

Analysis of political, economic, legal and technological risks in indonesia

[Economics](#)



Analysis of Political, Economic, Legal and Technological Risks in Indonesia By
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Introduction Doing or expanding business in Asia nowadays has become a popular trend from companies around the world, many big firms based on Europe and United States of America recently has opened a branch in Asia in order to reach the Asia Market.

The main attraction of Asia is the number of population, with approximately 4 million people spread around 5 regions, consist of Northern Asia, Western Asia, South Central Asia, South East Asia, and East Asia

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(OneWorldNationsOnline, 2012), it is apparent that Asia has become a large growing market that attracts companies around the world. Moreover, other than the large growing market potential it offers, there are other benefits that a firm can get by expanding business in Asia.

First of all the labor cost in some less developed Asia Countries, such as Indonesia, Vietnam, Thailand, is relatively lower than labor cost in Western Countries, for example, England and United States of America. Secondly, the land cost in Asia, Indonesia in particular is relatively much cheaper than in Western countries. However, despite the benefits that have been mentioned above, there are some risks that need to be known by a firm before deciding to expand business to Asia, Indonesia in particular.

The risks itself can be divided by four which are, political risk, economic risk, legal risk, and technological risk. Below, there is an explanation and examination about four of the risks that may arise while expanding business in Indonesia. Brief Introduction to Indonesia Indonesia is a country in South East Asia which consists of approximately 17. 508 islands. The official name of Indonesia is Republic of Indonesia. There are 5 main islands in Indonesia which are Sumatra, Java, Kalimantan or Borneo, Sulawesi and Papua.

Geographically, Indonesia is placed between Pacific Ocean and Indian Ocean as well. Jakarta is the capital city of Indonesia and is placed in Java Island. The Legal Currency in Indonesia is Indonesia Rupiah. In term of people, Indonesia has approximately 240 million of people with various ethnicities and is the fourth most populated country in the world. The current president of Indonesia is Susilo Bambang Yudhoyono. Political Risk According to

Deresky (2008) Political Risk is government actions or politically motivated events that can affect a firm in the long terms.

Furthermore, Kobrin (1979) states that political risk covers possibility of unwanted consequences created by governmental activity that affect international business. Nationalization, Expropriation and Confiscation, Terrorism, and Macro political and Micro political risk are the example of commonly known political risk events. Nationalization is a governmental action to take over a private asset to be owned and operated by the government. Next is Expropriation, Expropriation is a term to define a process of taking away a private property for a public use.

The difference between Expropriation and Nationalization may seem a bit vague, but the intentions for both terms are different. Nationalization is a process to take over a private asset by a government in order to make profits. For example is the nationalization of Netherland Enterprises by Indonesia Government after the independence war. On the contrary, Expropriation only takes private property to be used for public, for example, a government takes over a land of a private house to be used for highway because the public needs a highway to support the transportation around that area.

The third is Terrorism, Terrorism as defined by Ruby (2002) and Title 22 of US Code is politically motivated action committed in a violent manner against common people. And the last is Macro political and Micro political risk, Macro political risk is any governmental action that affects all the multinational companies within the country while micro political risk is the governmental actions which only affects some of multinational companies.

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Moreover, it is important for a firm to know and manage prevention of any political risk that they may encounter while expanding their business, without doing that matters a company may end up having no profits or even loss their assets while going global. In Indonesia, particular political risk events that a firm likely to encounter when expanding their business are expropriation and terrorism. It is because Indonesia is often considered Less Developed Countries. Moreover, based on Marshall, A. and Magnowski, D. (2010) multinational companies need to give attention on Political issues in Asia such as current tension between China and United States over the value of China currency, the development of crisis which is rising in North Korea, and the border issue between Indonesia and Malaysia. Those issues have possibility to affect Political situation in Indonesia. In order to measure the political risk in a country, there are some methods that can be done by multinational companies. The first method is computer modeling; this method is used by American Can's Primary Risk Investment Screening Matrix.

Using this method a company can predict and simulate the political risk that might happen in expansion target country. The Second method is Ranking Systems, with this method; a company can consult with some political risks expert such as AON, who use analysis tools and experience to help minimizing the political risk. The last method is Early Warning Systems, this method emphasizes on watching early signs of political dangers, such as demonstration, act of violence by the citizen, the atmosphere of political situation to predict the possible political risk in the future.

Basically, a multinational company can use four actions to manage the political risk. The first possible action is withdrawing their investment on a country which is likely to have a bad political event. The other way is by sharing their equity with local business. Thirdly, a multinational company can keep the subsidiary and host nation be more dependent on the parent firm by controlling input, market, position and staged contribution. Lastly, a company can use the political risk insurance to ensure their safety from political risk.

Additionally, Bribery is often practiced in Indonesia Political Environment which in some way makes the Political Situation in Indonesia become unstable. Economic Risk Economic risk refers to the risk from economy sector that may affect multinational companies to gain profit. Economic risk is vary in different countries, however it can be concluded that Economic risk in Less Developed Countries such as Indonesia, Vietnam, Thailand, tend to be higher than in Fully Developed Countries, Britain and United States of America for example.

Some common examples for economic risk are the changes in inflation and devaluation of the currency value, foreign investment policies, monetary and fiscal policies. According to A. M Best report the Economic risk in Indonesia is considered moderate due to four factors. Indonesia is ranked as the fourth country with most population in the world, having approximately 240 million people and placed bellow China, India, and United States of America. With that amount of people Indonesia has the opportunity to create a big market for multinational companies.

It is also stated that Indonesia's Economy is considered well balanced in terms of manufacture, service and agriculture. Despite those three terms, Indonesia also has considerable amount of resources such as wood, nickel, gas, oil, textile, and garment in export sector. Nevertheless, Indonesia also has a close trading partnership with Developed Countries in Asia, Japan, Singapore, South Korea, as well as Developed Country in America, United States of America. Moreover, Indonesia is expected to have economic growth for about 6% in 2012, and 5, 9% in 2013 due to healthy domestic investment and consume.

The last factor is Indonesia sovereign credit ranking was upgraded to one level below investment grade in 2011. Furthermore, although there are some factors above, Economic Risk in Indonesia is still risky. There are 2 major economic risks that threatening Indonesia's economy. The first one is the effect of global inflation nowadays. It is worrisome to some extent that the global inflation will badly affect Indonesia economy in the long terms. As a less developed country with highly dependence on export sector, Indonesia is highly vulnerable to be badly affected by the global inflation.

Second major risk is the after effect of the global inflation in the future, as the developed countries begin to recover from the global inflation, Indonesia is expected to find difficulties to recover as fast as those developed countries. Additionally, there are four ways that can be done by multinational company to assess economic risk in target country. Multinational company can measure the economic risk by analyzing the country ability to handle its debt. This kind of measurement is often called Quantitative method.

Other way is called Qualitative method; this method refers to sending a group of their experts to make a research about one particular country leader and their possible policies in the future. Checklist method is also can be done to asses an economic risk in a country; this method is done using the past events to measure the possibility of economic risks in the future. Nonetheless, a multinational company can use a combination of Qualitative, Quantitative as well as Checklist methods to measure the economic risk.

Legal Risk Legal Risk has the same meaning with Regulatory Risk, for Multinational Companies, it refers to potential of losing assets due to some legal or regulatory issues. Legal Risk or Regulatory Risk is often related to the Legal Environment. Legal Environment is the laws that are created and operated by the government to control the business operation. Generally, Legal Environment consists of local laws and legal systems. Local laws usually are varies in different countries, while Legal System is often similar.

There are three types of legal systems that are stated by Deresky, H. (2008). It consists of Common Law, Civil Law and Islamic Law. Common Law refers to Old English Law, this kind of law uses the previous cases to determine the punishment for the current cases. In terms of Contract Law for business purposes, Common Law emphasizes on writing the details on the contract to be used as a guide and proof in case of disagreement in the future. The other law is Civil Law. Civil Law is a law that is originated from Roman law and often used in modern western countries.

Civil Law emphasizes the defendant to prove their innocent. In term of Contract Law, Common Law affirms that promises can be enforced without the need to specify the details in the contract. The last type of legal system <https://assignbuster.com/analysis-of-political-economic-legal-and-technological-risks-in-indonesia/>

is Islamic Law, Islamic Law is a law based on Islam Religion, and this kind of law is often used in Islamic Country. Moreover, Indonesia has its own law. Indonesia Law is originally created based on Civil Law and some customization from the Dutch who used to rule Indonesia in the past.

Aside from the Legal Environment, there are some other regulatory issues such as, protectionist policies, tax systems and the level of government involvement in the economic and regulatory environment. Indonesia protectionist policies such as tariffs and quotas are vary, and often changed by the government which indicates that government involvement in the regulatory and economic sector is considerably high. Nonetheless, Indonesia charges 25% of the income to be paid for the tax, according to taxrates. cc.

This percentage is considered high, compared to Singapore, Indonesia's neighbor country which taxes foreign corporate for only 17% of the income. Technological Risk Technological Risk is a term that refers to the potential risk to lose assets due to technological sector. Two major issues in technological risk are to protect its own technology to not be copied by its competitors and to provide the capable operator and capable environment to use the technology. Technological risk may be a concern for multinational company in Indonesia; they may find difficulties to find highly skilled employees there.

However, labor cost in Indonesia is relatively cheaper compared to labor costs in western countries. Furthermore, it is possible to create a trademark or a copyright for Indonesia. Nevertheless, it must be noticed that there are many counterfeit products in Indonesia, and it seems that Indonesia

Government has lack of motivation to capture and punish the producer and
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the seller of those products as well. Conclusion In the conclusion, Indonesia has offered a great opportunity for Multinational Company to expand their business there.

With the constant growing market, cheap cost of labor, and the raw resources, in my opinion, it is promising for multinational company to expand their business to Indonesia. However, the potential risks in Indonesia, especially in Political and Economic sectors must be considered carefully. Nevertheless, if a multinational company manages to overcome the four risks, which are political risk, economic risk, legal risk, technological risk in Indonesia, it is obvious that particular company can gain a lot of profits from Indonesia.

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