TENGGARA STRATEGICS

BACKGROUNDER
WEEKLY BRIEFING

YOUR GUIDE TO INDONESIA'S POLITICAL & BUSINESS AFFAIRS | November 30th, 2018

Highlights of the week

Uncovering the shroud over new KSAD

The appointment of Andika Perkasa as the new Army chief of staff (KSAD) has raised speculations among public as it is considered too fast. Appointed as the Army Strategic Reserves commander (Pangkostrad) barely five months ago, it is reported that Andika's skyrocketing career is largely due to his father-in-law's, AM Hendropriyono, political standing as one of President Jokowi's confidantes.

The struggle of Soeharto clan into politics again

Berkarya Party's attempt to establish its political presence ahead of the 2019 legislative election illustrates the Soehartos prevailing power in the domestic politics. The family's considerable power in the country's business sector, furthermore, eases the Soehartos' effort to reestablish their stature.

Lobbying behind mining regulation reform

The planned revision of several regulations related to coal business seems to be part of the government's reform to provide business certainty to the coal mining industry. However, circumstances surrounding the plan suggest that the plan was full of political and business interests.

Fierce banking competition amid consolidation

Since 2014, the OJK has been implementing a banking consolidation policy by encouraging foreign investors from East Asian countries to acquire and merge Indonesia's small banks (BUKU I) to trim the total number of banks, as suggested by BI's API guideline. The mergers intensify competition among BUKU II and BUKU III banks. This competition benefits BUKU IV banks but has so far failed to improve BUKU II and BUKU III banks' profitability.

POLITICS

Andika Perkasa: Uncovering the shroud over new KSAD

The appointment of the Army Strategic Reserves Command chief (Pangkostrad) Lt. Gen. Andika Perkasa as the new Army chief of staff (KSAD) has sparked speculation among the public. His latest promotion, a testament to his skyrocketing career in the last four years, came just five months shy of the 2019 general election, which unsurprisingly raises a question about the motives behind the President's preference for him over other three other officers deemed equally qualified for the prestigious post.

Takeaway:

- Andika's appointment as the new KSAD may be largely caused by political considerations, namely Jokowi's attempt to ensure the military's unwavering support for his reelection bid
- Jokowi reportedly has yet to secure the military's support for his reelection campaign, particularly due to the presence of Prabowo Subianto's and Gatot Nurmantyo's sympathizers in the military
- Doni Munardo's, another strong contender for the KSAD position, close ties with former President SBY is another major reason why Jokowi finally chose Andika as the new KSAD

Background: Andika's military career was given a boost as soon as Joko "Jokowi" Widodo assumed the presidency in October 2014. The new president chose Andika as Presidential Security Details (Paspampres) commander, promoting him to major general. After a one-and-a-half-year stint as Tanjungpura Military commander, Andika became the youngest officer to receive a three-star military rank as head of the Army education and training center in January. Six months later, he was appointed Pangkostrad. Now, he holds the coveted Army chief post, replacing Gen. Mulyono who will retire in January.

Many argue that Andika's rise is way too fast. His close affiliation with the President has sparked rumors that nepotism played out in his career trajectory. It is reported that Jokowi prefers Andika over other candidates because of his readiness to stabilize and strengthen the President's political stronghold in the Army.

Insight: It is reported that four three-star generals, including Andika, had been proposed to the President to replace Gen. Mulyono as the new KSAD. Jokowi, in addressing public speculation over Andika's appointment, said the 53-year-old officer deserved the post because of his impressive trajectory in the military. This explanation, however, is unconvincing because of a number of reasons.

First, the other three candidates, namely National Resilience Council (Wantanas) secretary-general Doni Monardo, Indonesian Military (TNI) Inspector General Muhammad Herindra and Army deputy chief of staff Tatang Sulaiman, can match Andika in terms of aptitude and experience. Andika makes a difference because he is the youngest candidate, one month, one year and two years junior of Herindra, Tatang and Doni respectively. But age should not actually count in this regard, as previous KSAD like Moeldoko and Budiman were 56 and 57 respectively when taking office.

Second, Cornell University political scholar Made Supriatma says the widely circulated information on Andika's academic background is misleading, claiming he has never obtained a doctorate from George Washington University or studied at Harvard University as popularly claimed.[1] To make matter worse, according to an article published in *The Washington Post,* Andika's in-law, former State Intelligence Agency (BIN) chief AM Hendropriyono, was willing to work with the US Central Intelligence Agency (CIA) while he was heading the BIN in exchange for several favors, including the US' assistance to enroll Hendropriyono's relative into an American university.[2] Although the said relative was left unidentified, it is speculated that it was Andika, who later spent eight years in the US studying.

Third, Andika's alleged involvement in the murder of Papuan pro-independence figure Theys Hiyo Eluay in 2001 cast doubt over Andika's commitment to human rights. This contradicts Jokowi's promise of resolving past human rights abuses.

But why did Jokowi insist on selecting Andika?

The most popular speculation over Andika's express career trajectory is the close ties between his family and the President. Andika's fast-track career was made possible by his father-in-law Hendropriyono, who supported Jokowi's presidential ticket in 2014 and is one of the President's closest confidantes. Installing his staunch supporter's son-in-law in a strategic position months before the 2019 elections is deemed a political maneuver by the President.

It has been reported that Jokowi urgently needs stability within the Army to smooth out his reelection bid. A retired military general himself, Prabowo Subianto, Jokowi's contender, reportedly still holds considerable stature in the military. In the 2014 presidential race, Jokowi lost in polling stations inside military housing complexes because of his unpopularity among the military community. If an election constitutes a battle, winning the loyalty of an Army chief means securing the territorial network of the country's most organized institution that spans from Jakarta down to the outermost villages. In Indonesian politics, winning the presidency is impossible without support from the Army and tycoons.

Moreover, former Indonesian Military (TNI) commander Gatot Nurmantyo reportedly wreaked political havoc against Jokowi. The negative impact left by Gatot's leadership on Jokowi's political stature reportedly still prevails a year after he was replaced in December 2017. It is true that Gatot, who revealed ambitions to compete in the 2019 presidential election, has never explicitly announced his support for Prabowo's ticket. Nevertheless, his support for Prabowo is frequently assumed, particularly as the majority of his supporters shifted their allegiance to Prabowo after Gatot failed to secure his presidential candidacy.[3]

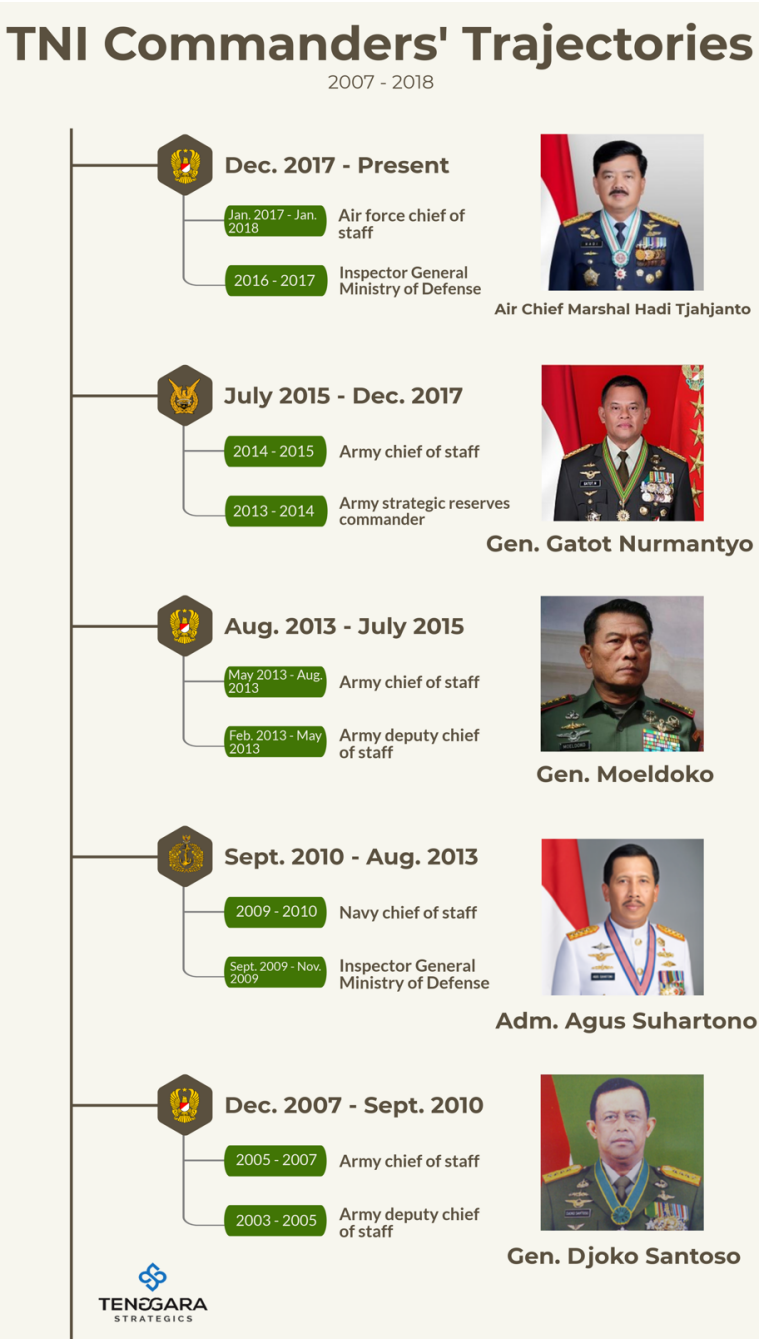
The latest Army reshuffle announced on Nov. 29, which saw Military Academy graduates of the early 1990s take strategic posts, should be deemed a consequence of Andika's rise to the chief post and, hence, further cleansing of Gatot's influence.

[1] Indoprogress, "Andika Perkasa Jejak Langkah Pengawal Presiden," 4 November 2014. https://tinyurl.com/y8c236za
[2] The Washington Post, "Foreign Network at Front of CIA's Terror Fight, 18 November 2005. https://tinyurl.com/y7wa7cqt
[3] CNN Indonesia, "Kecewa Gatot tak bisa nyapres, relawan dukung Prabowo-Sandi," 20 August 2018 https://tinyurl.com/yc6wuq5c

In the midst of political turbulence, it is naïve to assume that President Jokowi appointed figures into strategic positions in the military purely based on meritocracy as he claimed. Allegedly, President Jokowi had seriously considered Doni Monardo to be the new KSAD,

because of his close ties with regional military commanders (Pangdam), a factor that is believed to bring stability and conduciveness to the Army ahead of the elections. Nevertheless, Doni is also often labelled as former president Susilo Bambang Yudhoyono's confidante, causing anxiety among Jokowi's supporters that Doni's loyalty would be divided if he was appointed. Meanwhile, Andika's support for Jokowi's reelection is perceived more convincing because of his familial ties with Hendropriyono.

Now that Jokowi has entrusted the Army chief post to Andika in such a crucial period, it is very likely that the President will promote Andika to the TNI top job if he gets reelected. Andika stands a great chance as based on the rotation mechanism, though not mandatory, the next TNI chief should go to the Army, replacing Air Chief Marshal Hadi Tjahjanto.



Andika's further catapult to the highest military post will come true if he succeeds in helping Jokowi cement his grip on the armed forces and win reelection. As the 2004 TNI Law stipulates, only active four-star generals who have served as chief of any of the military branches can be nominated for the TNI commander post. In the case of Andika, the promotion may even occur within a year, as looking at the practice, a TNI chief only served for between two and three years.

What we've heard: On Tuesday, Nov. 20, President Jokowi reportedly summoned the then KSAD Gen. Mulyono, TNI commander Air Chief Marshal Hadi Tjahjanto and an unnamed minister who was a retired four-star general to discuss about Mulyono's potential successor. It was the second time Jokowi consulted them regarding succession in the Army.

A week before Jokowi left for Singapore for the ASEAN Summit, the military's Rank and Promotion Council for High-Ranking Officers (Wanjakti) had proposed four candidates, namely Andika, Herindra, Tatang Sulaiman and Doni Monardo to Jokowi. Jokowi reportedly considered choosing Doni due to his achievements, including a military operation he led to free KM Sinar Kudus cargo ship which was held hostage in Somalia waters.

Jokowi reportedly could not get along well with Andika. When Andika headed the Presidential Details, Jokowi complained to a number of chief editors that even a trivial accident like he dropped his mobile phone was immediately reported by Andika to Teuku Umar, which refers to former president and chairwoman of Indonesian Democratic Party of Struggle (PDI-P) Megawati Soekarnoputri. Jokowi decided to move to Bogor Palace early in 2015 reportedly because he felt Andika did not protect but stalk him.

Regardless, due to political considerations, Jokowi was advised to appoint someone from his inner circle as he had yet to secure the Army in his reelection campaign. Andika suits the recommendation because he is a son-in-law of AM Hendropriyono, a close confidant of Megawati.

It is reported as well that Army's high-ranking officers who are close to Jokowi feel uncomfortable with Doni as he is still regarded as a close confidante of Jokowi's predecessor SBY. Furthermore, Doni reportedly wields considerable control over a number of regional military commands (Kodam), partly due to his seniority.

With all the considerations, Megawati and Coordinating Maritime Affairs Minister Luhut Binsar Pandjaitan accepted Andika as the new KSAD on Nov. 19.

Meanwhile, according to sources from PDI-P and Coordinating Maritime Affairs Ministry, other posts have been prepared for other candidates. Doni will be reportedly appointed as deputy KSAD or the new TNI chief of general affairs (Kasum) before eventually replacing Andika as KSAD in 2019. Tatang, on the other hand, will be the new Kasum after Doni becomes KSAD in 2019. However, the plan will depend on the political landscape next year.

It is also reported that Hadi will join the Cabinet as Coordinating Political, Legal and Security Affairs Minister under Jokowi's second cabinet if reelected next year.

Soeharto clan struggles to return to political arena

When Titiek Soeharto said in a tweet that Indonesia will return to the glory days of her father president Soeharto if people vote for candidate Prabowo Subianto next April, it is unclear whether she is doing him a favor, or costing him even more votes. For Titiek, it matters not. This is part of the campaign of the Soeharto clan to make a political comeback. If using Prabowo does the trick, then by all means. Prabowo, a former general to whom she had been married to, is challenging incumbent Joko "Jokowi" Widodo in the presidential race.

Campaigning for the Berkarya Party, a political party they can claim their own, the Soehartos need to win more than 4 percent of the seats in the House of Representatives to get national representation. For the first time, all six siblings got together under one political party that Soeharto's youngest son Hutomo Mandala Putra (Tommy) founded for the 2019 general election. As they have no presidential candidate of their own, they have thrown their support behind Prabowo to help achieve this goal.

More than 20 years since Soeharto was forced to step down by a massive people's power movement, and 10 years since his death, this is the most serious attempt by his children to return to the political arena. They face many challenges that could frustrate their efforts. No doubt, however, that with their wealth and some political influence, they are still one of the country's most prominent political dynasties. It's a matter of time before the Soeharto clan makes a political comeback.

Takeaway:

- The Soehartos' attempt to revive their political prowess is illustrated by Tommy Soeharto, who is running for a House seat representing Papua province. Discussions on Soeharto's administration's alleged success in maintaining political stability, steady economic development and self-sufficiency in rice has been highlighted by the family as well in their attempt to restore their stature.
- Being one of the wealthiest family in Indonesia, the Soehartos' financial muscle may assist the family members in rekindling their political presence in the country.

Background: In the 1990s, Soeharto's children controlled many of the industries in the country thanks to the privileges they enjoyed as members of the first family. Soeharto had his own businesses managed by his charitable foundations. After his downfall in 1998, government attempts to repossess some of this wealth on the basis of corruption failed. The children got to keep their wealth and never had to leave the country. They have also kept their businesses, although now minus the privileges. They have divested from most of the companies they owned and largely kept a low public profile. But the fact that three of Soeharto's children still appear consistently in the *Globe Asia* list of 150 wealthiest Indonesians means they are still very much in business. And with the family ambitions to return to the political arena, they have the capacity to do so, sooner or later.

Insight: Tommy Soeharto is leading the family campaign to restore Soeharto's name through the Berkarya Party. He is also running for a House seat representing Papua province. There is a sentimental reason for this: His middle name "Mandala" is the code name of the military campaign his father led in winning Papua from Dutch hands in the 1960s.

Tommy's criminal record has not stopped him from plunging into politics. Tommy was convicted in 2002 for ordering the assassination of a Supreme Court justice who was handling his corruption case. He served four of the 15-year prison term after remission for good behavior. The Supreme Court, following the murder of one of their own by Tommy, acquitted him.

Nothing in the electoral rules bars a former convict for murder to found a political party or run for a House seat. Legally, there is no stopping Tommy. Since the election campaign began in September, five other Soeharto children have thrown their weight behind Berkarya. Titiek forfeited her House seat representing Golkar and declared her allegiance to Tommy's party.

The Soehartos in Globe Asia 2018 List of 150 wealthiest Indonesians

	Rank	Company	Business Sectors	Esimated Worth
Hutomo Mandala Putra (Tommy)	60	PT Humpuss Group	Investment, courier, property	$670m
Bambang Trihamodjo	124	PT Asriland	Property	$250m
Siti Hardiyanti Rukmana (Tutut)	130	PT Citra Lamtoro Gung Persada	Toll road operator	$205m

Source: Globe Asia

Soeharto's children have the financial muscle to mount a political campaign as they never had to give up their wealth. Several attempts to prosecute Soeharto for corruption were dropped in 2006 when the court declared him too ill to be tried. But a civil case against Soeharto's charity foundations Supersemar made some headway. The court found it guilty of embezzling education funds and ordered him to pay Rp 4.4 trillion (US$307 million). As this is a foundation, it falls on his next of kin, meaning his children, to pay up.

The sum is paltry considering what the Soeharto clan owns but refuses to pay. A mistake perhaps, as this is the reason why the Attorney General Office on Nov. 19 seized the Granadi office building on Jalan Rasuna Said, as part of the attempt to recuperate the money from the Soehartos. The timing looks suspicious, taking place a day after Titiek posted that tweet about her father. The building, owned by Tommy, is the headquarters of Berkarya. The government said it is looking at other assets to confiscate to recuperate the entire Rp 4.4 trillion.

The episode immediately triggered public debate on Soeharto's legacy, both good and bad. Public opinion is the one area where the Soehartos need to work. For many, he is the man responsible for bankrupting the country, in spite of its abundant natural resources, in 1998 and for repressing their freedom and basic rights for over three decades. The family has been trying to restore his good name by highlighting his many successes, including political stability, steady economic development and self-sufficiency in rice production.

Two years ago, posters and stickers bearing the face of Soeharto appeared in public places with the caption, in Javanese, "*Piye kabare, enak zamanku to*?" (How are you, my era was better, no?). Several political parties in the House have also been campaigning for the government to confer Soeharto the national hero title. But these efforts were conducted on their behalf. Clearly, the Soehartos still have many supporters in politics. Now they have decided to lead the campaign themselves.

BUSINESS & ECONOMIC POLICY

Business, political lobbying may be behind coal mining regulation reform

The government is working on a sixth revision of Government Regulation (PP) No. 23/2010 on the required change of mining contracts of work (PKP2B) into special mining permits (IUPK) to allow the first generation of coal miners to extend their expiring licenses five years before their expiry date, instead of two years as stipulated in the PKP2B. In addition, the government is also revising PP no. 37/2018 to bring down coal companies' corporate tax rate from 45 percent to 25 percent.

Takeaway:

- The planned revision of PP no. 23/2010 seems to be part of the government's reform to provide business certainty to the coal mining industry, giving the opportunity for the first generation of coal mining companies to convert their contracts of works into IUPK mining licenses that would allow them to renew their expiring mining concessions.
- If we look into the circumstances around the planned revision, it is not hard to suspect that the revision is politically motivated and loaded with business interests. It could spark protests and condemnation from activists, and could be used by the opposition to attack the incumbent.
- It would not be surprising if the government backed off, once again.

Background: Last year, the government made the fifth revision of PP no. 23/2010 and issued PP no. 1/2017 to facilitate the divestment of coal mining company PT Freeport Indonesia by changing its contract of work (CoW) into an IUPK. The divestment, however, has not proceeded smoothly, with the government issuing a series of temporary IUPK permits for Freeport. We are currently up to the seventh IUPK. [4]

Energy and Mineral Resources Ministry Mineral and Coal Director General Bambang Gatot Ariyono said the government was working on the sixth revision of PP no. 25/2010 as part of its efforts to reform the mining license arrangement, especially for first generation coal mining licenses. "Freeport and Amman [Mineral] have the legal basis for the IUPK. Therefore, we also need it [a legal basis] for the PKP2B holders." [5]

The change of permits for coal and mineral companies was mandated by Law No. 4/2009 on mining, which requires all coal and mineral companies seeking to continue their operations in the country to convert their CoW into a IUPK. PP no. 23/2010 is the regulation on this.

In addition, the government is also revising PP no. 37/2018 on mining taxes, to align mining taxation with prevailing taxation rules, and therefore reduce coal mining companies' corporate tax rate from the current 45 percent to 25 percent, as stipulated in the Income Tax Law. At the same time, the government will increase royalties and other non-tax levies from coal mining

[4] Katadata.co.id, "Perpanjangan IUPK Sementara Freeport Dinilai Cacat Hukum", 1 November 2018. https://tinyurl.com/y7c7dn3q

[5] The Jakarta Post, Government to issue new regulation on coal permits. 13 November 2018. https://tinyurl.com/yd6llb5e

companies. Therefore, in net, the government will collect the same amount of revenue or even higher.[6]

Insight: Following the government's logic, the planned revision of Government Regulation (PP) No. 23/2010 on coal mining companies seems logical and timely as it is first, gives fair treatment to both mineral and coal mining companies, and secondly, gives certainty to both

mineral and coal mining companies to pursue their investment plans by giving more time – five years instead of two – to process their concession license renewal.

The government has argued that it wanted to treat coal mining companies fairly after it revised PP no. 23/2010. Therefore, the government is again revising the regulation to allow coal miners whose concession licenses would expire in the next five years to process their license renewals earlier.

The government also wants to ensure the coal industry continues to make a large contribution the government's revenue as well as the country's exports. In 2017, the coal mining sector contributed Rp 40.6 trillion to the government's coffers, or 48.3 percent of non-tax revenue (PNBP), exceeding the sectoral target of Rp 32.7 trillion.[7] Therefore, the government is committed to providing a supportive policy environment for the industry.

Supportive regulations are often a key to attracting private investment. The case with Freeport, in which the American miner promised to make significant investment in Grasberg's underground mine after a "more welcoming" permit and regulation were issued, should serve a lesson as to why this is necessary. Allowing earlier permit renewal would give assurances to businesses and create a positive impression about the government's willingness to support businesses.

The coal mining industry is exuberant about the government's plan. Indonesian Coal Mining Association (APBI) executive director Hendra Sinadia said the planned revision would give businesses in the coal industry more certainty. "The earlier [license renewal is possible] the better because this way, companies can find funding earlier too." [8]

This planned revision will allow the first generation of coal mining companies to first of all change their contract of work (CoW) into a special mining permit (IUPK) and then to renew their mining permits for their expiring concessions.

The first generation of coal mining companies under PKP2B CoWs, whose concessions will expire soon, include PT Tanito Harum (2019), PT Arutmin Indonesia (2020), PT Kaltim Prima Coal (2021), PT Multi Harapan Utama (2022), PT Adaro Energy Tbk. (2022), PT Kideco Jaya Agung (2023) and PT Berau Coal (2025).

These first generation coal mining companies have brought huge fortunes to their owners and made them among the richest in Indonesia. They include Kiki Barki with Tanito Harum, the Bakrie family with Arutmin and Kaltim Prima Coal and until recently Berau Coal, Henry

[6] Kontan, "Pajak Pertambangan Batubara akan diturunkan," 14 November 2018, printed edition
[7] Republika.co.id, "Penerimaan negara dari sektor tambang naik 48.3 persen," 11 January 2018 https://tinyurl.com/y9qxtj53
[8] Bisnis.com. "Perpanjangan Kontrak Bisa Diajukan 5 Tahun sebelum Habis, Emiten Batu Bara Girang". 13 November 2018. https://tinyurl.com/ycg9kw2x

Pribadi with Multi Harapan Utama and brothers Garibaldi "Boy" Thohir and Erick Thohir with Adaro Energy.

However, the planned revision potentially contradicts some articles in Law No. 4/2009 on mining that requires all expiring concessions to be returned to the state, and that the government should prioritize state-owned companies and/or companies owned by local administrations to operate those expired concessions under PKP2B.

Also according to Article 62 of the Mining Law, the maximum concession area under a IUPK license should not exceed 15,000 hectares. Based on their PKP2B contracts, first generation coal mining concessions are far larger than 15,000 ha, with Arutmin's concession areas totaling 55,573 ha, KPC's 84,938 ha and Adaro's 31,379 ha.

Indonesian Resources Studies (IRESS) executive director Marwan Batubara argued that the 2009 Mining Law did not govern PKP2B, and therefore, expiring concessions under PKP2B must be included in state reserve areas (WPN). The government, he said, could not just replace a PKP2B CoW with a IUPK license and then renew the concession. The government, he said, had to take over the concessions and hand them over to a state coal mining company. [9] State-owned coal mining company PT Bukit Asam has expressed its interest in taking over expiring coal mining concessions under PKP2B. "It is up to the [Energy and Mineral Resources] Ministry, whether they tender them or not. What's certain is that we are interested in all of them, they are all big names and good concessions," said Bukit Asam president director Arviyan Arifin.[10]

Looking into the affairs surrounding the planned revision of PP. 23/2010, we therefore can understand why some quarters may question the motives behind it. It is obvious that among the main beneficiaries of the planned revision are those with close links to the highest political power, especially Boy Thohir and Eric Thohir, the chairman of incumbent Joko "Jokowi" Widodo's national presidential campaign team.

This is not the first time the government has tried its best to please coal mining companies. In late July, the government announced that it would eliminate the price cap in the coal Domestic Market Obligation (DMO) to boost coal exports and boost foreign exchange reserves. The announcement was made one day after President Jokowi met with a number of local businessmen, including Boy Thohir who was said to have made the proposal. Just one day after the announcement, the government decided to scrap the plan because of the policy's widespread implications for PLN, the government and the people.

Therefore, we would not be surprised if the government changed course again this time. First, this policy of renewing expiring concessions runs counter to Jokowi's populist tendency in policy making. Second, the issue could easily become too political, especially ahead of the presidential and legislative elections in April when Jokowi will seek reelection.

What we've heard: According to several sources in the government and the coal industry, the revision of PP no. 23/2010 was inevitably influenced by lobbying by the shareholders of first generation coal mining companies operating under PKP2B contracts.

[9] Sindonews.com. "Bakal rugikan keuangan Negara, revisi pp 23 tahun 2010." 15 November 2018. https://tinyurl.com/yd7a6zbq

[10] Kontan.co.id. "Bukit Asam (PTBA) siap sikat seluruh tambang PKP2B yang jatuh tempo, asalkan..." 15 November 2018. https://tinyurl.com/yc72qkh7

Another source who was involved in the meetings between the Energy and Mineral Resource Ministry and first generation coal mining companies said PT Arutmin Indonesia, PT Kaltim Prima Coal (KPC) and PT Adaro Energi Tbk were the most vocal in pushing for the revision. They also pushed for extending the concession renewal period from two years before the expiry date to five years.

According to the source, the coal businesspeople actually knew very well that the change of status from PKP2B contract to IUPK license would not automatically allow them to extend their expiring coal mining concessions. They also knew that PT Bukit Asam was eyeing their concessions.

Another source in the coal industry mentioned that these companies also refused to downsize their operational production areas to 15,000 hectares, as stated in the 2009 Mining Law. Reducing their concession areas would also reduce their potential revenue in the future. Arutmin and KPC were firm in defending their concession areas and extending their contracts for the next 20 years in order to secure the potential income. The two companies are the biggest revenue contributors for Bumi Resources Tbk – the parent company owned by the Bakrie family.

This year, Bumi has paid its debt twice, US$66.38 million and $45.28 million in April and July respectively. These payments were part of the installments to pay off the company's total debts of $1.6 billion. Bumi relies on its internal cash to pay off its debt and the sale of coal is often identified as the main source of revenue to pay off this debt. Despite the fluctuation of the coal price, the Bakrie group relies heavily on KPC and Arutmin. Moreover, Bakrie's businesses in other sectors are not performing very well.

Adaro, on the other hand, insists on extending its permit because it wants to secure its supply of coal for its power plants. Adaro, through PT Adaro Power, operates two 100MW power plants in its mining operation in South Kalimantan. The power company is now building two 1,000 MW coal-powered power plants in Batang, Central Java.

Boy Thohir, the founder of Adaro, is rumored to be close to Energy and Mineral Resources Minister Ignasius Jonan. In addition, his younger brother Erik Thohir leads the national campaign team of Jokowi-Ma'ruf Amin.

A number of state-owned enterprises have eyed the expiring PKP2B concessions. They include coal mining companies Bukit Asam and PT Indonesia Power, a subsidiary company of state-owned electricity company PLN. For Bukit Asam, taking over operatorship of the expired concessions would boost its coal production. For Indonesia Power, it wants to secure its supply of coal. However, according to a source at the State-Owned Enterprises Ministry, PLN and Indonesia Power's plan to take over the expiring PKP2B concessions faded after the PLTU Riau corruption case came to light.

OJK's drive to consolidate banking sector ups competition among BUKU II and BUKU III banks

Deposit Insurance Corporation (LPS) commissioner Destry Damayanti has warned banks of the categories BUKU I (core capital below Rp 1 trillion), BUKU II (core capital of Rp 1 trillion to Rp 5 trillion) and BUKU III (core capital of Rp 5 trillion to 30 trillion) over rising liquidity risks.[11]

Takeaway:

- Since 2014, the OJK has been implementing a banking consolidation policy by encouraging foreign investors from East Asian countries to acquire and merge Indonesia's small banks (BUKU I) to trim the total number of banks, as suggested by BI's API guideline.
- The mergers intensify competition among BUKU II and BUKU III banks. This competition benefits BUKU IV banks but has so far failed to improve BUKU II and BUKU III banks' profitability.
- BUKU I banks, often deemed inefficient and uncompetitive by BI, were able to maintain their performance, raising questions over the assumptions used by BI in its API study.

Background: Bank Indonesia's (BI) policy to stabilize the rupiah, which saw the 7-day reverse repo rate (7DRRR) raised by 175 basis points to 6 percent since May this year, has put strain on the banking system. The lenders, especially those categorized as BUKU III or BUKU IV (core capital of Rp 30 trillion or more), need fresh deposits to maintain their increasing loan-to-deposits ratio (LDR). Likewise, BUKU II banks need fresh deposits to maintain their LDR below the 90 percent level.

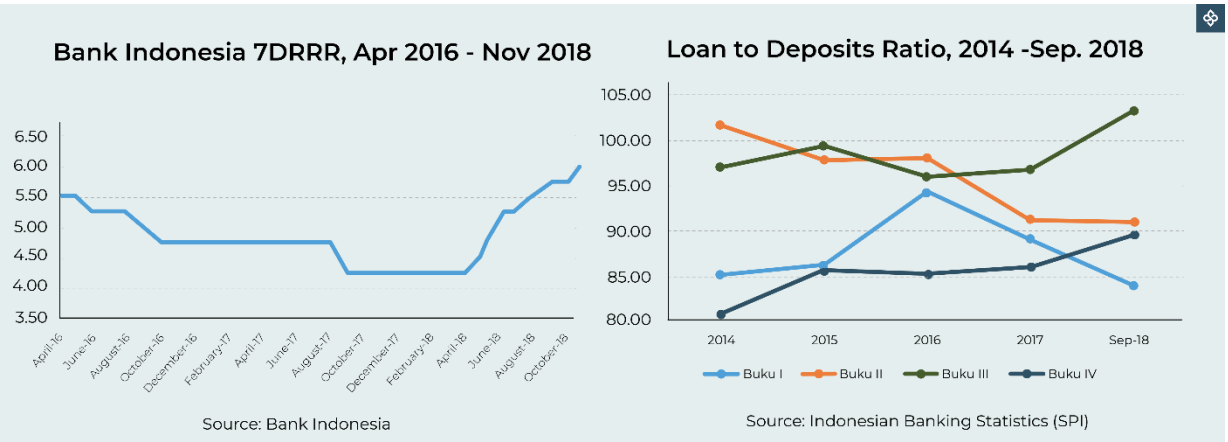
The competition to obtain fresh deposits has put BUKU I banks under heavy pressure. Besides competing directly with bigger banks for fresh deposits, they also face pressure from the Financial Services Authority's (OJK) drive to consolidate the banking sector.

The OJK's banking consolidation policy is based on a BI document from 2004, titled Indonesian Banking Architecture (API).[12] According to API, Indonesia needs to trim the number of its commercial banks to around 35-58 from 131 in 2004 to achieve greater economies of scale. To do this, BI enacted the single-ownership regulation in 2006, but progress so far has been disappointing.

Frustrated by the slow progress, then-BI governor Darmin Nasution pressured small banks into mergers arranged and facilitated by BI in 2012. However, this pressure met strong resistance from bankers.[13] In 2014, the Business Competition Supervisory Commission (KPPU) pressured the OJK, which just received the mandate to supervise the banking sector from BI in January, to accelerate small bank mergers.[14] The OJK responded to this pressure by encouraging small banks' acquisition by foreign investors from Japan, South Korea and China.[15]

[11] Kompas.com, "LPS: Bank harus pinter-pinter atur likuiditas." 29 November 2018 https://tinyurl.com/y9zbms3w
[12] OJK.go.id, "Program penguatan struktur perbankan nasional." https://tinyurl.com/ya26t5rc
[13] Kontan.co.id, "Bank-bank kecil sebaiknya segera merger." 20 October 2012 https://tinyurl.com/y7knfu6m
[14] Kontan.co.id, "KPPU minta OJK konsolidasi bank kecil." 30 September 2014 https://tinyurl.com/yajsqqc2
[15] Beritasatu.com, "Investor asing hanya boleh akuisisi bank kecil." 1 December 2015 https://tinyurl.com/y8ewklsw

This effort led to various high-profile mergers, such as the establishment of China Construction Bank Indonesia through a merger between Bank Windu and Bank Anda,[16] the merger between Bank Metro Express and Centratama Nasional Bank to establish Shinhan Bank Indonesia,[17] the merger between Bank Sumitomo Mitsui Indonesia and Bank Tabungan Pensiunan Nasional (BTPN),[18] the planned merger between Danamon, Bank Nusantara Parahyangan and MUFG,[19] and the proposed merger between Bank Mitraniaga and Bank Agris by Industrial Bank of Korea[20].



Insight: Because of these mergers, the number of BUKU I banks dropped significantly, namely from 42 to 18. However, the total number of commercial banks only decreased slightly, from 119 to 115, because the mergers resulted in a growing number of BUKU II banks, from 44 to 51, and BUKU III banks, from 17 to 27. In other words, the OJK's banking consolidation policy has failed to achieve the objective stated in the API guideline to reduce the number of commercial banks to 35-58. Rather, the mergers have created a greater number of bigger commercial banks, funded by foreign investment from major East Asian banks.

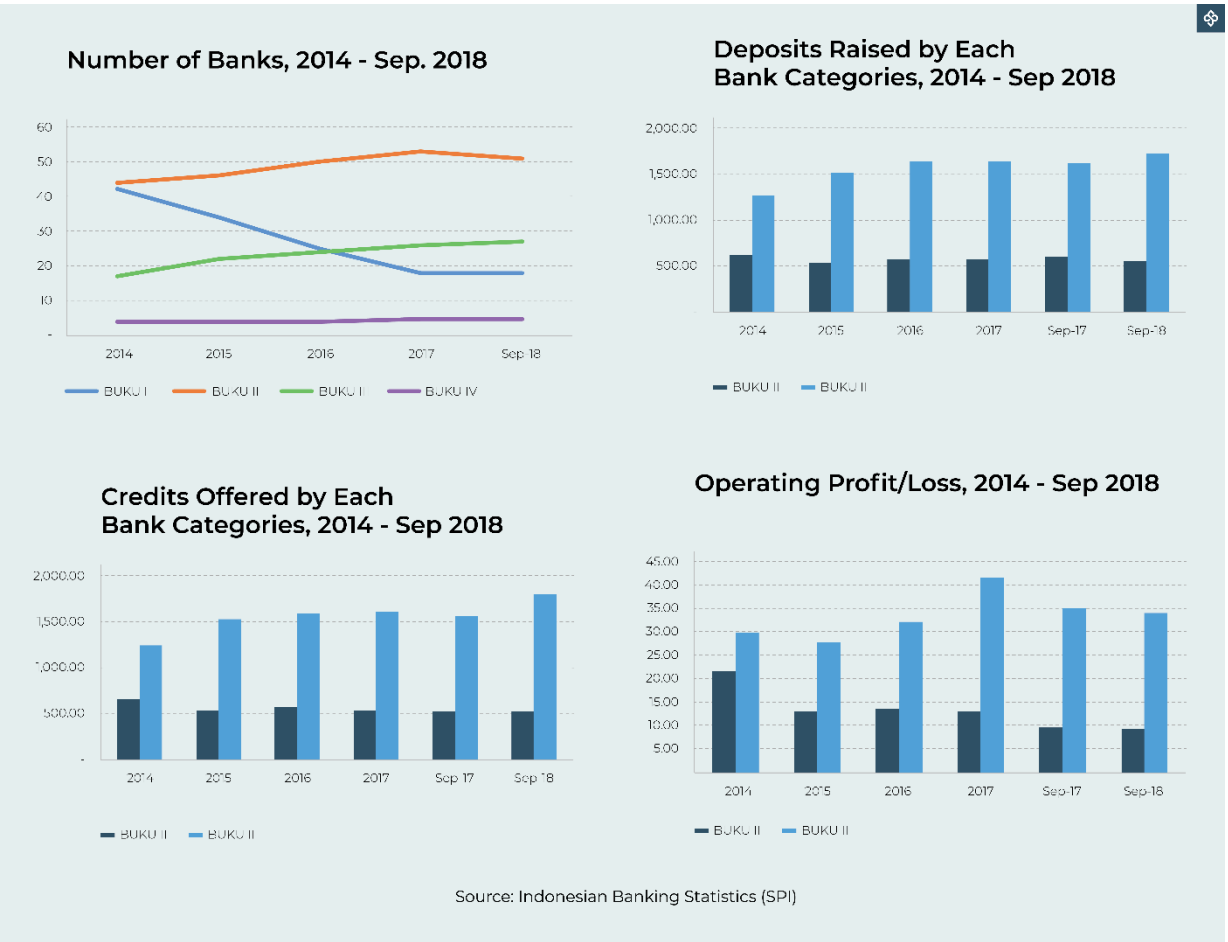
Besides increasing the number of bigger banks, the OJK's consolidation policy intensifies competition among BUKU II and BUKU III commercial banks. A first look at the data suggests that BUKU II banks are losing out to BUKU III banks in collecting fresh deposits. While the deposits collected by BUKU III banks increased from Rp 1,268 trillion in 2014 to Rp 1,730 trillion in September 2018, deposits collected by BUKU II banks fell from Rp 623 trillion to Rp 555 trillion. Consequently, the amount of credit offered by BUKU II banks also fell from Rp 648 to Rp 513 trillion, while the amount of credit offered by BUKU III banks grew from Rp 564 trillion to Rp 1,803 trillion in September 2018.

With operating profit falling from Rp 21.6 trillion in 2014 to Rp 8.98 trillion in September 2018, BUKU II lenders have been losing out to BUKU III banks, where operating profit increased from Rp 29.9 to Rp 34.1 trillion. Despite the increase in total operating profit, the mergers have not increased the average operating profit of BUKU III banks. Rather, the competition between BUKU II and BUKU III banks was followed by an improvement in the profitability of BUKU IV banks, which means fierce competition among BUKU II and BUKU

[16] CCB.com, "Pengumuman IT merger PT Bank China Construction Bank Indonesia TBK (eks. Bank Windu & eks. Bank Anda)." 5 May 2017 https://tinyurl.com/yabbhy72
[17] Shinhan.co.id, "Bank Shinhan Indonesia resmi ramaikan pasar keuangan." https://tinyurl.com/y8jbqhes
[18] Infobanknews.com, "Peta bisnis BTPN pasca-merger." 2 August 2018 https://tinyurl.com/ybhx9g8u
[19] CNBCIndonesia.com, "OJK: Danamon harus merger dengan BNP dan MUFG Indonesia." 15 August 2018 https://tinyurl.com/y8eh9juq
[20] Kontan.co.id, "OJK: merger Bank Mitraniaga dan Bank Agris akan jadi Bank BUKU II." 31 October 2018 https://tinyurl.com/y8bpz6da

III banks has created an opportunity for BUKU IV banks to consolidate their dominance in Indonesia's national banking system.

Ironically, BUKU I banks, which were deemed inefficient and uncompetitive by BI, the OJK as well as the KPPU, have maintained their average operating profit at the level of Rp 50 billion. These figures raise questions over the assumptions used by BI in its API study – now adopted by the OJK and endorsed by the KPPU – that Indonesia's small banks are inefficient and uncompetitive.



Disclaimer:
Tenggara Strategics always aims to use reliable sources in providing our best analysis to our clients, and is not responsible for any errors, inaccuracies and/or viewpoints in the original source material upon which we have based our analysis. The analysis contained in this document is intended exclusively for our clients who have subscribed to this service, and is not for public consumption or dissemination.

Nothing contained herein shall to any extent substitute for the independent investigations and the sound technical and business judgment of the reader. In no event will Tenggara Strategics, including its employees, be liable for any decisions made or actions taken in reference to the information contained in these documents, or for any incidental, consequential, indirect, special or exemplary damages, including damages from loss of profits or opportunities, even if advised of the possibility of such damages.

Tenggara Strategics is a business and investment research and advisory institute established by the Centre for Strategic and International Studies (CSIS), The Jakarta Post and Prasetiya Mulya University. Combining the capabilities of the three organizations, we aim to provide the business community with the most reliable and comprehensive business intelligence related to areas that will help business leaders make strategic decisions.

TENGGARA STRATEGICS

PT Trisaka Wahana Tenggara
The Jakarta Post Building
Jl. Palmerah Barat 142-143
Jakarta 10270

+62 21 5300476/8 ext. 2009
info@tenggara.id
www.tenggara.id

Board of Commissioners:
Jusuf Wanandi, Djisman S. Simandjuntak, Endy M. Bayuni

Board of Directors:
Riyadi Suparno, Phillips J. Vermonte,
Deddi Tedjakumara

Guarantor: Riyadi Suparno

Researchers & Writers:
Angeline Callista, Astria Zahra Nabila, Adinova Fauri, Benni Yusriza, Dwi Atmanta, Frans Surdiasis, Stella Kusumawardhani, Lionel Priyadi, Vincent Lingga, Yesaya Christianto, Yessy Rizky