

THE REPORT

Indonesia 2012

POLITICS
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BANKING
ENERGY

INFRASTRUCTURE
TOURISM
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TELECOMS & IT

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INTERVIEWS



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Banking

Volume of lending continues to increase in 2011

Loans to SMEs a driver of growth in system

Regulator proposes changes to ownership rules

Major banks required to publish prime rates

Expanding presence for sharia-compliant finance





The country's banks held assets worth nearly \$400bn as of mid-2011

Size and scope

New opportunities emerge as infrastructure plans are realised and lending grows

Despite a turbulent history in financial services, Indonesia has plenty to offer overseas bankers. Some of what is compelling has long been so, such as the huge potential inherent in the world's fourth-most-populous nation. Indonesia has for decades had a significant and largely untapped customer base – only about 20% of the country's adults have any sort of ongoing financial services relationship. It was for this reason that some of the larger names in the industry, such as Citigroup and HSBC, originally sought a banking licence in Indonesia.

RESILIENCE: Now there is more reason to enter the banking sector. The market has become both broader and deeper, and interest rates are sinking lower. These factors have combined to boost the already growing demand for financial services in the archipelago, from microcredit to mezzanine finance.

Since 2008 an extra incentive has been the country's remarkable resilience in the face of economic adversity. As banks worldwide were asking for aid from politicians, Indonesia's lenders did well, many of them even recording profits during the fourth quarter of 2008. Reactions to the global financial crisis of 2008 have helped sort out the well-managed financial sectors from those with improvements to make, and Indonesia has been one of the key winners in this process. Thanks in part to the fresh memories of the 1997-98 Asian financial crisis, the country's regulators have shown themselves to be a competent group, and confidence in their leadership is a large reason why investors have stayed.

SOUND FUNDAMENTALS: But beyond that, what the crisis has proved is that Indonesia no longer suffers from the concerns that have sunk South-east Asian economies in the past – a drop in demand for imports from the region. Indonesia and its neighbours have grown in large part by supplying cheap labour and therefore exports, and when global demand has shrunk, the fortunes of these countries did as well. Now, in the aftermath of the 2008 crisis, it is clear

that these countries, Indonesia perhaps chief among them, have enough domestic demand to sustain growth regardless of external economic cycles.

In the near term, it seems clear that Indonesia's banks will do well with their current mix of activity, which focuses on short- and medium-term lending, and their generally conservative approach to business. Performance will also likely be boosted as more Indonesians start to use formal financial services as they move out of poverty and into the middle class.

CHANGING FOCUS: However, at the same time, there is pressure for financial institutions to do more, particularly with respect to the average length of maturity for loans. Only select clients receive repayment terms that extend into multiple years, which means that it is difficult to use bank financing to fund infrastructure development. Indeed, Indonesia is looking to build the roads, ports, bridges, power plants and other key public works that are needed to unlock the country's economic potential. However, the government cannot afford to do all of this building and instead wants most of the money and expertise to come from the private sector. A mix of Indonesian and foreign investment is expected.

For the banks, the problem is that infrastructure projects typically require a long gestation period, and it is often more than a decade before profits materialise. That length of time is beyond the comfort zone of most Indonesian banks, whose loan officers expect to evaluate credit requests based on a faster turnaround. Guarantee funds and other methods have been created to help share the risk, and the overall performance of these groups of financiers will be closely watched in the next few years.

RETAIL OPERATIONS: The consumer finance side for banks will likely be more familiar in 2012 and beyond. Indonesia's banks run the gamut from small rural lenders to international players, and Indonesians are progressing through stages toward sophisticated financial relationships, starting with small

At present banks focus mainly on short- and medium-term lending. Although this business model is profitable, the government would like to see banks engage in more long-term financing, particularly for infrastructure projects.

As of August 2011 there were 1681 rural banks, which do not have direct access to the national payment system and are restricted to operations in defined territories.

loans and deposits with microfinanciers and rural banks, and then moving to regional or national banks and deepening their relationships through lines of credit, credit cards, savings schemes and other options. The country remains one of the world's most important markets for microfinance, which in Indonesia – unlike in some less developed countries – is commercially-oriented and centred on making small loans to entrepreneurs. Most of the main banks are involved in this segment (see analysis).

As the world's largest Muslim country, Indonesia is also a growth market for Islamic finance – lending, saving and investing without the use of interest, speculation or excessive risk. Jakarta has not promoted Islamic finance from on high, as has happened in neighbouring Malaysia. There, the government has worked hard to establish one of the world's largest and most sophisticated Islamic finance markets. By comparison, Islamic finance in Indonesia is evolving along with demand, which continues to increase steadily over time (see analysis).

HIGHLY FRAGMENTED: The country's banking system has undergone a decade of significant change, as the 1997-98 crisis spurred bailouts, mergers, acquisitions, closings and a host of other changes. When things settled the banking roster ended up about half its previous size. According to the Bank of Indonesia (BI), the country's central bank, as of August 2011, there were 120 commercial banks,

holding assets worth Rp3252.7trn (\$390.3bn). About 15 of these banks account for approximately 70% of the nation's credit. Four banks, including three of the top four, are at least partially state-owned. Of the private lenders, 11 are Islamic banks. Indonesia does not require banks to choose between sharia-compliant or conventional operations, instead allowing them to open windows or units if they choose to do so. However, BI does offer licences specifically for sharia-compliant banking. It also offers a separate category of licence for rural banks, of which there were 1681 as of August 2011, holding assets valued at Rp51trn (\$6.1bn). Rural banks do not have direct access to the national payment system, and they are restricted to operations in defined territories.

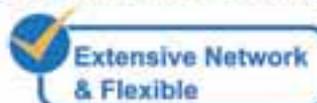
REGULATION: BI, the system regulator, uses as its governing framework the Indonesian Banking Architecture, a 2004 comprehensive plan introduced as a set of guidelines for development. Six broad goals are considered the pillars of the plan: a healthy banking structure, effective regulation, effective and independent supervision, adequate infrastructure, robust consumer protection and a strong banking industry. Overall the approach is a conservative one.

One of the issues that has seemingly slid down the regulator's agenda is consolidation. In the wake of the financial crisis and with so many banks in the country, slimming the roster to a smaller number of larger players was a significant goal. For some, the



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number of banks is too large, and many believe that BI would still like to see some consolidation, but the reality is that this is unlikely to happen. Banks are motivated to get bigger just as anywhere else, but with such explosive growth in the system, organic expansion – increases in customer base, branch network, loan books and so on – is an effective a tool for gaining market share, and does not come with the potential challenges of doing a deal.

Acquisitions in the near future are likely to come from major banks buying specialist banks in order to access a specific market. Microfinance is an example, as lenders such as Bank Mandiri and Bank Tabungan Pensiunan Negara (BTPN) have recently bought microfinance lenders or are set to do so soon.

FOREIGN BANKS: Perhaps the biggest regulatory discussion in 2011 addressed the presence of foreign financial institutions in the system. The banking sector has been largely welcoming to foreign investors since 1999, when the government opened up its financial system in an effort to recapitalise its failed banks after the financial crisis. As of mid-2011 about a third of banks operating in the country were either partially or entirely foreign owned, with several in the top 10, including CIMB, Danamon, Bank International and Permata. Foreign lenders also account for about 27% of outstanding loans.

According to rules that have been in place since 1999, any entity, whether domestic or foreign, can own up to 99% of a bank's shares. However, in July Darmin Nasution, the governor of BI, said that the central bank was considering a regulation to cap the maximum individual stake in a bank at 50%, to prevent a few people or companies from gaining too much control. Although the regulation would not single out foreign owners, there was sufficient speculation that this was the case such that Nasution made another announcement in August that the intent was not to target foreigners.

OWNERSHIP RULES: Foreign investors may have some basis for being concerned about the potential for the introduction of the new 50% regulation, having been subject to the government's changing of ownership rules in the past. The single-presence policy, introduced in 2006, prevents any person or company from owning a controlling stake in more than one bank. This policy has affected three groups – Singapore's Temasek sovereign wealth fund, a similar Malaysian government holding company called Khazanah and the Indonesian government itself.

Outstanding loans, Aug 2010-Jun 2011 (Rp trn)

	Working capital	Investment	Consumption
Aug-10	813	326	501
Oct-10	820	333	523
Dec-10	880	349	537
Feb-11	858	357	559
Apr-11	883	383	577
Jun-11	940	407	603

SOURCE: Bank Indonesia



Since March 2010, banks that do not keep loan-to-deposit ratios between 78% and 100% face penalties

While Temasek and Khazanah have each since merged their multiple banks into single institutions, the Indonesian government asked BI for an exemption from the rule until 2012. The exemption was granted, and what happens next for the four state-owned banks in Indonesia is unclear.

It is also unclear whether or not Nasution's proposed 50% cap on ownership would also apply to the state-owned banks, and how it would be implemented. The idea of finding new takers for up to half of the shares in more than 100 banks could create market confusion. It could also mean that assets would be sold at discounted prices. As Tony Costa, the president director of Commonwealth Bank Indonesia, told OBG, "There is talk of a new regulation limiting the ownership of a bank to less than 50% per shareholder. The major risk when implementing such measures is not to offer the owners the right timeframe to carry out the sale, which could lead to a severe decrease in the price of their shares."

Another proposed regulation would force foreign bank branches to operate as limited companies, which under Indonesian law would give BI more scrutiny of them, and perhaps the ability to insist that top management jobs are filled by Indonesians only.

ENCOURAGING LENDING: The central bank has also been active in trying to boost lending through means other than a reduction in the policy rate. In September 2010 BI introduced new rules that require a bank to keep its loan-to-deposit ratio (LDR) above 78% and below 100%, although an LDR above the maximum is allowed if the bank's capital adequacy ratio (CAR) exceeds 14%. The minimum is designed to spur lending while the maximum helps to ensure that banks do not take on unnecessary risk. For those banks that do not meet these requirements, they are obligated to hold more reserves with BI. At the same time, the central bank also raised the rupiah primary reserve requirement (for all banks, regardless of LDRs) from 5% to 8%, effective November 1, 2010.

According to regulations that have been in place since 1999, any entity, whether domestic or foreign, can own up to 99% of a bank's shares.



Loans to SMEs grew at a CAGR of 21.1% between 2005 and 2010

As of June 2011, total outstanding loans amounted to Rp1951trn (\$234.1bn), representing 23% year-on-year growth. Of this total, about 50% was accounted for by working capital loans.

The LDR rule, which did not go into effect until March 2011, has met with some criticism. While the policy appears to promote lending growth, in actuality, it may not. For banks that fall below the minimum, they could find it more profitable to incur the penalty rather than make loans that they perceive to be risky. At the other end of the spectrum, banks may be unfairly penalised for LDRs that exceed 100%, given that the rule does not take into account other sources of funding, such as debt or equity issuances, although this could be offset somewhat by the fact that banks with CARs that exceed 14% are not subject to the 100% maximum.

Setting aside the question of whether or not this policy was effective, lending nonetheless grew during the first half of 2011, despite the November 2010 hike in reserve requirements and a February 2011 increase in the policy rate to 6.75% from 6.5%, the first change since July 2009. By June 2011 total outstanding commercial bank credit amounted to

Rp1951trn (\$234.1bn), representing 23% year-on-year (y-o-y) growth. Of this total, almost half was accounted for by working capital loans, with consumer lending the next largest category, at 31%. The balance, at 21%, was made up by investment loans.

Finally, it is important to note that, when looking at the bigger picture, the sector's LDR has increased over the past five years, with loans growing more quickly than deposits. In fact, looking ahead, it may be deposits that constrain local lending, rather than an unwillingness to lend on the part of banks. Also, because most deposits are short-term, it is difficult for banks to engage in long-term lending, such as is required for infrastructure projects.

SMALL BUSINESS LOANS: Lending to the micro, small and medium-sized enterprise (MSME) segment is an important part of Indonesian banks' loan portfolios, accounting for Rp1035trn (\$124.2bn), or 53.1% of total system lending as of June 2011. Loans to MSMEs grew more quickly than overall lending between 2005 and 2010, increasing at a compound average growth rate (CAGR) of 21.1%, compared to 20.5% for all loans. Moreover, MSME lending is expected to be a driver of loan growth in the banking system going forward. According to a 2011 survey by PwC, the global tax and advisory services firm, some 31% of Indonesian bankers surveyed expected the MSME sector to achieve the highest growth in lending 2011. That said, MSME credit quality is relatively weaker. In June 2011 the ratio of non-performing loans (NPLs) for the MSME segment stood at 2.87%, compared to 2.74% for the overall sector (see analysis). For this reason, banks are likely to actively manage their deployment of these loans and apply credit analysis to keep NPLs at manageable levels.

CONSUMER LENDING: While overall lending had grown by 23% y-o-y as of June 2011, the value of consumer loans increased more quickly over this period, rising by 23.2%. This was apparently a cause for concern at BI, with local newspaper *Jakarta Post* reporting in early August 2011 that the central bank

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governor had said that it was keeping a close watch on growth in auto and housing loans.

Through August and into early September, the central bank continued with this stance. In late August 2011 Wimboh Santoso, the director for banking research and regulation at BI, told local reporters that, although consumer loans had not exhibited the largest y-o-y growth as of June 2011 – working capital had increased by 23.8% – their growth had reached the highest acceptable level set by BI. He noted that the central bank had prepared measures to slow the rise in consumer loans.

In early September Wimboh again addressed this issue, telling the local media that the central bank would prefer that banks direct their lending towards productive investments rather than consumer purchases. “We aim for credit to be channelled to more productive purposes, instead of consumptive loans. Working capital and investment loans are the kinds of loans that will support growth, as they are closely linked with job creation and multiplier effects,” he said. This opinion has been echoed by private sector market participants as well. Kamal Osman, the president director of BNP Paribas Indonesia, told OBG that lending should be aimed at projects that stimulate new economic activity and not consumers. “The banking industry has a responsibility to ensure that an adequate amount of capital is directed towards financing projects that will create real economic growth and not simply be made available for credit cards and consumer financing,” he said.

However, as of late 2011, the central bank had taken no steps to curb lending to consumers. On the contrary, while consumer spending, and private consumption more generally, remained strong entering into the fourth quarter of 2011, BI lowered its policy interest rate twice during the final months of 2011, to 6.5% in October and 6% in November. The central bank cited a slowdown in global economic activity and the easing of inflation as the main reasons for this reduction (see Economy chapter).

INTEREST MARGINS: While the central bank’s policy rate may be falling, Indonesia’s net interest margin (i.e., the difference between lending and deposit rates) is the highest in South-east Asia, perhaps because banks remain cautious lenders as a result of the 1997-98 financial crisis. Moreover, the local capital markets remain relatively shallow, which means that borrowers have few alternatives to the banks when it comes to raising capital. Moreover, by regional standards, Indonesia’s inflation rates are both high and volatile, so banks have a more difficult time in forecasting their future liabilities.

However, the central bank has taken steps to address this issue. As of March 2011 BI has required that all lenders with assets above Rp10trn (\$1.2bn) publicly announce their prime rates – the rates without the risk component – for corporate, retail and consumer credit. The idea was to foster competition, but BI data show that three months later rates were holding at similar levels. BI tracked the rates of more



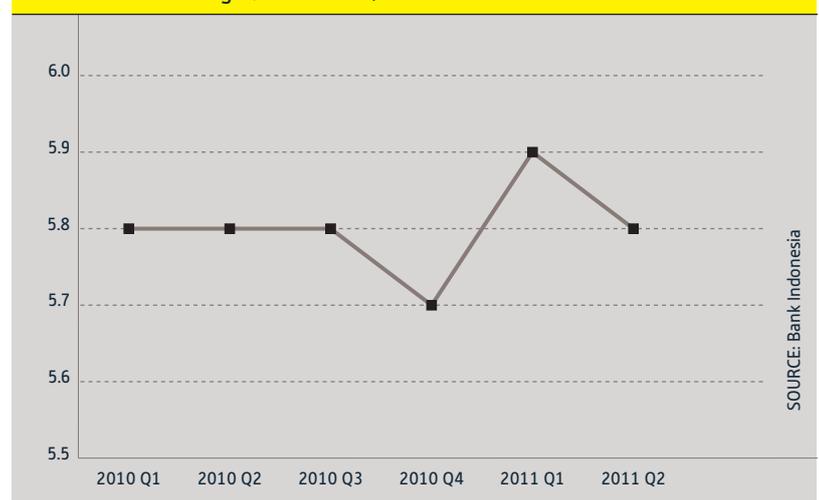
BI lowered its policy interest rate in October and November 2011

than 40 banks, and found that corporate loans were offered at 11.01% in March and 11.03% in June. Housing loan rates had dropped 20 basis points to 11.49% and non-housing consumer loans slipped to 11.84% from 12.1%. Those rates compare with a cost of funds ranging from 6.18% to 6.59%, according to BI data. Central bank officials told the local media that the plan to push rates lower through disclosure could require several months to take effect.

OUTLOOK: While profits could be squeezed if net interest margins fall in response to BI’s requirement that banks disclose their prime rates, such concerns may be more than offset by opportunities. The December 2011 decision by ratings agency Fitch to upgrade the country’s sovereign debt to investment grade is likely to reduce the cost of funds. At the same time, the central bank’s October and November reductions in the policy rate could also boost the sector. Finally, the development of infrastructure will support bank growth, not only in terms of financing opportunities but also as the multiplier effects of these projects attract new investors to the country.

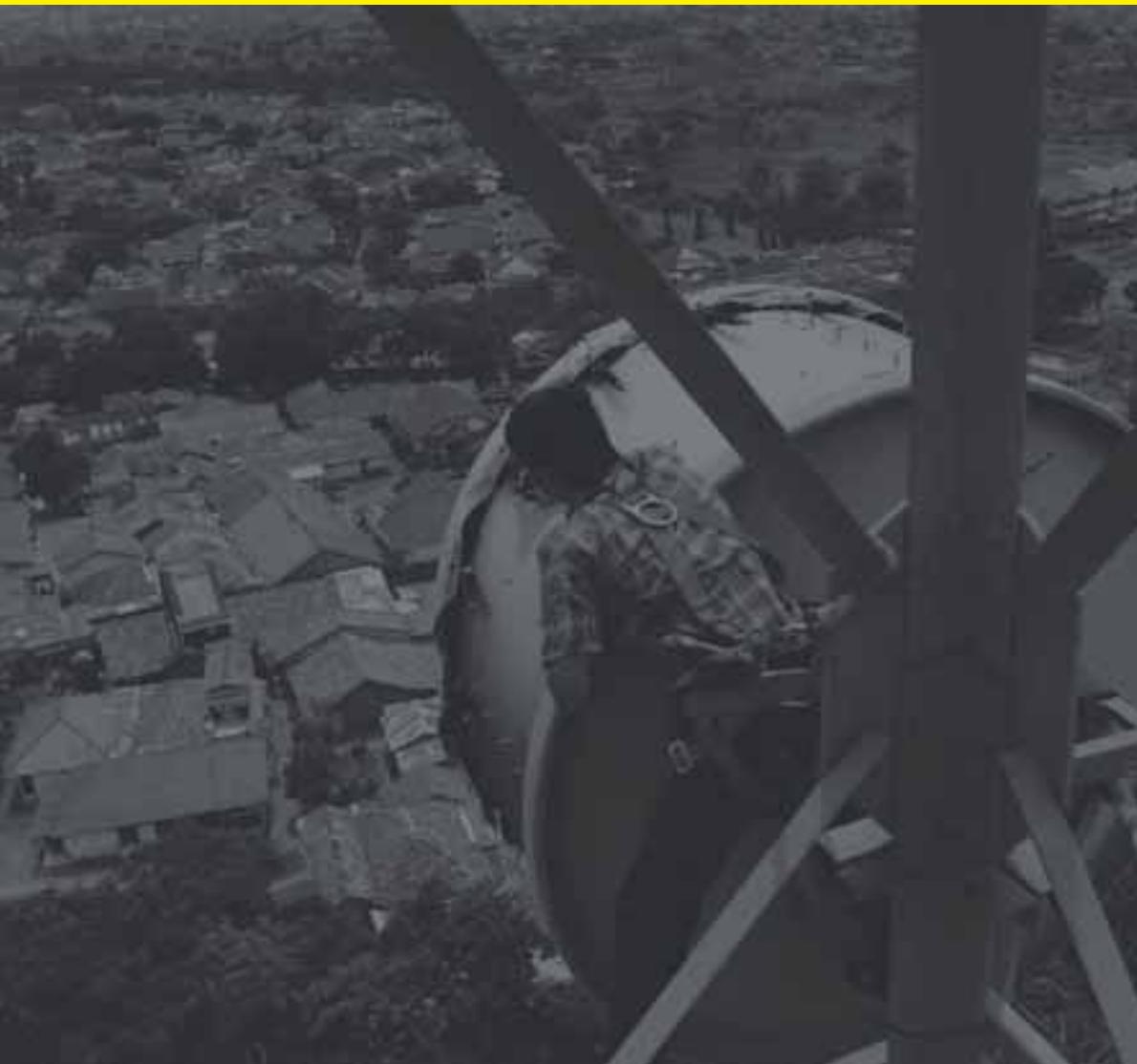
As of March 2011 the central bank has required that all lenders with assets above \$1.2bn disclose their prime rates. The purpose of this policy is to increase the level of competition among banks, which could reduce net interest margins.

Net interest margin, 2010-11 Q2



Telecoms & IT

An increasingly competitive market with many players
New entrants challenging dominant companies
Vast potential for cheap smartphone devices
Efforts to improve internet connectivity





Studies indicate tower sharing may soon replace separate networks

Sharing resources

A maturing wireless sector prompts competitors to share towers

With penetration rates nearing 100% and network coverage encompassing almost all of the country, Indonesia's wireless communications sector is approaching maturity. Furthermore, average revenue per user is falling and the main providers are now looking for other ways to keep profits from sagging. It is at this point in the development of a wireless telephony sector that selling and sharing network towers might come up, and that is now happening.

A SHIFT TO SHARING: According to a study by PwC, the end of the era in which each carrier built its own network will bring about cost savings. The tower-sharing system encourages the removal of duplicated resources, but moving into this new paradigm might result in increased consumer criticism.

"Sites may provide coverage that is unique, so consolidation may degrade the service in some places and trigger some customer complaints," the firm's report concluded. However, "the scale of the available savings means this consideration does not usually undermine the overall economic rationale." Nevertheless, tower sharing is likely to become increasingly prevalent and dedicated tower companies like Profesional Telekomunikasi Indonesia (Protelindo), Tower Bersama Infrastructure and Solusi Tunas Pratama (STP) are emerging.

In July 2011 Indosat, the second-largest mobile phone company, was looking to sell 4000 of its some 18,300 towers for \$500m, according to media reports. In other smaller transactions, Protelindo is in the midst of an agreement with Hutchison CP Telecommunications that will see it purchase 1000 of the latter's towers by 2012. That would give Protelindo more than 6000 towers as of mid-2011, compared with 3370 for Bersama and 1150 for STP. Therefore, a sale of 4000 Indosat towers would have a profound impact on market share. Indosat would refuse to sell to Telkom or XL Axiata, its two main wireless competitors. Foreign companies are also banned from participating due to a regulation updated in 2010 that

stipulates tower building and management be restricted to Indonesians and companies owned by them. The regulation, issued by the Ministry of Communications and Information, reiterates a 2008 ruling that also gives local governments the power to control the number of towers located in its territory, as well as where they are built.

BUREAUCRACY: Having to deal with government on the sovereign and sub-sovereign level in Indonesia is often a major hassle, as overlapping permit regimes, delays, fees and the potential for corruption are all serious obstacles. The decentralisation of government control has been a key theme in the post-Suharto era. These sub-sovereign and often cash-starved governments are extremely keen to grab and hold on to whatever turf they can. Some have interpreted the laws as an invitation to start their own tower companies, and to make life difficult for existing companies by claiming towers already in operation were no longer properly permitted, or finding other reasons to take them down. Chrisna Wardhana, PwC's telecommunications partner based in Jakarta, told OBG that negotiations with regional governments can often be lengthy. The restriction on foreign companies may also force carriers to sell their towers due to foreign ownership stakes, though the government's position on this is unclear. Singapore's SingTel has a 35% share of Telkomsel, and the two companies have been discussing the matter.

As of July 2011, a likely outcome seemed to be that towers would be transferred to Telkom's towers subsidiary Dayamitra Telekomunikasi. According to OSK Securities, an investment firm based in Kuala Lumpur, the towers subsidiary is a candidate for an initial public offering on the Indonesia Stock Exchange. Telkom has also been trying to buy out SingTel's 35% stake in Telkomsel, though a deal has not been reached because the mobile carrier is a major source of revenue for both companies. As of September 2011 it was reported that negotiations were still ongoing.

Telecommunications companies are becoming more aware of the benefits of tower sharing, which include substantial cost savings.

Media

Cross-cutting conglomerates dominate sector

Advertising expenditure recovers strongly

Room to grow in pay-TV segment as market expands

Popularity of social networking prompts online adverts





Developments in 2011 point to higher levels of competition ahead

The bigger picture

Cinema and television are both expected to see increased demand

Despite lagging behind its neighbours in terms of cinema and television market size, healthy competition and residual demand should see Indonesia catch up over the next few years.

The market in both pay-TV and cinema remains highly concentrated, but developments in 2011 and the prospects of strong growth point to a greater level of competition in years to come. Indonesian pay-TV is currently expanding at the slowest rate of all in Asia, with household penetration at a mere 3% in 2010 – roughly 1.3m households across the country.

However, operators are bullish, expecting the ratio to rise to 7% by 2015. Media Partners Asia, a pay-TV industry association, expects that the potential subscriber base could grow to 16m based on income and affordability. “The Indonesian pay-TV market remains small compared with other Asian markets,” Eric Thohir, the president director of TVOne, a branch of Visi Media Asia, told OBG. “But the number of pay-TV subscribers is set to grow rapidly over the next five years.”

FRESH DEMAND: PricewaterhouseCoopers’ “Media and Entertainment Outlook 2008-12” notes that growth in Indonesia’s pay-TV market is the slowest of all Asian countries, averaging only around 2% annually, far lower than in smaller markets like Vietnam, Malaysia and Pakistan. Some analysts nonetheless argue that the five years from 2010 will bring 18% annual growth, on the back of an improving economy and increased market competition. “It’s a tough market for service providers because many Indonesians are unwilling to pay for programming when so many free channels are available,” said Arya Mahendra, the corporate secretary for MNC SkyVision, the holding group for the market’s leading brand, Global Mediacom’s Indovision.

TAILOR-MADE TV: Operators have been expanding their offering to increase their appeal to lower-income segments of the TV market. MNC SkyVision has long dominated the pay-TV segment with its Indovision brand, but the group launched the TopTV channel in April 2008 to target the lower segment of the market. GSM operator Telkomsel similarly broke into the market in 2007 with the launch of its TelkomVision brand. This offers TV packages such as Hit Family, costing only \$6.5 per month. The group is already one of the top

three pay-TV groups. Indovision and TelkomVision both use a direct-to-home network while, the third operator, First Media, uses a cable network. These providers accounted for 95% of paying subscribers in 2010.

TelkomVision launched the first internet protocol television service in June 2011, called Groovia TV, capitalising on Telkomsel’s triple-play package of telephone, internet and television. Even as service options grow, an ongoing challenge for operators remains the large pool of illegal service providers, which cover a combined subscriber base larger than the legal brands. While the Ministry of Communications and Information Technology has only licensed 700 operators, the Indonesian Cable TV Association estimates a much higher figure of 2500 providers. This would put the total number of subscribers at 2.5m households instead of the official figure of 1.3m. However, with the number of illegal operations growing, industry players are lobbying the government to crack down on a practice that costs them around Rp1.2trn (\$144m) in lost revenue each year.

TAX ISSUES: While liberalisation is creating more competition on the small screen, the cinema business is still dominated by a single operator, which captures over 80% of the market. Group 21, Indonesia’s largest cinema operator with 500 of the country’s 600 screens, controls the three biggest film importers. Moreover, box-office sales for foreign and local film productions have grown rapidly, doubling in five years. However, at \$150m, Indonesia’s box-office revenues are still comparatively small by regional standards. A showdown was ongoing in 2011 between Global Mediacom and the state’s tax department, which has started enforcing a neglected clause for the taxation of royalties of imported films in addition to that on celluloid reels. The state is claiming Rp31bn (\$3.7m) in back taxes since 2009. Despite the modest sum, cinemas have halted film imports, with the showdown having no immediate end in sight.

While demand is growing substantially in both markets, convergence is spurring more market pressures in pay-TV as GSM operators vie for market share.

Operators are focusing on broadening choice, developing various products that are more affordable for the public to capitalise on predicted growth.

Tax

A number of reforms completed in 2010

Concessions available in certain qualifying sectors

Further implementation of deregulatory measures

New regulations for public-private partnerships



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The corporate tax rate is 25% on net taxable income

Reshaping the environment

An overview of the tax system and regulations for potential investors

The Indonesian tax system is mainly based on three tax laws – the General Tax Provisions and Procedures Law, the Income Tax Law, and the Value-Added Tax (VAT) and Luxury Sales Tax (LST) Law. The tax reforms, which started in 2008, covering amendments of the above laws, were completed in 2010. Subsequent to the commencement of the new laws, the government issued a number of implementing regulations which provide clearer guidance on various tax matters. The government is trying to reshape the tax environment and improve the investment climate. Tax concessions are being provided to certain taxpayers in particular sectors and/or particular regions, and further income tax exemptions or reductions will be given to companies in pioneer industries which have met certain criteria.

Internally, the Indonesian Tax Office (ITO) is becoming more professional in its approach to dealing with taxpayers. New tax audit guidelines have been issued, which provide more certainty to taxpayers about the process. In 2011 the ITO is focusing on carrying out tax audits on certain industries and high-wealth individuals, whilst the office also continues its focus on transfer pricing audits.

The key issues covered in the amended tax laws and their implementing regulations are summarised below. **CORPORATE TAXATION:** An Indonesian limited liability company, which is commonly referred to as a PT company, is an Indonesian tax resident by virtue of having its incorporation or its place of management in Indonesia. Its income is taxed on a worldwide basis under a self-assessment system. A branch of a foreign company, which constitutes a permanent establishment (PE), is also taxed in the same manner for the income attributable to the PE.

The corporate income tax rate is 25% on net taxable income. This applies to a company's profits, determined in line with Indonesian accounting standards, which reflect international accounting standards. Fiscal adjustments are required for certain items where different treatments apply for tax and accounting. For instance,

provision and benefits in kind should be accounted for as expenses for accounting purposes but generally are not claimable as deductible expenses for tax. Capital assets are also depreciated differently for tax and accounting purposes. If a company suffers a loss in a particular year, it may be offset against profits for the next five years. For a limited category of businesses in certain regions or businesses subject to certain concessions, the period can be extended for up to 10 years. Carrying back tax losses is not allowed and tax consolidation is not available.

Specific tax rates, generally referred to as final income tax, apply to certain types of income. Land and building rentals, for instance, are subject to 10% final income tax on the gross rental amounts. Final income tax also applies to construction service fees at 2-6%. Transfers of land and building rights have a final tax at 5% of the gross proceeds, however, for transfers of simple houses and apartments the tax rate is 1%.

Only certain categories of business (e.g. banking and public works) can formally establish a branch operation (generally referred to as a PE) in Indonesia. A PE of a foreign company is taxed in the same manner as the income of PT companies.

In addition, a PE is subject to branch profits tax of 20%, which is calculated on the net figure after income tax. The branch profits tax may be reduced under an applicable double-tax treaty.

WITHHOLDING TAX (WHT): A large proportion of income tax is collected through a comprehensive WHT system, which applies to resident taxpayers as well as non-resident taxpayers. For resident taxpayers, WHT mainly applies to services rendered, and it is accounted for by the recipient of the services at the time of invoice accrual or payment, whichever is earlier. A WHT rate of 2% applies to fees for various services. This WHT constitutes a pre-payment of the service provider's annual income tax liability.

The WHT rate for interest and royalty income received by a domestic taxpayer from an Indonesian company



Value-added tax is due on virtually all transactions involving the transfer of goods or provision of services

is 15%. Dividends received by individual taxpayers from an Indonesian company are final-taxed at 10%. The importation of goods into Indonesia is also subject to WHT at 2.5% (if an import licence is held) or in other cases 7.5%. This WHT represents a pre-payment of the taxpayer's annual income tax.

Dividends, interest, royalties and fees payable to non-residents are subject to 20% final WHT. A WHT exemption or a WHT rate reduction may be available under an applicable tax treaty. Treaties generally reduce rates on interest, dividends and royalties to 10% or 15%.

Indonesia has entered into 62 tax treaties. To enjoy the benefits, the income recipient must provide a certificate of domicile (CoD) by filling out the form of CoD prescribed by the Director General of Tax (DGT), which must be certified by the tax authority of the recipient's home country.

In the case of dividends, interest and royalties, the recipient must be the beneficial owner of that income; an entity benefitting from a tax treaty cannot be a pass-through entity. To support the beneficial ownership position the CoD form also requires a number of declarations to be made by the recipient that acknowledge that the use of the treaty jurisdiction has not been done merely to obtain the benefit of the treaty. In most situations beneficial ownership is determined under a series of tests, all of which must be met. In broad terms, these tests require the recipient entity to have substance and not be a pass-through entity.

Where a treaty does not have a beneficial ownership requirement, the test requires that the recipient entity was not set up to take advantage of the tax treaty and or that the transaction was not undertaken to take advantage of the tax treaty.

DIVIDEND TAX: In principle, dividend income received by a resident taxpayer from a PT company is taxable as ordinary income for the taxpayer receiving the dividend. However, if the dividend recipient is a PT company with a minimum shareholding of 25% in the firm paying the dividend and the dividend is paid out of profits, the

income is tax-exempt. Dividends received by individual resident taxpayers are final-taxed at 10%.

WHT ON SALE OF SHARES: The sale of shares in a non-listed Indonesian company by a non-resident is subject to a final 5% WHT based on the transaction value. Where the seller and the buyer are non-residents, the WHT must be accounted for by the Indonesian company whose shares are being sold. If the buyer is Indonesian, then the buyer is responsible for the payment of the tax. Gains on the sale of non-listed shares sold by an Indonesian company are taxed under normal principles. The 5% WHT also applies to the sale of shares in a conduit company domiciled in a tax haven country and used to escape Indonesian tax. In this respect, the sale of shares in the conduit company interposed between the actual shareholder and the Indonesian PT company or PE is treated as if it were the sale of PT company shares or the sale of the Indonesian PE.

Sales of shares in an Indonesian listed company are subject to a 0.1% final tax based on sale proceeds (see further comment below).

PAYROLL TAX AND PERSONAL INCOME TAX: Individual tax residents are liable for tax on their global income. An individual is regarded as an Indonesian tax resident if he/she stays in Indonesia for more than 183 days in any 12-month period or intends to stay permanently in Indonesia. Individual tax rates are graduated. The highest marginal tax rate is 30% and applies to income above Rp500m (\$60,000) per year. Employment income, a type of individual income, is taxed through withholding by the employer.

VAT AND LST: VAT is due on virtually all transactions involving transfers of taxable goods or the provision of taxable services in the Indonesian Customs Area. Under the VAT and LST Law, the VAT must be collected at the time of delivery when risk and ownership of goods have been transferred or when income from a service delivery can be reliably estimated or measured.

The standard VAT rate is 10% and calculated by applying the rate to a relevant tax base. In most cases, the tax base is the transaction value agreed between the parties concerned. The rate applicable to exported goods is 0%. Certain exported services, such as toll manufacturing, repair and maintenance, and construction services are also subject to 0% VAT. Most goods and business-related services are categorised as taxable goods or taxable services. Those categorised as non-taxable include unprocessed mining or drilling products, gold bars, securities, banking, insurance and finance leasing services.

The VAT system operates on an input-output model. In most cases the supplier of goods or services is responsible for collecting VAT from the buyer. The tax collected constitutes output VAT for the vendor and input VAT for the buyer. Firms liable for VAT are required to account for VAT on a monthly basis. A payment must be made to the extent that output tax exceeds input tax, and the taxpayer is entitled to a refund of the excess where the input tax exceeds output tax. Refund applications can be made at the end of a book year. It can take up to 12 months for companies to receive VAT

refunds, after going through a VAT audit. However, taxpayers meeting certain compliance criteria may obtain pre-audit refunds. Monthly refunds are possible for certain taxpayers, e.g. exporters of goods or services, suppliers to VAT collectors, companies in the pre-production stage and suppliers of goods or services for which VAT is not collected.

In addition to VAT, deliveries or imports of goods categorised as luxuries are also subject to LST. These goods include alcoholic beverages, certain household appliances and certain sporting equipment. LST is due either upon import or upon delivery by the manufacturer to another party, and the rates currently range from 10% to 75%.

OTHER TAXES: Stamp duty is nominal. The amount is Rp6000 (\$0.72) for each document stamped.

Land and building (property) tax is due every year. The effective property tax at present is either 0.1% or 0.2% of the official value of the land and buildings (a predetermined proportion of a deemed sales value determined by the government). The value is updated every one to three years by the government in light of market values. The transfer of land and building rights is subject to a 5% duty based on the official value or the transaction value, whichever is higher. The duty is payable by the purchaser.

TAX PAYMENT AND REPORTING: Corporate income tax returns must be submitted to the DGT on an annual basis. Monthly instalments of corporate income tax must be made based on the firm's prior tax liability. Any tax payable after taking into account the monthly instalments and tax withheld by third parties must be settled before filing the annual corporate income tax return and the annual filing must occur within four months of the book year-end. The time may be extended up to two months by notifying the DGT in writing. Final settlement of the tax payable must be made before the end of the fourth month. Payments of tax beyond the deadline will trigger an interest penalty, which is 2% per month. VAT, LST and WHT must be accounted for on a monthly basis. A VAT return for a particular month must be filed by the end of the following month, whereas a WHT return for a particular month must be filed by 20th of the following month. VAT and LST payment deadlines are before the reporting date while for WHT, the tax settlement must be made by the 10th of the following month.

ACCOUNTING FOR TAX: PT companies generally must maintain their books in rupiah and in Indonesian. The records must be kept in Indonesia. The tax year must coincide with the book year, which may be the calendar year or any 12-month period ending on a specified date, but consistency must be maintained.

Based on specific DGT approval, foreign-owned Indonesian companies and PEs can maintain their books in US dollars and in English. An approval application must be filed with the DGT no less than three months before the commencement of the US dollar accounting year. The DGT must issue a decision on the application within a month. If no decision is made within a month, the application is considered approved.



The highest marginal tax rate is 30%, and it applies to personal income above \$60,000 per year

TAX AUDITS AND TAX ASSESSMENTS: The DGT may perform a tax audit on a particular PT company for various reasons. A request for a tax refund will trigger a tax audit. Declaring continual tax losses in tax returns, failure to file a return after a DGT reminder, and business restructuring including acquisitions, mergers and liquidations, may also trigger a tax audit. The DGT may also select a taxpayer to be audited based on risk-based selection criteria. Based on tax audit findings the DGT will issue a tax assessment letter. Under the General Tax Provisions and Procedures Law, a tax assessment letter for a particular period or year may only be issued within five years of the end of the tax period or year in question (reduced from 10 years previously). Under the transitional provisions any assessment letters for tax years up to 2007 must be issued no later than 2013.

Tax audits in Indonesia can prove to be a difficult and protracted process and all taxpayers are well advised to be prepared in advance. This includes making sure that relevant documentation is ready for delivery to the tax auditors within a month of the request date. Under the one-month rule, any documents delivered to the tax auditors beyond a month of the request date can be ignored by the auditors.

TAX DISPUTE RESOLUTION: A taxpayer who does not agree with a tax assessment letter can file an objection with the DGT within three months of the issue of the assessment letter. The DGT has to issue an objection decision within 12 months of the objection being filed. If no decision is issued within this time frame, the objection is deemed to be accepted.

Under the General Tax Provisions and Procedures Law, taxpayers can elect to pay the amount of tax they consider properly due and contest the balance in the objection. However, if the objection decision is unsuccessful, a 50% penalty applies on the unpaid tax. This increases to 100% if the objection decision is appealed in the Tax Court and the court's decision is unfavourable.

A taxpayer who does not accept an objection decision can file an appeal with the Tax Court within three



Only certain types of businesses can formally establish a branch operation, including banks

months of the receipt of the objection decision. To the extent that the objection decision calls for a payment of tax due, according to the Tax Court Law, at least 50% of the tax due must be settled before filing the appeal. As set out in the General Tax Provisions and Procedures Law, the taxpayer is only required to pay an amount agreed in the tax audit closing conference. This creates a mismatch and taxpayers are generally advised to pay the 50% amount to ensure the Tax Court accepts the case. However, recently the Tax Courts have interpreted that the tax due refers to the amount agreed by the taxpayer as stated in the objection or appeal, which was already paid in full, and hence no additional tax in dispute needs to be paid.

The Tax Court should decide on an appeal within 12 months. In certain circumstances Tax Court decisions can be appealed in the Supreme Court. Supreme Court decisions are closed hearings with no representations made apart from the submission of a written appeal.

TRANSFER PRICING: By law, transactions between related parties must be conducted at arm's length; otherwise the DGT has the right to re-determine the transactions accordingly.

Under the General Tax Provisions and Procedures Law, the government requires taxpayers to maintain specific transfer pricing documentation to prove adherence to the "arm's length" principle.

The number of tax audits with transfer pricing as the key focus area has significantly increased following the issue of new regulations relating to transfer pricing. The DGT issued detailed transfer-pricing guidelines in 2010 which, broadly stated, generally follow OECD principles. Transactions under particularly close scrutiny include payments of royalties and technical or management service fees, intercompany services, royalty and financing transactions, and exports to related parties.

Where a taxpayer has no documentation available to substantiate these transactions, there is a high risk that deductions for the payments will be denied in full. In this regard, the one-month rule time limit within

which a taxpayer must produce any documentation requested by the ITO during an audit is being strictly enforced.

Transfer pricing disputes may be resolved through the domestic objection and appeal process, or, where the dispute involves a transaction with a related party in a country that is one of Indonesia's tax treaty partners, the parties may request double tax relief under the Mutual Agreement Procedures (MAP) article of the relevant tax treaty.

The ITO may terminate the MAP process if certain conditions exist, such as the Indonesian resident taxpayer making the request for MAP submits an objection letter to the DGT or an appeal to the Tax Court.

The tax law authorises the DGT to enter into advance pricing agreements (APAs) with taxpayers and/or another tax country's tax authority on the future application of the arm's length principle to transactions between related parties. The process may or may not involve cooperation with foreign tax authorities. Once agreed, an APA will typically be valid for a maximum of three tax years after the tax year in which the APA is agreed. The APA can also be applied to tax years before it was agreed if certain conditions are met, such as the tax year has not been audited and there is no indication of tax crime. However, the rollback of an APA to prior years is not automatic and will be subject to agreement between the taxpayer and the DGT.

BONDED ZONES: Bonded zone status can be granted by the Minister of Finance to qualifying companies that are export-oriented, upon their making a specific request. Import duty and VAT concessions are provided to companies with bonded zone status. This entails that no VAT or import duty is payable provided the underlying goods are exported. More than 2000 companies currently enjoy this facility.

INCOME TAX CONCESSIONS: The Income Tax Law provides various facilities and incentives, such as a package of concessions available for companies that invest in certain qualifying business sectors and/or regions. The main concession is a 30% investment allowance based on the amount of the investment (which essentially applies to investment in fixed assets), claimable over six years at 5% per year.

The other concessions include accelerated depreciation of fixed assets (twice as fast as the normal rate), a longer tax loss carry-forward period (extended from five years up to 10 years depending on certain criteria), and a reduction of WHT on dividends paid to foreign shareholders (from 20% to 10%).

Small enterprises, i.e. corporate taxpayers with an annual turnover of not more than Rp50bn (\$6m), are entitled to a tax discount of 50% off the standard rate which is imposed proportionally on taxable income of the part of gross turnover up to Rp4.8bn (\$576,000).

CAPITAL MARKET-RELATED INCENTIVES: A gain from the sale of shares traded on the Indonesian Stock Exchange is not taxable in the normal fashion, nor is any loss claimable as a deduction.

The sale of listed shares is subject to final WHT of 0.1%, which is based on the transaction value. Founder

shareholders are required to pay 0.5% tax at the time of listing based on the listing price. If this tax is not paid, those shareholders are taxed on any subsequent gains based on normal principles.

Interest income on Indonesian bonds is subject to final withholding tax of 15%. A 5% corporate tax cut is granted to public companies that satisfy three conditions: a minimum public listing of 40%; a minimum number of 300 public shareholders, each holding no more than 5% of the company's shares; and the maintenance of the first two conditions for at least 183 days in the relevant year.

TAX HOLIDAY: On 15 August 2011, tax facilities in the form of an income tax exemption (tax holiday) or reduction were announced by the Indonesian government. The tax facilities are provided to firms in pioneer industries which have a wide range of connections, provide additional value and high externalities; introduce new technologies; and have strategic value for the national economy. Currently five business sectors may enjoy the tax exemption. These are the industries of base metal, oil refinery and/or base organic chemicals sourced from oil and gas, renewable energy, machinery and telecommunication.

Eligible taxpayers may enjoy the income tax exemption for a period of five to 10 years from the start of commercial production. After the end of the tax holiday period, the taxpayers are given a 50% income tax reduction for a further two tax years.

Only Indonesian legal entities with a minimum investment value of Rp1trn (\$120m) will be eligible for the facilities. Eligible taxpayers will also be required to deposit 10% of their planned investment value in a bank or banks located in Indonesia.

Once the facilities are granted, taxpayers should submit periodic reports on the realisation of their investment plans and the use of the funds deposited in the Indonesian bank or banks. Failure to realise the investment plan and to submit the above periodic report will cause in a termination of the tax facilities.

CONTINUOUS DEVELOPMENT: Indonesia continues its serious effort to promote foreign investment, capital accumulation and the export of goods other than oil and gas, to expedite economic development and to become internationally competitive. A broad range of deregulatory measures has been implemented and additional measures can be expected to further enhance the investment climate.

The government is also committed to continuing tax administration reform, which aims to increase taxpayer compliance by increasing the efficiency and effectiveness of the DGT, and to improve good governance in tax administration by strengthening transparency and accountability mechanisms.

The ITO has introduced profitability benchmarking based on taxpayer industries. The benchmarking is based on analysis conducted internally by the DGT and is intended to be used in assessing the risk profile of Indonesian corporate taxpayers as a tool in its audit selection process. Taxpayers with profitability that falls below the DGT benchmarks for their industry may be



The government is committed to continuing reform of the tax system to promote foreign investment

asked for further information, asked to amend a tax return, or possibly be subject to an audit.

The benchmarking contains a range of profitability ratios for the industries examined, including gross profit margin, operating profit margin and corporate tax to turnover for 2005, 2006 and 2007.

Up to now, the ITO has released benchmarking guidelines for 115 industries. Further benchmarking regulations are likely to be issued in the future to cover additional industries.

The transfer of assets in a business merger, consolidation or expansion must be accounted for at market value. However, the transfer of assets at book value may be allowed for certain qualifying mergers, consolidations or expansions. This will apply where it results in no gain or loss on the transfer. Certain criteria such as the "business purpose test" must be met and specific approval must be obtained from the DGT.

If the merging companies are VAT entrepreneurs (i.e. taxpayers subject to VAT) the transfer of VAT-able goods between the merging companies is VAT exempt. Merging companies can also apply for a 50% reduction of duty on the acquisition of land and building rights.

Facilities for foreign companies operating through their branches in Indonesia are also available. PEs may be exempted from the imposition of branch profit tax if they reinvest their after-tax profits in Indonesia in one of the following forms:

- 1) Capital participation in a newly established Indonesian company as a founder or participant founder;
- 2) Capital participation in an established Indonesian company as a shareholder; or
- 3) Acquisition of a fixed asset or investment of intangible asset used by the PE to conduct its business or activities in Indonesia.

The above forms of reinvestment must be executed no later than at the end of the tax year following the year when the income subject to BPT is earned by the PE. PEs must also fulfil certain administrative requirements with regard to their reinvestment.



Much of the work will take the form of public-private partnerships

Collaborating for success

Regulatory reforms accelerate private sector participation in infrastructure development

Indonesia, with an average GDP growth of around 5-6% per annum during the past three years, has emerged as one of world's potential economic powerhouses. As a member of the G20, Indonesia is already in the process of transforming into one of the developed nations. This fourth-most-populous country in the world has most of the requirements to reach a higher economical level. Natural resources, population, political stability and solid macroeconomy provide the foundations for Indonesia in achieving its full economic potential.

As part of the government's initiative in accelerating and expanding the economy, a Master Plan for the Acceleration and Expansion of Economic Development of Indonesia (MP3EI) has just been initiated. The MP3EI aims to provide the building blocks to transform Indonesia into one of the world's major economic powers by 2025. To achieve this, real economic growth must reach 7-9% per year, on an ongoing basis.

Implementation of MP3EI will include eight main programmes, which consist of 22 main economic activities. The implementation strategy of MP3EI will integrate three main elements:

- 1) Developing the regional economic potential in six Indonesia Economic Corridors: Sumatra Economic Corridor, Java Economic Corridor, Kalimantan Economic Corridor, Sulawesi Economic Corridor, Bali-Nusa Tenggara Economic Corridor and Papua-Kepulauan Maluku Economic Corridor;
- 2) Strengthening national connectivity locally and internationally;
- 3) Strengthening human resource capacity and national science and technology to support the development of the main programmes in every economic corridor.

The government recognises that the provision of sufficient infrastructure, such as energy facilities, seaports, airports, railways and roads, is in line with its overarching goal of achieving faster economic growth and is fundamental to its ability to attract foreign investments, support the growth of businesses and communities

and reduce income inequality and poverty. According to the agency responsible for national development planning, Badan Perencanaan Pembangunan Nasional (The National Development Planning Agency – BAPPENAS), around \$150bn (or 3% of GDP) will be needed for infrastructure development during 2010-14 to meet the country's economic growth target of 6-7% per annum during that period. Of this amount, the government's budget can only cover around 30% (\$45bn) of total planned infrastructure investment, leaving around 70% (or \$105bn) of the needed investments expected to come from the private sector under the public-private partnership (PPP) scheme.

BAPPENAS has set up the Government and Private Sector Cooperation Centre to facilitate cooperation in infrastructure projects between the government and private investors. The Bappenas "PPPs Infrastructure Projects in Indonesia 2010-2014" report shows 100 projects valued at around \$47.3bn available under the PPP programme. These include one marine transportation project ready for offer valued at \$36m; 27 priority projects (18 toll roads, six water supply and three sanitation projects) valued at \$8.3bn; and 72 other potential projects valued at \$38.9bn.

Private investor participation in the Indonesian infrastructure sector started in the early 1990s. By the end of 1997 it had attracted over \$20bn in investment, dominated by electricity (\$10.2bn), telecommunications (\$8.4bn) and transport (\$2.1bn). In the wake of the Asian financial crisis in the late 1990s and a much more competitive global PPP environment elsewhere, the government was forced to reassess its PPP framework to attract additional investment to Indonesia and compete with other countries. Regulatory reforms have been initiated since then with the purpose of allowing more competitive and transparent private sector participation in infrastructure development.

Several challenges, however, may hinder the progress of PPP development in Indonesia. The main impediments can be categorised as follows:

- Political, legal and regulatory challenges, for example, the decline in institutional strength and/or adverse policy or rule changes;
- Financial challenges, for example, unfavourable changes to the fiscal regime, inability to bill customers and collect cash;
- Construction and operational challenges, for example, environmental risks, land acquisition risks, social risks, water supply risks, construction risks, performance risks; and
- Market risks, for example, new entry, demand risks, price or service competition.

Of all of these challenges, land acquisition remains the most significant because of cost uncertainties and timing risks. The government has put into place several initiatives to address these issues. The initiatives include regulatory reforms and financial initiatives.

REGULATORY REFORM: Indonesia has made significant efforts to improve the legal framework at all levels. The umbrella regulations for each sector have been amended and are now more amiable to private investors. PERPRES 13/2010 (presidential decree), superseding PERPRES 67/2005, provides a cross-sector regulatory framework for private sector participation in infrastructure projects. This framework provides a clear, transparent and accountable basis for PPP.

Procurement of the PPP concessionaire or business licensee must be done on a competitive basis, and the unsolicited approach is discouraged. It stipulates that proper due diligence must be conducted by the government contracting agencies before any PPP project is put out to tender.

FINANCIAL INCENTIVES: The government, through the Ministry of Finance, has established several financial instrument agencies to support the PPP programme in the infrastructure sector. These are:

- **Land Fund:** The land fund consists of a land capping fund and a land revolving fund. The land capping fund is currently available for toll road investors and provides private investors with downside risk protection should land acquisition costs significantly exceed initial estimates. The government will cover any changes in land acquisition costs above 110% from the agreed price in the concession agreement or 2% of investment cost, whichever is higher (regulation of the Minister of Public Works No. 12/PRT/M/2008).
- **Guarantee Fund:** The guarantee fund will be provided by the Indonesia Infrastructure Guarantee Fund (IIGF). IIGF was set up in 2010 with the aim of being a guarantee provider for PPP projects. It will have a detailed appraisal and claim system for guarantees and therefore facilitate the deal flow for contracting agencies. Possible risks that can be covered by IIGF include specific issues related to the pre-construction phase such as land acquisition, as well as issues in the construction and operation phases such as breach of contract, change in law and delay in financial close. The aim of IIGF is to improve the creditworthiness of PPP projects. The company is 100% owned by the government and will be run as a commercial entity. It will work as a single window for the

appraisal and structuring of guarantees for the government. This will allow for consistency in policy, process of claims at a single window and will hopefully streamline procurement for complex PPP projects. IIGF, however, will not guarantee risks for which coverage can be purchased in the private market.

- **Infrastructure Fund:** While there is a sizeable banking market in Indonesia, the local project finance market (especially local currency) is very limited. This has significant cost implications in the financing of infrastructure projects in Indonesia. The development of PPP will help spear this segment of the market if properly facilitated by financing institutions, such as PT Sarana Multi Infrastruktur (SMI).

SMI was set up in February 2009 by the Ministry of Finance in order to act as a catalyst and provide funding for infrastructure projects. Both the World Bank and ADB have provided initial funding for SMI. The government provided equity of Rp1trn (\$120m), while the World Bank and ADB provided loans of \$100m each through SMI for infrastructure financing. The company provides finance in terms of long-term loans, equity, contract financing and invoice financing.

RECENT DEVELOPMENTS: Under the new PPP regulatory framework (PERPRES 13/2010), the government has successfully tendered the Central Java IPP project (CJPP), which is the largest power project in Indonesia.

The CJPP serves as a model project, which enhances the transparency and competition of the tender process. One of the key elements that distinguishes it from the previous bidding process is on the matter of negotiation. In the CJPP, the negotiation process was conducted at the beginning of the tender process before the bid submission. In this way, the process involved all the tender participants and enhanced the transparency and competitiveness of the process. By doing this, the process of signing of the power purchase agreement (PPA) is expected to be accelerated. The provision of a government guarantee is also clearly disclosed under this regulation; which includes the guarantees from IIGF and Ministry of Finance.

Indonesia's long gestation period for the regulatory reform and financial support initiatives contributed to the slow development of infrastructure facilities. Issues facing the infrastructure sector include inadequate capacity building, especially at the regional level. The government and the private sector are working towards risk allocation to the party best able to handle it. Imbalance in risk allocation leads to failed projects, which negatively affect the acceptability of future projects.

Recent developments on those areas, however, have set Indonesia in the right direction in ensuring the delivery of infrastructure projects. Continuous and open communication between key government departments and the private sector would create an environment conducive to successful collaboration. Consistency in policy and transparent procurement processes would help attract both funding and expertise to Indonesia.

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Irhoan Tanudiredja, Senior Partner, PricewaterhouseCoopers

An important responsibility

Irhoan Tanudiredja, Senior Partner, PricewaterhouseCoopers, on business's role in delivering a high-growth/low-carbon economy

The need to sustain economic growth and further improve living standards in a resource-constrained environment is the key challenge facing the world in the next few decades. Resource-rich countries such as Indonesia will face specific challenges to reconcile required changes in land-use and energy intensity, while maintaining economic growth, meeting the demands of an ever-larger population and lifting thousands of people out of poverty.

The solution to this dilemma is increasingly sought in sustainable (or “green”) growth. This economic approach recognises the value of natural capital (alongside other standard drivers of GDP) as a key element of economic competitiveness, and promotes long-term economic growth that will be both environmentally sustainable and socially inclusive. Indonesia has an opportunity to be among the leaders in this approach, and President Susilo Bambang Yudhoyono's commitment to a “pro-growth, pro-job, pro-environment and pro-poor” agenda, along with a pledge to maintain economic growth of 7% per year while reducing emissions by 26% below business-as-usual estimates for 2020 (or 41% with appropriate international support), encapsulate the key messages of the new approach.

Delivering sustainable growth is not, however, a job for government alone. Business must play its part. The approach brings risks and opportunities – investment in clean technology and renewable energy sources such as geothermal or micro-hydro power could give the country an opportunity to follow China's impressive growth trajectory. Delay, however, will carry significant costs as a failure to invest in clean technology now will simply result in Indonesia needing to buy more from others later. Scale matters too. As time goes by, damage caused by climate changes, water scarcity and deforestation will increase, making it more costly to alter policies and practices in subsequent years.

Business has a critical role to play in determining the path Indonesia takes. It can provide both the technological and financial resources needed to make this

green economic vision a reality, but to do this it must become proactively involved in policy-making itself. While some Indonesian companies are not yet convinced about the business case for sustainable growth, others, including members of the Alliance of Low Carbon Business in Indonesia (ALBI), a group of firms focused on the benefits of low carbon development across many sectors, stand ready to make their needs known and play their role in ensuring a prosperous future both in the short and the long term.

The government must play its role in creating the enabling conditions required for an effective public-private collaboration. Indeed, while recent surveys by ALBI on sustainable growth have seen many members of the Indonesian business community supportive of the concept, there continue to be calls for policy improvements, such as greater clarity around government decision-making processes, including responsibilities within and across departments.

Businesspeople also want improved alignment between national and regional government bodies, including joined up policy-making and improved coordination and communication. The increased stability of regulatory frameworks would help eliminate conflicting legislation and enable consistent enforcement. Also beneficial would be pricing structures and incentives conducive to doing sustainable business. This could include minimising up-front investments for capital intensive projects, such as those directed towards geothermal power generation. Finally, the business community would like to see more capacity building to enable people to make knowledge-based decisions.

Given that many of these challenges are already being considered by the government, business must also prepare to take up its own challenge to deliver sustainable growth. After all, it is only as the contributions of and benefits to both parties start to become better understood and the promises made by them start to be delivered that Indonesia can truly begin thinking of itself as a world leader for the new global economy.