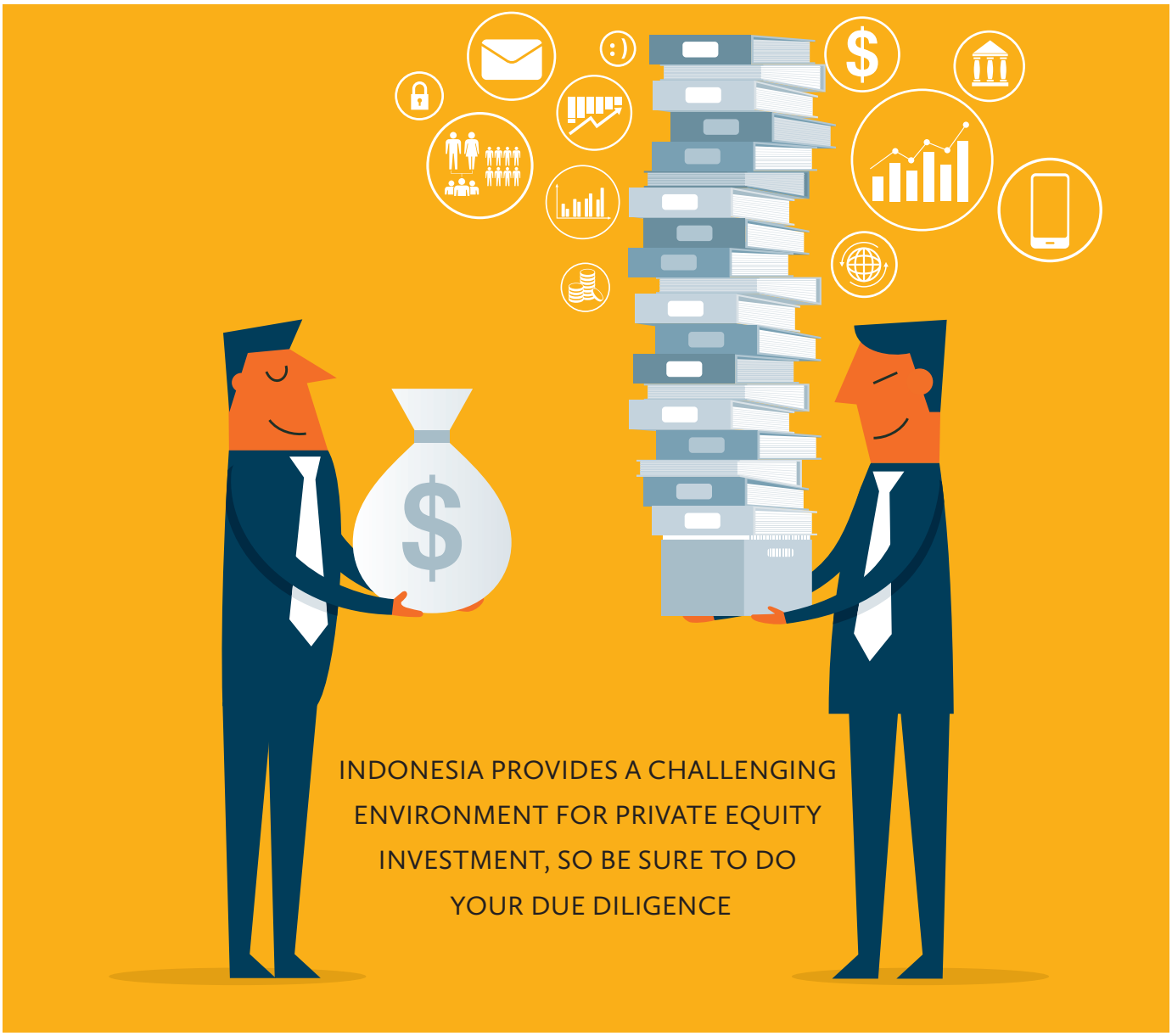
PE INVESTMENT IN INDONESIA



Indonesia is known for its large domestic consumption base and natural resources. These factors make investing in Indonesia interesting despite the complicated bureaucracy and uncertainty of laws and regulations.

Indonesia has become one of the most interesting places to invest in private equity (PE), usually invested directly through mezzanine loans or convertible notes, which can be converted into shares in certain cases.

This article elaborates on the legal framework governing PE transactions in Indonesia, the trends in these transactions, governance arrangements and other relevant issues.

LEGAL FRAMEWORK

The Investment Regulations – regulations issued by the Investment Co-ordinating Board (BKPM), the company law – Law No. 40 (2007) regarding Limited Liability Companies, and the Tax

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regulations – regulations issued by the Minister of Finance and the Directorate General of Taxation, as well as tax treaties, are typically the key regulations governing a PE transaction in Indonesia.

The Investment Regulations plays a major role if there are foreign investors or if the investors are local but require certain facilities from the BKPM. The Company Law regulates the corporate governance of the investee, while the Tax Regulations govern the most efficient, tax-wise investments in Indonesia.

TRENDING

In the past mining, banking, consumer goods, telecoms and transportation were the popular sectors for PE investment, but this trend seems to have changed slightly. Hot industries at the moment are the digital sector, which includes fintech, as well as healthcare, retail, media and financial services. Recently, peer-to-peer lending industries have been popular. This industry became more popular once the regulator issued a new regulation governing this specific type of industry.

STRUCTURE AND GOVERNANCE

Apart from picking the right investment, finding the most tax-wise structure, as well as governing the relationship between investor and investee will determine the success of an investment. Investors need to pay attention to detail in structuring and governing their investment in the investee.

DRIVERS OF STRUCTURE

The main drivers for these structures are: (1) the exit possibility; (2) the negative list issued by the authorities, where some activities are closed or restricted from foreign investment; and (3) the dividend repatriation and tax considerations.

Factors (1) and (3) drive the new trend of setting up a foreign entity for investment purposes. The investors request the founders of the target company to establish a new entity in a country that they consider to be investment friendly for them (in regard to tax treatment and exit possibility) so that they can achieve their main goal, i.e. exit from the investment with optimum upside.

In choosing a suitable country for the holding company, investors must consider the tax provisions of the resident country and the relevant tax treaty. One thing that must be noted is that the Indonesian government regulates special purpose vehicles that are established in a tax haven country. Based on Minister of Finance Decree No. 258 (2008), a transfer of shares of a company that was established in a tax haven country, and that has a special relationship with an Indonesian company or permanent establishment in Indonesia, is subject to 20% of the estimated net sales amount.

In addition, the president of the Republic of Indonesia has just issued Perpres No. 13 (2018), which regulates principles to get to know the beneficial owner of legal entities in Indonesia. This regulation explores, among others: (1) the criteria of a beneficial owner; (2) the reporting; and (3) the possibility of automatic exchange of information with another institution, either nationally or internationally. Even though the purpose of this regulation is to combat terrorism and money laundering, many believe this will impact taxation and transfer pricing activities as well, since the beneficial owner is important in determining tax avoidance or illegal transfer pricing practices.

For factor (2), if the line of business is closed or restricted to foreign investment, then the PE investor cannot easily invest through equity in an Indonesian target company. Therefore, they will use convertible bonds, where they will require the same rights as if they are shareholders in the target company, or use other sophisticated structures such as back-door listing, utilization of venture capital or mutual funds as a holding company, etc.

GOVERNANCE AGREEMENT

The following features are frequently included in the governance agreement of PE investment in Indonesia:

- Different class of shares for the investor and the founders, or previous investors, to provide them with the ability to: (1) accelerate the return of investment via dividend preference and/or mandatory IPO; and (2) avoid higher risk by having liquidation preference and anti-dilution protection.
- Investor's representation on the board of

directors and board of commissioners.
- Certain protective rights to the investor (reserved matter), which require that certain actions cannot be taken without the affirmative approval of the investor. This effective veto ensures that no key decisions are entered into without the consent or approval of the investors. The veto rights for a PE investor who takes a position as a minority shareholder usually include the following matters: (1) issuance of new shares or convertible instrument coupled with anti-dilution rights; (2) transfer of shares of the other shareholders' combined with tag-along; (3) change of articles of association and management team; (4) entry into affiliated parties or material transactions; (5) dividend distribution and buyback shares; (6) proposed merger, acquisition, liquidation and litigation of the target company; (7) approval of the business plan; and (8) put option.
- Right of first refusal and tag-along right.
- Certain information and audit rights.
- Exclusivity to key personnel.
- Non-compete and non-solicitation provisions (if applicable to the business of the target company).
- Exit mechanism, which usually includes mechanism for deadlock.
- The governing agreements are usually made in the form of a joint venture agreement or shareholders agreement.

MISCELLANEOUS REGULATION

In addition to regulations in the above-mentioned legal framework, investors should also take into account the following miscellaneous regulations that may impact their investment in Indonesia:
- Any agreement with an Indonesian party needs to be translated pursuant to article 31 of the Law on Flag, Language, Emblem and National Anthem.
- Law No. 13 (2003), the Labour Law, contains several provisions that may adversely impact PE investment, including:
- In the event of a change of a company's status, merger, consolidation or a change of ownership (frequently associated with a change of the controlling shareholder, but a change in the management's policies regarding employees' rights and entitlements may also qualify for a change of ownership), employees have the right to choose whether to remain or to terminate their employment with the company (article 163(1) of the Labour Law), in which case severance entitlement could be payable.
- However, recently a judicial review decision by the Constitutional Court, under Decision No. 117 (2012), decided that the right of termination is in the hands of the employer, meaning that the employer decides whether to terminate or not. The right of the employee to decide not to continue the employment relationship in the event of a change of ownership is conditional only if there is a restructure, rotation, reposition, inter-department transfer (mutasi), promotion, demotion or change of working conditions of the employee.
- If there is no such condition, the employer may reject the request of termination and the employee will be deemed to have voluntarily resigned from the company. However, the authors' research with the Ministry of Manpower indicates that given that the term "may" as stipulated in article 163 is vague, the mediator and Industrial Relations Court may have different interpretations on this clause.
- Under article 163(2) of the Labour Law, the employer has the right to dismiss employees only in the event of a change of the company's status, merger and consolidation, but not in the event of a "change of ownership".
- Some joint ventures may be subject to mandatory merger control requirements (article 28 of Law No. 5 (1999), the Anti-Monopoly Law.
- Rupiah must be used in certain cash and non-cash transactions occurring in Indonesia under Bank Indonesia Regulation No. 17 (2015).

NOTIFICATION/APPROVAL

One of the major issues relating to PE investment in Indonesia relates to timing issues, which are usually held back due to prior-notification/approval requirements. The following are the common notifications/approval for PE investments:
- Since most PE transactions involve a foreign investor, approval from the BKPM is required before the investor can invest as a shareholder in the target company. This usually takes the most time because it involves discussion with the BKPM to decide the most appropriate Business Classification Code Number for company activities, as well as the minimum investment amount.
- There are a number of notifications that need to be made to creditors, employees and other public disclosures in the event of a takeover or merger. These include: (1) the company's creditors need to be notified at least 30 days before notice of the general meeting of shareholders (GMS). Any objections from creditors must be submitted at least seven days before notice of the GMS. The merger may not proceed until all objections have been resolved; and (2) employees of the company must be notified at least 14 days before notice of the GMS.
- Investment in certain industries (e.g. telecoms and transportation) may require additional licensing and notification requirements to relevant government agencies. KPPU reporting may be required in certain takeover situations.
- If the target is a public company, Indonesia's capital market regulator, the Financial Service Authority may request additional information and the investor, who would be the new controlling shareholder, would be required to do a tender offer post-closing transaction.

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