Client Update

Foreign investment changes in Indonesia

23 May 2014

Some Indonesian business sectors are closed to foreign investment, while others are subject to foreign ownership limits. There have been some changes to these foreign investment restrictions under Indonesia's widely anticipated revised Negative Investment List, which became effective on 24 April. The revisions reflect the intention of the Indonesian Government to prepare for a more open economy whilst preserving certain sectors for domestic investment. Overall, there has been a liberalising trend, with a number of sectors becoming more open for foreign investment. However, there are now some business sectors that are subject to foreign investment limits for the first time, some that have become subject to increased foreign ownership limits and some that have become closed to foreign investment altogether. In this Client Update, we outline the sectors that are affected by the changes to the list.

Background

A revision to the Indonesian Negative Investment List of 2010 (the ***2010 Negative List***) has been widely anticipated since the end of 2013. The revised Negative List (the ***2014 Negative List***) became effective on 24 April 2014 under Presidential Regulation No. 39 of 2014. As Indonesian law requires that the list be revised every three years, the 2014 Negative List will apply until at least 2017, subject to any policy changes made in the interim.

The revisions reflect the intention of the Indonesian Government to prepare for a more open economy, as will be required on the commencement of the ASEAN Economic Community in December 2015 (which promotes the four principles of free flow of goods, services, investment and capital). At the same time, regulators need to balance the interests of domestic investors while boosting foreign investment.

Clarification of foreign investment limits for certain sectors

Under the 2010 Negative List, business sectors are either 'closed to' foreign investment or 'conditionally open' (meaning that they are subject to foreign ownership limits or require special arrangements and permits). Business sectors that are not mentioned are, in theory, considered completely open to investment from non-Indonesian investors but this is not always the case in practice.

In Article 3, the 2014 Negative List confirms that business sectors which are **not specifically mentioned** are **unconditionally open for foreign investment.** Therefore, where new business sectors have been introduced, although a new foreign ownership limit may now apply where previously there was no formal restriction, investors at least have some certainty as to what limit applies. However, given past practice, we consider that it would be prudent to re-confirm with Indonesia's Investment Coordination Board (***BKPM***) (as the government institution that administers the enforcement of the foreign ownership limitations provided in the 2014 Negative List other than those in banking, finance and mining sectors) that there is no unwritten policy in place that restricts foreign investment into business lines that are not listed in the 2014 Negative List.

How does it affect you?

- The new foreign ownership limits under the 2014 Negative List will only apply to ***new*** investment approvals to be issued from 24 April 2014 onwards.
- Existing foreign-invested businesses that are now subject to less favourable foreign ownership limits, or that are in sectors now closed to foreign investment, will have the benefit of **'grandfathering' protection**. This means that the foreign shareholders may maintain their current percentage of foreign ownership above the new limits under the 2014 Negative List. If at any time in the future the foreign shareholding percentage is reduced, it cannot be increased again to the foreign ownership level it had before the reduction.
- Those businesses for which the foreign ownership limits have been relaxed may increase their foreign capital percentage with an approval from BKPM, or (where applicable) the relevant sector regulator.

What are the key changes?

- Business sectors that benefit from more liberalised foreign investment limitations include: advertising, broadcasting, healthcare, pharmaceuticals, telecoms, transportation and venture capital. The most significant liberalisation is to the **advertising industry**, which was previously completely closed to foreign investment.
- Business sectors subject to greater foreign investment restrictions include: **energy and mineral resources** and **trade**.
- Key business sectors that remain largely unaffected by the revisions include **banking, finance** and **retail**. The mining sector is subject to the foreign investment rules issued by the sectoral regulator, which also include a specific regime that requires divestment of foreign interests over a specified time frame.

Sectors in which foreign ownership restrictions have tightened

Energy – Electrical power installation services – now closed to foreign investment (previously open for up to 95 per cent foreign capital).

Oil, gas and minerals

- **Land drilling services** – now closed to foreign investment (previously open for up to 95 per cent foreign investment).
- **Offshore drilling services** – now subject to a foreign ownership limit of 75 per cent (previously subject to a 95 per cent limit).
- **Certain oil and gas support services** – now closed to foreign investment (previously 95 per cent open).
- **Certain oil and gas construction services** – not previously mentioned in the 2010 Negative List but now either closed to foreign investment or subject to limits ranging from 49 per cent to 75 per cent.

Trading – Distribution, warehouse and cold storage, which were previously completely open to foreign investment, are now subject to a foreign ownership limit of 33 per cent except for cold storage businesses in Kalimantan, Sulawesi, Nusa Tenggara, Maluku and Papua, which are now subject to the increased foreign ownership limit of 67 per cent.

One point to note is that the 2014 Negative List has not assigned a specific Business Classification Code (***KBLI***) for the now restricted distribution business sector. It is therefore not clear whether the 33 per cent cap is intended to capture all distribution businesses regardless of whether any such lines of business are also covered under a specific KBLI. Initial verbal confirmations received from BKPM indicate that this is the intention. We expect that further coordination with consultation with ministries will be required before clarification on the precise scope of this new restriction can be obtained.

Industries in which foreign ownership restrictions have been relaxed or the position clarified

Advertising – now open for investment by ASEAN member countries, subject to a foreign ownership limit of 51 per cent, after previously being entirely closed to foreign investment.

Broadcasting – The 2014 Negative List now permits up to 20 per cent foreign ownership in existing radio or television broadcasting companies by way of new capital injection by foreign investors. This is not, strictly speaking, a new rule, since the 2002 Broadcasting Law already provides that a foreign investor may participate in the capital of an existing broadcasting company for its business expansion. We believe this change was made to harmonise the regulations.

Electricity generation

- **Large-scale power plants (capacity of >10MW):** The foreign investment limit for power plant projects carried out in a public-private partnership has been increased from 95 per cent to 100 per cent. Under the partnership terms, a foreign investor can wholly own the power plant during the concession period, after which some equity must transfer to the Government.
- **Small-scale power plants (capacity of 1-10 MW):** Previously, small-scale electricity generation could be carried out in partnership with local businesses, with no express restriction on foreign capital. It is now subject to a formal foreign ownership limit of 49 per cent.

Healthcare – The 2014 Negative List has changed the investment conditions for several business fields in the medical services sector. It now provides greater flexibility for ASEAN investors to invest in sub-specialised hospital services, specialised medical clinics, specialised dental clinics and specialist nursing treatment services. These business lines are subject to foreign ownership limits of

70 per cent in certain regions in Eastern Indonesia, and 67 per cent in the rest of the country.

Pharmaceuticals – The foreign ownership limit for pharmaceutical companies in the manufacture of drugs, raw pharmaceutical materials and finished drugs has been increased from 75 per cent to 85 per cent.

Provision of port facilities – The 2010 Negative List provided for a 49 per cent foreign ownership limit in the provision of port facilities business. However, the 2014 Negative List extends this limit to 95 per cent for port provision services in a public-private partnership scheme.

Retail – Previously, most retail business lines were, in practice, not open to foreign investment. This position has now been confirmed by the 2014 Negative List, which specifically provides that small-scale retail business lines are closed to foreign investment. While 'large scale' retail business may therefore still be open to foreign investment, there is still no clarity on what constitutes 'large-scale' retail business.

Telecommunications

- **Fixed telecommunication network provider services:** The foreign investment limit has increased from 49 per cent to 65 per cent. The revision brings this in line with the limit that applies to mobile network services providers. The activities included in this line of business includes the operation, maintenance or provision of network access for facilities used for voice, data, text, sound and video transmission using wired telecommunications infrastructure.
- **Provision of content services (for example, ring tone, premium SMS), call centres, data communication system services and internet services:** Previously, these businesses could only be conducted in partnership with local partners (with no clear definition of what form such partnerships should take). These are now expressly stated to be open for foreign investment, subject to a limit of 49 per cent. While this may mean that foreign investment in these services is actually more limited, the legal position is at least now clear that a limit of 49 per cent applies.

Transportation – The 2014 Negative List includes two new lines of businesses within the general transportation sector: land terminal construction and periodical motor vehicles testing services. These are now both subject to a 49 per cent foreign ownership limit. Previously, these two lines of businesses were not covered under the 2010 Negative List, so this revision has now clarified what limits apply to these two lines.

Venture capital – The foreign ownership limit for a venture capital company has been raised from 80 per cent to 85 per cent, encouraging venture capital as a form of foreign investment.

This note is intended to give an overview on the effect of the 2014 Negative List and may not cover all lines of businesses provided in the 2014 Negative List. Please do not hesitate to contact us if you need more detailed advice, or have specific questions on foreign investments into Indonesia.

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