

1. Introduction

Indonesia has historically been plagued and associated with weak institutions and a myriad of other problems, being one of the countries hardest hit by the 1997 Asian Economic crisis, which caused a major recession, widespread civil unrest, sectarian violence and resulting socio-economic fallout. At the height of the crisis, foreign investment virtually collapsed against the USD and other foreign currencies and interest rates and inflation reached unprecedented levels.

Today, Indonesia is a politically stable democracy, has enjoyed sustained periods of record economic growth and foreign investment, as well as now being the largest economy in South East Asia. However the country is still not without need for significant policy reforms and various challenges remain, with new ones emerging. This publication is intended as a general guide to investing and doing business in Indonesia for new foreign investors looking to enter the Indonesian market, but also tries to capture practical insights and other intelligence from KPMG's experience "at the transaction and M&A coalface" based on our experience in providing transaction, M&A and tax advisory services to both foreign and local investors.

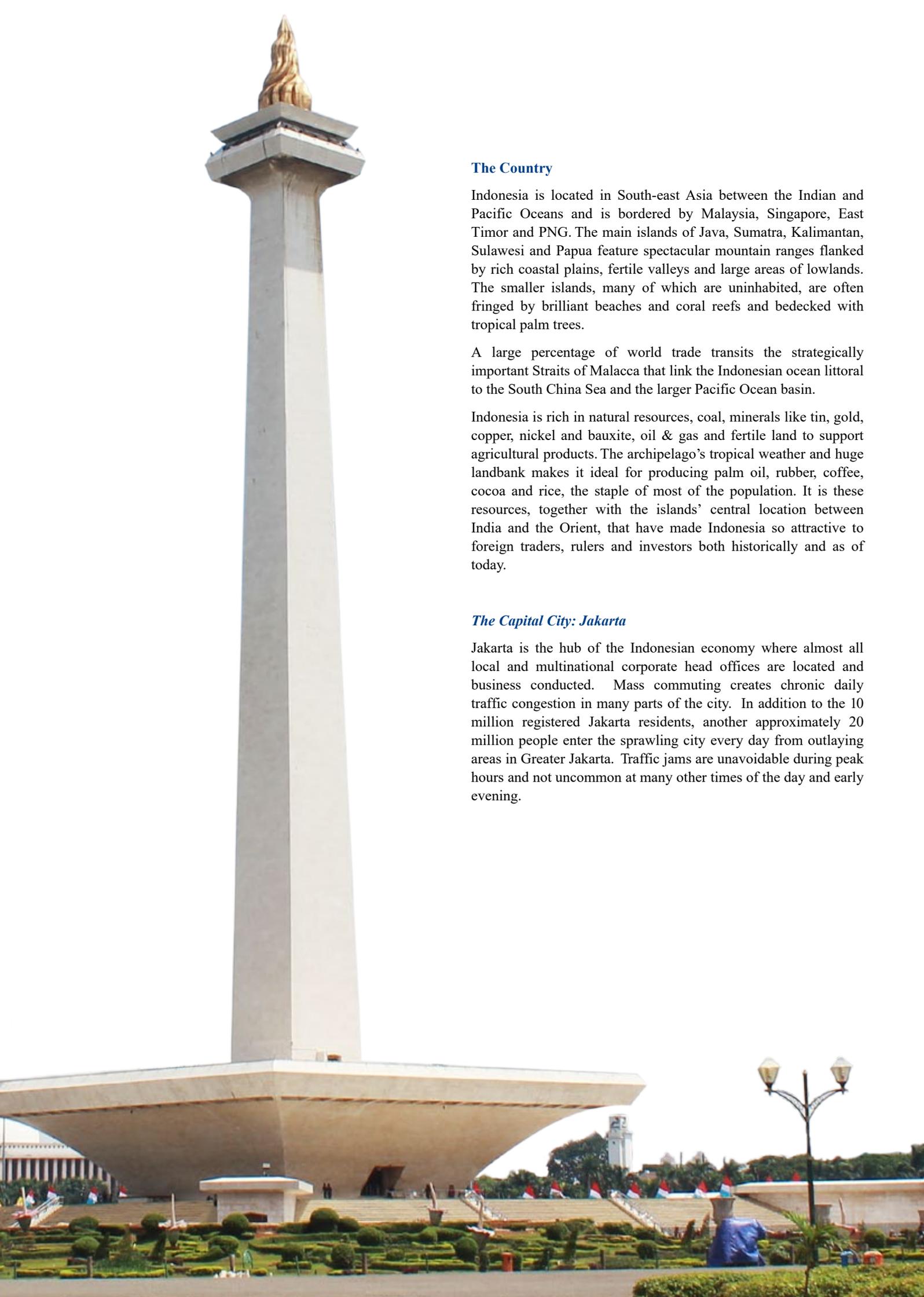
Why Investing in Indonesia?

With GDP more than US \$ 1.1 trillion and GDP per capita US\$ 3,377.1 in 2015, Indonesia is the largest economy country in South-East Asia. Not affected by the global financial crisis in 2008, compared with neighboring countries, Indonesia proved to be stable in terms of both national politics and national security. Indonesia's economy grew stable on average of 6% from 2012 to 2015, and make Indonesia had the fastest economic growth in the G-20 after China. Although still at the level of developing country, Indonesia big GDP made it into G-20, a collection of 20 countries with the largest GDP in the world.

Indonesia's economy grew by 5% in 2015 and expected to grow above 6% in 2016, giving the state a case for inclusion in the so-called BRIC. Economic expansion in the future is expected to include more inclusive growth as nominal GDP per capita expected quadruple by 2020, according to Standard Chartered. Most of our economic success is the result of prudent fiscal management that focuses on reducing the debt burden. Indonesia's debt to GDP continued to decline from 83% in 2001 to less about 27% at the end of 2015, the lowest among ASEAN countries, except Singapore has no government debt. Consequently, at the beginning of this year, Moody's and Fitch has raised Indonesia's credit rating to investment grade. The ratings reflect Indonesia's resilience to the global financial crisis, the government and improving external credit metrics, and the ability to manage domestic political challenges to the reform agenda. In a strong economy, political stability and reform-minded, Indonesia is a global powerhouse that emerged in Asia.

In a strong economy, political stability and reform-minded, Indonesia is a global powerhouse that emerged in Asia. Indonesia vast population also means that a lot of workers are ready to enter into the production process along with a variety of infrastructure and facilities that are being built massive. Expected in 2025 Indonesia become a developed country, and in the year 2045, Indonesia joined the super-power state. Do you want to be part of it?





The Country

Indonesia is located in South-east Asia between the Indian and Pacific Oceans and is bordered by Malaysia, Singapore, East Timor and PNG. The main islands of Java, Sumatra, Kalimantan, Sulawesi and Papua feature spectacular mountain ranges flanked by rich coastal plains, fertile valleys and large areas of lowlands. The smaller islands, many of which are uninhabited, are often fringed by brilliant beaches and coral reefs and bedecked with tropical palm trees.

A large percentage of world trade transits the strategically important Straits of Malacca that link the Indonesian ocean littoral to the South China Sea and the larger Pacific Ocean basin.

Indonesia is rich in natural resources, coal, minerals like tin, gold, copper, nickel and bauxite, oil & gas and fertile land to support agricultural products. The archipelago's tropical weather and huge landbank makes it ideal for producing palm oil, rubber, coffee, cocoa and rice, the staple of most of the population. It is these resources, together with the islands' central location between India and the Orient, that have made Indonesia so attractive to foreign traders, rulers and investors both historically and as of today.

The Capital City: Jakarta

Jakarta is the hub of the Indonesian economy where almost all local and multinational corporate head offices are located and business conducted. Mass commuting creates chronic daily traffic congestion in many parts of the city. In addition to the 10 million registered Jakarta residents, another approximately 20 million people enter the sprawling city every day from outlying areas in Greater Jakarta. Traffic jams are unavoidable during peak hours and not uncommon at many other times of the day and early evening.

The Economist Intelligence Unit has released “The Safe Cities Index 2015: assessing urban security in the digital age” report covering 50 cities based on an Index comprising digital and health security, infrastructure and personal safety. Jakarta ranks 50th and is in the bottom 6 places for all 4 indicators. Cities in developing markets typically fall in the bottom half, with the top half of the index generally occupied by rich cities from Europe, East Asia and North America.

To put things in perspective, it is relevant that Jakarta is in a “bottom eleven” with Ho Chi Minh City, Bangkok and cities of the BRIC economies. Selected sub-indicators that surface for Jakarta are number of doctors per 1,000 people, incidence of petty crime, population size, poverty (or GDP per head), poor sanitation systems and pollution. Other indicators likely to be relevant indirectly drawn from a comparison to 1st ranked Japan include lack of privacy policies or enforcement, low vigilance of disease outbreaks and natural disasters as well as transport system design and construction. Whilst needs for improvements and remedial action is recognized and are underway to varying degrees, long lead times are involved.

The city’s vibrance is not captured in reports like these, nor the friendliness of the Indonesian people.

The people

The people of Indonesia are culturally diverse reflecting their differing ethnic origins, religions and histories.

With an estimated population of 252 million, Indonesia is the fourth most populous nation in the world after China, India and the USA, as well as the world’s most populous Muslim nation. 51% of the population is below 29 years of age, while about 67% is below 39 years of age. The most populated islands are Java, Sumatra, Sulawesi and Kalimantan. Java, Bali and Madura are the most densely populated with Papua, Kalimantan and many of the smaller islands having low population densities. The most populous cities are Jakarta, Surabaya and Bandung in Java, and Medan in Sumatra. About 53% of the population resides in urban areas, with the annual rate of urbanization estimated at 1.4% over 2010-15.

Most Indonesians are of Malay descent and the largest ethnic group, the Javanese, make up 42% of the total population. The Javanese are pre-eminent in the social elite, bureaucracy and the armed forces. There is also an ethnic Chinese minority whose influence in business is proportionately greater than their numbers. Papua, the eastern half of the island of New Guinea, is peopled by Melanesians.

The official language of the country is Bahasa Indonesia, which is similar to Malay. This is the second language of many rural Indonesians after their local dialect or tongue, of which there are almost 300. English language skills are actively encouraged in recognition of the opportunities English affords to Indonesians in education, commerce and international relations. English is understood by business people in the cities. The country has a 93% literacy rate.

Over 87% of the population follow the Moslem faith, but there are significant minorities of Hindus (centered in Bali), and Christians.

The climate

Straddling the equator from latitude 60°N to 110°S, Indonesia has a typically tropical climate marked by heavy rainfall as well as high humidity and temperatures. Rainfall increases during the monsoon season which typically runs from October to April. The tropical climate is moderated by mountains in large parts of the country. Temperatures generally range from 23° to 33°C.

The type of government

The 1945 Constitution of the Republic of Indonesia provides for independent executive, legislative and judicial functions. The highest authority is the People’s Consultative Assembly (MPR), which meets annually to hear accountability reports from the President and government agencies and provide policy guidance. The MPR includes the House of Representatives (DPR), which has 560 members, and the Council of Regional Representatives (DPD) which has 132 members. Members are elected to five year terms.

The President and Vice-president are elected by direct popular vote. The president is the Chief Executive, the Head of State and Commander-in-Chief of the Armed Forces, and also appoints Cabinet Ministers who are responsible only to him/her.

The country is divided administratively into 34 provinces headed by a Governor and elected provincial assemblies, and hundreds of districts and municipalities headed by a Regent, each with its own elected council assemblies. Governors and Regents are appointed by, and report to, the local assembly or council. These regional governments have responsibility to administer a wide range of matters, including health, education and investment.

In October 2013 the House of Representatives approved the creation of 8 new provinces involving formation of 65 new regions. The mindset at the time was based around bringing government closer to the people, making land ownership processing more accessible and improving prosperity, particularly in under developed border areas. The House's proposal was rejected or set aside, with criticism sighting opening up of regional bureaucracies bringing fresh opportunity for corruption, and costs of financing elections better applied in building infrastructure, education and health facilities: Infrastructure is discussed in Chapter 4. Statistics presented by APINDO (Indonesian Employers Association) showed that 85% of new regions failed to develop due to reluctance of investors to do business in new and geographically remote areas due to legal uncertainty, unclear and conflicting regional regulations as well as hidden fees: regional autonomy is a country investment risk referred to in Chapter 5: Investment.

The Type of Legal System

The judiciary is based on the Supreme Court and separate courts for public administration and military, religious and civil matters. A comprehensive system of civil laws has replaced most of the statutes established by the Dutch. In addition, there is an extensive range of decrees and regulations developed and applied by government departments. For foreign investors, the most relevant areas are laws regarding:

- foreign investment
- company law
- business licensing and trade
- taxation and customs
- labor
- land and buildings
- regional regulations.

Professional advice should always be obtained with regard to contracts and agreements made in Indonesia. One reason is that the civil law provides for certain clauses to apply to all agreements unless specifically excluded. Litigation can be unpredictable in terms of outcomes, protracted and time consuming, and as a result is not commonly an effective route to resolve disputes. The protection provided by agreements of themselves can be limited, and commercial arrangements should be designed, where possible, with safeguards which can operate in the event of later disagreements. Contracts commonly include Indonesian or international arbitration for resolution of disputes. A popular choice is Singapore in accordance with the rules and regulations of the Singapore International Arbitration Centre, where the final, binding arbitral award is automatically ratified in the Indonesian Courts.

Indonesian laws become operative following issuance of implementing regulations, and can be subsequently stipulated in Ministerial and Presidential regulations and decrees. A significant period of time can elapse between new laws being announced, drafted, passed by Parliament and final regulations or decrees being rolled out.

Sources:

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- (4) Economist Intelligence Unit (EIU), "The Safe City Index 2015", January 2015
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