UNLEASHING SERVICES SECTOR POTENTIAL

INDONESIA SERVICES OUTLOOK 2017

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ISD Board of Advisors

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General updates on Services
Services sector continues to grow and contribute to GDP accounting for 43% GDP in 2015 (a 1% increase from 2014). Services sector increasing as industry & agriculture decline.

**Economic Sectors Share to GDP (Value-Added)**

- **Agriculture**
- **Industry**
- **Services**

Sources: World Bank (2016)
Services the only sector that continues to create a largest share of total employment (45%) while industry and agriculture are in stagnant and decline respectively (22% and 33%)

Sources: World Bank (2016)
Still mostly in unskilled and informal sector such as trade in construction, but growing in other more formal sector

Figure 4. Services Employment, by Subsector, Indonesia, 2013 (%)
Current Account Deficit Stabilizing:

Improvement in Current Account Deficit in Q3 2016 To $4.5 billion (1.9% of GDP) from Improvement in balance of trade (non oil and gas) and decline in balance of services trade

Source: Bank Indonesia, Neraca Pembayaran, Semester II 2016
However trade in services remain in deficit. Services export was at $22.2 billion in 2015 while services import was at $30.5 billion (deficit of $8.3 billion). Services sector made up 11% of total export and 16% of total import.

Sources: ISD Calculation based on Bank Indonesia (SEKI-2016)
Tourism and Business Services are the biggest contributors to export of services

Sources: ISD Calculation based on Bank Indonesia (SEKI -2016)
Tourism is experiencing the highest growth of export of services

Sources: ISD Calculation based on Bank Indonesia (SEKI -2016)
Selected Services Sector highlight in 2016
• Visitor exports reached 6.4% of total exports in 2015, its share forecasted to grow by 1% in 2016.
• Tourism investment was 5% of total investment, it could rise to 7% in 2016.

Sources: World Tourism and Travel Council (2016)
Indonesia tourism contribution to GDP and employment is well below neighbouring countries

<table>
<thead>
<tr>
<th>Travel &amp; Tourism's Total Contribution to GDP</th>
<th>2015 % share</th>
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<tbody>
<tr>
<td>19 Cambodia</td>
<td>29.9</td>
</tr>
<tr>
<td>34 Thailand</td>
<td>20.8</td>
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<tr>
<td>55 Vietnam</td>
<td>13.9</td>
</tr>
<tr>
<td>58 Malaysia</td>
<td>13.1</td>
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<tr>
<td>73 Australia</td>
<td>10.8</td>
</tr>
<tr>
<td>76 Sri Lanka</td>
<td>10.6</td>
</tr>
<tr>
<td>77 Philippines</td>
<td>10.6</td>
</tr>
<tr>
<td><strong>World</strong></td>
<td><strong>9.8</strong></td>
</tr>
<tr>
<td>93 Indonesia</td>
<td>9.6</td>
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<tr>
<td>Asia Pacific</td>
<td>8.5</td>
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<tr>
<td>117 China</td>
<td>7.9</td>
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<td>142 India</td>
<td>6.3</td>
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<tr>
<td>22 Cambodia</td>
<td>26.9</td>
</tr>
<tr>
<td>50 Thailand</td>
<td>15.4</td>
</tr>
<tr>
<td>56 Australia</td>
<td>12.6</td>
</tr>
<tr>
<td>65 Malaysia</td>
<td>11.4</td>
</tr>
<tr>
<td>70 Vietnam</td>
<td>11.2</td>
</tr>
<tr>
<td>79 Philippines</td>
<td>10.3</td>
</tr>
<tr>
<td>87 Sri Lanka</td>
<td>9.7</td>
</tr>
<tr>
<td><strong>World</strong></td>
<td><strong>9.5</strong></td>
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<tr>
<td>99 India</td>
<td>8.7</td>
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<tr>
<td>103 China</td>
<td>8.4</td>
</tr>
</tbody>
</table>

Sources: World Tourism and Travel Council (2016)
ICT; Connectivity today…

Internet Penetration Rate and Impacts

- APJII 2016 survey finds that Internet penetration reaches 51% of population in 2016 (132.7 million people), that’s a 44 million increase from 2014 (88 million people) and 70% of all internet users access internet by mobile phones.

- Oxford Economics 2016 Highlight 1% increase in mobile internet could add US$640 million to GDP

Trade in ICT Services (in USD billions)

Domestic ICT industry relies a lot on foreign ICT provider. It can be seen from ICT import has surged since 2012 while export remain stagnant. ICT had a trade negative of -745 million dollar in 2015.
Customers now live in an ‘everything digital’ world

- 15% of retail purchases are made online
- 51% of payments are made digitally
- 58% of households subscribe to online streaming services
- 66% of adults have smartphones
- 72% of adults use social media
- 80% of households have broadband
- 62% get news from online aggregators
- 93% of millennials regularly use email
- 38% of media interactions are on smartphones

SOURCE: OECD; ONS; Parks Associates; Payments UK; N/A; Institute; onemarketer.com; Moneysupermarket.com; Google
Most popular B2C site in Indonesia in 2013, is Amazon despite not having a local presence, recently overtaken by Lazada Indonesia (Rocket Internet) by providing better servicing the local market including Indonesian language marketing, same day delivery and customized payment schemes (Lazada was recently acquired by Alibaba at $1 billion dollars to increase Alibaba’s reach in Southeast Asia)

Zalora which is Rocket Internet’s fashion platform is also doing well in the local market. Local fashion designers also sell online themselves or through platforms. Other players are Rakuten Belanja Online (subsidiary of Japanese giant Rakuten).

As for online forums local players lead such as Kaskus being the leader on online platforms (6.8 million registered users) and OLX being second. And C2C marketplace, Tokopedia a local player is growing exponentially as well as bukalapak.com. Tokopedia claims to draw 10 million monthly visitors per month with shoppers buying an average of Rp.2 million of products a month in 2014.

Brick and mortar retail all responding also with e-commerce platforms: Matahari Mall, MAP Mall
**Fintech: the next wave in digital economy and inclusiveness**

The banking landscape is changing rapidly, with Asia leading the way in rapid adoption.

**Evolution of digital banking penetration for transactions and services**

2007 - 2014, percentage of respondents using online banking

<table>
<thead>
<tr>
<th>DEVELOPED ASIA</th>
<th>EMERGING ASIA</th>
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<tbody>
<tr>
<td></td>
<td>2007</td>
</tr>
<tr>
<td>Japan (N = 789)</td>
<td>82</td>
</tr>
<tr>
<td>Korea (N = 756)</td>
<td>33</td>
</tr>
<tr>
<td>Taiwan (N = 811)</td>
<td>92</td>
</tr>
<tr>
<td>Australia (N = 728)</td>
<td>94</td>
</tr>
<tr>
<td>Hong Kong (N = 758)</td>
<td>31</td>
</tr>
<tr>
<td>Singapore (N = 742)</td>
<td>94</td>
</tr>
<tr>
<td>China (N = 3,558)</td>
<td>4</td>
</tr>
<tr>
<td>India (N = 3,004)</td>
<td>1</td>
</tr>
<tr>
<td>Indonesia (N = 1,103)</td>
<td>9</td>
</tr>
<tr>
<td>Philippines (N = 897)</td>
<td>6</td>
</tr>
<tr>
<td>Vietnam (N = 844)</td>
<td>7</td>
</tr>
<tr>
<td>Thailand (N = 755)</td>
<td>6</td>
</tr>
<tr>
<td>Malaysia (N = 706)</td>
<td>44</td>
</tr>
</tbody>
</table>

1 From the year when the data was first collected

Fintech: *the next wave in digital economy and inclusiveness*

FinTech is no exception, new offerings seen across all areas

**Comparison Websites**
- HaloMoney.co.id
- cekaja.com
- cermati
- ATMUDIT.com
- asuransi88.com

**Personal Financial Management**
- NgaturDuit.com
- DompetSehat

**Lending**
- DANAdidik
- MODALKU
- investree

**Investments**
- bareksa.com
- Stockbit

**Payments and Transactions**
- veritrans
- DOKU
- KARTUKU

**Corporate Solutions**
- JoinomicPRO
- veryfund

*McKinsey & Company 7*
Logistic and Transportation; *What holding back?*

- World Bank’s Logistics Performance Index (LPI) has Indonesia at 63rd place in 2015, 10 points lower from 53rd in 2014. (LPI 2016)
- High shipping and inventory costs
- Further relaxation in custom regulations needed to increase the flow of traded goods and services
- Unbalanced distribution of logistics services – currently very concentrated in Java
- There have been some efforts Logistics reforms, especially in border agency area
- Logistics sector reforms are essential both for the development of remote regions and for economics diversification
Insurance Services; *The impact of global downturn...*

**Regulations, laws and accounting standards**
- Government increased efforts to prepare a framework for Indonesian insurance industry development
- Compliance with stringent tax regulations
- Limitation of foreign ownerships
- Implementation of insurance standards (SFAS 62, SFAS 28/36) and insurance regulations which have vary interpretations due to unclear implementation guidance.

**Trend towards auto insurance and unit-link products**
- Auto insurance cover and unit-link products have become more popular and is preferred by consumers in Indonesia.
- Companies not offering auto insurance through multi-finance/bancassurance and unit-link products appears to grow at a slower pace.

**Challenges in the Indonesian Insurance Industry**

**Competitive landscape**
- Insurance industry in Indonesia shows a large opportunity for growth in the future (low market penetration, large numbers of people who are underinsured/uninsured)
- The insurance industry in Indonesia is fragmented considering the large number of players
- Limited underwriting capacity of domestic insurers (shifting premiums to overseas)

**Distribution network and talent**
- Traditional ways versus bancassurance.
- Distribution channel competition.
- Bancassurance becomes more common and popular in the recent trend. Strategic initiatives is one of the key in growing customers base.
- Scarcity of talents for insurance expertise

**Financial market**
- Interest rate – volatile interest rates will create challenges to financial performance
- Volatility of exchange rates
- Limited availability of investment portfolios

*Sources: PWC (2016)*
Prospective ‘Selected’ Sector in Services 2017
Tourism services is a promising growth sector in the economy. This is an opportunity to unlock: (private) investment, new jobs, higher export earnings, and infrastructure improvement.

The Ministry of Tourism Republic of Indonesia has focused on developing 10 destinations which required US$20 billion to create the ten destinations as “Bali Baru”.

The World Bank has planned on giving a loan worth US$200 million to develop 3 of the 10 selected destinations which are Mandalika, Danau Toba, and Borobudur.

Every $1 million in tourism and travel spending support around 200 jobs and $1.7 million in GDP for Indonesia.
• The increasing mobile internet growth stands to contribute $30.1 billion in GDP and 498,000 new jobs by 2020 (Oxford Economics 2016)

• An increase of another 35% in internet penetration rate by 2020 (as predicted), could add a total of $44 billion to the GDP (Allan Asher, AIPEG 2016)
Fintech: *Untapped potential and room to grow*

2. Indonesia presents a large, underpenetrated population

- Only 36% of adults have a bank account
- ~50% send remittances through non-banks
- Only ~27% save money at a financial institution
- Only 7% used an account to receive wages in the last year
- 44% borrowed money from family, friends or informal lenders
- Only 9% used a debit card to make payments

SOURCE: Global Findex database (2014)
Healthcare Services; For More Affordable and Available Services

- One of the most promising sectors since the launch of JKN in 2014
- Health spending forecasted to increase by 200% by 2020 from US$ 26 Bn (3.1% of GDP in 2011)
- Pharmaceutical industry forecasted to grow at 10-12% per year
- Medical device market to grow by 13% pa, projected to be at 1.22 bn by 2018
- JKN means increasing access to Health, cased health services to be undersupplied, which led to hospital groups rapidly plan to launch new facilities and programmed to cover the whole population by end of 2019.
- However, number of Indonesian physicians are relative low compared to neighbouring countries (0.4 per 1000 populations (far below Singapore 2.3, China 1.8, Malaysia 1.6, Philippines 1.2, Vietnam 0.8)
- This applies the same to hospital bed (1.0 per 1000 people), compared to China 3.3, Vietnam 2.9, Malaysia and Singapore 2.0, Philippines 1.1 (make graph of this)
Recommendations; next steps...
• **Strengthening Infrastructure.** Spending on Infrastructure was USD57.3bn in 2014, projected to increase to US$138.6bn by 2025. Moreover, RPJMN (2015-2019) – is a good start to improve infrastructure but also need support from the private sectors and regulations need to be attractive to investors.

• **Intensifying Digitalization.** Digital infrastructure sharing has strategic importance for licensed operators trying to extend network while minimizing costs for Indonesia Broadband Plan (*Rencana Pita Lebar Nasional*). This will lead to higher penetration rates and therefore facilitate many new sectors, i.e. e-commerce, etc.

• **Streamlining Regulation.** Increase market access, i.e. reduce barriers to entry to incentivize companies to develop innovations and offer quality services and reforms in the systems of licensing, registration and permit issuance.
<table>
<thead>
<tr>
<th>Ecosystem for Innovation</th>
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<tbody>
<tr>
<td><strong>Partnerships</strong></td>
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<tr>
<td>Encouraging partnerships both within the ecosystem and across different ecosystems</td>
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<tr>
<td>37% of all funding rounds in the top 20 ecosystems have at least one investor from another ecosystem</td>
</tr>
<tr>
<td><strong>Talent</strong></td>
</tr>
<tr>
<td>Developing a hub that is attractive for talent to live and work in</td>
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</tbody>
</table>
| “The real secret of Silicon Valley is that it’s really all about the people”  
  Reid Hoffman |
| **Access to capital**     |
| Helping startups with access to funding as well as exit options |
| Total VC investment across the top 20 ecosystems rose 95% from 2013-2014; total exit growth also rose 81% in the same time period |
| **Infrastructure and regulations** |
| Infrastructure that supports growth through continued investment; responsive regulations that do not stifle innovation |
| “To bolster ecosystems, we need to think like a startup, not a government agency”  
  Innovation think-tank Nesta |

Services Trade Restrictiveness Index shows that logistic, architecture, and engineering services are three sectors with the lowest scores (better performance). The sector with the highest score are legal services, motion pictures, and air transport.

Sources: OECD STRI (2016)
0% VAT rate in services export is common in international practices, including in many neighboring countries such as Singapore, Malaysia, The Philippines, Thailand, Vietnam, China and Australia.

In Indonesia, 0% VAT rate in services export only applies to 3 services sectors, which are manufacturing services, construction services, maintenance & repair services.

VAT taxation hurts the competitiveness of domestic services sectors, especially when other countries already eliminated VAT on financial, consultancy, accounting, call center and many other crucial services that provide big employment.

Benefit of Eliminating VAT in services export:
- Increasing trade and making investment in services look more attractive to potential investors.
- Boosting economic growth as trade in services increases & lead to new jobs
- Increasing in tax revenue in the long term
- Increasing Indonesia’s participation in Global Value Chain
Regulators should focus on three main areas to help encourage FinTech innovation:

1. Simpler but more secure requirements
   - Remote/e-KYC
   - Multi-factor authentication
   - Cryptographic encryption

2. Enable the adoption of new technologies
   - Common standards on use of cloud
   - Enhanced data security

3. Enabling regulations to encourage experimentation
   - “Sandbox” measures to encourage experimentation
   - Level playing field for new models
Harnessing Bilateral and multilateral FTAs and CEPAs

- The FTAs & CEPAs facilitates sufficient supply of quality services to support the economy
- The FTAs & CEPA can improve the performance of Indonesia's services sector through increased competition and transfer of know how
- The FTAs & CEPA might open opportunity for Indonesian supply Mode 4 services
- An agreement in services will force the authority to review all existing regulations, while at the same time increasing regulatory transparency

- There is a strong correlation between import of services and export performance