Direct appointment of state-owned enterprises in the procurement of goods and services: unfair competition in tender in Indonesia

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Abstract: This research aimed to analyse the provision of the direct appointment of state-owned enterprises in the procurement of goods and/or services in Indonesia. This is a qualitative normative legal research drawing on descriptive secondary data. The appointment of State-Owned Enterprises is regulated under the Ministerial Regulation on State-Owned Enterprises No. PER-05/MBU/2008 *juncto* Ministerial Regulation of State-Owned Enterprises No. PER-15/MBU/2012 on the General Guidance for the Implementation of Procurement of Goods and/or Services by State-Owned Enterprises. However, this business practice seems to have failed to bring about the results sought by the government. This study reveals that the regulation on General Guidance for the Implementation of Procurement of Goods and/or Services by State-Owned Enterprises contradicts Law No. 5/1999 on the Prohibition of Monopolistic Practices and Unfair Competition, especially Article 19d on discrimination and 22 on conspiracy with regard to the application of the principle of *Lex Superior derogat Legi Inferior*. The also shows that the appointment of State-Owned Enterprises in the procurement of goods and services entails corrupt practices and therefore does not guarantee a fair and competitive business environment in Indonesia. the study also reveals that there is corruption within the procurement of goods and services by State-Owned Enterprises in Indonesia.

Keywords: direct appointment; procurement; state-owned enterprises; SOEs; unfair competition; tender; Indonesia.

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1 Introduction

As a part of the effort to boost economic development, the Indonesia government established state-owned enterprises (SOEs) regulated under Law No. 19/2003. For the procurement of goods and services to the public (Andy, 2012), the President of the Republic of Indonesia issued Presidential Regulation No. 16/2018 on Public Procurement of Goods/Services in replacement for Presidential Regulation No. 5/2010 on Public Procurement of Goods/Services. Procurement of goods and services by a SOE can be achieved through several methods including direct appointment. Under Indonesian law, SOEs are allowed to make direct appointments in the procurement of goods and/or services, which raises the question to what extent this business practice violates Article 19d and Article 22 of Law No. 5/1999 on the Prohibition of Monopolistic Practices and Unfair Business Competition.

The notion of SOE was established as an implementation of the state's obligation to promote the prosperity of the Indonesian people (Ferry et al., 2018). One way to achieve this is to build a strong economic structure through fair and ethical business schemes. According to Article 1 section 1 of Law No.19/2003 on SOEs, a SOE/Enterprise is an entity whose capital is in part or in whole owned by the state through direct participation that is derived from the state's separated assets. According to Asian Development Bank (2018), the term 'state-owned enterprise' includes, but is not limited to, any entity recognised by the borrower's national law as an enterprise in which the state or government exercises direct or indirect (whole or partial) ownership or control (Asian Development Bank, 2018). SOEs must be distinguished from public agencies, quasi-governmental, or parastatal organisations that carry out public policy functions, but that do not include any economic or similar type objectives and activities such as the commercial supply of goods, works, or services (Asian Development Bank, 2018). A SOE is one of the economic actors in the national economic system, besides private business entities and corporations (Tavares, 2017).

Whereas, the procurement of goods and or services is the process of acquiring goods, services from an external source, often via a tendering or competitive bidding process. The process is used to ensure the buyer receives goods, services, or works at the best possible price when aspects such as quality, quantity, time, and location are compared (van Weele, 2010). According to Article 1 section 31 of the Presidential Decree No. 54/2010, direct appointment is a method of selecting goods and/or services Provider by appointing directly one provider of the goods and/or services. SOEs may take on different legal forms and be subject to either public or private legal and regulatory frameworks, or a combination of both, as is the case of the Ministerial Regulation of SOEs No. PER-05/MBU/2008. An SOE can be a statutory corporation established by an act of parliament and governed by its own special statute. However, many SOE laws, as well as local company-related legislation, allow government extensive managerial and operational powers over overriding typical corporate regulatory provisions. Such effective operational or management control may compromise the transparency of a bidding process by creating unfair competitive conditions for private sector bidders, as pointed out by the Asian Development Bank (2018). Asian Development also observed that while unfair competitive conditions may be created by the participation of foreign SOEs, their impact will be mitigated when operating outside their home countries (Asian Development Bank, 2018). Similarly, Ilyas et al. (2015) also point out that direct

appointment of SOEs in the Procurement of goods and services entails corrupt practices [Ilyas et. al., (2015), pp.17–26], which Kutosi et al. (2015) describe as 'malpractices'.

The relationship between the presidential decree on the Procurement of goods and services and Law No. 5/1999 on the Prohibition of Monopolistic Practices and Unfair Competition, especially Article 19d on discrimination and 22 on conspiracy with regard to the application of the principle of *Lex Superior derogat Legi Inferior* is what this paper endeavours to investigate. In so doing, this study seeks to analyse the regulations surrounding the appointment of SOEs by the government in the procurement of goods and/or services so as to find out whether or not it is in contradiction with the business competition law. Public procurement is important, not just to governments tasked with providing public services, but to local, national, and international economies (Harland et al., 2013). The present study not only aims to investigate the regulations related to such an important economic practice but also and more importantly to denunciate corrupt practices within the business environment in Indonesia. The findings of this study will give policymakers a glimpse of how public procurement practices can be harnessed by the government to increase the productivity of SOEs, which is vital to economic growth and development in Indonesia. As far as the scientific world is concerned, this study will be useful in enhancing the body of knowledge and would also help other scholars in carrying out further and related studies in public procurement.

2 Direct appointment of SOEs in the procurement of goods/services

The direct appointment, as one method to conduct the procurement of goods and/or services, is regulated by the Presidential Decree No. 54/2010. According to this decree, a direct appointment is started by inviting one of the providers of goods and/or services to determine their qualification. Should they fail to pass the qualification process, other providers are called upon until a price deal and the specification of goods/services is reached. Direct appointment of a provider of goods/construction work/other services is done under certain conditions (Article 38 of President Regulation No. 54/2010):

a Emergency handling that cannot be planned before and the time of completion of work must be immediate such as national defence, security and public order, safety/protection of the community whose work cannot be postponed. This includes natural disasters and/or non-natural disasters and/or social calamities; damage to the facilities/infrastructure that can stop the activities of public services.

b Sudden overseas agendas of the president/vice president.

c Activities pertaining to state defence stated by the Ministry of Defense and activities related to public order and security which are determined by the Chief of Police of the Republic of Indonesia.

d Confidential activities for the purpose of intelligence and/or protection of witnesses in accordance with the duties stipulated in the legislation.

e Goods/construction work/other services that are specific and can only be implemented by one provider of goods/other services because as only one manufacturer, one patent holder, or party who has obtained permission from the patent holder, or the winning bidder who have permission from the government.

Based on the above explanation, the procurement of goods/services with direct appointment cannot be done immediately as several conditions that must be met. Procurement of goods or services using direct appointment method must be based on legal reasons as set forth in Article 38 paragraph 4 of President Decree No. 54/2010, which stipulates that the procurement of goods and/or services of government should be based following principles:

a efficiency

b effectiveness

c transparency

d openness

e competitiveness

f fairness/impartiality

g accountability.

According to Regulation No. 5/2008 on the Procurement of Goods and/or Services by SOEs issued by the Ministry of SOEs, there are four methods of procurement of goods and/or services:

a open auction

b direct election

c direct appointment

d direct purchase.

According to Article 5 paragraph 2 of the above regulation, a direct appointment is the procurement of goods and/or services, which is done by appointing one provider of goods and/or services. Direct appointment by SOEs can only be done only if one of the following conditions is met:

a The goods and/or services which are urgently needed for the main performance of the enterprise.

b The intended goods and/or services are the only one specific goods.

c The use and maintenance of the product need the continuity of knowledge of Goods and/or services providers.

d If the procurement of goods and/or services is carried out twice but the bidder or a direct election does not meet the criteria, then no party shall participate in the auction or direct election.

e Providers are individuals who own the intellectual property rights over goods and services or those who have a warranty from the original equipment manufacturer.

f Emergency security handling, community safety, and corporate strategic assets.

g Emergency handling due to natural disasters, both locally and nationally.

h Advanced goods and/or services that cannot be technically separated from previous work.

i Goods and services providers are SOEs, SOE subsidiaries or SOEs affiliated enterprises, as long as the needed goods and/or services are their own products or services, and that their quality, price, and purpose can be accounted for.

j Procurement of goods and/or services in a certain amount and value determined by the Board of Directors by first obtaining approval from the Board of Commissioners.

The difference between a direct appointment by SOEs and A direct appointment by the government lies in the fact that in the former there is no submission of the qualification documents by the providers of goods/services to the committee of procurement. From the business competition perspective, this circumstance does not allow other Enterprises running a business in the same field to join and compete in the same market. Additionally, Regulation No. 15/2012 enacted by the Ministry of SOEs stipulates that in a direct appointment, the provider of goods/services is SOEs, SOEs subsidiary, or SOEs affiliated Enterprises as long as one of the above requirements is fulfilled. That provision discriminates against other business entities operating in the same field.

The fact that there is no open principle in the procurement of goods by SOEs is another difference between direct appointment by the SOEs and the direct appointment by the government. Open principle means that Procurement of Goods/Services can be followed by all Goods/Services Providers who meet certain requirements based on clear terms and procedures (President Regulation No. 54/2010 on Procurement of Goods and/or Services by the Government). The absence of open principle indicates that the procurement of goods by SOEs can be done in a closed manner which could lead to discrimination and monopoly. Market concentration solely in the hands of large Enterprises is not necessarily in the interests of the procuring entity; vendor lock-ins, monopolistic behaviour and unbalanced negotiation power are some of the typical risks, as Saarela et al (2018, p.93) pointed out.

3 The legal status of direct appointment in the procurement of goods/service by SOEs and business competition law

Direct appointment by SOEs is regulated by the Ministerial Regulation No. PER-05/MBU/2008 on General Guidelines for Procurement of Goods and/or Services of SOEs that have been amended by the Ministerial Regulation No. PER-15/MBU/2012. From both the material and formal aspects this regulation is in contradiction with Article 19d and Article 22 of Law No. 5/1999 on the Prohibition of Monopolistic Practices and Unfair Competition, especially Article 19d on discrimination and 22 on conspiracy with regard to the application of the principle of *Lex Superior derogat Legi Inferior*. In fact, Article 19d states that business actors are prohibited from carrying out one or several activities, either alone or together with other business actors, which can result in monopolistic practices and or unfair business competition in the form of discriminatory practices against certain business actors.

The scope of the prohibition of activities regulated by Article 19d covers the practice of discrimination carried out by business actors. Discriminatory practices are the determination of treatment in different ways regarding the requirements of supply or the

requirements for the purchase of goods and or services. So, any kind of different treatment for certain business actors can be included in the scope of Article 19d. Discriminatory practices can also be interpreted as activities that inhibit or conflict with the principles of fair business competition. Actions that inhibit or conflict with unfair business competition under Article 19d can be in the form of price or non-price discrimination.

Similarly, Article 22 of Law No. 5/1999 states that "Business actors are prohibited from conspiring with other parties to regulate and/or determine the tender winner so that it can lead to unfair business competition." The article's consideration of the existence of tender conspiracy depends on two conditions, namely the parties must participate and agree on collusive activities together. Participants are parties who do not have to be competitors of the first party and do not need to be business actors. This understanding has a broad impact, so it raises the interpretation that the ban on conspiracy is not only horizontal (between bidders) but also vertically (between the committee and the bidders). Based on the explanation of Article 22 of Law No. 5/1999, the tender is an offer to propose prices to buy a job to procure goods or provide services. The definition of this tender includes an offer to submit prices for:

a buying or carrying out a job

b holding procurement of goods and/or services

c buying goods and/or services

d selling goods and/or services.

The above definition covers tender done through:

a open tender

b limited tender

c general auction

d limited auction

e direct appointment

f direct election.

Furthermore, there are three kinds of tender conspiracy:

a Horizontal tender conspiracy which occurs between a business actor and other fellow business actors by creating false competition among bidders.

b Vertical tender conspiracy, which takes place between one or several business actors with the tender committee or the owner or employer.

c Vertical and horizontal tender conspiracy, which happens between the tender committee or the owner of the work with the business actor involving two or three parties related to the tender process. This form of conspiracy is a fictitious tender, whereby both the bidding committee of the employer and the business actor conduct the tender only through a closed administrative process.

Consequently, the direct appointment above is categorised as a form of vertical conspiracy, meaning a conspiracy facilitated by the committee/tender implementer to win

one of the tender participants without going through standard procedures that must be carried out based on the principle of fair business competition. Article 19d is related to Article 22 of the same regulation which prohibits conspiracy, especially direct appointment. Both of these articles have the same impact, namely the entry barrier, but the prohibited aspect is different. Article 22 prohibits conspiracy activities, while Article 19d prohibits discrimination resulting from the conspiracy. Article 19d is needed to trap discriminatory practices that are not caused by conspiracy. Procurement of goods and/or services is a market that should be completed to obtain competitive and efficient goods or services. The law on the appointment of SOEs violates Article 19d and Article 22 of Law No. 5/1999 for the following reasons [Zihaningrum and Kholil, (2016), p.111]:

a It prevents other bidders who are more likely to win because both the goods/services offered are better than the winning bidder determined from the conspiracy;

b It causes losses to the State because government procurement of goods/services uses government budgets;

c It causes immaterial losses, namely reduced market confidence, especially the public who know about the existence of the tender to the credibility of the government or government officials as the tender organiser (tender committee).

From the formal aspect, the Ministerial Regulation No. 5/2008 was enacted by the Ministry of SOEs based on:

a Law No. 40/2007 on Limited Liability Enterprise

b Law No. 19/2003 on SOEs

c Government Regulation No. 41/2003 on Delegation of Position, Duties, and Authority of the Minister of Finance in Corporate Enterprises (*Persero*) Public Enterprises (*Perum*) and Enterprise Services (*Perjan*) to the Ministry of SOEs

d Presidential Decree No. 45/2005 on Establishment, Supervision and Dissolution Management, SOEs

e Presidential Decree No. 9/2005 on Position, Task, Function, Organizational Structure and Work Procedure of the Ministries of the Republic of Indonesia

f Presidential Decree of the Republic of Indonesia No. 1871M/2004 as amended by the Presidential Decree No. 31/P/2007.

Furthermore, the Ministerial Regulation No. 15/2012 mentioned earlier, which was enacted based on Government Regulation No. 41/2003 and Government Regulation No. 45/2005 does not explicitly mention the granting of authority that was not based on the principle of fair business competition. Considering there is a conflict or contradictory regulation between the SOEs Ministerial Regulation No. PER-15/MBU/2012 with Law No. 5/1999 with regard to the principle of *Lex Superior Derogat Legi Inferiori*, which means that if there is a conflict or contradiction between higher law and lower law then the higher must prevail (Febriansyah, 2016). Even though the Ministry of SOEs is authorised to make regulations, it is important that the hierarchy of laws be preserved and respected to avoid contradictions and overlaps.

Additionally, the procurement of goods/services by SOEs environment is not provided for by Article 51 of Law No. 5/1999. This is due to the fact that the

procurement of goods/services does not include strategic industrial fields that require the act as a basis for regulation, for example in the fields of mining, water resources, electricity, public transportation, plantations, ports, telecommunications, and so on. However, the basis of SOEs in making direct appointments based on the SOEs Regulation No. 5/2008, as amended by the SOEs Regulation No. 15/2012 on the Guidelines for Procurement of Goods and/or Services, is, in essence, contrary to the provisions of the Business Competition Law.

4 Monopoly and unfair business competition

In a report published in 2018, the Organization for Economic Co-operation and Development (OECD) observed that to support competitive neutrality, procurement policies and procedures should be competitive, non-discriminatory and safeguarded by appropriate standards of transparency (OECD, 2018). With regard to direct appointment or the discriminatory action in the tender conducted by the committee against the winner of the tender, the Indonesian Business Competition Supervisory Commission has several times sentenced the procurement committee in accordance with Article 19d and Article 22 of Law No. 5/1999 prohibiting monopolistic practices and or unfair business competition in the form of a discrimination against certain business actors. Several cases of direct appointment in the procurement of goods/services by SOEs have been ruled unlawful since the enactment of these two laws. These cases include among many others, the appointment of Landor, a communication consultant, by PT. Pertamina to design its new logo, PT. PLN and Disjaya's direct appointment of PT. Netway Utama for the procurement of Outsourcing Roll Out Customer Information System, and the selling of two VLCC tanker ships of PT. Pertamina.

Concerning the direct appointment of PT. Netway Utama to conduct the Outsourcing Roll Out Customer Information System project or *Rencana Induk Sistem Informasi* (CIS RISI) of PT. PLN (*Persero*) Jakarta Raya and Tangerang Distribution (*Disjaya*), the Business Competition Supervisory Commission conducted a Preliminary Examination which found strong indications of the violation of Article 19 a and d, and Article 22 of Law No. 5/1999 by preventing other business actors to work on the project. Moreover, Netway did not meet the criteria for direct appointment as stipulated in the Directors' Decree No. 036.K/DIR/1998. Because of the violation, the Business Competition Supervisory Commission ruled to fine Netway Rp. 1,000,000,000 (about $70 million) (Case Decision No. 03/KPPU-L/2006).

As far as the case of direct appointment of Landor as the implementer of PT Pertamina's new logo, $255,000 was paid to Landor by PT. Pertamina's Director for the Brand Audit & Strategy Development work, Identity Development, Enterprise's look and Brand Guidelines development. However, after ruling that PT. Pertamina's deal violates Article 19d of Law No. 5/1999 on the Prohibition of Monopolistic Practices and Unfair Business Competition as the direct appointment of Landor to design the logo was done without a valid reason, the Business Competition Supervisory Commission fined PT. Pertamina to pay a fine of Rp.1,000,000,000 (about $70.000.000) (Case Decision No. 02/KPPU-L/2006).

In the case of the sale of the VLCC tankers, due to a bad financial situation, PT Pertamina urgently appointed Goldman Sachs Ltd (Singapore) to conduct financial evaluations and advice on ownership of VLCC. Initially, PT. Pertamina had held a tender

and had determined Japan Marine to be the winner of the tender as a VLCC tanker ownership consultant. However, as PT. Pertamina did not understand its finance and took too long to provide evaluation results, it decided to cancel the deal with Japan Marine and to sell the two tankers through direct appointment to Goldman Sachs which would conduct reviews and provide a second opinion on the policy. Goldman Sachs was also appointed as a financial advisor in order to obtain maximum sales results. Sales were carried out through tenders held in Singapore by the Divestment Team and Goldman Sachs. In the first and second bids, PT. Essar made the highest offer but was overbid by Frontline, Ltd. in the third bid. Frontline's bid was made to Goldman Sachs through Equinox Shipping Enterprise as a broker. As a result, the VLCC tankers were sold to Frontline, Ltd by PT. Pertamina. In this case (Case Decision No. 07/KPPU-L/2004 KPPU), the Business Competition Supervisory Commission ruled that:

1 PT. Pertamina violated Article 19d of Law No. 5/1999 with the direct appointment of Goldman Sachs (Singapore) as financial advisor and arranger.

2 PT. Pertamina and Goldman Sachs (Singapore) also violated Article 19d of Law No. 5/1999 in the case of a third bid from Frontline, Ltd.

3 PT. Pertamina, Goldman Sachs, Frontline, Ltd., and PT. Equinox Shipping Enterprise violated Article 22 of Law No. 5/1999.

4 Goldman Sachs (Singapore) be fined Rp. 19,710,000,000 (about $1.400.000) which must be deposited into the State Treasury as a non-tax state revenue, to the Ministry of Finance, the Directorate General of Treasury, and the Jakarta Office of State Treasury Services (KPPN) I.

5 Frontline, Ltd. also be fined Rp. 25,000,000,000 ($1.800.000) which must be deposited to the State Treasury as a non-tax state revenue, to the Ministry of Finance, the Directorate General of Treasury, and Jakarta State Treasury Service Office (KPPN) I.

6 PT Equinox Shipping Enterprise be fined Rp. 16,560,000,000 (about $1.200.000) which must be deposited to the State Treasury as a non-tax state revenue, to the Ministry of Finance, the Directorate General of Treasury, and Jakarta Office of State Treasury Services (KPPN) I.

7 Each reported party pay compensation:
   a Goldman Sachs (Singapore): Rp. 60,000,000,000.00 (about $4.200.000)
   b Frontline, Ltd.: Rp. 120,000,000,000.00 (about $8.300.000); to the Republic of Indonesia which must be deposited to the State Treasury as a non-tax state revenue, to the Ministry of Finance, Directorate General of Treasury, and Jakarta State Treasury Service Office (KPPN) I.

In these cases, the Business Competition Supervisory Commission based its ruling on the principle of reason as stipulated in Article 19d and Article 22. The decision of the commission is just and fair for two reasons: Firstly, the sentence "…which can result in monopolistic practices and/or unfair business competition" mentioned in the business competition law. Secondly, the impact caused by direct appointment of certain Enterprises based on the provisions of SOEs Regulation No. 5/2008, which prohibits the use of conspiracy and discriminatory practices in a direct appointment for the

procurement of goods/services. Based on the explanation above, direct appointments in the cases mentioned above are contrary to the Business Competition Law. As mentioned earlier, these business practices entail corruption and do not provide for a fair and competitive business environment. This is in line with the findings of Wang (2007–2010) who observes that one of the major forms of abuses in procurement is corruption. Wang claims that is reported that some managers of state enterprises use public fund to apply to investor migration, gamble, seek profit in the stock market and in particular, take bribery or favoured relatives in procurement supplies and construction (Wang, 2010). It is also in line with the findings of Liu (2013) who points out that imbalance/lack a supervision mechanism, unqualified supervision staff, lack of a scientific and strict bid management system and high cost of supervision can result in unfair and unjust practices in the procurement of goods and services by SOEs in China.

5 Conclusions

The direct appointment in the procurement of goods/services by SOEs differs from the direct appointment in the procurement of goods/services by the government in that in the former, there is no qualification process for the invited service providers and no principle of openness to be followed by all goods and/or service providers who pass the qualification test. This study has shown that direct appointment of SOEs, as specified in the SOEs Ministerial Regulation No. 5/MBU/2008 in conjunction with SOEs Regulation No. 15/MBU/2012 violates Article 19d and Article 22 of Law No. 5/1999 on the Prohibition of Monopolistic Practices and Unfair Business Competition. A direct appointment is included in the form of vertical conspiracy, a conspiracy facilitated by the tender committee to make one of the tender participants win without going through standard policies and procedures of procurement (OECD, 2018). Even though both articles promote open and fair business practices, they prohibit different elements. Article 22 prohibits conspiracy in appointment while Article 19d prohibits discrimination caused by the conspiracy. Support competitive neutrality, procurement policies and procedures should be competitive, non-discriminatory and safeguarded by appropriate standards of transparency. Moreover, the regulations that become the basis of direct appointment cannot override the application of the Business Competition Law. It is worth noting that due to their privileged position SOEs may negatively affect competition and it is, therefore, important to ensure that, to the greatest extent possible consistent with their public service responsibilities, they are subject to similar competition disciplines as private enterprises. Although enforcing competition rules against SOEs presents enforcers with particular challenges, competition rules should, and generally do apply to both private and SOEs, subject to very limited exceptions (OECD, 2009). This study has pointed out two major issues in the procurement of goods and services in Indonesia: first the discrepancy/contraction between General Guidance for the Implementation of Procurement of Goods and/or Services by SOEs contradicts Law No. 5/1999 on the Prohibition of Monopolistic Practices and Unfair Competition, especially Article 19d on discrimination and 22 on conspiracy and second, the corruption within in the procurement of goods and services by SOEs in Indonesia. These finding will give policymakers a glimpse of how public procurement practices can be harnessed by the government to increase the productivity of SOEs, which is vital to economic growth and development in Indonesia. As far as the scientific world is concerned, this study will be

useful in enhancing the body of knowledge and would also help other scholars in carrying out further and related studies in public procurement. It is important to note, however, that this study lacks in-depth statistical data therefore further research in this sense is suggested.

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