

CLIENT UPDATE

26 MAY 2016

MERGERS & ACQUISITIONS

New DNI Marks Step Forward, But Still More to be Done

1. Introduction

As promised back in February, the Government has revised the Negative Investment List (*Daftar Negatif Investasi* / “DNI”) so as to liberalize the country’s foreign direct investment (“FDI”) rules. While the changes that have been made certainly amount to a degree of liberalization, they by no means constitute a wholesale opening up of the Indonesian economy to FDI. One particular disappointment is the government’s failure to more significantly liberalize the pharmaceutical sector.

The new DNI is incorporated in Presidential Regulation No. 44 of 2016,ⁱ which entered into effect on 18 May 2016.

2. Highlights by Sector

- *Crumb rubber*
The FDI cap in this industry has been removed (it was previously set at 49 percent). However, foreign investors are required to secure licenses from the Ministry of Industry and establish their own plantations, enter into partnership arrangements with MSMEs and cooperatives, and establish “plasma-nucleus” schemes.ⁱⁱ Thus, we may say that crumb rubber processing is now 100 percent open to FDI, provided that the processing operation is integrated with a plantation operation.
- *Health Sector*
Despite the government’s promises in February to significantly liberalize the pharmaceutical and medical equipment industries, little in the way of concrete relaxation has actually transpired. However, there are a number of changes, as described below:
 - Class A medical equipment (the simplest kind) – 33 percent open to FDI, subject to the obtaining of a license from Ministry of Health
 - Classes B, C and D medical equipment (in increasing order of complexity) – 100 percent open to FDI, subject to the obtaining of a license from Ministry of Health
 - Cell banks and laboratories – 100 percent open to FDI, subject to the obtaining of a license from Ministry of Health
 - Hospitals and specialist clinics – FDI capped at 70 percent for ASEAN investors and 67 percent for non-ASEAN investors.

In a nation where doctors rarely make house calls and getting to a hospital is often accomplished by taxi, it is interesting to see a new category being added to the DNI, namely, the provision of ambulance services, where FDI is capped at 65 percent. Other new categories are pest control and testing of medical equipment, both of which are also capped at 65 percent for FDI.

- *Film Industry (film production and distribution, and cinema operation)*
Now 100 percent open to foreign investment. With a population of some 250 million and a kaleidoscope of cultures, Indonesia has enormous potential to develop a successful film industry, and greater foreign investment is one way in which this could be brought about. In addition, with one of the lowest cinema penetration rates in the world and a market that is currently carved up between three operators, there is significant potential for foreign cinema operators to set up business here.

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- *Communications and Information Technology*
On the upside, the FDI cap is increased from 49 percent to 67 percent for the following businesses:
 - a. telecommunications services with content provision (ring tones, premium SMS services, etc.)
 - b. call centre and other added value telephony services
 - c. internet service provider
 - d. data communications services
 - e. public internet telephony services
 - f. internet interconnection services (network access points), other multimedia services

In addition, the FDI cap has been tweaked upwards from 65 percent to 67 percent in the case of wired telecommunications services, wireless / satellite telecommunications services, and wired/wireless/satellite telecommunications services integrated with telecommunications services.

On the downside, commercial transaction services using electronic systems (market place with platform basis, daily deals, price grabber, online classified advertisements) with a proposed investment of less than IDR 100,000,000,000), a business that was previously not regulated, is now subject to a 49 percent FDI cap.

- *Financial Services*
The new DNI incorporates three new financial services categories: investment financing, working capital financing, and multipurpose financing, all of which are 85 percent open to FDI. Pension funds have also been deleted from the DNI, meaning that this sector is now 100 percent open to FDI.

On the downside, underwriting firms and non-bank money changers, business lines that were previously unregulated, have now been brought within the ambit of the DNI, with FDI in an underwriting firm being capped at 30 percent and totally prohibited in the case of a non-bank money changer.

- *Manpowerⁱⁱⁱ*
Vocational training – FDI cap increased from 49 percent to 67 percent.
- *Retail and Trade*
The 2016 DNI incorporates a new business line, namely, department stores with floor space of between 400 m² and 2,000 m², with FDI being capped at 67 percent. In addition, a special license must be obtained from the Ministry of Trade.

The FDI caps in the warehousing industry and for distributors that do not operate production facilities have been increased from 33 percent to 67 percent.

Meanwhile, futures brokerages have been removed from the list and this business is thus 100 percent open to FDI.

- *Public Works*
The operation of tolled expressways and the treatment and disposal of non-hazardous waste are not included in the new DNI, meaning that these businesses are now fully open to FDI, compared to being capped at 95 percent under the 2014 DNI.

The 2016 DNI also incorporates two new categories in this sector:

- Construction services using advanced technology and/or which are high risk and/or with a value of IDR 50 billion or more – FDI cap of 67 percent for non-ASEAN investors and 70 percent for ASEAN investors

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- Construction consultancy services using advanced technologies and/or which are high risk and/or with a value of IDR 50 billion or more – FDI cap of 67 percent for non-ASEAN investors countries and 70 percent for ASEAN investors.
- *Energy & Mineral Resources*
FDI in the following fields, which were previously not regulated, is now capped at 49 percent:
 - geothermal power plants with a capacity of less than 10 MW
 - construction and installation of high / super high voltage electrical installations
 - operation and maintenance of high / super high voltage electrical installations
 On a more negative note, the operation and maintenance of low / medium voltage electrical installations is reserved solely for domestic investors.
- *Fisheries*
This particular sector has been very much in the news over the last few years. In line with the government's focus on the industry, the "capture fisheries using fishing vessels in Indonesian waters and the open seas" category, which was previously reserved for MSMEs and Cooperatives, is now 100 percent open to domestic investment (subject to the fulfilment of a number of requirements, such as obtaining a license from the relevant line ministry). While this may be seen as a belated realization that MSMEs simply do not have the capital or knowhow required to develop a modern fishing industry, it remains to be seen whether many domestic investors with access to the sort of capital required to modernize the sector will actually be interested in investing given the traditional uncertainties associated with fishing.

3. Portfolio Investment

As with the 2014 DNI, the new DNI states that portfolio investments (i.e. investments in listed companies through share purchases on the Indonesia Stock Exchange) are not covered by the FDI restrictions in the DNI (Article 8(1)). In reality, this is already clearly stated in the governing legislation, i.e., the Investment Law (No. 25 of 2007). However, practice on the ground has often been different. Given the prevailing economic conditions, it is now incumbent on the Investment Coordinating Board to issue a regulation to remove any remaining doubts on the issue.

4. What exactly is the DNI?

The DNI sets out a long list of business sectors that are either completely closed, completely open or conditionally open to foreign investment. This list of business sectors is based on the comprehensive classification of sectors set out in the 2015 Indonesian Business Sector Classifications ("KBLI"), drawn up by the Central Statistics Bureau. However, the classifications are very general in nature, with no definitions being given.

5. Caveats

As always, a number of caveats should be entered when discussing the DNI. Despite the relaxations contained in the new DNI, there continue to be various other restrictions on FDI in practice. For example, the Investment Coordinating Board ("BKPM") requires a minimum investment of USD 300 thousand, rising to USD 1 million within one year (depending on what is stated in the BKPM's preliminary approval), for the setting up of a foreign direct investment company, which is a prerequisite for an overseas investor wishing to establish a venture in Indonesia (although portfolio investments by foreign investors in Indonesian listed companies are not subject to restriction).

Further, the BKPM has a great deal of discretion in interpreting which precise business activities come within the ambit of each business line listed in the DNI. Even if a particular business is not specifically mentioned in the DNI (which one would therefore expect to be 100 percent open to foreign investment), the BKPM may still decide that that business in question comes within the scope of another sector. Such discretion is possible due to the lack of definition of business sectors in the KBLI, as mentioned in section

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3 above. Thus, potential investors need to test the waters first by consulting with the BKPM before taking the plunge.

In addition, various sectors are reserved for Indonesian SMEs, or minimum investment thresholds are imposed below which FDI is not permitted. As a developing nation, Indonesia obviously has a strong interest in nurturing its SME sector, something that the Government has stressed it will continue to do.

6. AHP Comment

While certainly to be welcomed, the extent of the liberalization brought about by the new DNI will come as something of a disappointment to many, especially given the excitement generated by the government's announcement back in February that it planned a root-and-branch overhaul of the DNI. The fact remains that FDI is either completely prohibited or severely restricted across large swathes of the economy.

From the technical perspective, the 2016 DNI affords practitioners and investors greater clarity as it incorporates a definitions section. It also contains a new chapter (Chapter IV), whose provisions mandate the Coordinating Minister of the Economy to conduct monitoring and evaluation of the investment process and to attempt to resolve any difficulties encountered.

The new DNI further stresses the importance of protecting MSMEs and cooperatives, as the government promised back in February. This is also to be welcomed, given the importance of small businesses to Indonesia's economic development.

In conclusion, while the changes brought about by the new DNI are generally positive, it seems doubtful that their impact will be anywhere near sufficient to ramp up FDI to the extent required to jump start the country's sluggish economy.

- i. Presidential Regulation No. 44 of 2016 on Business Sectors that are Closed or Conditionally Open to Investment
- ii. A "plasma-nucleus" scheme is one where a plantation company sets aside a specified portion of its concession for smallholders, who receive financial assistance and mentoring from the company. In return, the smallholders act as suppliers to the company based on agreed prices and quantities.
- iii. A number of business lines have been transferred to the Manpower Sector in the 2016 DNI from the Education Sector in the 2014 DNI.

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ASEAN Economic Community Portal

With the launch of the ASEAN Economic Community (“AEC”) in December 2015, businesses looking to tap the opportunities presented by the integrated markets of the AEC can now get help a click away. Rajah & Tann Asia, United Overseas Bank and RSM Chio Lim Stone Forest, have teamed up to launch “Business in ASEAN”, a portal that provides companies with a single platform that helps businesses navigate the complexities of setting up operations in ASEAN.

By tapping into the professional knowledge and resources of the three organisations through this portal, small- and medium-sized enterprises across the 10-member economic grouping can equip themselves with the tools and know-how to navigate ASEAN’s business landscape. Of particular interest to businesses is the “Ask a Question” feature of the portal which enables companies to pose questions to the three organisations which have an extensive network in the region. The portal can be accessed at <http://www.businessinasean.com/>.

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