

2019 Indonesian Elections Q&A

OUTLOOK & PERSPECTIVES FOR JAPANESE INVESTORS

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Indonesia's national and regional elections on April 17, 2019 may prove to be a watershed moment for the country.

On this one day, more than 187 million eligible voters will be electing:

- president and vice president;
- members of the People's Consultative Assembly (MPR), which consists of the People's Representative Council (575 seats) and the Regional Representative Council (136 seats); and
- the provincial People's Representative Council (2,207 seats at 34 provinces) and district People's Representative Council (17,610 seats).

Hiroki Katayama: Indonesia attracts many foreign investors, what will the elections mean for foreign investors?

Budi Santoso: Uncertainty over how the election will ultimately play out translates into concern by foreign investors over whether the new government will be supportive of foreign direct investments (FDI) or if it will take a protectionism approach. Ideally, with the right policies & proposals put forth by the winning party, the election should help focus on providing foreign investors with the confidence and legal certainty to conduct business in Indonesia harmonizing national and local regulations, preventing political intervention into business operations (as well as any related disputes) and also averting fraud in the country.

The most likely outcome will be government policies that continue to support economic growth. The completion of major infrastructure investments, such as the Trans-Java toll road, new airports in tier-two cities and new ports, have boosted the confidence of foreign business operators in Indonesia's capabilities to drive economic growth. With that said, additional funds are needed to continue other infrastructure projects, including the other inter-region connecting toll road projects.

As election day draws nearer, the nation's economy has emerged as a hot button campaign issue. The election results may have significant implications for Japan Inc., whose investment in Indonesia is second only after Singapore. In particular, firms in the construction, engineering, oil and gas, and mining sector will be closely watching developments.

Hiroki Katayama, managing director and head of Japan for Kroll's Business Intelligence and Investigations practice, recently spoke about the elections with senior director **Budi Santoso**, a senior director in Kroll's Business Intelligence and Investigations practice, who has more than 13 years of experience conducting investigations in Indonesia, as well as advising and assisting a wide range of foreign clients considering investing in the country. Earlier in his career, Budi served in various roles at the Indonesian Corruption Eradication Commission (KPK).

HK: How will FDI in the country play a part in boosting the Indonesian economy?

BS: FDI is critical to Indonesia's economic growth. To date, the positive impact of foreign investment can be seen in several areas, such as labour absorption costs that in turn strengthen export competitiveness and overall productivity as a result of bigger output. The introduction of transitional technology likewise modernizes and improves operational elements, such as human resources and overall management. From a societal perspective, FDI also elevates the quality of life for Indonesians in terms of greater income, education and skills.

With economic growth stalling last year at only 5.18% (after the government set a target of 5.4%), FDI is likely to remain attractive to any new government. Faced with challenges that include high unemployment, significant state debt and volatility in the rupiah currency, government leaders will be looking to FDI to cushion and catch up on shortfalls, particularly after setting a growth target of 5.3% for 2019. FDI also dovetails with goals of pushing exports and controlling imports.

HK: What do you see as the main roadblocks for FDI and what more can be done to improve?

BS: Many foreign investors in Indonesia are often focused on the following issues and any changes in policies or regulations by the new government will be greatly welcomed:

- **Improved ease of doing business:** clear business-related laws and regulations, including effective and efficient licencing processes (e.g., no illegal levies), which when present, boosts investors' confidence and reflects an openness to foreign investment
- **Clean business environment:** fair playing field supported by modern attitudes toward compliance, rule of law and market transparency
- **Reduced government intervention in markets:** greater openness to international markets, tax decreases and privatization in some industries to attract more players and boost overall market competitiveness

One of the most common risks in Indonesian politics is the presence of vested interests during policy formulation. The lack of integrity among key stakeholders can result in not only bad overall governance but it can also result in regulations or policies which adversely impacts ease of business operations.

CASE STUDY: MINING

Understanding business partners and processes

Key challenges for investors in the mining sector are the licence application process and achieving clarity on land ownership. For one client, Kroll mapped the application process, verified claims from potential partners on what they owned, and confirmed land ownership. Another client, a foreign multinational, lost millions of dollars when it purchased coal that was only small part delivered. Kroll traced and mapped interconnections between parties involved and relevant assets.

HK: Corruption has been a hot topic in previous elections. Is that still the case for this year's election? What other business-related topics are candidates focusing on this year?

BS: In their first debate in January 2019, presidential candidates focused on corruption. Related topics that have come up on the campaign trail include suggestions to increase the salaries of civil servants, law enforcement officers and the judiciary in an effort to combat bribery and corruption; increasing cooperation among law

enforcement agencies, particularly the KPK and police; and allotting more funds to KPK for recruitment purposes and to strengthen its presence in more provinces.

For the second debate, the candidates weighed in on energy, food security, infrastructure, natural resources and the environment. To a certain degree, each candidate espoused an "Indonesia first" philosophy, although they diverged on how to translate economic growth into a better quality of life for Indonesians as individuals.

HK: The Corruption Perceptions Index (CPI), published by Transparency International, measures the perceived levels of public sector corruption worldwide. Indonesia ranked 89 out of 180, meaning the levels of corruption in Indonesia are perceived to be relatively high. Can foreign investors expect to see any improvements with respect to corruption with the new government?

BS: Both candidates have expressed similar intentions to uphold justice and eradicate corruption. As I mentioned earlier, some proposed initiatives to combat corruption include strengthening cooperation among law enforcement agencies and increasing public servant salary.

CASE STUDY: OIL AND GAS, PROPERTY, AGRICULTURE AND PLANTATION

Business Intelligence

In order to make wise decisions, foreign investment companies must understand many facets of prospective business partners in Indonesia. Kroll provides independent and nuanced business intelligence on partner attributes such as integrity and reputation; corruption and litigation history; financial condition; ultimate beneficial ownership; family background; and political connections. Kroll also helps clients answer questions that arise post-transaction.

HK: What has been the state of infrastructure in Indonesia, and what kind of opportunities await? What risks hinder investors?

BS: Indonesia has made great strides in recent years when it comes to infrastructure, especially regarding increased investments in diverse projects and reducing associated red tape. Some factors that make Indonesia an attractive target for foreign investment include low labour costs, low material costs and readily available raw materials.

Some beneficial deregulation has also occurred since 2014. For example, 134 deregulations have simplified the economic permits process. Before these deregulations, employers required 258 permits to build power plants; now only 58 permits are required in a more much simplified licensing process conducted in stages.

That all being said, regulatory risk is still a major concern for foreign investors. There remains a need to centralise the process of business licence applications and issuance, while also harmonizing central government regulations with those at the local level (e.g., district, city, province). Also, as I mentioned earlier, foreign owned businesses can often be disadvantaged by vested interests that affect the issuance of licences, contract, concessions and permits.

To protect their investments and interests in Indonesia, foreign investors should be prepared to conduct sufficient pre-transaction due diligence in order to help make informed decisions and mitigate corruption, compliance and third-party risks prevalent in Indonesia business today.

CASE STUDY: BANKING, INSURANCE, INVESTMENT

Pre-transaction due diligence & internal investigations

Kroll helps investors with pre-transaction due diligence; we also stand ready to support clients with internal investigations when issues or disputes arise. Examples include:

- Assisting foreign banks who are contemplating the purchase of or investing in Indonesia banks by tracing nonperforming loans, identifying major borrowers and checking for potential links to politicians or financial crime
- Checking disbursement of funds suspected to be invested in illicit channels
- Investigated allegations of organized insurance fraud when a client suspected collusion among claimants, lawyers and doctors



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About Kroll

Kroll is the leading global provider of risk solutions. For more than 45 years, Kroll has helped clients make confident risk management decisions about people, assets, operations and security through a wide range of investigations, cyber security, due diligence and compliance, physical and operational security and data and information management services. For more information, visit www.kroll.com.

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