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SERIAL OFFENDERS: WHY SOME INDUSTRIES SEEM PRONE TO ENDEMIC COLLUSION

Contribution from Indonesia

-- Session IV --

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WHY IS THE CONSTRUCTION SECTOR PRONE TO COLLUSION?

-- Indonesia --

1. Introduction

1. Collusion has become a chronic problem in Indonesia and kept growing in spite of the reformation and regional autonomy era. Practices of collusion and nepotism and corruption have also expanded and involved central and regional public officials, business actors, and the public. Collusion mostly relates to business activities that regulate licensing, concessions, procurement, and many more. A number of efforts have been put to eradicate collusion in Indonesia, particularly since 1998, when the waves of reformation began to roll on. A variety of social organisations have kept growing and actively demanding its eradication. Apart from its shortcomings, reformation has successfully resulted in a number of laws to stimulate democratic values in the fields of politics and economy followed by good, clean, transparent, and accountable government. Among others are laws on general election, laws on prohibition against monopolistic practices and unfair business competition, and laws on corruption eradication.

2. However, those efforts are still not enough. Collusion practices that have been systemic and deeply rooted in Indonesia require more serious, systematic, simultaneous, and co-ordinated eradication efforts. Collusion eradication has to become national priority by involving all elements and layers of the society. Both the system and the actors have to be good. Without exception, efforts for law enforcement on competition have to bring about positive impacts to efforts for collusion eradication. At least, with law enforcement on competition, the climate of fairer business competition will grow, so that business actors will be encouraged to set more competitive prices with nearly normal/reasonable level of profit. With smaller profit, the potency of collusion will also be reduced.

3. Construction service is a sector with the most case handled by the Indonesian competition commission, KPPU. It has becoming priotrities sector to supervised for years to come, apart from other strategic sector like commodity, health and education, foods and commodities, banking, transportation, and energy.

2. Indonesian Construction Market

4. Construction sector plays important role in any countries development, since it will affect most of economic sectors and a maverick for infrastructure development which provide continous growth and standard of living. Thus, the need for construction was arising. This year, Indonesia puts optimistic growth to 5.8% with infrastructure as their main driver.

5. As seen by the following chart, the World Bank also viewd that construction has dominated fixed investment growth in Indonesia since the mid-2000s, compare to foreign machinery and equipment and tranportation.

Chart 1 : Investment components' contribution to real investment growth, by percentage points

Note: * Other includes domestic machinery, equipment and transportation
Source: BPS; World Bank staff calculations

6. Currently, state-controlled companies have long played and continue to play an important role in Indonesia's construction industry. Most of them are listed on the stock market with the state holding a majority stake in each. State-owned enterprises are more successful in being awarded public-sector contracts than their private competitors and have displayed a strong financial performance in recent years thanks in large part to public infrastructure development. Meanwhile, the vast majority of Indonesia's more than 100,000 registered construction companies are small sized that cannot take on large-scale projects, with relatively few companies in the medium-size segment and a distinct lack of specialised, niche players. The market is in for a significant degree of consolidation in reaction to toughening competition. While owners of smaller companies are calling for government protection against large domestic and foreign players, mergers and acquisitions should prove the most straightforward way for them to increase their capacity and improve their odds of survival.

7. The ASEAN Economic Community (AEC) viewed will boost cross-border business in the ASEAN region and increase competition in construction as well as in other industries. Local businesses are ill-prepared to take on foreign competitors and thereby take full advantage of what will be an integrated regional market. For many Indonesian construction enterprises, a lack of scale and expertise is also a competitive disadvantage. Yet, while local businesses may see foreign companies as a threat to their market share, they also need to cooperate with them. Partnering with experienced foreign players is in many cases the most straightforward way for private local businesses to get in on large-scale projects and at the same time benefit from a transfer of know-how, which in turn will help them catch up and adapt to international standards.

8. There are challenges in Indonesia's construction industry, and one of the biggest at present is the high price of building materials. The property boom of recent years has driven up demand, while inadequate transportation infrastructure adds a logistical element to the cost of materials. That said, local and foreign cement makers have begun to invest heavily in Indonesia to increase their output. Much the same is true for steel makers. Other challenge is human resources. While Indonesia has a large and relatively young workforce, finding qualified and certified builders and engineers is hard. This is especially true outside of Java, where an increasing proportion of building activity is set to take place over the coming decades. Foreign companies in joint projects need to carefully improve their local partner's capabilities and standards. Another labour-related aspect to consider is the rapid increase in minimum salaries during recent years. Contractors and investors willing to deal with these challenges can expect to enjoy long-term growth in Indonesia's construction industry. Housing needs, rail and road networks, ports and airports, power generation and distribution all point to growing demand as the country's economy matures and as the

population grows in number and affluence. The industry's growth also spells attractive opportunities for suppliers of building materials and companies selling or leasing equipment.

9. Unfortunately, this promising industry also comes with its competition problem. Many companies chose a shortcut to get the project by colluding with other companies or the government. Their collusion have become a main target by competition authority for many year due to its contribution to national income and impact to economic development. Most collusion occured in public procurement for construction project. The symptom mostly similar and repetitive, to cooperate with other companies and or the bid committee (the government) with the rewards of sub-contracting contract or hard cash (bribery).

3. Why is there too much collusion in construction?

Reason 1 : Construction is an overwhelm market

10. Indonesia has grown significantly for the past years, driven by the rapid growth of construction sector in the country, and the increase in private investment and government spending. Contribution by construction sector to national income is numerous. Its contribution on national gross domestic product (GDP) has grown from about 7.07% in 2009 to 13% in 2014 and has encouraged the growth of building materials and other related industries in Indonesia. The construction sector is projected to grow by 14.26% to reach Rp 446 trillion (USD 31.9 billion) in 2015 and will be one of the most promising sectors. Thanks to the acceleration of the government's infrastructure development plans, construction spending growth in Indonesia is estimated at 5.2% for the period 2012-2017. This puts Indonesia among the world's top ten largest growing construction market. This was supported by a statement by Indonesian Minister for Public Works who said that Indonesian construction market is the largest ASEAN with more than 67% contribution to ASEAN construction market. In local local level, Capital Jakarta is the most promising city for construction.

11. As the market growth, competition will escalated in an industry. Demand for construction is enourmous. It has become a most wanted sector and choice for any developers, even small and new players.

Reason 2 : Lots of market players, few are specialized

12. Construction industry is heterogeneous and competition seem to lead to the contractor pegging its market in order to understand the market structure it will serve. Grouping the market focused on the needs and desires of the consumer that need to be provided and the users of the product that need to be supplied. This is indicated by the dominant use of project-type variable and ownership status of a project as one of the basic variables in classifying construction sector. Another basic variables considered no less important is the value of projects that reflect the scale of business of a company.

Table 1: Number of Construction Companies, 2014

	2010	2011	2012	2013	2014	
Small	116.982	115.515	109.683	110.321	109.924	84,67%
Middle	21.279	16.372	17.699	18.243	17.421	13,42%
Large	2.516	2.117	2.480	2.516	2.474	1,91%
TOTAL	140.777	134.004	129.862	131.080	129.819	

Source: Statistics Indonesia, 2015

13. Indonesian construction market is dominated by large companies accounted for 1.9% of number of companies in construction (129,819 companies in 2014). Middle and small construction companies accounted for another 13.42% and 84.67%. However, most of them is general companies (88%), while

specialize enterprises only consist of 12%. In developing countries, most of contractors are specialized. In addition, competition pressure from foreign enterprises also escalated from 195 companies in 2010 to 295 companies in 2014, or 50% increased for the past five years.

14. In general, larger companies seem to be able to serve more market segments than smaller companies. It is logical, because of limited resources (funds, manpower, expertise, technology) seems to be an obstacle to serve all market segments that have been previously identified. This is presumably what causes the differences of each contractor in the view of the existing market potential as well as differences in the number of market segments served. In terms of market grouping in the construction sector, there is a difference between one business asscoation to another. This can be seen from different groupings made by the government (through the construction law), namely the Indonesian Contractors Association (AKI), Gabungan Pelaksana Konstruksi Indonesia (GAPENSI), or the grouping is done by survey institute such as the Central Bureau of Statistics (BPS) and the Building and Construction Interchange Asia (BCI Asia, 2006). This makes it difficult to obtain an idea about the market potential possessed by the uniform and existing group, because the varied viewpoints, means and needs of the company or the organization to classify the market where the company will carry out its business.

15. Less specialization means two thing in competition. First, in certain construction projects, few players are exist. The likelihood for the creation of oligopolistic market is high. Smaller player will only act as second hand, where they expect for a sub-contract agreement from the larger companies. They may join a bidding as a companion, instead of put their mind on winning the bidding. Therefore in many procurement in construction, KPPU found many companies act only as the secondhand of larger companies. Collusion mostlikely occured in these specialized market. Second, competition in non-specialized market is severe. Companies will intensively compete for smaller cakes. This is where collusion between bid committee and bid participant will exist.

Reason 3 : They fish from the same lake

16. A study by Biemo SW shows that the construction companies today have a higher tendency to serve government clients than private clients. This means government projects have a certain appeal for companies when compared to private projects. From the research, there are several reasons why the government market is likely to be considered more potent than the private market. The first reason is the presence of the certainty of the development budget listed in the state budget both at the central level (APBN) and local level (budget) annually allocated for infrastructure development. This led the government market is seen as a market that is potentially provide revenue for the company. The other reason is high levels of risk in terms of uncertainty of payment, especially in the final moments of the completion of the project, also expressed by the companies as a reason to prefer the government market as a target market. This is because, the government must close their account by the end of year, so all yearly project must be paid before their fiscal year’s end. Different with private project who can transfer their expenditure or payment to the following years. For companies, it means they understand that they will get paid before the end of year. This surely create certainty to their perspective. Certainty means lower risk. It is why many companies seek their opportunity with the project provided by goverments.

Reason 4 : Less innovation

17. The Indonesian construction industry is often described as less innovative industries. This is due to the conventional characterisic of construction industry itself, which causes a lack of dynamism and innovation. Some say that the Indonesian construction industry has weak competitiveness. Environment is not supporting/enabling and lack of strategic direction to improve performance and competitiveness. Another view states that the Indonesia's construction sector was still shows lack of competitiveness with foreign actors construction services. This is due to poor productivity, low efficiency, poor quality of

construction, the accident rate is still relatively high, and almost no creativity and innovation. As a proof of the weakness of Indonesian construction innovation is, more foreign contractors working in Indonesia rather than national contractors are expanding abroad. This demonstrates the weak competitiveness of Indonesian contractors. While competitiveness is output on the innovation capability of a company. The cause of weak innovation can be grouped into five major causes namely the character of the industry itself should be done in a relatively short time, the rules are less supportive, low research culture, awareness on innovation is low, and reluctance to make changes.

18. Furthermore, a research by Indonesian construction expert (Mochtar: 2014) also discovered that the contractors have only average efforts to improve or innovate their service, mostly using the latest construction methods and management approach. Correlated to their policy, they are still national oriented and not international oriented in marketing their services, this may lead to the big question of their survival; their motivation to innovate is only average while their target market is only national market. Their attitude to use more intensive “fees” policy rather than both product innovation and promotion is also interesting. Big percentage of the responding contractors assumes these “fees” are regular marketing practices. One surprising research finding regarding pricing strategy in the Indonesian construction industry is that most (60%) respondents spend over 2% of their annual contract value for marketing expenditure.

19. So, companies tend to choose to bribe the bid committee or other bid participants to have them win their bid. Some said there isn’t a success collusion without the involvement of bid committee. It is therefore, in all suspected bid-rigging activity by competition commission always put the bid committee or work owner as one of the reported parties. Some of them did proved to set such collussion.

20. Therefore, the law on business competition should be enforced also as efforts for corruption eradication, at least as efforts for corruption prevention. This is very possible as the potency of corruption with bigger scale may be attributable to business actors who have some funds from their profits, which are very potential to be granted as illegal fees or bribes or other forms to policy makers. One of the characteristics of a government with high corruption level is strong relationship between those in power and business actors. Business actors who have access to power are usually provided with exclusive rights and other facilities with proportional compensation to the related officers. The business actors can then freely exploit consumers by excessive pricing in order to gain supernormal profits.

21. It is through these supernormal profits that business actors are able to set aside some quite big funds potential for corruption practices in order to maintain status quo or even business expansion. As such, those rogue officers will be stronger and richer by the grants of related business actors. Policies and regulations are used as tools to enrich themselves and maintain their power. It goes on with win-win principle to be a vicious circle that is not easy to break.

Reason 5 : High profit margin

22. Many experts have opinion to support Indonesia as a centre for growth opportunity. Asia Construction Outlook 2014 by Aecom puts Indonesia as the top three in the ASEAN region for the size of construction market (in addition to the Phillipines and Malaysia). They also characterised its profitability in Indonesia as ‘unchanged’ or ‘increasing’. Their survey results indicate that Indonesia, Thailand and Malaysia stand out as countries which respondents expect to become increasingly attractive to foreign suppliers of construction services in the next 12 months.

23. One suprising opinion we noted is the statement of unchanged or increasing profitability of construction market in Indonesia. At first we are not agree, but taking into account the statistic produced by Statistic Indonesia 2015, we have to confirm that fact.

Table 2 : Cost Composition (in million rupiah), 2014

	2011	2012	2013	2014
Gross income	435.543.546	510.172.764	589.742.861	665.269.841
Gross expenditure	255.707.040	301.900.098	347.873.247	391.704.770
Gross profit	179.836.506	208.272.666	241.869.614	273.565.071
Percentage of gross profit to expenditure	**41,29%**	**40,82%**	**41,01%**	**41,12%**

Source: Statistics Indonesia, 2015

24. The table highlighted that gross profit margin in construction is relatively stable at 40s% for the past four years. Gross income means company's revenue from contract value and other income. Gross expenditure consists of many items like material cost, equipment cost, and other costs. Even though the statistic has not been considered other costs like marketing or taxes, but they do have a great potency to the companies. Such high number of profit margin in avoidable can be an opportunity for certain people. In a word, they may 'distribute' the margin with other parties, such competitors, sub-contractors, and government. This is where collusion can easily be created, since everyone in a win-win environment.

4. How does technology affect the enforcement?

25. In order to prevent collution in public procurement, Indonesian government introduced the application of e-procurement to any procurement, including those of construction services E-procurement projects have been implemented since 2008, with the Presidential Decree No. 80/2003, which managed goods/services government procurement. The Decree explicitly regulates the procurement through e-procurement. With the Presidential Decree 17/2011 about the action of prevention and elimination of corruption instructed all of Ministry/Institution goods purchased must use "e-procurement" in as much as 75% of their purchases. For regional budget (APBD), 40% of goods purchase must be obtained via "e-procurement". To accelarate e-procurement implementation in Indonesia, the Government established the procurement service institution called independent e-procurement unit (LPSE). This unit is actually a work unit formed by the Ministry/Institution/College/State-Owned Enterprises and local governments to serve the Independent Procurement Unit (ULP) which will implement the procurement electronically. As of 2013 there are 1176 e-procurement independent units throughout Indonesia which consists of 543 e-procurement system provider, 40 e-procurement service providers and 583 autonomous e-procurement systems serving 33 provinces and 731 agencies.

26. Using such complex system for electronic procurement, the question left is the implementation of e-procurement reduces collusion in the construction? The answer is not yet, because number of complaint in collusion on the procurement of construction services is still high. It suggests that there has been no significant change in the use of technology with a reduction of collusion. But the introduction of technology do help competition authority to find or gather evidence or necessary documents. Acquisition of documents is needed because all the information or documents can be downloaded from the website of procurement unit (LPSE), especially with the good cooperation between the competition authorities with national agency procurement. Thereon, all documents can be obtained electronically.

27. Collecting evidence of collusion can also be easy, particularly by observing and comparing the electronic documents delivered in their procurement. Either in the form of similarity or mistakes in the procurement documents, as well as in the form of metadata derived from their offering documents. In addition, the time analysis on submitted documents over internet protocol address were also very helpful in

the process of proving collusion. In various cases of procurement in construction, these coordination models are still frequently performed.

5. Conclusion

28. Indonesian construction sector plays important role in any countries development, since it will affect most economic sectors and a maverick for infrastructure development which provide continous growth and standard of living. Their contribution to the economy is significant. However, this sector is prone to collusion due to several factors, like the significancy of the market, few specialized construction companies, severe competition in public procurement (specially those for small and medium companies), less innovation, and high profit margin in the sector. The existence of technology, in this sense, the use of electronic and integrated procurement system (including for construction) has not been able to reduce collusion in construction. But it did help competition authority to prove or investigate cases in construction services.

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