Joint Venture Advisory Practice

ISSUE 6 | August 2016

Joint Ventures and Partnerships in Indonesia

The Indonesian industry constantly faces testing market conditions — understandable growing pains of a giant awakening. In spite of this, Indonesia's foreign direct investments (FDI) reportedly grew an impressive 19.2% in 2015 and it continues to remain a target for inbound investors. However, Indonesia's economic growth faces the headwinds of less than ideal demand from its major trading partners, as well as the much-publicized fall in commodity prices.

To further enhance Indonesia's economic competitiveness, the Government released a revised Negative List on May 18th this year aiming to boost FDI in certain priority sectors. For those uninitiated, the Negative List provides foreign ownership restrictions for certain sectors in the market, which means that much of the FDI into Indonesia is done through a form of partnership, particularly joint ventures.

For local companies, partnering with a foreign counterpart is common, so those interested in entering this market need to be educated in what makes a successful partnership, so as not to join the list of unsuccessful deals. One common statement from foreign companies with existing joint ventures or partnerships in Indonesia is that they are repeatedly hampered by complicated regulations and restrictions, rapid changes in the market, and ever-changing strategies of both parent companies. This re-enforces our view that partnerships need to be flexible, and given constant care and attention to succeed.

One way to mitigate such risk is to take a minority stake in a business, much less than what is allowed under the Negative List —just to establish a foothold and presence in the market. Contrary to popular belief, economic benefit does not always have to align directly to ownership, so long as the partners can identify how it correlates to value contributed. Ensure your agreements are flexible. Then, once you have a better understanding of how the market operates and the potential return on investment, you build out your position and discuss how to grow the business together.

[1] From IDR307 trillion in 2014 to IDR366 trillion in 2015, as stated in "Foreign Direct Investment into Indonesia Grows 19.2% in 2015", www.indonesia-investments.com, 2015

Some other best practices for partnering in Indonesia

Always seek local advice

The Negative List usually changes every three years under the Investment Law. For companies with limited or no operations in country, it is recommended to seek advice to obtain assurance on your maximum allowable playing field and the best practice steps to setting up a joint venture smoothly. Changes in investment rules and regulations can also prove challenging for existing businesses, as sometimes foreign partners need to divest a part of their shareholding to a local partner.

Develop a joint strategy

Whether your intention is to block a competitor, enter a new market, or gain access to intellectual property quicker, it is important to ensure that your objective is aligned with that of your partner. Ensure, also, that you assess the risk of your paths becoming crossed in the future, as too often the company with the best local knowledge and contacts, wins.

Select the right partner

Every country has its own unique way of doing business. Cultural differences and behavior within an organization are among the biggest challenges for every joint venture. The corporate culture of a potential partner should be assessed and compared with alternatives using a diverse set of both internal requirements and selection criteria. The importance of each criteria should be specific to each situation and is subject to change as the market and competitive landscape changes. So, build flexibility into agreements to avoid getting 'stuck' sometime in the future.

Understand the risk culture

The key pillars of a good risk culture can be summed up in four words: transparency, challenge, humility and curiosity. No matter how well the joint venture is organized, how much money or knowledge both partners have contributed, and how prominent the joint venture or the parent companies' risk officers are in the corporate hierarchy – good risk culture is a vital prerequisite to good governance. Time and again, we have witnessed joint ventures with excellent risk governance but poor risk culture. It is critical to educate those working in the joint venture on how they should manage risk and what they should be thinking when executing risk governance or risk process.

Obtain independent pre-deal advice

Successful joint ventures are the result of thorough, well-structured negotiations which eliminate ambiguity. A party independent to the negotiations can often spot omitted topics or potential areas of future conflict, which are always better off being ironed out before the deal is signed.

Follow through

Foreign deal makers often fall into two traps. Firstly, the person negotiating the deal can sometimes fail to communicate effectively with those who are a part of the joint venture, and the essence of what has been agreed is lost. Then, too much emphasis is placed on 'the agreement', with words on paper being a less than ideal fallback to an established personal relationship. Mitigate this by ensuring that those who will be involved in the business are involved in its design, and have power to influence.

Making the most out of an existing joint venture

Your parent company's strategies and market circumstances may change over time, often making the initial plans or structures of your joint venture irrelevant or impractical. The absence of a regular review period may seem fine in the first few years, but in the future such a review could prove invaluable and save your joint venture from risk or potential shareholder dispute. Build simple clauses into your agreements. You will appreciate these later.

The KPMG Joint Venture Advisory Practice can help you assess your current and future needs, and restructure your business to minimise risk and maximise commercial performance, irrespective as to whether you have many partnerships already, or are considering embarking on more in the future.

[2] "KPMG Global CEO Outlook Survey", 2016

Contact us

KPMG Indonesia
35th Floor, Wisma GKBI
28, Jl. Jend. Sudirman
Jakarta 10210, Indonesia
T: +62 (0) 21 574 0877
F: +62 (0) 21 574 0313

David East
Head of Transaction Services, Deal Advisory
David.East@kpmg.co.id

Brad Johnson
Director, Deal Advisory, Joint Ventures
+65 6213 3800
bradjohnson@kpmg.com.sg

Find out more about our services at **kpmg.com/id**

kpmg.com/socialmedia