

FOREIGN INVESTMENT OPPORTUNITIES

KEY POINTS

- Indonesia's foreign direct investment, FDI, has not yet recovered from post crisis falls. However, its foreign investment regime is more open than before the crisis, generating potential opportunities in an environment of ongoing reform.
- Already, investors can operate 100 per cent foreign owned enterprises in most sectors and no longer need to sell down equity at a later date. Only a few sectors restrict foreign investment; in most of these joint ventures are possible.
- The outlook for foreign investment in Indonesia also is assisted by the sale of state held assets and enterprises, more competitive export-oriented and import substitution sectors due to the weaker rupiah and a more open economy.
- Opportunities are diverse. Foreign investors can purchase assets from IBRA's sizeable bank equity holdings, operate retail outlets, distribute goods produced locally and apply to import and distribute other products. They also can enter joint ventures to supply educational, medical and infrastructure services including telecommunications.
- The sale of corporate assets under IBRA's control also should generate significant foreign investment opportunities. The Government also is selling many state enterprises.
- Major issues for investors include the difficulty of valuing distressed assets given weak accountancy standards, workforce management and sometimes political resistance to sales, and legal and sovereign risks.
- Buyers can manage risks by commissioning independent audits to corroborate IBRA's risk appraisal, completing comprehensive due diligence assessments before acquiring assets, insuring against risk and monitoring closely the local social and institutional environment.

The strong export and small and medium enterprise, SME, sector, government asset sales and relaxed foreign investment laws are driving a recovery in foreign direct investment, FDI, inflows from post crisis falls. Potentially rewarding investments exist for those prepared to undertake due diligence assessments, manage risks and remain sensitive to local stakeholder concerns.

This chapter details foreign direct investment, FDI, prospects in the short to medium term flowing from significantly relaxed sectoral access restrictions for foreign investors, sales of IBRA's asset holdings and other state owned assets, and the strong competitiveness of export-oriented and import substitution sectors due to the rupiah's depreciation. It also examines key changes to foreign investment laws, then appraises the current benefits and risks of investing in Indonesia.

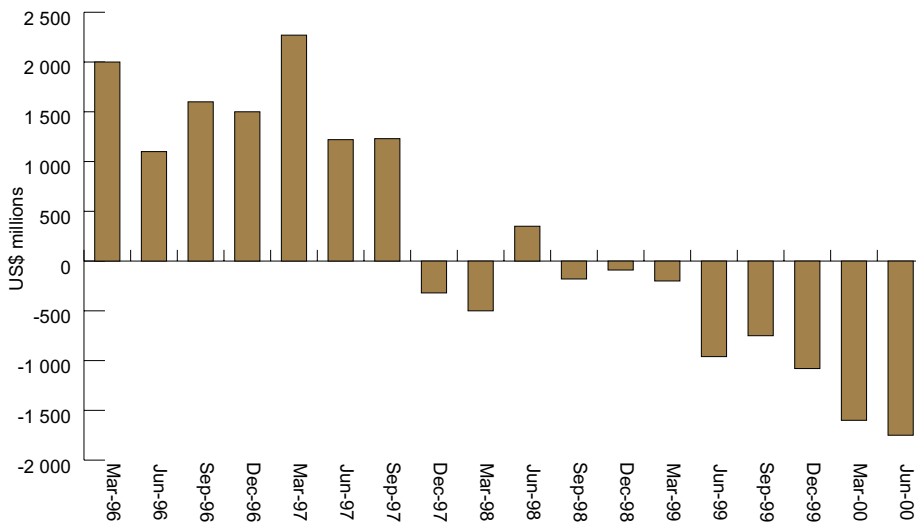
FUTURE TRENDS IN FDI

The crisis severely reduced Indonesia's FDI inflows, but they began to recover in 1999 and analysts expect inflows should continue to grow by 20 per cent per year between 2000 and 2003 (Figure 3.1). Foreign investor confidence appears to be increasing, with FDI approvals during the September quarter of 1999 exceeding all 1998 approvals. Ongoing sales of corporate and financial assets should offer significant opportunities in the short term, and liberalised access for wholly foreign owned enterprises to most sectors should underpin FDI growth in the medium to long term. However, doubts over economic and social stability, and an underdeveloped legal system deter more rapid growth in new foreign investment.¹

Figure 3.1

FDI Rising from Low Levels

Foreign Direct Investment Inflows to Indonesia, US\$ million



Source: CEIC, 2000.

¹ Fears of instability has deterred several high profile investors; for example, in 2000 Taiwan's China Steel cited political uncertainty in explaining its decision to delay a planned US\$1.4 billion joint investment with Pt Krakatau Steel.

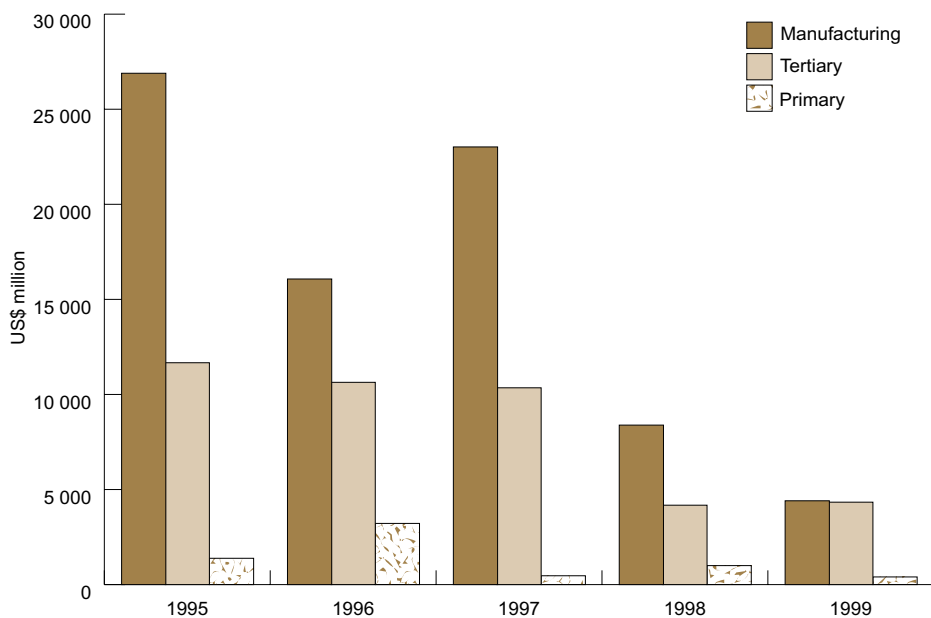
Sectoral Distribution of FDI

Pre-crisis, FDI inflows were mainly to manufacturing, but the crisis affected these more adversely than inflows to services (Figure 3.2). Although approvals somewhat overstate eventual flows, they indicate sectors hit hardest by changing sentiment. Further, the time lag between the approvals stage and actual implementation can be up to three years.

Figure 3.2

All Sectors down, but Particularly Manufacturing

Sectoral Distribution of FDI Approvals in Indonesia, 1995-99^a



Note: ^a Data are for approvals only, and significantly exceed eventual investment flows.

Source: Wee, 1999.

In 1999, industrial FDI approvals were concentrated in the chemicals, electricity, gas, water and paper sectors (Table 3.1). While traditionally these have attracted strong interest, several state enterprise and restructured assets sales featured in 1999 inflows.

Table 3.1

Heavy Industry Dominates Industry FDI
Industrial Foreign Investment Approvals by Sectors, 1999^a

Sector	Projects	Total (US\$ millions)
Chemicals	75	3 266
Electricity/gas/water	2	2 310
Paper	15	1 412
Food industry	48	681
Metal goods	85	593
Basic metals	9	501
Plantations	17	284
Trade	348	279
Textiles	121	240
Food crops	10	224
Other	357	1 101
Total	1 164	10 891

Note: ^a Data are for approvals only and do not include oil and gas, and financial and insurance sectors.

Source: Deacons, 2000.

FOREIGN INVESTMENT REGIME REFORMS

To attract foreign capital to post crisis asset sales and boost foreign exchange reserves, the Government significantly liberalised foreign investment laws, extending the liberalisation started in the mid 1990s. A new draft foreign investment law released in October 2000 would allow wholly foreign owned enterprises to invest in most sectors of the economy. Although opposition to its passage may be mounting, the new draft law only requires investors to register, rather than seek approval for new investment. This law also proposes the removal of all regulations that discriminate against foreign firms, introducing full national treatment of foreign investors (Investment Review Board, BKPM, 2000).

Liberalising Investment Access to Sectors

Even without the new draft law, foreign companies can own all the issued capital of a newly established Indonesian company and need not divest a majority of shares at some future date. FDI is restricted in a few sectors because of national interest; in those sectors, investors need only sell a nominal percentage of equity after 15 years. These reforms augment successive changes since 1994 to Indonesia's 1967 foreign investment law.

Reforms in 1998 allowed foreign companies to operate retail outlets in Indonesia, with some restrictions, and fully opened the distribution sector to foreign investment. Foreign manufacturers now can distribute goods produced locally and apply for permits to import and distribute other products.² Foreigners can establish holding companies to facilitate debt restructuring in local businesses.

In August 2000, the foreign investment law's negative list was amended to allow foreign investors to enter joint ventures with local partners for medical services and telecommunications.³ Maximum permissible foreign ownership is unspecified as yet, but expected to be 95 per cent. If passed, the Government's new draft law would reduce further the number of sectors prohibiting foreign investment.

Since 1994, Indonesia has allowed foreign investment in infrastructure sectors including sea ports, electricity generation and distribution for public use, shipping, airlines, drinking water supply, public railways and nuclear power generation. These projects require a joint venture with the Indonesian partner holding at least 5 per cent of shares in the investment.

Indonesian law does not recognise freehold land rights. Instead, the Government holds all land under a system of land titling. Hence neither foreigners nor nationals can own land, but they take out long term leases which grant the right to use or improve the land. Investors take over an existing lease when investing in commercial property.

Streamlining the Application Process

In early 2000, the Government streamlined licensing procedures for foreign investment; this reform promises to reduce the number and duration of application procedures. Approved applications remain valid for up to three years without being implemented, instead of only one year under the previous law.

Despite recent reforms to foreign investment regulation and laws, implementation is lagging. The Investment Review Board, BKPM, still applies conditions before approving foreign investment applications. BKPM often requires foreign buyers to reserve a percentage of shares for local or original owners. If the local firm is distressed, BKPM may ask foreign buyers to inject capital in addition to assuming outstanding loans. In certain sectors, foreign investors also must cooperate with small and medium sized firms through partnerships.

OPPORTUNITIES IN THE EXPORT SECTOR

Indonesia's competitively valued exchange rate and large supply of relatively low cost labour is generating good investment prospects in export-oriented industries. Large industrial estates across Indonesia, but particularly concentrated on Java, are enjoying rapid export growth and already play host to a wide range of foreign operators. These investors report they are unaffected by banking sector problems because they can access offshore funds, and their output and profits have risen significantly since 1998. Locating close to population centres ensures a good supply of workers. The approval process for investing in these estates also is very efficient (World Bank, 2000).

² Companies involved in distribution cannot retail directly, but can form separate foreign investment retail companies to do this.

³ The negative list defines sectors closed or partially closed to foreign investment; prior to August 2000 it was last revised in July 1998.

SALE OF IBRA'S ASSETS

Before 2004, the Indonesian Bank Restructuring Agency, IBRA, responsible for most government asset sales, plans to sell up to 80 per cent of the Rp. 564 trillion (US\$65 billion) of assets it holds; this equals around 57 per cent of Indonesia's GDP (World Bank, 2000).⁴ (See Chapter 7 - *Financial Sector Restructuring* and Chapter 8 - *Corporate Restructuring*.) As domestic savings are insufficient to purchase these assets, foreign investment will be crucial for the success of this program.

IBRA's assets fall into three categories:

- government equity in recapitalised and taken over banks, Rp. 139 trillion (US\$16 billion)
- non-performing and performing loans, and associated collateral transferred from recapitalised, state owned, frozen and taken over banks, Rp. 298 trillion (US\$34 billion)
- corporate assets transferred by banks to IBRA in return for Bank Indonesia liquidity credits, Rp. 127 trillion (US\$14.6 billion).

SALE OF BANK EQUITY

Despite delays in 2000 with some planned bank sales, the ongoing sale of IBRA's sizeable bank equity holdings may present good opportunities for foreign banks and other investors wishing to expand into Indonesia. New regulations allow foreign investors to acquire up to 99 per cent of bank equity. IBRA has removed the non-performing loans of transferred banks and is close to fully recapitalising them; it hopes to sell them via public offerings of shares and private placements with strategic investors. Australian banks are efficient, large by international standards and have high standards of prudential and risk management; they should be well placed to access these opportunities.

In October 2000, the Government announced the planned sales of Bank Central Asia and Bank Niaga would be delayed until 2001. IBRA previously had announced it would complete all

ASSET OPPORTUNITIES FOR AUSTRALIAN BANKS

While the Asian financial crisis severely weakened most Indonesian banks, Australian financial institutions and investors still can acquire sound Indonesian banks. In late 1999 and early 2000, ANZ increased its share in Bank Panin from 4.9 to 11 per cent, and holds an option to increase its share further to 28 per cent. ANZ also has a technical service agreement to support Panin in human resources, information technology, trade and risk management (*Asia Pulse*, 15 April 2000). In addition, in May 1999, ANZ acquired the credit card operation of Bank Papan Sejahtera from IBRA for US\$4 million.⁵

Source: ANZ, 2000.

⁴ The total value of the assets IBRA holds could increase further as bank shareholders unable to repay the liquidity assistance provided by Bank Indonesia and who exceeded the legal lending limits on loans to their affiliated companies transfer additional assets to IBRA's holding companies.

⁵ This business cost ANZ A\$7 million. ANZ also has negotiated with IBRA on behalf of clients interested in buying industrial assets.

nationalised bank sales by 2001, including selling majority equity in Bank Danamon. IBRA also intends to sell some of its interests in the seven recapitalised private banks now their performance has improved.⁶ (See Chapter 7 - *Financial Sector Restructuring*.)

SALE OF NON-PERFORMING LOANS

Opportunities also exist to buy non-performing and performing loans from IBRA's loan portfolio. In mid 2000, IBRA outsourced management of commercial loans worth between Rp. 5 billion and Rp. 50 billion (US\$0.58 million to US\$5.8 million) totalling Rp. 24.7 trillion (US\$2.8 billion) to domestic and foreign banks, including ANZ-Panin Bank (*Economist*, 8-14 July 2000).⁷ In December 2000, it will sell all retail loans under Rp. 5 billion in an open tender (International Monetary Fund, 2000) and eventually will sell all loans under Rp. 50 billion by October 2001 (World Bank, 2000).⁸

SALE OF CORPORATE ASSETS

IBRA's sale of corporate assets under its control also could generate significant foreign investment opportunities. IBRA owns these assets because former bank owners transferred corporate assets to IBRA to repay liquidity support from Bank Indonesia and debt workouts often involve debt equity swaps.⁹

Recent direct sales of IBRA corporate assets include auctions of hotels, office buildings and industrial estates throughout Jakarta, Bali, Bintan and Batam, worth around US\$12.6 billion.¹⁰ Smaller investors may want to acquire individual assets rather than large bundles of assets. So far, few Australian investors have participated in these assets sales, with most interest coming from Singaporean, European and US investors (Hong, 2000).

To expedite sales, IBRA's Asset Management Investment Unit has established five holding companies to manage more than 200 companies under its control with assets of Rp. 109 trillion (US\$12.6 billion) (Figure 3.1 and Appendix Table 3.1).¹¹ For example, the largest holding company, PT Holdiko Perkasa, owns and supervises all assets transferred from the Salim Group, including shares, exchangeable bonds, convertible bonds and inter-company debts from 107 subsidiary companies valued at Rp. 52.6 trillion (US\$6.1 billion).¹²

⁶ These are BII, Bank Lippo, Universal, Patriot, Artemedia, Prima Ekspres and Bukopin Banks.

⁷ These loans remain on IBRA's accounts but their management is outsourced. To outsource tranches of smaller loans, IBRA calls for expressions of interest from financial institutions and selects a servicing agent. It selects banks according to their technical capacity, reputation and expertise.

⁸ IBRA plans to restructure or liquidate the debts of the largest debtors itself, particularly the largest 21 debtors.

⁹ Other large workouts have resulted in original shareholders retaining ownership of their corporate assets, as was the case with three large restructuring deals the Government announced in early October 2000. These involved the debts of Texmaco Group, PT Chandra Asri and Tunggal Group.

¹⁰ Shops, warehouses and residences in Jakarta and Bekasi, West Java, valued at around Rp. 15 billion (US\$1.7 billion) were auctioned in May 2000.

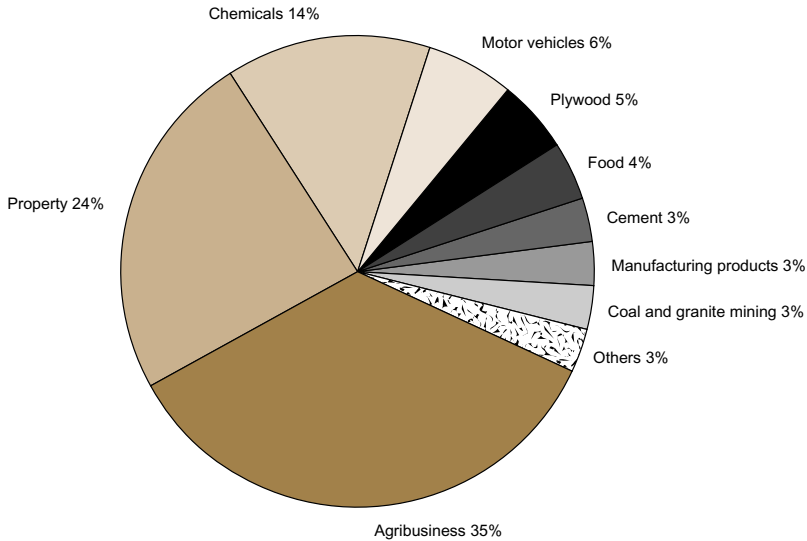
¹¹ These companies are in agribusiness, the largest share, followed by property portfolios, including hotels, industrial estates, office properties and shopping centres located throughout Jakarta, Bali, Bintan, Batam and the rest of Indonesia.

¹² Detailed information on PT Holdiko Perkasa and the assets it is managing is set out in a preliminary information memorandum dated December 1999. PT Cakrawala Gita Pratama holds mainly property sector assets in nine companies transferred by the Modern Group. PT Kiani Wirudha holds mainly financial and timber processing sector assets of 30 companies transferred by the Hasan Group. PT Bentala Kartika Abadi owns mainly finance and property assets transferred from the Danamon Group. PT Tunas Sepadam Investama owns the mainly agribusiness and chemical sector shares and assets transferred by the Gadjah Tunggal Group. (See details of these holding companies and their assets on the East Asia Analytical Unit web site, www.dfat.gov.au/eaau/indonesia.)

Figure 3.3

Agribusiness and Property Dominate IBRA Assets

IBRA's Corporate Assets for Eventual Sale, by Sector



Source: Deacons, 2000.

Independent accounting firms under IBRA's direction have valued all corporate assets IBRA controls and determined appropriate sale prices. However, IBRA has indicated it will not offer 'fire sale' prices and will wait until the market improves before offering many assets for sale; the August 2000 sale of a package of Bank Central Asia shares demonstrates this approach.¹³

IBRA's disposal of corporate assets started in 1999 and will continue until 2004 and include:

- initial public offers, selling shares to the public through the Jakarta or Surabaya Stock Exchanges
- share placements, selling shares to identified purchasers
- asset sales, selling specific assets to third parties
- settlement with joint venture partners, selling shares in companies under IBRA's control to joint venture partners, such as shares in PMA company to joint venture partner, Dow Chemical Company
- strategic sales, involving the sale of shares to identified strategic buyers, where purchasers need particular expertise in the relevant business (Indonesian Bank Restructuring Agency, 2000b).

Asset sales to strategic investors are more likely to maximise revenue than other approaches, so increasingly IBRA may favour this strategy. IBRA recommends investors interested in specific sectors

¹³ IBRA stated it would set a fair price for the public offering (*Jakarta Post*, 29 April 2000). The sale price of Rp.1 400 per share was at the lower end of the indicated range of Rp. 1 350 to Rp. 1 750 per share.

register their interest with it, so it can inform them of relevant upcoming asset sales.¹⁴ IBRA does not recommend prices for assets on sale, encouraging prospective investors to undertake detailed accounting and legal due diligence of assets.

ISSUES FOR INVESTORS

Although purchasing IBRA's assets can be risky, especially for investors unfamiliar with Indonesia, buyers can apply strategies to minimise risk. Major risks include the distressed nature of many assets, and lack of financial information, especially potential undisclosed liabilities. Independent auditing in collaboration with IBRA's own appraisal can help manage risks. While IBRA encourages investors to complete comprehensive due diligence assessments before acquiring assets, in some cases, incomplete record keeping makes this a time-consuming process, particularly if former owners are uncooperative. Other risks relate to the broad uncertainty surrounding the future of the Indonesian social and institutional environment, and the volatility of the rupiah.

Political Stability

The Wahid administration, the first democratic government for two generations, is attempting to build its economic credentials with an increasingly empowered electorate. However, the transition to a new political system and its associated political instability complicates the implementation of the economic reform program in the short term, posing risks to the investment environment. (See Chapter 2 - *Political Developments*).

Valuing Distressed Assets

Complex financial relationships, including inter-firm obligations, often feature in corporate assets originally part of an industrial conglomerate. Detailed financial information on assets generally is not publicly available.¹⁵ Once the asset is sold, investors can face third party claims. Normally, obtaining the information on claims on assets is difficult, given the level of enforcement of financial disclosure before the crisis; however, IBRA independently assessed assets under its control and fully discloses claims on assets to interested investors. IBRA also ensures investors receive full title when purchasing an asset; this reduces the risks of third party claimants.¹⁶

¹⁴ IBRA holding companies have sent to investors more than 200 requests for bids, with approximately 50 per cent expressing interest. Around 20 per cent have submitted preliminary bids, with around 80 per cent of these from investors in Singapore, Malaysia, Japan, Germany, UK and the United States (Indonesian Bank Restructuring Agency, 2000a).

¹⁵ The relevant holding company appoints a financial advisor for each asset disposal, who prepares a detailed information memorandum on the asset and distributes this to all interested parties. However, all parties must sign a confidentiality agreement before conducting due diligence of the asset. As of October 2000, IBRA had valued assets of PT Holdiko Perkasa, but its information memorandums are not yet publicly available.

¹⁶ In the case of equity, investors can conduct due diligence to confirm the legitimacy of the title. IBRA also provides indemnity in some cases, as reflected in the asset price. IBRA signed Asset Transfer Agreements with all debtors when assets were transferred, so it has sole ownership. However, this process ultimately relies on the willingness of courts to enforce these titles. In some instances, such as Bank Bali, the court failed to do so.

Potential investors should seek access to shareholder agreements drafted between IBRA and the original owners; these define the assets transferred to IBRA and strategies for meeting debts owed to banks IBRA took over or closed down.¹⁷ A new compliance team for each holding company monitors individual companies and identifies specific problems. IBRA also intends to adopt a corrective action program, including changing company management. Potential investors must ask company directors about undisclosed tax liabilities, as these need to be factored into the asset's purchase price.

Worker and Management Resistance

Remaining sensitive to the interests of stakeholders, including the workforce, is critical to a smooth transition of asset ownership. Existing management retains considerable influence in many companies. Unions, long suppressed under the New Order regime, now operate more freely and are becoming very active. Consequently, a successful investment would include existing management, labour representatives and possibly the local community in the acquisition process. It would advise them of the long term management strategy, stressing the likely benefits of the takeover, including financial rehabilitation of the company, employment maintenance and creation, management and marketing expertise, and technology transfer.

Legal Risks

Because courts have questioned IBRA's ownership of assets, investors must confirm the transfer of assets to IBRA was legitimate. To overcome past problems in this area, the Government is working to improve the legal system. Amendments to Indonesia's bankruptcy law and a new commercial court system aim to improve outcomes, especially the prosecution of debtors. The Government also has responded by establishing an official watchdog, the Ombudsman Committee, to oversee IBRA transactions.¹⁸

Importantly, foreign investors may be restricted to acquiring a minority of a company's shares, depending on the terms of the shareholder agreement reached between IBRA and bank shareholders. Potential investors should investigate this issue before registering their interest. Where such restrictions do not apply, smaller investors are advised to form consortiums with other interested investors to secure a controlling interest, as occurred in the sale of Astra.

Foreign investors buying shares must ensure shares are not the subject of third party claims, and the relevant company was incorporated properly and approved by the Ministry of Law and Legislation.¹⁹

¹⁷ In all cases, original shareholders committed not to reduce the value of the holding company assets. However, IBRA is not yet legally obliged to supply these agreements to prospective investors. Further, where shareholders provide IBRA with a fiduciary transfer (a form of Indonesian security over tangible and non-tangible assets), they cannot sell or transfer the assets to third parties without IBRA's consent. IBRA confirmed in the July 2000 Letter of Intent, it would exercise greater control over the pledged assets and take steps to preserve the value of companies in the holding companies.

¹⁸ The Ombudsman Committee monitors the conduct of IBRA's employees and is chaired by individuals of high standing. The Ombudsman Committee collects and processes public and internal complaints.

¹⁹ The difficulties faced by Canadian insurer Manulife in buying the shares of its bankrupt joint venture partner illustrate some of the obstacles to purchasing corporate assets.

Indonesia does not have a complete central Register of Companies, so the onus is on purchasers to confirm these conditions are met. Investors taking over a going concern also must ensure all operating licences are valid, particularly if investors plan to expand or diversify the business.

CASE STUDIES OF ASSET SALES

Astra

Building on lessons learned from the failed sale of Bank Bali, IBRA's sale of 39.5 per cent of Astra to a foreign consortium was highly transparent, sought to include key stakeholders, and generally was welcomed by the market. IBRA adopted a strategic bidding process involving several rounds and including the winning consortium, led by Singapore's vehicle distributor Cycle and Carriage Ltd, US Newbridge Capital and Gilbert Global Equity consortium.²⁰ By March 2000, PT Astra International was IBRA's biggest sale.

Bank Central Asia

In May 2000, IBRA divested 22 per cent of Bank Central Asia, one of Indonesia's largest private banks, previously owned by the Salim family.²¹ The sale was highly transparent, via an initial public offering that was fully subscribed. Foreign investors including from Hong Kong, Europe and Singapore, purchased 25 per cent of the 662.4 million shares offered, exceeding the 20 per cent sales target for foreign investors (*Asia Daily News*, 26 May 2000). IBRA rejected strategic offers by investors, publicly stating that to maximise transparency, it would only offer shares through the initial public offering. While the offer was successful, it achieved only 13 per cent of the book value of the shares (World Bank, 2000).

TIMETABLE FOR IBRA ASSET SALES

The Indonesian Government has directed IBRA to complete its assets sales by 2004. IBRA plans to sell assets worth Rp.18.9 trillion (US\$2.2 billion) in the nine month financial year to the end of December 2000; Rp. 16.3 trillion should come from corporate and banking asset sales. It had realised Rp. 12 billion by the end of September (World Bank, 2000). While IBRA delayed asset sales in 1999 and into 2000, including shares in Bank Central Asia and Bank Niaga, in the belief that flooding the market would lower prices, it plans to reach its target by substituting other assets for sale (Table 3.2).

IBRA now is trying to attract foreign investors using road shows.²² Sale timetables are on IBRA's web site, www.bppn.go.id. IBRA is targeting a range of assets sales over 2000-01 (Appendix Table 3.1).

²⁰ The consortium also included Batavia Investment Management Ltd; Lazard Asia Fund, a unit of the French group Lazard Freres; PT Bhakti Investama; and the Government of Singapore Investment Corporation, GSIC.

²¹ Bank Central Asia booked a net profit of Rp. 641.29 billion (US\$85 million) in 1999 compared to a loss of US\$5 billion in 1998.

²² Road shows to Singapore, Hong Kong, the United States and Europe took place in mid 2000. One to Australia is planned for early December 2000.

Table 3.2

Upcoming Asset Sales
IBRA'S Planned Sale Details and Methods

Company	Industry	Method of Sale	Advisor
Indomarket	Mini market chain	Initial public offering	Danareksa, Nikko Securities
Indomilk/Indolakto	Milk processing	Strategic sale	Chase Jardine
Indomiwon	Food seasoning	Strategic sale	KPMG
Indosiar	Television station	Loan refinancing, initial public offering	PWC, Trimegah Securities
Mosquito Coil Group	Mosquito repellent coils	Strategic sale	Chase Jardine
Salim Oleochemicals	Chemicals	Strategic sale	Chase Jardine
Salim Palm Plantation	CPO palm oil plantations	Strategic sale	Goldman Sachs
Salim Coal	Mining	Strategic sale	BNP Peregrine
Sulfindo	Chemicals	Strategic sale	Chase Jardine, Bhakti Investama
Pangansari Utama	Industrial catering	Strategic sale	Deloitte
Puri Imperium Apartment	Property	Auction	na
Bentala	Property	Auction	na
Diners Jaya Indonesia	Credit card	Strategic sale	na
Ficor Sekuritas	Securities	Strategic sale	AAJ Associates
Bank Hanvit Indonesia	Bank	Sale of minority interest	na

Source: Indonesian Bank Restructuring Agency, 2000b.

In 2000, the Singaporean Government and Singaporean investors showed strong interest in acquiring assets, including hotels and buildings. To encourage Singaporean interest, the Singaporean Government pledged US\$500 million in loan facilities for its investors to acquire IBRA assets and another US\$400 million in guarantees for its businesses investing in Indonesia.

SALE OF STATE ENTERPRISES

Another opportunity for investment arises from the Government's privatisation program. In 1999, to increase enterprise efficiency and fund expensive financial sector restructuring, the Indonesian Government committed to privatising around 140 state enterprises, SEs. SEs operate alongside private businesses in all major sectors, including natural resources, infrastructure, finance, agriculture and transport (Table 3.3). A government masterplan outlines the firms to be privatised, preferred method of privatisation and sales timetable.

Table 3.3

Bulk of SE Assets in Banking**Value of SE Assets and Turnover by Sector, 1998**

Sector	Number of SEs	Turnover 1998 (Rp. trillion)	Per cent of total turnover	Assets 1998 (Rp. trillion)	Per cent of total assets
Agri-industry and consumer goods	33	20.2	14.0	26.3	5.6
Energy	3	14.3	9.9	70.0	15.0
Tourism	10	13.9	9.6	13.0	2.8
Strategic industries	13	8.4	5.8	14.7	3.1
Telecommunications and media	4	8.8	6.1	28.8	6.2
Financial services	19	61.1	42.4	271.5	58.2
Logistics	32	8.1	5.6	20.3	4.3
Mining	4	3.9	2.7	5.8	1.2
Construction and building materials	18	3.4	2.4	13.0	2.8
Forestry, paper and wood products	8	1.9	1.3	3.2	0.7
Total	144	144.0	100.0	466.6	100.0

Source: Deacons, 2000a.

Although this timetable has been delayed, the Government recently recommitted to majority privatisation of all state owned assets.

Assets for Sale

The Government's stated strategy is to sell first the SEs foreign investors find most attractive. It intends to delay selling a majority of individual SE's shares in key sectors, and accelerate sale of other SEs allowing foreign majority ownership.

In addition to eight SEs shortlisted for privatisation (Table 3.4), the Government plans significant telecoms privatisation. It will sell a further 8 per cent of domestic telecom operator, PT Telkom, leaving it with a 58 per cent share.²³ The Government plans to maintain majority ownership in PT Telkom, but will allow foreign investors to buy a majority share in international telecom company, PT Indosat, currently listed on the Jakarta and Surabaya Stock Exchanges, and its subsidiary, PT Satelindo. These companies currently hold the exclusive right to provide international telecom services until 2004.

²³ Telkom has a monopoly over private domestic fixed line telecom services until 2010 and domestic long distance services until 2005.

Table 3.4

Major SE Asset Sales Planned
Shortlisted SEs for Early Sale

State enterprise	Industry
PT Pupuk Kaltim	Fertiliser maker
PT Bukit Asam	Coal mining
PT Aneka Tambang	Coal mining
PT Perkebunan Nusantara PN III	Plantation
PT Perkebunan Nusantara PN IV	Plantation
PT Indo Farma	Pharmaceuticals
PT Kimia Farma	Pharmaceuticals
PT Angkasa Pura II	Airport operator

Source: Deacons, 2000a.

In both cases, the Government plans to rationalise their telecom operations, including reviewing their non-core business before their privatisation (International Monetary Fund, 2000).

Sales Strategy

Eventually, the Government is expected to sell a majority of all state assets. As part of the revised masterplan, the Government set out the criteria for selecting suitable privatisation methods for each SE.

Initial public offering

SEs will seek to sell shares through initial public offerings on the stock exchange to attract new capital for debt refinancing or business expansion, and when business prospects are relatively strong. Before listing, firms must record positive profits for two consecutive years, and the Capital Markets Regulator, Bapepam, must determine the SE's accounts comply with capital market laws.

Strategic sales

The Government will pursue strategic sales if a SE is deemed profitable, has good prospects, and needs a particular technology, marketing network or professional staff. In the bidding process, it will favour firms offering these qualities.

Liquidation

When a SE's business prospects are poor and declining; it has a high and unsustainable level of gearing; and it is projected to be consistently loss making, the Government is likely to liquidate it. Firms that are difficult to restructure or lack qualified management also are more likely to be liquidated. The Government will consider the possible effects on public service provision before it decides whether to liquidate.

Employee buy outs

Employee buy outs will be used where the SE is profitable or has reasonable business prospects, owns a relatively low level of fixed assets, and has relatively highly skilled employees and/or management.

Financial Restructuring

The Government retains its in principle commitment to improve SEs' financial structures before sale. Steps include replacing directors, improving internal governance and reviewing existing contracts. The Government is auditing boards of commissioners and, especially for SEs likely to remain in government hands, developing statements of corporate intent. SEs also will be publicly audited and announce their financial statements through a company registry. The Government indicated it will consider the costs and benefits of restructuring to determine if this will increase the asset's attractiveness to investors. Also, the Government recently canvassed having a long term, share buy back option in profitable SEs (*Jakarta Post*, 5 September 2000).

Timetable

The US\$400 million raised from privatising five SEs²⁴ by the end of 1999-2000 was considerably less than the US\$1.5 billion originally targeted from selling 12 enterprises. This shortfall is due to government attempts to restructure SEs before sale, poor market conditions that threatened to reduce prices and resistance from SE management.

ISSUES FOR INVESTORS

Managing risks is critical to investing successfully in SEs. Potential investors must thoroughly audit accounts and explain their intentions to shareholders, workers and managers.

Corporate Governance

The Government advises potential investors to conduct due diligence before registering their interest in assets, as information on SEs' financial position is difficult to access. Prevailing accounting standards and potentially uncooperative management may make SE due diligence complex.

Potential investors must examine closely a SE's viability before outlaying large amounts of capital. Contracts between the enterprise and third parties may not be commercially viable; consequently, investors need to clarify their right to nullify these before purchase. New government laws ensuring access to relevant financial information, and government efforts to restructure and clarify the financial position of these enterprises should help.

²⁴ These included part sale of PT Telkom, PT Semen Gresik, PT Pelindo and PY Krakatau Steel.

Management Control

As most government assets are slated for selling in stages, full control of a SE may not be a medium term option. Before purchase, investors will need to clarify and formalise their rights to manage the financial affairs of the enterprise, if they hold a minority share. Investors also should ensure management agrees to their business plan before the purchase.

Support from Previous Management

Investors must consult with and include existing management in new initiatives. Privatisation must be transparent to avoid shareholder, staff or public accusations that foreigners are being favoured. Selling the benefits of the privatisation to the community and labour groups is an important part of this process.

CASE STUDIES

The following case studies highlight the importance of managing these issues when investing in a SE.

PT Pelindo II and III

Privatisation of Indonesia's leading ports at Jakarta and Surabaya was transparent and inclusive, and received widespread public and management support. P&O Ports Australia successfully bid for Surabaya port operator, PT Pelindo III, from a field of four foreigners, see box below (P&O Ports Australia, 2000a).²⁵ Hong Kong based Hutchison Whampoa acquired a 51 per cent interest in Pelindo II, outbidding the AP Moller Group, International Container Terminal Services of the Philippines, P&O Ports Australia, Peony Investment SA and a joint venture between US based Stevedoring Services and the locally controlled shipping line, Samudera Indonesia.

PT Krakatau Steel

Poor transparency prevented the sale of PT Krakatau Steel to foreigners. Dutch company, Ispat International NV, signed a memorandum of understanding with Krakatau Steel allowing it alone to conduct a due diligence of the company (Ispat, 1998).²⁶ This feature of the sale, along with concerns the share price was too low, and considerable labour and management resistance, caused the privatisation to be abandoned.

PT Semen Gresik

Labour resistance also thwarted the majority sale of Semen Gresik. Mexican company Cemex secured a 35 per cent share in the company following the first round of bidding, and expected to purchase a further 16 per cent in a second bidding round that included three other firms.²⁷ Workers at Gresik's Semen Padang unit in Sumatra protested against majority foreign ownership, forcing the Government to sell only a further 14 per cent to Cemex.

²⁵ These were American Samudra Indonesia, Fountain Head of France, International Container Terminal Services of the Philippines and P&O Ports Australia.

²⁶ Ispat decided not to proceed with the terms of its memorandum of understanding to conduct the due diligence.

²⁷ These included Germany's Heidelberger Zement, Switzerland's Holderbank and France's Lafarge Asia Pacific.

P&O INVESTING IN PORTS

P&O Ports acquired 49 per cent of the SE container terminal at Tanjung Perak, Surabaya in 1999, resulting in a joint venture company, PT Terminal Petikemas Surabaya. This follows P&O's joint venture investment in APT Kuala Pelabuhan Indonesia in Irian Jaya in 1995, to perform logistics functions at the Freeport Copper and Gold Mine.

An international bank administered the public bidding process that led to the Surabaya port investment. P&O carefully sought to understand the needs of stakeholders, including the partner company, management and employees, to ensure the sale was a success. As a result, management, labour and existing shareholders have cooperated since the investment was made. While some delays occurred in government approval of a necessary stevedoring tariff rise, this rise was approved. P&O advise investors interested in Indonesia to research the market carefully and seek advice from many sources to ensure they form a balanced view.

Source: P&O Ports Australia, 2000b.

DEVOLUTION AND FDI

Devolving government responsibilities to the regions introduces new complexities to the investment application process, and companies should remain sensitive to increasing decision making authority in the regions. The increasing prominence of regional agencies in the investment process introduces potential inconsistencies. New regional levies and charges could be introduced. (See Chapter 2 - *Political Developments*.) For most potential investments in Java, investors are reasonably protected from many of these risks; however, infrastructure and mining companies are likely to be affected.

OTHER EMERGING SECTORS FOR FDI

Rapidly growing demand for infrastructure, education and health services reflects Indonesia's development priorities and provides scope for foreign investment.

Infrastructure

FDI opportunities are emerging in privately provided infrastructure, given expanding demand and the Government's reduced capacity to fund new infrastructure over the medium term. Priority areas include transport, public sanitation, water treatment, telecommunications and possibly electricity (Table 3.5). However, ongoing disputes with foreign joint venture independent power producers over US dollar denominated power supply contracts signed by the Soeharto Government will reduce market confidence in Indonesia unless a mutually acceptable outcome can be negotiated.²⁸ The Government recently announced it would continue to implement 27 infrastructure projects suspended in 1997. It has identified a further 190 priority project proposals costing a total of Rp. 5.3 trillion (US\$6.2 billion) (BAPPENAS, 2000).

²⁸ A few of these power producers are selling power to the Indonesian electricity authority, PLN, but for well below the contracted price. Electricity demand is expected to exceed supply again reasonably soon, so incentives will increase to reach a solution to outstanding IPP contract disputes.

Table 3.5

Infrastructure Opportunities Significant
Major Infrastructure Projects Requiring Funding, 2000

Type	Description of project
7 toll roads	Building toll roads to connect Cikampek to Padalarang, Cileunyi to Nagreg, Cikampek to Padalarang, Cileunyi to Nagreg, Gompol to Pandaan, Pondok Aren to Serpong, Semarang to Batang, as well as a toll road in Semarang.
6 communications projects	Improving meteorological and geophysical equipment, improving the automated frequency management system, procuring and installing airport security equipment for 50 airports, procuring and installing VHF extended range communication system and ATC Radar facilities, phase II, and procuring SAR communication systems.
2 Pelindo II Projects	Constructing and operating coal and general goods terminals in North Sumatra, and constructing a terminal pier in Gresik Port, East Java for logs and general goods.
PT Semen Tonosa	Constructing a cement factory.

Source: *Asia Pulse*, 16 May 2000.

Education

1998 reforms allow foreign educational institutions to invest in universities and other non-school educational facilities. This liberalisation could provide significant opportunities for Australian education and training providers to cooperate with Indonesian institutions in expanding available courses. Decentralising education responsibility to the regions also should provide opportunities for educational service providers to help establish new institutions in undersupplied regions. Some Australian universities already are providing services in this sector. (See Chapter 5 - *Australian Opportunities*.)

Health

Foreigners have been able to invest in hospitals since 1990. Over the medium to long term, significant investment opportunities for Australian health service providers exist in private hospital development and management projects, provision of private health insurance schemes, export of medical and hospital equipment, provision of health worker training and promotion of Australia as a health care destination.

GOVERNMENT INCENTIVES

Due to fiscal pressures, the Government is reassessing many foreign investment incentives. However, it has shelved plans to abandon tax concessions in the Batam free trade zone, at least for the present; and new tax exemptions encourage investment in pioneer industries, including machinery and electronic products.²⁹ So these incentives do not favour entrenched interests, the Government only allows new companies to apply for tax exemptions. Tax exemptions can last up to eight years for companies located outside Java and Bali, and up to five years for companies located in Java and Bali. An additional year may be granted if companies:

- employ at least 2 000 Indonesians once commercial production is underway
- have at least 20 per cent ownership by cooperatives
- invest more than US\$200 million in assets other than land and buildings.

A project must be completed within five years of government approval. The tax exemption takes effect when the company completes project development and begins commercial production. Foreign investors and local investors must apply to the Minister of Trade and Industry for these exemptions.

IMPLICATIONS

Recent foreign investment regime liberalisation and major IBRA and SE asset sales expected from 2000 to 2004 should provide foreign investors with good opportunities to acquire some strategic shares in Indonesian industries. While social instability in some provinces and the need for ongoing economic and legal reforms may affect the assessment of investment opportunities, investors undertaking thorough due diligence and negotiating sensitively with stakeholders may make valuable acquisitions.

While IBRA and SE asset sales were delayed in 1999 and 2000, progress should be steadier in 2001 and beyond. Potential investors need to be prepared by completing their due diligence, so they can participate as asset sales proceed.

²⁹ Pursuant to Presidential Decree No. 7/1999.

Appendix Table 3.1

IBRA Assets Cover All Sectors
Sectoral Distribution of IBRA's Five Holding Companies

Holding companies	Sectors represented	Number of companies
PT Holdiko Perkasa	Chemicals	13
	Coal and granite	5
	Communications	1
	Food and consumer products	10
	Multi industry	6
	Oil and fats	3
	Palm plantations	24
	Plywood	4
	Property	25
	Publicly listed companies	6
	Sugar	4
	Textiles and garments	3
	Trading	3
PT Cakrawala Gita Pratama	Hotels and resorts	1
	Property	8
PT Kiani Wirudha	Catering and food distribution	1
	Glue and chemicals	2
	Timber/logging	8
	Financial services and others	9
	Plywood	4
	Pulp	4
	Shipping	2
PT Bentala Kartika Abadi	Financial services/related business	10
	Property	12
PT Tunas Sepadan Investama	Automotive/tyre	3
	Chemical/petrochemical	6
	Agribusiness/shrimp aquaculture	12

Source: PT Holdiko, 1999; PT Cakrawala Gita, 1999; PT Tunas Sepadan Investama, 1999; PT Kiani Wirudha, 2000; PT Bentala Kartika Abadi, 2000.

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