attributes of a country's economic system that together shape the environment in which local companies compete. They are 1) Factor conditions; 2) Demand conditions; 3) Related and supporting industries and; 4) Company strategy, structure and rivalry.

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In addition, further research by Dunning (1993) found that there are secondary attributes that contribute to the extended form of the model. The secondary attributes are identified as the role of chance, the role of government and multi-national business activities.

Agriculture industry is the field suitable for diamond model and it is the major exports of East Timor and the major revenues, some main attributes are:

Factor conditions would be mainly land, labour, capital, climatic or weather condition and fertility of the soil are important factor conditions.

Demand conditions for agriculture products is high in local market and scarcity of food in East Timor should be avoided by only investing in agricultural industry by East Timor government. The global demand for coffee, copra, vanilla and other agricultural products are very high.

Related and supporting industries would be the transport and manufacturing industries. Packing of the agricultural products is very important and processing of the products also plays a role.

Firm strategy, structure, rivalry would be depicted as below:

The East Timor government had support the firms by lifting the tax on coffee export which is sure to boost the coffee trade. Rivalry is the investor from other countries to the coffee industry also enjoys the benefit, so it increase the local competition.

Recommendations for EAST TIMOR's International Trade Strategy

I conclude my research with a Strengths, Weaknesses, Opportunities and Threats Analysis (SWOT) as below:

Strength:

East Timor has blessing with the nature, this small nation have a variety of natural resources. Some of these natural resources include gold, petroleum, natural gas, manganese and marble. These valuable natural resources are found scattered all over the East Timor. They are aware of the scarcity of the natural resources like petroleum all over the world. So they are sensibly using their stock of this “ liquid gold”. But a large amount of petroleum in East Timor is also found in the bottom of the sea. Also there are many gold mines in East Timor. There are some mines here in East Timor where we find manganese ores as well. The country is also blessed with marble mines. The quality of manganese and marble found here is pretty high. The government was facing some political unrest with the Australian Government regarding their stock of petroleum. But now both nations have come to a peaceful agreement which increases the possibility of a more strong economic structure of East Timor based on their natural resources.

Source : Maps of world dot com

Weakness:

The nation continues to face a range of long-term development challenges that will impact on the achievement of broad-based economic growth

including labour force incapacity, weak public governance and inadequate infrastructure. Political instability has undermined Government efforts to promote private sector investment as a basis for long-term development. East Timor ranked 170 of 181 in the World Bank's 2009 Doing Business report. East Timor's economic challenges are compounded by profound infrastructure deficits, notably in the areas of transportation, telecommunication and electricity.

Source: Timor-Leste government website

Opportunity:

East Timor has plenty of resource in agricultural sector and petroleum and oil sectors. They had to generate revenues from those available resources. East Timor's government has take primary steps to overcome the weakness by developing National Development Plan identifies governance, poverty reduction and improved food security as development priorities. Objectives include reaching an annual GDP growth rate of 5 per cent in the medium term and the 50 per cent reduction of the number of people living below the poverty line by 2015. Other development priorities include strengthening the judiciary and other institutions; creating an enabling environment for civil society and business; reducing unemployment and providing skills training and education. Continued reform of the power sector and improvement of infrastructure will also be important.

If the government increase the above mentioned details then the East Timor's Economy will grow definitely.

Threat:

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The main threat faced by East Timor is the Rebel attacks and the neighbouring countries took over their resources. With offshore oil and gas coming on stream and revenues to be placed in a Norwegian-style escrow accounted trust fund, East Timor has a US\$100 million a month resource potential that could lay the bedrock for a viable state. But as the record shows, “ the resource curse” has left oil-rich countries elsewhere mired in corruption, ethnic conflict and widespread poverty. So East Timor has to strengthen their boundaries with military departments.

In conclusion, in order to develop a competitive advantage over other nations, East Timor should have good relation with the foreign countries and ready to share the resources to earn potential revenues.

(Source : Asia Times article posted on February 15, 2008)

Lastly, concluding this research, the chosen industry is agricultural industry, because plenty of resource in this East Timor country. Although corruption and political instability, poor infrastructure facility in East Timor, leads to many problems to run a business, so government should strengthen every sector and appreciates foreign direct investments and make the country to grow steadily in the global market.