

4. Investment



Introduction

Indonesia welcomes foreign investment on its own terms. Government policies aim at ensuring that foreigners work with Indonesians to assist in development of the country's economy and skill-base. There is a general recognition that Indonesia needs the development capital, and the technical and management skills of foreigners.

Government regulation of foreign investment in Indonesia is manifested in a variety of ways, for example:

- approved and monitored through governmental bodies
- companies can employ only a limited number of expatriates, and are required to demonstrate plans for replacement of
- those expatriates by Indonesians (with the exception of expatriate directors and commissioners)
- certain fields of business are closed to investment by foreigners
- foreign individuals are permitted to acquire land or land rights with a number of restrictions.

A "foreign investor" is usually a foreign company incorporated under the laws of its host nation; however foreign individuals are also acceptable.

Direct and Indirect Investment

Law No.25/2007 concerning Capital Investment ("Investment Law") defines investment as Direct investment and Indirect investment. Indirect investments, also known as Portfolio investments, are transactions made through the domestic capital market/stock exchanges of a country. The Indonesian equity market is highly institutionalized, whereby over the period from 2002 to 2014 foreign institutions

generally held around 65-70% of the free-float value of the Indonesian equity market. At 31 December 2014, the foreign portfolio ownership was 72.1% of the Total Free Float Value of the Jakarta Composite Index (JCI).

The Indonesian government encourages Direct investment by foreigners or Foreign Direct Investment ("FDI") in most areas of the Indonesian economy, and less so in others. Foreign investment approvals can be issued either by BKPM in Jakarta or an Investment Board (BPM) in every Province, Investment Institution in Regency Municipality or through Representative Offices of the Republic of Indonesia in several countries.

Investment Law, Negative List and FDI

The Investment Law regulates FDI by granting a right of entry to foreign businesses through a government licensing procedure principally controlled by BKPM. It specifies that foreign investment shall be in the form of a limited liability PMA Company incorporated in Indonesia, in which the investor goes into partnership with an Indonesian person or entity as shareholders. Foreign investors can hold between 30% to 95% ownership in various industries or even up to 100%, but this varies within sectors and business fields.

Foreigners are permitted to invest with no restriction on the maximum size of the investment, the source of funds or whether the products are destined for export or for the domestic market. This is except in an industry sector which is listed as closed to foreign investment on the Negative Investment List ("Negative List") which attaches to the Investment Law under Presidential Regulation. The principal starting position (not always the case in practice) is that all industry or fields of business are open to foreign investment unless mentioned otherwise in the Negative List. This is provided that certain conditions are fulfilled and foreign investment in an industry is not also regulated in Ministerial or other laws, regulations and decrees.

To invest in Indonesia, an investor must first look at the Negative List which is updated with policy changes every three years under the Investment Law. As indicated, if a business field is not mentioned in the Negative List, it is regarded as 'open' to foreign investment.

In general conceptual terms, the following lines of business are not open to FDI in Indonesia:

- those that are reserved for micro, small, medium enterprises and cooperatives
- those for which a partnership is required
- those for which certain shareholding arrangements are required
- those that may be conducted only in certain locations
- those for which a special license is required

The underlying principle is that if a business within a certain industry can be capably conducted by Indonesians, then that sector will be closed to foreign investment.

Navigating the Investment Law and Negative List together with other regulations, decrees or specific industry laws that can interplay with, override or supercede each other is fraught with danger. Professional advice is recommended together with consultation with government officials at BKPM and/or relevant Ministries that regulate specific industries on how the business field of a particular target or business is categorized.

Negative List: Presidential Regulation No. 39/2014

On 24 April 2014 the GOI's long awaited modifications to the Negative List became effective under Presidential Regulation No. 39/2014, revoking the previous Negative List under Presidential Regulation No.36/2010.

The 2014 Negative List did not provide for any real liberalization but a tightening of foreign Investment restrictions in key sectors.

There has been closing or tightening of restrictions in oil & gas services, retail trade, transportation, agriculture, small scale power generation, security services, trading and logistics. There has been opening up and some loosening in port facilities and energy, pharmaceutical, fixed line telecommunications and various sectors for investors from ASEAN member states, although these sectors are not typically where significant foreign investment interest has historically been directed. A possible exception is medical clinics and hospital services, and then only a nominal foreign investment limitation increase from 67% to 70% is given and then there are potentially unappealing geographical conditions.

Industry sectors where foreign ownership restrictions have been relaxed or sectors opened up:

- New lines of business have been opened up in Marine affairs and Fisheries and General or "other manufacturing" where requirement for Indonesian partnership is removed
- Sectors now more open to foreign shareholding include: -
Pharmaceuticals (85% up from 75%)
 - Venture Capital financing (85% up from 80%)
 - Fixed line telecommunications (65% up from 49%)
- Foreign ownership which opened up or levels increased for ASEAN country investors include: market research; production of film promotion facilities advertising; tourism and recreation (motels and golf courses); specialist medical clinics, hospitals and nursing services
- There is higher foreign ownership of 95% to 100% for PPPs
- Port facilities and energy

Where there has been a tightening of limits or closure to foreign investment:

- Investment has been closed in sectors where in most cases the Negative List was previously "silent" and the sectors thus open: Oil & gas construction, on-shore (land) drilling and other supporting services; Retail trade across automotive, non-mini markets or department stores, textiles, garments and toys, cosmetics, footwear, electronics, food & beverage and e-commerce retailing as well as "alternative trading" business fields. In practice, retailing has been closed to foreign investment except for large scale hypermarket format. These new provisions formalize positions being taken in practice by BKPM
- The Foreign investment threshold has been reduced for small scale power generation (1-10 MW), now 49%; and certain offshore oil & gas drilling services business fields to between 49% to 75% (previously 100% and 95%)
- New restrictions have been imposed in various sectors previously excluded from the Negative List and therefore are no longer 100% open to foreign investment:
 - security services (49%)
 - oil & gas construction, offshore drilling and survey services (49% - 75%)
 - distribution, warehousing and cold storage has a new lower 33% limitation. The general position taken by BKPM is that a PMA Company cannot sell directly to end users but only through a 100% owned Indonesian distributor. Onshore distribution here is being distinguished from import and wholesale activity where foreign investors can take up to 100% ownership

Grandfathering

Grandfathering provisions continue to apply to existing investments regardless that new foreign investment limitation reductions or closures have been introduced in the 2014 Negative List. Laws and regulations in Indonesia when made or enacted are generally not retrospective.

Publicly listed companies and the Negative List

Based on the Elucidation to Art. 2 of the Investment Law, current practice is that foreign investment limitations and restrictions in the Negative List do not apply to Indirect (or Portfolio) investments, and thus public companies. However BKPM has openly communicated that this position is still subject to review; recent regulatory history is relevant.

In 2013 BKPM Regulation No. 5/2013 regarding Guidelines and Procedures for Capital Investment Licenses and Non-licenses dated 12 April 2013 (“BKPM Reg. No. 5/2013”) introduced new requirements for capital investment regulation and licensing, in particular formalizing prior “rules of thumb” and policies applied by BKPM: refer also Chapter 6 on Business Structure and Establishment under “Minimum investment.”

BKPM Reg. No. 5/2013 aligned with BKPM policy regarding a controlling share ownership in a public company as a Direct investment and not an Indirect or Portfolio investment, thus triggering an obligation to convert to a PMA Company and a potential requirement to comply with the Negative List.

In late 2013 BKPM issued Head of BKPM Regulation No. 12/2013 on “Head of BKPM Regulation No. 5 of 2013 on Guidelines and Procedures for Licensing and Non-licensing matters in relation to Investment” BKPM Reg. No. 12/2013 revoked the position regulated in BKPM Reg. No. 5/2013 being that a public company did not need to convert to PMA status regardless of it having a foreign shareholder. It is understood that the revocation of this key (and other mostly procedural aspects) of BKPM Reg. No. 5/2013 was due to a recognition that elements of detail in the drafting of the regulation had been overlooked.

List of business fields that are closed to foreign investments

Sector	Business Field
Agriculture	Marijuana Cultivation
Forestry	<ol style="list-style-type: none">1. Capturing of Fish Species as Stated in Appendix I Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES)2. The use (removal) of coral/atoll from nature for construction material/lime/calcium and souvenir/jewelry, also live or dead coral (recent dead coral) from nature
Energy and Mineral resources	<ol style="list-style-type: none">1. Testing and analysis of electrical installations2. Electrical installation3. Oil and gas construction services:<ol style="list-style-type: none">a. oil and gas upstream productionb. conduit installation on landc. horizon/vertical tanksd. tanks and gas storage installation and marketing on land4. Oil and gas drilling services on land5. Oil and gas supporting services:<ol style="list-style-type: none">a. well operation and maintenance servicesb. oil and gas design and engineering servicesc. technical inspection services
Trade	<ol style="list-style-type: none">1. Retail of motorcycles and commercial vehicles2. Retail trade, namely retail sales in non-minimarkets, non-department stores, textile, games and toys in stores, cosmetic articles, footwear, electronics, mail order houses or via internet (consequently will restrict e-retailing for foreign ownership), and food and beverages3. Alternative trading, namely alternative trading systems and alternative trading system parties

Sector	Business Field
Industry	<ol style="list-style-type: none"> 1. Chemical Material Industry that can damage the environment, such as: <ul style="list-style-type: none"> • Mercury processed Chlorine Alkali Maker Industry • Pesticide active material industry: Dichloro Diphenyl Trichloroethane (DDT), Aldrin, Endrin, Dieldrin, Chlordane, Heptachlor, Mirex, and Toxaphene • Ozone depleting substances industry: Carbon Tetrachloride (CTC), Methyl Chloroform, Methyl Bromide, Trichloro Fluoro Methane (CFC-11), Dichloro Trifluoro Ethane (CFC-12), Trichloro Trifluoro Ethane (CFC-113), Dichloro Tetra Fluoro Ethane (CFC-114), 'Chloro Pentafluoro Ethane (CFC-115), Chloro Trifluoro Methane (CFC-13), Tetrachloro Difluoro Ethane (CFC-112), Pentachloro Fluoro Ethane (CFC-111), Chloro Heptafluoro Propane (CFC-217), Dichloro Hexafluoro Propane (CFC-216), Trichloro Pentafluoro Propane (CFC-215), Tetrachloro Tetrafluoro Propane (CFC-214), Pentachloro Trifluoro Propane (CFC-213), Hexachloro Difluoro Propane (CFC-211), Bromo Chloro Difluoro Methane (Halon-1211), Bromo Trifluoro Methane (Halon-1301), Dibromo Tetrafluoro Ethane (Halon-2402), R-500, R-502 2. Chemical Material Industry list-1 chemical weapons convention as stated in Appendix 1 of Law No. 9/2008 concerning on the use of chemical materials and the prohibition chemical materials as chemical weapons 3. Beverage industry contains alcohol: <ul style="list-style-type: none"> • Liquor • Wine • Beverages containing Malt 4. Manufacture of crumb rubber
Transportation	<ol style="list-style-type: none"> 1. Implementation and Operation of Land Terminals 2. Implementation and Operation of Weight Stations 3. Telecommunication/Supporting Facility of Shipping Navigation and Vessel Traffic Information System (VTIS) 4. Implementation of air navigation services 5. Implementation of Motor Vehicle Type Tests 6. Passenger land transport on scheduled routes (cross border transport) and unscheduled routes (tourism transport, specific destination transport, specific area transport)
Communication and Information	<p>Management and Implementation of Radio Frequency and Satellite Orbit Spectrum Monitoring Stations</p>
Culture and tourism	<ol style="list-style-type: none"> 1. Public Museums 2. Historical and Ancient Heritage (temples, castles, epigraphy, remains, ancient buildings, etc) 3. Residential/Traditional Environment 4. Monuments 5. Gambling/Casinos

Source: President Regulation No.39/2014, Investment Negative List

FDI in specific sectors – Negative Investment List

Sector Heading	Sub-sector Heading	Regulation of PDI
Agriculture	<ul style="list-style-type: none"> Seeding plantation and crop cultivation (area more than 25 Ha) 	<ul style="list-style-type: none"> Maximum 49% Requires a recommendation from Minister of Agriculture
	<ul style="list-style-type: none"> Seeding plantation and crop cultivation (area less than or equal to 25 Ha); Pig (less than or equal to 125 pigs) and free-range poultry breeding and farming; Plantation product processing 	<ul style="list-style-type: none"> Reserved for micro, small, medium enterprises and cooperatives
	<ul style="list-style-type: none"> Pig breeding and farming for quantity of more than 125 	<ul style="list-style-type: none"> Allowed in certain location and must not contradict with local regulation
	<ul style="list-style-type: none"> Use of genetic in agriculture product 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding Requires a recommendation from the Minister of Agriculture
	<ul style="list-style-type: none"> Plantation business (with and without processing unit or mill) including seedling, and product processing business (area equal to or more than 25 Ha) 	<ul style="list-style-type: none"> Maximum 95% foreign shareholding Requires a recommendation from the Minister of Agriculture
	<ul style="list-style-type: none"> Horticulture (including cultivation, industry, research and development, agro tourism, etc.) 	<ul style="list-style-type: none"> Maximum 30% foreign shareholding. This conforms with the Horticulture Law which requires divestment by November 2014
Forestry	<ul style="list-style-type: none"> Non-reptile wild life capturing and propagating; Swallow's nest business in nature; Forest plantation business (sugar palm, pecan, etc.); Pine sap, bamboo, and rattan processing primary industry; Forest processing prime product industry; Mangrove semi finished goods and saw mill - under 2,000 m³/year; Resin, eaglewood, shellac, bee, latex, natural silk, and alternative crop plant business 	<ul style="list-style-type: none"> Reserved for micro, small, medium enterprises and cooperatives
	<ul style="list-style-type: none"> Hunting business, raising wildlife plants, coral raising/ cultivating 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding
	<ul style="list-style-type: none"> Nature tourism and ecotourism business 	<ul style="list-style-type: none"> Maximum 51% foreign shareholding
	<ul style="list-style-type: none"> Capturing/taking and distributing reptiles and coral/decorative coral 	<ul style="list-style-type: none"> Requires recommendation from the Minister of Forestry
	<ul style="list-style-type: none"> Development of technology use on plant and wildlife genetics 	<ul style="list-style-type: none"> Requires a statement on partnership with accredited institution/national institution in research and development area appointed by the Minister of Forestry
	<ul style="list-style-type: none"> Wood processing industry 	<ul style="list-style-type: none"> Require recommendation on sustainable raw material supply from the Minister of Forestry and compliance with President Degree No.6/2007.
	<ul style="list-style-type: none"> Timber utilization and forest plant's seed and seeding export and import; Water environment use service business in forest area 	<ul style="list-style-type: none"> Requires 100% domestic capital

FDI in specific sectors – Negative Investment List (continued)

Sector Heading	Sub-sector Heading	Regulation of PDI
Marine Affairs and Fisheries	<ul style="list-style-type: none"> Capture fisheries with a fishing ship of 100GT and/or more in capture areas in high seas 	<ul style="list-style-type: none"> Open for foreign shareholding Subject to special licenses/permits from the Minister of Marine Affairs and Fisheries
	<ul style="list-style-type: none"> Fishery business with a fishing ship above 30GT and in capture areas above 12 miles (Big scale Fishing Business) and Sea Sand Extraction 	<ul style="list-style-type: none"> Requires 100% domestic capital
	<ul style="list-style-type: none"> Small scale fishery processing business; Capture fisheries with a fishing ship of 30GT and/or in capture areas in 12 miles 	<ul style="list-style-type: none"> Reserved for Micro, Small, Medium Enterprises and Cooperatives
	<ul style="list-style-type: none"> Marine, brackish water and freshwater fish rearing and hatchery; fishery processing, marketing, and distribution, wholesale fish products, export trade of fish product business 	<ul style="list-style-type: none"> Requires a partnership with small enterprise
	<ul style="list-style-type: none"> Indonesian Exclusive Economic Zone ("ZEEI") fishing using 100GT ship or above 	<ul style="list-style-type: none"> Requires a special license Compliance with the Ministry of Marine Affairs and Fisheries Regulation Number PER 12/MEN/2009 on Fish Catching Business
	<ul style="list-style-type: none"> Usage (taking) and distribution of decorative coral/atoll from nature for aquariums 	<ul style="list-style-type: none"> Require recommendation from the Minister of Marine Affairs and Fisheries
	<ul style="list-style-type: none"> Lifting of valuable items from a Sunken Ship's cargo 	<ul style="list-style-type: none"> Compliance with Presidential Decree Number 19 of 2007 concerning National Committee for Salvaging and Exploiting Valuable Objects Retrieved from Shipwreck
Energy and Mineral Resources	<ul style="list-style-type: none"> Less than 1 MW power plant 	<ul style="list-style-type: none"> Requires 100% domestic capital
	<ul style="list-style-type: none"> Small scale power plant (1-10 MW) 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding
	<ul style="list-style-type: none"> Oil & gas drilling service onshore; Oil and gas upstream production; Installation of pipeline onshore; Horizontal/Vertical tanks; Installation of onshore oil & gas storage; Well operation and maintenance services; Technical inspection services; Oil & gas design and engineering services; Construction of electrical utility installation; Inspection and testing of electrical installation 	<ul style="list-style-type: none"> Requires 100% domestic capital
	<ul style="list-style-type: none"> Power plant more than 10MW, power transmission, and power distribution 	<ul style="list-style-type: none"> 100% for foreign shareholding with a PPP arrangement during the concession period, otherwise maximum 95% foreign shareholding is applied
	<ul style="list-style-type: none"> Offshore oil and gas drilling services 	<ul style="list-style-type: none"> Maximum 75% foreign shareholding
	<ul style="list-style-type: none"> Operation and maintenance of geothermal facility 	<ul style="list-style-type: none"> Maximum 90% foreign shareholding
	<ul style="list-style-type: none"> Oil & gas and geology & geophysics survey services 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding
	<ul style="list-style-type: none"> Manufacture of biomass pellets for energy 	<ul style="list-style-type: none"> 100% foreign shareholding with an Indonesian partnership cooperation
	<ul style="list-style-type: none"> Oil and gas construction services: <ol style="list-style-type: none"> Platform Spherical tanks Conduit installation on sea 	<ul style="list-style-type: none"> Maximum 75% foreign shareholding Maximum 49% foreign shareholding Maximum 49% foreign shareholding
	<ul style="list-style-type: none"> Geothermal survey services 	<ul style="list-style-type: none"> Maximum 95% foreign shareholding
	<ul style="list-style-type: none"> Drilling services of geothermal 	<ul style="list-style-type: none"> Maximum 95% Foreign shareholding
	<ul style="list-style-type: none"> Construction of electrical generator installation; Electricity consultation service; Operational and maintenance electricity installation 	<ul style="list-style-type: none"> Maximum 95% foreign shareholding

FDI in specific sectors – Negative Investment List (continued)

Sector Heading	Sub-sector Heading	Regulation of PDI
Industrials	<ul style="list-style-type: none"> Salting/drying fish; Processed food (seeds, roots, sago, gnetum gneumon nut); Root peeling and cleaning; Palm sugar; Hand work thread coloring; Cloth printing industry especially Batik and traditional patterns; Hand painted Batik; Knitted cloth (lace); Moslem woman's praying cloth; Rubber curing; Handicraft; Manual/semi mechanical hand tool and hand tool for farming; Clay made household (pottery); Motorcycle maintenance and repairing 	<ul style="list-style-type: none"> Reserved for Micro, Small, Medium Enterprises and Cooperatives
	<ul style="list-style-type: none"> Food processing (copra, soya sauce, tempe, and fruits industry) ; Milk powder process and condensed milk industry; Printed batik; Forest product processing (rattan processing and rattan, bamboo preserving industry); Mangrove wood industry; Essential oil industry; Tobacco drying and processing; Construction material and spare parts; Medium technology machinery, tools, equipment industry and maritime tourism; Silver jewelry industry; Metal hand craft and non-metal recycle goods 	<ul style="list-style-type: none"> Requires a partnership with small enterprise
	<ul style="list-style-type: none"> Car maintenance and repair industry 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding
	<ul style="list-style-type: none"> Cigarette industry 	<ul style="list-style-type: none"> Required to obtain recommendation from the Minister of industry.
	<ul style="list-style-type: none"> Pulp industry 	<ul style="list-style-type: none"> Requirement to obtain raw material from Industrial Forest plant (HTI) or imported wood chip if supplies from domestic sources are insufficient
	<ul style="list-style-type: none"> Valuable paper printing industry; essential ink industry 	<ul style="list-style-type: none"> Requires an operational license from the Counterfeit Money Coordinating Agency under the National Intelligence Agency and a recommendation from the Ministry of industry
	<ul style="list-style-type: none"> Cyclamate and saccharin industry 	<ul style="list-style-type: none"> Compliance with requirements of Indonesia's National Agency for Drug and Food Control ("BPOM") and the Minister of Trade
	<ul style="list-style-type: none"> Crumb rubber industry 	<ul style="list-style-type: none"> Requires 100% domestic capital
	<ul style="list-style-type: none"> Lead smelting industry 	<ul style="list-style-type: none"> Requires a recommendation of the State Minister for the Environment and Minister of industry especially for the industry using used car batteries as raw material
Defense and Security	<ul style="list-style-type: none"> Explosives industry (raw materials and all components) 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding Requires a recommendation of the Minister of Defense
	<ul style="list-style-type: none"> Production of weapons, ammunition, explosive devices, and war equipment 	<ul style="list-style-type: none"> Requires 100% domestic capital Requires recommendation from Minister of Defense
	<ul style="list-style-type: none"> Security consulting and provision of security guards; Money and valuable goods transport escorting services; Security equipment implementation, education and training services; Animal provider services; Security system devices and security education and training 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding Requires an operational license from the Republic of Indonesia Police Department

FDI in specific sectors – Negative Investment List (continued)

Sector Heading	Sub-sector Heading	Regulation of PDI
Public Works	<ul style="list-style-type: none"> Construction service under and/ equal to IDR 1 billion contract value 	<ul style="list-style-type: none"> Reserved for Micro, Small, Medium Enterprises and Cooperatives
	<ul style="list-style-type: none"> Drinking water and toll road business 	<ul style="list-style-type: none"> Maximum 95% foreign shareholding
	<ul style="list-style-type: none"> Construction service above IDR 1 billion contract value 	<ul style="list-style-type: none"> Maximum 67% foreign shareholding
	<ul style="list-style-type: none"> Construction consultant service 	<ul style="list-style-type: none"> Maximum 55% foreign shareholding
	<ul style="list-style-type: none"> Treatment and disposal of non-hazardous waste 	<ul style="list-style-type: none"> Maximum 95% foreign shareholding
Trade	<ul style="list-style-type: none"> Direct selling through marketing network developed by business partner 	<ul style="list-style-type: none"> Maximum 95% foreign shareholding
	<ul style="list-style-type: none"> Retail of motorcycles, spare parts, non-minimarkets, non-department store, textiles, games & toys, cosmetic articles, footwear, electronics, online or offline retail shopping, food & beverages; Large trade and property/real estate broker based on fee or contract; Machinery and equipment rental for land transportation, agriculture, construction, and office; Building cleaning service, and others (such as salon, barbershop, dressmaking, photocopy, etc.); Survey and other activities services related to survey; Alternative trading 	<ul style="list-style-type: none"> Requires 100% domestic capital
	<ul style="list-style-type: none"> Public opinion polling and market research 	<ul style="list-style-type: none"> Maximum 51% foreign shareholding for investors from ASEAN countries Closed for investors from non-ASEAN countries
	<ul style="list-style-type: none"> Distribution 	<ul style="list-style-type: none"> Maximum 33% foreign shareholding
	<ul style="list-style-type: none"> Warehousing 	<ul style="list-style-type: none"> Maximum 33% foreign shareholding
	<ul style="list-style-type: none"> Cold storage 	<ul style="list-style-type: none"> Maximum 33% foreign shareholding for Sumatera, Java, and Bali Maximum 67% foreign shareholding for Kalimantan, Sulawesi, Nusa Tenggara, Maluku and Papua
	<ul style="list-style-type: none"> Futures brokers 	<ul style="list-style-type: none"> Maximum 95% foreign shareholding
	<ul style="list-style-type: none"> Large trade of liquor (importer, distributor and sub-distributor), liquor retail business 	<ul style="list-style-type: none"> Must have Business License Certificate (SIUP), Business License Certificate of Liquor Business (SIUPMB), have distribution network and a special place

FDI in specific sectors – Negative Investment List (continued)

Sector Heading	side walk vendor liquor business	Regulation of PDI
Tourism and Economic Creative	<ul style="list-style-type: none"> Homestay; Tour agent and guide services; Art studio and gallery 	<ul style="list-style-type: none"> Reserved for Micro, Small, Medium Enterprises and Cooperatives
	<ul style="list-style-type: none"> Film promotional facility (advertisements, posters, stills, photos, slides, negatives, banners, pamphlets, billboards, etc.) 	<ul style="list-style-type: none"> Maximum 51% foreign shareholding for investors from ASEAN countries Closed for investors from non-ASEAN countries
	<ul style="list-style-type: none"> Film taking studio, film processing laboratory, film dubbing facility, and film printing and/or duplication 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding
	<ul style="list-style-type: none"> Film distribution; Viewing/movie theatres; Film taking, editing and subtitling facility; Film making, distribution; Recording studio (Cassette, VCD, DVD, etc.) 	<ul style="list-style-type: none"> Requires 100% domestic capital
	<ul style="list-style-type: none"> Private museum; Cultural heritage managed privately 	<ul style="list-style-type: none"> Maximum 51% foreign shareholding and compliance with local regulations
	<ul style="list-style-type: none"> Art gallery and art performance building 	<ul style="list-style-type: none"> Maximum 67% foreign shareholding
	<ul style="list-style-type: none"> Travel agency; Bar and café; Recreational and entertainment business (sports and golf field), Impresario business services, karaoke 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding Maximum 51% foreign shareholding with an Indonesian small scale business partnership Compliance with local regulations
	<ul style="list-style-type: none"> Other accommodation services (motel) 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding Maximum 51% foreign shareholding with an Indonesian small scale business partnership Maximum 70% foreign shareholding for ASEAN investors, in certain regions of Indonesia (located in Java and Bali) Compliance with local regulations
	<ul style="list-style-type: none"> Golf course 	<ul style="list-style-type: none"> 100% foreign shareholding for investors from ASEAN countries, outside Java and Bali Maximum 70% foreign shareholding for ASEAN investors, in Java and Bali Maximum 49% foreign shareholding for investors from non-ASEAN countries Maximum 51% foreign shareholding for investors from non-ASEAN countries with partnership with Micro, Small, Medium Enterprises and Cooperatives Compliance with local regulations
	<ul style="list-style-type: none"> Restaurant, Catering, Hotel, SPA, Convention, exhibition and incentive tour service 	<ul style="list-style-type: none"> Maximum 51% and compliance with local regulations
<ul style="list-style-type: none"> Natural tourism out of conservation areas 	<ul style="list-style-type: none"> Maximum 51% foreign shareholding 	
<ul style="list-style-type: none"> Dexterity 	<ul style="list-style-type: none"> Maximum 67% foreign shareholding and compliance with local regulations 	

FDI in specific sectors – Negative Investment List (continued)

Sector Heading	Sub-sector Heading	Regulation of PDI
Transportation	<ul style="list-style-type: none"> International shipping (excluding sabotage) 	<ul style="list-style-type: none"> Maximum 60% foreign shareholding for investors from ASEAN countries
	<ul style="list-style-type: none"> Transportation (container, general cargo, dangerous cargo, special cargo, heavy equipment, liquid & gas cargo, plant & animal cargo); Domestic and overseas sea transportation; Ferry; River and lake boat transportation < 30 GT; Port facility (waste storing); Salvage service and/or underwater work; Airport services, Air transportation supporting service (ground handling, cargo and aircraft leasing); Terminal supporting business; Multimode transportation; Non-commercial air transportation; General selling agent (GSA) of Foreign air transport company; Airplane cargo service; Transportation arrangement service; other service related airport 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding
	<ul style="list-style-type: none"> Unloading/loading cargo (maritime cargo handling service) 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding Maximum 60% foreign shareholding for investors from ASEAN countries
	<ul style="list-style-type: none"> Crossing harbor and river and lake harbor provision and business 	<ul style="list-style-type: none"> Requirement to cooperate with a company appointed by the government
	<ul style="list-style-type: none"> Passenger transportation and traditional shipping 	<ul style="list-style-type: none"> Requires 100% domestic capital
	<ul style="list-style-type: none"> Commercial air transportation 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding. Domestic shareholding must hold majority Requires a special license
	<ul style="list-style-type: none"> Port facilities (jetty, building, cargo, handling terminal, liquid and dry bulk terminals, Ro-Ro terminal) 	<ul style="list-style-type: none"> Maximum 95% foreign shareholding with a PPP arrangement, otherwise maximum 49% foreign shareholding is applied
	<ul style="list-style-type: none"> Operation of periodic testing of vehicles; Terminal construction (land passenger transport and general cargo terminal), but not management 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding Requires a recommendation from Minister of Transportation
Communication and Informatics	<ul style="list-style-type: none"> Community based broadcasting; Telecommunication and internet kiosk; Home and building cable installation 	<ul style="list-style-type: none"> Reserved for Micro, Small, Medium Enterprises and Cooperatives
	<ul style="list-style-type: none"> Telephone value added service provider (e.g. content service, call center, ring tone, internet service provider, data communication system service, internet connection service, etc.); Network access point; Closed fixed and mobile telecommunication network provider; Internet interconnection service 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding
	<ul style="list-style-type: none"> Telecommunication device testing agency (laboratory test) 	<ul style="list-style-type: none"> Maximum 95% foreign shareholding
	<ul style="list-style-type: none"> Fixed telecommunication network; Telecommunication network provider integrated with telecommunication services 	<ul style="list-style-type: none"> Maximum 65% foreign shareholding
	<ul style="list-style-type: none"> Public radio and television broadcasting agency 	<ul style="list-style-type: none"> Requires a special license (Monopoly only for Public Broadcasting Agency Radio Republic of Indonesia (RRI), Television Republic of Indonesia (TVRI), and Local Public Broadcasting (LPPL))
	<ul style="list-style-type: none"> Telecommunication tower business activities; Press company, magazine, bulletin; Private and subscription based broadcasting agency 	<ul style="list-style-type: none"> Requires 100% domestic capital
	<ul style="list-style-type: none"> Private Broadcasting Agency (LPS)*; Subscription Broadcasting Agency (LPB)* 	<ul style="list-style-type: none"> Requires 100% domestic capital and only for business addition and development, maximum 20% foreign shareholding
<ul style="list-style-type: none"> Mail provider 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding Mail provider must comply with regulations in the postal sector 	



FDI in specific sectors – Negative Investment List (continued)

Sector Heading	Sub-sector Heading	Regulation of PDI
Finance	<ul style="list-style-type: none"> Leasing and non-leasing financing; Venture capital 	<ul style="list-style-type: none"> Maximum 85% foreign shareholding
	<ul style="list-style-type: none"> Insurance company (general insurance, life insurance, reinsurance, general insurance adjuster, insurance agent, insurance broker, and reinsurance broker); Actuary consulting company 	<ul style="list-style-type: none"> Maximum 80% foreign shareholding
	<ul style="list-style-type: none"> Pension fund 	<ul style="list-style-type: none"> Requires 100% domestic capital
Banking	<ul style="list-style-type: none"> Conventional People's Credit Bank ("BPR"), Sharia BPR and foreign exchange trader 	<ul style="list-style-type: none"> Requires 100% domestic capita
	<ul style="list-style-type: none"> Foreign and non-foreign exchange bank, Sharia Bank, and Money market brokerage 	<ul style="list-style-type: none"> Compliance with Law No. 7/1992 concerning Banking, Law N0. 23/1999 concerning Bank Indonesia, Law No. 21/2008 concerning Sharia Banking, and their amendments and implementation regulation
Manpower and Transmigration	<ul style="list-style-type: none"> Agriculture business activity and fisheries in transmigration areas 	<ul style="list-style-type: none"> Requires a Transmigration Implementation License from the Minister of Manpower and Transmigration
	<ul style="list-style-type: none"> Indonesian workforce domestic placement, supplier and training services 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding
	<ul style="list-style-type: none"> Indonesian worker placement service 	<ul style="list-style-type: none"> Requires 100% domestic capital
Education	<ul style="list-style-type: none"> Non-formal education business (e.g. private education services) 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding
	<ul style="list-style-type: none"> Formal education including early, basic and secondary, and higher education (starting from pre-school to degree/non-degree education program) 	<ul style="list-style-type: none"> Compliance with Law No.20/2003 concerning National Education System and Implementation regulations

FDI in specific sectors – Negative Investment List (continued)

Sector Heading	Sub-sector Heading	Regulation of PDI
Healthcare	<ul style="list-style-type: none"> Pharmaceutical industry, i.e. manufacture of drugs raw materials, and manufacture of finished drugs 	<ul style="list-style-type: none"> Maximum 85% foreign shareholding
	<ul style="list-style-type: none"> Hospital management and health assistance services (health aid and patient evacuation in emergency situations) 	<ul style="list-style-type: none"> Maximum 67% foreign shareholding
	<ul style="list-style-type: none"> Calibration testing, health and medical equipment rental, maintenance and repair services; Acupuncture 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding
	<ul style="list-style-type: none"> Supporting health services (medical equipment rental) 	<ul style="list-style-type: none"> Maximum 49% foreign shareholding (Can be conducted all over Indonesia)
	<ul style="list-style-type: none"> Specialist nursing treatment services 	<ul style="list-style-type: none"> Maximum 70% foreign shareholding for investors from ASEAN countries, in all capital cities in eastern part of Indonesia except Makassar and Manado Maximum 51% foreign shareholding for investors from ASEAN countries, in Makassar and Manado Maximum 49% foreign shareholding for investors from non-ASEAN countries
	<ul style="list-style-type: none"> Pharmaceutical drug producer and wholesaler 	<ul style="list-style-type: none"> Requires a special license from the Minister of Health
	<ul style="list-style-type: none"> Traditional medicine producer and business industry; Pharmaceutical including raw material, wholesaler, and drug store/pharmacy; Health care providers (hospital, health research center); Private maternity hospital; Clinic General Medical services; General hospital; Basic Health Service Facility; Health worker individual practice; Supporting health service (ambulance service, pest control service/fumigation) 	<ul style="list-style-type: none"> Requires 100% domestic capital
	<ul style="list-style-type: none"> Clinical specialized dental services; Clinical specialized medical services; Hospital services (specialist/subspecialist) 	<ul style="list-style-type: none"> Maximum 67% foreign shareholding Maximum 70% foreign shareholding for investors from ASEAN countries, in all capital cities in Eastern part of Indonesia, except Makassar and Manado
<ul style="list-style-type: none"> Hospital Services (mental rehabilitation clinic); Supporting health service (laboratory clinic, medical check up clinic) 	<ul style="list-style-type: none"> Maximum 67% foreign shareholding (Can be conducted all over Indonesia) 	



Foreign Investment Restrictions

Fields of activity and local JV Partner

Initial investment proposals to BKPM need to be in fields currently open to foreigners, as do applications for capital or capacity utilization expansion of existing facilities.

Foreign investment will usually require a JV arrangement between the foreign investor and at least one local partner, either from inception of the project, or within a specified period for those companies which have approval to be wholly foreign-owned in the initial stages. The selection of a reliable and understanding local Indonesian shareholder and partner is essential. Unsuccessful foreign investment ventures can be associated with a background of tense relationships between local and overseas foreign shareholders. Once an investment is made, it can be a difficult, costly and painful exercise to extract or divest.

BKPM and industry regulators may maintain lists of potential local partners in certain fields from time to time, while banks, embassies and accounting firms can often provide information of a similar nature. In addition, accounting and investigation services firms can undertake independent, confidential corporate intelligence checks into the background and integrity of prominent or low profile local individuals.

Minimum investment and equity participation: divestment rules

Foreign investors can hold up to 100% equity initially, except in the industries where the various limitations on maximum foreign ownership exist which vary within sectors and business fields.

The old "Foreign Investment Law" No. 1/1967 through implementing regulation GR 20/1994 expressly provided for where 100% foreign ownership is initially permitted, for the foreign shareholder to divest a minority share to an Indonesian shareholder within 15 years, and that 5% is the intended minimum divestment

The 2007 Investment Law which revoked Law No. 1/1967 is silent on divestment obligations. However, the general view is that implementing regulation GR 20/1994 remains valid, and thus the statutory obligation to divest. However, based on BKPM Circular Letter No. 23/SE/11/2008, a PMA Company established under the 2007 Investment Law is no longer required to divest whilst older companies established pre-2007 Investment Law, with BKPM approval letters containing a divestment obligation, are still required to divest.

In practice, BKPM appears not to be enforcing any divestment obligations for PMA Companies incorporated in the late 1990's operating in a business field where 100%

foreign ownership is permitted and now reaching the 15 year point to divest. The position on divestment obligations is further contained in a 2013 BKPM Regulation.

BKPM Regulation No. 12/2013 and divestment requirements

Regulation 12 removes the requirement in Regulation 5 for a PMA Company which has complied with divestment obligations in the original BKPM foreign investment approval to maintain the shareholding composition of the new Indonesian shareholder. Thus the door is open to temporary divestments and subsequent disposals of shares to a foreign shareholder.

Regulation 12 provides for PMA Companies applying for divestment deadline extensions to furnish evidence that unsuccessful efforts have been made to identify a suitable Indonesian shareholder.

Legal form

The Investment Law specifies that foreign investment shall be in the form of a limited liability company, Perseroan Terbatas (PT), incorporated in Indonesia in accordance with the requirements of the Ministry of Law and Human Rights ("MOLHR"). A PMA Company is a PT company having an approved foreign shareholding. Other forms of companies are addressed in Chapter 6.

Term Limit

The operating permit for a PMA company is unlimited as long as the "PMA Company" is still active.

Operations

The Investment Law grants the foreign investor the freedom to manage a company for the term of its permit approval, which includes the right to appoint directors and, if necessary, foreign technicians and managers, where skilled Indonesians are not available. Certain industries only allow expatriate Technical Advisors (with the exception of Board of Directors and Commissioners). More information on obligations around domestic and foreign employees is set out in Chapter 9 on Labor and Employment.

Industries That Are Treated Separately

Introduction

Foreign investment in certain industries is not administered by BKPM, but by the relevant Ministry or regulatory authority directly. These industries are oil & gas, banking and non-bank financial institutions including multifinance, securities brokerage and asset management. While BKPM has some role in the approval of mining and forestry licenses, the principal approvals are granted by the Ministry of Energy and Mineral Resources (MEMR) and the Ministry of Forestry. Shipping, sea ports and telecommunications are other industries where regulation of foreign investment and related

approval applications has been complicated by multiple laws, regulations and decrees issued by more than one regulatory authority body or institution.

Oil & Gas

Under Law No.22/2001 concerning Petroleum & Natural Gas (“the Oil & Gas Law”), the oil & gas sector was administered by two state owned legal entities: BP Migas for upstream operations and BPH Migas for downstream operations. Prior to establishment of BP Migas in 2002, regulation of the oil & gas sector was conducted by the State owned oil & gas company, PERTAMINA.

BP Migas had responsibility for management of the upstream operation of joint cooperation contracts which are predominately in the form of a Production-Sharing Contract (PSC), with the foreign party/contractor responsible to BP Migas for the execution of the operation. BPH Migas had responsibility for granting licenses and supervising the operation of the downstream business.

In November 2012 a Constitutional Court Ruling dismantled the legal basis for upstream oil & gas regulation by BP Migas following application by various prominent organizations on the grounds the 2001 law did not adequately manage the nation’s natural resources for the benefit of the Indonesian people. Industry commentators had referred to the disbandment of BP Migas to be negative for investment sentiment at a time when crude oil production is declining. A temporary oil & gas regulatory authority or “Task Force; SKSP Migas, was established at the MEMR. Subsequently, in January 2013 a Presidential Regulation No.9/2013 was issued to establish a special task force, SKK Migas, to replace SKSP Migas.

Under the Oil & Gas Law, the industry is one of two that allows foreign participants to invest in the upstream oil & gas sector through a local branch of an overseas company (called a Permanent Establishment or PE, which is referred to further in Chapter 10 on Taxation).

Banking

Introduction

Effective 31 December 2013, the regulatory and supervisory functions, duties and authority in the banking sector moved from the Central Bank, Bank Indonesia (“BI”) to the Indonesia Financial Services Authority (Otoritas Jasa Keuangan or “OJK”). The OJK now regulates and supervises all financial institutions (banking, insurance, and other non-bank financial institutions). BI is responsible for macroprudential regulation and supervision. Both BI and the OJK are generally free from interference from the government.

Since the OJK took over, six new banking regulations have been issued, which are effective 1 January 2015. The focus of these new regulations is to: strengthen governance and risk management, increase supervision of smaller rural banks, encourage financial inclusion and improve the financial strength of Sharia banks.

Banking is the only other sector, in addition to upstream oil & gas, which allows foreign investors to invest direct into a local branch. Foreign banks are allowed to open branches in Indonesia; however, the government extends this advantage only to the world’s 200 largest banks by assets and only if they have a minimum Standard & Poor’s or Moody’s credit rating of A. Further, the 300 largest banks in the world by assets can have a Representative Office in Indonesia to perform asset and relationship monitoring or to support a branch opening, but are restricted from offering banking services. No foreign bank branch licences have been issued since 2003; and foreign banks have only been able to enter through acquisition of existing banks.

Single Presence Policy

Bank Indonesia Regulation No.8/16/PBI/2006 updated by Bank Indonesia Regulation No. 14/24/PBI/2012 dated 26 December 2012, specifies a ‘Single Presence Policy’ in respect of Indonesian banks, which provides for no single person, entity or group of companies to own more than 25% or otherwise be a “controlling shareholder” in more than one Indonesian bank.

Exceptions to the ‘Single Presence Policy’ allowing an investor to be a controlling shareholder in more than one Indonesian bank are:

- the investor is a controlling shareholder in one conventional or commercial bank and one Sharia bank
- the investor is a controlling shareholder in two banks and one of the banks is a JV bank

Ownership structures that do not comply with the ‘Single Presence Policy’ need to be restructured through merger/consolidation, establishment of an investment holding company or establishment of a holding function.

A shareholder which meets the criteria as a “controlling shareholder” is subject to PBI 14/24/PBI/2012 as set out above, as well as PBI 14/8/PBI/2012 which is summarized below.



Shareholding Thresholds and Limitations

Pursuant to Bank Indonesia Regulation No.14/8/PBI/2012 concerning Commercial Bank Share Ownership, the maximum amount of bank share ownership for a single shareholder depends on the category of shareholder. Shareholders that are related through share ownership or family ties, or that are deemed to be acting in concert with one another, are treated as a single party in determining the overall ownership cap that applies:

- banks, or a non-bank financial institutions: 40% of a bank's paid-up capital (subject to BI approving a higher amount: see below)
- non-financial institutions : 30% of a bank's paid-up capital.
- individual shareholders: 20% of a bank's paid-up capital (25% if the bank is a Sharia bank).

The New Bank Ownership Rules provide that only those 'non-bank financial institutions' that are: (a) authorized under their constitutional documents to participate in a 'long-term' investment; and (b) governed and supervised by a financial regulator/authority, are permitted to hold up to a 40% stake in an Indonesian bank. A non-bank financial institution which fails to satisfy these two criteria is only allowed to hold up to a 30% stake in an Indonesian bank.

The Central Government is exempted from the limits (as is any agency that is called on to rescue a failing bank). That means the limits do not apply to state-owned banks.

The regulation only affected future transactions. Pre-existing bank shareholders that exceeded the ownership thresholds are not required to divest unless the bank's Good Corporate Governance ("GCG") or "soundness" rating (as determined by Bank Indonesia) was 3, 4 or 5 at the 31 December 2013 cut-off date. GCG ratings range between 1 to 5, with 1 being the best. Foreign investors, (including Singapore's United Overseas Bank and OCBC Bank, HSBC and Malaysia's CIMB and Maybank) which already owned majority stakes in Indonesian banks were not automatically forced to cut their stakes to comply with the new limits. Existing shareholders of Indonesian banks that exceed the limits will be assessed on their financial strength and corporate governance. After 31 December 2013, existing bank shareholders need to sell down to the 40% cap within 5 years if GCG ratings are down graded to 3 or worse on three consecutive assessments.

For foreign or domestic investors that require a shareholding interest of more than 40% or a "controlling interest," application needs to be made to the OJK for approval.

The bank must have a soundness rating of at least 1 or 2, financially strong - CAR tier 1 of minimum 6%, be publicly listed and have a recommendation from the bank's home regulator. An Indonesian bank that is acquired will need to sell at least 20% of its shares to the public within five years of the transaction. Additional capital must also be committed by agreeing to buy hybrid debt securities issued

by a local lender that are convertible into equity. A bank that receives approval to own more than 40% of a local bank will first be allowed to reach that 40% threshold. To raise its stake further, the local target bank must be assessed by the OJK to be financially strong and well-governed for three consecutive assessment periods within five years from the time the OJK approves the transaction. Notes accompanying the guidelines suggest that such assessments will be conducted in June and December each year. If the local bank does not meet those criteria, ownership will remain capped at 40%.

Foreign Investor Criteria

Any prospective controlling shareholder who is a foreign investor must meet the following additional requirements:

- the investor is committed to support the economic development of Indonesia by owning shares in the bank
- the investor has obtained recommendation from the financial services supervisory authority of the country of origin
- the investor is ranked at least: (a) one notch above the lowest investment grade for banks; (b) two notches above the lowest investment grade for non-bank financial institutions; and (c) three notches above the lowest investment grade for non financial institutions.

Minimum capital requirements for commercial banks and Capital Equivalency Maintained Assets ("CEMA") for foreign banks

On 27 December 2012, BI issued Bank Indonesia Regulation No. 14/26/PBI/2012, ("PBI 14") on Business Activities and Office Network in accordance with Banks' Core Capital. PBI 14 categorizes Banks into four types:

1. BUKU 1: each bank whose core capital is less than IDR 1 trillion;
2. BUKU 2: each bank whose core capital is at least IDR 1trillion and less than IDR 5 trillion;
3. BUKU 3: each bank whose core capital is at least IDR 5 trillion and less than IDR 30 trillion; and
4. BUKU 4: each bank whose core capital is at least IDR 30 trillion.

The PBI 14 BUKU classification is important as it determines: (a) what kind of banking business activities can be conducted by a bank (e.g. ability to conduct business in foreign currency) (b) restrictions on the opening of offices (e.g. ability to invest offshore) and (c) obligations to provide credit and financing to productive businesses (the detailed permissions for each BUKU classification are beyond the scope of this document).

In December 2013, BI issued a new regulation, updating PBI14, setting a minimum capital requirement for commercial banks, to strengthen the country's banking system. Under the new regulation, the OJK requires a minimum 8% capital adequacy ratio for banks with the soundest risk profile (rating 1) and 14% for banks with a risk profile rating 5 (worst). On top of the 8-14%, banks are required to add a capital conservation buffer (an additional 2.5% by 2019). Additionally, the supervisor may impose a Countercyclical Buffer, at a discretionary percentage.

To calculate the minimum capital based on risk profile, the OJK requires banks to implement an Internal Capital Adequacy Assessment Process (ICAAP). The OJK will perform Supervisory Review and Evaluation Process (SREP) on the ICAAP, which includes review of the sufficiency of active supervision from the banks' management; capital adequacy assessment; monitoring and reporting as well as internal controls.

In particular for foreign bank branches operating in Indonesia, the OJK requires maintenance of a portfolio of assets called Capital Equivalency Maintained Assets ("CEMA") which is designed to serve as a liquidity buffer in the event of liquidity/solvency problems (or a "ring fence"). CEMA must be maintained at: (1) a minimum 8% of a bank's total liabilities every month; and (2) a minimum 8% of a bank's total liabilities every month and IDR 1 trillion at the minimum. Foreign branches must comply with the first CEMA requirement by November 2017 and with the second by December 2017.

Micro Small and Medium Business Lending

Banks must comply with a new regulation on provision for loans or financing to micro, small and medium business ("UMKM"), which is by 2015 at least 5% of total financing; by 2016 at least 10% of total financing; by 2017 at least 15% of total financing; and at by 2018 at least 20% of total financing. UMKM financing can include direct financing and indirect financing (executing or channeling by rural banks, syariah banks or non financial institutions). For joint venture banks and foreign branches, UMKM can include export financing (non-oil & gas).

Basel III

Indonesia, as a member of the Basel Committee on Banking Supervision (BCBS), is committed to adopting the Basel III framework. However, Basel III is only at very early stages of implementation in Indonesia.

BI issued BI Regulation No. 15/12/PBI/2013, effective 1 January 2014 regarding Minimum Capital Requirement. Banks are required to consider an additional Capital

Conversation Buffer progressively starting from 1 January 2016: 0.625%; 1.25% on 1 January 2017; 1.875% on 1 January 2018 and 2.5% on 1 January 2019. Banks are also required to consider a Countercyclical Buffer in Capital starting from 1 January 2016. Domestically-Significant Banks (DSIB) are required to consider a Capital Surcharge starting from 1 January 2016.

BI and the OJK have issued a draft Consultative Paper on Basel III for Liquidity Coverage Ratio (LCR) and Leverage Ratio (LR). The Consultative Paper provides for a trial run on LR to commence in first semester 2015 with the effective implementation date being 1 January 2018. The LCR Consultative Paper indicates that implementation will be in stages starting 31 December 2015 targeting to 31 December 2019 for full implementation.

Foreign entrants will need to be mindful of the stringent requirements around Basel III which may involve sizeable investment based on what is being seen in other countries: systems and operational modifications, establishment of new risk management and compliance functions and hiring of rare, qualified resources as well as consulting fees and other costs. Functionality of Basel III will need to be carefully controlled and monitored going forward.

Insurance

Effective 1 January 2013, the OJK assumed the role of insurance industry regulator.

Since the OJK's formation, the insurance industry started to experience some regulatory changes, some of which are already in effect while others have yet to be fully implemented.

The 'New Insurance Law' (UU No. 40/2014) came into effect on 23 October 2014 replacing the previous Insurance law (UU No. 2/1992). Under both the old law and the New Insurance Law, Indonesian shareholders must hold at least 20% of the issued capital of any joint venture Insurance Business Company ("IBC"), while foreign shareholders can hold up to 80%.

Shareholding thresholds and limitations

Under the Old Insurance Law, the Indonesian shareholders of an IBC can be Indonesian citizens and/or Indonesian legal entities fully owned by Indonesian citizens and/or Indonesian legal entities. The New Insurance Law has removed the italicized words meaning that an Indonesian corporate IBC shareholder must now ultimately be fully owned by Indonesian citizens in order to qualify as Indonesian. This now makes unlawful the use of the dual-layer PMA Company structure which foreign entities had previously utilized to ultimately own 100% of an IBC.

Insurance companies have five years in which to either:

- ensure that the shares that must be held by Indonesian shareholders are all directly or indirectly held by Indonesian citizens; or
- conduct an IPO, we presume with a minimum free float of 20%

Single presence policy

The New Insurance Law also introduced a 'single presence' policy to the insurance sector in Indonesia. This law provides that each party can only be the 'controlling shareholder' of one of each of the following categories of insurance companies:

- Life insurance company
- General insurance company
- Re-insurance company
- Syariah life insurance company
- Syariah general insurance company
- Syariah re-insurance company

The New Insurance Law does not provide further detail on how this new policy will be applied in practice in the event that a party is already, or becomes, the controlling shareholder of more than one entity in each of the relevant categories of insurance companies set out above, apart from specifying that the requirement must be complied with within three years of the New Insurance Law being promulgated.

Relevant OJK regulations need to be rolled out with further details in relation to what is considered a 'controlling shareholder' for the purpose of the New Insurance Law, and how any consolidation or merger requirement will be implemented (including whether pre-existing holdings, prior to the New Insurance Law taking effect, will be grandfathered).

Other major changes introduced in the 'New Insurance Law'

Other impacts include:

- Insurance and reinsurance companies must separate into a stand alone entity all sharia divisions within 10 years from the enactment of the New Insurance Law, or when the sharia component exceeds 50% of the total insurance portfolio, whichever is the earlier
- The insurance for any asset or risk located in Indonesia must be placed with a local insurer, irrespective of ownership of that asset or responsibility for a risk, unless no local insurer is able or willing to underwrite the risk. This removes the previous concession that allowed foreign entities to purchase insurance from offshore insurers

- A new policy assurance program replaces the existing mandatory guarantee fund, with the aim of providing protection to policyholders in case their insurer is liquidated or has its license revoked
- Insurance and reinsurance companies must optimize domestic capacity. In other words, domestic insurers and reinsurers must provide local reinsurance coverage "as far as possible." The intention is to encourage all insurers and reinsurers (both conventional and Sharia) to assist with the expansion of the local reinsurance market

Minimum capital requirements

Current regulations require an insurance company's minimum capitalization to be IDR100 billion. Indonesian Ministry of Finance regulation No.53/2012 further requires an insurance company to target its RBC solvency margin ratio at 120% and maintain its solvency margin ratio at minimum 100%. The regulator will require an insurance company to alter its business plan if it fails to exceed the 120% ratio.

Other matters

The OJK also requires insurance companies directors and commissioners to pass the 'fit and proper' test. This test includes requirements for an insurance company to have at least three directors and three commissioners (at least one independent commissioner).

Other financial institutions

Effective 31 December 2013 "Other financial institutions" including multi-finance companies (finance, venture capital, infrastructure finance, and microfinance) pension funds, and securities companies (asset management, underwriting, and brokerage) and other financial services institutions (such as credit insurance institutions, Indonesian export finance agencies and pawn shops) are supervised and regulated by the OJK.

In 2014, the OJK issued 14 regulations covering non-banking financial institutions and capital markets. The OJK has signaled it will issue regulations around pension funds and venture capital in 2015.

Certain, older regulations continue to apply, including Law No. 11 of 1992 on the Pension Fund and Law No. 2 of 2009 on Indonesian Export Financing Institutions.

Multi-finance companies

The multi-finance sector was previously regulated under Presidential Regulation No. 9/2009 on Multi-finance Institutions and MOF Regulation No. 84/PMK.012/2006 on Multi-finance Companies. On 19 November 2014, the OJK issued four regulations which relate to the multi-finance sector:

- OJK regulation No. 29/POJK.05/2014 concerning Arrangement of Multi-finance Company Business
- OJK regulation No. 28/POJK.05/2014 concerning Licensing and Organization of Multi-finance Companies
- OJK regulation Reg. No. 30/POJK.05/2014 concerning Good Corporate Governance for Multi-finance Companies
- OJK regulation No. 31/POJK.05/2014 concerning Arrangement of Sharia Multi-finance Business

These new OJK regulations provide more detailed requirements and definitions around multi-finance companies. OJK 29/2014 defines a multi-finance company as an entity that finances the procurement of goods or services. Permitted business activities include: (i) investment financing; (ii) working capital financing; (iii) multipurpose financing; and/or (iv) any other financing business subject to OJK approval.

Multi-finance companies are prohibited from engaging in banking, issuing promissory notes, or providing security, and they must maintain financial soundness at all times, including: an equity ratio (comparison of adjusted capital and adjusted assets) of 10%, minimum IDR 100 billion equity, and at least 50% of equity must be paid-up capital.

Any party wishing to engage in multi-finance activities must apply for a multi-finance business license from the OJK. The application review period is 30 days. Upon issuance of the OJK License, the company must commence operations within two months.

The maximum foreign shareholding (either direct or indirect) is 85% of the paid-up capital. Multi-finance companies having foreign ownership (whether direct or indirect) must have at least 50% Indonesian-citizen directors. In the event there is an odd number of directors, the number of Indonesian-citizen directors must be greater than the number of foreign-citizen directors.

The primary parties of a multi-finance company, (e.g. controlling shareholders, directors and commissioners) are required to pass the OJK Fit & Proper test (Regulation No. 4/POJK.05/2013), prior to holding their positions.

A multi-finance company with assets of more than IDR 200 billion is required to have: (i) at least three directors; (ii) two

commissioners and at least one independent commissioner; (iii) audit committee; (iv) a function assisting the commissioners in monitoring and ensuring the effectiveness of the internal control system and the implementation of internal and external auditors' duties.

A multi-finance company with assets of less than IDR 200 billion is only required to have two directors.

Capital markets and securities companies

Any party wishing to engage in capital markets activities (e.g. a securities company) must obtain an operating license and approval and registration from the OJK.

The principal regulation governing the capital markets is Law No. 8 of 1995 concerning the Capital Market. There are also implementing regulations issued by the President of Indonesia, the Minister of Finance, the Capital Market and Financial Institution Supervisory Board (BAPEPAM-LK) and the OJK. The Indonesia Stock Exchange (IDX) also issues regulations and rules related to listing of companies and securities trading.

Based on Ministerial Decree No.153/PMK.010/2010 concerning Share Ownership and Equity of Securities Companies, there are several requirements:

- Investment manager, underwriter combined with investment manager, and brokerage combined with investment manager should at least have IDR 25 billion, IDR 75 billion and IDR 55 billion paid-up capital, respectively
- Foreign non-securities financial Institutions may own up to 85% of the paid in capital of JV securities companies
- Foreign securities companies that are licensed or regulated by their respective local regulators may own up to 99% of paid up capital of a JV securities company
- Both foreign and local investors may purchase up to 100% shares of local or JV securities companies both in the primary and secondary market
- Foreign ownership of a private securities company is limited to a foreign legal entity that operates in the financial services sector area or in securities.

Mining

In January 2009, Law No.4/2009 on Mineral and Coal Mining (“2009 Mining Law”) came into effect, replacing Mining Law No.11/1967, which provided for foreign investment in coal and minerals mining in Indonesia to be based on contractual agreements with the GOI. Government Regulation 23/2010, as amended by Government Regulation 24/2012, Government Regulation 1/2014 and Government Regulation 77/2014, is the principal regulation that implements the 2009 Mining Law. Under Law No.11/1967, there were essentially two ways any party could hold exploration and mining rights in Indonesia:

- a Contract of Work or “COW” (for minerals)/ Coal Contract of Work or “CCOW”
- a Kuasa Pertambangan (Mining Authorization or “KP”).

No foreign entity could have an equity interest directly or indirectly in a company which held a KP. A KP could only be owned by an Indonesian legal entity owned 100% by Indonesian nationals. In practice however, many foreign entities controlled mining operations of a KP through nominees. Nominee shareholdings were expressly made unenforceable by Law No.25/2007 on Investment, after which many foreign “ownership” arrangements were structured through complex contractual agreements with a KP holder which were designed to give the foreign entity the economic benefit in the mining project albeit without any share ownership in the KP holder.

Unlike KPs, COWs or CCOWs were allowed to be owned by foreign-owned Indonesian entities. Standard forms of contract were developed over the years for each generation of COW, with different generations having different provisions. The most important differences across the generations relate to:

- applicable taxes
- ownership of minerals
- ownership of plant and equipment at site
- divestment requirements.

The 2009 Mining Law provides that no new COWs or CCOWs are to be granted and, instead, both foreign and domestic investors would be granted the same form of license (discussed below). Existing COWs were to remain effective until their expiry but certain terms were required to be amended to be consistent with the 2009 Mining Law by January 2010. This is yet to occur and negotiations between COW mining companies and the GOI/MEMR are continuing. It is expected that the amendments to existing CoWs will include the following:

- the extension of COW or CCOW will be granted in the form of a Special Mining Business License (IUPK)
- the state income should be amended in an effort to increase state revenue

- processing and refining activities are to be conducted onshore
- a reduction of the mining area granted under the COW or CCOW to bring it into line with the maximum mining areas provided for in the 2009 Mining Law. If a COW or CCOW holder is able to provide an activity plan over its larger mining area which satisfies the MEMR that the entire area will be utilized, the MEMR will allow the COW or CCOW holder to retain the larger mining area despite the area limitations in the 2009 Mining Law
- divestment requirements to be in line with the divestment requirements provided for in the 2009 Mining Law
- the priority of utilization of domestic manpower, goods and services

How far reaching the amendments to existing COWs or CCOWs are intended to be is not clear from the law. There is at least the potential for increases in mining cost structures and impacts on general operations.

The framework of the licensed based system in the 2009 Mining Law is applicable to both foreign and local investors including State-owned enterprises, Regional State owned enterprises, Indonesian limited liability companies (including foreign investment companies (PMA)) and Co-operatives. The law is built around the granting of a Mining Business License Area (“WIUP”) and Mining Business License (“IUP”) from a regional/provincial government or the central government. WIUP areas for coal or metal minerals are granted through a competitive tender process administered by the relevant level of government, and WIUPs for non-metal minerals or rocks by direct application to the relevant level of government. Once the WIUP has been awarded, an IUP for coal or the relevant mineral is granted to the winner. Which level of government (central, provincial or regional) has authority to award the WIUP and IUP depends on a range of factors including the geographical location of the mine, the location of any captive jetty and refining/processing facilities, and whether the entity has any foreign ownership. Separate Exploration and Production Operation licenses are issued, with the holder of an Exploration IUP being guaranteed to receive a Production Operation IUP automatically issued, provided certain conditions are met.

In April 2015, the MEMR issued a Circular Letter containing a formal Instruction for all local governments to transfer administrative authority over IUPs of all foreign owned (PMA) companies by 14 October 2015.

The 2009 Mining Law requires all existing KPs to be converted to IUPs. The MEMR maintains a “Clean and Clear List” which provides some comfort that an IUP has been validly issued and does not overlap with other mining contracts or licenses, but not whether it is free of other competing land uses.

The 2009 Mining Law removed the legal certainty provided under the contract-based COW system when replaced by the license based IUP regime leaving investors open to changes in government policy. There has been significant regulatory uncertainty following the issuance of the New Mining Law, and there remains a lack of clarity around the operation of the law and various subsequent implementing regulations. In practice, mining companies have reacted in a range of different ways from doing nothing until more clarity is obtained, to aggressively restructuring mining activities and operations to comply with their interpretation of the law.

Key implementing regulations for the 2009 Mining Law issued to date (and the areas key subjects which they regulate) are:

- Ministerial Regulation No.18/2009 on “Change of investment terms in COW and CCOW companies” dated 19 August 2009 - requirements for COW and CCOW holders to obtain approval of MEMR to certain corporate actions, including changes in shareholding
- Ministerial Regulation No.28/2009 on “Implementation of Mineral and Coal Mining Services” dated 30 September 2009 as amended by Ministerial Regulation No.24/2012 -requirements for mining companies when using service providers, with the key principle being that preference must be given to local/national service providers over foreign-owned providers
- Ministerial Regulation No.34/2009 on “Preferential supply of domestic Mineral and Coal demands” dated 31 December 2009 - obligations of mining companies to sell a certain percentage of their production to the domestic market
- Government Regulation No.22/2010 on “Mining area” dated 1 February 2010 - umbrella regulation setting out the determination of mining areas within Indonesia (including Peoples Mining Area, WUPs and State Reserve Areas)
- Government Regulation No.23/2010 on “Mining business activities” dated 1 February 2010 as amended by Government Regulation 24/2012, Government Regulation 1/2014 and Government Regulation 77/2014 - umbrella regulation setting out general requirements for holders of mining business license
- Government Regulation No.55/2010 on ”Supervision, consultation and guidance on mining activities” dated 5 July 2010 -intergovernmental arrangements regarding the supervision of the mining sector within Indonesia
- Ministerial Regulation No.17/2010 on “Determination of the reference price for Mineral and Coal sales” dated 23 September 2010 - requirements for mining companies to sell their coal/ minerals with reference to a Government benchmark price
- Government Regulation No.78/2010 concerning Reclamation and Post Mining dated 20 December 2010 - umbrella regulation governing obligations of mining companies to carry out reclamation and rehabilitation work at completion of mining activities
- Ministerial Regulation No.1/2014 concerning Adding Value to Minerals Through Processing and Refining Activities dated 11 January 2014 - requirements for mining companies holding licenses for mineral production to carry out onshore processing prior to export.
- Ministerial Regulation No.27/2013 concerning Procedures and Determination of Shares Divestment Price, and Change of Investment in Mineral and Coal Mining Business Activities dated 13 September 2013 -requirements for foreign shares divestment and change of investment in mining companies.
- Ministerial Regulation No.32/2013 concerning Procedures of Granting of Special Licenses in Mineral and Coal Mining Business Activities dated 19 November 2013 -procedures for obtaining mining business license for trading and transportation, and mining business license for processing and refinery.
- Ministerial Regulation No.28/2013 concerning Procedures of Tender of Mining Business License Area and Special Mining Business License Area in Mineral and Coal Mining Business Activities dated 13 September 2013 - tender procedures for mining business license area.

Majority or wholly foreign-owned companies holding an IUP need to gradually divest shares of the mining company to an Indonesian participant (being Central/Regional Governments, Central/ Regional Government owned companies or 100% Indonesian owned private companies) starting 5 years from commencement of production, such that by the end of the 10th year from when production starts, the foreign shareholding is no greater than 49%.

At the time of writing, media reports are indicating that the New Mining Law is being revised by the GOI to regulate certain new matters (e.g. the authority of governors in regards to permitting process, better access of state-owned companies in obtaining mining permits as well as grouping of mining commodities that are considered to have strategic importance to the country). It will be interesting to see what happens next with the hope these changes will improve and provide some regulatory certainty around the mining investment climate in Indonesia.

Other Industries

Forest concessions are issued to Indonesian companies for specified activities, such as industrial estate forestry, natural wood forestry and rattan wood forestry. A number of forestry activities are restricted to domestically owned businesses.

Other industries where foreign investment regulation is to varying degrees under the control of Ministries through Ministerial Regulations, decrees or other authorities include shipping, construction, sea ports, telecommunications, healthcare and pharmaceutical and now plantations with the introduction of a new “Law on Plantations” effective October 2014, replacing the existing 2004 framework. Designed to attract more investment in the plantation industry sector, legal uncertainty in the drafting is having the opposite effect with an Implementing Regulation on foreign investment needing to be issued: this is expected to articulate the extent of changes, if any, to the current 95% foreign ownership level.

As indicated, navigating the Foreign Investment Law, Negative List and other regulations, Ministerial decrees or specific industry laws that also can regulate foreign investment is fraught with danger without professional advice and support.

A good example of this is the shipping industry where some or all of the following (depending on the sector) may need to be considered in addition to the Negative List:

- the Negative List and ASEAN country exemptions referred to in the Negative List
- Law No.17/2008 regarding Shipping
- Government Regulation No.20/2010 concerning Water Transport
- Government Regulation No.9/1999 concerning Commodities future trading and Decree No.33/2001 concerning Implementation and Utilization of Sea Transport
- Presidential Decree No.61/1988 concerning Financial Institutions
- Presidential Instruction No.5/2005 on National Sailing Industry empowerment and Ministry of Transportation Regulation
- Regulation No.71/2005 which applies the principle of Cabotage
- Discussions with BKPM and the Ministry of Transportation.

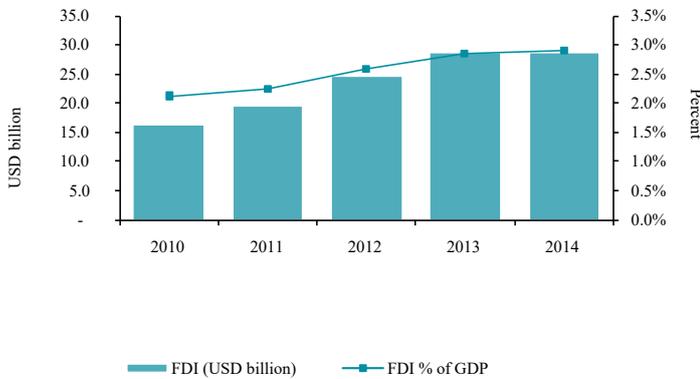
Composition of FDI: Country of Origin and Industry

Indonesia FDI by sector 2014 - 2014									
No	Sector	Investment value (IDR trillion)	Investment value (USD million)	No. of project	No	Sector	Investment value (IDR trillion)	Investment value (USD million)	No. of project
1	Mining	46	4,816	820	1	Mining	50	4,665	950
2	Motor Vehicles & Other Transport Equipment Industry	35	3,732	342	2	Food Industry	34	3,140	1,054
3	Metal, Machinery & Electronic Industry	31	3,327	679	3	Transport, Storage & Communication	32	3,001	333
4	Chemical and Pharmaceutical Industry	30	3,142	430	4	Metal, Machinery & Electronic Industry	27	2,472	986
5	Electricity, Gas & Water Supply	21	2,222	156	5	Chemical and Pharmaceutical Industry	25	2,323	578
6	Food Industry	20	2,118	797	6	Food crops & Plantation	24	2,207	586
7	Food crops & Plantation	15	1,605	520	7	Motor Vehicles & Other Transport Equipment Industry	22	2,061	442
8	Transport, Storage & Communication	14	1,450	198	8	Construction	15	1,384	199
9	Paper and Printing Industry	11	1,169	103	9	Electricity, Gas & Water Supply	13	1,249	221
10	Non Metallic Mineral Industry	8	874	138	10	Real estate, Industrial Estate & Business Activities	13	1,168	387
11	Others	39	4,162	5,429	11	Others	52	4,860	6,896
	Total	270	28,618	9,612		Total	307	28,530	12,632

Source: BKPM website: www.bkpm.go.id, January 2015

Note: The data tabled above from BKPM excludes investments in the oil & gas, banking, non-banking financial services, leasing, investment for which investment approvals and licenses are granted and issued by the relevant Ministry or regulatory authority. Portfolio and Household investment is also excluded.

Foreign Direct Investment 2010 - 2014



Source: BKPM website: www.bkpm.go.id, January 2015

The Japanese have been heavily investing in Indonesia since the 1970's and generally have not been dissuaded by economic blips or bumps, regulatory or other country investment risks. A softening of inflows in 2014 was attributable more to domestic economic conditions and the political landscape in Japan. With domestic organic and acquisition growth opportunities shrinking, Japanese corporates are actively looking for expansion opportunities abroad. The Japanese know emerging markets well, and are well received in South-east Asian countries like Indonesia, Thailand and Vietnam which the Japanese generally prefer to China.

Foreign investors from many countries typically structure transactions through group holding companies or other entities in Singapore for tax structuring and other reasons, thus distorting to some degree the ranking of Singapore in the foreign investment stakes.

In terms of industries, foreign investment in the mining sector through M&A has dramatically declined in recent years due to regulatory uncertainty and falling commodity prices. The composition of foreign investment in 2013 and 2014 is believed to be largely comprised of existing capacity expansions by a few large players in this highly capital intensive Industry and not new FDI.

BKPM classifies investment into three categories: FDI, Domestic Direct Investment or "DDI" and Non-direct Investment which includes foreign and local domestic expenditure on housing and commercial buildings, transportation, machinery and heavy equipment. Both FDI and DDI will comprise the following investment types:

- M&A
- Greenfield
- Existing capacity expansions (which also require BKPM approval and licensing)

As indicated, historical economic growth levels have largely been driven by domestic consumption with investment making up around 30% of the Indonesian economy (China: 48% in 2014). It is relevant that foreign investment through M&A will represent only a portion of total reported FDI, with the balance being capacity utilization expansions undertaken by foreign companies on their existing investments in Indonesia and new Greenfield investments.



Total reported FDI inflows were relatively flat in 2013 and 2014 in USD currency. In IDR terms (as reported by BKPM), a 14% increase of IDR37 trillion was achieved due to depreciation of the IDR against the USD. The data compiled and presented each year by BKPM excludes investments in the oil & gas, banking, non-banking financial services, leasing and investments where investment approvals are granted and licenses issued by the relevant Ministry or regulatory authority (Portfolio and Household investment is also excluded).

Foreign investment and market entry

Foreign investors have a number of options in terms of market entry:

- Share acquisition (Buy-out majority and minority) through M&A
- Asset acquisition deals or transfer through M&A
- Greenfield through establishment of a PMA Company
- Partnership arrangements under distribution agreements with an Indonesian distributor or importer

Analysis and discussion of the benefits, risks, challenges, opportunities and pitfalls surrounding each of the above is outside the scope of this publication. The steps involved in establishment of a PMA Company, a Representative Office and other less common options are addressed as part of Business Structures and Establishment in Chapter 6.

Country investment risks and practical insights *Country investment risks*

Political instability and economic uncertainty together with some other country risks that prevailed post-Asian Economic Crisis and in the years leading up to the 2008 GFC largely disappeared some time ago, with the major remaining ones being:

- Regulatory risk around foreign investment and other laws; underpinned by
- Legal uncertainty from unclear, conflicting laws and regulations and delayed law changes. This also applies to the tax regime; and
- A judicial system still in need of significant reform. Enforcing rights under contracts and agreements in the Indonesian courts is not a preferred route for foreign or Indonesian investors (refer Chapter 2 and “The type of legal system”).

In addition, a lack of adequate infrastructure, crucial to sustained long term economic growth, including basic road, as the platform for other primary and secondary infrastructure, continues to hamper development across the country, as well as adversely impacting cost structures and the international competitiveness of Indonesian companies. Investment in education and healthcare is also crucial to maintain sustained levels of economic growth.

A new key country investment risk that emerged post GFC, when the Indonesian economic growth story really took flight, is a human capital shortage which is restricting Indonesian companies from reaching their potential, and is now a potentially key constraint to economic growth. This is a function of deficiencies in the formal and tertiary education sectors which would benefit from investment by foreign higher education strategic corporates and PE Houses. Also, continuing rapid population growth, a reducing rate of poverty reduction and increase in the number of Indonesians living below the poverty line, are restraining economic growth by stagnating domestic consumption in the lower income class.

Foreign currency risk has resurfaced as a potential country investment risk when in 2013 the IDR encountered some volatility before progressively depreciating through 2014, adversely impacting the operating performance of foreign exchange risk exposed Indonesian companies.

Corruption is still endemic in government and some other circles, but not uncommonly viewed by many foreign investors as being manageable, particularly those which have had a presence in Indonesia or Asia for a long time. A potential exception exists if an investor needs to formally comply with Foreign Corrupt Practices Act (FCPA) or UK Anti-bribery Act (UKBA) due diligence (but even then adverse findings can have remedial options). What are considered common practices forming part of day-to-day business in Indonesia in order to “get things done” might not pass corporate governance standards in developed Western markets. Efforts by recent governments to tackle corruption have generally been commended. It is slightly ironic that a myriad of local Indonesian Anti-bribery and corruption laws, regulations and decrees administered by various different regulatory authorities are actually more onerous than the corresponding FCPA and UKBA.

In 1999 the GOI implemented Law No.22/1999 regarding Regional Governance or the “Regional autonomy Law” designed to decentralize certain powers to the regencies. This has adversely impacted companies operating in ENR sectors and remote geographical locations through double taxation or local regulations conflicting with higher central government law. Recent reports from the Home Affairs Ministry refer to 780 problematic regulations out of 13,000 most relating to implementation of local taxes.

Uncompetitive labor laws create challenges for employers, particularly those operating in highly labor intensive industries. The revised Law No.13/2003 on Labor imposes onerous obligations on employers in the areas of the ability to involuntarily terminate and severance benefits: refer to Chapter 9.



Practical insights and observations

Indonesia has an abundance of foreign capital lining up for investment, but a relative lack of readily identifiable targets and deals to invest in. For a combination of reasons, deal origination, execution and completion presents significant challenges right across the transaction cycle for foreign and local investors alike. Sustained investment interest and transaction activity are accompanied by high deal execution risks which translate into volatile country FDI inflows. It is common for transaction and due diligence timetables to experience slippage, and the rate of deals “falling over” or aborting is high. Reasons include overcooked pricing or pricing mismatch, transactions structuring complications and other “deal breakers” or deficiencies found in due diligence.

Despite all the challenges and frustrations, for foreign investors that “get it right” by finding the right local Indonesian partner, and the right “best fit” target at the right price, a not uncommon story is that a multinational’s Indonesian investment can be its most profitable and favorite in South-east Asia.

Many global and local PE firms, foreign strategic corporates and international Trading Houses from diverse countries (with Japan and Korea featured prominently) have prioritized Indonesia as one of their “Top 3” preferred FDI destinations in South-east Asia, if not the destination of choice. A number of governments have also openly signaled that Indonesia is their country’s preferred investment destination.

Post GFC, the large international PE Houses generally started to shift attention away from China and India finding those countries’ investment landscapes too difficult, crowded or overpriced, with better opportunities and less competition for foreign capital in South-east Asia. There are indications that investment activity by global PE Houses in Indonesia may finally be gaining some momentum and traction in 2015 after a slow start. Local PE Houses have been active to varying degrees for many years.

2014 and 2015 has seen the potential for M&A deal origination opportunities with Indonesian targets slowly starting to surface and become more visible, in what is still however a seller’s market. The passing of time has seen prospects of opportunities opening up for foreign investors in large, diversified family owned Indonesian private company groups as the aging patriarch or a key decision-maker becomes resigned to the fact that immediate family succession options are “stretched too thin,” and there being no option but to divest certain businesses, many of which are well performing despite perhaps not getting the management attention they deserve. Previous “willingness to sell” barriers may finally be starting to alleviate within these often large diversified groups. A “prodigal son” or daughter returning from overseas studies and/or business experience is usually more approachable and commercial than his or her father, also bringing home a recognition that partnering with the right foreign Investor can deliver scale, expertise, a new customer platform or other values to a business operating in a competitive Indonesian domestic environment to preserve is longevity.

To conclude, there are risks and challenges in investing and doing business in this emerging, high growth market, and Indonesia continues to be a difficult country in which to do business, relative to Western or more developed Asian markets. A successfully planned and executed investment however can be very rewarding. Foreign investors, of course, take a country’s investment risk profile into their overall investment models and decision-making policies. Indonesia is no different. To successfully invest in Indonesia and reap the benefits from a large, rapidly expanding population and all the upside of a quite remarkable economic growth story, having a degree of risk appetite is fundamental.

Sources:

- (1) KPMG Research and Intelligence
- (2) Bloomberg, March 2015
- (3) Discussion with Investment Banking Equity Analyst: March 2015
- (4) Indonesia Investment Coordinating Board (BKPM), “Domestic and Foreign Direct Investment Realization in Quarter IV and January – December 2014;” 28 January 2015
- (5) Indonesia Investment Coordinating Board (BKPM) Press Release, “Domestic and Foreign Direct Investment Realization Steadily Increased, Beyond the Annual Target of 2014;” 28 January 2015



The Company Law

The Company Law issued in 1995 stipulates the legal framework for companies. Previously, business was regulated by the provisions of the Indonesian Commercial Code and Indonesian Civil Code. These were drafted in the last century based on Dutch Colonial Law. The 1995 Company Law was most recently amended by Law No.40/2007 concerning Limited Liability Company (“the Company Law”).

Legal Entities for Doing Business

There are a number of legal forms of entities that can engage in business in Indonesia:

- Sole Proprietor: proprietor has unlimited liability
- General Partnership (FA or “Firma”): partners have joint and several unlimited liability
- Limited Partnership (CV): silent partners are liable to the extent of their capital contribution, while managing partners have unlimited liability
- State-Owned Corporation (BUMN): company owned by the government and reliant upon the state to fund any deficit
- Branch of a foreign corporation: foreign companies cannot, in most cases, establish operations in Indonesia through a locally-registered branch; banking and upstream oil & gas being the only exceptions
- Limited Liability Companies (PT): shareholders have limited liability.

As indicated, a PT company formed with a foreign shareholder in accordance with the requirements of the Investment Law and BKPM rules and regulations is referred to as a PMA Company, and PTs with domestic investment status are known as Domestic investment companies or “PMDN.” A “PT Biasa” is the term given to a local Indonesian private company administered by the MoT which is unlikely to be directly relevant to foreign investment. A customs Master List regulated by BKPM provides Import Duty relief and incentives on import of machinery and equipment for initial and capacity expansion investments made by PMA and PMDN companies. An older Dutch form of limited liability company, known as NV, still exists but no new companies are formed in this way.

For foreign investors, a PMA Company is the only form permitted under the Investment Law. However, foreigners may have a presence other than through a direct investment, and this is discussed later in this Chapter.

Establishment and Application Procedures for Incorporation of a PMA

The provisions relating to the PT are contained in the Articles of Association (“AoA”) formed by the Notarial Deed of Establishment.

The AoA contained in the Deed address, among other things:

- Rights and duties of shareholders
- Rights and duties of commissioners and directors
- Name of the company, its purpose, duration, domicile
- Authorized capital and the division into shares
- Number of shares taken by founders
- Dividends.

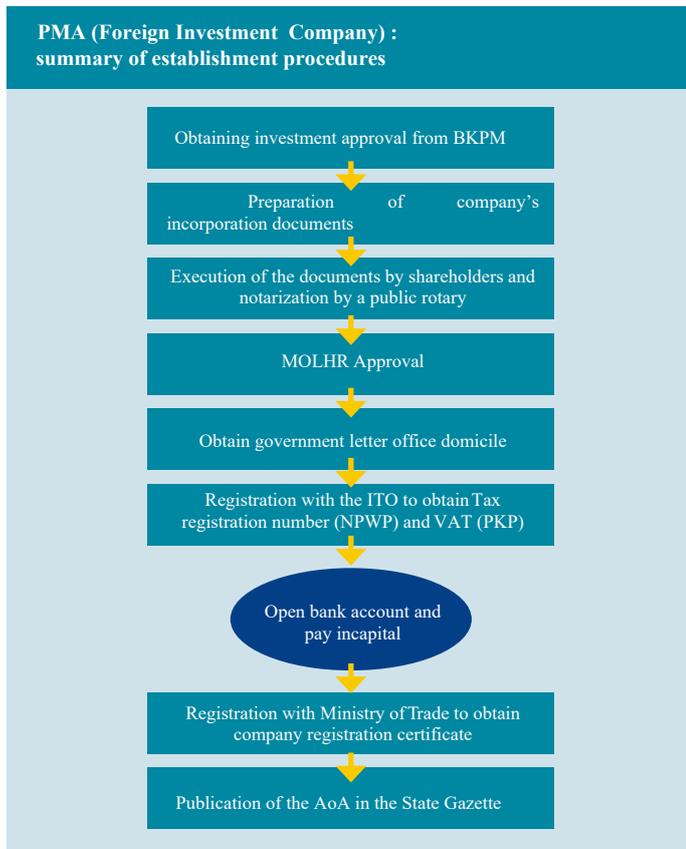
Once the nature of the project and size of investment have been established, registration must be made with BKPM. Historically the registration needed to be supported by a description of the proposed business activities and with copies of:

- Notarized AoA for both foreign and local parties, or a copy of a passport for individual shareholders
- Tax payer registration number (NPWP) including Letter of Domicile; and operating license (SIUP) of local party
- Letter of Power of Attorney (“PoA”) from shareholders
- Documentary evidence of receipt of capital being paid-up by shareholders.

Now the process can be fast-tracked as follows:

- All of the above are covered in a Statement Letter(s) from shareholders
- The Notary attends the offices of the MOLHR for registration processing.

The summary of establishment procedures below reflects this process.



Notes:

- (1) In practice, publication of the AoA in the State Gazette can take up to 12 months, however this is procedural only and does not impact establishment or ability to carry on a business
- (2) The procedures for establishing a PMDN are the same as a PMA company.

The indicative time frame for establishment and incorporation of a PMA Company (same for PMDN) has in recent years typically been around 3 to 4 months. New On-line procedures at BKPM (see below) and involvement of MOLHR approval are intended to reduce establishment timelines going forward, but to date these developments have not translated to any significant shortening of the process.

As part of recent informal BKPM announcements in May 2015, times involved for processing business license applications for manufacturing and services sector companies have reduced by up to 2 weeks, down to ranges of 12 to 23 and 9 to 18 days, respectively.

On-line Company Folders: foreign investment and licensing application

Effective 1 October 2014, all PMA (and PMDN) companies are required to create their own on-line company folder at BKPM. After this date, applications submitted to BKPM will only be processed for companies with on-line folders.

Additional time is needed for BKPM to process applications submitted after 1 October for companies without On-line company folders.

Licenses and Permits

If a project meets with BKPM approval, an initial investment approval will be issued, which permits the process of the establishment of the company to get started until it obtains legal status from the MOLHR and is registered in the Company Registry with the MoT. To establish a PMA Company, it is necessary to apply to BKPM for a Principle License and then a Permanent Business License. These licenses will enable the company to apply for other necessary licenses: Import licenses, permit for factory location, work permits for expatriates and Nuisance Act Permit. The Principle License normally has up to a five year validity (which can be extended). The Principle License can only be used until the PMA Company reaches the commencement of commercial operations or production.

The official date of commencement of commercial operations is triggered by the issuance of a Permanent Business License (IUT). An IUT is active as long as a company is still operating. Prior to commencement of commercial production, a Quarterly Activity Report must be submitted in standard format to BKPM and Bank Indonesia (“BI”) detailing, among other things, disbursements of foreign currency financing approved in the BKPM application. Bi-annual reports are required after the IUT is issued.

An important aspect of the investment application process is the compilation and approval of the BKPM Master List, which details the imported capital equipment and initial raw materials required, as inputs to the proposed investment. The imported items must be verified as suitable and relevant for the proposed project. Only items on the approved Master List are available for Import Duty relief and other concessions that will be documented in Exemption Certificates on imported equipment or materials.

BKPM Reg No. 5/2013 regarding Guidelines and Procedures for Capital Investment Licenses and Non-licenses dated 12 April 2013 (“BKPM Reg. No. 5/2013”) has modified the license profile under BKPM’s authority which is now authorized to issue:

- Principle License
- Business License
- Principle License for Expansion
- Business License for Expansion
- Principle License for Amendment
- Business License for Amendment
- Principle License for Company Merger
- Business License for Company Merger
- Branch Office License
- Foreign Company Representative Office License
- Foreign Trading Company Representative Business License (“SIUP 3A”).

Non-license matters are no longer administered by BKPM. In terms of licencing of importers, BKPM has been given authority over issuance of General Importer Identification Numbers (API-U) and Product Importer Identification Numbers (API-P) for PMA Companies (MoT for PT Biasa companies): refer further discussions on Customs registration in Chapter 8.

Deed of Establishment, Authorized and Paid-up Capital

The Deed of Establishment requires the approval of the MOLHR, which will ensure that the terms do not contradict the Company Law, or other laws, regulations and policies. The MOLHR has issued standard forms of Establishment Deeds to simplify approval requirements. There are requirements that at least 25% of the Authorized capital must be subscribed at the time of a company’s establishment, and all issued shares must be fully paid up before the Operation Permit is obtained. The Company Law stipulates minimum authorized share capital to be IDR 50 million, of which at least 25% must be issued and fully paid up.

In practice, as a general guide BKPM has historically required share capital for a small to medium sized company engaged in trading activities, for example, to have share capital in a range of USD100,000. There are no formal thin capitalization rules in Indonesia, however a “general rule of thumb” that has been applied by BKPM is 1/3:equity and 2/3:debt. This has varied depending on the nature of business and scale of investment. Investors in the manufacturing sector typically are expected to have a debt to equity ratio of 3:1 or less, while those in the agricultural or mining sectors may have ratios of 6:1 or greater. The expansion of existing facilities funded with retained earnings, new equity or loan capital also requires approval by BKPM.

Incorporation is not finalized until MOLHR approval is entered in the public register by the Court of Justice, and a notice published in the State Gazette; this can take up to one year to happen, but will not impede a company’s ability to commence and carry on normal business activity. Care must be taken during this establishment phase, as the directors will be jointly and severally liable on a personal basis for their dealings with third parties.

The Deed of Establishment can be drafted by a lawyer or a notary, and a notary public will attend to the requisite approvals and registrations.

BKPM Reg No. 5/2013: New Investment Rules

BKPM introduced new investment rules through Regulation No. 5 of 2013 which became effective 27 May 2013. There are new capital investment registration requirements and procedures but foremost a formalizing of minimum investment and the above “rules thumb” adopted by BKPM not specifically reflected in previous BKPM Regulations:

- Article 22 expressly stipulates minimum capital investment thresholds for PMA (more than IDR10 billion) and PMDN (IDR500 million) Companies
- For PMA Companies:
 - Minimum paid-up capital is IDR2.5 billion (as indicated, informal BKPM policy has been 1:3 Equity/ Debt ratio of total Authorized Capital)
 - Shareholder equity is (more than) IDR10 million.



Shareholders and Directors, employees

A company must have two shareholders upon establishment, even for a PMA initially permitted 100% foreign ownership.

Article 33 of the Investment Law expressly prohibits or deems unenforceable nominee arrangements in making investments in limited liability companies. Any agreement and/or statement providing for share ownership in a limited liability company to be for and on behalf of another party is null and void. In practical terms, in the event relationships breakdown between a real foreign owner and a local Indonesian nominee shareholder, the foreign investor effectively “has nothing” in terms of legally enforceable rights. Such nominee arrangements are not uncommon in Indonesia.

Companies may have one or more directors, one of which must be the President Director. The Board of Directors (“BOD”) oversees the day-to-day operations. The directors are usually full-time employees of the company or a related party or group company. Under the Company Law, a company is also required to have a Board of Commissioners (“BOC”). These are non-executives who oversee the activities of the directors. They supervise the corporate governance aspects of the company and the policies of the BOD. Under certain circumstances they may perform some executive functions on a temporary basis if all the members of the BOD have been dismissed or there are no members of the BOD available for whatever reason. Minimum requirements are one BOD and one BOC member, and these cannot be the same person. Both the Director and Commissioner can be foreign or Indonesian nationals. The Director must be an Indonesian resident.

There are no written regulations, but BKPM may impose a requirement of a minimum of 5 local employees.

On-going Accounting and Reporting Requirements

There is a public register of PT companies maintained by the Ministry of Trade (“MoT”), and there are annual corporate filing obligations. Companies are required to keep accounting records and prepare annual financial reports in accordance with Indonesian Financial Accounting Standards (or “SAK” which consists of PSAK and ISAK as well as regulations issued by the OJK for entities subject to its supervision) which are adopted from International Financial Reporting Standards. It is relevant however that no private company search function exists in Indonesia and, as corporate filing obligations are not strictly enforced, the level of compliance by private companies can be low.

The BOD is required to present an Annual Report (that includes the financial statements of the company) after it has been examined by the BOC at a General Meeting of Shareholders (“GMS”) within six months of the company’s financial year end. Generally, financial year ends are the same as the calendar year; however companies are allowed to have a different financial year. The Establishment Deed may impose other obligations.

The Company Law requires annual and extraordinary GMSs in accordance with the AoA. Unless stated to the contrary in the Establishment Deed, shareholders will hold one vote for each share, and a simple majority is all that is needed for voting purposes. The Company Law prohibits the directors from voting on behalf of shareholders. Directors acting as proxies of the shareholders will have no voting rights.

Tax regulations require the books to be maintained in Indonesian language and IDR currency. However in certain cases companies may seek permission from the MoF to maintain records in other languages and USD currency.

In addition, the following types of companies are required to present audited financial statements to the regulating government ministries:

- Publicly-listed companies
- Companies involved in accumulating funds from the public (such as banks and insurance companies)
- Companies issuing debt instruments
- Companies with assets of IDR 25 billion or more (see below)
- Bank debtors whose financial statements are required by the bank to be audited
- Certain types of foreign entities engaged in business in Indonesia that are authorized to enter into agreements
- Certain types of state-owned enterprises.

A PMA Company is required to have a physical office address. The Indonesian authorities do not recognize virtual offices.

Financial statements and statutory filing and audit obligations

Companies over a certain size and foreign-owned companies are required to prepare annual statutory financial statements in accordance with Indonesian Financial Accounting Standards which have generally converged with IFRS with the process having commenced in 2006. The first wave of an adoption process was completed in 2011 with full IFRS implementation in 2012. The following were gaps between IFRS and SAK as at 1 January 2012:

- IFRS 1 “First-time adoption of IFRS”
- IAS 41 “Agriculture”
- IFRIC 15 “Agreements for the Construction of Real Estate”

The new and revised IFRSs, which were effective for financial statements beginning on or after 1 January 2013 and which are effective for financial statements on or after 1 January 2015 in Indonesia, are listed below:

- IFRS 10 “Consolidated Financial Statements”
- IFRS 11 “Joint Arrangements”
- IFRS 12 “Disclosures of Interest in Other Entities”
- IFRS 13 “Fair Value Measurement”
- IAS 1 (2011 version) “Presentation of financial statements”
- IAS 19 (2011 version) “Employee Benefits”
- IAS 27 “Separate Financial Statements”
- IAS 28 “Investment in Associates and Joint Venture”

A new IFRS, which was effective for financial statements beginning on or after 1 January 2014 but not yet adopted by SAK, is IFRIC 21 “Levies”.

The Company Law, as well as regulations issued by the MoT, set out requirements for the filing of annual financial statements. Filings are required within six months of an entity’s financial year end. These statements are to be filed at the MoT.

Under Article 68 of the Company Law, financial statements of a private company with assets and/or turnover exceeding IDR 50 billion are required to be audited. Furthermore, MoT decree No.121/MPP/Kep/2/2002 regarding “Submission of annual financial statements” stipulates that a private company with assets of at least IDR25 billion is required to submit annual financial statements (audited) to the MoT at the latest 6 months after financial year end. Under the Company Law, the appointment of a statutory auditor needs to be ratified at an Annual General Meeting of Shareholders.

According to MoT No.121/MPP/Kep/2/2002 concerning Submission of Company Annual Financial Statements, every PMA Company must submit annual audited financial statements to the Directorate of Business Development & Regulations of the MoT.

Loss of limited liability

The Company Law stipulates that a company must have at least two shareholders to retain its limited liability status. If a company is left with only one shareholder and this situation persists for six months or more, then that shareholder will be liable for the company’s liabilities and losses, and the company may be dissolved.

Options open to foreigners other than incorporating a PMA company

Background

In Chapter 5, the opportunities for non-Indonesians to seek approval for investment in sectors open to foreigners was discussed. Foreigners can also have a business presence in Indonesia through entities other than PMA companies. These options are set out below.

Representative office

Trade promotion can be encouraged through the establishment of a Representative Office. The representative, who may be an expatriate or an Indonesian national, is not usually permitted to carry out any direct business activities, such as accepting orders, bidding for tenders, importing, exporting, signing contracts or distributing. The activities of a Representative Office are restricted to the issue and collection of information, and the provision of assistance to local agents and distributors as well as marketing and promotional activities.

An exception applies to Representative Offices of foreign companies engaged in construction services. Foreign companies have been allowed for some time to provide construction services in Indonesia in a Joint Operation (“JO”) with a local construction company. In a recent development, “Minister of Public Works Regulation No. 10/PRT/M/2014 concerning Guidelines on License Issuance for Foreign Construction Company Representative Office” articulates various qualifying criteria including: completion of at least one construction project in 3 years; JO arrangement; for construction implementation and planning projects, the composition of total construction value undertaken by local Indonesian and foreign partners.

Representative office applications are generally made to BKPM. Some foreign investors initially enter the Indonesian market through a Representative Office, and later as business opportunities grow, apply for establishment of a PMA Company in order to commence proper trading activities.

Care must be taken in establishing a Representative Office due to the possibility or risk that group company transactions otherwise not taxable in Indonesia may become assessable due to the existence of a Permanent Establishment or “PE” for tax purposes. This is discussed further in Chapter 10 on Taxation.

Branch

The oil & gas sector and foreign bank branches were addressed in Chapter 5. No foreign bank branch licenses have been issued since 2003.

Agent or distributor

A foreign company that wishes to sell its products in Indonesia will usually appoint one or more Indonesian agents or distributors. The agent or distributor may apply for a work permit for the employment of an expatriate, who is familiar with the foreign company’s products.

Technical assistance or franchise agreement

A local company may sign a contract with a foreign party to supply technical assistance and management services or support. It would be normal for the local company to employ foreign experts, supplied in accordance with the agreements, and for fees to be charged based on an agreed mechanism or structure.

Government contracts

Where technology or expertise is not available domestically, the GOI can enter into contracts with foreign companies. A company would normally enter into a contract in conjunction with local contractors, or may act as a subcontractor to a local contractor. The contract permits the company to establish a presence in Indonesia for the purpose of undertaking a project.

Sources:

- (1) KPMG Research and Intelligence
- (2) Law No. 40/2007 concerning Limited Liability Company
- (3) BKPM website: www.bkpm.go.id
- (4) BKPM “Monitoring Investment Climate in Indonesia”: Seminar 20 May 2015