HANDBOOK
Challenges of Doing Business in Indonesia

Prepared for :

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Table of contents

Introduction

Indonesia is not an easy place to do business. Widespread corruption, a weak legal system and social instability are some Indonesia-specific traits many foreign investors continue to struggle with. This *Handbook* will discuss several of these challenges, and provide some insights and advice on how to deal with them. By doing so, it will paint a picture of the Indonesian investment climate that can come across as very bleak and negative.

It's therefore important to underline that, while undoubtedly challenging, the prospects for foreign investors doing business in Indonesia are better today than they ever have been. For the first time in a long time, Indonesia has a government with a clear pro-business stance, and a firm commitment to increasing Indonesia's competitiveness and deepening the integration with the global economy. That said, investing in Indonesia requires extra effort compared to many other markets, but when foreign investor sets aside the sufficient time to understand Indonesian society, business climate and regulatory environment, doing business in Indonesia can be sound and profitable.

This *Handbook* is also primarily intended for the oil and gas industry where the test for whether or not to enter a country is different than for many other sectors. It's not simply a case of Indonesia being a difficult place to invest, but whether the risks are higher in Indonesia than in other oil and gas-rich countries such as Russia, Nigeria, Angola, Mozambique or Brazil. By this yardstick, Indonesia would probably be ranked as a relatively easy place to do business.

The Indonesian business climate has also greatly improved in the past decade, and particularly the past couple of years has seen a wide-ranging cleanup of Indonesia's regulatory and legal framework. Creating a business-friendly regulatory environment has been at top of the agenda for administration of President Joko Widodo, which took office in October 2014. Thousands of unnecessary regulations that in the past have acted as brakes on investment and economic growth have been cut in the past two years, and the new legislation and regulations introduced are focused on lowering cost and increasing flexibility for investors.

These reforms have taken place at the central government level. The same commitment to reform has yet to trickled down to the local government level, where institutions hold an ino46rdinate amount of power, and added to the complexity of doing business in Indonesia. Up until 1998, Indonesia was a highly centralized authoritarian regime and foreign companies dealt primarily with one stakeholder - the central government. As long as this relationship was good, businesses had few worries. Today things are different. The central government is still important, but in a decentralized and democratic Indonesia foreign, foreign investors have to deal with a much larger stakeholder universe, including provincial and local government officials with significant powers, political parties, NGOs, media and an active civil society.

This *Handbook* will focus on the issues foreign investors face on a day-to-day basis. It will provide insights into Indonesia-specific challenges concerning employees, customers, business partners, government officials and local communities. It will also discuss how to navigate in the Indonesian environment, without resorting to the types of financial persuasion Indonesia is known for and western companies cannot afford to be associated with. Topics covered will range from cultural and religious issues which impact the way a company operates, to subjects such as corruption and rent-seeking in the Indonesian bureaucracy and business-to-business transactions.

In a pre-investment phase, the *Handbook* serves two purposes. It identifies many of the risks and challenges linked to doing business in Indonesia, and give investors an opportunity to assess the pros and cons of entering the Indonesian market. Second, by highlighting the stumbling-blocks that exist, investors can set more realistic goals for what can be accomplished within a given timeframe in Indonesia. In a post-investment phase, the *Handbook* can be a reference-point for expatriate managers, providing insights into why certain things happens in the workplace, in business meetings or in meetings with government officials, and provide guidance on what to do, how to act, and how problems can be solved.

Checklist

There are a number of recommendations in this *Handbook*. The six most important are highlighted in the table below, and the order in which they are listed is also a suggestion for how they should be prioritized. It can serve as a basic checklist for companies doing business in Indonesia.

Priority	Task	Status
1	Carry out stakeholder analysis – mapping of all central, provincial and local level stakeholders with influence on your company's business.	
2	Brief headquarters openly on the ethical challenges linked dealing with the Indonesian bureaucracy.	
3	Establish relationships with key stakeholders that over time can become part of network of "corporate friends".	
4	Establish clear corporate policy and guidelines on business ethics and provide continuous training for staff in what's expected of them.	
5	Notify headquarters about religious holidays and weekly events like Friday prayers which impacts work output.	
6	Decide whether the company wants to hire agents to deal with the Indonesian bureaucracy on visas, work-permits, customs and business licenses.	

1. Impact of Indonesian society and culture on business

Indonesia is arguably Southeast Asia's most traditional culture. For foreign investors, it is easy to lose sight of this fact in modern day Jakarta with its skyscraper lined streets and glossy shopping malls, and where on the surface people's aspirations closely matches those found in the west. However, Indonesia is also a conservative society where historical, cultural and societal traits are deeply rooted and very much part of present day Indonesia. Most Indonesians, irrespective of how westernized they appear, struggle to break free from these traditional and conservative values, attitudes and outlooks.

A. Indonesia education system and human resources

One entry-point for understanding Indonesia society and its impact on business is the education system. Indonesia is one of Southeast Asia's least educated countries. Over 30% of the population is school-aged, and while improvements in the public education system has been made in recent years, Indonesia still scores lowest among its regional neighbors in terms of public education outcomes. An estimated 80% of Indonesians only have a primary-school education (1^{st} to 9^{th} grade), and a staggeringly low 0.03% of the Indonesian workforce holds university (tertiary) degrees. In comparison, 38% of Norway's workforce hold tertiary degrees.

Less than half of primary-school teachers and two-thirds of secondary-school teachers have sufficient teaching qualifications. However, the situation is not all bleak. Indonesia's education budget for 2016 represented 20.5% of the total state budget. A sharp increase in education spending in recent years has brought Indonesia on par with neighbors such as Malaysia (19%) and Thailand (18%) and above Philippines (13%). The Indonesian constitution mandates that 20% of the state budget is spent on education, and after years of non-compliance Indonesia reached this target for the first time in 2015.

The shortcomings of the public education system have also paved the way for Islamic-schools, with an estimated 20% of Indonesia's school-aged children enrolled in these schools. Education experts say the low quality of instruction and the emphasis that is put on religious studies mean that most Islamic-school graduates lack the skills to participate in the modern labor market.

Another shortcoming of the Indonesian education system can be found among professionals with university degrees. A legacy from the Suharto-era that prevails in Indonesia's education system today is a suppression of analytical and writing skills. The teaching focuses on the learning of factual knowledge, and multiple-choice tests dominate. Essay writing is very rare, and Indonesian students can graduate from university without having done much actual writing or been exposed to analytical thinking and problem solving.

The weaknesses of Indonesia's higher education system are also reflected in how Indonesian universities are ranked globally. The Bandung Institute of Technology (ITB) was ranked 800 in the world among engineering schools, while Indonesia's two top universities, University of Indonesia and Gadjah Mada University were ranked 995 and 1004 respectively in a 2017 global ranking of universities. The situation is unlikely to improve in the short term as Indonesia's top academic talent usually don't pursue academic careers at home. They seek teaching positions abroad, which offer better pay in more academically rigorous settings.

What to do?

Foreign companies in Indonesia often need to invest in training of staff to make up for shortages of skills. Multinationals recruiting staff directly from universities should do so with the understanding that their recruits may have a few "holes" in the skill-base compared to the average western graduate. Report writing and analytical skills will often be poor, and companies that require employees to express themselves in writing should be prepared to devote resources to training staff on how to structure and write a longer document.

Most Indonesian companies are not focused on training of staff, so setting up a good employee training program can be a competitive advantage for foreign companies that will help with the recruitment of the best candidates. Among Indonesian white-collar workers there is a lot of prestige attached to having worked in a multinational company, and particularly in the companies that are recognized for devoting resources to training, as it is seen as a stepping stone for career advancement.

B. Respect for authority

Ethnic Javanese makes up around 50% of Indonesia's population, and Javanese culture and traditions continue to infuse and dominate Indonesian society, business, bureaucracy and politics. Java, and therefore Indonesia, is a highly class divided society which places an unusual amount of value with traits such as harmony, stability, and acceptance of one's place in life. From the time Indonesian children start school they are taught not to question figures of authority, and this stays with them into adulthood. The respect for authority and hierarchy spills over into the workplace. It can be difficult for expatriate manager to adjust to Indonesian's established notions of hierarchy, particularly for managers from Northern European countries where equality is a deeply rooted virtue.

This Indonesian hierarchical mindset influences the workplace in numerous ways, some of which are not obvious to foreigners. Attempts by foreign companies to remove the division among "classes" in an office by treating everyone the same is often counter-productive. Taking Indonesian employees out of the context of the class system and into a flat corporate structure rarely produces the intended result. For example, if an expatriate manager does a job intended for local employees, it will often be interpreted as the "boss" having to step in to teach the staff how to do their job properly. It is usually not seen as helping out and being part of the team.

If it is taken as a genuine attempt by an expatriate manager to help, it puts the Indonesian managers in a difficult position. They may feel pressure to follow the expatriate managers' example, but at the same time they are prevented from doing so by Indonesian culture and the loss of face that comes with doing tasks meant for someone lower in the corporate hierarchy.

The hierarchical mindset also means that western management ideas such as a flat corporate structure don't translate well in an Indonesian working environment. Professional titles that differentiate employees are viewed as important as they allow for the hierarchy inside a company to mirror that found in Indonesian society. Equally important is the way an office is set up. Mixing administrative staff and leadership in an open office-landscape is usually not well received, as it means the Indonesian class-system is no longer reflected in the workplace. In the mind of an Indonesian manager, having to work alongside colleagues that are lower on the corporate ladder in an open office landscape where desks, chairs and other office equipment is the same, is a visual demotion and can be a point of embarrassment.

Similarly, a company town hall meeting asking for input from employees at all levels will often find an unreceptive and uncomfortable audience. It should not be taken as a sign of employee apathy. Simply put, Indonesia's class structure and respect for authority require ideas to come from the top. Lower level employees should not be asked to provide ideas about a company's direction in a public setting. Moreover, for senior Indonesian managers it also represents a loss of face to be put in a professional setting where they are made "equal" to colleagues lower on the corporate rungs.

Age adds additional complexity to an Indonesian office environment. An individual is not considered mature in Indonesia until the age of 40, and hiring someone young for a position that ordinarily would be filled by a more senior person creates confusion. Western companies often send their best and brightest, who happen to be young, to work in Indonesia. This can cause tension because of the mixed signals it sends. Indonesian counterparts, regardless of it being colleagues, business partners or government officials, will feel confused and in some cases a little insulted that not someone more "senior" was sent. It may be well understood that the person has the seniority in terms of rank, but that does not remove the perception among Indonesians that the person is too young to be in that role.

What to do?

Indonesia's specific cultural traits doesn't mean western companies should change their corporate philosophy or human resource policy. A company should use a flat organizational structure, involve employees at all levels in the decision-making processes or send "younger" staff to Indonesia, if that is important to the way the company wants to operate. The key word is patience and not trying to do everything at once, and also be willing to compromise in areas where it's is not as important to stick with the established corporate line. By gradually introducing "western" management ideas, and by being mindful and respecting that cultural differences exist, most employees and counterparties will adapt to and accept management's decision.

There are also a few common traits related to Indonesian respect for authority that expatriate managers should be aware of. First among these is the Indonesian "yes" culture. Indonesians often say "yes" as an indication that they are listening, and not necessarily as an indication that they agree with or understand what is being said. Indonesian staff will often pretend they understand, rather than asking for clarification after getting unclear instructions from a superior. This is partly because it's thought impolite to ask a superior to repeat the instruction regardless of how vague or unclear it was, and partly because of the embarrassment the employee feels from not having understood the instruction in the first place. Expatriate managers often learn this the hard way when they realize several days of work is lost due to an employee misunderstanding an assignment, realizing it early on, but still not asking for clarification. To make sure the meaning is clear to employees when giving an instruction, it's important to repeat important details and ask open-ended follow-up questions to confirm a shared understanding. Simply asking for a "yes" or "no" will not suffice.

C. Attitude towards multinationals

The attitude that exists in Indonesia towards multinational companies and expatriates can also be seen in the context of the Indonesian class system. Broadly speaking, Indonesia's poor and lower income groups view multinationals with skepticism. The root cause can be found in the Suharto regime's approach to foreign investment. For more than 30 years, all power lay in the hands of an authoritarian central government. When foreign investors came to Indonesia, local communities were by-passed in the consultation process, and very often forced to accept unfavorable terms.

Most of the economic benefits also didn't end up in local communities, but rather with the Jakarta-based political- and business-elites, which on the back of their relationships with the Suharto government got favorable contracts as suppliers and service providers to multinationals. Things have gotten better in the past 20 years, but the Indonesian economy is still dominated by the relatively small group of Jakarta-based political- and business-elites which reaps the majority of the benefits from foreign investments.

Case study – The Bakrie family's regulatory arbitrage

Indonesia's Bakrie family has more than anyone else in Indonesia excelled at taking advantage of a system where politically connected domestic companies collaborate with the government to create bureaucratic problems for foreign investors, which they subsequently reap huge financial rewards from fixing. Below are some examples of how the Bakrie family over the past 25 years has benefitted from a practice that can be described as regulatory arbitrage.

Grasberg Gold & Copper Mine

In 1991, PT Freeport Indonesia sold a 9.36% stake in the Grasberg mine to a Bakrie company for US$212 million, financed by a US$172 million loan from Freeport's parent company in the US. At the time Freeport were in stalled negotiations about extending the contract for the Grasberg mine in Papua. In 1992, after Freeport Indonesia's contract was extended, but before the loan was due, Bakrie sold back a 5% stake in Freeport Indonesia to Freeport's parent company in the US for US$211 million. In 1997, Bakrie sold its remaining 5% stake in Freeport Indonesia to President Suharto's foundation Nusamba for US$315 million, and Nusamba sold this stake back to Freeport in 2002 for an undisclosed amount.

Kangean Gas Block

In 2004, the Bakrie-controlled oil and gas company Energi Mega Persada (EMP) purchased a 100% stake in BP's Kangean gas block for US$160 million after BP failed to secure a contract extension for the block from the Indonesian oil and gas regulator. Six months after the acquisition was completed, EMP secured a contract extension for Kangean and then immediately sold a 50% stake in the block to Mitsubishi for US$300 million. Mitsubishi became the operator of the block, leaving EMP with a US$140 million profit and a 50% stake in the block which it still owns.

Dairi Zinc Mine

In 2008, Bakrie-controlled Bumi Resources acquired a 100% stake in Australian Herald Resources for US$550 million, a price which reflected that Herald had failed to secure the forestry licenses it needed to develop the Dairi zinc mine in North Sumatra. In 2011, President Yudhoyono issued a Presidential Decree giving Bumi Resources the forestry licenses it needed to develop the mine, dramatically increasing the value of the asset which subsequently was sold on to Chinese investors for an undisclosed amount.

Masela Gas Block

In 2009, Bakrie-controlled Energi Mega Persada (EMP) bought a 10% stake in INPEX's Masela block in the Timor sea for US$77 million. At the time, Indonesia's oil and gas regulator was refusing to approve INPEX's Plan of Development for the block. In 2013, after the Plan of Development was approved, EMP sold the 10% stake in the Masela block back to INPEX and Shell for US$313 million.

Multinational mining and oil and gas companies were the largest investors in Indonesia under Suharto. These companies had no choice but to deal with the Suharto government. However, the lack of community consultation, limited focus on economic development in local communities and inadequate hiring of local staff, created a hostility and skepticism towards foreign investors that continue to prevail today among Indonesia's poor and lower income groups.

Many foreign investors have not broken free from the Suharto-era "mindset". They rely on the letter of the law and their relationships with the central government to secure their rights, and often overlook the aspirations of the local communities where they operate. At the same time, traditional principles of governance are very strong all over Indonesia. Local communities often feel they have a say in what happens in their surroundings, regardless of the fact that land titles, licenses or contracts are awarded by the government, whether it's at the central, provincial or local level. Many of the recent conflicts involving foreign investors in Indonesia have their roots in lack of communication between the company and the local community, and could have been avoided if more effort was spent in establishing good relationships with a company's immediate neighbors.

Indonesia's elites and upper middle classes benefited greatly from the flow of foreign direct investment into Indonesia, and hold a more positive view of foreign investment. That said, there has in recent years been growing economic nationalism in Indonesia and foreign investors don't enjoy the same standing among Indonesia's elite and upper-middle classes as they previously did. Once Indonesia needed foreign capital and technology for industrial development and extraction of natural resources. Today foreign capital and technology is not needed in the same way. Indonesia's elites have realized this and pushed for legislation and regulations that gradually have closed the door to foreign investment in sectors where Indonesian companies previously were shut out of but today are competitive.

The mining sector is a case in point. Indonesian conglomerates have concluded, and with some exceptions rightly so, that international mining companies are no longer needed to exploit Indonesia's mineral resources. Mining technology is in most cases non-proprietary and available to anyone who can pay, and Indonesian conglomerates have today the ability to raise funds in the international capital market for large-scale mining operations. It was therefore no surprise that Indonesia's new Mining Law, which passed in 2008, terminated the long-established Contract of Work (CoW) regime that foreign investors trusted and replaced it with a set of rules much more detrimental to multinational involvement in the Indonesian mining sector. To move the mining industry over on Indonesian hands the government put together a set of investment rules it knew would be unacceptable to most foreign investors. It's the culmination of a process that has been going on since 2004, and which effectively leaves all Indonesian mineral resources to be developed by Indonesian mining companies. The only exception is Freeport's and Rio Tinto's Grasberg gold and copper mine in Papua, which is so complex that there are only four or five mining companies in the world that can operate the mine.

The resource nationalism seen in the mining sector has also spilled over into the oil and gas industry. This is more worrying since Indonesian companies don't have the same capabilities in oil and gas as they do in mining. Most of Indonesia's unexploited oil and gas is found offshore and deep-sea, and at the moment no Indonesian energy company has the financial strength or technological know-how to get these resources out of the ground. The same is true for Indonesian oil service companies. This reality, however, is not stopping Indonesian conglomerates, analysts, government officials and top politicians from talking as if Indonesian oil and gas companies are ready to go at it alone. These views have also been presented repeatedly in Indonesian media, creating a perception that international oil and gas companies and oil services companies operating in Indonesia are largely redundant. This could not be further from the truth, but it's a perception international oil and gas companies operating in Indonesia have to deal with.

By 2024, 75% of Indonesia's oil and gas blocks currently in operation will see their Production Sharing Contracts (PSCs) expire, with the state-owned oil company PERTAMINA set to take over the operatorships from the international oil companies currently operating the blocks. The Mahakam block will be the first big test of this transfer of operatorships to PERTAMINA. Mahakam, Indonesia's largest gas block, has been operated by Total for the past 50 years, but from 2018 the operatorship will be transferred to PERTAMINA. Serious doubts exist among industry insiders about PERTAMINA's capability to take over the operatorship. More recently the Indonesian government has taken a similar view, with the Minister of Energy & Mineral Resources urging PERTAMINA to strike a deal with Total so they can stay on and support PERTAMINA with operating the block. With only months to go before Total leaves Mahakam, the government seems to have realized PERTAMINA isn't ready. It is a case that will be important to watch, as PERTAMINA's success or failure at Mahakam will determine if it is given the operatorship of other blocks. One consequence of PERTAMINA becoming a large operator is that it will have to buy a lot of services in the market, especially in the first few years, to compensate for what it doesn't have in-house. This should again create great opportunities for oil services companies in Indonesia.

What to do?

Due to the complexities involved with investing in Indonesia, getting a comprehensive overview of stakeholders is important for all foreign companies entering the Indonesia market. A Stakeholder Audit should therefore feature high on a company's to-do list. This should be a mapping of all institutions and individuals with an impact on a company's business, ranging from ministries and government officials to local community leaders, business partners, industry associations and NGOs. The mapping should to the extent it's possible to give an overview of the stakeholder's political, financial and personal networks. The findings will later provide valuable guidance on how to interact with the different stakeholders.

Information that is particularly important to identify in a stakeholder analysis is whether partner companies have government officials as owners or large shareholders, have ownership interest in competing companies, and if there are any links to the military or any of Indonesia's large conglomerates. Whether a partner company or its owners has been involved in any corruption cases or other illegal activities, got any unresolved legal disputes, or has been involved in bankruptcies or debt defaults is also valuable information a stakeholder audit should uncover. This kind of information is not as readily available in Indonesia as it is in a western country, but it can be obtained through research. There are also a number of consulting companies and law firms in Indonesia that can provide this kind of service. Finding evidence of any of the issues highlighted above does not mean that you should automatically walk away. However, it does mean that you should proceed with extra caution.

D. Attitude towards expatriates

Opinions of expatriate workers in Indonesia vary depending on whom you speak to. There are around 70,000 expatriate workers in Indonesia, which is small considering the country's population of 261 million. The majority live in the Greater Jakarta area, with smaller expatriate communities in Surabaya, Medan, Balikpapan and Bali. Given that there are so few expatriates, most Indonesians will not interact with expatriates and they therefore know very little about them. For Indonesia's poor, lower- and middle-income groups, expatriate workers will be viewed as extremely wealthy. Considering that an average monthly salary of an Indonesian factory worker is around US$ 200 per month and US$ 800 per month for a university graduate in a white-collar job, a western-level professional salary put expatriate workers in Indonesia in the absolute highest income bracket.

Because of the enormous income disparity that exists in Indonesia, most expatriates will find that the Indonesians they meet professionally or socially come from Indonesia's wealthy elites, who in some cases can have as little in common with their Indonesia countrymen as the expatriates. They are often western educated and from a very privileged background. This can again lead to a very skewed impression among expatriates of what “real” Indonesia is, and lead to many misunderstandings when they step outside of the expatriate “bubble” they exist within on a day-to-day basis.

E. Differences in approach to human resource management

As discussed above, Indonesian society is highly hierarchical and class-divided and the approach to human resource management is also reflected in this hierarchical worldview. Against this background, management styles should also when possible be adapted to the Indonesian way of doing things. While this may appear less efficient at the offset, it usually turns out to be better in the long run. A foreign company can make some changes, but should not attempt to go against the culture too much.

It’s not advisable for a multinational company to attempt to establish a clinical western-style business environment with a strict separation of home and work. For most Indonesians, work is an extension of their social life and they have a strong preference for feeling certain about their place and role. Companies that fail to deliver what Indonesian employees view as an appropriate social environment in the workplace can be plagued by productivity problems, absenteeism and high staff turnover.

Case study - Whatsapp

Indonesians are also early adopters of new technology, and with rise of various smartphone apps like Blackberry Messenger and more recently Whatsapp, has changed the way Indonesian professionals communicate. Among most Indonesian professionals there is today a strong preference for communicating exclusively through Whatsapp on almost all work-related matters. This has several advantages and matches with the short form most Indonesians prefer to express themselves in writing, but also a few drawbacks.

Multinationals may for regulatory and information-control reasons require employees to use the corporate email system as it creates a paper trail the company later can easily access. Employees communicating and sharing documents outside the corporate system also often means documents get overlooked as your average Indonesian Whatsapp user will get hundreds of private messages each day, in addition to the work-related messages. More importantly, documents shared on Whatsapp never gets saved on a company server so it can be accessed by other employees later, which is a problem from an information management point of view.

Whatsapp's short form messaging also has an informality to it that doesn't always work in a western corporate setting, and Indonesians communicating with colleagues abroad sending a mix of work and non-work related messages may cross work/private boundaries for some non-Indonesians. However, getting Indonesians to use email for work-related matters when all their other communications happens on Whatsapp is increasingly hard, and a battle that may not be possible to win at this point. The better option is probably to establish a company-wide policy on information management and alert employees to always save all work related information they receive through Whatsapp on the company's servers.

By the end of the day, most Indonesians are aware that multinationals have a different corporate culture, and they will accept differences up to a point. In most cases, a job in a multinational company is seen as a more secure and better paid, which trumps other factors. There are also other benefits attached to working for a foreign company. Multinationals are known for investing more money in training their staff, so having a couple of years work experience from a multinational looks good on the CV and is seen as an advantage for Indonesians who want to further their careers. Moreover, clerical and support staff may also prefer to work for a multinational company as they see a flatter western corporate structure as a bonus where their work is more valued and where their voice are heard.

F. The impact of religion on business

Around 88% of Indonesians are Muslim. Islam dominates over Indonesia's three other official religions - Christianity, Hinduism and Buddhism - and is the only religion that is highly visible in Indonesian society. However, at an individual level the commitment to Islam, and how it is expressed in daily life, varies more in Indonesia than in most other majority Muslim countries. Comparing Islam in Indonesia to the Islam practiced in the more conservative countries in the Middle East is also a cause of many misperceptions.

While the numbers have been rising in recent years, only an estimated 25% of Indonesian Muslims are devout and adhere to Islamic dress code. In Indonesia's larger cities the percentage of people who adhere closely to Islam and its aesthetics is even lower. This devout group of Muslims is again divided into traditionalist and modernists. Contrary to what the name would have you believe, modernists take their cues from how Islam is practiced in the Middle East and adhere to a more conservative interpretation of Islam that gives greater weight to literal or textual interpretations of the Koran and Islamic law. Traditionalists on the other hand adhere to an Indonesia-specific version of Islam that is more flexible in its interpretation of Islamic teachings, and which draws inspiration from indigenous mystical animism as well as Hinduism. Both traditionalist and modernist closely observe the five pillars of Islam and identify themselves as Muslim.

Although they certainly refer to themselves Muslim, the majority of Indonesia's Muslims will not perform Islam's religious duties such as prayers on a daily basis. Friday prayer, however, is a religious ritual most Indonesian male Muslims perform regardless of how devoted they are to their faith. This larger and more secular group of Indonesian Muslims has a world view colored by indigenous religion, mixed with influences from Indonesia's deeply rooted class system. The stereotypical secular Indonesian Muslim is conservative, skeptical of change, and prone to fatalism through acceptance of misfortune and one's place in society.

Indonesia's ruling elites will most often belong to the more secular Muslim faith. In the Suharto-era, official policy mandated that the executive branch of government and state institutions should exist separately from religious beliefs. While no longer officially in place, this notion of a secular Indonesia continues to exists today, and most top government officials, military officers, and intellectuals are usually moderate Muslims that separate religion and work.

The introduction of democracy in Indonesia in the past 20 years has also led to the establishment of Islamic-based political parties, which also have had an influence on government and the bureaucracy. While the support for Islamic parties has been limited, they have managed to convert some of their agenda into policy. At the local level, this has led to by-laws banning women from going outside after dark unaccompanied by a man, and public caning of adulterers and homosexuals in the semi-autonomous province of Aceh. At the national level, a Pornography Law and a Blasphemy Law with strong religious undertones have been passed in recent years. In Jakarta's 2017 Governor election, the Islamic groups used the Blasphemy Law to unseat Jakarta's Christian and ethnic Chinese incumbent governor, and he is currently serving a two-year sentence for insulting Islam at a political rally. It underscored how potent an issue religion is in Indonesia, and how religion can be used as a weapon to sideline a political candidate.

So how does religion in Indonesia impact business? First of all, in the larger Indonesian cities it is often easy for foreigners to forget that Indonesia is a majority Muslim country. Indonesia's cities are secularized, and on a day-to-day basis religion has very little impact on how the average person lives and the way businesses operate. As a foreigner, politeness and good manners are sufficient in most social settings. In business settings, there are also no specific requirements on how to act based on religious sensitivities.

There are, however, a few issues foreign companies operating in Indonesia should be mindful of. Friday prayer is supposedly a 1-1.5-hour break in the middle of the day. Because the prayer starts at midday Friday and functions as a reminder that the work-week has come to an end, the reality is that very little work takes place after Friday prayer. As a consequence, scheduling meetings, conference calls or setting deadlines that requires work on Friday afternoon is difficult. Friday is not a half day, but productivity drops on a Friday afternoon.

During the Ramadan fasting month business activity slows to a crawl. Although most Indonesian's don't strictly observe fasting from sunrise to sunset for the entire month, a majority will forgo lunch and not take any liquids during the day. Productivity levels consequently drops throughout the day, and late afternoon meetings in the hours before the breaking of the fast at sunset are usually unproductive. At the end of the Ramadan comes the Eid ul-Fitr holiday, which marks a mass exodus of Indonesian's to their hometowns. The holiday is meant to be three working days, but is usually extended to a full week for white-collar workers. For blue-collar workers, the expectation is to be given two weeks off.

With regards to productivity, Ramadan can be compared to the peak summer vocation months in Europe (July and August), where it difficult to schedule meetings and work on group projects due to the absence of colleagues and counterparties. The Eid ul-Fitri holiday is comparable to the Christmas holiday in Scandinavia where everything shuts down for one week, and where the week first week of January is slow as many people take some additional days off.

What to do?

Because it concerns the way people practice their religion it's impact on business is not an easy issue to address. With regards to Friday prayers, companies can issue clear guidelines about the time employees have to pray. The reality, however, is that it's difficult to change the established perception that the weekend starts with the end of Friday prayer. Similarly, while Indonesian Muslims don't view the month of Ramadan as time off from work, they also don't expect to be held to the same standards of efficiency, output and working hours during the fasting month.

By recognizing these limitations, a company can organize its operations so it has the least impact on overall output. For foreign companies operating in Indonesia, it's also important to notify headquarters in the home country about the shorter working hours and drops in output so activities and timelines can be adjusted accordingly.

G. Rent-seeking and kick-backs in B2B transactions

Indonesia's problems linked to corruption, collusion and nepotism (KKN) have its roots in a long-established culture of gratuity. This means changes are not happening overnight, and it requires more than new legislation and political commitment. In the two decades since the fall of Suharto, some progress has made in changing the mentality that allowed corruption to thrive and expand in Indonesia. It has, however, been a slow and painful process and much work remains. That habits established over generations don't disappear overnight is underlined by the seemingly endless stream of corruption scandals that continue to rock Indonesia.

Corruption in the Indonesian bureaucracy is a top of mind issue, and as will be discussed in detail below, a lot of resources have been put towards tackling this problem. However, what's rarely discussed is the "corruption" that exists in business-to-business (B2B) transactions in Indonesia.

Kick-backs, side-deals, personal success fees and other schemes that stay off a company's books are very common in Indonesian B2B deals. A culture that often overlooks kick-backs and rent-seeking at the corporate level provide employees with ample opportunity to make money on the side, and the practice is in most cases not seen as illegal or even unethical. It's rather seen as an action where no one gets hurt. When two companies enter into an agreement, a personal "reward" is expected by employees on both sides of the deal for making it happen, and this is deeply ingrained in Indonesian culture.

The scale of the problem is difficult to estimate since few resources are put towards tackling it, but any expatriate manager that has spent some time in a sales or service organization in Indonesia will tell you it's a real problem. Foreign companies operating in Indonesia can at a corporate level of course stop payouts that allow these side deals to take place. Strict accounting standards solves this. More difficult is making sure your own employees don't accept any gratuities from other companies as a reward for making a business transaction happen. By the end of the day, a company's leadership can only make it clear what the company's policy is, and hope that the employees follow these rules.

However, the biggest risk for foreign investors in stopping the B2B kick-back culture is that it breaks with the way business is done in Indonesia. The whole dynamic of a business transaction changes when employees don't act based upon what is best for the company, but also factor in what is most financially rewarding on a personal level. Offering the best service or product at the best price is no longer enough, and this can be a frustrating reality to face for many foreign companies operating in Indonesia. This is particularly true for smaller companies without the financial muscles to take a long-term view, and which needs to win business quickly to stay afloat.

What to do?

B2B corruption is a problem rooted in Indonesia's culture of gratuity, and no magic wand exists that will make this go away overnight. Regrettably, many foreign companies in Indonesia fall for the temptation of turning a blind eye to side deals because it makes doing business a lot easier.

So what can be done to deal with B2B corruption? First, foreign companies have to recognize that rent-seeking, kick-backs and side payments are problems not only limited to the Indonesian government, but are also very much a part of B2B transactions. Companies then need develop clear policies and procedures for how to deal with it. Employees should be made aware of what a company's policy is on side-payments in cash or kind in B2B transactions. No ambiguity should exist that allows employees to later claim that they weren't aware that their actions were in breach of company policy.

Employees should also be asked to sign a "code of conduct" that clearly outlines what is expected of them, and the sanctions that exist for not following company rules. Training session in business ethics that highlights the dilemmas and temptations employees can face in B2B transactions are also important and needs to be carried out on a frequent basis. If done only when a new employee is hired and never mentioned again, it sends a signal that a company is not ready to practice what it preaches.

After these precautionary measures have been taken, employers have to trust their employees and hope that they follow the standards set by the company. The alternative is to micro-manage and double-check everything every employee does. This is usually so troublesome and time-consuming that it undermines the financial rationale for hiring the employees in the first place. In a sales organization this becomes particularly difficult, as the top performers are also likely to be the employees that take part in B2B kick-backs. Reprimanding, or in the worst case firing a top performer in a company is not easy.

2. Indonesian bureaucracy

Indonesia is known for having one of the most corrupt bureaucracies in the world, and dealing with different government agencies can be one of the biggest challenges for foreign investors doing business in Indonesia. This section will look at some of the shared characteristics of Indonesian government institutions, while more detailed information on specific branches government will be provided in the subsequent sections below.

Before looking at the causes behind the rampant corruption in Indonesia, it's important to understand that the Indonesian bureaucracy functions and operates fundamentally different from bureaucracies in the west. First and foremost, Indonesian bureaucracies are not characterized by a service culture where bureaucrats exist to serve the public. A cynical view of the Indonesian bureaucracy is that it exists to rule the public. Indonesian bureaucrats referred to themselves as "government officials" and expect to be approached with humility and respect. Generally speaking, their attitude is usually not one of "what can I do for you?" but rather one of "what can you do for me?" Providing a public service is not seen as a duty, and in line with the Indonesian gratuity mindset, instead dispensed under the premise of being a favor. Permits and licenses are often granted at the whim of the government official with the expectation of gratuity in return, and limited opportunity for objection or appeal in the case of a denial.

A. Salary levels and clean government

If you had to point to one reason to explain Indonesia's endemic corruption it would have to be the salaries of bureaucrats. After Suharto took to power in the 1960s, a vast expansion of the bureaucracy became the tool for lifting millions of Indonesian families out of poverty. There was not, however, enough money to pay the newly hired bureaucrats professional salaries. The salaries of even the highest-ranking government officials didn't allow for maintaining more than an absolute minimum living standard. The extremely low wages for the highest to the lowest ranking bureaucrats is the primary explanation for the institutionalized corruption that can be found in Indonesia today.

With salaries that only covered a bare minimum, Indonesia's bureaucrats quickly developed ways to supplement their income. The result was a whole array of legal and illegal rent-seeking and money-skimming schemes that continue to exist today. The system evolved and expanded over the years, and for high-ranking Indonesian government officials their official salary is today only a small fraction of their monthly take-home pay. The government is of course fully aware of these money-making schemes, but because the people at the top are also this system's biggest benefactors there are few incentives for reforms.

The days of high-level corruption involving millions of US dollars in kick-backs to the Suharto-family and his cronies is gone, but the lower-level corruption involving smaller amounts of money being paid to Indonesian bureaucrats is very much alive. What institutionalized the lower-level corruption, and what makes it so difficult to get rid, was the decision to make many Indonesian government agencies self-financing. Because rent-seeking was so rampant the official budgets of the highest "earning" government institutions were cut to almost zero, based on the premise that parts of the illegal levies then would have to be used to fund the institution's day-to-day operation and not only go into the bureaucrats' pockets. The government institutions then had no choice but to continue their bad practices, while the obligation to fund their own operations removed some of the guilt linked to charging the illegal fees. Corruption became a necessity rather than a choice. Today, the highest "earning" government have had their state-funding reinstated, but the money-making schemes on the side has not gone away.

Government salaries in Indonesia have improved a lot in the last decade, but continue to be low. The government simply can't afford to pay a professional salary to Indonesia's 3.8 million bureaucrats. The average Indonesia bureaucrat still only makes between US$ 200 and US$ 250 per month, and salary levels for top government officials is not much better. For example, a Director in government ministry with more than 20 years' experience makes around US$ 1000 per month. An Indonesian Government Minister takes home around US$ 2,000 per month. However, there are several notable exceptions to these low salaries, and the situation is improving. The Ministry of Finance was until a few years ago known as a hotbed of corruption and illegal money-making schemes. In particular, government officials in the Tax Office and the

Customs & Excise Unit were making vast sums of money on the side. In an effort to clean up these departments, a whole range of reforms have been implemented. Most important among these was the decision to raise the salaries of the top bureaucrats in some cases by as much as 1,000 percent, bringing it up to a level that surpasses the Minister's salary and where the take-home pay of bureaucrats equals that of top executives in the private sector. While these initiatives are showing positive results, they have unfortunately so far only been limited to the Ministry of Finance, the Central Banks and the regulatory arm of the Ministry of Energy & Mineral Resources. The majority of Indonesian government officials are still grossly underpaid, and despite of a 20-year effort to get rid of the problem, the charging of illegal levies is happening at all levels of the Indonesian bureaucracy.

What to do?

The prospect of having to pay illegal fees is something almost all foreign investors in Indonesia will be faced with at some point. Getting your belongings through customs when moving to Indonesia, obtaining a work permit and an entry visa, or establishing a business with all the necessary licenses and permits will in most cases require the payment of some kind of "facilitation" fee that comes on top of any official fee you get a receipt for.

In reality, most foreign investors in Indonesia don't actually have to deal with this though. An agent or consultant will be hired to deal with the bureaucracy on a "don't ask, don't tell" mandate, and the foreign investor will never know how much of the agent's fee ended up in the pockets of bureaucrats. This practice is very common in Indonesia, and allows the foreign investors to stay ignorant of any wrongdoings taking place on their behalf.

Multinational companies bound by a strict zero-tolerance policy on corruption will often hire a reputable law firm or global accounting firm to handle license or permit issues to make sure they are done properly, without any illegal payments being made. Regrettably, this doesn't come with any guarantee. By the end of the day, Indonesian bureaucrats expect to get paid irrespective of who they are dealing with. What usually happens is that the reputable firm law firm or global accounting firm will also hire a local "agent", which pays the facilitation payment. The only thing accomplished by this practice is establishing an additional layer between the company in question and the illegal fee being paid.

Another common approach for foreign investors to deal the ethical and legal challenges created by corruption in Indonesia is to hire a well-connected and powerful Indonesian national. This can for example be a retired police or army general, a former government minister, a family member of a high-ranking government official or politician or a person linked to one of Indonesia's powerful family conglomerates. These are individuals that due to their stature make facilitation payments redundant. A quick phone call from a person like this can make sure a license will be issued or a permit will be granted without any payment ever being made.

When taking this route, the ethical dilemma foreign investors is faced with is the question of why the bureaucrats suddenly become so cooperative. In most cases the answer is fear of what the individual can do to the bureaucrat's career if he or she doesn't cooperate. Another factor to consider is that this can be expensive, and usually costs considerably more than hiring an agent. Indonesians with this kind of leverage in the bureaucracy know to price their services, and will usually only do it if hired on a retainer-basis for 12 months or longer. The ethics of the latter approach can also be questioned. The money will go to individuals who in most cases already are very well off, instead of going to under-paid Indonesian bureaucrats who charge fees to supplement their income to make ends meet.

This is an area where there are no good answers. Most foreign investors in Indonesia realize that small payments are required when dealing with the bureaucracy. It's not vast sums of money, but payments ranging from of US$ 10 to US$ 100 are usually expected by Indonesian bureaucrats. Foreign companies not willing to make any sort of payment, either directly or as mentioned above indirectly through an agent, will find Indonesia a very difficult place to do business. Operation 100 percent "clean" is probably possible, but it will mean that what should take days will take weeks, and what should take weeks will take months.

B. Regional autonomy

Another big challenge when doing business in Indonesia is the unclear lines of competence that exists between the central, provincial and local administrations due to Indonesia's regional autonomy laws. This is particularly a problem for oil and gas and mining companies which operate in a field highly regulated by the central government, but where many of the projects are located in Indonesia's remote and highly autonomous regions.

Indonesia's regional autonomy laws were rushed through the Indonesian parliament just before the 1999 elections by the government of President Habibie to prevent Indonesia from disintegrating. The trigger for Indonesia's wide-reaching regional autonomy laws was East Timor's referendum that same year in favor of independence. The Habibie government feared that following East Timor's decision to secede, other provinces would follow suit. Moving power from the central government and closer to the Indonesian people was seen as the best way to quell a growing independence movement. At the same time, the government assumed that handing the power to Indonesia's 34 provinces could create economic entities that over time would be strong enough to follow in East Timor's footsteps and seek independence. The solution became transferring authority to Indonesia's 300 regencies (*kabupaten*), none of them large enough for there to be any risk of them seeking nationhood.

Under the regional autonomy laws, numerous powers were taken from the Jakarta government and handed over to the regencies, along with revenue sharing formulas that keep up to 80% of provincial revenues within the province itself, including revenues from mining and oil and gas. Regional and provincial governments have the right to take up to a 10% stake in all new oil and gas fields, unless the fields are located more than 12 nautical miles offshore in which case the stake goes to the central government. The same is true for mining. The right of the local government to take a stake is one of the factors that have held back the development of Indonesia's oil and gas and mineral resources.

Local governments desperately want to take a stake, but they don't have the financial resources to pay for their share of the development costs. The stakes are therefore immediately sold again to indigenous Indonesian business groups through the establishment of public-private partnership, where the local government receives a "broker fee" for making the deal possible.

This does give the local governments a one-time cash infusion, but it doesn't provide the long-term revenue stream the law set out to accomplish.

Case study – Bakrie Group and Newmont's Batu Hijau mine

In 2009, Bakrie-controlled PT Multi Capital paid US$624 million for a 24% stake in Newmont's Batu Hijau gold and copper mine, which US-based miner Newmont was required in its Contract of Work to divest after 20 years of operations.

By law, the local government in East Nusa Tenggara had the right of first refusal to buy the shares that came up for sale, but it had no way of raising money. By forming a partnership with the East Nusa Tenggara government, paying them a one-time fee of US$ 7 million to act as the front for the acquisition, Bakrie beat out state-owned miner PT Aneka Tambang, which was next in line to acquire the stake in the Batu Hijau mine.

Bakrie was also in line to acquire an additional 7% stake that Newmont was required to divest, but this transaction was blocked by the Indonesia Ministry of Finance. In May 2016, Bakrie was part of a group that sold a majority stake in the Batu Hijau mine to an Indonesian consortium led by Medco Energi for around US$2 billion.

In the end, Bakrie successful use of the East Nusa Tenggara local government as a front for the acquisition in exchange for a fee of US$ 7 million, started a process where a mine that by law was intended to end up as government property fell into in private hands.

With hindsight, it's easy to argue that the central government conceded far more power than it should have with the regional autonomy laws, and that local autonomy on the scale envisaged in the 1999 law is unrealistic in present day Indonesia. The extent regional autonomy has been implemented varies from region to region. Wealthy provinces, such as Bali and Riau (which includes Batam), along with resource-rich provinces such as Papua have tried to gain as much autonomy as possible. Less wealthy provinces, by contrast, have been less enthusiastic about autonomy given the increased cost that comes with growing governing responsibilities.

The lower than expected foreign investment in Indonesia over the past 10 years can't alone be traced back to regional autonomy, but it has certainly been a contributing factor. It has added several extra layers of bureaucracy, and this has often proved to be one hurdle too many for foreign investors. The complexities of provinces and regencies making their unique administrative systems and policies, has only made the situation worse. And while the intentions of placing more authority closer to the people were good, the fact is that each new layer of bureaucracy investors has to deal with represents an opportunity for bureaucratic obstruction and rent-seeking. Sadly, such opportunities rarely go unexploited in Indonesia, and it has added to the costs of doing business. Many claim, and probably rightly so, that regional autonomy has done nothing more than to decentralize and expand Indonesia's already endemic corruption.

Within mining, the rent-seeking at the provincial and regency level had gotten so bad that the government in 2011 started to take back some authority. The trigger was the high number of overlapping mining licenses, where new administrations would issue new licenses over areas where licenses already had been awarded, presumably in exchange for fees. This triggered numerous lawsuits and doubts in the minds of investors about legal certainty, and prevented many mining projects from ever being developed.

C. Bureaucratic decision-making processes

Indonesian bureaucracies are usually top heavy. While an official decision-making structure exists which allows for decisions to be made at lower levels, this actually rarely happens. Most decisions, even the most routine, are pushed upwards and made by only a handful of high-ranking bureaucrats. Foreign investors new to Indonesia are often surprised by the fact that the simplest license, permit or application has to be approved by the upper echelons of a government agency, ministry or state-owned enterprise. The consequence is of course that it takes a long time for even the simplest decisions to be made.

There are several reasons why this happens. Rent-seeking is one explanation. The "fee" follows the decision, so the top bureaucrats will ignore existing decision-making procedures and get involved in order to collect a fee. The Indonesian bureaucratic mindset also comes into play. As mentioned above, public servants in Indonesia exist to rule the public rather than to serve the public.

Bureaucratic services are often dispensed as favors granted at the whim of the government official, irrespective of established rules and regulations. In a system where bureaucrats are "rulers" granting favors, having a lower level bureaucrat handle these tasks would take authority away from the top bureaucrats. To be able to take the credit, the top officials need to be involved.

A third factor which explains the tendency in the Indonesian bureaucracy to push all decisions upward is the fear of making mistakes. First among these "mistakes" is "causing loss to the state". This is dubious legal principle that emerged in post-Suharto Indonesia. In theory it means that a government agency buying a product or a service from anybody but the cheapest vendor is causing a loss to the state and the bureaucrat that approved a purchase of a product or a service that was not the cheapest option could face criminal charges.

The idea was to break up the unholy alliance that existed between the bureaucracy and the private sector, which was riddled with kick-backs and rent-seeking schemes. While the intentions behind the "causing losses to the state" initiative were honorable, the real-life implications have been problematic as a strict application of the "causing losses to the state" rule is absurd. It would only work in circumstances where all services or products are of equality, or in a situation where all transactions are done with dishonest intent, making price the only yardstick upon which the value of a service or a product can be accurately measured. The reality is different where some products and services cost more than others because they are better. The "causing losses to the state" principle, however, is still strictly applied by many Indonesian government institutions. The result is that Indonesia bureaucrats often are scared of making any decision involving the use of state funds. The bureaucrats' response is not to make any decision, pushing it up to their superiors to decide which again leads to a slow decision-making.

What to do?

For foreign investors in Indonesia the reluctance of Indonesian bureaucrats to make decisions can be very frustrating, and the inability move forward with investments within any reasonable timeframe is one of the main reasons why foreign investors lose their patience and leave Indonesia. It is therefore important for companies that enter the Indonesian market set aside sufficient time to understand and deal with the bureaucracy.

Companies that have just gotten a foothold in Indonesia usually don't have a network that can help them solve problems related to the Indonesian bureaucracy. Establishing relationships with stakeholders such as government officials, regulators, industry associations, embassies and chambers of commerce, which later can help with bureaucratic hurdles is key for foreign investors new to Indonesia. Establishing these relationships should be on the top of a company's agenda when entering the Indonesian market.

It's also important to at the offset make headquarters aware of how slow the decision-making process can be in Indonesia. This way, expectations on what can be accomplished within a set time frame can be adjusted. That a company already has an international presence doesn't mean that all people working at headquarters are familiar with a challenge like Indonesia's slow-moving bureaucracy. Sitting in Norway, it's hard to comprehend how different Indonesia's regulatory environment is. Colleagues and superiors at headquarters will therefore benefit from frequent reminders about the realities on the ground in Indonesia when it comes to issues such as slow government decision-making.

D. State-owned enterprises

The involvement of the state in Indonesian private sector is surprisingly large. The explanation can be found in the Suharto-era where government control over Indonesia's largest industries provided greater opportunity for rent-seeking. Despite Suharto's embrace of free market philosophies, the state-owned enterprises grew to dominate large parts of the Indonesian economy during Suharto's 32 years in power. Twenty years on the influence of the state in Indonesian business is smaller, but still substantial. Energy (oil, gas and electricity), heavy industry, banking, pharmaceuticals and telecommunications are all sectors dominated by state-owned enterprises. State-ownership is in and of itself not a problem if companies are professionally and transparently managed. Regrettably, some of Indonesia's largest state-owned enterprises like PERTAMINA and PLN are notoriously corruption and plagued by the same institutionalized rent-seeking found in the bureaucracy. Dealing with these companies require careful planning so an exit available.

Case study – Perusahaan Listrik Negara (PLN)

PLN is a company in a continuous financial crisis. As a monopolist, required by law to sell electricity to Indonesian consumers at below production cost, it is highly dependent on large cash transfers from the government to cover its losses. This would have not been a problem if the government had diligently followed the obligation to refund PLN for its losses, but that has often not been the case. On the contrary, PLN has become the last bill the government pays. Moreover, when times are tough PLN is paid late, and sometimes not in full.

Faced with these challenges PLN has had to adapt, and make itself as financially independent as possible of the government. Over the last decade it has therefore strongly favored the cheapest solutions for new power plant developments, which invariably have been Chinese made and financed coal-fired power plants. Requests by the government to develop higher costs power-generating solutions, such as renewable energy or gas-fired plants, have been largely ignored. Similarly, PLN has been dragging its feet on entering into Power Purchase Agreements from independent producers offering anything other than electricity from low-cost coal-fired power plants. It has all been part of a very rational strategy of reducing its own losses, making itself less dependent on the government refunds that often hasn't been forthcoming.

PLN is also widely known as one of the state-owned enterprises where a culture of corruption is deeply ingrained. Corruption is certainly a problem at PLN, and the company has had its share of corruption-scandals, but for foreign investors dealing with the company this issue takes a back-seat to the much larger issue of PLN's precarious financial situation. PLN's reluctance to do anything but to develop the absolute cheapest coal-fired power plants, is the hurdle that stops most partnerships and power purchase agreements with independent power producers.

During the Widodo administration, PLN has been saddled with large responsibilities in the government's program to develop 35,000 MW of new power generation capacity. PLN has committed to develop several large new power plants, but has recently been criticized by Finance Minister Sri Mulyani Indrawati which has raised concerns about PLN's ability to pay back the debt it recently has taken on. Minister Indrawati knows how precarious PLN's financial situation and she also knows the Ministry of Finance would be stuck with the bill if PLN goes into default. She therefore decided to flag the issue publicly, to the irritation of both PLN's management and that of State Owned Enterprise Minister Rini Soemarno, who has been pushing for PLN's entry into new projects. That Indonesia's highly respected Minister of Finance raises concerns about PLN's ability to service its debt will certainly not help the company as it goes back to the market to raise more funds, and will raise the company's risk profile and financing cost.

What's not yet part of the political discourse around PLN is talk about deregulation of the Indonesian power market and splitting the company into separate producing and grid-operating entities. There has in recent years been some talk of removing the electricity subsidies and allow PLN to sell electricity at a profit, but it is not an idea that has entered the Indonesian mainstream and it is not likely to materialize in the short- to medium-term.

That said, there are some well-managed state-owned enterprises in Indonesia. Telecommunications company Telkomsel and Bank Mandiri are two state-owned enterprises with a strong presence in their respective sectors. Both have performed very well in the past decade and they have managed to break with the corruption that in the past has plagued their organizations. Both were partially privatized in the mid-2000s, and being obligated to live by the transparency and reporting requirements that come with a stock exchange listing has played an important role in cleaning them up.

The positive results from the partial privatization of state-owned enterprises in Indonesia should have cleared the path for others to follow. These success stories, however, have not triggered many new privatizations. The partial privatizations of Telkomsel and Bank Mandiri took place shortly after the 1998/99 Asian Financial Crisis. They came as a result of the Indonesian government's need to quickly to raise capital to cover budget gaps, and were not driven by a real commitment to privatization. Later, the Yudhoyono administration pushed through the partial privatizations and listings of Krakatau Steel and national flag-carrier Garuda, but abandoned a larger privatization program when it became clear that Krakatau Steel's management was completely unprepared for the kind of transparency the listing brought.

Under President Widodo there has been no talk of privatizing state-owned enterprises. Instead the government has attempted to put the state-owned enterprises into sectoral holding companies. The idea has been to strengthen their balance sheets so they can play a bigger role in the economy, particularly in infrastructure financing, but also as buyers of mining and oil and gas assets.

Case study - PERTAMINA

First among Indonesia's ill functioning state-owned enterprises stands oil and gas company PERTAMINA. Since the company was founded in 1968 it has been the textbook example of everything that is wrong with Indonesia's corruption riddled economy. PERTAMINA was taken over by special interest early on, and the company became a tool for rent-seeking at an unprecedented scale. The Suharto family alone is estimated to have taken out more than US$ 20 billion from PERTAMINA, and today some of Indonesia's largest fortunes stem from illicit dealings with the company.

PERTAMINA is arguably the state-owned company most resistant to change. Numerous attempts have been made in the past 20 years at fighting corruption, establishing Good Corporate Governance and increasing transparency inside the company, but the results have been mixed. Every step forward seems to be followed by a step back.

Deeply entrenched and powerful interest groups oppose any type of meaningful reforms. Companies, politically connected individuals and political parties have business dealings and various rent-seeking schemes with PERTAMINA that have been running for decades. For example, Pertamina's annual oil sales, fuel purchases and shipping costs amounts to around US$ 16 billion, with somewhere between 20 percent, or US$ 3.2 billion, being lost to corruption every year. In recent years, a PERTAMINA CEO and an Energy & Mineral Resources Minister have on separate occasions tried to plug this huge "leakage" by shutting the most corrupt business units, and replacing them with new units run by outsiders. Both attempts have at been very successful in ridding PERTAMINA of corruption, and both officials have been removed from their jobs for succeeding. The bad business units shuttered have been resurrected, and the corrupt practices have returned with billions of US dollars lost.

Real reform at PERTAMINA is hard because nobody can accurately predict the fall-out, or ring-fence specific violations. The company is a "Pandora's Box" of interconnected illegal activities that stretches back more than 40 years. Every time a real clean-up takes place, politicians and political parties, past and present ministers, their families, and powerful business groups gets implicated. Faced with the prospect of losing huge amounts of money, and in the worst case their freedom, they push pack with the all the resources at their disposal. So far they have won.

The one bright spot for PERTAMINA has been its upstream unit. In recent years, the company has taken over several operatorships and also gotten large stakes in big oil and gas block. Most important has been the Cepu oil block in Central Java, which ExxonMobil operates, but where PERTAMINA holds a 45 percent stake. The next big test for PERTAMINA is the take-over of the operatorship of the Mahakam gas block where TOTAL is pulling out after 50 years. The Mahakam block will make PERTAMINA a large gas producer in a Southeast Asian context, and is a chance to show that the company capable of managing a relatively complex block.

What to do?

The PERTAMINA case study above shows how deeply ingrained corruption can be in Indonesian state-owned enterprises and why meaningful change is so difficult to accomplish. There is at the same time a limit to the lessons that can be drawn from PERTAMINA as there are also state-owned enterprises in Indonesia that function well. However, as a rule of thumb foreign investors should be extra cautious when dealing with Indonesian state-owned enterprises. Regardless of the state-owned enterprise's reputation for good corporate governance, decisions will not always be made according to commercial logic. Even the well-managed Indonesian state-owned enterprises are highly politicised entities, and decisions are often made for other than commercial reasons.

That decisions are made according to non-commercial logic also has an impact on how and when projects are implemented. There are numerous examples of how large developments in the oil and gas industry have been linked to election cycles, where some of the financial benefits go to ministers, political parties and candidates standing for election. Foreign investors interacting with Indonesia's state-owned enterprises should make an effort to understand the political context the state-owned enterprises operate within, the political pressures that exist for specific projects, and the logic upon which state-owned enterprise employees base their decisions.

3. Executive branch

Indonesia's executive branch is widely regarded as the most competent branch of the Indonesian government and it is trusted and popular with the public. Historically all power rested with the executive branch, and while some of its formal powers have been lost due to regional autonomy and introduction of democracy, the executive branch still wields more influence that the constitution strictly gives it. This is primarily due to the fact that Indonesia's most knowledgeable and experienced bureaucrats are found here. In today's Indonesia, the three centers of power are parliament, regional authorities and the central government, but because the executive branch has vastly better human resources than the other two branches of government it still wields the most power. Parliament for example has extensive legislative powers, but weak human resources means it has limited ability to question the legislation put forward by the executive branch, and it rarely drafts its own legislation.

A. Ministries foreign investors interact with

The Energy & Mineral Resources Ministry and the Upstream Oil and Gas Taskforce (SKK MIGAS) are the two parts of the executive branch foreign investors in the oil and gas industry will interact with most frequently. SKK MIGAS is a relatively new creation, established in 2012 after Indonesia's Constitutional Court ruled that its predecessor, the independent regulator BP MIGAS' right to represent the Government and sign contracts with foreign companies was unconstitutional. The fix became SKK MIGAS, which while continuing to hold similar powers as BP MIGAS, was moved in under the Ministry of Energy & Mineral Resources to address the concerns raised by the Constitutional Court.

Energy companies have by and large been happy with SKK MIGAS, as actual changes in how the industry is regulated have been marginal. The concern now is that an announced new Oil & Gas Law would dissolve SKK MIGAS and move the regulatory powers for the sector over to PERTAMINA, which is the way it was in the Suharto administration. Early drafts of the new Oil & Gas Law have proposed reinstating PERTAMINA as the regulator, sparking an outcry among oil and gas executives over the obvious conflicts of interest that would be triggered by having PERTAMINA as an operator and regulator. This would look particularly bad now as PERTAMINA is about to become a large operator of oil and gas blocks, and not the passive investor it was in the past.

The Ministry of Energy & Mineral Resources and SKK MIGAS' attitude to foreign investors can be described as mixed. Both clearly understands that international oil companies (IOCs) and multinational oil services companies have important roles to play in bringing Indonesia's untapped offshore oil and gas fields on stream. Many ideas have been floated, but the Ministry of Energy & Mineral Resources has in the past decade failed to provide a favorable regulatory framework to attract foreign investment. With Indonesia not able to match the regulatory and fiscal terms offered elsewhere, it has been unable to attract its share of new exploration, particularly in deep-water blocks where there is the best chance of significant new discoveries. No major new oil or gas fields have come on stream since 2008, and the existing resources are rapidly being depleted. Indonesia's oil production has dropped from 1,340,000 barrels per day in 2001 to around 950,000 barrels per day in 2009, to 830,000 barrels per day in 2017.

Indonesia's easy oil and gas has for the most part been tapped, and developing the resources that remain require technology held by the international oil companies, and they haven't been willing to invest. Analysts say exploration investment will continue to sink until Indonesia devises a commercial and regulatory framework that provides fiscal certainty over the anticipated life of a project and balances the fundamentals of risk and reward with new marketplace realities.

Companies operating in Indonesia will also interact with the Ministry of Finance and the Tax Office. Indonesian introduced a flat 25% corporate tax rate from January 1, 2010, replacing a progressive corporate tax of 15-35% based on several income benchmarks. Public companies that meet a minimum listing requirement of 40% are entitled to an additional tax cut of 5% from the standard rate, giving them an effective tax rate of 20%. Small companies with an annual turnover of no more than Rp. 50 billion (US$ 3.75 million) are entitled to a 50% discount on the standard 25% tax rate.

The simplification was meant to streamline the tax bureaucracy and allow for better supervision and higher compliance. Since there no longer are any questions about which tax rate to apply there is much less need to interact with tax officials, and this provides less opportunity for rent-seeking and toll-collection. There have been improvements in tax collection with the reform, but tax collection is still low compared to Indonesia's regional peers.

Foreign companies operating in Indonesia also needs to needs to interact closely with the Manpower Ministry. The Manpower Ministry is responsible for approving the number of expatriate workers allowed in a company, which tasks they can perform, and the number of Indonesian staff that has to be hired by a company for every expatriate work-permit that is issued.

Leading up to and immediately following the election in 2015 there was a clamp-down in the number of work permits given to foreign workers. It was driven by a mix of xenophobic politics that played well in the election, and a sudden influx of Chinese workers in the construction sector, which never before had seen many expatriates. The result was that most new foreign work-permit applications were rejected, and the few that were approved were shorter three- or six-month permits. The situation has improved somewhat since 2015. There are today more one-year work permits being issued, and fewer short-term permits. However, the situation has not gone back to where it was before 2015 when most expatriate work-permit applications were approved as long as the expatriates and the employers fulfilled the established criteria.

Case study – Renewable energy in Indonesia

Indonesia is one of the most prospective countries in the worlds for renewable energy. It has an enormous untapped potential for geothermal energy, and parts of the country also has very strong prospects for hydro power. In addition, Indonesia's location on equator means its potential for solar power is enormous. Give how much the price of solar panels have come down in recent years, solar power is now competitive with coal-power in some parts of Indonesia.

Not surprisingly, pricing is key to understanding the current Indonesian policy debate on renewable energy, and why so many renewable energy projects are planned but why so few are developed. Because Indonesia has no inter-connected national grid, the country is essentially a collection of separate markets where the government sets the price. PLN is the monopolist supplier, selling electricity at different prices in different markets but usually a loss to the end users (see Case Study – Perusahaan Listrik Negara).

Because of its precarious financial situation, PLN has been reluctant to develop and buy electricity from anything but cheap coal-fired power plants. At the same time, the Government of Indonesia has set ambitious targets for reducing its CO2 emissions which means more of Indonesia's new energy needs to come from renewable sources. To create an incentive for PLN to enter into offtake agreements with renewable energy producers, the Ministry of Energy & Mineral Resources issued in early 2017 a regulation (No. 12/2017) which set the feed-in tariff pricing for renewable energy to between 85% and 100% of PLN's regional production price. This certainly helped PLN, but ruined the economics of the renewable energy projects for the independent power producers that were developing these projects. The government has now realized the flaws of its proposed pricing scheme and is working on fixes that can satisfy both sides. A few new initiatives and some tweaks to the regulation have been announced, but there have so far not been any proposals that would bridge the price-gap between what PLN wants to pay and what the independent power producers need to get in order to develop the renewable energy projects.

B. Commitment to bureaucratic reform and good governance

Over the past decade, the Ministry of Finance has been the bright spot in Indonesia's executive branch, which by and large has been reluctant to undertake any serious reform. In recent years the salaries of top bureaucrats in the Ministry of Finance have continued to increase to make them competitive with the private sector. Several thousand bureaucrats in the highly corrupt and cash-rich Tax Office and Customs & Excise Office have also been replaced with new and young staffers don't come with the same mindset on rent-seeking.

The Ministry of Energy & Mineral Resources has seen less reform. There is a new generation of bureaucrats at the top of the Ministry, they can hardly be labeled reformers. While Indonesia's oil and gas and mining sectors have been in decline in the past decade, it is still one of the country's largest sectors in terms of revenue. The amount of money involved in the sector has also been the key driver of the corruption and rent-seeking within the Ministry of Energy & Mineral Resources.

At the end of Yudhoyono administration's tenure in 2014, the Ministry of Energy & Mineral Resources was rocked by a series of high-profile corruption scandals that implicated several top officials. The Chairman of SKK Migas was jailed for seven years for taking over US$ 1 million in bribes from a Singapore-based oil-trader and, Jero Wacik, the Minister of Energy & Mineral Resources from 2011 to 2014, was in 2016 sentenced to four years in prison for accepting US$ 841,000 in kickbacks during his tenure as minister. During his trial, Minister Wacik said he took the money in order to pay reporters at national newspaper to write positive stories about him and the work he was doing as Minister of Energy & Mineral Resources. The newspaper in question was read every day by President Yudhoyono., and Minister Wacik saw the positive news coverage as an investment in job security.

In the Widodo-administration, there has so far not been any major scandals involving Ministry of Energy & Mineral Resources officials, but the across-the-board reforms the Ministry needs have also not taken place. President Widodo's first Minister of Energy & Mineral Resources started a big clean-up of PERTAMINA right after he was appointed in October 2015, but was removed after 18 months on the job. Minister Said became a victim of his own success, with the financial losers from his cleanup of PERTAMINA successfully pushing for his ouster. Since then, the government has put a lid on the goings-on in Indonesia's energy sector. No major scandals have erupted, but there have also been no major reforms.

Case study – The GOI's Flip-Flop on Masela

The Masela block is Indonesia's second largest undeveloped gas block and holds an estimated 22 tcf of recoverable reserves. Located in the Timor Sea, closer in distance to Australia than Indonesia, the remote block's development has been a point of contention since it was discovered by Japan's INPEX in 1992. After studying the available options, including bringing the gas to an LNG plant in Australia, INPEX decided to develop Masela as floating LNG. It brought in Shell as a 35% partner in the block as it was one of only a few companies globally with any experience in floating LNG.

By selling a 10% stake to the Bakrie family (see Case Study – The Bakrie family's regulatory arbitrage), INPEX and Shell got in 2013 approval for its Plan of Development for floating LNG at Masela. That should have been it, but in 2015 President Widodo asked for a reassessment of the

Masela block's Plan of Development. Then Minister of Energy & Mineral Resources Sudirman Said hired US consulting firm Poten & Partners, which after assessing the available options concluded that floating LNG was the best solution for Masela. This was also Minister Said's recommendation to President Widodo, but in March 2016 the president announced that Masela should be developed as conventional onshore LNG. The location of the onshore LNG plant was to be Tanimbar Islands, located some 170 kilometers away, requiring a gas pipeline to be laid across the 3000-meter deep and seismologically active Timor Trench. President Widodo said he wanted an onshore LNG solution as it would bring greater benefits to local communities and enable higher local content for the development.

The decision took many people by surprise, not the least INPEX and Shell, which for years had prepared for developing Masela as floating LNG project. The onshore LNG plant INPEX and Shell now are planning has a larger capacity (9.5 million tons) than the floating LNG's (7.5 million tons), but it also comes at a considerably higher cost. Floating LNG was priced at US$ 14.8 billion, while early estimates for onshore LNG at Masela are coming in at US$ 19.3 billion.

With the economics of onshore LNG at Masela considerably worse than floating LNG, it is difficult to understand why President Widodo went against INPEX's and Shell's wishes as well as the recommendation of Minister Said. The answer is most likely found in the president's statement about higher local content. Floating LNG meant that the entirety of the contract would have ended up in shipyards in South Korea. Onshore LNG offer greater opportunities for Indonesian companies to get contracts, particularly for the pipelines which for the onshore LNG development will be a huge part of the project's development cost.

What is less discussed, but what has become increasingly clear following President Widodo's surprise U-turn on Masela, is that that the whole development is now in jeopardy. INPEX and Shell are not walking away from the development, but they are certainly only half-heartedly progressing the project. This became clear when INPEX in mid-2016 cut 300 staff that had been working on the project. Masela is now estimated to come on stream sometime after 2026.

It's not without a certain amount of irony that the only people who so far has made any money on Indonesia's most prospective gas block is the Bakrie family, which cleared more than US$200 million when they secured INPEX and Shell the approval for a Plan of Development for floating LNG at Masela that President Widodo later overturned.

C. The government's stance of foreign investment

The Indonesian government has a mixed attitude to foreign investment. The current Widodo-administration is undoubtedly sincere about re-establishing Indonesia's 1980s and early-1990s reputation as a welcoming destination for foreign investment, and has since it came to power in 2015 been on a deregulation drive where the primary goal has been to make Indonesia more attractive to foreign investors.

Indonesia was in 2017 ranked 91st in the World Bank's Ease of Doing Business Index, and President Widodo has set a target of 40th place by 2018. Indonesia is unlikely to reach this, but it may get close. It jumped 15 places in 2016, and as the government's economic policy and deregulation packages have started to take full effect, further improvements are expected.

While the Yudhoyono-administration from 2005-2015 was marked by inward-looking and protectionist policies which raised overall cost and decreased Indonesia's competitiveness, President Widodo has a very different outlook. He is committed to an Indonesia that is more closely integrated with the global economy, underlined by the 25 bilateral investment treaties Indonesia is negotiating at the moment. The government's objective with opening up the Indonesian market is to boost the manufacturing sector, make Indonesia part of global supply chains, and attract much higher levels of foreign direct investment.

Despite the Widodo administration's foreign investor friendly rhetoric and policies, economic nationalism and skepticism to foreign investment runs deep in Indonesia. This is particularly true for oil and gas and mining sectors where foreign investors have lived through a decade of an increasingly difficult operating environment. President Widodo's administration has so far not done much to break with economic nationalism in the natural resources sector. The last-minute U-turn on the Masela gas development, changing it from floating to onshore LNG, and thereby delaying the development with up to 10 years. The refusal to extend Total's PSC for the Mahakam block after 50 years of operations. The endless maneuvering and delays in the negotiations with Freeport about the extension of the Grasberg mining contract, which is putting the mine's expansion in jeopardy. These are all examples of an administration that when it comes natural resources is not practicing what it preaches.

That the otherwise investor-friendly Widodo administration is so recalcitrant when it comes to oil and gas and mining underscores how difficult and sensitive this issue is. Resource nationalism runs so deep that all economic logic seems to go out the window, and a bad local solution is perceived as many times better than a good foreign solution. For politicians of all colors there is nothing to gain, but much to lose for siding with foreign investors in natural resource projects.

Case study – Freeport and the Government of Indonesia

Indonesia's deep-rooted resource nationalism is maybe best exemplified by the Government of Indonesia's long running dispute with US-based Freeport-McMoran on the contract extension for the Grasberg gold and copper mine. Freeport began its mining operations in Indonesia in the late 1960s and is today running the world's largest gold and copper mine in the Papuan highlands. It is an operation that generates huge profits for Freeport, employs more than 30,000 workers, and holds an undisputed status as Indonesia's single largest tax-payer. A US$ 20 billion underground expansion, which will extend the life of the mine for more than 40 years, has been on hold as Freeport's current contract for the Grasberg mine expires in 2021, and no certainty has been provided by the Indonesian government about what happens after that.

After more than 50 years of operations, Freeport is widely regarded as the only realistic operator of the mine. The Indonesian government, on the other hand, has argued that Freeport can be replaced by an Indonesian mining company, although no Indonesian mining company exist that has the financial resources or technical expertise to take on a project like Grasberg's underground expansion. With the government unwilling to face the fact that Freeport can't be replaced, the contract-extension talks have until recently been at a deadlock.

The Indonesian government's actions during the negotiations have also have also stymied Grasberg's production and lost the government several hundred million US dollars in tax revenue. The losses are expected to grow as the mine's above-ground resource is soon depleted, and Freeport has been putting the underground expansion on hold until a contract extension is signed.

In late August 2017, the Widodo-administration announced the framework for a deal with Freeport where it continues to operate the mine until 2041, but divests a 51% stake in PT Freeport Indonesia in a yet to be determined Indonesian entities. The details for how the divestments would work are not clear, and many industry insiders doubt it will ever happen as few Indonesian buyers exists for such a stake at market rates. Further adding to the complexity is the fact that the buyers would be responsible for financing their share of Grasberg's US$ 20 billion underground expansion in accordance with their ownership stake.

An area where the Widodo administration has made great strides is in the revision of the Negative Investment List of local industries where foreign investment is partially or wholly restricted. Under President Yudhoyono, this list grew to include 350 sectors, but in mid-2016 President Widodo eased the number or fully opened sectors by 35, with promises of further market openings to come. That more than 300 sectors are still fully or partially closed to foreign investment speaks volumes about the challenges the Indonesian economy is facing, but the country now has a president that believes the only way to make Indonesia's industry competitive is to open the market to foreign competition. This is a big change in outlook from the Yudhoyono administration from 2005-2015, which took the view that industries could only be opened to foreign competition when they were competitive, which they never became as long as they were hiding behind high tariff walls.

One area where recent Indonesian governments haven't made much progress is amending Indonesia's *Labor Law*. Passed under President Megawati Sukarnoputri in 2003, subsequent administrations have without success tried to repeal and later revise a *Labor Law* that dramatically favors workers at the expense of employers. The law offers almost unprecedented protection for employees and is so rigid that it is almost impossible to fire employees without having to make severance payments that can amount to several years' salary. In the manufacturing sector, which often experiences ebbs and flows in the workload, foreign investors have largely stayed away from Indonesia since the *Labor Law* doesn't allow for the workforce to be scaled up and down.

In the textile and footwear industry, foreign investors have been known to flee the country when an economic downturn has caused fewer orders and required layoffs. Faced with the prospects of large severance payments, several have instead chosen to pack up and leave Indonesia. Local manufacturers don't have the same option, and have instead tried to shift the responsibility over to the global brands that source from them. Nike is one of the companies that has been forced into making large severance payments to the workers of a politically connected local firm that it was sourcing from.

For white-collar jobs, recruitment of workers must also be done with care. According to a 2017 McKinsey report, 52% of the employed population is underqualified for their job position. Incompetence or unsuitability for a job is *not* sufficient reason to terminate an employee. A worker can only be dismissed for misconduct, and only after receiving three separate warnings spaced three months apart which means it can take almost a year to dismiss an unsatisfactory or unsuitable worker. In reality, few companies go through these legal steps and usually handle human resource problems with a golden handshake and a face-saving exit for the employee.

4. Legislative branch

The Indonesian Parliament has for several years running been listed as one of Indonesia's most graft-ridden institutions by the Corruption Eradication Commission (KPK), Transparency International and Indonesia Corruption Watch. Parliament has repeatedly been tarred and feathered by bad press from corruption allegations, arrests, prosecutions and convictions of not only former and current lawmakers, but in one case in 2007 an entire 52-member legislative commission. In 2016 and 2017, it has been disclosed that 37 parliamentarians colluded with businesspeople and the bureaucracy to rig a tender for a new national identification card, with around 50% of the US$620 million budget being set aside for being siphoned off. The funds did not only line the pockets of the individual parliamentarians, but also went to fund the operations of several political parties.

These revelations have given the Indonesian public a glimpse into the depth of the corruption in parliament and showed beyond doubt that none of the political parties in parliament are clean. Few signs exist to indicate that the situation is about to change for the better. The public shaming of legislators caught up in corruption scandals should under normal circumstances mean that others would be more cautious and change their behavior. However, this logic does not seem to apply to the Indonesian parliament. One corruption scandal rolls into the next without there being any signs of behavioral change. The prospect of jail seems insufficient to motivate changes in behavior, leaving the judiciary and anti-corruption activists equally flummoxed about what the fix is.

A. Indonesia's legislative chambers - MPR, DPR and DPD

Indonesia has three representative bodies at the national level - the People's Consultative Assembly (MPR), the House of People's Representatives (DPR) and the House of Regional Representatives (DPD). The DPR is 560-strong and consists of representatives from Indonesia's 77 electoral districts. It meets throughout the year and its main function is passing legislation, but it also has an important supervisory role over the executive branch. The DPR is by far the strongest of the three representative bodies, and it overshadows the other two in almost all cases.

The DPD, which was created in 2001, consists of 136 elected members where Indonesia's 34 provinces regardless of their population have four representatives each. Although intended to play the role of a senate in a bi-cameral system, the DPD has in fact very limited powers and has never been able to live up to its constitutional mandate. It doesn't function as a true upper house and can at best be said to have a more of an advisory role. The MPR has 696 members comprising of the 560 DPR members and the 136 DPD members. The MPR's powers are primarily linked to constitutional amendments, and it also has the authority to impeach the President and the Vice President. The MPR's narrow parameters for how it can wield its power mean that on a day-to-day basis it is largely irrelevant in Indonesian politics.

B. Political stance

The Indonesia parliament can be very nationalistic and legislators from all parties have a healthy skepticism of foreign investors. How deeply rooted this negative sentiment really goes is more questionable. More than anything, their skepticism stems from the fact that a nationalist sentiment is smart politics. Few votes are found in being a strong proponent of foreign investment, while many can be won by aggressively opposing foreign involvement in Indonesia.

Following the April 2015 general election, the Indonesian parliament is dominated by just six parties – PDI-P, Golkar, Gerindra, Demokrat, Pan, and the mildly Islamist PKB. No fewer than 46 parties registered to run in the election, but only 12 passed the requirements set by the General Election Committee to run and in the end 9 parties won seats in parliament. Although pragmatism trumps principles in most Indonesian political parties, it is possible to discern some differences in ideology. The Democrats are pro small business and are the proponents of a reform agenda of bureaucratic overhaul, privatization of state-owned enterprises and corruption eradication. PDI-P is leftist and increasingly populist, opposing privatization and favoring strong labor rights and limited bureaucratic reform. Golkar was the ruling party in the Suharto-era and its authoritarian roots means it's close to Indonesian elites and big business (Indonesian conglomerates). Its base can be found among the millions of Indonesian civil servants who favor status quo over reform. PAN and PKB takes their political outlook from Islam and find its base among the pious middle-class.

The 2015 election was the 4th free election since the fall of Suharto, and a political party system has now started to take shape. There are now five parties with a national presence and a stable supporter base, and are expected to outlast their founders. The other parties are the personal vehicles of politically ambitious and financially resourceful individuals and unlikely to survive long term.

C. Involvement in business

Looking more closely at the way the Indonesian parliament operates one discovers that while there is clearly an element of self-enrichment, lawmakers are also trapped in a system that pushes them towards rent-seeking and corrupt behavior. Lawmakers are susceptible to bribes as they want to recoup the vast sums of money they have spent out of their own pockets to win seats in parliament. Indonesian politicians don't get any money from their political parties and they must finance their own campaigns. This is also not their only expense. In most cases the candidates pay the party large cash sums to be selected to run for a seat.

Because securing a seat in Parliament can be very expensive for individual candidates, many develop close ties to Indonesian business groups who serve as their sponsors. In return, the business groups get an indebted legislator that can represent their interests. Indonesia is maybe no different from many other countries in this regard, but the level of influence Indonesian conglomerates get for their sponsorship of legislators is pretty unique. This is usually seen in the cases where individual members of parliament, and in some cases whole commissions, interfere in issues clearly outside parliament's mandate. It often happens in government tender processes where DPR members meddle in the affairs of the executive branch to give their "corporate sponsor" a leg up on the competition.

Law-making in Indonesia also has a unique symbolic quality, and DPR members appear to give very little thought to how the legislation they pass will actually be implemented and enforced. Most new laws are packed with the interest of each party to avoid conflicts even if articles in a law stand in direct contradiction to each other. The laws that emerge are therefore often not very helpful and implementation of the laws and regulations is extremely problematic.

What to do?

The best advice to foreign investors in Indonesia is to stay away from parliament. Although building relationships with a wide variety of stakeholders is important for companies new to Indonesia, parliament does not need to feature on this list of “friends”. Due to the rampant corruption, and the close ties of individual members to Indonesian business groups, parliament is an institution foreign investors should not trust. Even engaging with parliament in a completely clean and transparent manner will be counterproductive as there among other stakeholders will be a suspicion of wrong-doing as soon as they hear a company has engaged parliament.

If a company for some reason is required to meet with DPR members, try to keep it as formal and official as possible. First, meet in an office and not in a more informal setting like a restaurant or somebody’s home. Second, do not go alone. Bring several people so there are witnesses that later can account for the conversation that took place. Third, ask if it’s OK to take minutes from the meeting. If this is allowed, it’s an indication that there will be no improprieties. If the request is denied, it serves as an early warning that there potentially are more sinister motives behind the meeting and you need to be alert to the direction the conversation is taking.

5. Judicial branch

Whatever expectations foreign investors have of Indonesian courts they always seem to disappoint. Far too often rule of law simply doesn't apply to foreign nationals or international companies in the Indonesian legal system. Some progress has arguably been made in the past few years, but arbitrary rulings that defy all legal logic continue to be issued. The question, of course, is whether economic self-interest and the fear of sacrificing foreign investment will eventually lead Indonesia to disallow clear legal abuses. It might, but it seems unlikely to happen in the short term.

Indonesia has so far chosen to disregard international outcry over violations of even the most basic legal principles, and has been proven correct in its assessment that foreign investors are willing to take the risk of investing in Indonesia as long as there is money to be made. However, an argument can also be made that Indonesia is missing out on investments because of its weak legal system, with many international companies choosing to service the Indonesian market from the more business friendly and legally sound Singapore, with only a small or no footprint in Indonesia.

A. The judiciary

The Indonesian judicial system consists of several types of courts under the oversight of the Supreme Court. Most disputes appear before the courts of general jurisdiction, with the court of first instance being the State Court. There are about 250 State Courts (often referred to as District Courts) throughout Indonesia, each with their own territorial jurisdiction. Appeals from the State Court are heard in the High Court, of which there are 20 throughout Indonesia. Appeals from the High Court, and in some instances the State Court, go to the Supreme Court in Jakarta. The Supreme Court can hear a *cassation appeal,* which is a final appeal from lower courts. It can also conduct a *case review* of a previous Supreme Court ruling if new evidence is found or if it is deemed that the law was wrongfully applied in a previous Supreme Court ruling.

In 1998, a Commercial Court was established in Indonesia. It was initially tasked with handling bankruptcy and insolvency cases, but its jurisdiction also extends to other commercial matters.

Appeals from the Commercial Court go directly to the Supreme Court. There is also a State Administrative Court that hears administrative cases filed against the government. In 2003, a Constitutional Court was established with jurisdiction to hear cases on the constitutionality of legislation, general elections, dissolution of political parties and the scope of authority of state institutions.

B. Corruption in Indonesian courts

The Indonesian court system has stubbornly resisted reform, and since the fall of Suharto it has been “business as usual”. Payment in exchange for favorable rulings is rampant throughout Indonesia. A 2008 study by Transparency International showed that 30% of all interactions people had with Indonesian courts involved paying a bribe. The average bribe paid was Rp. 102,412,000 (US$ 8,545), the highest for any Indonesian government institution. Similar studies have not been carried out in recent years, but the situation is not expected to have improved much.

In cases involving foreign investors there is also a clear influence of “legal nationalism” in Indonesian courts. Its origins can be found in the years following the fall of Suharto, where it was argued that the way some multinationals had gained access to the Indonesian market in the Suharto years was unjust and that contracts needed to be redone because of it. This might have been true in some cases, but as 20 years have passed and courts show no evidence of becoming less arbitrary in their rulings, this justification is wearing increasingly thin. These factors conspire to put foreign companies at considerable disadvantage if they go to court and the chances of getting a fair trial is usually pretty slim. Indonesia’s judicial branch also suffers from the fact that most judges of any honesty and integrity were removed by the Suharto regime. What is left is a court system that uses the symbolic forms and the language of law, but which dispensed precious little actual justice. For example, the Supreme Court’s Chief Justice from 2001 to 2008, Bagir Manan, said 75% of Indonesia’s Supreme Court judges were susceptible to taking bribes during his tenure.

The lack of clean and competent judges becomes particularly clear in commercial disputes, and Indonesia’s bankruptcy laws are a case in point. Indonesia’s bankruptcy laws may have been reformed, but it seems that Indonesian courts are still reluctant to protect creditors from debtridden Indonesian companies, especially, when those creditors are foreigners. Indonesian lawyers usually don't bring bankruptcy cases or other commercial disputes in front of the Commercial Court, which are meant to resolve these cases. Instead they prefer to take these cases to the State Courts, where judges are unfamiliar with commercial disputes and struggle to come to grips with concepts such as bankruptcy and debt restructurings.

Case study – Debt restructuring

The most common legal maneuver used by Indonesian companies to avoid repaying foreign creditors is to retreat to Indonesian jurisdiction. For tax- and market trust reasons, most Indonesian corporate bonds are issued in foreign jurisdiction through special purpose vehicles (SPV), and governed by either US or Singapore law. The foreign jurisdiction creates an expectation of fair treatment in the event of a dispute, but this has time and again proven to be a misconception.

When debt goes into default, Indonesian companies usually retreat behind Indonesian borders, regardless of what they had agreed to when the debt was issued. Creditors are outraged, but as long as the Indonesian entities don't have any assets abroad that can be confiscated, creditors are forced to come to Indonesia and seek debt restructuring through Indonesian courts, where the odds of success are long. The Indonesian Bakrie family has in recent years used this tactic with great success. Since 2014, companies linked to the family have defaulted on several billion US dollars in debt issued under US and Singapore jurisdiction. The Bakries have refused to deal with creditors other than in Indonesian courts. Indonesian courts have in all instances ignored the contractual commitment to settle disputes in US or Singapore courts, and issued rulings that strongly favored the Bakrie family. This has helped the Bakries avoid bankruptcy, and forced creditors to accept debt-to-equity swaps on terms that effectively means the entire debt is wiped off.

These actions hurt the credibility of the entire Indonesia private sector, and increases the risk profile and financing cost for all Indonesian corporates. At the same time, the international financial community has both a short memory and a willingness to overlook past misdeeds. The Indonesian conglomerate Sinar Mas defaulted on US$ 13.9 billion in debt in 2001, and spent the next decade hiding from international creditors behind Indonesia's borders. At the time, the assumption was that no investors or banks would ever deal with Sinar Mas again. However, in 2015 this was all forgotten when a Sinar Mas subsidiary issued a US$ 225 million bond using the same SPV structure that had allowed Sinar Mas to retreat to Indonesia and avoid paying back billions of US dollars in debt. A new generation of bankers and investors had arrived on the scene since 2001, and were willing to ignore past misdeeds when the prospects of fees and high returns dangled in front of them.

C. Contracts in Indonesia

Notwithstanding the obvious weaknesses of the Indonesian legal system, contracts are still an important part of Indonesian business. However, there are some distinct differences it is important for foreign investors to be aware of. In the west the attitude is that "a deal is a deal, and contracts consequently use a language where rights and responsibilities of the contracting parties are clearly laid out in writing. Once an agreement has been signed it's usually closed for further negotiations and is binding regardless of changes in circumstances.

In contrast, contracts in Indonesia are usually much less detailed and often subject to constant renegotiation and reinterpretation. Flexibility is seen as a virtue, and contracts are worded accordingly. This means that the context upon which an agreement is made is much more important than the signatures on a document. Shared goals, mutual understanding, trust and economic interdependency between the contracting parties are key elements for successful partnerships in Indonesia, and trumps the value of any contract. In this context, formal signing ceremonies that may appear strange to a westerner company serve an important purpose. They carry symbolic power and increase the prestige and legitimacy of the contract and cements the business relationship. On the same note, a contract drawn-up and co-signed by a public notary and given an official stamp carries more legal weight and is more difficult to break in the minds of most Indonesians than a contract drawn-up by a non-notary.

Foreign investors who have seen the dark side of Indonesian business will often argue that Indonesian companies will always make a net present value calculation - the value of cheating a partner against the value of not cheating a partner. This was probably truer in the past than it is now. Today, many Indonesian companies, especially in the oil and gas sector, want partnerships with foreign companies to improve or manage their operations. They also want to gain access to international capital markets, which means they have to be more above board in their business dealings than in the past. This all suggests that they will clean up their acts and live by a different set of rules.

Many foreign investors try to get around the uncertainties in the Indonesian legal system by making contracts subject to foreign jurisdictions such as Singapore, the UK or the US. While this provides some extra security, it gives as already mentioned above no guarantee of not being taken in front of Indonesian courts. There are many examples of contracts between foreign and Indonesian companies that clearly commits the parties to a foreign jurisdiction, but which have ended up in Indonesian courts.

What to do?

It's not pleasant for a foreign investor to be faced with prospect of going to court in Indonesia. As highlighted above, the chances of getting a fair trial are slim. Against this background, a foreign investor should only take a dispute to court when all other avenues for conflict resolution have failed. And then, the threshold for a foreign investor to go to courts should be very high.

Because of the limited legal protection that exists in Indonesia, it's absolutely vital for foreign companies to establish relationships with as many different layers of Indonesian society as possible and make a positive contribution to the environment where they operate. These networks should interweave and overlap with those of your Indonesian business partners. By the end of the day, social pressure for business partners to act fairly and honestly towards one another is of much greater value in Indonesia than any legal document.

In the cases where a foreign investor is taken to court by another party and named as a defendant, the same rules as above apply. As many stakeholders as possible should be briefed about what's going on, and the process that lead to the case ending up court in the first place. It's equally important to hire a highly reputable lawyer. In fact, hiring a reputable lawyer is more important in Indonesia than in most other countries. In general, Indonesia’s lawyers have a reputation that matches those of the courts. There are, however, some notable exceptions and being represented by one of Indonesia’s “clean” lawyers sends a strong signal about a company’s integrity and innocence. The latter is due to the fact that Indonesia’s well-reputed lawyers make a point out of representing the aggrieved parties in a dispute. Since Indonesian courts have such a shabby reputation, the fact that a company is represented by a well-reputed lawyer sends a signal of innocence to a company’s stakeholders that is stronger than the actual ruling in a case.

On the flip side, Indonesia’s reputable lawyers have a high loss rate. This is due to the fact that they don’t pay bribes, and the ruling usually goes in favor of the party that does. Corruption in Indonesian courts is so common, and the prejudices against foreign companies so many, that when a foreign company actually gets a favorable ruling it is usually followed by speculation of pay offs.