

**Problematizing the Indonesian Government's  
Facilitation of PPPs through the Project  
Development Facilities: Lessons from East Java**

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## List of Acronyms

AMDAL	Environmental Impact Analysis
COD	Commercial Operation Date
DGSIF	Directorate of Government Support and Infrastructure Financing
FBC	Financial Business Cases
IIGF	Indonesia Infrastructure Guarantee Fund
KPIP	Committee for Acceleration of Priority Infrastructure Delivery
LARAP	Resettlement Action Plan
MoF	Ministry of Finance
NGO	Non-Governmental Organization
OBC	Outline Business Cases
OECD	Organization for Economic Co-operation and Development
PPP	Public-Private Partnership
PDF	Project Development Facilities
PT SMI	PT Sarana Multi Infrastruktur
VGF	Viability Gap Fund

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## Abstract

This research paper looks at the effectiveness of Project Development Facilities as an intermediary in achieving two main goals; creating a successful PPP project and at the same time, building the capacity of the local government as the project owner.

The effectiveness of Project Development Facilities is being questioned since the appointment of state-owned enterprises tends to raise power implications between the national and the local government. The Umbulan Water Supply project in East Java will be used as the case study to analyze the implementation of the Project Development Facilities in practice.

Using qualitative interviews as the main data collection method, this research paper tries to argue that the conceptual framework of the intermediary is contradictory. On one side, the intermediary is effective in creating a successful PPP project, however, it also prevents the local government from having their own capacity for running a PPP project.

## Relevance to Development Studies

The provision of infrastructure highly depends on how the government can maximize its role to achieve a successful development by using the most effective scheme, including the Public-Private Partnership. However, due to the complexity of Public-Private Partnerships, the local government as project owner sometimes faces difficulties in running their project since there are gaps in capacities. Considering the importance of the capacity in the regional government, therefore, the research on the role of an intermediary is critical to the development studies as it expected to enhance the ability of the local government to provide the most effective public service delivery.

## Keywords

Intermediary, Public Private Partnership, Capacity, Indonesia, Local Government, Power

# Chapter 1

## Introduction

### 1.1 Background to the Proposed Study

The public-private partnership issue has gained public attention since President Widodo of the Republic of Indonesia has started to massively promote foreign investment to the country. In supporting these ambitions, the Government of Indonesia has reformed thirteen policies on investment and tax incentives in order to attract private investments (PWC Indonesia, 2018). The overall policy reform aimed to cut bureaucracy and provide a legal framework to attain business certainty. As a result, Indonesia's ease of doing business has gone up from rank 120 to 73 in 2018 (World Bank, 2018). As another impact of the investment policy reform, Indonesia has also made significant progress in supporting the Public-Private Partnership (PPP) delivery in Indonesia. The framework for PPP delivery was established by presidential decree number 38 of 2015 (Cabinet Secretary of Republic Indonesia, 2015).

Based on this decree, PPP in Indonesia is defined as:

Collaboration between the government and private bodies in the provision of Infrastructure services for the public interest and based on agreements between the Government and the private sector that focuses to the principle of risk-sharing among the parties.

#### 1.1.1 History of Public-Private Partnership in Indonesia

The development of the economy and infrastructure in Indonesia can be structurally explained by how the government of Indonesia dealt with the economic crisis that hit Indonesia in 1998. The plight of 1998 brought Indonesia to extreme currency depreciation and led to other unfortunate economic conditions such as high unemployment, an unstable business climate, and a surge in foreign debt (Sadli, 1998). In addressing the effects of the crisis, it made sense for the government of Indonesia in the early 2000s to only focus on the economy by improving the business climate, handling foreign debt, and providing welfare to its citizens. The 'recovery mode' continued until President Yudhoyono's administration in 2004 – 2014. Under his administration, several efforts in improving the economy have been made including the regulation regarding PPP in 2005 and the government guarantee policy in 2010. However, as the administration still had to focus on the crisis recovery, the PPP regulatory framework did not work well as it was expected. There was a tiny amount of successful PPP projects and there was no significant interest generated from the project owners (Ministry of Finance Republic of Indonesia, 2017).

A significant change happened in 2014 when President Widodo took the presidential seat. He completely shifted the focus of Indonesia's administration from 'crisis recovery' mode to 'building infrastructure' mode (National Development Planning Agency, 2014). Despite the limitation of the country's budget, he was still eager to build the infrastructure by any means, including PPP as the financing option. The role of Mrs. Mulyani as the former managing director of the World Bank, who currently serves as the Minister of Finance, more or less has affected the bold urge to implement the PPP scheme in Indonesia. As a result, the Government of Indonesia took efforts to refine the PPP regulatory framework in order to improve the attractiveness of Indonesia's PPP projects, such as (Ministry of Finance Republic of Indonesia, 2015):

1. Presidential Regulation Number 38/2015 issued by the government as replacement of presidential regulation number 67/2005. The regulation covers the cross-sector regulation framework for implementing PPPs in the provision of infrastructure. The amendments have provided for a clearer, more detailed, and unsolicited proposal, user charge, availability payment, cooperation agreement, and other forms of government support and guarantees.
2. Presidential Regulation Number 78/2010 on government guarantees in PPP infrastructure project, which was then enhanced by the Ministry of Finance regulation number 8/2016.

As a follow-up, some government organizations have also been assigned to dedicate their support to the acceleration of PPP programs such as PPP Joint Office, PT Sarana Multi Infrastruktur (SMI), Indonesia Infrastructure Guarantee Fund (IIGF), and the Committee for Acceleration of Priority Infrastructure Delivery (KPPIP). The committee has also set a framework where there should be four stages components that PPP projects in Indonesia need to meet in order to achieve a successful PPP project that is in good standing, they are (The Committee for Acceleration of Priority Infrastructure Delivery, 2017):

1. Planning that consists of budgeting, identification and determination, decisions on PPP plans, and categorizing PPPs;
2. The preparation that consists of the development of the preliminary study and final study, public consultations, submission of support and government guarantees;
3. The transaction that consists of scoping market interests, determination of location, procurement of business entities, contract signing, and funding acquisition; and
4. The implementation including detailed engineering designs, construction, operations and maintenance, and final handover after the concession period.

Unfortunately, the implementation of the PPP project in Indonesia has been slow because of constraints at various stages of the project, especially in planning, preparation and transaction stages. For example, regional governments often cannot provide high quality of preliminary preparatory work and develop an appropriate project structure due to the lack of capacity, knowledge, and funding (Aditya, 2019).

## 1.2 Project Development Facilities in a Nutshell

The constraints at various stages of PPP triggered the government of Indonesia to perform a policy reform in order to accelerate the development of PPP projects. In assisting the local government to produce proper project preparations and transactions, on 31 December 2015, the government of Indonesia reformed its policies by issuing Minister of Finance decree 265/2015 about project development funds to be updated later in Minister of Finance decree 73/2018. The policy provides the local government with a facility to support the project preparation and infrastructure in the PPP project.

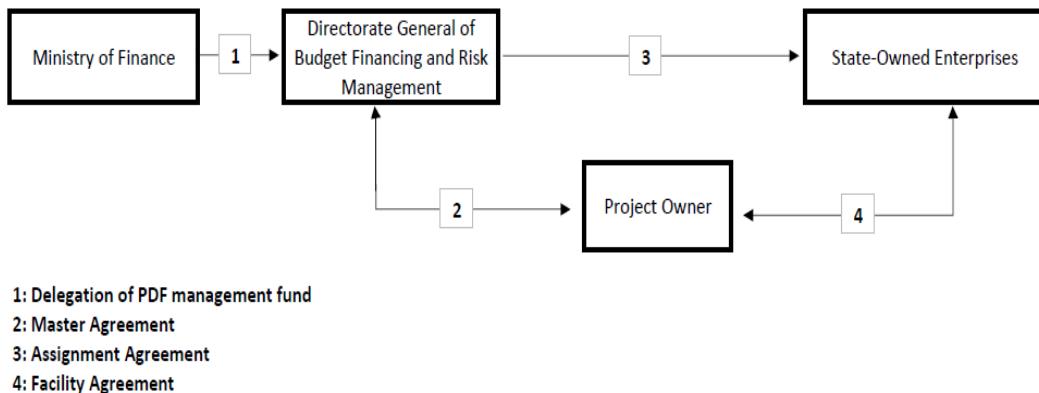
Article 9 paragraph 3 stated that:

The Ministry of Finance will provide the strategic direction for the obstacles that affect the implementation of facilities and the PPP projects – which is not able to be resolved by the regional government.

The Ministry of Finance will also appoint the state-owned enterprises in order to assist the regional government, as stated in article 15:

The Ministry of Finance, Director General of Management Financing and Risk, can provide assignments for a State-Owned Enterprise under the provision of legislation to implement facilities with the intention of creating a more effective and efficient project.

**Figure 1.1**  
The Overview of Project Development Facilities



Source: PT SMI Presentation

In practical terms, the Project Development Fund was transformed to become Project Development Facilities (PDF). It is defined as government support to assist the local government (the project owner) in the preparation and transaction until the project reaches the financial close. In translation, the Ministry of Finance instructs an intermediary body to assist the local government to 'get things done.' As seen in figure 1.1, the Ministry of Finance through its Directorate General of Budget Financing and Risk Management has an agreement with the State-Owned Enterprises and the project owner to provide the Project Development Facility. This facility is aimed to create project pipelines that are ready to be financed will finally become more attractive to private investors.

As referred above, the Ministry of Finance has prerogative rights to assign the state-owned enterprises as an intermediary to provide the service to the local government. The cost recovery of the state-owned enterprises is obtained from the compensation of basic facility service cost plus margin. In the end, there is no facilitation cost recovery from the bid winner (investor).

### 1.3 Research Problem

As an intermediary, Project Development Facilities aim to achieve two main goals (Ministry of Finance 2019, personal interview)<sup>1</sup>; (1) be effective in creating a successful PPP project, and (2) be effective in building the capacity of local government. However, the appointment

<sup>1</sup> Personal interview with Deputy Director for PPP Project Preparation, Ministry of Finance, in Jakarta 24 July 2019

of an intermediary to achieve those goals seems to be problematic. The fact that some state-owned enterprises will represent the Project Development Facilities will likely lead to power implications between the intermediary itself as a representation of the national government and the local government as the project owner. It will impact the effectiveness of Project Development Facilities themselves in supporting the local governments in achieving a successful PPP project while at the same time building their capacity. In fact, the points of effectiveness became the primary consideration during the policy formulation and was stated clearly on Minister of Finance decree 73/2018 article 9 paragraph 15.

Considering the power implications of the Project Development Facilities, I have two main hypotheses for this research paper. Firstly, an intermediary with power implications is effective in supporting the local government in accelerating the PPP project. The definition of acceleration itself is based on whether the PPP project has completed the project and received the project financing. Secondly, I argue that the intermediary with power implications will eventually prevent the Project Development Facilities in building the capacity of the local government. This conclusion is drawn from the dependency of the local government that still seeks support from the national government any time they run a PPP project.

## 1.4 Research Question

### **Main research question:**

To what extent is the Project Development Facilities effective in achieving the Indonesian government's goals of creating successful PPP project while at the same time building the capacity of the East Java government?

### **Sub questions:**

- What is the role of Project Development Facilities in the PPP projects?
- How effective is the intermediary in PPP as measured by having the proportional risk sharing, building a strong private consortium, gaining political support, and creating transparent procurement as the success factors of PPP?
- What is the implication of the Project Development Facilities on the capacity of local government?

## 1.5 Justification of the Research

This study has a leading objective to analyse the role of Project Development Facilities as an intermediary in assisting local governments in achieving successful PPP projects while at the same time building their capacity. The study takes a look at the Umbulan Water Supply Project in East Java as the first project that received the Project Development Facilities assistance.

The findings of this research is expected to contribute to academia and social relevance. In terms of academia, the results of this research will contribute to the literature gaps in the role of the intermediary in PPP, specifically in the Indonesian context. In terms of social

relevance, this research will be useful as constructive feedback for the practice of an intermediary in assisting the local government in achieving the successful PPP project and emphasizing the importance of the sustainable capacity building.

## **1.6 Organization of the Paper**

The journey to prove my hypotheses will pass through several sections. In the first chapter, I provide the context of the problem of Project Development Facilities in PPP project in Indonesia. In addition, I also present the case study of my research paper—the Umbulan Water Supply project. In the second chapter, I construct the theoretical framework for the analysis of my arguments. The enabling condition for PPP is explained as the basis for my review of whether the Project Development Facilities as an intermediary contributes to the success of the PPP project. Later, I present the intermediary framework of PPP as the foundation to argue whether the Project Development Facilities are effective in both accelerating the PPP project and building the capacity of local governments, using indicators from capacity frameworks. The third chapter mainly presents the stakeholder analysis in order to provide a sense of the relationship between stakeholders and their power relations. This analysis is essential to contextualize the argument in the later chapters that relate to the power implications of an intermediary.

The fourth chapter argues that the power implications of the Project Development Facilities is even effective in assisting the local government in accelerating PPP project under four leading indicators: risk allocation and sharing, a strong private consortium, political support, and transparent procurement. The fifth chapter argues that the Project Development Facilities prevent the local government in building their capacity by using analytical, operational, and political indicators. Finally, the last chapter concludes the findings and provide three principal recommendations. The connectedness between chapters is designed to make it easier for readers to structure the research paper.

## **1.7 Methodological Consideration**

### **1.7.1 Methods**

In terms of data collection, I used semi-structured interviews to verify assumptions of the effectiveness of Project Development Facilities by understanding the perspectives of each stakeholder. During the field trip, I conducted four interviews as a representative of four organizations. The interviewees were selected based on the consideration of their relevance to the implementation of Project Development Facilities. Firstly, I interviewed staff from the Ministry of Finance as the policymaker. This interview aimed to understand the perspective of the Ministry of Finance in formulating and implementing the 265/2015 Minister decree. The meeting took place in the Ministry of Finance office in Jakarta and lasted for around 1,5 hours with fifteen questions asked. Secondly, I interviewed staff from PT SMI who oversee the implementation of Project Development Facilities. The primary purpose of conducting this interview was to understand the structure of Project Development Facilities and their interaction with the East Java government. With ten main questions asked, the conversation lasted for 1,5 hours and was took place in the PT SMI office in Jakarta.

Most importantly, I interviewed a representative of the East Java government and Umbulan water supply committee. As the beneficiaries of the Project Development Facilities, this interview was crucial to understand their thoughts on the effectiveness of the facility, whether it has helped or has not helped them in accelerating the PPP projects in East Java. Due to his rigorous schedule, this interview was conducted on the weekend in a café in Surabaya with seven leading questions asked. Lastly, with assistance from the East Java government, I secured an interview with the investor of this project: PT Meta Adhya Tirta Umbulan. The primary purpose of this interview was to further learn their rationale for investing in the Umbulan Water Supply project and determining whether the Project Development Facilities played a significant role in assuring them to invest. The interview was conducted in a café during their lunch break in Jakarta.

After obtaining primary data from the interview, I also have acquired secondary data from policy reports, articles, journals, and newspapers, which are related to the Umbulan Water Supply project. Notably, I received relevant policy documents from the Minister of Finance about the Project Development Facilities. I also received significant amounts of materials from PT SMI about the implementation of Project Development Facilities in general and for the Umbulan Water Supply project. Finally, I acquired the Feasibility Studies to understand the complete project information for Umbulan Water Supply.

In terms of generating the output of the research, I used a crucial case study methodology. Gerring (2007) argued that crucial case methodology can be used to prove the case that is least-likely or most-likely to exhibit a specific outcome. The Umbulan Water Supply project in East Java will be used as a sample to determine how effective an intermediary works in accelerating the PPP project and building the capacity of the local government. As I have presented my initial hypotheses for this case, therefore, the crucial case study methodology is a valuable tool to explore the research proposition that is currently assumed. Ultimately, I chose the theoretical framework that would help analyse the problems. In specific, I am interested in finding out how the conceptual frameworks describe successful PPP project and how the intermediary would be useful to achieve this while at the same time closing the capacity gap in PPP areas.

### **1.7.2 Strategy and Limitations of the Research**

I have been involved in PPP initiative in Indonesia since 2016, when I worked for the British Embassy in Jakarta. Therefore, the process of data collection for this research relied on my network from my previous job, where I was frequently in contact with the Ministry of Finance, PT SMI, the chief of Umbulan Water Supply in East Java, and the investor. However, I also bear in mind my position as an independent researcher/student for this study. I position myself to be as neutral as possible and ensure that the data collection process is merely for my research project which does not represent any other organization.

The limitation and challenge of this research are the accessibility of the primary information from the Umbulan Water Supply project as a case study. Many of the project documents are categorized as classified documents and are quite difficult to obtain. Therefore, in order to receive specific information I had to make frequent requests to my contacts in the relevant organization. To close the information gap, I was forced to depend on incomplete public information.

Another limitation during the data collection was the fact that the project has reached the financial close and it has been constructing for four years. Therefore, it is quite challenging to access the people who worked for this project besides the person in charge. Most of them have resigned from their organization, left their position, or were reassigned to another job. Accordingly, I only interviewed four people from the relevant stakeholders: Ministry of Finance, the Umbulan water supply project committee, PT SMI, and the investor of the Umbulan water supply project. Albeit the number of interviews may seem limited, but I was able to interview the right people within every stakeholder who were involved and understand the case. In the end, I found my data collection process was indeed useful and able to grant me the appropriate data as the basis for my analysis.

# Chapter 2

## Constructing the Theoretical Framework

To better understand the role of the intermediary in accelerating the PPP project and enhancing capacity, there are two kinds of literature that need to be presented in this chapter: research on Public-Private Partnership and Intermediary. Since it is quite challenging to find the intersection between both subjects, then the review of the relevant literature will be done separately. The discussion on the conceptual framework of capacity is also necessary to be conducted as the measurement of the intermediary model.

### 2.1 Enabling Condition for Public-Private Partnership

The concept of Public-Private Partnership (PPP) has been developing since the late 1990s. Following the 2008 global financial crisis there was more interest in adopting PPP as an alternative to seek funding for development. The main arguments for the Government in choosing the PPP scheme was to tap into the private sector for its expertise and its capital without losing the ownership of infrastructure projects. Given the crises, it made sense that many academicians and researchers increased their interest in studying PPP, which is highlighted by the large number of literature written in the past years.

The definition of Public-Private Partnership itself has been varied—depends on the context of the research. One of the main definitions of PPP is the allocation and risk-sharing between the public and private parties (McQuaid and Scherrer, 2010). These risks are necessary to be identified from the initial project plan and then allocated carefully to have a better mitigation technique. The partnership between those entities are usually for a long-term contract—over a ten year period. Therefore, a stable and eternal relationship is crucial to achieving effective operation of the PPP project.

Following the development of the PPP concept over the past 30 years, the scheme has been implemented in some structure, such as (Osei-Kyei and Chan, 2015); Build - Operate - Transfer (BOT), Design – Build – Finance - Operate (DBFO), Build – Transfer - Operate (BTO), Design – Build – Operate – Maintain (DBOM), Build – Own – Operate - Transfer (BOOT), Operate and Maintain (O&M), Design and Build (DB), Build - Lease and Transfer (BLT), Design Construct , Manage and Finance (DCMF), Design – Construct - Manage and Finance (DCMF), and many other structures and acronyms.

Some scholars provide a comprehensive argument about the success factor in PPP projects such as Babatunde, Opawole, and Akinsiku (2013). They argued that transportation such as roads, rails, and airport construction, provision of electricity and water, and environmental and natural resources projects, are the sectors that work best using the PPP scheme in developing countries. In order to achieve the best project result in the transportation sector, there were nine critical success factors identified, such as competitive procurement process, thorough and realistic assessment of the cost and benefits, favourable framework, appropriate risk allocation and risk sharing, government involvement by providing a guarantee, political support, stable macroeconomic condition, sound economic policy, and the availability of a suitable financial market.

On another side of the debate, some scholars provided research on the practicality of the implementation of PPP projects around the world. Klijn and Teisman (2003) in *Institutional and Strategic Barriers to Public-Private Partnership: An Analysis of Dutch Cases* found that the public and private parties in the Netherlands are not able to develop a good partnership in executing government projects. The complexity of actor composition, institutional factors, as well as strategic choices of public and private actors have become the main reason why the partnerships did not work well as expected.

In particular for the Indonesian context, Kurniawan (2014) argued that there are some significant issues about the capacity of the local government in executing PPP projects. The capacity refers to financial knowledge and bureaucratic understanding of PPP. Moreover, Kurniawan argued that the coordination issue frequently existed as PPP require the involvement of many stakeholders.

Other scholars, Abednego and Ogunlana (2006), argued that proper risk allocation is vital to achieving excellent project governance to perform PPP in Indonesia. The appropriate risk allocation itself has eight criteria that need to be completed such as the right decisions at the right time, contract fairness, information transparency, responsive, continuous project control and monitoring, equality, effectiveness and efficiency, and accountability. Especially for the infrastructure project, the assessment of risk allocation should also consider the project management process and its output.

Finally, Osei-Kyei and Chan (2015) would be best to conclude the enabling condition for PPP. They conducted an academic review on the critical success factors for public-private partnership projects from 1990 to 2013. The result indicated that there were five most reported of critical success factors in PPP during that time:

1. risk allocation and sharing;
2. strong private consortium;
3. political support;
4. transparent procurement; and
5. community/public support

These five critical success factors in PPP are useful as the basis for the analysis to determine if the Project Development Facilities was effective in accelerating the Umbulan Water Supply project in East Java. In addition to that, Kurniawan's (2014) argument on the capacity issue will also be useful to integrate the framework of PPP and intermediary.

## 2.2 Intermediary Framework in Public-Private Partnerships

As mentioned in the literature above, one of the problems with Public-Private Partnerships implementation in Indonesian is the lack of capacity of the local government regarding substantial and technical knowledge of PPP. Moreover, it is appropriate to further discuss the framework of the intermediary as it offers the conceptual model to solve the capacity problem in the general policy implementation. In the end, a connection between the intermediary and PPP context in Indonesia will be drawn to contextualize the challenges.

The concept of an intermediary refers to various organizational arrangements that support and enable collaboration between the different actors and applying different processes

(Schneider et al., 2014). Intermediaries facilitate the related process by using three main channels; structural arrangement, mediating approaches, and duration. The outcomes of such intermediation depend on the skills and competence of the intermediary, their context-specific knowledge, and expertise in assisting multiple agents within their network. The study on intermediaries has been conducted and used for several contexts including policy entrepreneurship (Wihlborg, 2014), consulting (Bessant and Rush, 1995) and human resources development (Wallo et al., 2012).

In a study about intermediaries and the different roles of consultants, Bessant and Rush (1995) identified the key to the mediation of relationships. They set out the role of consultants in four different ways; (1) direct transfer of expertise, (2) experience sharing, (3) marriage broker, and (4) diagnosis. They found that consultants bridge the interaction between clients and their demand with the supply side. For example, the consultants mediate the client's needs for new technology information by providing critical sources of knowledge. Most of the time, the consultants share best practices resulting from experiences in other countries.

In supporting the argument, Tsukamoto and Nishimura (2006) explained that intermediary organizations with an advocacy purpose could play an essential role in solving the problem created by contracting relationships. It is also beneficial as they could have a direct influence on government policies including contract rates, funding levels, and procurement processes. They also need to have the advocacy and networking roles in order to solve the contractual relationship problem that may occur. As a consequence, an intermediary organization must engage with the local government in setting up and implementing policies for the relevant sector (Osborne and Ross, 2001).

Additionally, Laur et al. (2012) defined an intermediary as an entity that has a unique institutional role that provides resources such as business information, shared infrastructure, and knowledge. Therefore, an intermediary can be defined as a mediator of interactions between parties by its systemic status (Wallo et al., 2012). Schneider et al. (2014) also described an intermediary as a learning center that plays multiple roles, including meeting place, broker and engine. It is then argued that an intermediary for development could play a passive or active role.

The conceptual frameworks of intermediaries are also used for capacity building. Schneider et al. (2014) argued that intermediary plays the role of bridging a difference quality gap within a specific system among various stakeholders. They even further claimed that intermediaries exist due to a discrepancy in the relation between the quality that is expected in the policy-making and practice. The disparity exists both in the centralized structure like a country council as well as in the more extensive system with similar entities such as social services with its relevant actors, including state, private entity and non-profit organization. In the end, intermediary provides tools to build a learning environment between relevant stakeholders with better opportunities to participate. By this, it is expected that intermediaries will develop regulatory standards to improve the quality of organizations. It can also obtain context-specific knowledge on how to improve the quality of policymaking at the grassroots level. In order to do that, intermediaries could use the variation of resources from external consultants to the in-house development units in a larger organization.

Schneider et al. (2014) also proposed a specific conceptual model that may explain how an intermediary can help solve the problems with three characteristics which are as follows:

1. Structural Position

The structural situation of an intermediary is linked to its position in the network of actors in which it is embedded with contextual information. While intermediary may have various roles within the network, previous studies on intermediaries tended to focus on improving tasks and supporting changes (Howells, 2006). It is supposed that an intermediary bridges frequent activity and the organization as well as the institutional setting of these practices. Therefore, an intermediary will introduce and link relevant actors to improve its quality practices in the areas of policy, structure, and processes.

The structural position of intermediaries could be found from a weak to a robust scale. An intermediary with a formal position in ownership, resources, external knowledge, and services providers will enable intermediaries to achieve profound network penetration and accessibility. Thus, a strong structural position will lead to detailed knowledge about the relationships among actors. The robust information and server frameworks are another component of a robust structural position. The transfer of knowledge between actors depends upon structures that permit the transmission of information, including quality registers, health records, and infrastructure measurements. Finally, a weak structural position, by contrast, defined in terms of informal position, lack of network access to the actors concerned, lack of data infrastructure, and contextual awareness of all actors involved.

2. Mediating Approaches

As discussed above, the structural position of an intermediary is mostly related to the way it operates in various processes. However, the critical role of an intermediary in mediating approaches is to build and transfer relevant knowledge. It is also important to create understanding as the ideas which are established in various contexts must be translated and changed for specific purposes. Then, the intermediary has a role as a broker for the search of new concepts, amplifies other types of ideas and filters them out.

An intermediary can either act as an actor to interpret and reinterpret the change or an entity that disseminates a fixed set of practices, allowing them to move through without alteration (Whittle et al., 2010). The previous study has shown that the central role in achieving effects and impacts is the adaptation and translation of concepts and methods (Andersson et al., 2013). Translation, shifting, and seeking for the objects are described as a dynamic mediating approach. For instance, the intermediary could traduce information from different stakeholders to endorse the changes and finally achieve its purpose. Meanwhile, the passive methods, by contrast, are rigid and accept the ideas as they are.

3. Duration of an Intermediary Support

The term is one of the main characteristics of an intermediary as it could differ over various periods. In comparison to others that have a more distinct beginning and ending such as innovation, Bhuiyan and Bagel (2005) defined the duration of an intermediary based on the improvement of the quality management that tries to evolve into continuous processes. The long period of the intermediary is described as efforts to support the process beyond the limits, meanwhile, the short duration refers to a facility that is given only to some part of the process.

Although the above model is proposedly used for general policy intermediary, however, I found the model is also useful to explain the condition of Project Development Facilities for PPP project in Indonesia. The similar gap between the practice of Project Development Facility in the field and the expectation of the Ministry of Finance as the policymaker creates a bold connection to fit the intermediary policy framework in the Indonesian context. The structural position model will be specifically used to analyse the role of a powerful intermediary to support the success of the PPP project (chapter four). Meanwhile, the mediating approach will be used to analyse the significance of an intermediary in building capacity of local government (chapter five). Then the duration model will be used to support the argument of an intermediary process.

Lastly, it is also essential to acknowledge that there is still a substantial gap in interpreting the role of intermediary specifically for the PPP project. Regarding that matter, the study on the role of an intermediary in accelerating PPP projects and developing the capacity of the local government is necessary.

### **2.3 The Capacity for an Intermediary in Public-Private Partnerships**

As the main point of an intermediary is to close the quality gap by enhancing the capacity, thus, it is also essential to understand the concept of the capacity itself. In general, capacity is an important aspect of improving the performance of the public sector that will lead to a great development initiative. Grindle and Hilderbrand (1995) defined capacity itself as the ability to perform an appropriate task effectively, efficiently, and sustainably. Based on these characteristics the effectiveness of performing tasks refers to the ability to achieve a particular purpose. Meanwhile, the efficiency of completing tasks refers to the increase in productivity, which is related to the input or resources. Lastly, the sustainability point refers to the subject that could always generate resources even though the actual goals are changed.

It is also argued that the capacity of the government is crucial to create an effective government performance and the institutional circumstances for the market-oriented economic countries. Similarly with Grindle and Hilderbrand, Fukuda Parr et al. (2002) also defined capacity as the ability to perform a specific function, solve the problem as well as set and achieve a purpose. However, Fukuda Parr et al. (2002) emphasized that the capacity of local government and institutions seems to be less adequate to face the development challenges nowadays and to perform effective governance. This argument is also important to be taken for consideration as the local government capacity also contributes to the sustainable capacity at the national level.

In order to further understand the policy competencies and capabilities, Wu et al. (2015) created a conceptual framework for these areas. They argued that the improvement of capacity in the public sector needs the utilization of relevant policy knowledge, skills to encase options, efficient communication, and strategic stakeholder management. Based on this premise, Wu et al. (2015) have categorized the analysis of capacity based on three areas which are as follows:

**Table 2.1**  
Categorization of Capacity

Level of capabilities	Skills and Competences		
	Analytical	Operational	Political
Individual	Individual analytical capacity	Individual operational capacity	Individual political capacity
Organizational	Organizational analytical capacity	Organizational operational capacity	Organizational political capacity
Systemic	Systemic analytical capacity	Systemic operational capacity	Systemic political capacity

Source: Wu, et al. (2015)

Based on table 2.1, there are three main levels of capabilities; individual, organizational, and systemic.<sup>2</sup> Within the individual level of capabilities, there are also three main skills and competences; analytical, operational, and political. Firstly, the analytical capacity on the individual level requires the ability to collect and process data on every aspect of policy development, decision-making, execution, and evaluation by the government official. Secondly, the operational capacity on the individual level refers to the ability of the government official to perform essential governance functions which is a vital determinant of the government's overall policy. Lastly, the political capacity on the individual level refers to the ability that requires political knowledge and experience by defining key players, understanding the relationships between their fundamental interests and ideologies. The individual should also understand the political interaction between competing actors and interests required for an agreement to be concluded. In the Indonesian context, these categorizations of capacity are useful to prove the assumption of effectiveness in Project Development Facilities in building the capacity of the local government.

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<sup>2</sup> For the relevance of this research paper, I only explain the individual capacity, as the organizational and systemic capacity will not be used as the tool of analysis.

# Chapter 3

## Contextualization of the Case & Stakeholders Analysis

The context of Project Development Facilities as an intermediary would be best described by the Umbulan Water Supply project in East Java. As the first project which was assisted by the Project Development Facilities, there are a lot of interesting points that illustrate its power implications. This chapter specifically explains the contextualization of Umbulan Water Supply project and the power diffusion amongst the relevant stakeholders which shapes their relationships.

### 3.1 Study case: Umbulan Water Supply Project in East Java

This case study aims to contextualize the role of Project Development Facilities in practice. Particularly for the Umbulan water supply case, the Project Development Facilities have been applied and assumed to be effective in making this project work. Interestingly, the implementation of PDF in this project was set as a benchmark of a ‘successful’ PPP project that needed to be replicated in other projects (Insyafiah 2019, personal interview)<sup>3</sup>. The Umbulan Water Supply Project in East Java Province, Indonesia was designed to provide safe and affordable water services to society. This project was initiated in 1970s but only tendered in 2010 then procured five years later. Primarily, the Umbulan Water Supply project has goal to provide service to 1.3 million people who lives in five regencies with a 93-kilometer transmission line costing Rp 2.05 trillion dollars or equal to \$143 million USD.

After conducting a financial study, it is found that the combination of private investors and the local government could only cover  $\frac{3}{4}$  of the project financing. In order to close the market-price gap, the Ministry of Finance provided a viability gap funding that valued around Rp818 billion (\$57 million USD). The Ministry of Finance also appointed PT Sarana Multi Infrastruktur through the Project Development Facility, to assist the East Java Provincial Government during the project preparation and transactions process. A consortium of PT Medco Gas Indonesia and PT Bangun Cipta Kontraktor won the tender for this project. Then the consortium created PT Meta Adhya Tirta Umbulan to focus on this project and started construction in 2017. The project concession period is determined for 25 years and the revenue stream comes from user fees.

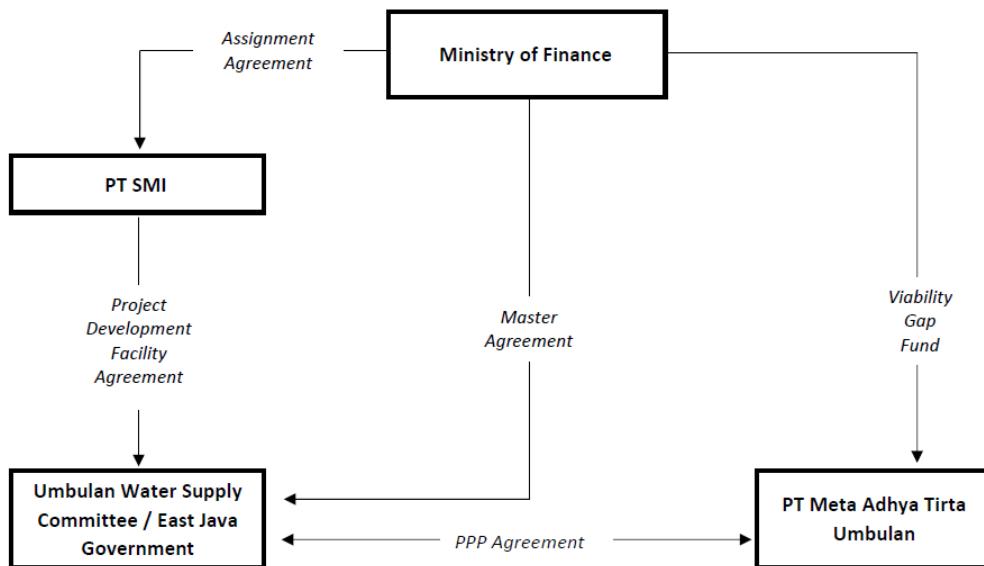
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<sup>3</sup> Personal interview with Deputy Director for PPP Project Preparation, Ministry of Finance, in Jakarta 24 July 2019

## 3.2 Stakeholders Analysis

Figure 3.1

Contextualized Project Structure



Source: author's elaboration

Figure 3.1 explains the contextualized project structure that consists of the main stakeholders in Umbulan Water Supply project. The analysis of each stakeholder and its relations to the others are explained as follows:

### 3.2.1 The Ministry of Finance

As a tangible follow up from the Minister of Finance Decree 78/2018, the Ministry of Finance established the Directorate of Government Support and Infrastructure Financing (DGSIF) under the auspices of the Directorate General of Financing and Risk Management. The DGSIF plays a role in managing the provision of facilities and government support, as well as facilitating local government in preparing and conducting PPP project transactions (Ministry of Finance, 2019). This directorate also has the authority to decide the eligibility of projects to be assisted by the Project Development Facilities. In the end, this directorate has prerogative rights to appoint a state-owned enterprise to provide Project Development Facilities to the local government with the details in article 14 of Minister of Finance Decree 73/2018 as follows:

Assigned state-owned enterprises can correctly work with the International Organization and/or other parties who have expertise in PPP and/or related sectors in order to conduct preparation and transaction advice according to the national regulation.

Based on figure 3.1, the Ministry of Finance has the most significant power in the Umbulan Water Supply project. The Ministry has three different agreements with each stakeholder. In terms of assigning PT SMI to provide the service, the Ministry of Finance has Assignment Agreement with PT SMI that consists of budgeting, expected output, and duration of the

service (PT SMI 2019, personal interview)<sup>4</sup>. As the one who holds the budget, the Ministry of Finance has the authority to control PT SMI to provide assistance that is in line with their interests.

Besides the Assignment Agreement with PT SMI, the Ministry of Finance also has a Master Agreement with the East Java government that consists of some requirements that East Java government should fulfil during the Project Development Facilities. The agreement regulates a lot of aspects including practicality; the East Java government should create an ad-hoc team for this project and they should always attend the meeting with PT SMI, take a strategic decision based on the PT SMI's recommendation, be cooperative, and much more (Ministry of Finance 2019, personal interview)<sup>5</sup>. The very details and practical agreement between the Ministry of Finance and East Java government show the diffusion of power between both parties and how the Ministry of Finance controls the facilities.

Lastly, the controlling role of the Ministry of Finance extended to the investor, PT Meta Adhya Tirta Umbulan. Both parties signed a Viability Gap Fund (VGF) agreement, which has the purpose of increasing the bankability of Umbulan Water Supply project by closing the gap between the market price and affordability cost of buyers. The amount of assistance that pieces of literature ministry of Finance provided is Rp 818 billion (\$80,000 USD).

### **3.2.2 PT Sarana Multi Infrastructure (SMI)**

PT SMI is a state-owned enterprise that was founded in 2009 with a thorough stock held by the Ministry of Finance. The organization has a mandate to support the development of infrastructure in Indonesia through some interesting features. Besides serving as the infrastructure financing, PT SMI also focuses on the development of PPP by providing the project development facilities (PT SMI, 2018).

As an intermediary in Umbulan Water Supply project, PT SMI holds the coordination roles to all stakeholders, including the Ministry of Finance, East Java government, and the investor (Ministry of Finance Republic of Indonesia, 2016). PT SMI signed a Project Development Facility Agreement with the East Java government. The agreement consists of the detail of the services, including providing technical, financial, and legal consultants. It also mentions that PT SMI should always be ready for an accompaniment to the East Java government in every occasion (PT SMI 2019, personal interview)<sup>6</sup>.

### **3.2.3 East Java Government/Umbulan Water Supply Committee**

The East Java provincial government is the project owner of Umbulan Water Supply project. Under the supervision of Governor of East Java, an ad-hoc committee of the Umbulan Water Supply project was created in order to focus and accelerate this project. This committee aimed to cover any operational work for Umbulan Water Supply projects including project

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<sup>4</sup> Personal interview with Deputy Project Manager for Umbulan Water Supply project, PT SMI, in Jakarta 19 July 2019

<sup>5</sup> Personal interview with Deputy Director for PPP Project Preparation, Ministry of Finance, in Jakarta 24 July 2019

<sup>6</sup> Personal interview with Deputy Project Manager for Umbulan Water Supply project, PT SMI, in Jakarta 19 July 2019

preparation, conducting the auction, choosing and appointing the investor, project transaction, contract negotiations, and much more. Under this basis, the Umbulan Water Supply Committee is the primary stakeholder in determining the success/failure of the project. As the main organ in the project, the East Java government and PT Meta Adhya Tirta Umbulan as investor signed a PPP agreement for the project valued at Rp 2,3 trillion, equal to \$170 million USD. The agreement regulates the PPP type which is the Build Operate & Transfer of new facilities (production, transmission & offtake system). It also set the construction period of 3 years from the effective date of the PPP agreement in 2016 as well as 25 years concession period from the commercial operation date (COD) (PT SMI, 2018).

East Java government plays a crucial role in the Project Development Facilities as the beneficiaries as well as the project owner. As the project owner, the East Java government is supposed to have a higher authority in deciding everything during the project preparation and transaction. However, as the consequence of having the Project Development Facilities, the East Java government no longer has single authority of the project. The reduction of project ownership and the intervention from the national government through this facility is something that the East Java government had to face.

### **3.2.4 PT Meta Adhya Tirta Umbulan**

PT Meta Adhya Tirta Umbulan is a company formed by a consortium of PT Medco Gas Indonesia and PT Bangun Cipta Kontraktor as the winner of Umbulan Water Supply Project bid (Ministry of Public Works, 2016). PT Bangun Cipta Kontraktor itself is a long-established company that serves the construction industry, including sky-scrappers building, harbours, piers, bridges, and roads. They also have 23 years of experience in irrigation structures and dams. Lately, the company has grown into an investment company in Public-Private Partnerships in water management (PT Bangun Cipta Kontraktor, 2019). As a condition of the bid for Umbulan Water Supply project, the potential company must possess a minimum of Rp 2 trillion rupiah (\$150 million USD) in assets—therefore, PT Bangun Cipta Kontraktor engaged PT Medco Gas Indonesia to form a consortium.

PT Medco Gas Indonesia is an oil & gas exploration and production company. The company has not only been developing its business in gas exploration and production, but also providing services in the integration of the gas value chain, high-speed diesel marketing, Liquefied Petroleum Gas (LPG) processing, storage and transportation for the last 30 years. Specifically for the Umbulan Water Supply Projects, PT Medco Gas Indonesia will be responsible for the water piping meanwhile PT Bangun Cipta Kontraktor will be accountable for the operational and technical part of water irrigation.

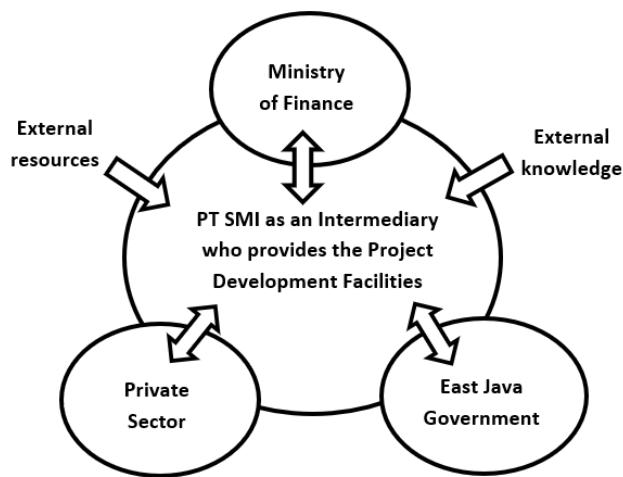
# Chapter 4

## Project Development Facilities for Creating a Successful PPP Project: Are they Effective?

Relevant to what has been described in chapter three about the diffusion of authority and power control, this chapter will use Schneider et al.'s (2014) points on the structural position to explain the role of an intermediary in creating a successful PPP project. The success criteria of the PPP project itself consists of five indicators which include a proportional risk allocation and sharing, strong private consortium, political support, transparent procurement, and community & public support. Before further discussing those indicators, at the beginning of this chapter I explain the context of Project Development Facilities as an intermediary and the process of the facility in general.

### 4.1 Project Development Facilities as an Intermediary

**Figure 4.1**  
Illustration of Project Development Facilities as an intermediary



Source: author's elaboration

The 4.1 illustration shows how PT SMI plays an intermediary role through Project Development Facilities in Umbulan Water Supply project in East Java. According to Schneider et al. (2014), the main point of intermediary refers to some arrangements that assist the collaboration within the different processes. In the same manner, PT SMI, through the Project Development Facilities contributes to the arrangement among the beneficiary, which is the East Java government, the Ministry of Finance and private sector. This collaboration aims to achieve the excellent quality of the PPP Umbulan Water Supply project. The intermediary's role between the Ministry of Finance and East Java government is as an extension body of Ministry of Finance to fulfil their interest to ensure the East Java government follows the

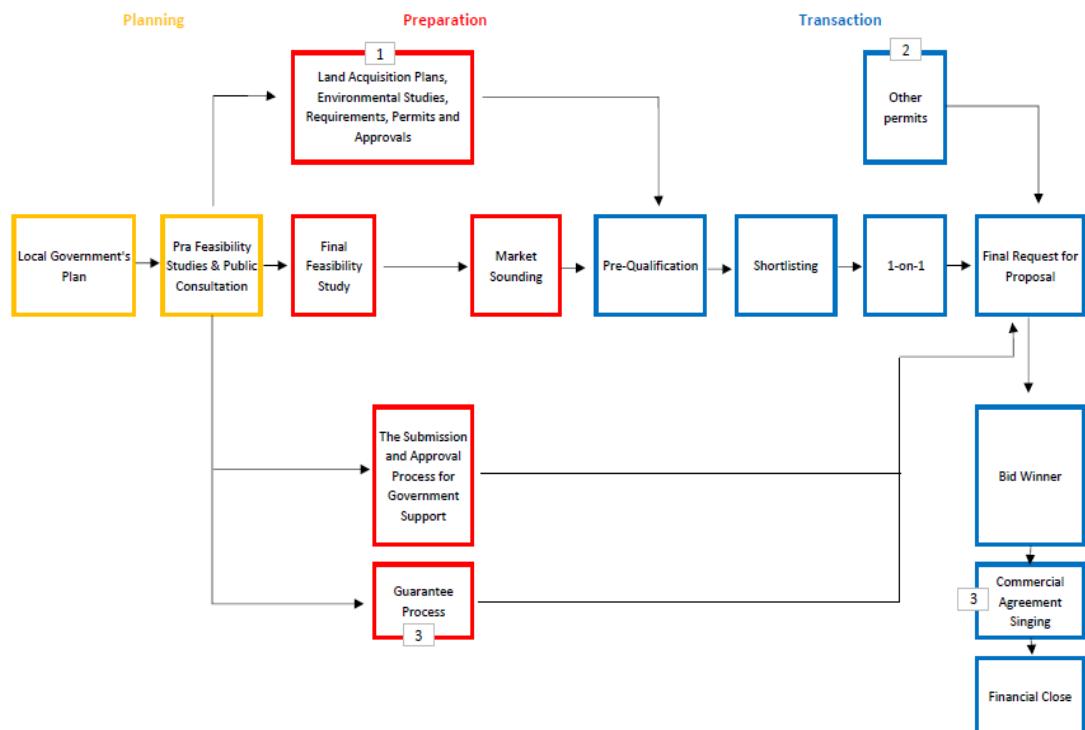
national government framework on conducting PPP projects. Otherwise, PT SMI also plays a role as an extension body of East Java government to fulfil the their interest in obtaining a guarantee from the Ministry of Finance. Most importantly, PT SMI takes part in bridging the knowledge gap between the private sector and the East Java government. Finally, it is expected that PT SMI could comply with the market requirements from the private sector as well as meet the objective of East Java government to have an investor for their Umbulan Water Supply project.

In the context of an intermediary in structural position (Schneider et al., 2014), the Project Development Facilities links its position in the networks of actors with comprehensive contextual information. As also illustrated in figure 4.1 – as an intermediary, PT SMI obtains the external bits of knowledge and external resources including from private consultants. Referring to Bessand and Rush (1995), the role of the consultant is to provide crucial mediation of relationships among the relevant stakeholders, including the knowledge gap. For instance, the private consultants that were hired by PT SMI shared the best practices from their experiences in another country in calculating the risk-sharing, conducting the financial business case, or even creating the data room as a hub for procurement.

The structural position of Project Development Facilities as an intermediary is classified as a robust scale. With the strong support from the Ministry of Finance, PT SMI is proven to own a formal position in resources, external knowledge, and reliable network penetration and accessibility at the national government level. Therefore, a robust structural position will eventually lead to a handy implementation process of the Umbulan Water Supply project. With detailed knowledge, PT SMI through the Project Development Facilities could quickly identify the demand of the market by having an effective PPP structure in risk-sharing, political support, and transparent procurements. Overall, Schneider et al. (2014) argued Project Development Facilities as an intermediary could smoothly impose its power and control to make the project work.

In order to add a further understanding of the Project Development Facilities, it is crucial to also understand the context of the Project Development Facilities' process in general.

**Figure 4.2**  
Illustration of Project Development Facilities in PPP Project Preparation and Transaction



Source: PT SMI presentation

Figure 4.2 portrays three main stages of the PPP projects: planning, preparation, and transaction. Based on the chart in yellow – in the planning stage, the local government should already have a solid plan and initial documents such as Outline Business Cases (OBC) and conducted market sounding in order to identify the market interest. When the local government has met all the requirements, then the proposal will be submitted to the Ministry of Finance for further assessment and screening. During the assessment and screening stage, the Ministry of Finance will consult the relevant state-owned enterprises to decide which projects that should be prioritized based on the political and economic aspect of the project as well as its urgency. In the end, if the Ministry of Finance decides which project should be assisted by Project Development Facilities, then the Ministry of Finance will appoint the state-owned enterprises. The instructed state-owned enterprises would then accompany and support the regional government in the preparation and transaction process of PPP (PT SMI 2019, personal interview)<sup>7</sup>.

<sup>7</sup> Personal interview with Deputy Project Manager for Umbulan Water Supply project, PT SMI, in Jakarta 19 July 2019

In the red chart – the preparation stage, the scope of work of Project Development Facilities are drafting the final financial business case (FBC), preparing the environmental impact analysis (AMDAL) and Land Acquisition and Resettlement Action Plan (LARAP), developing the application of government guarantee, procuring the external consultants, and finally conducting the risk study. If the study has been conducted and reviewed, then the market sounding should be done. In the market sounding, the Project Development Facilities needs to identify the potential bidding participants, creating project marketing, gathering feedbacks and developing the project's package (PT SMI, 2019).

At the beginning of the transaction stage – the blue chart, the Project Development Facilities assist the local government in preparing the bidding (pre-qualification) documents, announcing the pre-qualification results as well as plan and draft the PPP agreement. Most importantly, they assist local government in procuring the private entity (investor). The most crucial assistance from the Project Development Facilities is to transfer and evaluate the bidding documents as well as announce the bid winner until the signing of the PPP agreement. Lastly, the final assistance of Project Development Facilities is to accompany the local government to reach the financial close of the project (PT SMI 2019, personal interview)<sup>8</sup>.

## **4.2 Project Development Facilities and Their Effectiveness in Accelerating PPP Project**

The acceleration of one PPP project depends on how the project has successfully met with the criteria that has been outlined by the theoretical frameworks. As mentioned in the literature review, Osei-Key and Chan (2015) argued that five areas play a very crucial role in the acceleration of PPP projects or what they referred to as critical success factors. As the framework is relevant to the circumstances of the PPP project environment, especially in the Umbulan Water Supply project, it will be used as the primary analysis to understand whether the Project Development Facilities are useful in accelerating the PPP project. The five critical success factors are explained below:

### **4.2.1 Risk Allocation and Sharing**

One of the fundamental components of the PPP arrangement is how appropriate the risk allocation and sharing between relevant stakeholders in a PPP project (Jin and Doloi, 2008). The risk allocation itself involves the process of how stakeholders identify, share, and negotiate the amount of risk among public and private parties (Ke et al., 2010).

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<sup>8</sup> Personal interview with Deputy Project Manager for Umbulan Water Supply project, PT SMI, in Jakarta 19 July 2019

**Table 4.1**  
 Final Risk allocation between public and private parties in Umbulan  
 Water Supply project

Nr	Risk	Risk Allocation	
		Government	Private
1	Political risk	v	
2	Raw Water	v	
3	Social and Environment Risk	v	
4	Project Network and Land Acquisition	v	
5	Permission	v	
6	Market Risk		v
7	Investment and Banking		v
8	Project Construction		v
9	Project Procurement		v
10	Termination	v	v

Source: feasibility study document and PT Meta Adhya Umbulan Presentation

Table 4.1 portrays the risk allocation between the government and the private entity in Umbulan Water Supply project. The table is based on my personal summary from the feasibility study, and presentations I attended by PT Meta Adhya Umbulan. In general, table 4.1 shows quite an equal division of risk between the government and the private entity. Basically, the formulation of risk-sharing between public and private entities has started long before the bidding process happened. PT SMI as an intermediary took control and dominated most of the risk-sharing formulation process by hiring the private consultants and created an initial document internally. After that, PT SMI presented the initial risk-sharing and allocation document to the East Java government to seek approval. During this process, the power implication of the structural intermediary was clearly exposed. With the knowledge domination of PT SMI, the East Java government tended to agree with the risk-sharing document that they proposed. In addition, as explained in the stakeholder analysis, the Ministry of Finance also supports the power domination of PT SMI by having an agreement with the East Java government that required them to make a strategic decision based on PT SMI's recommendation (Ministry of Finance 2019, personal interview)<sup>9</sup>.

Nevertheless, with the power domination of PT SMI as an intermediary was indeed significant in the risk-sharing formulation process. The Project Development Facilities provided a short cut for the East Java government as the final approver of the risk document formulated by PT SMI. This scheme is necessary as the East Java government does not have any capability to understand the technicality of the project in order to create a proportional risk-sharing. Without this assistance, most likely the East Java government would create an unfair risk allocation that will eventually create an increased burden for one of the parties involved.

In terms of the risk negotiation process, Roumboutsos and Anagnostopoulos (2008) argued that the risks of the party who has better mitigation techniques are clearly defined and

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<sup>9</sup> Personal interview with Deputy Director for PPP Project Preparation, Ministry of Finance, in Jakarta 24 July 2019

allocated during negotiations periods. Therefore, the risks negotiation period is also vital to reach the proportional and fair risk-sharing between the public entity and the chosen private entity. In the case of the Umbulan Water Supply project, the role of Project Development Facilities was to assist the East Java government in conducting the technical, financial, and legal negotiation in the investor (PT SMI 2019, personal interview)<sup>10</sup>. This is necessary as the East Java government does not have the confidence to face the investor which has the tendency to create an unequal negotiation process. During the negotiations the investor always brought experts such as financial experts, lawyers who asked very detailed and technical questions. This is where the role of an intermediary who holds a robust structural position is important. With adequate knowledge, PT SMI was there to accompany the East Java government and assist them in answering the technical questions. Furthermore, PT SMI was also responsible for providing the materials and briefing for the negotiation meeting. With the comprehensive knowledge as a robust structural positioned intermediary, the Project Development Facilities intermediary made all the technical discussions conducted properly without any party carrying unnecessary burden.

#### **4.2.2 Strong Private Consortium**

For a successful PPP project, it is very important to have a stable and well-structured private company. However, the complex and complicated nature of PPP projects makes it very difficult for a single construction company to carry out the project, and therefore, various companies frequently form a consortium when applying tender for PPP. Nevertheless, the private entity plays a significant role in the project's performance. In that regard, the consortium needs to be able to carry out PPP projects with strong technical, organizational, and managerial capabilities (Zhang, 2005).

In the case of the Umbulan Water Supply project, the characteristic of the private consortium could be seen from the nature of the company that is interested in the project. The pre-qualification of the project was conducted from 2012 – 2015, and within that period, there were twenty-two companies that expressed their interest in investing in the project (Sari, 2015). At the end of 2015, it was announced that there were only 5 consortiums which passed to the final qualification: 1 consortium from South Korea, 1 from Japan, 2 from China; (1) China Harbour Engineering Co.Ltd with Sound Glob-al Ltd and PT Manggala Purnama Sakti and (2) Beijing Enterprise Water Group with PT Amerta Bumi Capital and PT Bakrieland Development Tbk, and the last one is from Indonesia which is consortium between PT Medco Gas Indonesia and PT Bangun Cipta Kontraktor. In February 2016, it was then announced that the Indonesian consortium (PT Medco Gas Indonesia and PT Bangun Cipta Kontraktor) won the tender for the Umbulan Water Supply project, which later became PT Meta Adhya Tirta Umbulan (Sari, 2016).

The winning consortium was proven to have a strong technical and financial background, as well as cultural approaches for completing the project. In terms of technicality, PT Bangun Cipta Kontraktor itself has expertise and experience in drinking water supply for 23 years. In addition, the nature of Umbulan Water Supply project is very similar to the projects that they usually implement and as a result they have familiarized themselves with the potential obstacles and challenges. On the other hand, PT Medco Gas Indonesia is one of the leading oil and gas companies in Indonesia with extensive projects and experience—a fact they gave as

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<sup>10</sup> Personal interview with Deputy Project Manager for Umbulan Water Supply project, PT SMI, in Jakarta 19 July 2019

assurance on PT Medco Gas Indonesia's abilities to handle the piping for the Umbulan Water Supply project. In terms of financially, the consortium of both companies has a strong financial capacity that fulfilled the requirement of a minimum of Rp 2 trillion rupiah, equal to \$ 150 million USD, in order to invest in this project (PT Meta Adhya Tirta Umbulan 2019, personal interview)<sup>11</sup>.

The role of Project Development Facilities provided by PT SMI as an intermediary is indeed crucial in order to create a trustworthy, clear, and convincing preparatory document. As a result of knowledge control and dominance by an intermediary, Umbulan Water Supply Project finally has proper preparation documents. PT Meta Adhya Tirta Umbulan as the investor explained that the feasibility studies created by PT SMI provided clarity, made sense and were attractive. After receiving the feasibility studies, the investor recalculated the project based on the market and their own experiences and it turns out the data provided in the feasibility study was accurate. The licensing and permission arrangement were clear, the pricing determination was fair, and the government guarantee was provided. Moreover, because of the control from an intermediary, the East Java government had successfully set the tender process to be very punctual. Besides, the brand of PT SMI is also appealing for the investor. Once they created a tender plan for the project and presented it to the bank for initial discussion for loan the bank responded positively as PT SMI has an excellent track record in project financing (PT Meta Adhya Tirta Umbulan 2019, personal interview)<sup>12</sup>.

#### **4.2.3 Political Support**

Understandably, the PPP reform strategy as a public policy is directly linked to the country's political environment (Li et al., 2005). As public approval also plays a crucial role in granting the success of a public policy that relates to the greater public service, thus a supportive political environment would be necessary (Jacobson and Choi, 2008). In the case of Umbulan Water Supply project, Project Development Facilities provided significant political support and control primarily through the Minister of Finance. As the notion of Public-Private Partnership in Indonesia is something that is entirely new, it makes sense if it requires extra effort to create awareness amongst bureaucrats and ministries. The power domination of the Minister of Finance, Sri Mulyani, is significant in influencing other ministers to support the PPP initiative of Umbulan Water Supply project. With the benefit of Sri Mulyani as a former managing director of the World Bank Group, it is easier for her to gain political support at the national level of government without the need of involving the participation of the East Java government (Ministry of Finance 2019, personal interview)<sup>13</sup>.

Instead of being something negative, the power domination and political drive by the national government has proven to be an effective channel to gain political support to accelerate the Umbulan Water Supply project. In general, the support from political leaders is also crucial in terms of attracting more investors to a particular economy (OECD, 2008) and finally could drive the development of PPP projects in Indonesia. The story from the investor in the Umbulan Water Supply project is living proof of how political support is crucial in the PPP project. In the beginning, PT Bangun Cipta Kontraktor was not sure whether they wanted to invest in this project because of the negative narrative regarding the Umbulan

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<sup>11</sup> Personal interview with Director of PT Meta Adhya Tirta Umbulan, in Jakarta 20 August 2019

<sup>12</sup> Ibid.,

<sup>13</sup> Personal interview with Deputy Director for PPP Project Preparation, Ministry of Finance, in Jakarta 24 July 2019

Water Supply Project has been in limbo for almost 40 years without any clarity. However, the Governor of East Java's support of the project in 2011 was the momentum of PT Bangun Cipta Kontraktor needed to take a closer look at the project. Especially after they received the project documents which were done by PT SMI, it further attracted them as the document showed the government support for the Umbulan Water Supply project. In the end, as the potential investor at that time, PT Bangun Cipta Kontraktor claimed that the tangible government presence and support in every aspect of PPP project was essential in order to make the project more attractive in the view of investors and banks (PT Meta Adhya Tirta Umbulan 2019, personal interview)<sup>14</sup>.

#### 4.2.4 Transparent Procurement

PPP is a procurement process and therefore the transparency within its procurement is fundamental. Ideally, it should be emphasized that transparency should not only exist in the tender process but also in the whole project including its execution<sup>15</sup> (Osei-Key and Chan, 2015).

**Table 4.2**  
Tender Timeline

Nr.	Activities	Date
1	Project Progress Explanation Meeting	26 August 2015
2	Issuance of the 3rd Addendum of Bid Documents	28 August 2015
3	Auction explanation and Field Review	9 September 2015
4	Issuance of the 4th Addendum Bidding Documents	15 September 2015
5	One on one meeting for the Draft Cooperation and Guarantee Agreement	21-22 September 2015
6	Final Issuance of Bid Documents	30 September 2015
7	Consortium Participant Confirmation Entry in accordance with Section 4.1.3. Addendum III Tender Documents	1 October 2015
8	Evaluation of the Consortium	1-8 October 2015
9	Establishing a Shortlist	13 October 2015
10	Bid Submission	13 November 2015
11	Bid Evaluation	13 November 2015
12	Announcement of Bid Winner	14 December 2015
13	Finalization of Bid Winner	31 December 2015

Source: PT SMI document

Thanks to PT SMI as a robust structural positioned intermediary, the tender process for the Umbulan Water Supply project was appropriately scheduled and transparent as displayed in

<sup>14</sup> Personal interview with Director of PT Meta Adhya Tirta Umbulan, in Jakarta 20 August 2019

<sup>15</sup> Due to the scope of this research that limits the observation only to the project preparation and transaction, thus the analysis of project transparency will only be done to the tendering process.

table 4.2. At the beginning of project preparation, IFC assisted the Government of East Java to set up a website bidding platform called 'Umbulan Data Room Establishment.' Afterwards, PT SMI worked together with the Governor's Office to develop the data room in order to provide a very systematic and transparent bidding platform. The purpose of this data room was to be an intuitive tool for the management of bidders, documents, permissions and to serve a secure online project website where prospective bidders could get the most updated information about the project. The main contents of the data room were the tender document, technical documents, and legal and regulatory documents of the Umbulan Water Supply project. It served bilingual user interfaces in Indonesian and English in order to reach the broader segment of users, specifically for the groups of governments and its advisors and the prospective bidders. In the end, the data room is wholly owned by the East Java Governor office, and they are responsible for updating the platform with the documents provided by PT SMI.<sup>16</sup> Because of the establishment of the Umbulan Data Room, the project and tender information was publicly available for the intended users.<sup>17</sup> Despite its limitation, this was an innovative effort given the fact the government of Indonesia does not often publish information.

In addition to the Umbulan Data room, Li et al. (2005) argued that transparency also relies on consistent and cordial communication between internal and external stakeholders. In order to obtain clarity of the execution of the projects, those stakeholders need to consult each other as well openly. This is also something that an intermediary takes control. Through the master agreement between the Ministry of Finance and the East Java government, the Project Development Facilities required the East Java government to frequently conduct meetings with investors (or potentials), which will be facilitated by PT SMI (Ministry of Finance 2019, personal interview).<sup>18</sup> Because of the power control within the agreement, it indirectly forces the East Java government to support the transparency procurement by increasing the number of meeting with external stakeholders.

#### **4.2.5 Community and Public Support**

The public and community support refers to the acceptance and recognition from the media, trade unions, NGO and the broader civil society about the on-going PPP project. Initially, public support will help to reduce delays of any kind, such as land acquisition during the project construction period. However, the Project Development Facilities does not support to such points as they are part of the construction stage. Meanwhile, the project development facility only covers the project preparation and transactions stage where most of the activities are conducted in private and internally.

In summary, the power implication of the robust structural positioned intermediary is even effective in accelerating the PPP in the East Java context. It supports the fulfilment of four out of five critical success factors in PPP project. As a result of an intermediary's knowledge

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<sup>16</sup> The information comes from internal document from PT SMI titled "Umbulan Data Room Establishment Briefing" collected during the field trip.

<sup>17</sup> This availability of the documents could not be proved as at the moment the Data Room is no longer accessible. The information about the availability of Data Room is only obtained from interview and personal documents that PT SMI provided to me.

<sup>18</sup> Personal interview with Deputy Director for PPP Project Preparation, Ministry of Finance, in Jakarta 24 July 2019

control and dominance, the Umbulan Water Supply project had a high-quality preparation documents. Those documents are useful as the foundation of proper risk allocation and sharing as well as inviting a strong private consortium. The power domination and political drive are also effective for gaining political support mainly from the national government. In the end, the power control that exists within the Project Development Facilities agreement would eventually support the procurement transparency by requiring the East Java government to conduct regular meetings with the external stakeholders.

# **Chapter 5**

## **The Implication of Project Development Facilities on the Capacity of the Local Government**

Despite the effectiveness that an intermediary generates in achieving a successful PPP project, however, it is also essential to recall the initial purpose of the Project Development Facilities. As explained in chapter one, the Project Development Facilities aim to achieve effectiveness in creating a successful PPP project and building the capacity of the project owner (Ministry of Finance 2019, personal interview)<sup>19</sup>. Besides analysing the role of an intermediary in achieving a successful PPP project, it is also crucial to find out whether it is also effective in building the capacity of the local government as the project owner. The notion of capacity itself is important to be discussed because of the local government's necessity in having sufficient capabilities in all aspects of PPP success factors. Without an adequate capacity in the local government, it is impossible to have an accelerated PPP project. Therefore, Schneider et al. (2014) conceptual framework on mediating approaches will be used as the basis to analyse the role of an intermediary in building the capacity of the local government.

### **5.1 The Significance of the Project Development Facilities on the Capacity of the Local Government**

Schneider et al. (2014) argued that one of the reasons why intermediaries existed in the first place was to close the capacity discrepancy between the policymakers and the practice in reality. Therefore, it is essential to highlight that the purpose of the intermediary is to provide quality improvement for its beneficiaries. In order to further understand the intermediary performance in bridging the quality gap in its beneficiary, the conceptual model for quality improvement proposed by Schneider et al. (2014) is used as the basis of the analysis. The study on the roles of the consultant by Bessand and Rush (1995) will also be used as a complement.

Firstly, in terms of the framework for capacity development in an intermediary, the mediating approaches are very relevant to analyse how the Project Development Facilities supports the capacity improvement of the East Java provincial government. As explained in chapter two, the mediating approach is an intermediary model that aims to build, transfer, and translate knowledge for a specific purpose in order to achieve a quality improvement for its beneficiaries. Secondly, in terms of the role of consultants, they have four leading roles in transferring the expertise, sharing the experience, diagnosing the problem, as well as being the broker.

If the case of Umbulan Water Supply is securitized by using those two lenses, it shows that the Project Development Facilities only act as the intermediary which diagnoses the problem and to be the broker that connects East Java government, the private sector, and the Ministry

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<sup>19</sup> Personal interview with Deputy Director for PPP Project Preparation, Ministry of Finance, in Jakarta 24 July 2019

of Finance. Furthermore, the Project Development Facilities does not, or minimally provides, any specific and tangible action on knowledge transfers nor expertise sharing (Umbulan Water Supply Project Committee 2019, personal interview)<sup>20</sup>.

Under this particular Project Development Facilities platform, the Ministry of Finance decided not to focus on strengthening the capacity of the East Java government but only to contract out all work to the PT SMI. The Ministry took a shortcut for the sake of completing the PPP project that has been uninitiated for 40 years without accentuating the improvement of the local government capacity. This circumstance, also similar to Kurniawan (2014), has highlighted a significant issue on the capacity of local government when executing the PPP project. He further explained that national government work is quite similar to the way that donors usually do business. Despite the donor's understanding of the lack of capacity in the local government most of their program was only to achieve some artificial development goals instead of building sustainable institutions and capacity.

The limitation on the Ministry of Finance budget for Project Development Facilities is the reason why the sustainable capacity should be built for the local government in order to prevent further dependency on the national government. PT SMI, as one of the leading providers of the Project Development Facility could only offer the service to around 5-6 projects per year. Meanwhile, the demand for Project Development Facilities is quite high. For East Java itself, there are around 5-10 potential PPP projects that need urgent assistance from Project Development Facilities. Those projects are Kediri Airport, Sidoarjo Hospital, Surabaya Tram, Surabaya – Madura toll bridges, and some other potential PPP projects. At the national level, the demand for PPP is coming from roughly 19 sectors from drinking water, airport, waste management, health care and so on. The total potential PPP projects from all over Indonesia are more than 50 projects. In the end, the gap between the demands and the supply of the service would eventually restrain the overall development of PPP efforts in Indonesia. It is even worse since the local government always relies upon the Project Development Facilities as the only convenient option for helping them in accelerating their PPP project.

In understanding what kind of capacity that is referred to this context, it has been touched upon in chapter two that scholars differ in their definition of capacity. One of the most relevant scholars who has been discussing capacity is Grindle and Hilderbrand (1995). They defined capacity with three leading indicators: whether the government official can perform the task effectively, efficiently, and sustainably. Howlett (2009) argued that functional capacity relies on advance policy knowledge, skills to enhance the action, strategic communication, effective stakeholder management, and good decision making. In summary, the capacity of the East Java government can be referred as capability of understanding Indonesia's PPP policy, capability in comprehending the technical, financial and legal issues of the project, capability to take an effective decision during the project development periods, and capability to have a strategic communication within the government as well as to external stakeholders, especially investors.

The current capacity of the East Java government could be determined by using the framework from Wu et al. (2015). From three areas on individual, organizational, and systemic

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<sup>20</sup> Personal interview with Chief of Umbulan Water Supply project (2014-2018), in Surabaya 10 August 2019

capacity, this analysis will focus only on individual analytical, individual operational, and individual political capacity as they are the most relevant elements in the Umbulan Water Supply project. The organizational and systemic capacity will be excluded from the analysis as the team for the Umbulan Water Supply project in East Java is an ad-hoc format and therefore those capacities are quite difficult to measure. The analysis of analytical, operational and political capacity is as follow:

**Table 5.1**  
The connection between the PPP Success Factor and Capacity

PPP Success Factor/Capacity	Risk Sharing & Allocation	Strong Private Consortium	Transparent Procurement	Political Support
Analytical	v	v		
Operational			v	
Political				v

Source: author's elaboration

### 5.1.1 Analytical Capacity for Achieving Risk Allocation & Sharing and Strong Private Consortium Criteria

The analytical capacity on the East Java government refers to the ability to access, apply, execute technologically and analyse information and techniques efficiently. The individual analytical skills for East Java government are required in order to achieve a good Umbulan Water Supply project in terms of risk allocation and sharing, and getting a strong private consortium.

In the process of creating a proportional risk allocation & sharing resulting in a strong private consortium, the individual analytical capacity is necessary for collecting, processing, and verifying the data on Umbulan Water Supply project. The data gathering for preparatory documents is usually outsourced to a third party, most commonly a private consultant, but in order to understand the data provided by the third party, the East Java bureaucrats should have the individual analytical skill to verify the data and finally provide the substantial and critical feedback for the report. The considerable knowledge of the financial, technical, and legal aspects of PPP projects is also necessary as a basis for analysing the data. Additionally, the decision-making skills also lie under the analytical capacity in order to have a final decision on preparatory documents and the risk allocation & sharing. Furthermore, the negotiation skill is also crucial for the East Java bureaucrats to be able to negotiate with the investor regarding the final risk allocation and sharing.

However, the current status-quo shows that PT SMI possesses the complete technical, financial, and legal knowledge of the Umbulan Water Supply project under the framework of Project Development Facilities. As PT SMI is the one who has the relevant knowledge, then the process of collecting, processing and verifying data from the consultants is entirely conducted by them. The authority of the East Java government is merely on the final decision making of the preparatory documents, which is also based on the recommendation of PT SMI. The decision making without any more in-depth understanding of the context is

problematic. Lastly, the negotiation exercise either in the daily communication with the investor or to negotiate the risk-sharing and allocation is not that effective as the East Java government is overly dependent on the presence of PT SMI in meetings.

### **5.1.2 Operational Capacity for Achieving the Transparent Procurement Criteria**

The operational capacity in the Umbulan Water Supply project links to the ability of East Java bureaucrats to perform the government functions and create a pleasant environment in order to run the PPP project efficiently. Therefore, the operational capacity relates to transparent procurement.

The transparent procurement requires individual operational capacity to commit and schedule tenders on time. Not only that, but transparent information is also necessary to provide accessibility to the potential investor and the general public. The ability to operate the technology is crucial as the Umbulan Water Supply project has one information center, which is the Umbulan data room. The terms of “operating” technology do not only refer to the running the program but also understand and create comprehensive content to be featured in the information center.

As a matter of fact, the concept of transparent procurement seems to be quite vague under the perspective of East Java bureaucrats. PT SMI is the one who guides them always to update the Umbulan data room establishment. Although the East Java bureaucrats are the ones who manage and run the Umbulan data center, PT SMI is the one who provides the entire contents of its data center. Not only that, but the East Java government also relies on PT SMI in terms of publication materials for the general public, which disseminates through mass media.

### **5.1.3 Political Capacity for Achieving the Political Support Criteria**

The political support is one of the keys to running the PPP project in Indonesia, therefore the political capacity is also crucial for the bureaucrats. In the context of the Umbulan Water Supply project, the nature of the project is complex and complicated, the political capacity refers to the political knowledge and experience, ability to understand the political interaction between competing actors, and the relationship between its fundamental interest and ideologies.

The capability in understanding the political knowledge, structure, and political interaction is vital as the Umbulan Water Supply project depends on various stakeholders from the national level to the regional level, as well as the provincial house of representatives. For instance, in order to gain political support from five local governments for this project, it is mandatory to obtain approval from each regional House of Representatives. This approval took quite long as interest between the local House of Representatives and the East Java provincial government did not always align. In the end, it hampers the project preparation and overall project timeline. Besides regional political support, the national political support is also crucial. In order to have good project preparatory documents, the East Java government should have obtained the government guarantee and approval from all relevant ministries such as the ministry of public works, ministry of development planning, and so on.

However, the existence of Project Development Facilities automatically provides an advantage in gaining political support for the Umbulan Water Supply project in gaining political support either from the national government or even the President. The support is obtained from the network that is provided by PT SMI as the subsidiary of the Ministry of Finance and the power of the Minister of Finance herself. This is quite problematic since it limits the East Java government's agency in further understanding the political landscape and strategy to gain support.

## 5.2 The Urgency of Sustainable Capacity

It is evident that some capacity gaps exist in the East Java government especially in terms of analytical, operational and political capacity. In fact, those capacities are very crucial in supporting and accelerating the PPP project. In conclusion, the Project Development Facilities have failed to achieve its goal as an intermediary in mediating approaches to develop the capacity of the East Java government. Not only is this problematic in theory, but the absence of capacity at the local level would lead to the counterproductive long-term impact on the development of PPP in East Java itself. As has been explained briefly, the East Java government has several potential PPP projects at the moment. However, the lack of either analytical, operational, and political capacity in developing PPP projects makes the East Java government entirely reliant on the Project Development Facilities assistance from the Ministry of Finance. As the resources of Project Development Facilities are very limited, it is an unfortunate consequence that the potential PPP projects in East Java will go nowhere. Because of those reasons, then it is essential to have an in-house capacity among government officials in East Java. By the time the PPP team in East Java government has adequate and sustainable analytical, operational, and political capacities, it is expected that in the long term, the East Java government would be able to run their PPP project dependently.

Another reason why the sustainable capacity is critical for the East Java government is to avoid the power competition between the local government and the national government regarding the project ownership. At the moment, there are some negative sentiments among East Java government officials concerning ownership of the Umbulan Water Supply Project (Umbulan Water Supply Project Committee 2019, personal interview)<sup>21</sup>. This “interference” of the national government through the Project Development Facilities limits the authority of the East Java government in owning the project. Even worse, it also questions the commitment of the East Java government to support the policy. Fukuda Parr et al. (2002) argued that the absence of a sense of ownership would lead to a condition where the local government seems to support the policy, but on the ground, they may not have the commitment to make the program work.

This is precisely what happened in the Umbulan Water Supply project. Without the strong leadership of the Chief of Project the Umbulan Water Supply project would not run as smoothly as until now (Umbulan Water Supply Project Committee 2019, personal interview).<sup>22</sup> There is a lot of turmoil among the East Java government who question the existence of PT SMI, or even the project ownership itself. The East Java government feels like they don't have any authority to manage the project despite the fact they are the project owner.

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<sup>21</sup> Personal interview with Chief of Umbulan Water Supply project (2014-2018), in Surabaya 10 August 2019

<sup>22</sup> Ibid.,

Therefore, in order to prevent the negative sentiments between the national and local government, sustainable capacity is crucial to make the local government fully independent.

# Chapter 6

## Conclusion and Recommendation

### 6.1 Conclusion

Based on the analysis presented in the preceding sections, an intermediary with a power implication is even effective in achieving a successful PPP project and proven to bring the Umbulan Water Supply project to be the first PPP project in the water sector in Indonesia. This conclusion is drawn by the completion of the project with the fulfilment of four out of five critical success factors in PPP including have allocated and shared the risk proportionally, having PT Meta Adhya Tirta Umbulan as a strong private consortium, have gained robust political support both national or regionally, and have successfully conducted a transparent procurement.

However, this effectiveness does not come without costs. The power implication through the deep engagement and control of an intermediary resulted in the inconvenience of the local government. During the project development facilities, it is believed that the national government becomes too controlling of the project and seems to neglect the fact that the local government is the project owner. The stakeholder analysis shows that the formal agreement even facilitates the power control on the Project Development Facilities. For instance, the Master Agreement between the Ministry of Finance and East Java government regulates what the East Java government should or should not do in terms of project execution. This demonstrates how the title of East Java government as Project Owner is only on paper, but not in reality.

These findings clearly illustrate that the power implication in the conceptual model of a structural positioned intermediary is counterproductive with its other function in mediating approaches. As a result, the Project Development Facilities fails to demonstrate their effectiveness in building the individual capacity of the local government in analytical, operational and political aspects. Even worse, the Project Development Facilities even prevent the local government from having their capacity for running a PPP project. It is a direct consequence of a dominating environment formed by PT SMI as a powerful intermediary that instantly offers all conditions to build a successful PPP project. If this continues to occur it will lead to never-ending dependency that will obstruct the sustainable development of Public-Private Partnerships in Indonesia.

### 6.2 Recommendation

Several problems have been highlighted in the way Project Development Facilities have been implemented in East Java. In order to improve the current circumstances, I would like to propose the following recommendations:

- 1) Firstly, the major cause of the inability of Project Development Facilities to create a sustainable capacity is because the PPP committee is only on an ad-hoc basis and temporary. It resulted in a difficulty in determining who is the right person who needs to be given the capacity in the first place. Therefore, I recommend the East Java committee to establish a permanent committee that is in charge of every PPP related

project under the East Java provincial government. When the permanent committee is formed, it is expected that the member of the committee is more likely the same person and will become more of an expert in the PPP field due to the experiential learning.

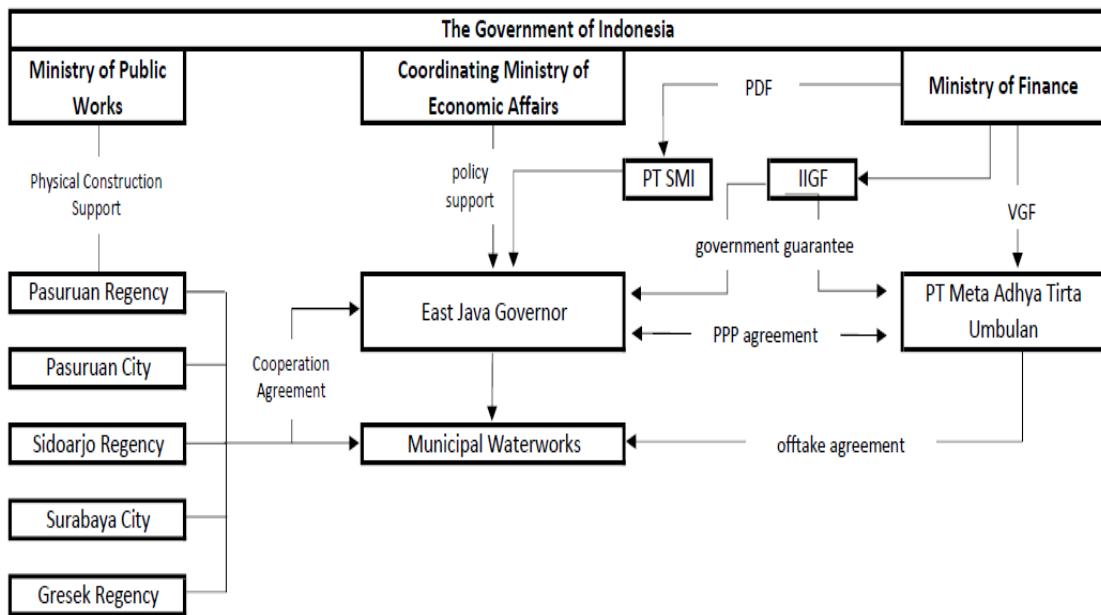
- 2) Secondly, the targeted individual capacity building is recommended to improve the understanding of the PPP and the project context, especially in the technical, financial, and legal aspects. At the moment, the knowledge transfer in Project Development Facilities is only limited to understanding the context of PPP themselves without more profound technical knowledge of the project. Therefore, the combination of learning will be an advantage to the East Java government to accelerate their potential PPP project without further dependency on the national government.
- 3) Lastly, as my research and findings are only limited to problematizing the current situation, this is something that further research could explore. Specific studies in the area on how an intermediary could build sustainable capacity for local government for a PPP project would be something very beneficial and helpful to the acceleration of PPP in Indonesia.

## Appendices

### **Appendix 1** List of Interviews

	<b>Position</b>	<b>Affiliation</b>	<b>Place / Date</b>
Interview 1	Deputy Project Manager for Umbulan Water Supply project	PT SMI	Jakarta, 19 July 2019
Interview 2	Deputy Director for PPP Project Preparation	Ministry of Finance	Jakarta, 24 July 2019
Interview 3	Chief of Project	Umbulan Water Supply Project Committee	Surabaya, 10 August 2019
Interview 4	Director	PT Meta Adhya Tirta Umbulan	Jakarta, 20 August 2019

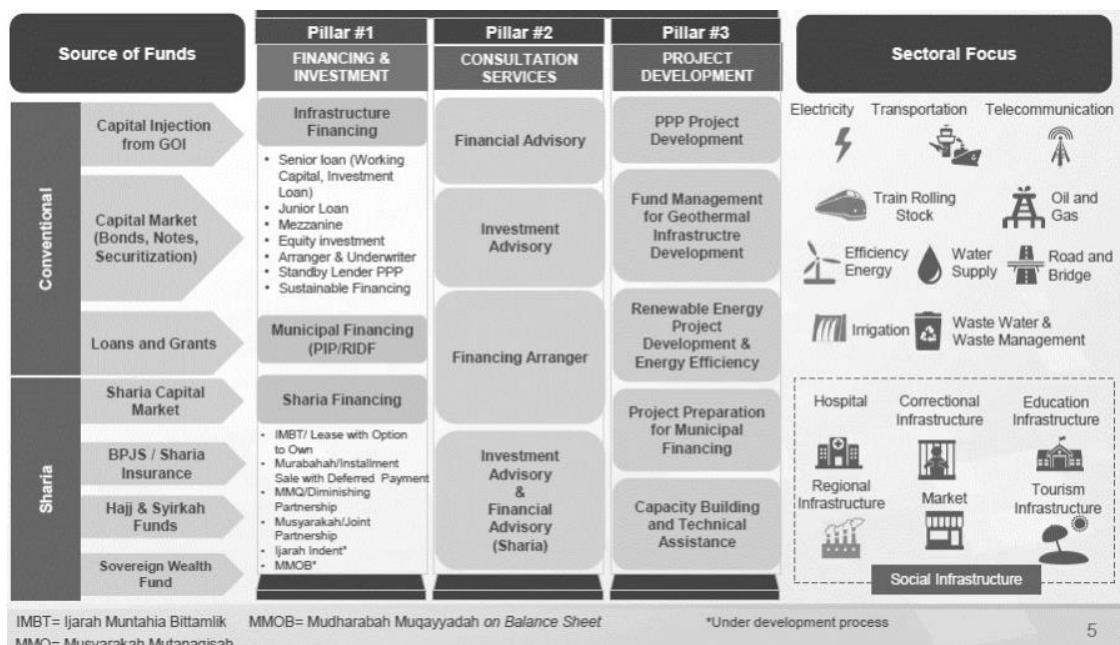
**Appendix 2**  
Complete project structure of Umbulan Water Supply project



Source: PT SMI

Appendix 2 shows the complete project structure of Umbulan Water Supply project and the complex relationship amongst the stakeholders. The Ministry of Finance as a primary role in implementing the Project Development Facilities by having a coordinating control towards its main stakeholders. The Coordinating Ministry of Economic Affairs and the Ministry of Public Works also plays a vital role in the project construction stages and implementation by connecting the relevant stakeholders in the local level.

**Appendix 3**  
PT SMI Business Pillars



Source: PT SMI

Appendix 3 illustrates the primary business pillar of PT SMI. The state-owned enterprise has two main sources of funds, which are from Sharia and conventional. Regarding to its pillars, the organization has three main functions; financing & investment, consultation services, and project development. Under the project development pillar, PT SMI has PPP project development unit that specifically aims to provide service in Project Development Facilities. Overall, PT SMI manages ten sectors and six social infrastructures focus.

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