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Industry Report: Automotive Industry in Indonesia

I. Introduction

Indonesia is the fourth largest economy in Asia and the 16th largest economy in the world. Its gross domestic product ("GDP") amounted to around USD 1.0 trillion in 2020. It is rich in natural resources such as oil, natural gas, coal, gold, silver and copper.

The Indonesian economy is characterised by its extensive production of raw materials and a strong agricultural sector. Key export commodities include palm oil, rubber, coffe, and tea, which play a pivotal role in the country's trade dynamics. Additionally, the service sector, particularly tourism, makes a substantial contribution to the national economy, reflecting Indonesia's diverse cultural heritage and natural beauty.

As a member of the G20, Indonesia has demonstrated a commitment to economic progression and stability. Recent years have seen the Indonesian government undertake a series of reforms aimed at economic liberalisation and enhancing the country's attractiveness to foreign investors, signaling a strategic shift towards fostering sustainable economic growth and development.

Investment climate in Indonesia

Indonesia presents a favourable investment climate characterised by robust economic growth and a youthful population. In recent years, the government has undertaken significant reforms to liberalise the economy and enhance its attractiveness to foreign investors.

In October 2020, Indonesian lawmakers enacted the Omnibus Law on Job Creation, part of the government's comprehensive economic reform package designed to stimulate investment and enhance global competitiveness. This legislation introduced several key reforms aimed at attracting foreign investment, including:

- The corporate income tax rate was lowered from 25% to 22% in 2020, to bolster business investment and align Indonesia with international tax competitiveness.
- Investment regulations have been revised to simplify the approval procedures. A significant development is the introduction of the Online Single Submission System (OSS), which consolidates and accelerates the process for obtaining necessary permits and licenses for business operations.
- Deregulation in numerous sectors, allowing greater foreign ownership and participation. This initiative has opened up previously restricted sectors, such as digital and telecommunications, healthcare and energy, to foreign investors, aiming to drive sectoral growth and innovation.

Automotive industry in Indonesia

The automotive industry has become a vital component of Indonesia's manufacturing sector, with numerous prominent global car companies establishing or expanding their manufacturing plants in the Association of South East Asian Nations ("ASEAN") largest economy. Indonesia has undergone a significant transformation, evolving from primarily an export-oriented car production hub, particularly for the ASEAN market, to a substantial domestic car sales market, driven by an increasing per capita GDP.

Indonesia is the second largest automotive producer in ASEAN. The market is growing steadily and is expected to expand further in the coming years. In 2023, the Indonesian automobile manufactures association (GAIKINDO) reported a total 1,395,717.000 vehicles were produced in Indonesia, which shows that the automotive sector recovered well from its COVID-related plunge in 2020.

In terms of market size, Indonesia is the biggest car market in Southeast Asia and ASEAN. Indonesia accounts for about one-third of total annual car sales in ASEAN, followed by Thailand on second position. Indonesia not only has a large population (258 million inhabitants), but is also characterised by having a rapidly expanding middle class. Together, these two factors create a powerful consumer force.

Attracted by low per capita-car ownership, low labour costs and a rapidly expanding middle class, various global car-makers (including Toyota and Nissan) decided to invest heavily into expanding production capacity in Indonesia and possibly making it their future production hub. Others, such as General Motors (GM) have come back to Indonesia (after GM had shut down local operations years earlier) to tap this lucrative market. However, Japanese car manufacturers remain the dominant players in Indonesia's car manufacturing industry, particularly the Toyota brand.

More than half of total domestic car sales involve Toyota cars. It is a very difficult challenge for western brands to compete with their Japanese counterparts in Indonesia, known as the backyard of Japanese car manufacturers.

II. Regulatory framework for foreign direct investment in Indonesia

Indonesia offers various options for foreign investors to engage in business activities.

Incorporation of a subsidiary in Indonesia

In Indonesia, PT (Perseroan Terbatas) is the only body corporate open to FDI. PT is a limited liability company with a two-tier board structure (management provided by the Board of Directors, while the Board of Commissioners is a supervisory office). PT requires a minimum of two shareholders for incorporation and will lose its limited liability status if and for as long as at any time during its existence it has less than two shareholders for more than six consecutive months. PT with FDI is locally called PT PMA (*Perseroan Terbatas Penanaman Modal Asing*).

The Indonesian Capital Investment Coordinating Board (*Badan Koordinasi Penanaman Modal, or "BKPM"*) is the government agency empowered to approve the establishment of PT PMA through the Online Single Services ("OSS") system. Prior to incorporating PT PMA, it is required to review the following:

- The investment limitation, to determine whether a business field can be wholly-foreign owned or only partially-foreign owned. As a general rule, all business fields are open to investment, except for those which are otherwise stipulated in the Presidential Regulation No. 10 of 2021 (as amended by the Presidential Regulation No. 49 of 2021) on Investment Business Fields.

- The investment value and capitalisation. Currently, the investment value for FDI shall be more than IDR 10,000,000,000 (ten billion Indonesian Rupiah), excluding land and buildings, per business field and project location. Meanwhile, the minimum paid up capital shall be IDR 10,000,000,000, provided that no shareholder is allowed to pay up a capital less than IDR 10,000,000. However, this capital participation can be repatriated back to the shareholders when closing their investment in Indonesia.
- The founding shareholders must also arrange for the name of PT PMA to be reserved at the Ministry of Law and Human Rights (“MOLHR”). This reservation is in practice usually handled by a public notary in Indonesia.

Following the above stages, the founding shareholders should incorporate a PT PMA by way of executing the Deed of Incorporation containing the Articles of Association which must be signed before a public notary and filed with the MOLHR.

The filing will be undertaken by the notary and will be done electronically. The notary will complete the electronic form prescribed by the MOLHR with the required information and supporting documents and submit them to the MOLHR at the latest 60 days after the date the Deed of Incorporation is executed.

If the information contained in the electronic form and supporting documents are in line with the prevailing laws and regulations, the MOLHR will issue a no-objection statement to the application. Within 30 days of the issuance of the statement, the founding shareholders or the notary as their proxy must deliver to the MOLHR the original, hard copy application letter together with the supporting documents. 14 days after the completed application and supporting documents are received by the MOLHR or sooner, the MOLHR will electronically issue a signed decision to approve the newly-founded PT PMA as a legal entity.

Relationship with the European Union

EU-Indonesia trade relations have significantly deepened, especially since the launch of negotiations for an EU-Indonesia Free Trade Agreement ("FTA") on 18 July 2016, with 16 rounds of talks held to date. The ongoing FTA negotiations aim to address a broad spectrum of issues, including tariffs, non-tariff barriers, public procurement, competition and intellectual property rights, with the overarching goal of facilitating trade and investments.

The FTA aims at developing a key aspect of the overall relationship between the EU and Indonesia, which is framed by the Partnership and Cooperation Agreement. This agreement entered into force on 1 May 2014.

In 2020, bilateral trade in goods was valued at EUR 20.6 billion, with EU imports from Indonesia at EUR 13.3 billion, setting Indonesia as the EU’s fifth-largest trading partner within ASEAN.

III. Challenges

Although Indonesia offers numerous opportunities for foreign investors, certain challenges exist that can impact the viability and profitability of their business ventures in Indonesia. This may include the following:

Regulatory barriers

Investors may find navigating the regulatory environment in Indonesia challenging, due to multiple layers of bureaucracy, which can potentially cause delays in obtaining necessary permits and approvals.

Rapid policy changes and the implementation of new regulations without adequate notice can complicate long-term planning. Additionally, regulatory guidance may appear unclear, resulting in businesses having to consult local experts, which can increase the time and costs to start operations.

Quality of infrastructure

The quality of infrastructure is still a concern, especially considering that Indonesia is an archipelago. Indonesia consists of more than 17,000 islands, and around 6,000 of them are inhabited. The nature of these islands poses logistical challenges, especially in the areas of transportation and connectivity.

Even though big cities such as Jakarta and Surabaya have experienced infrastructure development, many other areas are lagging behind. Inadequate road networks, limited port facilities and inconsistent electricity supplies can hinder operations, especially for industries that depend on strong infrastructure.

Corruption and political risks

The risk of terrorism and high levels of corruption can be a deterrent for foreign investors. Despite efforts to eradicate corruption, it is still a big concern in Indonesia. Businesses often face requests for unauthorised payments or encounter systems where corruption can impact decision making at various levels.

Although Indonesia is relatively stable politically, occasional flare-ups related to regional or religious tensions can pose risks. In addition, the threat of terrorism, although it can be overcome with strong anti-terrorism measures, remains a concern for foreign parties.

IV. Your contact persons in Indonesia

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