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PERSPECTIVE

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Managing the Debts of State-Owned Enterprises: Case Studies of Indonesia's BUMN Karya

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Indonesian President Joko Widodo (R), Minister of Transportation Budi Karya Sumadi (L), Minister of State Owned Enterprises Erick Thohir (2nd R), and West Java Governor Ridwan Kamil (3rd R) ride on Jakarta's new light rail transit (LRT) on 3 August 2023. Photo by ADEK BERRY/AFP.

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EXECUTIVE SUMMARY

- Infrastructure development plays a pivotal role in enhancing Indonesia's economic competitiveness and supporting the country's ambition to become one of the biggest economies in the world by 2045.

- Over US$400 billion is needed to meet Indonesia's infrastructure financing needs until 2024. State funds can only contribute around 30% of the total figure. To close the gap, the government has been inviting private sector investments and encouraging public-private partnerships (PPP) for a number of infrastructure projects.

- In practice, getting private sector investments into such projects can be challenging. To expedite the construction process, the government assigned some State-owned enterprises (SOEs), known as BUMN Karya, to lead the construction and operation of various infrastructure projects that are deemed 'strategic'.

- These SOEs have seen their financial condition deteriorating since the COVID-19 pandemic, and there is an increasing likelihood that they need more state capital injections to remain viable. It is important to reduce the burden on SOEs through restructuring or asset selling and to improve their corporate governance. Allowing international investors or construction and operating companies to become shareholders may help to reduce these SOEs' over-reliance on the government's budget.

- Moreover, the government also needs to be mindful of the risks of SOEs' debts to Indonesia's economy, credit standing and investors' confidence.

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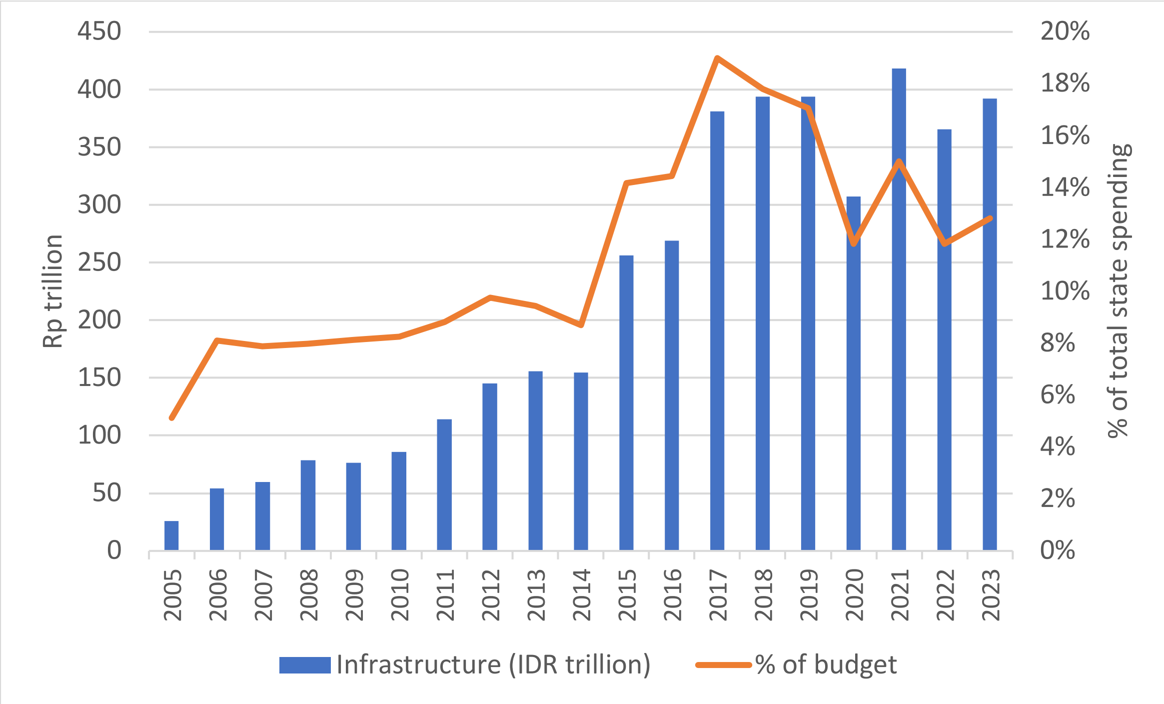
INTRODUCTION

Since the beginning of his presidency, President Joko “Jokowi” Widodo has been intensively building infrastructure in various parts of Indonesia. This infrastructure development aims to accelerate growth, create jobs, and promote more balanced development, especially in the outer islands.

Over Rp 3,000 trillion (approximately US$192 billion) has been spent on infrastructure projects since President Jokowi took office in 2014 (Figure 1). This state fund has been used to construct roads and toll roads, dams, airports and seaports, and power plants across the country. The Ministry of National Development Planning (Bappenas) estimates that Indonesia needs Rp 6,445 trillion to meet its infrastructure financing needs until 2024.[1] Based on the National Medium-Term Development Plan (RPJMN) 2020-2024, the government can only come up with Rp 2,385 trillion or 37% of the total needed, and the rest will need to come from private investors.[2]

The government has been encouraging public-private partnerships (PPP) and inviting domestic or foreign private investors for a number of infrastructure projects. Yet, in practice, most infrastructure projects are built and managed by State-owned enterprises (SOEs), often with government financial support. For the government, the fastest strategy to accelerate infrastructure development has been to assign it to SOEs. To invite foreign investors or to look for aid from foreign partners requires longer time and procedures, which delay government plans. Projects funded under PPP schemes are still limited, mostly in the energy sector, which is more attractive for the private sector. The biggest challenges for private participation in specific projects proposed by the government are reliability and profitability. Some projects have been making very slow progress due to specific issues, such as land acquisition or unclear regulations.

Figure 1: Infrastructure spending increased significantly during Jokowi's era



Note: The 2023 figure is the budget allocation.
Source: Directorate General of Budget, Ministry of Finance

The state assignment for SOEs to build various infrastructure projects has some implications for SOEs' cash flow and government fiscal space. The implications are often not well understood, and this essay seeks to shed some light on the matter by looking at three case studies of Indonesia's major SOEs which are in charge of developing infrastructure nationwide. They are PT Hutama Karya (Persero), PT Waskita Karya (Persero) Tbk, and PT Wijaya Karya (Persero) Tbk (the three SOE companies are often called BUMN Karya).[3] PT Hutama Karya (Persero) and PT Waskita Karya (Persero) Tbk are the main contractors for many toll road projects in Indonesia. PT Wijaya Karya (Persero) Tbk, on the other hand, is the main contractor for dam projects. Waskita Karya and Wijaya Karya are listed on the Indonesia Stock Exchange, which means these SOEs are only partially owned by the government. Hutama Karya, however, is fully owned by the government. Finally, we want to examine their financial liabilities and the potential risks these pose to the fiscal and financial sectors.

STATE ASSIGNMENTS AND INCREASED BURDENS

To expedite infrastructure development throughout the country, President Jokowi through the Ministry of State-owned enterprises, assigned some state companies to "lead" the construction of a number of "strategic projects".[4]

There are usually two types of infrastructure projects involving the BUMN Karya. First is that BUMN Karya is contracted to build the infrastructure and is then paid by the government once

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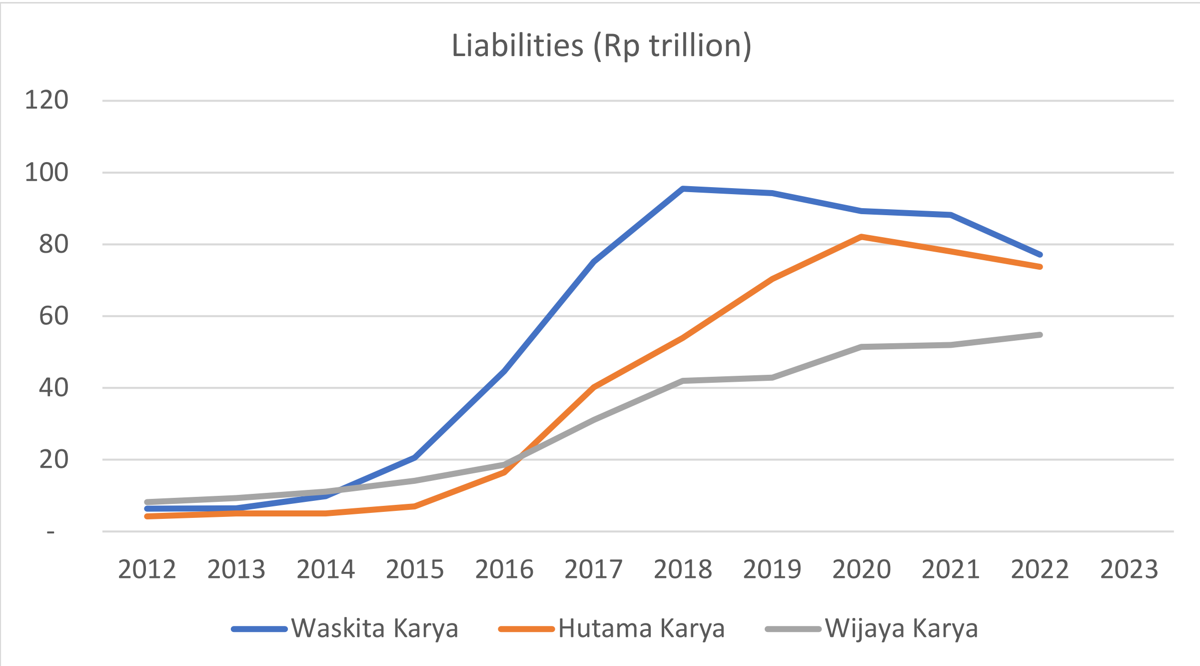
they have completed the project and met specifications. Second is what is known as Build, Operate and Transfer (BOT) after a couple of years. The first type of project (just build) is more straightforward. During the COVID-19 pandemic, many of these projects were delayed, so the companies could not receive payment from the government. Yet, even when the companies finally completed the project, government payments were often late in coming. Moreover, the pandemic has also caused cost overruns, which hurt the companies' profitability. The BOT arrangement is more complex as it requires operating the project and getting paid from the revenue generated by the project operation. These arrangements are mostly related to toll roads. In practice, the profitable toll road projects (with significant traffic volumes) are often given to the state toll road company PT Jasa Marga, leaving the BUMN Karya with the less attractive toll projects.[5]

For instance, Waskita is assigned to build Trans-Java and Sumatra toll roads. Mostly, it takes over private toll road projects that have stalled, and that are no longer profitable as seen from the point of view of private investors. In total, Waskita acquired 12 stalled toll roads from the private sector from 2015 to 2017.

Likewise, Hutama Karya received special assignments to construct sections of the Trans-Sumatra toll road. As a result, the company's liabilities have increased rapidly. Unlike Waskita Karya, Hutama Karya receives state capital injections, or PMN (*Penyertaan Modal Negara*).

Figure 2: Government assignment increased BUMN Karya's liabilities



Source: Companies annual reports

It is important to note that not all SOEs undertaking infrastructure projects receive state equity participation (PMN). PMN is an additional capital injection given for a specific project or purpose. The allocation of PMN is proposed by the government and requires parliament's

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approval. Thus, deciding which SOEs can receive PMN is the political discretion of the government and the parliament. The SOEs Minister and Finance Minister, in consultation with the parliament, reach joint agreements on which SOEs should be given PMN.

Those strategic SOEs that have too high a debt burden and whose ratings get downgraded to non-sustainable levels are the ones that get PMN, or capital injections, through the budget. The healthier ones typically do not get PMN. Those SOEs which do not receive PMN must use their own finances, often by going into debt; the latter are vulnerable to changes in interest rates. Rising interest rates increase the cost of servicing existing debt or obtaining new loans. Also, an SOE's credit rating can influence its access to debt markets and the cost of borrowing. A lower credit rating may result in higher interest rates on debt.

Figure 2 shows the three largest infrastructure SOEs that face increasing liabilities due to the government's assignment to construct various infrastructure projects. So what could be the financial implications of growing SOE liabilities?

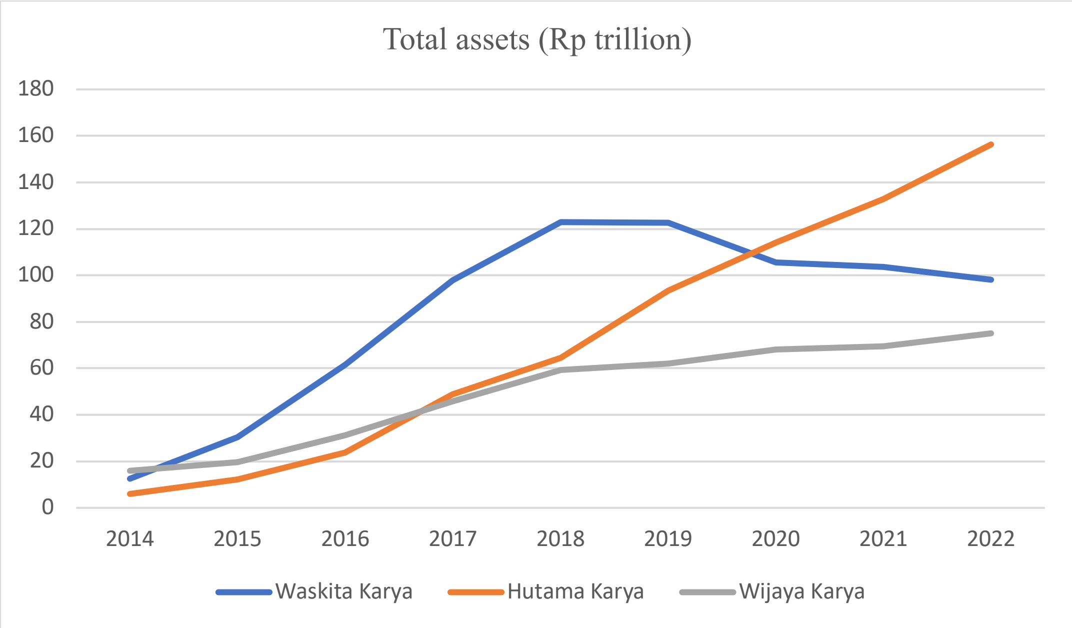
FINANCIAL IMPLICATIONS

In response to the worsening financial health of BUMN Karya, the government, through the Ministry of Finance, allocated Rp 28.16 trillion in the state budget 2024 to support these SOEs with state equity participation (PMN). This policy indicates the government's commitment to continue infrastructure development during the transition to the next leadership in October 2024.

For infrastructure projects, state equity funds will be allocated to PT Hutama Karya (Persero), amounting to Rp 18.6 trillion, and to PT Wijaya Karya Tbk, amounting to Rp 6 trillion. However, PT Waskita Karya (Persero) Tbk will not receive PMN due to internal issues related to fraud allegations and some bad management practices.[6]

Among the three BUMN Karya, i.e., PT Waskita Karya (WSKT), PT Wijaya Karya (WIKA) and PT Hutama Karya (HK), HK has the largest asset, at Rp 156 trillion, followed by Waskita, which has a total asset of Rp 98 trillion, and WIKA, with a total asset of Rp 75 trillion (Figure 3). The asset values of the BUMN karya have increased significantly alongside the country's massive infrastructure development.

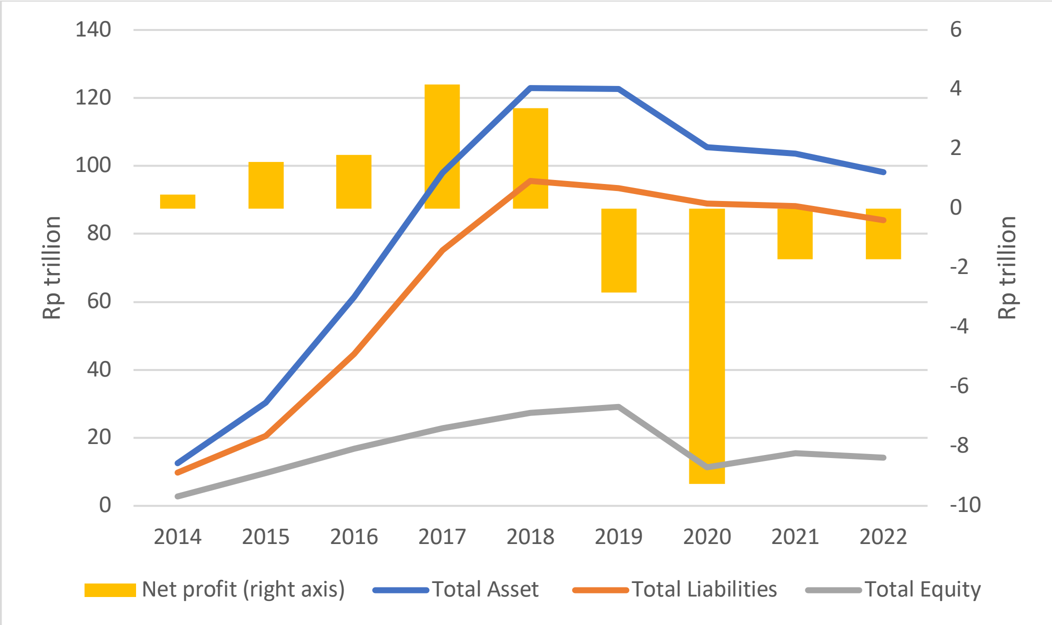
Figure 3: BUMN Karya's Total Asset Values



Source: Companies annual reports

Interestingly, Waskita's asset values have been declining since 2019. In 2019, Waskita's assets (Rp 122 trillion) were bigger than HK's (Rp 93 trillion). But in 2022, HK's assets surpassed Waskita's. Based on its financial statement, Waskita's revenue had started to decline in 2019. In 2019, Waskita booked losses of Rp 2.8 trillion, which by 2020 had increased to Rp 9.2 trillion. The company's equity has also decreased since 2019 (Figure 4). According to Waskita's management, the losses were caused by decreasing revenues due to the COVID-19 pandemic and exchange rate costs on their liabilities.[7]

Figure 4: PT Waskita Karya (Persero) Tbk Financial Situation



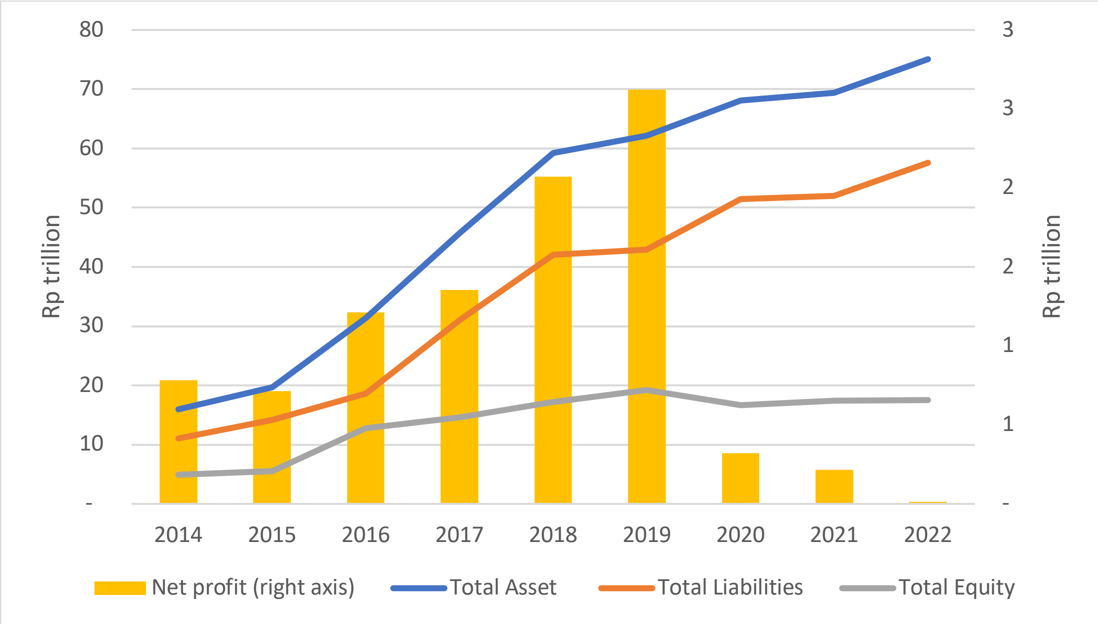
Source: PT Waskita Karya (Persero) Tbk annual reports

More recently, Waskita faced some complicated issues ranging from high debt and increased loss to internal corruption and the cancellation of PMN. Waskita's stock trading was suspended in May 2023 after the company failed to make timely coupon payments on its corporate bonds. The Indonesia Stock Exchange Authority is now considering delisting the companies' stock from the market due to the subsequent lack of significant improvement.[8] Several companies have also sued Waskita over delays in debt payments.[9]

The Vice-minister of SOEs, Kartika Wirjoatmodjo, in a public statement in September 2021, stated that Waskita's increased liabilities were due to assignments from the government to lead several infrastructure projects.[10] The high debt burden reached its peak in 2019 after Waskita acquired several toll roads from private parties from 2015 to 2017 (Figure 4). That year, Waskita's debt reached Rp 70.9 trillion; these were comprised of bank loans and bonds, and a debt of around Rp 20 trillion to its vendors. Moreover, the COVID-19 pandemic had worsened the company's financial condition due to a decline in revenue, many projects being delayed and cost overruns incurred.

Based on Waskita's case, one may conclude that several internal and external factors have been affecting the financial soundness of SOEs. Waskita's financial problems have been exacerbated by poor governance within the company. The former CEO of Waskita was named a suspect in corruption allegations regarding misappropriation in the use of a subsidiary company (PT Waskita Beton Precas) in 2016-2020.[11] This case saw the company's share price fall drastically (Figure 4) by around 6%, forcing the market authority to suspend trading to protect its shareholders.[12]

Figure 5: PT Wijaya Karya (Persero) Tbk Financial Situation



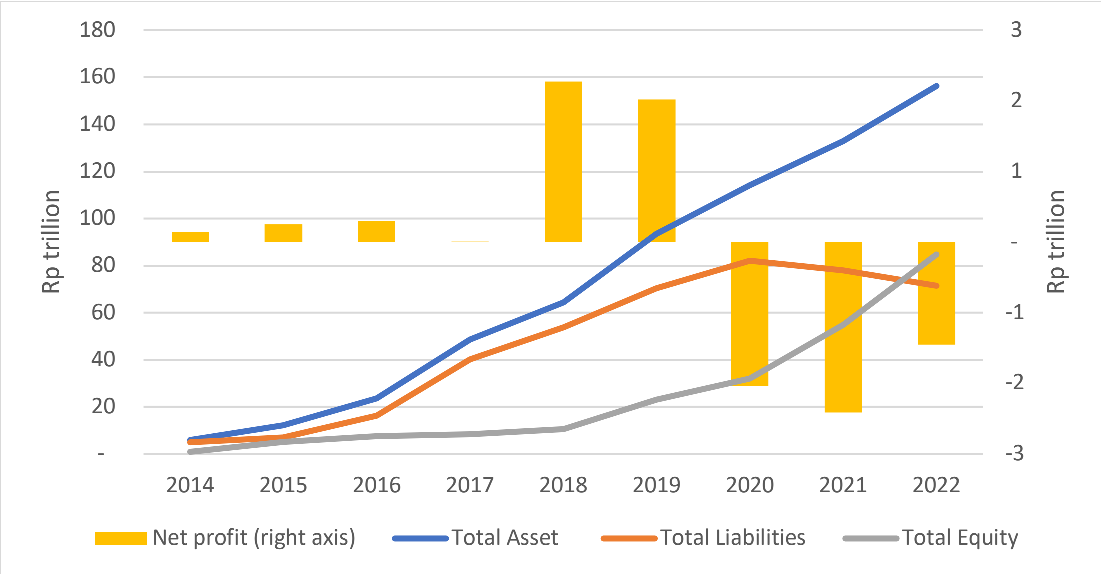
Source: PT Wijaya Karya (Persero) Tbk annual reports

In fact, all the BUMN karya experienced decreasing revenue due to the COVID-19 pandemic. Their profits have dropped significantly due to project construction delays. WIKA, whose core business is in real estate and properties, has been suffering financial losses since the pandemic (Figure 5). It is currently applying for postponement of payment of principal and interest obligations to its creditors. This company will be receiving Rp 6 trillion of PMN to overcome its financial difficulties. This state equity injection is related to cost overrun in the Jakarta Bandung High-Speed Train project or KCJB (Kereta Cepat Jakarta Bandung), in which WIKA participated.[13] So far, this state support may suffice for WIKA to maintain its capital structure.

Together with three other BUMN Karya, WIKA has become the major player in the construction of the new capital (IKN) Nusantara in East Kalimantan province.[14] WIKA is responsible for two main constructions, namely residences for the workers and offices for the coordinating ministry for maritime and investment affairs. The total project is valued at around Rp 1.3 trillion.

The financial condition of HK has also been worsening, though not as badly as Waskita's. Starting in 2020, HK has experienced massive losses. These continued until 2022 (Figure 6). The main cause of its losses was the low revenue from its Trans Sumatra toll road project. This project was initiated by the government as a strategic project, and therefore, revenue has not been a key consideration for its construction. The traffic volumes in Trans Sumatra are very low, drawing no private sector interest to the project.[15] Be that as it may, the government pushed for the project to promote connectivity and people mobility, and to stimulate economic activities across the island. Increased economic activities would in turn lead to higher traffic volumes which would eventually attract private investments.

Figure 6: PT Hutama Karya (Persero) Tbk Financial Situation



Source: PT Hutama Karya (Persero) Tbk annual report

The revenue from the Trans Sumatra project has been insufficient to cover HK's operational costs. This happened alongside other unprofitable projects that the company has been involved in. As a result, HK had to raise its finances by proposing more debt. This condition is reflected in its financial performance, where HK booked a significant loss of around Rp 1.4 trillion. To save HK, the government decided to increase its state capital injection (PMN) in the company. HK is also involved in several IKN projects valued at around Rp 4.3 trillion, covering toll roads, ministerial offices, as well as residentials for state civil servants and the presidential security forces.[16]

POTENTIAL RISKS TO THE ECONOMY

SOEs play a significant part in the Indonesian economy. So, excessive debts on their part pose risks to the overall economic health. For instance, if SOEs are unable to service their debt, the government must step in to bail them out. This can strain government finances, lead to budget deficits, and potentially result in increased public debt.

The financial difficulties of heavily indebted SOEs can also distort prices, as the government provides subsidies or state equity to keep these companies afloat. This can lead to market imbalances and resource misallocation. Moreover, during Jokowi's administration, we have seen how SOEs absorb a large portion of available credit, stifling private investment and economic growth, and crowding out private sector borrowing.[17]

Indonesia's sovereign credit rating can potentially be affected if SOE debt becomes a serious liability for the government. A lower credit rating can result in higher borrowing costs for the government and the private sector. Also, if a large SOE like Waskita defaults on its debt, it can spill over to other SOEs and to the country's financial system. This can lead to systemic risks

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and financial instability. In turn, a large SOE default that leads to financial distress can erode investor confidence in the country and cause capital flight and reduce foreign direct investment. Therefore, SOE debt should be carefully managed. If it becomes excessive, it may adversely affect financial stability and hamper the country's long-term economic growth. Too many state assignments given to SOEs will certainly strain limited fiscal resources, thus reducing the government's ability to invest in other important programmes. The government needs to be more prudent when investing in infrastructure projects.

From the government's perspective, assigning SOEs to participate in infrastructure projects like toll roads, airports, dams, power plants, and railways has advantages in the short run. Expecting the private sector to lead infrastructure development projects is not realistic, especially if the project is meant to promote development in less populated and less lucrative areas. Therefore, for strategic development, SOEs play a leading role. However, in the long run, it is important to develop a roadmap and define which sectors should involve SOEs and which ones should include private sector, national and/or international partners. Assigning SOEs does not mean ignoring risk management and prudential governance. In fact, good governance is critical in minimising fraud and corrupt behaviour related to infrastructure projects.

CONCLUSION

Managing SOE debt can be a contentious political issue. It is alarming that SOEs mandated to focus on infrastructure projects suffer serious financing issues hindering their competitiveness and sustainability. The government needs to avoid high levels of SOE debt to fund politically motivated and non-productive projects, with unclear benefits. In fact, one of the Presidential candidates has highlighted that massive infrastructure development without careful thought under the current administration has put BUMN Karya in a critical financial condition.[18] He further said that the main factor that caused the BUMN Karya to 'close its books' was poor governance.[19]

The lack of independence on the part of BUMN Karya managements to accept or decline a project, and to determine what criteria need to be met before constructing the project is another reason for their current financial difficulties. The management has little say on such matters, and must follow government orders. One solution to this is to invite international investors or construction and operating companies into the projects as shareholders.[20]

We see from the three BUMN Karya cases that a lack of transparency in SOE debt can be a risk in itself. There is a need to provide clear information on the extent and terms of SOE borrowing; this is critical for assessing and managing risks effectively. To stop further deterioration of SOE debt, the government needs to establish robust oversight and governance mechanisms and adopt prudent fiscal and monetary policies.

To address growing SOE debt, there is a need for a combination of financial restructuring, operational improvements, and perhaps privatisation or asset sales (the case of INA). It is important to balance the strategic role of SOEs and their financial sustainability so as to minimise risks to the country's overall fiscal health.

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The role of the Indonesia Investment Authority (INA) can be further enhanced by its participation in strategic projects. Waskita has released two toll roads and prepared four others for INA to take over. This will make its financial condition healthier.[21] Another initiative is better use of Government Non-Budget Infrastructure Financing or PINA (*Pembiayaan Infrastruktur Non-Anggaran Pemerintah*). PINA was initiated by Bappenas for strategic and priority projects, especially in the infrastructure sector. PINA financing may come from capital markets, managed funds, insurance, banking and other legitimate financing. Several projects have been using the PINA scheme, such as the North Sumatra toll road and Yogyakarta International Airport in Kulan Progo.[22] Basically, PINA offers creative financing by matching the needs of specific investors with particular financing schemes, through hybrid instruments, limited participation funds and customised supply chain financing. These schemes can be developed and expanded for future infrastructure projects.

ENDNOTES

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