



A STUDY OF CHINESE CAPITAL FLOWS TO SIX COUNTRIES: **INDONESIA**

Mitigating Governance Risks From Investment in Southeast Asia

**CENTER FOR INTERNATIONAL
PRIVATE ENTERPRISE**

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FORWARD & INTRODUCTION

Forward

CIPE works at the intersection of economic development, democracy and human rights, a unique position from which to address governance challenges posed by high-risk capital flows. In recent years, CIPE and its partners have witnessed an alarming trend: large amounts of capital invested by authoritarian regimes flowing through opaque channels into emerging markets. In these markets where governance is already weak and corruption is already rampant, high risk capital creates political and economic distortions which often do more harm than good in the recipient country. CIPE coined

the term corrosive capital to describe state-backed financing that lacks transparency and accountability flowing from authoritarian states into new and fragile democracies.

CIPE's approach to combatting the effects of corrosive capital centers on identifying specific governance gaps in countries where democratic processes are at risk. Then, working with local partners, we design and implement projects that help close these gaps, fostering collaboration and information sharing among civil society, the private sector, and lawmakers. Because the adverse governance impacts in countries that receive this capital are well-documented and the global flows of such capital are growing

exponentially, CIPE is currently expanding both its policy research and programming on corrosive capital.

This report is unique in a number of ways: (1) it presents invaluable local perspectives on how Chinese investments are being documented, perceived, and implemented in countries around the world; (2) it identifies governance gaps which permit capital inflows to exploit or exacerbate weakness in young democracies; and (3) it provides recommendations for local stakeholders to address these gaps and make the most of Chinese investments. This publication is a demonstration of CIPE's commitment to the principles of local ownership, inclusion, learning & innovation, and accountability which are essential for emerging economies to enjoy sustainable and inclusive growth.

The report represents a group effort by CIPE and its partners. The effort grew out of a long-running dialogue on Chinese investment in Southeast Asia. CIPE partners cited a lack of data and consistency in the existing literature on the governance effects of Chinese state-backed debt and investment in emerging Asian markets. This report aims to fill that information gap and illuminate the governance distortions engendered by corrosive capital.

The first step in this effort was a set of deep-dive country-specific assessments. CIPE

partnered with five think tanks and three independent researchers based in Southeast Asia to systematically study the issues. In addition, CIPE commissioned the Rhodium Group to collaborate with our partners in the development of a comprehensive dataset to track Chinese direct investments flowing into Southeast Asia.

It is CIPE's hope that this publication equips donors, implementers, policymakers, and advocates with information that makes their work more effective at managing the risks of corrosive capital. By mitigating the risks of corrosive capital, the targeted investments of CIPE's ongoing program can achieve a larger scale and aggregate impact on the resilience of markets and democracies in the face of capital flows from nondemocratic countries.



Andrew Wilson

**EXECUTIVE DIRECTOR
CENTER FOR INTERNATIONAL
PRIVATE ENTERPRISE**

Introduction

Chinese outward investments have increased substantially in recent years, especially after 2013's introduction of its Belt and Road Initiative (BRI). BRI is the most ambitious infrastructure investment effort in recent history. The effect of BRI in Southeast Asia has been a tremendous volume of capital rushing in over a very short period of time. Chinese capital (including foreign direct investment, aid, and commercial loans) offers many benefits. It contributes to economic growth, job opportunities, and better-connected infrastructure networks in local economies. However, a growing volume of evidence indicates that many forms of capital emanating from authoritarian nations have a corrosive effect on democratic institutions and private enterprise in recipient countries.

The genesis of this publication was a CIPE forum in December 2017 at which CIPE's Southeast Asian partners expressed the urgent need to fill the information gap of the impact of corrosive capital on governance distortions. Local researchers and analysts across the region have identified an absence of evidence in the existing body of work on Chinese investment projects and the impact on the local economies and communities. Additionally, researchers and scholars sought greater clarity on specific gaps in governance through which Chinese capital can flow.

This report analyzes the patterns, trends, and characteristics of Chinese investments in Southeast Asia. Against the backdrop of the rising flood of Chinese investment across the region, the report highlights common issues and shared governance risks across countries, and identifies questions requiring further study. The sizable economic interests and political intricacies of China and BRI make this research sensitive in some countries; as result, some information has been redacted from the final report.

Countering corrosive capital requires working closely with local partners in vulnerable countries. In each case, the specific governance gaps which place democratic institutions at risk must be identified. In cooperation with local partners, CIPE can then design and implement local projects to help close those gaps and reinforce democratic institutions by fostering collaboration and information sharing among civil society, the private sector, and lawmakers.

Objectives, Scope & Methodology of the Report

This report aims to answer an important policy question: How can Southeast Asian economies benefit from the Chinese investment while mitigating the associated risks? This report will provide authoritative

and up-to-date data on Chinese regional FDI and loans in chapter 1; the following seven chapters document different forms of Chinese capital flows and identify governance gaps in six countries. Chapter 2 presents the case of Malaysia which highlights issues of opaque procurement practices associated with Chinese mega projects, as well as the need to improve corporate governance of state-owned enterprises to avoid conflict of interest. In chapter 3, Chinese investments are involved in controversial price fixing in the Indonesian extractives industry. Chapter 4 demonstrates the development of evolved oversight mechanisms to screen infrastructure projects in Myanmar. In Chapter 5, Cambodia provides an illustration of what can happen in a small to mid-sized country that becomes overly dependent on Chinese investment. In Chapter 6, the authors raise environmental concerns in Vietnam. Chapter 7 discusses regulatory capture issues in the Philippines using the online gambling industry as an example. Looking into the fast-growing

Fintech industry, chapter 8 showcases risky investments and the data abuse problem in Indonesia. In all the case studies, authors examine the macro-level impact of Chinese investment, identify governance gaps, assess its initial impact. They then develop policy recommendations for key stakeholders such as businesses, governments, civil society organizations and international organizations to address these challenges and develop a streamlined, transparent, foreign investment monitoring and management process.

The scope of this report is primarily Foreign Direct Investment (FDI) from the People's Republic of China. During the research process, some authors discovered that domestic controversy centered primarily on Chinese commercial loans funding large infrastructure projects. The capital discussed in this report therefore encompasses all investments from China. Some authors focus on FDI while others place greater emphasis on other official financing such as aid and loans.



THE OUTCOME OF CHINA'S INVESTMENT IN INDONESIA: LESSONS FROM THE NICKEL INDUSTRY

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Introduction

As the largest country in Southeast Asia, Indonesia is among the top destinations for Chinese investment. Several researchers, including Priyandita (2018) and Damuri et al. (2019), have tried to analyze the impact of Chinese investment in Indonesia, but these studies have tended to focus only on investment in the infrastructure sector. In addition, the aforementioned reports do not adequately assess the positive and negative side effects of Chinese investment in Indonesia. For example, Damuri et al. provide evidence for benefits from Chinese investment in Indonesia, but include limited

commentary on the social, economic and environmental impacts of such investments.

In light of the scant critical analysis on the impact of Chinese investment in Indonesia, the Paramadina Public Policy Institute (PPPI) provides a more comprehensive analysis of the nature and characteristics of China's investment in the country. This paper explores the complexities of Chinese FDI through a case study on nickel mining and the midstream operations industry in Sulawesi.

China's economic growth and industrial policy have fed a growing, aggressive demand for nickel in recent years. The PRC established a policy framework and

committed financial assistance to develop its electric vehicle (EV) industry in the early 2000s. What was once a nascent sector has become a booming industry which demands increasing quantities of nickel to produce EV batteries. This demand is a driver of China's rapidly growing presence in the mining sector of Indonesia, which holds the largest laterite nickel deposits in the world according to the U.S. Geological Survey. While there is evidence that such Chinese investments have harmed Indonesian national interests, especially with regards to the local economy, environmental sustainability, technological advancement, and absorption of local workers, the complex impacts on the Indonesian economy remain poorly understood.

This study examines these impacts in greater depth in order to generate policy recommendations that will help Indonesian government officials better manage the threats and opportunities related to Chinese investment and foster Indonesia's sustainable economic development.

This report is based on data collected through document analysis and in-depth interviews with 22 stakeholders from both government and non-government agencies. Between February and June 2019, researchers interviewed representatives from the Ministry of Industry, state-owned enterprises (namely, GAG Nikel subsidiary

of PT Antam), the Corruption Eradication Commission (KPK), and the China Chamber of Commerce in Indonesia. From the non-government sector, researchers conducted field interviews with business stakeholders at the national and local Sulawesi levels, including representatives from companies such as PT Vale Indonesia (Ex-Inco), PT Sulawesi Mining Investment (SMI-IMIP), PT Virtue Dragon Nickel Indonesia, Cipta Smelter Indonesia, and the Indonesian Nickel Mining Association.

This research aims to deliver both theoretical and practical lessons that can subsequently be applied in other Southeast Asian countries. In theoretical terms, this research seeks a realistic perspective, one balanced between the optimistic and pessimistic views about the outcomes of China's investment for Indonesian social, political and economic contexts. Meanwhile, the practical contribution of this research will be to drive policy debates pertaining to foreign direct investment (FDI). This research will serve two significant roles in this regard. First, this study will conclude with policy recommendations for the design and implementation of constructive and productive investment at local and national levels. Second, the research will encourage a more neutral, fact-based national debate on the impact of Chinese investment. These findings will be informative for many citizens of newly

economically-liberalized societies that are pursuing economic development requiring financing from abroad. They will learn that non-transparent financing from authoritarian states is particularly risky.

Chinese FDI in Indonesia

In 2005, Indonesian President Susilo Bambang Yudhoyono (SBY) and Chinese President Hu Jintao signed a joint declaration for a “strategic partnership” (Qin, 2005). The declaration included agreements on visa exemption for diplomatic and service visits, maritime co-operation, infrastructure and natural resources, economic and technological assistance, finance, preferential buyer’s credit, and earthquake and tsunami relief. In 2013, the relationship was upgraded again to a “comprehensive strategic partnership,” with a focus on infrastructure construction, manufacturing, agriculture, investment and finance (Xinhua, 2005). It is worth noting that Indonesia was the first country in Southeast Asia that President Xi Jinping visited after taking office. It was during his inaugural trip to Indonesia that President Xi announced his plans for the Asian Infrastructure Investment Bank (AIIB). More recently, President Joko Widodo (“Jokowi”) agreed to establish a “new level of bilateral and global partnership” under China’s Belt and Road Initiative (BRI).

Against this bilateral policy backdrop, Chinese FDI in Indonesia grew from USD 300 million in 2012 to 3.36 billion in 2017. This exponential annual growth makes China the third largest foreign investor in Indonesia, up from 12th just five years before.

Composition

This section presents data on annual Chinese FDI transactions and cumulative FDI inflows to Indonesia based on 2019 research by the Rhodium Group (hereafter RG). Foreign direct investment is classified into various types, namely acquisition (buying shares of an existing firm) and greenfield (newly established) projects. For an acquisition to qualify as FDI, the investing party must purchase more than ten percent of the target firm’s shares. For greenfield projects, investment funds are frequently used to buy factories, offices or subsidiaries, or to fund research and development.

From 2000 to 2017, the cumulative gross value of Chinese acquisition and greenfield FDI transactions amounted to USD20 billion in top sectors, the majority of which was invested in basic materials, transport, utilities, infrastructure and energy. Nickel mining, the industry highlighted as a case study in this report, is classified as a “basic materials” industry.

Based on RG 2019, there were 27 mergers and acquisitions completed from 2002 to 2018, 30% of which targeted the basic materials sector. In addition to that, Rhodium has documented 49 greenfield projects initiated from 2000 to 2018, with 27% of this total targeting basic materials. Among the investors covered in these statistics is the Jinchuan Group, which had invested USD500 million in the WP&RKA nickel project on Nov 25, 2016. Jinchuan is a Chinese state-owned enterprise (SOE). Construction of the WP&RKA laterite nickel mine officially began on Obi Island on November 25, 2016 (China Metal News, 2019).

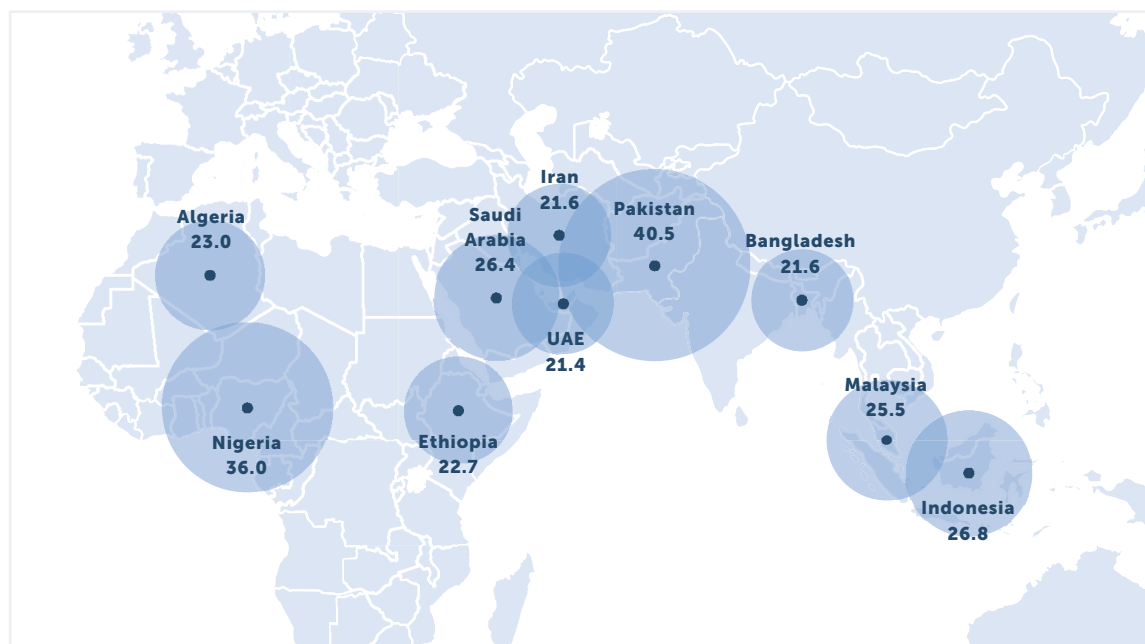
Construction contracts refer to work completed in a target country under a contracted agreement. Besides merger and acquisition and greenfield projects, Chinese FDI also takes the form of construction

contracts. In fact, in 2019, Indonesia has been one of top target countries for Chinese construction activity, as shown in Figure 1 (PG. 147), taken from a China Global Investment Tracker (CGIT) map produced by the American Enterprise Institute in collaboration with The Heritage Foundation.

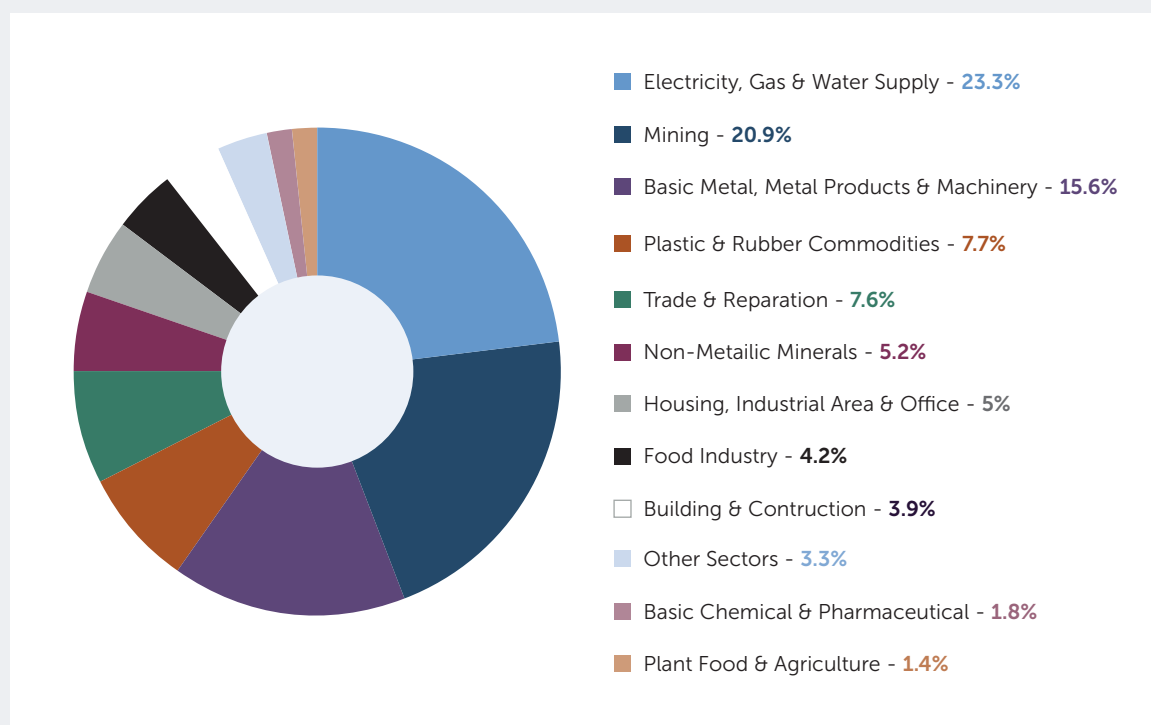
Types of Industries

Based on recent official data from the Indonesia Investment Coordinating Board for years 2017 and 2018, Chinese investment in the form of inward FDI focused on several sectors and industries, including mining, electronics, chemicals, pharmaceuticals, electric and gas utilities, water supplies and others. Figure 2 (PG. 148), depicts the proportion Chinese FDI in these sectors over the period 2010-2015 (Table 1, PG. 148-149).

FIGURE 1: China Global Investment Tracker



SOURCE: Scissors (2019)

FIGURE 2: Chinese Investment in Indonesia by Sector (2010-2015)**SOURCE:** CSIS (2019)**TABLE 1: Chinese FDI in the Mining Sector 2011-2018**

YEAR	MONTH	CHINESE ENTITY	QUANTITY (USD MILLION)	SHARE	TRANSACTION PARTY
2011	July	Jilin Nonferrous	930	100%	
2011	October	China Nickel Resources	270	80%	PT Yiwang Mining
2012	Juni	China Nickel Resources	1,260	61%	PT Jhonlinto
2012	July	Beijing Shenwu	420	N/A	Titan Mineral
2012	July	Beijing Shenwu	180	N/A	Balinton Resources

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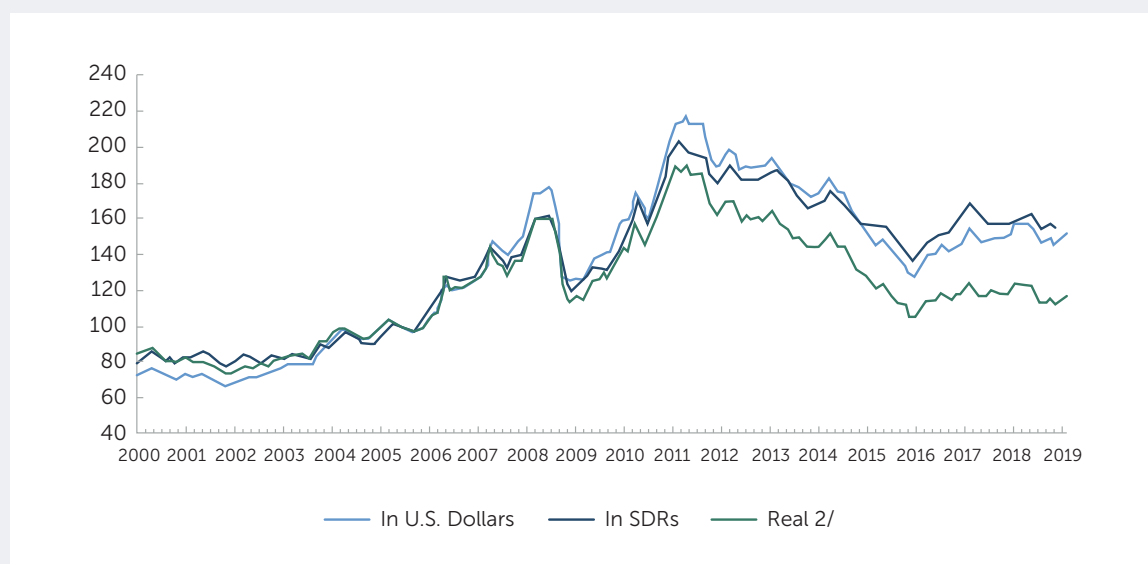
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YEAR	MONTH	CHINESE ENTITY	QUANTITY (USD MILLION)	SHARE	TRANSACTION PARTY
2013	May	Fosun	100	N/A	Gunung Gahapi
2013	July	Tsingshan Steel	320	50%	Bintang Delapan
2013	December	MCC	180	N/A	SMI
2014	July	CIC	1,360	19%	Bumi Resources
2014	August	Hongqiao	840	56%	Well Harvest
2015	May	Sinosteel	120	N/A	DBM
2015	July	Tsingshan Steel	510	50%	Bintang Delapan
2015	November	MCC	110	N/A	Tsingshan

SOURCE: American Enterprise Institute (2018), All fourteen separate Chinese firms listed here are owned or controlled by the Chinese government.

China's economic growth during the first decade of the 21st century was the fastest and most resource-intensive economic expansion in history..(Garnaut, 2015). This rapid development led to extraordinary rates of growth in demand for almost all commodities. This effect was strongest in the market for energy and metal commodities, which the Chinese required in unprecedented amounts.

Nickel was one of the basic metal commodities impacted by the global resource boom between 2000 and 2011. Indices for non-fuel primary commodities prices increased gradually from 2000 to 2011, with a brief falling period during the 2008 global financial crisis. Figure 3 (PG. 150) depicts these movements.

FIGURE 3: Non-Fuel Primary Commodities Indices from IMF Primary Commodities Prices

SOURCE: IMF Primary Commodities Prices (from Garnaut, Ross, 2015)

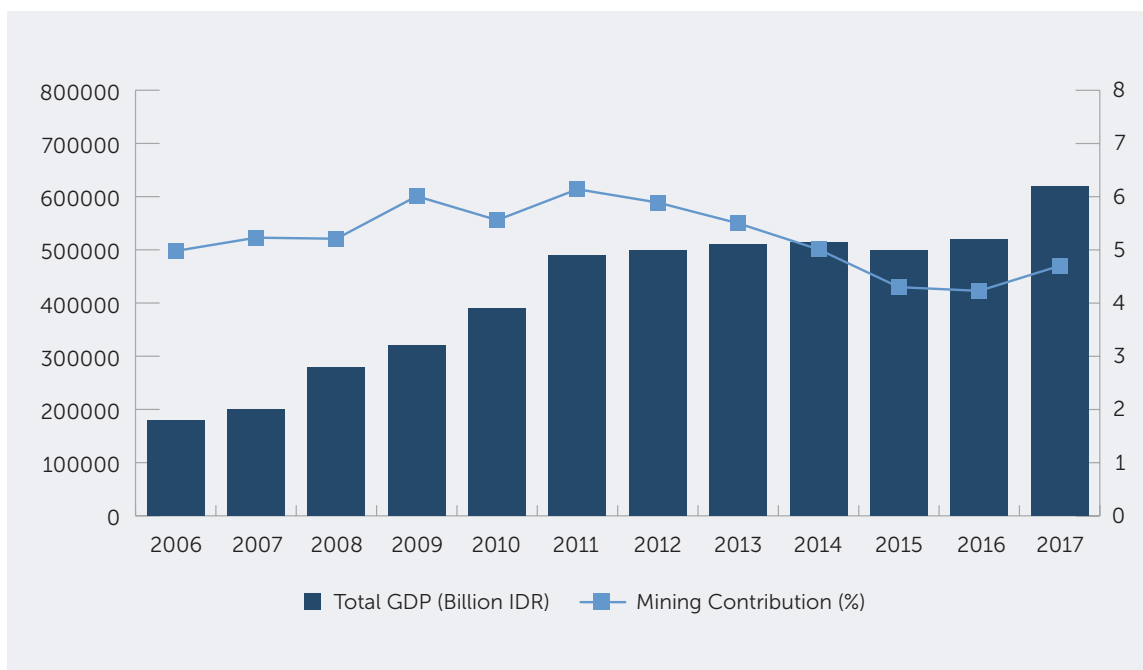
Indonesia's Nickel Mining Industry—Background

The mining sector has been critical to Indonesia's economic growth for several decades. Mining contributes to Indonesia's gross domestic product (GDP) through exports, government revenue, worker salaries, and perhaps most importantly, through associated development projects in many remote regions of Indonesia. Mining companies are often the largest employers in these remote areas (Figure 4 & 5, PG. 151).

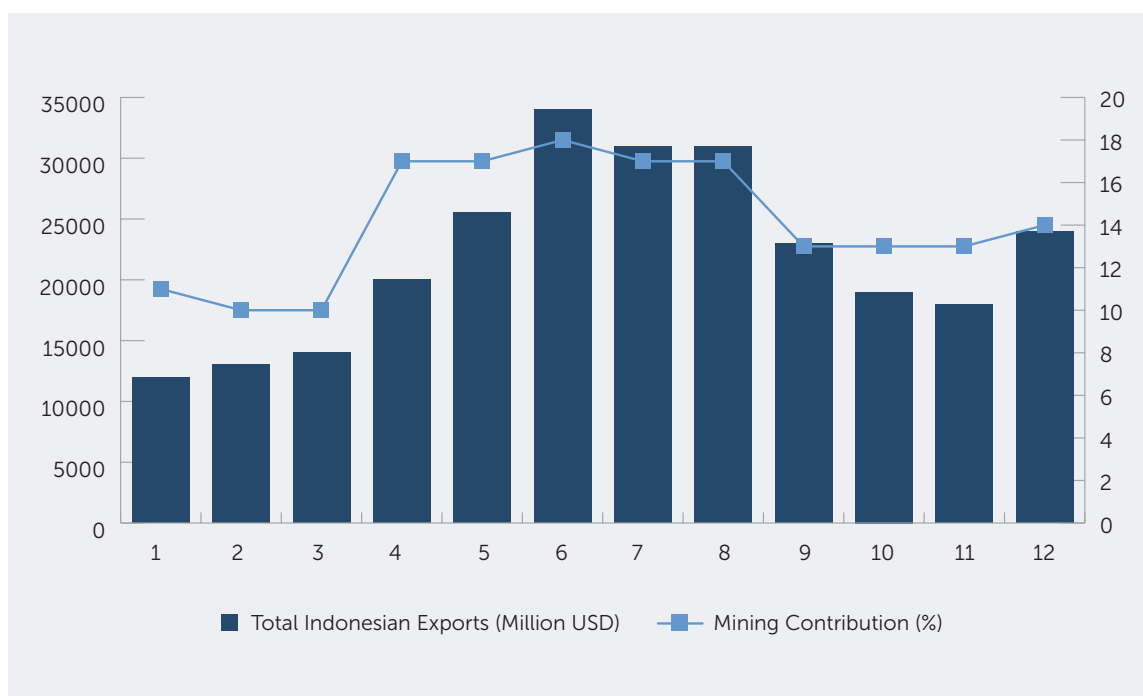
This paper focuses on the development of nickel processing at the national level and the Indonesia Morowali Industrial Park (IMIP) provides an illustrative case study.

IMIP was established in the nickel-rich Central Sulawesi Province of Eastern Indonesia, and it is owned by a holding company called Sulawesi, which is two-thirds owned by a Chinese SOE. The Indonesian partner owns only 33.75%. Morowali's holding company, Sulawesi Mining Investment (SMI), is jointly owned by China-based Shanghai Decent Investment (66.25% shareholders) and Indonesian mining company Bintang Delapan Group (33.75% shareholders) (See Box 1: Indonesia Morowali Industrial Park) (Figure 6, PG. 152).

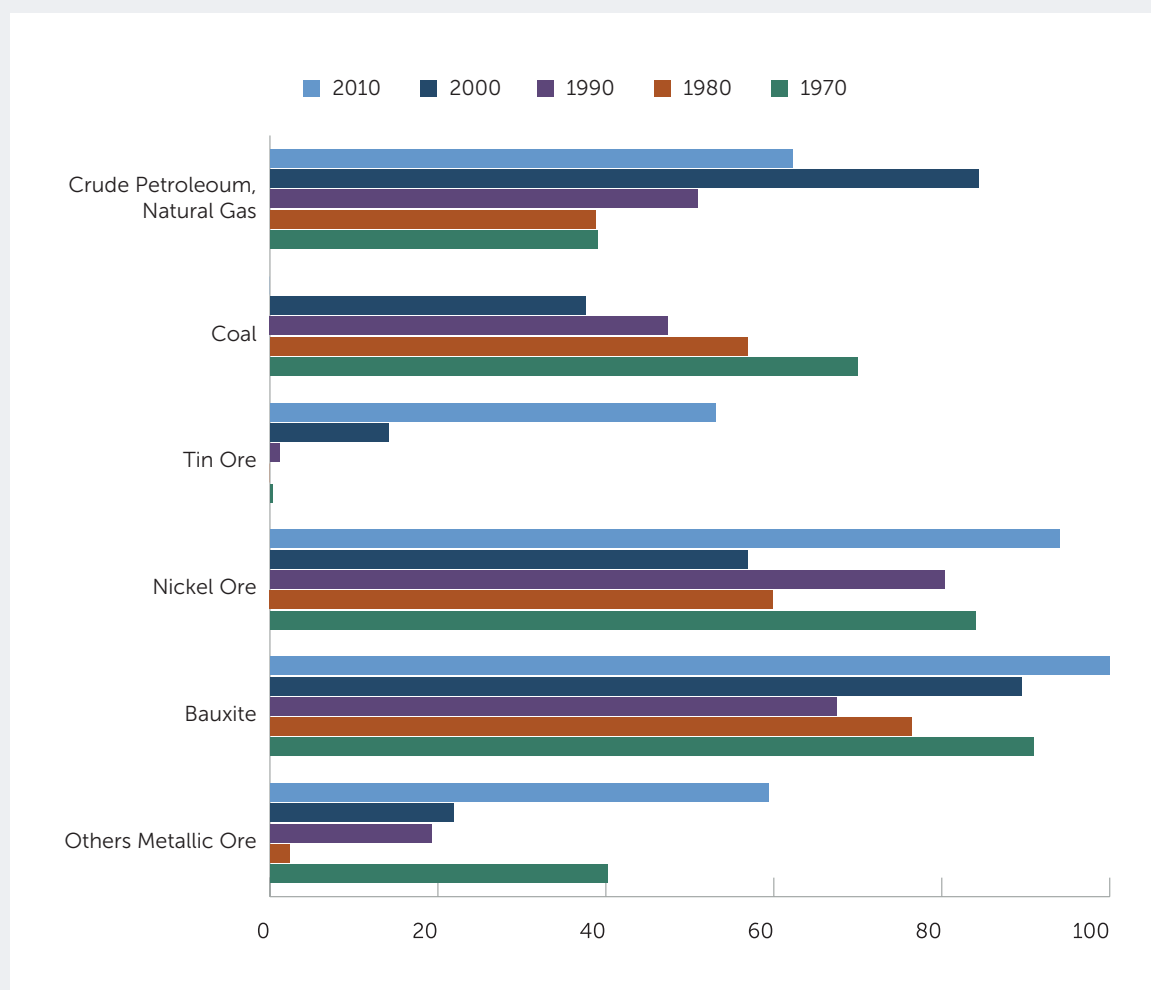
The natural resources sector, particularly mining, has been a backbone of Indonesia's economy for a several decades. Owing to the country's vast mineral resources,

FIGURE 4: Mining Industry Contribution to Indonesian GDP

SOURCE: PriceWaterhouseCoopers (2019)

FIGURE 5: Mining Industry Contribution to Indonesian Exports

SOURCE: PriceWaterhouseCoopers (2019)

FIGURE 6: Time Series Oil & Gas and Mining Contribution

SOURCE: Pierre van der Eng (2014)

Indonesia has made significant contributions to the global mining industry. Up to early 2000, a number of global mining companies had their operations in Indonesia. In addition to Canada's International Nickel Company mentioned above, other multinational mining companies including Freeport, Newmont, Barrick Gold, Rio Tinto and BHP have all been very active in Indonesia.

While the presence of giant exploration companies is good for upstream mining sectors, turning latent mineral deposits into exploitable resources and reserves, the country's downstream sector was barely developed. For decades, Indonesia's mining sector was an export-oriented industry, with commodities sent to advanced industrial countries such as Japan, South Korea and

European states. Indonesia enjoyed the status quo of being a commodity exporter, although it was generally recognized that exporting processed materials rather than raw commodities would be a better strategy for the country (Maulia, 2018). Not only is the price of processed materials less susceptible to global price fluctuation, but developing a domestic mineral processing sector would also support industrial growth, providing additional income for the state and creating new jobs.

The golden years of mining eventually came to an end when changes in the national political landscape slowed industrial growth. As part of the democratic transition that occurred after the 1998 economic crisis and reform, Indonesia decentralized political power, ceding autonomous economic control to regions that formerly had been left behind by Jakarta under the Suharto regime. Under Suharto, economic development had focused on Java, Bali and some parts of Sumatra, neglecting other areas. Those neglected areas were now granted authority over certain industries, including mining.

Unfortunately, abuses of power by heads of government regencies¹ (including over-regulation, corruption, nepotism, and arbitrary fees levied against companies), have driven

many mining companies to pack up and leave Indonesia, driving the mining sector into decline (Hamidi, 2015). Excessive demands by authorities on mining companies have also harmed the industry (Devi & Prayogo, 2013). In 2017, the Fraser Institute recognized Indonesia as one of the least attractive jurisdictions for mining investment, along with Venezuela, Democratic Republic of Congo, China, the Philippines, Bolivia and Ecuador. Indeed, political factors account for some 40% of the reasons investors decide to put money into a country' (Stedman & Green, 2018).

After the departure of the larger mining companies, local miners took over the sector. Local government officials began lavishing mining licenses, known locally as IUPs (Ijin Usaha Pertambangan or Mining Business License), upon designated recipients. It was not unusual for IUPs to be concentrated in the hands of local kingpins, relatives of high-ranking government officials, or even government officials themselves (JPNN.com, 2012). Mineral exports increased sharply, and the central government soon realized it was time to address the issue of exporting raw materials.

In 2009, Indonesian mining policy underwent a major shift. The government mandated that mining companies must build smelters or processing facilities or face revocation of their

1 Regencies are administrative subdivisions of Indonesian provinces.

export licenses. Companies were granted a five-year grace period to comply, and targeted companies were expected to have their smelters ready by 2014. This decision was supported in particular by the Ministry of Industry, which had multiple reasons for supporting the ban of raw ore exports.

Based on this decision, it seems that the state failed in its objective to strengthen regional autonomy and increase freedom for regions to manage their own economies. High levels of corruption and abuse of power have left investors reluctant to invest outside the more developed areas of Java, Sumatra and Bali. Supported by more advanced infrastructure, these three regions have remained more attractive destinations for investment, and the gap between them and Indonesia's remote areas only grew larger during this period. While mining resources are also plentiful in areas outside of Java and Bali, the mandate to build processing facilities is projected to spur development (United Nations, 2017).

The new regulation on smelter construction sent shockwaves through Indonesian mining communities, which usually operate locally on a small-to-medium scale. Even large corporations like Freeport and Newmont ended up in protracted negotiations over the new policy. Scraping nickel from the ground and refining the nickel ore are two different things, and smelter construction requires

sizable investment. Smelters are so expensive that even mining giant Freeport McMoran found smelters very challenging to finance and build (Bisara, 2019).

Nickel smelter construction requires an estimated USD5-7 million before commission fees (Adjie, 2019), a difficult financing target for Indonesian miners. In fact, many smelter projects failed to achieve their target completion date, forcing the government to extend the deadline to 2022 because the target would not be achieved by 2019. Even the government has admitted that smelter construction is not easy (Hukumonline.com, 2017). The export ban was also relaxed because the government needed the revenue from mineral export.

China Nickel Investment in Eastern Indonesia

Other than nickel mining giant Brazilian Vale, which was already operating smelters (under contract with Japanese investors since the 1970s), no Indonesian nickel miners had thought to build smelters until the government forced them to do so. At the time of Indonesia's smelter push, Chinese firms were already involved in Indonesia's nickel mining sector through capital injection or other partnerships. One of the first Chinese companies to get into the smelter business was Tsingshan Group, a company headquartered in Zhejiang Province.

Tsingshan, the largest stainless steel producer in China, with a record of 9 million tons of crude stainless steel produced in 2018, and one of the world's major stainless steel producers, had actually been partnered with the Bintang Delapan Group in the nickel mining business long before the government imposed its smelter policy.

The idea for Bintang Delapan to build an industrial complex instead of just a smelter may have come from the Ministry of Industry, which said that Tsingshan Group's participation in the deal could draw additional investment. The Ministry of Industry took a "mall approach" in this project, hoping that one large, central brand would attract other tenants (Suryawirawan, personal communication, 2019). The Tsingshan Group–Bintang Delapan Group joint venture has now developed the Indonesia Morowali Industrial Park, or IMIP, in Morowali Regency, Central Sulawesi Province. IMIP was completed in only five years and now hosts 16 tenants, including an Australian nickel mining company and producers of stainless steel and other steel products. The latest addition to the industrial park is PT QMB New Energy Materials, a joint venture between Chinese and Japanese companies that produces the material for electric vehicle batteries (Asmarini, 2018). Backed by strong capital, IMIP is an impressive industrial park with its own hotel, ports of 100,000 tons deadweight,

and 1,830-megawatt steam power plants. Currently, IMIP operates 20 smelters with possible expansion in the future. The industrial park employs 32,000 people, including workers not only from the Morowali area, but also from other regions in Indonesia, as well as workers from Mainland China. As of April 2019, an airport with an 1,800-meter runway was under construction. One interviewee said of the project,

When Tsingshan and the Bintang Delapan Group said they wanted to build a smelter, we told them, "why not build an industrial complex instead?" They are big investors, and as owners of the industrial park, they can invite and select companies that fit with the park (Suryawirawan, personal communication, 2019).

Tsingshan is also reported to be cooperating with French company Eramet to develop the nickel concession in Weda Bay of Eastern Indonesia. The plan is to build another industrial park worth USD5.5 billion that will also produce materials for electric vehicle batteries (Silaen, 2018).

Another noteworthy Chinese investment project in Indonesia's nickel sector is Virtue Dragon Nickel Industry (VDNI) in Morosi–Konawe, South East Sulawesi Province, eight hours' driving distance from Morowali. With a plan to build a total of 45 smelters, VDNI

is projected to be bigger than IMIP. VONI is a subsidiary of DeLong Nickel Co. Ltd., headquartered in Jiangsu Province, China. Like IMIP, VONI also exports its intermediary products, ferronickel, to China.

China's appetite is not limited to large-scale projects. Most of the sources interviewed for this research said there are traces of China's investment and Chinese components in every new smelter facility in Sulawesi and Eastern Indonesia. Currently there are more than 15 smelters across Sulawesi and Eastern Indonesia.

The Chinese smelters, through trading companies, finance miners' operational expenses. The lending is made on one condition: the nickel ore mined must be sold to the traders. When the miners fail to repay their loans, they are forced to sell the nickel at a very cheap price. In some cases, indebted miners are forced to give up their mining concession. This demonstrates China's weaponization of debt. China has monopolized these companies, becoming the only buyer. Such constraints limit these companies' abilities to diversify partnerships and scale their businesses. Many local miners operate as small or medium enterprises and often suffer from low cash flow. Due to the opaque terms of financing agreements, these miners often go into default and are seized by their Chinese creditors.

China's Dominance in the Nickel Industry

Chinese nickel mining business practices reflect customary Chinese investment behavior where the promise of quick funding is made at the expense of domestic and international law. There has been a debate over the extent of Chinese investment in both the upstream and downstream sectors of Indonesia's nickel industry.

The biggest controversy over Chinese investment in the nickel industry centers on IMIP. PT Sulawesi Mining Investment (SMI), the managing company of the industrial park, has been accused of employing illegal workers from Mainland China. Illegal workers are the most controversial issue in regard to Chinese investment, and IMIP management has repeatedly denied the use of illegal Chinese workers in the park. In response to these allegations, then-Minister of Manpower Hanif Dhakiri visited the site to check on the issue; he later released a statement claiming that no illegal manpower was being used at the site (Dwinanda, 2018). Another debate has focused on the park's patronage by military generals. Both of these issues will be covered in a later section of this report.

The strong presence of Chinese investment in Indonesia, of course, cannot be separated from China's ambition to control the global market. China knows exactly how to make

itself welcome in a resource-rich country like Indonesia. For example, Chinese investors are known to be very flexible when doing business. In one anecdote, a major local nickel producer made a purchasing agreement worth USD32 million over text message after only hours of negotiation; the legal contract was ready the next day. The Chinese also understand when their counterparts are facing difficulties, and the Chinese investors are willing to make exceptions and to compromise. A mining company was recently obliged to pay a USD24,000 penalty due to high moisture content in a quantity of ore delivered to a purchaser. When the mining company that sold the ore came to the Chinese buyer saying it actually needed the money used to pay the penalty, the buyer returned the USD24,000. However, winning the trust of a Chinese counterpart is not easy. Despite the general perception that it is easy to do business with Chinese investors, just like any other investors, Chinese investors require assurance of the security of their investment (personal communication, 2019).

China's competitive technology also makes partnerships with Chinese firms attractive. The pioneer in Indonesia's nickel mining and processing, PT Vale Indonesia, has announced a joint venture with a Chinese company to improve its undeveloped Bohodopi concession, also in Central

Sulawesi. PT Vale's current smelter in Sorowako is linked to a hydropower plant; competitive technology is needed to help the company develop its other concession in Bohodopi.

We need competitive technology that can help us manage the costs in our Bohodopi site. We have carefully selected a potential partner who will not dent our reputation. I tell you, there are some excellent Chinese companies. If we're conducting the Feasibility Study with any western companies, it would cost us \$70 billion compared to a maximum \$15 billion with the Chinese, not to mention the time needed to complete the project. Working with the Chinese partner would also reduce the necessary capital expenditure by 30%. We recognized differences between the two companies. There are things that we can change and can't change, practices that we can and can't adopt. But it is certain that we won't sacrifice our good reputation by carelessly selecting a partner (Superiadi, personal communication, 2019).

These comments suggest the Chinese company has a superior product at a lower price, validating the decision to partner with Chinese firms. Yet in truth, Chinese start-up costs are so low because they are subsidized

by the Chinese government, and projects are completed at an unmatched speed because the Chinese firms ignore local laws that would inevitably slow project development.

China also has in-depth knowledge of Indonesian nickel resources. The president-director of a local nickel mining company shared his company's experience in conducting open tenders for smelter projects:

Of the nine companies submitting tenders, six are Chinese; one is Finnish; one Korean; and one Filipino. The Finnish had the technology, but they didn't have people to do the project due to other engagements in other countries, while the Koreans didn't have the right technology. Eventually, it's the Chinese who won the tender. They have all the technology and expertise on Indonesia. But I have to admit that Chinese technology is still inferior to the Japanese (personal communication, 2019).

One of the controversies involved in accepting Chinese investment is the "all China technology" requirement of many projects, leaving Indonesian vendors a very tiny piece of the cake. Because Indonesia continues to lag behind in smelter technology, Chinese investors must ship in all the technology from China (Sen, personal communication, 2019).

And of course, China offers the cheapest technology in the world. A source at the Indonesian Nickel Mining Association provided rough comparisons of smelter technologies available on the market:

A US machine would cost you \$15 million, while a China-made machine will cost you only \$7 million. This excludes the commissioning cost. The cost of electricity is also higher for non-China technology. An electric furnace needs at least 33 megawatts per line. The cost of electricity per megawatt would be \$900 thousand using Chinese technology, \$1.5 million using Japanese technology, and \$1.7 million using German or US technology (Adjie, personal communication, 2019).

China also has the speed-of-work Indonesia needs. In its ambition to dominate the world's steel and battery markets, China has been very quick in building processing facilities, at the expense of upholding environmental protection laws. By contrast, Freeport and Newmont had engaged in long and tiring negotiations with the Indonesian government regarding smelter building. China and Indonesia are complementing each other in the case of the nickel industry. While Indonesia is hoping to build a national downstream industry, China needs the nickel to feed its home industry and to fulfill its global ambition. This has helped

the two countries to accomplish their joint smelter projects. China's lavish funding is also a driver. Finally, the Indonesian Ministry of Finance has provided special zero-tariff conditions for machinery imported for industrial development for all investors (Minister of Finance, 2015). This has also helped the growth of China's investment in Indonesia.

While China seems to find Indonesia a rewarding place to invest, Chinese businesses may still find Indonesia a challenging place to do business. Indonesian counterparts need to ensure that Chinese investors feel confident. According to one interviewee, Mr. Suryawirawan, "...it was really not an easy job, but we need big investors to attract even more investors to come to the area."

PT Bintang Delapan, the Indonesian partner of Tsingshan Group at IMIP, feels heavy pressure to ensure the security of its Chinese counterpart's investment. It seems that IMIP enjoys high favor from the central government, as evidenced by countless visits from high-ranking government officials, an inauguration event hosted by President Jokowi, and special attention from the Coordinating Minister of Maritime Affairs. Nevertheless, a senior officer, Irsan Wijaya, still believes that IMIP lacks necessary attention from the central government:

We want the government to pay more attention to our operation. It is not easy to secure such a big project. We have had to deal with worker demonstrations over some wages and other issues as well as inter-ethnic tensions between the natives and people of other ethnicities. This project has benefited the country. It brings revenue and opens up employment. I think we deserve extra attention from government. The extra cost we have to bear in this operation is huge (Wijaya, personal communication, 2019).

Mr. Bai Sen of VDNI told of challenges he has faced in managing a plant with a diverse labor force:

Infrastructure in this area [Konawe Utara] is so bad that we can't go anywhere. The working culture is also different. The Indonesians have never worked in a plant before. Indonesian workers have a rest day, but the Chinese workers don't. We work 12 hours per day, every day. I envy the Indonesian workers. But the Indonesian workers are getting better now. Their reputation is better than before. Their conceptions are changing, too, and they really needed to change. Our plant is producing 24 hours a day, 7 days a week. If the workers are always absent and late, we definitely don't want them.

We respect Indonesia's laws as well. The workers can rest during their days off. On working days, they have to follow the company's rules and regulations.

Costs vs. Benefits of Chinese Investment in the Nickel Mining Industry

The massive influx of Chinese investment has undoubtedly created economic opportunities that Indonesia desperately needs. Indonesia's economy relies heavily on Chinese investment both for capital injection and technological know-how, and the liquid capital and speedy execution typical of Chinese investment have supported China's rapid growth and market dominance in Indonesian nickel mining. These assets have already established China as Indonesia's top investor in the mining industry. Chinese investment in Indonesia has been flexible, involving the acquisition of raw materials as well as establishment of new markets for Chinese products. In the case of the mining industry, it is clear that the primary investment motive was to obtain raw materials to meet industrial demand back in China. Nevertheless, Chinese investment has also involved development of target markets, as exemplified by the chemical, pharmaceutical and electronic industries.

The speed of project execution by Chinese companies is second to none. The

consortium of Tsingshan–Bintang Delapan built the IMIP in less than five years. The industrial park has 20 smelters with its own ports, power plants and other infrastructure, and it is projected to be Indonesia's largest integrated nickel-based industrial complex. Delong Group, the owner of VDNI, has also set up a large plant and delivered its first export only three years after breaking ground. This has made China a favored investor for Indonesia, which has seen many projects stalled or failed for numerous reasons. China's ability to execute large projects in a blink of an eye is also a result of its flexibility. However, this rapid execution in nickel mining increases environmental risks. The ease with which Indonesian environmental and labor regulations can be ignored reveals a widely exploited governance gap through which Chinese money can easily flow.

Although China's government actively supports state-owned enterprises (SOEs) and private companies investing abroad, there are ample examples of business-to-business cooperation between China and Indonesia. A study from Gammeltoft and Tarmidi found that nearly two-thirds of companies report business-to-business to be their most important market, while a quarter of companies sell primarily to private consumers and the remaining 10% primarily export their products (Gammeltoft & Tarmidi, 2013).

While acknowledging the benefits of Chinese investment, it is important to also highlight some potential risks. In recent months, Chinese FDI has spurred debate over issues of imported labor and small and medium-sized enterprises (SMEs) losing out to monopolistic Chinese firms. This research will analyze these issues and explore solutions to mitigate associated risks.

Exploitation of Illegal Workers

As in most places where Chinese investment exists, use of illegal workers is a major issue in China's nickel projects in Sulawesi. During field research, we observed Chinese workers in all work sites funded by Chinese nickel investment. While we did not obtain proof of the legal status of these workers or ascertain whether they held working permits from the local Ministry of Manpower office, a simple analysis can help to answer this question. Chinese FDI-funded projects are implemented very rapidly and require thousands of workers, both high- and low-skilled. If one worker quits, the replacement worker from China arrives and begins work only a few days later (PT VDNI staff, personal communication, 2019). Due to the notoriously slow Indonesian bureaucracy, it is unlikely that workers from Mainland China could receive working permits this quickly, even if their employers have the

intention of obtaining proper authorization from the relevant authorities. Because of the lack of workers possessing skills and knowledge of nickel processing in the Indonesian market, Chinese investors must fly these workers into Indonesia from China (Sen, personal communication, 2019). It is very easy for Chinese visitors to enter and leave Indonesia, because Indonesia provides a visa on arrival for Chinese tourists in an effort to boost Indonesia's tourism sector. Monitoring from the Office of Manpower might be insufficient, however, because the closest office is often located hundreds of kilometers away from a project site (*Jakarta Post*, 2017). Thus, we believe the presence of illegal Chinese workers is very likely in China-funded projects.

Control of the Price of Nickel

Vast Chinese investment has opened up the possibility of price control by smelters. Although the government's Mineral Purchasing Price Reference (Harga Patokan Mineral, HPM) regulates the price of nickel ore, smelters rarely comply with the HPM. In reality, nickel's sale price is very low due to an oversupply of nickel ore in the domestic market. The selling price thus could be as much as 50% lower than the regulated market price (Mulyana, 2019). The miners themselves have no option but to sell the ore to the China-controlled smelters at

the offered price. The Indonesian Nickel Association (APNI) says miners do not receive a fair profit due to the low buying price of the smelters. The APNI is currently working to establish an Indonesian Nickel Index (INI), an initiative that has gained support from government authorities who have admitted that the sale price of nickel ore in the domestic market remains an issue. However, the smelter association denies the APNI's statement, saying that the purchasing price is in accordance with the international market price.

Low nickel prices could harm the environment. Small profits may induce miners to disregard expensive environmental protections at mining sites. The cost of environmental protection often constitutes a significant portion of the total production cost for miners (Superiadi, personal communication, 2019). Thus, a depressed sale price for nickel ore can also lead to environmental consequences if miners lack sufficient funds to repair environmental damage caused by mining. Chinese enterprises customarily ignore environmental protection laws. Indonesia has laws mandating environmental protection for precisely this reason—miners cannot choose when to obey them and when to ignore them. To best address this governance gap, CIPE launched a project with Paramadina under the premise that when there is

compliance with environmental laws, there is an increase in transparency, a legitimization of rule of law, and a reduction in environmental damage.

Lack of Health, Safety, and Environment Assessments

Because Chinese FDI-funded projects tend to operate quickly and cheaply, health, safety, and environment (HSE) issues remain a concern. We made a comparison of HSE treatment between PT Vale Indonesia, IMIP and VDNI. Although we do understand the methodological concerns in directly comparing two industrial parks with a standalone company, we did note that PT Vale has the best safety procedures in place, while IMIP and VDNI need improvement on HSE. Company budgets do not yet place high priority on HSE items (PT VDNI staff, personal communication, 2019).

Military Connection

The Indonesian military is known for its long history of running businesses in Indonesia, both institutionally and personally. Some retired army generals who are currently serving civilian roles in government are said to be involved in IMIP's operation through local partner PT Bintang Delapan. These individuals were involved with the company long before IMIP was constructed (Wijaya, personal communication, 2019).

It is not hard to make the case that military connections help to “grease the wheels” of economic growth. Therefore, it is noteworthy to look at the number of capital investments related to the industrial park. Transaction-based data from AEI presents 21 transactions from 2011 to 2018 related to the metal and mining sectors and the steel subsector, illustrated in Table 2 above. From this list, we have identified five transactions that directly relate to the Indonesia Morowali Industrial Park:

- In July 2013, Tsingshan Steel took a 50% share in a new firm with Bintang Delapan Group with an investment of USD 320 million.
- In July 2015, Tsingshan Steel took a 50% share in a new firm with Bintang Delapan Group with an investment of USD 510 Million.
- In December 2013, MCC group invested USD 180 million in a project with Sulawesi Mining Investment.
- In November 2015, MCC group invested USD 110 million in a project with Tsingshan.
- In June 2017, Tsingshan Steel engaged in a joint investment in IMIP with Delong Holding, with an investment of USD 150 million.

Together, these five transactions amount

to USD1.27 billion. This is a huge investment considering the challenging business environment and the number of environmental permits that must be obtained.. The necessary condition for businesses to operate is to obtain political support from the military and local authorities. By securing support from military and political elites, businesses are able to operate securely and smoothly without impediment.

Prone to Potential Corruption

In a country where corruption is still a major issue, investment from China may open the possibility of corrupt practices. Laode M. Syarif, the chief of the Corruption Eradication Body (KPK), even warned state-owned companies to be careful in their selection of investment from China (Adharsyah, 2019).

Lack of Good Corporate Governance

To end the practice of companies offering bribes to authorities, it is necessary to establish a system of values, principles, and implementation of good corporate governance. Namely, companies need to embrace the concepts of transparency, accountability, responsibility, independence and fairness in their daily operations and policies. Many foreign companies are forbidden under their home country's

law to pay bribes and are thus limited in their capacity to engage in corruption. To our limited knowledge, many companies engaged with Chinese FDI lack good corporate governance principles and practices. Another issue related to corporate governance is the troubled implementation of corporate social responsibility, because many Chinese companies have no experience with this concept.

Conclusion and Recommendations

Based on various information obtained through document analysis, in-depth interviews, and field observation in the nickel-rich region of Sulawesi, we conclude that China's investment in Indonesia's nickel industry has produced mixed results. As a developing country, Indonesia needs productive foreign investment to boost its economic power. China has seized on this need and established itself as a primary investor in Indonesia, and in doing so has also secured a supply of natural resources, particularly nickel and other metals, for sustaining and developing its own industry. For decades, Indonesia's mining sector was an export-oriented industry, while most of the giant exploration companies did their business in the upstream sector. As a consequence, Indonesia lost its potential to generate the higher revenues available in

downstream sectors. Subsequently, China arrived in Indonesia with large amounts of cash to develop Indonesia's first downstream industry and support generation of bigger revenues from selling processed materials, compared to those from selling raw materials mined for export.

Even though the downstream industry developed with Chinese investment has increased the competitiveness of Indonesian export commodities, China's investment has also created opportunities for mid-stream market power, under which the sale price of the nickel ore falls below market price, while local miners have no option but to sell their ore to China-controlled smelters. In the long term, these minimal profits will be insufficient to manage the environmental damage caused by the mining industry.

Indonesia's Corruption Eradication Commission (KPK) has warned the government and business communities about Chinese investors failing to meet their obligations for environmental sustainability. The rise of vibrant new economic sectors has the potential to increase the misuse of power by state officials, who may be offered incentives to provide official assistance, such as concessions involving more flexible application of regulations, to business actors intent on maintaining their successful positions in the new, openly competitive market system.

This situation incentivizes business groups to seek political patronage and support from government leaders by providing funds and other forms of support to policy makers in the circle of power. The interaction of these groups can create a powerful coalition of vested interests, which in turn may foster technocratic incompetence, hindering reforms via both legal and illegal channels and endangering good governance efforts in the newly democratic Indonesia.

In light of these concerns, KPK commissioners have warned state-owned companies to be careful in their selection of Chinese investment partners. However, China's companies face limited checks on their activities due to political support from those in Indonesia's circle of power, including high-ranking members of political, economic and military networks. Many retired army officials allegedly benefit from this business process. While the presence or involvement of military persons is unconfirmed, given the fact that big projects in Indonesia are generally difficult to execute due to bureaucratic delays, China's ability to efficiently navigate business obstacles in Indonesia may indicate that these investors are receiving support from military networks. Due to this support, Chinese companies investing in Indonesia enjoy certain benefits and flexibility.

Given the concerns identified in this research and analysis, we propose four

policy recommendations. If the concerns behind these recommendations are addressed, Chinese investment in Indonesia can proceed in a way that is beneficial for both countries.

1. Improving the system of working permits and business licenses for foreign investors. In a related case study, when an issue concerning a project using illegal Chinese workers emerged, the government acted swiftly to address the problem. However, there is still room for improvement in the availability of up-to-date data about the exact number of foreign workers involved in projects. Without improvement to the systems providing and tracking work permits and business licenses, the problem of illegal foreign workers will persist in any region that gets large amounts of foreign investment.
2. Establishing a fair and transparent nickel trading system. This will involve preparing and implementing a nickel price index to set benchmark prices for all market participants. The proposed Nickel Price Index will ensure that local mining companies and foreign buyers pay the same price for nickel. As of the publication of this report, Indonesia still does not have a Nickel Price Index. As a result, the price of nickel can occasionally fluctuate widely.

3. Becoming more selective in welcoming Chinese investment. In January 2020, Indonesia banned nickel ore exports. The implication of this is a further increase in Chinese investment.
4. Inviting more international competitors to invest in downstream industry and nickel refinement. The case of IMIP provides a great example of how business-to-business schemes can fulfill downstream policy and comply with the current regulatory framework, while at the same time provide quality investment and new job opportunities for the local economy.

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IDENTIFYING GOVERNANCE GAPS IN FINTECH: COUNTRY EXAMPLES AND INDONESIA CASE STUDY

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Introduction

As addressed in the previous chapter, Chinese foreign direct investment (FDI) in Indonesia's mining industry is significant and it appears that more money is beginning to flow to other sectors. Indonesia's Investment Coordinating Board (*Badan Koordinasi Penanaman Modal*, or BKPM) announced that Indonesia received USD 2.7 billion¹ in FDI from China in 2016. When FDI from Hong Kong is included, this figure rises to an unprecedented USD 4.9 billion. In 2017, China overtook Japan and now trails only

Singapore on the BKPM list of Southeast Asian countries investing in Indonesia.

Although China's investment fell to USD 2.4 billion in 2018, behind Singapore (9.2 billion) and Japan (4.9 billion), BKPM did not include investment from Hong Kong (2 billion) in this figure. A significant amount of Singaporean investment is also assumed to have originated from China (Van der Eng, 2018).

Chinese investment occurred in the electricity sector, where it funded the construction of power plants and supporting facilities, such as ports, and increased in Indonesia's downstream industries, mainly

1 Unless otherwise specified, all dollar amounts are in United States dollars.

nickel smelters. Much of this investment is related to China's Belt and Road Initiative (BRI), and both governments have agreed to joint infrastructure projects in three Indonesian provinces specifically designated for BRI investment: North Sumatra, North Kalimantan and North Sulawesi.

Reflecting global advancements in technology, Chinese companies have also expanded overseas investments in emerging technologies. In the case of Indonesia, Chinese investments in financial technologies, or fintech, have drawn considerable attention. These businesses are dominated by electronic/digital payment (e-payment) systems and online/digital lending, popularly known in Indonesia as "fintech lending."

In addition to these two major fintech sub-sectors, major fintech players operate to a lesser extent in the financial marketplace², artificial intelligence (AI), big data for financial services (e.g., credit scoring), and wealth management (including robo-advisory). Fintech has flourished in Indonesia, especially since 2016, in part because Indonesia's more traditional financial industry cannot keep up with the growth of the middle class and its increasing demand for technology-based services.

On one hand, digital adoption is growing at a rapid rate. The majority of Indonesia's almost 270 million citizens are under the age of 35, and a study by *We Are Social* in 2019 shows that the total number of active internet users in Indonesia reached 150 million, 56% of the total population, with 13% annual growth in users from 2017 to 2018. Mobile internet (smartphone) penetration is also high in Indonesia (WAS, 2019). A study from Morgan Stanley shows that Indonesia's smartphone penetration steadily rose from 28% in 2014 to 54% in 2017, which is similar to China's at 52% in 2014, and double India's level in 2017 (Morgan Stanley, 2019). An estimated 60% of the adult population owns a smartphone and the total number of active mobile internet users reached 142.8 million in 2019, representing 53% of the total population (WAS, 2019). In a recent Boston Consulting Group survey, 88 million people—35% of the population—were designated as middle-class, affluent consumers who regularly spend more than \$140 per month on food, utilities, communications, and regular household supplies (Morgan Stanley, 2019). By 2020, this number is expected to reach 141 million, or 53% of the country.

On the other hand, penetration by the traditional financial sector is lacking. The

2 The financial marketplace here refers to the platform through which financial products including insurance, mutual funds, credit cards, and personal loans from banks are sold.

2018 World Bank Findex Report shows that 49% of Indonesian adults have savings accounts with a bank. That is an increase from 2014 when the survey found 36% of adults had savings accounts (World Bank, 2019). In a market with nearly 270 million people, approximately 17 million credit cards were held in Indonesia in March 2019, up only slightly from 2012, when about 14 million were in circulation. These approximately 17 million cards are held by approximately 10–11 million individuals, only 6% of the total adult population. Financial access touch points between customers and traditional financial institutions are also lagging behind demand, in part because Indonesia's archipelagic nature makes it challenging to service all geographic locations. There are only about 38,000 bank branches, about 109,000 ATM machines, and around 500,000 merchants that can accept card payments (IFA, 2018).

All of these conditions in the Indonesian financial market are signs that the country needs more efficient financial products (whether for saving, payment, or loans) that are cardless and branchless—in other words, less physical and more digital. The best way to accomplish this is by leveraging smartphone penetration. The strong appetite

for consumption among the middle class has been fueled by easy access to online loans and aggressive marketing behavior of payment platforms. Fintech companies looking to expand in Southeast Asia would be remiss if they were to overlook Indonesia as a potential market.

Despite the bullish fintech market, fintech in Indonesia has a negative public image. In March 2018, Wimboh Santoso, the newly appointed Chairman of the Indonesian Financial Services Authority (OJK)³ for the first time raised the issue of using regulation to address the ultra-high interest rates of 1–2% per day at which some fintech lenders offer cash payday loans. From July through December 2018, a series of protests and mass rallies throughout cities in Indonesia targeted fintech payday lenders for these interest rates and the aggressive way in which they offer some services. The claim is that fintech lenders that offer payday loans exploit the absence of adequate interest rate regulations and insufficient price transparency rules.

Most protests targeted fintech lenders that are not registered with OJK, although a handful of registered fintech payday lenders were also targeted. In December 2018, the Indonesian Legal Aid Foundation, a reputable

3 The government agency that oversees Indonesia's financial services industry and grants registration and licenses for fintech lending businesses.

legal assistance organization, compiled a list of violations committed by fintech payday lenders (CNN, 2018a). These included:

- Charging an ultra-high interest rate of 1–2% per day
- Insufficient pricing transparency (hidden fees and penalties)
- Changing business names without properly notifying consumers
- Lack of proper registered address and contact number
- Poor administrative and record keeping systems (which meant that compliant customers were accused of default)
- Accessing sensitive personal data in customers' mobile phones (including contact lists)
- Using the borrower's contact list to make calls and otherwise reach out to contacts without the borrower's consent
- Threats and persecution during the collection process

The aggressiveness of personal data collection and use by fintech payday lending firms can be attributed primarily to the lack of a reliable system to provide credit scores or equivalent information about Indonesians. Indonesia has a weak credit reporting infrastructure and only around 10% of adult

Indonesians have credit data recorded at OJK's central financial repository system, SLIK (previously known as BI Checking).

These data were developed through contributions by approximately 1,600 licensed financial institutions in Indonesia that used consumer credit reports from sources such as credit card payment records, mortgage defaults, and consumer loans.

Because there is no way to reliably check creditworthiness, most people go to a bank or other financial institution to get a loan, only to have their application rejected when they cannot prove their creditworthiness. In response, consumers may decide to seek out unlicensed or unregistered (fintech) lenders in spite of their higher interest rates. Fintech lenders employ alternative (non-SLIK) data for underwriting, ID verification, address verification, income prediction, spending habits, and (if a client is seeking a business loan) merchant analytics.

Fintech firms operating in retail payment and consumer lending may request around 3,000 data points for their credit assessment. These include:

- Identity and location: fraud-proof identity, location, gender, education;
- Behavioral: browser history, footprints, cookies, interaction of apps;
- Financial: deposits, withdrawals;

- Technical: operating system, browser, hardware;
- Social Media: social graph, sentiment analysis;
- E-commerce: consumption pattern;
- Repayment records: punctuality.

In short, fintech payday lenders are operating in a space where the requirements are still evolving, and public and semi-public institutions are still taking shape. While the promulgation of OJK Regulation No. 77 in December 2016 was meant to facilitate innovation in this new sub-sector of financial services, fintech payday lenders are still able to operate in a largely unregulated environment. For example, in contrast to regulations governing banking, to date there have yet to be any requirements on interest rates, pricing and information disclosure, or on collection standards. There is also no specific prohibition on lending money without a license. This lax regulation contrasts with strict requirements that banking activities can only be conducted with a license, or otherwise be subject to criminal sanctions. The state regulator responsible for managing and sharing credit information with banks—OJK—has yet to expand such activities with licensed credit bureaus.

These governance gaps, in turn, enable fintech operators to grow their business at

the expense of consumers. A recent review of consumer protection law and policy in Indonesia by the United Nations Conference on Trade and Development (UNCTAD) concluded that Indonesia's consumer protection system needs to address emerging issues with e-commerce and data protection. The review concluded that general provisions exist in Law No.19/2016 on electronic information and transactions but "specific laws on data protection, data sovereignty and other issues have yet to be formulated and certain standards applied across all sectors" (UNCTAD, 2019). But there are plans to fill these legal gaps. The blueprint of Indonesia's central bank (Bank Indonesia) for Indonesia's Payment Systems (IPS) 2025 includes the protection of consumer data as one of its five principles. Working groups were established in early 2019 that aim to create a regulatory framework that determines what financial information can be shared, what information is private, and what method would be used to share information (Harsono, 2019).

One of the key issues raised by consumer groups is that personal data protection has been unable to keep up with fintech developments, leading to data abuse by some fintechs. These abuses included using the borrower's contact data to call close relatives for repayment without the consent of the borrower or the borrower's relative.

Collection calls were problematic not only because of the misuse of data but because of the behavior of these debt collectors, which in the case of several companies was reported as aggressive.

Central to the heated public debate in Indonesia and major controversy surrounding fintech payday loans is the association of this particular business model with Chinese-controlled companies. During the second half of 2018, OJK noted that the arrival of predominantly Chinese fintech lenders, which often did not register at OJK and employed aggressive debt collection practices, started to alarm the regulator. It produced a blacklist of 222⁴ banned fintech lenders in July 2018 and continuously updated the list until April 2019, when the total number of banned apps reached 947.⁵ In early January 2019, the cybercrime unit of the Indonesian National Police Force (*Kepolisian Negara Republik Indonesia*, “Republic of Indonesia State Police” or POLRI) arrested three employees working for a Chinese-owned fintech payday lender for aggressive debt collection behavior including online threats and harassment.

Whether protests of fintech payday lending were the result of a problem with lending regulations and practices or of underlying

anti-Chinese sentiment in Indonesia, they shine a critical light on Chinese fintech investment. An appropriate response requires finding the root problems that need to be addressed. Are Chinese fintech payday loan providers importing unethical business practices that harm Indonesians? If so, does this provide evidence to the claim that Chinese capital undermines democratic governance in other countries? Is this investment a move coordinated by the Chinese government or were decisions made by largely autonomous Chinese businesses attracted by opportunities in the Indonesian market?

China’s Fintech Investment in Indonesia

THE NOTION OF “CONTROL” AND IDENTIFICATION OF THE FLOW OF CAPITAL

The issue of corporate control is important to understanding the policy environment in which fintechs operate in Indonesia. There are several ways to determine who legally controls the company. A quantitative measure relies on the control of shares in the company. The standard rule is simple majority rule, or 50% +1. However, in some cases, including the case of companies

4 Previously 227, but five were later excluded because they were found to be licensed financial institutions.

5 Based on official data released by OJK. See further discussion on Section C5.

listed publicly in Indonesia before 2008, the threshold can be set lower so that any person or entity controlling as little as 20% or 30% can be considered in control of the company.

Control can also be measured qualitatively, by the ability to control the management and/or the policy of a company. An organization can have a small stake in a company but retain control through its authority to appoint the board of directors, for example.

Both quantitative and qualitative approaches to evaluating company control are recognized in securities regulations that apply to publicly traded companies and may be adopted to assess the fintech sector. For tech businesses and digital companies, the qualitative approach can be more suitable for determining company control even though it is harder to measure. There are many instances in which even a small minority stake (below 5%) can retain control of the company, especially in venture capital-backed companies that have undergone multiple funding rounds. In these cases, the founders typically retain a management control right—for appointing the board of directors and board of commissioners—even when their share of the company's total capital has been substantially reduced by the inclusion of new funders.

It is also possible for a venture capitalist to own a majority stake of a tech company

without gaining control. Venture capitalists are generally more interested in financial returns from startups than they are in controlling the companies in which they invest. They typically have authority in financial decision making, including decisions to secure new funding from investments or through a loan, but not necessarily management control.

A nominee structure that represents a foreign interest—a common model in Indonesian fintech—can be considered a vehicle for financial control. This can be seen in the composition of many boards of directors and boards of commissioners, which are often mostly local to make it easier to qualify for work permits or qualification assessments. Strict and thorough assessments by the regulators (OJK or BI) of the identity of license applicants prior to the issuance of a business license has made it more difficult to use a nominee structure in financial services compared to other sectors. If the parties decide to proceed with a nominee arrangement, pursuant to the Indonesian Investment Law of 2007, the agreement will be deemed void and the foreign shareholders will have no legal protection in the company. They will be responsible for covering their own risks and liabilities.

Indonesian financial regulation does not allow 100% foreign ownership in fintech. The limit on foreign ownership varies with the

business model, from 85% (for P2P lending) to 49% (for e-money enterprises). Given this restriction, within this paper we divide the term control into “exclusive control,” in which the controller has exclusive control regardless of whether they work with a local partner, and “joint venture” or “shared control,” in which the structure of the partnership more resembles an equal arrangement between the foreign and the local partner. Shared control occurs in large part because the local partner is a considerably larger or more reputable business group with strong bargaining power. Exclusive foreign quantitative control of e-money licenses is impossible because of the 49% foreign ownership cap, but in online lending it is possible to exercise exclusive foreign control through the 85% maximum foreign ownership threshold.

Once control is determined, the next step is to identify the country from which that control is exercised. For years, the Indonesian Investment Coordinating Board (BKPM) has listed Singapore as the top country of origin for foreign investment in Indonesia. Singapore is known as Asia’s business hub because capital in-flows from various regions including the United States, Europe, China, India, and Southeast Asian regions are aggregated through the country. It is therefore likely that some Chinese investment facilitated through

Singapore would be officially recorded as investment from Singapore rather than as Chinese investment. In 2015 Singapore held 51% of the USD 62.8 billion outward stock of Chinese FDI to ASEAN countries. This is almost as much as the USD 64.7 billion outward stock of Singapore’s FDI in other ASEAN countries in 2015 (Van der Eng, 2018). Indonesia hosted 51% of Singapore’s outward stock of FDI that year. It may also be the main recipient of Chinese FDI channeled through Chinese subsidiaries located in Singapore (Kong, 2017).

The combination of qualitative ownership control, the potential for nominee structure, and investment flows through Singapore make it impossible to accurately assess the level of foreign ownership and control of fintechs operating in Indonesia without access to each company’s confidential legal documents. This paper therefore approaches the problem of assessing foreign ownership through a deal or transaction basis, relying on disclosed deals and/or in-depth interviews with key business insiders conducted by CIPE.

IDENTIFYING DEAL SIZE OF UNICORNS, INDEPENDENT FINTECH STARTUPS, AND CHINESE SUBSIDIARIES

A first attempt to understand Chinese investment in fintech is to divide these companies into *startups* and *subsidiary*

companies (in this case, subsidiaries of a Chinese parent company). Startups are typically portrayed as led by local founders/entrepreneurs trying to implement new business models in Indonesia, whereas Chinese subsidiary companies import already successful business practices from China to Indonesia. In terms of control, the founding team in startups usually retains management control⁶ even when the majority of shares is held by financial investors, while the controlling shares of a Chinese subsidiary remain with the Chinese parent company.

Startups can be further divided into *independent fintechs*, which usually have a single business focus (online lending, e-payment, insurtech, etc.) and *unicorn startups*, which leverage their main, often non-fintech businesses (e-commerce, ride-hailing, or online travel) to drive their fintech arms. The unicorns are key players in fintech because they attract the majority of funding and allocate those funds to build their fintech products or acquire fintech companies.

Unicorns

Since 2016, the Indonesian tech ecosystem has been dominated by the rise of the unicorns: private companies valued at \$1 billion. Unicorns are flourishing in Indonesia. Some are home-grown, such as Go-Jek,

Traveloka, Tokopedia, Bukalapak. Some are regional companies based out of Singapore, such as Grab, SEA Group, and Lazada. Some are out of China, such as JD.com. A recent study by Google shows that between 2015 and 2018, total funding raised for unicorn startups in Southeast Asia was raised in Singapore (approximately USD 16 billion) and Indonesia (roughly USD 6 billion), with the remaining USD 2 billion raised in the rest of Southeast Asia. It is not safe to assume that only USD 6 billion of this funding went to the Indonesian market. The same study concludes that almost 80% of funds raised went to the unicorns of Southeast Asia (and Indonesia), and that these unicorns afterwards invested heavily in Indonesia. Grab, Lazada, and Sea Group (in addition to local Indonesian unicorns) have deployed funds to build businesses across the region, including, and especially, in Indonesia.

Unicorns have invested substantial funds into fintech product development. In many cases, these products are well-integrated into the company's main app, although legally they can be part of different but affiliated companies.

Table 1 (PG. 178-180) shows how Chinese funds have played a major role in the establishment and rise of seven Southeast

6 There are some exceptions to this rule, including the acquisition of Lazada by Alibaba.

Asian unicorns, all of which have substantial fintech operations in Indonesia. Underlined companies originated from China.

Of these seven unicorns, Lazada is the only company in which corporate control has changed from the original founders to a new, Chinese controller (upon its acquisition by Alibaba). Other unicorns remain under

the management control of their founding teams, but this does not diminish the importance of Chinese investments in fueling their growth. As indicated in the published transaction deals above, Chinese investors have been active in acquiring financial stakes in Indonesia's and Southeast Asia's technology giants.

TABLE 1: Chinese Funds and the Rise of Southeast Asian Unicorns

UNICORNS	FINTECH RELATED BUSINESS IN INDONESIA	RECORDED DEALS <small>The author does not have access to what percentage of these amounts went to the respective company's fintech arms.</small>
Go-Jek	<ul style="list-style-type: none"> Go-Pay (e-payment) Kartuku (e-payment) Mapan (payment agent network) Midtrans (e-payment) Findaya (lending) 	<ul style="list-style-type: none"> 2016: valued at \$1.3 billion and secure over \$550 million from investors including KKR, Warburg Pincus, Farallon Capital, and Capital Group Private Markets. 2017: valued at \$2.5 billion and secures over \$1.2 billion in funding. China Giant, Tencent reportedly led this round. Early 2018: secured another \$1.5 billion fund injection at a \$5 billion valuation, from Google, Singapore's Temasek Holdings, and BlackRock. October 2018: raised \$1.2 billion and sought a valuation of \$9 billion. Investors are said to include Google, Tencent, and JD.com.
Bukalapak	<ul style="list-style-type: none"> In-app financial marketplace In-app bill-payment Payment agent network 	<ul style="list-style-type: none"> Major shareholder is EMTEK, through PT. Kreatif Media Karya, holding 36.86% of shares. Alibaba's Ant Financial was reported to lead Bukalapak funding rounds in 2017. Another major shareholder is GIC, the Singapore government's investment arm. January 2019: Bukalapak announced the arrival of another key shareholder, Asset-Naver Asia Growth Fund from Korea.

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UNICORNS	FINTECH RELATED BUSINESS IN INDONESIA	RECORDED DEALS <small>The author does not have access to what percentage of these amounts went to the respective company's fintech arms.</small>
Tokopedia	<ul style="list-style-type: none"> • In-app financial marketplace • In-app bill-payment • Payment agent network 	<ul style="list-style-type: none"> • 2014: The company raised \$100 million from SoftBank and Sequoia in 2014. Beenos, East Ventures, and CyberAgent Ventures are among its early backers. • <i>Tokopedia</i> has raised a total of \$2.4 billion in funding over nine rounds. • In December 2018, Tokopedia had secured \$1.1 billion in its latest financing round, led by the SoftBank Vision Fund and Alibaba Group with participation by Softbank Ventures Korea and other existing investors. • August 2017: Alibaba has led a \$1.1 billion investment in Indonesia's Tokopedia.
Traveloka	<ul style="list-style-type: none"> • Recently acquired DIMO (e-payment) 	<ul style="list-style-type: none"> • <i>Traveloka</i> has raised a total of \$920 million in funding over five rounds • October 2018: raised roughly \$420 million reportedly led by GIC, Singapore Government's investment arm. • July 2017: raised \$400 million in a funding round led by Expedia, valued a \$2 billion valuation. • Previously the company raised roughly \$100 million from by East Ventures, JD.com, Sequoia Capital, and Hillhouse Capital Group.
Grab	<ul style="list-style-type: none"> • OVO (Grab as the largest shareholder) • Taralite (lending) 	<ul style="list-style-type: none"> • <i>Considered Southeast Asia's first Decacorn</i>, Grab's latest funding round in March 2019 was reported to be \$1.5 billion, led by Softbanks' Vision Fund. In total, Grab has raised \$9.1 billion Grab's latest valuation is reported to be \$14 billion. • Grab has attracted funding from many sources and sectors, including the United States (500 Startups), Japan (Softbank), Australia (Macquarie Capital) and China (Ping An Capital, China Investment Corporation, China Cinda Asset Management, Didi Chuxing). Key banks (HSBC, Kasikorn) and automotive manufacturers (Yamaha Motor, Hyundai Motor, and Toyota Motor) have also invested in Grab.

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UNICORNS	FINTech RELATED BUSINESS IN INDONESIA	RECORDED DEALS <small>The author does not have access to what percentage of these amounts went to the respective company's fintech arms.</small>
SEA Group	<ul style="list-style-type: none"> ShopeePay (e-payment) ShopeeKredit (lending) 	<ul style="list-style-type: none"> Sea is a NASDAQ listed company (listed in October 2017) that has raised a total of \$2.6B in funding over eight rounds. In March 2019, the Company is raising additional \$1.5 billion from a new share offering in American Depository Shares (ADS) to be funneled into its Shopee e-commerce business. Prior to the 2017 IPO, Tencent was the largest shareholder in Sea group, followed by founder Forrest Li.
Lazada	<ul style="list-style-type: none"> HelloPay (e-payment) 	<ul style="list-style-type: none"> 2016: Lazada was acquired by Alibaba 2018: Alibaba's stake increased to an undisclosed size following the latest investment, a spokeswoman told Reuters. It held an 83 percent stake prior to the investment, which now doubles to \$4 billion from a \$2 billion infusion over the past two years.

Independent Fintech

Outside of the unicorn-linked mega deals that fueled the fintech arms of these companies, independent fintechs, which are not affiliated with international or local groups, have also been attractive targets for investment in Indonesia. Media announcements have revealed that fintech startups raised around \$280.3 million, of which \$170 million went to Akulaku, which was founded by an independent Chinese entrepreneur who relocated to Indonesia and secured funding from a group of investors led by Alibaba's Ant

Financial. Other significant deals included those by Kredivo, a consumer installment platform worth roughly USD 30 million, Modalku, an SME lending marketplace worth roughly USD 25 million and led by Softbank and Sequoia, and Cekaja, a marketplace for bank and insurance products worth roughly USD 25 million and led by Experian. None of the funding for these three companies was led by Chinese companies or investors, although some Chinese venture capitalists did participate in the deals.

Chinese Subsidiaries

While Chinese investors into Indonesian unicorns or independent fintech startups are typically not able to control these companies, which are generally controlled by their founding team, Chinese investors definitely control the operations and management of the subsidiaries of Chinese firms in Indonesia. Significant Chinese influence in the Indonesian market originates from internal deals formed by strategic partnerships or the opening up of local subsidiaries by Chinese companies. Key China-related transactions are⁷:

- Xiaomi's financial arm, Mi Credit, aggregating financial products for the purchase of Xiaomi phones;
- JD Finance Indonesia, a fintech arm of JD.ID, a Chinese e-commerce company;
- The launch of OneConnect Indonesia, the subsidiary of Ping An Group, China's insurance firm and largest consumer finance provider;
- Several key investments by Chinese operators to enter the e-payment market, as described below; and
- Several Chinese operators setting up subsidiaries in online lending, as described below.

Identifying the Control Structure of Fintech Payment Companies

A substantial portion of the funding that went to the unicorns was used to develop fintech products in Indonesia, although the exact numbers are known only to the companies themselves. The same applies to major Chinese investments that open e-payment businesses in Indonesia. All of these companies have similar strategies when it comes to fintech: start with payment products and later build various offering on top of the payment platform.

Digital money and digital wallets are payment products that interact directly with users such as retail customers. Table 2 (PG. 182 lists the five of 18 Indonesian companies (28%) that are joint ventures with foreign entities.

Interestingly enough, three of these five companies are directly linked to China and the remaining two are linked to Grab and SEA Group, which although not Chinese-controlled have substantial investors from China. Didi Chuxing reportedly invested as much as USD 2 billion into Grab in 2017 (Russell, 2017b), while Tencent owned about 34% of SEA Group through 2017 (Chandler, 2018). Another company worth mentioning is Go-Pay, which although locally-

7 No transaction values have been disclosed for any of these deals.

TABLE 2: Joint Venture with Foreign Entities

COMPANY	JOINT VENTURE
Visionet	Brand: OVO, a local financial partner of Grab of Singapore which has invested substantially in the Lippo-owned company, according to which now Grab owns at least 41% of OVO pursuant to PT. Visionet public corporate registry.
Witami	A local affiliate of Thailand-based True Money, in which Ant Financial owns around 20% in the Thai holding.
DANA	A joint venture between EMTEK local conglomerate group with Ant Financial that has leveraged Bukalapak's online outreach using the close relationship between EMTEK, Ant Financial, and Bukalapak.
Blue Pay	A China-based fintech company.
Airpay	A subsidiary of Garena and SEA Group of Singapore.

controlled, has received substantial funding from Chinese giants such as Tencent and JD.com, most notably in 2018 when roughly USD 1 billion in investment was led by Google, Tencent, and JD.com, but also included Meituan Dianping (Potkin, 2019), and in 2017 when roughly USD 1.2 billion of investment was led Tencent, in which Tencent reportedly contributed around USD 150 million and JD.com USD 100 million (Russell, 2017a).

Before 2017, Alipay and Tencent attempted to apply for e-money licensing without local partners but had difficulty obtaining

regulatory approval. It is not clear whether they would still pursue this license given that they eventually managed to secure the license through partnerships with, or investment in, local businesses.

Identifying the control structure of fintech lending companies

Fintech lending can be divided into four general products: the SME lending marketplace, microfinance marketplace, consumer loans, and cash payday loans. This division allows us to see how the country of

origin affects which business model a fintech will pursue. For example, all fintech lenders in the microfinance marketplace are domestic, while Chinese-controlled companies dominate the payday loan market.

It is also worth noting that the majority of fintech lenders in Indonesia are properly registered with the designated authority, OJK. Further, all unregistered fintech lenders were operating payday loan businesses.

REGISTERED FINTECH LENDERS⁸

Below is our finding based on the controller's country of origin:

- The SME lending marketplace is dominated by domestic companies (96%), except for one company from Singapore.
- All microfinance operators are locally controlled.
- As illustrated in Figure 1 (PG. 184), the ownership and control of consumer loan companies are more diverse, but still dominated by domestically controlled businesses (57%), whereas four companies are from China and one is a Chinese joint venture. Of the four Chinese-controlled companies, three

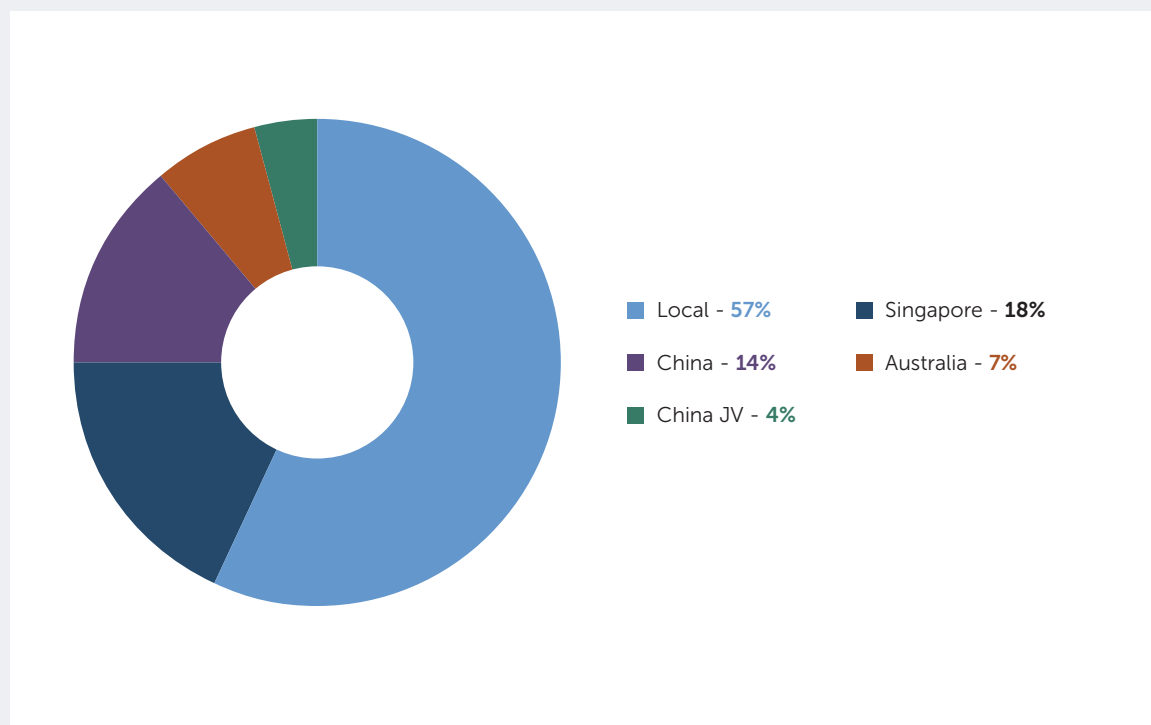
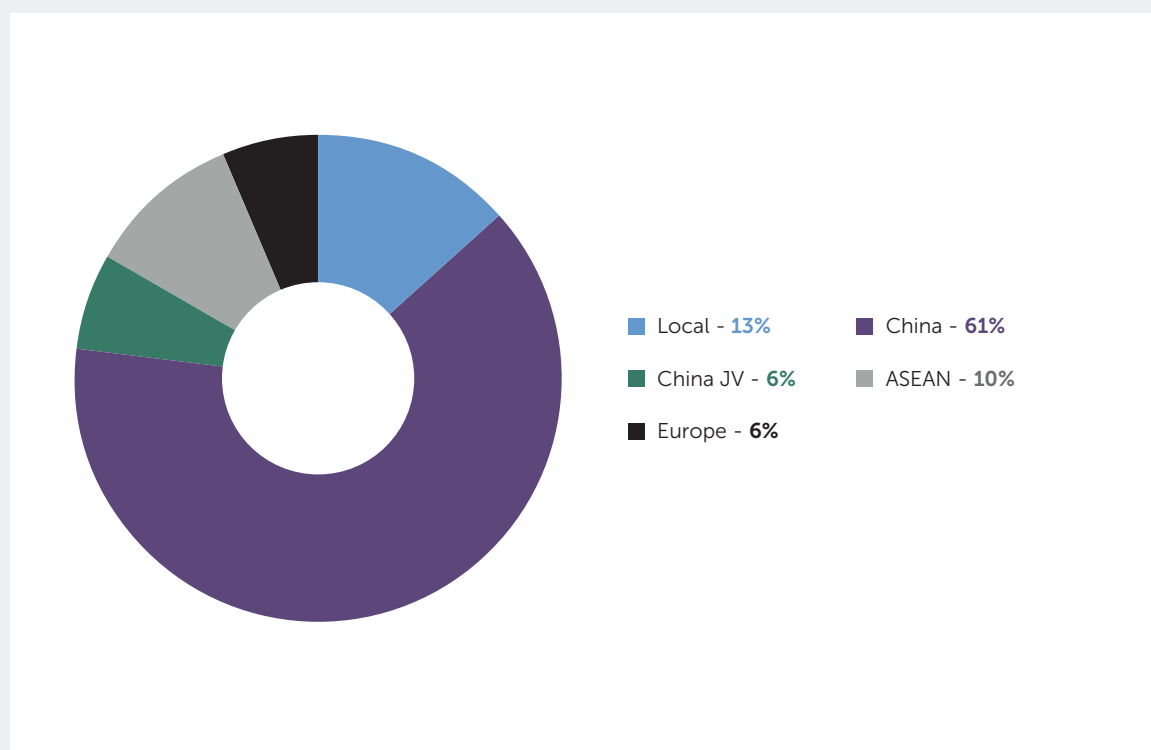
originally planned to offer payday loans, but OJK has temporarily suspended the granting of new payday lender registrations due to controversies.

- In payday lending, two-thirds of controlling stakes are either Chinese (61%) or Chinese joint ventures (6%), as illustrated in Figure 2 (PG. 184).

Among the four main product offerings by fintech companies, Chinese-controlled companies are only dominant in the payday loan sector. Among offerings for SME loan marketplaces, microfinance marketplaces, and consumer loans, the controllers' countries of origin are either balanced or dominated by the domestic businesses.

The predominance of Chinese control in payday loans compared to other fintech products is important because payday loans are the main source of controversy revolving around fintech in Indonesia. Complaints about fintech tend to relate to the use of ultra-high interest rates, the potential for abuse (non-consensual use) of personal data, and threats and persecution during call collection. Rather than assuming these concerns are a product of fintech, it's useful to ask whether these problems

8 OJK 77/2016 Regulation recognizes two licensing steps: registration and full license. A company will receive registration status and will be given 1-2 years to complete the audit and documentary requirements before being fully licensed. Once registered, a company can fully operate as if it is licensed. Therefore, being registered is more of the same of being licensed in terms of permitted activities.

FIGURE 1: Controlling Shareholder of Fintech Operators Providing Consumer Installment Products**FIGURE 2: Controlling Shareholder of Fintech Operators Providing Pay Day Loan/Cash Loan**

are the result of the business model used for payday lending or in the controllers' approach to the Indonesian market, which may not be in line with Indonesian business practices.

The top lending platforms by transaction volume and the number of borrowers are all payday lenders from China. Below are the top five companies by transaction volume through the end of 2018, as ranked according to analysis by the authors through interviews, listed in alphabetical order.⁹

- Akulaku, founded by an independent Chinese entrepreneur, William Li, with substantial investments from Alipay's Ant Financial, offering consumer installment products;
- Dana Rupiah (a subsidiary of China-based Weshare Group), offering payday loan products;
- Kredit Pintar (a subsidiary of China-based Advance.AI), offering payday loan products;
- Pendanaan, founded by an independent Chinese entrepreneur, Jasmine Hao Dai, offering payday loan products; and
- Rupiah Plus (recently changed to Perdana), founded by an independent

Chinese entrepreneur, Rebecca Wang, offering payday loan products.

Akulaku Finance is the number one company by transaction volume, but as discussed earlier it is not a fintech company, though it operates in the same way that fintech lenders do. Akulaku Finance is a Chinese-controlled company.

UNREGISTERED / ILLEGAL FINTECH LENDERS

Starting in June 2018, the spread of improper debt collection practices carried out by fintech lenders made national headlines.

Only later was it discovered that these practices were largely undertaken by fintech operators not registered with OJK (although some registered fintech payday lenders have also been caught using such practices). Since that time, OJK has regularly published a list of unregistered fintech lenders. OJK can only govern and supervise business activities under its licensing regime because it relies on administrative sanctions on the 106 companies it has recognized as licensed entities for enforcement. OJK lacks the tools and the authority to act against unregistered entities. Almost all unregistered apps conducted payday loans, which by their nature (immediate, cash loans under USD

⁹ Unfortunately, OJK does not publish transaction volume by company for comparison.

140 offered at a high interest rate) target the poorer population, who receive minimum wages and lack access to more traditional consumer loans that offer better interest rates, such as credit cards or personal loans from banks.

To try to deal with the creation of so many unregistered fintech lenders, OJK sent the list to the Ministry of Communications and Information Technology (Kominfo), which responded by sending instructions to licensed Internet Service Providers (ISPs) to block the IP addresses of these unregistered apps. Kominfo also requested that Google remove these apps from the Google Play Store.¹⁰ From July 2018 to April 2019, OJK has blocked 947 mobile apps. Nearly all of these apps¹¹ were operating as fintech payday lenders. Table 3 (PG. 187) displays the series of blocked apps during July 2018 to April 2019.

OJK also sent the list of illegal fintech lenders to the Indonesian National Police (POLRI), but unlike accepting deposits (considered illegal banking), unlicensed moneylending is not a crime. Because fintech lending merely matches borrowers with lenders (even when they are super-lenders), POLRI and the Attorney General's Office have no authority over unlicensed money lending activities.

As of the July 2018 release, OJK had discovered that at least half of the 227 unlicensed P2P lending providers identified – more than 100 – were developed by Chinese firms, (Aisyah, 2018). In December 2018, OJK issued a statement that out of roughly 400 apps that had been closed down in July and September, the majority were from China (CNN, 2018b).

The high number of apps being shut down could mask a much smaller number of actual companies operating these apps. A single firm may develop multiple lending platforms. This appears to be the case for at least some firms. For example, a developer named Xinhe had uploaded at least nine P2P lending apps to the web and Google Play Store, and other developers with Chinese names such as LiChen, Tupulian, Xiehualei also established lending apps with Indonesian names such as Dompot Pinjaman (loan wallet), DompotKamu (your wallet) and Duit Instan (instant cash).

At the next round of app closures in February 2019, the illegal foreign fintech services operating in Indonesia were mostly from China, Russia, and South Korea, according to the OJK Investment Alert Task Force. But they are not overwhelmingly Chinese—the

10 The segment of the population targeted by unregistered payday loan apps is much more likely to own an Android-based phone, as iPhones are normally not affordable to poor Indonesians.

11 Five apps were blocked in error.

chief of the task force, Tongam L. Tobing, reported that only 23 of 231 fintechs that were forced to stop their activities during January-February were Chinese firms (Dwinanda, 2019).

In March 2019, the OJK Investment Alert Task Force reported that out of 803 fintech lenders blocked (by that time), further analysis of their IP locations showed that the country of origin of 323 (40%) were not identified, while 178 companies (22%) were from Indonesia and the rest (38%) were

from various jurisdictions, including China, Singapore, Russia, Hong Kong, and Malaysia.

Of course, analysis of the server location based on IP addresses is not a reliable indicator of the country of origin. Many companies operating in Indonesia can be owned and operated by foreign nationals, including Chinese controllers, either directly or through nominee arrangement. However, it is safe to conclude from OJK's analysis that at least half of the apps have been owned and operated by Chinese-linked

companies. **TABLE 3: Chinese Funds and the Rise of Southeast Asian Unicorns**

NO.	RELEASE DATE FROM OJK	# OF FINTECH BANNED
1	27 July 2018	222 (previously 227) ¹²
2	7 September 2018	182
3	13 February 2019	231
4	14 March 2019	168
5	28 April 2019	144
TOTAL		947

¹² Previously 227, but later 5 excluded because they were found to be licensed financial institutions.

Taking into account that almost all blocked apps were conducting payday loan activities, and OJK's assessment of the registered payday loan businesses, it is likely that this sub-sector of fintech lending is largely operated by Chinese-controlled companies.

The Impact of Chinese Capital on Indonesian Fintech Development

GENERAL PERCEPTION ON THE IMPACT OF CHINESE CAPITAL IN INDONESIAN FINTECH FROM A MARKET PERSPECTIVE

Indonesia's fintech growth since 2016 and its rapid market adoption since 2018 are undoubtedly fueled by funding from China—exponential growth in e-payments and online lending cannot be separated from investments by companies connected to China. The development of Indonesian companies also mirrors that of China's earlier digital path. Similarities include:

- Focus on transactions through payment facilitation and the extension of various financial products built on top of the platform (from loan, insurance, and wealth management), mirroring the Chinese models of Alibaba or WeChat

and contrary to the more prominent use in the U.S. of advertising-based businesses like Facebook or Google;¹³

- Strong emphasis on the online-to-offline (O2O) model, in which a mobile phone is used for physical payment (for example, for QR-based payment) or brick-and-mortar outlets or individual agents facilitating online transactions that eventually bridge Indonesians without mobile internet access; and
- The emergence of "super-apps" to aggregate different services—again mirroring Alibaba or WeChat, in contrast to the more fragmented services and products, in which consumers still prefer to use different apps to perform different transactions/functions, prominent in the United States.

In 2017, Adrian Li, a reputable venture capitalist, argued that three metrics in particular reveal that Indonesia is a lot like the China was in 2007/2008:

"E-commerce as a percentage of retail sales (1.4 percent in 2015), Internet penetration (28 percent in 2015) and GDP per capita (USD 3,834 in 2015.) The economy grows about five percent annually, e-commerce is expanding

13 Amazon is the exception, rather than the rule.

rapidly (by USD 10 billion a year and forecast to hit USD 130 billion by 2020), and smartphone use is forecast to swell to 100 million by 2020... All that, coupled with weak infrastructure and poor logistics systems, makes it an especially big opportunity for e-commerce growth.” (Li, 2017)

Another reason the Chinese model works better for Indonesia compared to the U.S. model results from the revolutionary impact of the mobile internet on daily activities. In China (2007) and Indonesia (2016), the rise of the digital economy coincided with the growth of mobile internet penetration, and therefore changing habits to incorporate mobile internet use is relatively easy. By contrast, in the United States consumers had internet access before the rise of smartphones, so “the landscape was pretty much set when iPhone was introduced: Facebook in social, Twitter in news, Google in search and Amazon in e-commerce.” (Zhao, 2019)

For this reason, Chinese investments and technologies are perfectly suited to support the growth of Indonesia’s digital aspirations. Chinese investors understand the Indonesian market better and may be able to replicate the formula that produced Chinese success with some degree of adaptation for the Indonesian market.

PUBLIC ANGER DIRECTED TOWARDS FINTECH PAYDAY LENDERS ASSOCIATED WITH CHINESE OPERATORS

The rapid development of the fintech industry has left Indonesian regulators catching up to an evolving industry, struggling to react as it adapts and innovates to meet consumer needs rather than trying to anticipate consumer needs and control the industry’s development. In many ways, this catching-up by regulators feeds into public perception that fintech lenders, and especially Chinese fintech lenders, are bypassing, ignoring, or undermining Indonesian regulations.

One of the key complaints raised by consumer groups is the feeling that existing personal-data protection systems are inadequate at governing fintechs, leading to data abuses and this has led to data abuse by the majority of fintech payday lenders. Many fintech payday lenders used the borrower’s contact data to call close relatives of the borrower for repayment without the consent of the borrower.

These collection calls were problematic not only because of how the data was used, but because of the behavior of the debt collectors. In early January 2019, the cybercrime unit of POLRI arrested three employees working for a Chinese-owned fintech payday lender called V-Loan. They

were charged with committing threats during debt collection calls. The owner of the company, a Chinese national, fled Indonesia and has not since resumed business operations in Indonesia.

During July through December 2018, there was a series of protests and mass rallies throughout urban cities in Indonesia targeting fintech payday lenders for improper behavior. Most of these protests were addressed to fintech lenders not registered with OJK, although a handful of registered fintech payday lenders were also the targets of public protests. In December 2018, the Indonesian Legal Aid Foundation (YLBHI), a reputable legal assistance organization in Indonesia, compiled a list of violations committed by fintech payday lenders specific to personal data abuse:

- Accessing sensitive personal data in the mobile phone (including contact list);
- Calling any person in the borrower's contact list, without the borrower's consent; and
- Making threats during debt collection calls.

The Indonesian Consumer Watch, a reputable NGO on consumer affairs, recorded 234 consumer complaints about fintech lending—all of which regard payday loans (Reily, 2019). As of February

2019, YLBHI has received more than 3,000 complaints specifically regarding payday lenders (Heriani, 2019).

In February 2019, a local taxi driver committed suicide. He had failed to repay his debt and being chased aggressively by fintech payday lenders and their debt collectors. An investigation by OJK showed that he had borrowed from more than 10 fintech apps, most of which were unregistered apps, allegedly Chinese-owned. The authorities could not directly attribute which app caused the victim to commit suicide.

In response to the growing concerns over personal data abuse, on 12 February 2019 under OJK Fintech Lending Department Director Letter No. S72/NB/13/2019, OJK issued a decree that restricts fintech lenders' access to mobile internet data, except for:

- Microphone;
- Camera; and
- Location.

OJK requires all fintech companies to be audited under the framework of ISO 27001 and found in compliance in order to be eligible for full operational licensing. This move is more restrictive than the previous letter issued on 17 October 2018 that prohibited access to "contact lists" and "other data unrelated to credit assessment." The Indonesian Fintech Lenders Association

(AFPI), however, demands the right to also access app histories and call logs.

There are valid reasons for fintech lenders to challenge the OJK directive. As discussed in the first part of this paper, Indonesia has a weak credit reporting structure and its national ID system has not stopped widespread identity fraud. Providing consumer loans is therefore extremely risky because it is difficult to learn with whom a lender is dealing and their creditworthiness. Contact list assessment is one of the ways that fintech lenders have developed to perform a credit-risk analysis in the absence of a developed credit report or trustworthy identification system. For example, fintechs are able to analyze communication patterns to learn a great deal about someone who has applied for a loan. However, none of these reasons justify harassment and bullying of consumers or those on their contact lists, as this behavior violates both the ethical and legal use of personal data.

There is no direct relationship between the fintech operator's country of origin and its likelihood to commit privacy violations, but several factors feed the popular perception that it is the result of foreign, and specifically Chinese, involvement. The following three issues in particular have shaped the perception by regulators that China-linked companies not only contribute directly to the problems with payday lending in Indonesia

but also risk inspiring other companies to employ abusive tactics to secure their financial interests:

- All consumer complaints about fintech lenders are about payday lenders. This is in part because higher value loans cater to more sophisticated market segments, such as SMEs, more wealthy borrowers, and the socio-entrepreneurs serviced by microfinance;
- Most fintech payday lenders (both registered and unregistered) are Chinese-controlled;
- Despite high media coverage and public outcry (including a series of public protests by and for "fintech victims"), OJK so far has sanctioned only one registered company: Rupiah Plus (now Perdana), which is owned and operated by a Chinese national, and POLRI has made an arrest for online harassment to only one unregistered company: V-Loan, also owned and operated by a Chinese national.

At the end of the day, despite public concern about them, Chinese fintech operators are not particularly adept at bypassing Indonesian regulations. Exploitation of regulatory gaps is not an inherent feature of Chinese fintech operators - except when it comes to personal data and customer protection in payday loans.

The business model for payday loans regardless of the origin of their controlling shareholders, on the other hand, does exploit the existing regulatory framework, which was not originally designed to govern payday loans. High interest rates, a lax approach to personal data protection, and aggressive debt collection are closely associated with fintech payday lenders. It happens that the majority of fintech payday lenders are linked to China, but there is no evidence that their poor behavior should be attributed to China instead of the poorly regulated state of the fintech industry itself. However, the perceived correlation has been enough to cause public outcry and consequences for Chinese-linked firms.

There are certainly gaps in the regulatory environment in which fintech payday lenders operate that these companies have exploited in terms of data and consumer protection. But the actions of fintech payday lenders have alerted OJK, which has been keen to close those gaps. This is not evidence of failure, but evidence that the system addresses the concerns of consumers as service providers adapt to meet their rapidly evolving needs without restricting their choices or stifling innovation by blocking Chinese or other firms from the market without sufficient evidence. As such, there is no reason to believe that democratic or governance systems have been corroded by Chinese fintech operators in Indonesia.

GOVERNANCE CHALLENGES IN FINTECH LENDING

Ever since the 1998 financial collapse, the Indonesian financial regulators (BI and OJK) have been focusing on detailed and specific regulations for financial prudence and market conduct. On one hand, this creates high barriers to enter into the Indonesian financial services sector. On the other hand, it also led to a large segment of the market not being properly served. Since the fintech lending regulation was introduced in 2016, the requirements for fintech have been somewhat more open, but regulators have been expected to tighten the rules to match banking regulations. In addition, the open nature of the digital space further exacerbates the difficulties of controlling market entry.

Fintech payday lenders have taken advantage of a weak regulatory regime that provides:

- Minimum guidance on interest rates, pricing transparency, and disclosure standards;
- Minimum guidance on data protection;
- Minimum guidance on debt collection standards;
- Insufficient credit information and institutional governance to facilitate data sharing to minimize credit risk; and

- Almost no barriers to market entry, leaving app stores such as Google Play Store or Apple App Store to act as the “gate-keeper” to determine which applications are fit for consumers to download.
- This paper found no evidence of a link between Chinese fintech investors or operators and the Chinese government. Instead, each sub-sector of fintech has different levels of investment and control by Chinese investors, whether Chinese technology giants or independent Chinese investors. However, Chinese technology giants are predominantly found in e-payment, either as strategic investors in unicorns or as direct operators, arguably because e-payment is a capital-intensive business and only a few companies can compete in the market as it exists.

Summary, Recommendations and Conclusions

- The Indonesian digital financial market is growing exponentially, led by local and regional unicorns and independent tech entrepreneurs. This growth is happening most rapidly in two areas: e-payments and online lending. Chinese and Chinese-linked companies have been backing this growth through capital investments in and strategic partnerships with these leading companies. Some have attributed these capital investments to the similarity between Chinese and Indonesian markets being interpreted as an opportunity by Chinese opportunities to apply their knowledge from the Chinese experience to the Indonesian market.
- In most cases, consumers enjoy the benefits that have come from fintech innovation. Retailers now have the ability to use digital payments at a lower cost than credit card payments, consumers who once lacked access to credit can now find willing lenders, and the public has more options for financial products.
- As is the case in many sectors (such as ride-hailing, hospitality, and fintech) and jurisdictions, the key success factor of fintech has been about “creative compliance” with existing regulatory regimes in order to drive innovation and push the boundaries of what is permitted by law.
 - There is one area of fintech that has received completely negative coverage, not only from regulators but also from tech communities for the reputational damage they have caused to the whole industry: the area of payday lending. Payday lending grants micro consumer loans of up to USD 140 disbursed in cash with repayment in full at the end of

the month. These lenders charge ultra-high interest rates, up to 2% per day, prompting discussions about how to reduce the maximum interest rate. Some consumers of these loans borrowed from too many lenders, and lenders failed to effectively screen for creditworthiness in their customers and failed to clearly disclose all penalties for delayed payments. This combination harmed customers who were less legally or electronically savvy.

- Many payday loan operators acted unethically, but the fact that this sector is dominated by Chinese-owned or controlled companies is incidental and not the explanation for these practices. Hundreds and thousands of consumer complaints have been lodged to consumer organizations, legal aid, and regulators to report these practices of fintech payday lenders.
- The remaining gaps in data and customer protection have breached ethical standards with tragic individual consequences. In response, the Indonesian government is working to fill these gaps. This is not evidence that the system is broken, but that it is working. What remains crucial is that the regulatory environment is meant to facilitate the growth of the fintech sector

instead of stifling it along the lines of the existing limitations for the traditional financial service institution.

- As such, in terms of policy recommendations, consumer protections can be further advanced if the governance gaps are properly addressed. Rules on pricing transparency, data protection, and debt collection are emerging gradually to respond to the regulatory demands. The enforcement of these rules, however, will not be straightforward considering any non-compliant firms can still offer their products and reach any consumer in the current structure of an open digital market. Long-term institutional reform, such as the development of a robust credit information institution, is therefore crucial because it will provide more comprehensive data in loan decision-making.
- Moreover, the government needs to address the loophole concerning capital inflows from foreign P2P lending platforms. Foreign platforms lend to Indonesian fintech lenders, which will in turn loan the funds to their debtors. Given this practice, foreign online lending companies lend to Indonesian debtors without an Indonesian license. The practice has led to accusations of being “online loan sharks” (Ginting, 2019).

The media scrutiny of these practices contributed to the issuance of OJK Regulation No. 77/2016 on P2P lending. It also resulted in OJK's increased protection of both the existing industry players and the consumers.

- The absence of a Data Protection Law remains a burden to the law enforcement process in Indonesia's fintech industry. If data protection is meant to be covered by this law, then OJK and MOCI need to cooperate to ensure that the law

will accommodate the growing fintech industry while protecting the consumers' data. Cooperation with the National Consumer Protection Body is highly advised. The government had proposed a Draft Bill on Personal Data Protection (PDP) but the bill did not pass into law before the end of the parliamentary term in September 2019. Because of overlapping authorities, the PDP Bill is on-hold for further review (Pos, 2019). More needs to be done.

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CONCLUSION

Investments from China into Southeast Asia have contributed to economic growth and the development of the private sector in the host countries. For example, in Malaysia the solar panel and glass industries have seen leaps in growth due to Chinese investments. Yet there are also cases in Southeast Asia in which the local private sector received marginal benefit from Chinese investments. For instance, in Cambodia, the report showed that Chinese firms have little interaction with local firms and do not contribute much to the capacity and skill development of the local workforce. As a result, the spillover effect of Chinese investments on local SMEs has been limited.

Local firms in host countries seek to benefit more from investments from China. Several

authors pointed out that small businesses are concerned about being unfairly outcompeted by Chinese firms, which are supported by state-led industrial policies and cheap credit from the state.

Foreign direct investments from China sometimes goes into high risk and lightly regulated industries, such as mining, online gambling, and payday lending. In the cases of the Philippines and Indonesia, the authors documented that these investments bypass, ignore, or undermine regulations in the host countries. Problems include importing illegal workers, evading taxes, and exploring military networks which are deeply vested in the economy. Southeast Asia's young democracies have suffered from weak rule of law and lax enforcement. Chinese

investments at times exploit and exacerbate these governance gaps.

Chinese-funded megaprojects raise more concerns than traditional FDI due to a lack of transparency and the opacity of the deal-making processes. The deals are made among the ruling elites of China and the host countries without proper scrutiny or oversight. It is widely recognized that the influx of Chinese capital and contractors help to alleviate the massive infrastructure

gap in the region. To better utilize these capital inflows, the governments in Southeast Asia need to strengthen their capacity to mitigate the risks identified in this report, such as weak public procurement regulatory regimes, a lack of information on and robust oversight of BRI projects, weak governance of SOEs, and corruption.

Table 1 (PG. 198-199) lists recommendations to help mitigate risks stemming from large Chinese investment inflows:

TABLE 1: Recommendations to Help Mitigate Risk Stemming from Large Chinese Investment Inflows

PROBLEMS	SOLUTIONS
Lack of transparency in public procurement	<ul style="list-style-type: none"> • Increase transparency of the public sector and public procurement process • Have clear legal regulations on public procurement • Follow public procurement international best practices, such as competitive and public bidding • Replace low-bid procurement practices with Life-Cycle Cost Analysis (LCCA) to promote quality infrastructure project • Empower civil society and interested stakeholders to advocate for greater transparency on public procurement process
Corruption	<ul style="list-style-type: none"> • Strengthen anti-corruption work through institutional changes • Lawmakers should exercise oversight of loans that the government undertakes • Implement Freedom of Information act • Publicize government loan terms • Disclose ownership of companies which participate in mega infrastructure projects (especially if these companies are owned by government officials, their families, or close associates). • Provide for third party quality control/independent audit mechanism of the mega infrastructure projects • Implement PPP laws to facilitate investments and monitor PPP projects in hopes to increase transparency and accountability

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PROBLEMS	SOLUTIONS
Weak governance of state-owned enterprises	<ul style="list-style-type: none"> • Demand greater scrutiny of SOEs by lawmakers • Require disclosure of SOEs' annual reports and detailed financial statements as well as disclosure of remuneration of company directors, any financial liabilities potentially borne by the taxpayer and justification of the entities' activities against public policy objectives • Implement mechanisms for SOEs to reduce conflicts of interest among directors
Illegal worker/migration	<ul style="list-style-type: none"> • Implement better management systems for foreign workers • Improve the system of working permits and business licenses for foreign investors
Social tension, environmental degradation, land grabbing and force eviction	<ul style="list-style-type: none"> • Apply multilateral development bank (MDB) standards (such as financial feasibility, environment assessment, social and governance impact analysis) for Belt and Road Initiative loan projects • Promote Corporate Social Responsibility and corporate governance among Chinese firms
Little contribution to local private sector	<ul style="list-style-type: none"> • Provide a level playing field for local and foreign contractors by requiring foreign firms to abide by the OECD guidelines on export credit assistance • Ensure any local content requirements focusing on promoting technology and knowledge transfer between foreign and local firms

The countries of Southeast Asia should strengthen their regulatory environment to reduce the likelihood of corruption, increase transparency, enhance oversight mechanisms, and improve their public procurement framework. In addition, civil society organizations can play a more significant role as a bridge between foreign investors and local communities to spearhead inclusive dialogue among governments, local civil society, and foreign

investors before megaprojects begin so as to ensure that local voices are heard. Civil society and a free press can also help monitor foreign business behavior and promote OECD guidelines for multinational enterprises in agriculture supply chains, the extractive sector, mineral supply chains, and textile and garment supply chains to advocate for more responsible business practices.

Governments can also use regional platforms such as ASEAN to gain stronger negotiation power when advocating for more responsible investments from China.

For China

Chinese civil society is eager to work with foreign counterparts to encourage Chinese firms to engage in more corporate social responsibility and be more responsive to local communities' concerns. Chinese companies could seek Chinese civil society's assistance to try to act more responsibly and inclusively.

The Chinese government could work with Chinese companies abroad to ensure that they are abiding by guidelines released by Chinese business associations. The mining and construction industry associations from China have published guidelines that are on par with international standards. More broadly promoting and sharing these guidelines would help improve business behavior overseas.

Regarding investments with an international development purpose, China should try to employ the standards of AIIB in all its BRI projects to ensure that this new global power is also advancing development goals by acting more responsibly. Greater transparency in business engagements and MOUs between governments would help improve China's image in the region and counter a reputation of colluding with ruling elites.

Lastly, the report highlights research questions requiring further scholarly attention, including:

- Whether Chinese private firms are driven purely by the profit motive or instead act based on the policy guidelines from the state
- Whether SOEs and private firms from China respond differently to local pressure and incentives
- The extent to which China uses its economic leverage to influence host countries' domestic politics or foreign policy

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