OVERVIEW OF IBRA FOREST SECTOR DEBT
With Perspectives on Forest Area & Processing Capacity

Policy & Planning Group
USAID/NRM Program

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GOI Commitment on Restructuring:

- "Restructure wood-based industries to enhance competitiveness & to balance timber needs and supply" -- (Kepres 80, June 2000)
- "Close down heavily-indebted wood industry under monitoring of BPPN" -- (GOI Action Plan on Forestry: Issue 5, Dec. 2000)

Purposes of Presentation:

- Highlight key facts & anecdotes about debt & industry structure
- Review new results based on combination of data sources
- Illustrate some potentially useful approaches to assess firm viability based on physical features
- Outline important issues, questions & challenges that need to be addressed

Summary of Presentation

Background:
- Overview of the Debt
- Overview of the Data

Basic Description:
- Overall “Match” Among Firms Between Data Sets
- Area, Capacity, & Debt Of Concessions & Mills
- Summary and Questions

Preliminary Analysis:
- Locations of Indebted Mills and Concessions
- Physical Condition vs. IBRA “Recovery” Rankings
  - Years Remaining in Concessions
  - Ratio of Debt to Forest Area
  - Ratio of Debt to Productive Capacity
- Summary and Questions

Progress Toward Restructuring:
- Review of Actions Toward Commitment
- Review of Tasks Remaining
- Important, Complex Issues to be Addressed

Background: Overview of the Debt
High Concentration in Key Corporate Groups

- IBRA holds 129 forest sector firms: 21.9 T Rp in debt
  - Principal is two thirds, interest a third, penalty is 2 %
- Highly concentrated: few large, connected firms & groups
  - Two groups caused 47% of the debt
  - 3 firms caused a third of the debt: 8 T Rp
- Most indebted HPHs are judged good recovery prospects
  - Can value of remaining timber clear debt, cover operations?
- Over half the debt, 12 T Rp., is in mills with no HPH
  - Judged as medium to low recovery prospects
  - Without a stable source of timber, can these firms be viable?
- Pulp & paper firms (4% of debt): judged good recovery prospects
  - Does this account for large pulp & paper firms in press reports?

Background: Overview of the Data
Old Data Set Allows New Links & Analyses

"IBRA Forest Sector Debt Data"

- Includes firm, group, debt, type, recovery category
- Excludes location & physical features of firms

"DFID Data Set"

- Provides snapshot of HPHs & linked saw & plymills, mid-1990s
- Includes capacity, region, forest area, age of license
- Developed for "*Addicted to Rent.*" D.W. Brown. DFID/ITFMP. Sep. 99
- Based on: *Profil Industri Pengolahan Kayu,* DepHut; "*Integrated Woodbased Industry,*" CIC 94; "*Forestry Indonesia,*" PDBI 94

Linking These Data Sources Illustrates:

- *Why* restructuring should consider location, forest area, capacity
- *How* debt load compares to physical features of indebted firms
- *Where* forest debt is located across Indonesia
- *What* analyses can help to match timber demand with supply
- *Who* (agencies) could produce, verify, analyze forest sector data

Basic Description:
Overall "Match" Among Firms Between Data Sets

Many Matched:

Of the 129 firms controlled by IBRA, 57 (44%) match to DFID data

- These account for 12.2 T Rp of debt, 55% of IBRA forest sector debt
- 11 IBRA firms (3.4 T Rp.) matched a HPH in DFID data
- 25 IBRA firms (6.8 T Rp.) matched a DFID mill
- 21 IBRA firms (2.0 T Rp.) matched both a DFID HPH & a mill

Still, Many Not Identified:

For other IBRA categories, need more info. Could not identify:

- 30 of the 52 (60%) mills with no links to HPH
- Any of the 4 Pulp & Paper firms
- 30 of the 38 firms classified as "Other" by IBRA

- Where can we (efficiently) get complete data on unmatched firms?

Basic Description:
Area, Capacity, & Debt Of Concessions & Mills

Area of Concessions

- As of mid-1990s, DFID data account for 51.4 M ha of HPH
  - Most private, but 4.0 M ha (7.8%) in Inhutanis
- IBRA-indebted HPHs matched to DFID data account for:
  - 5.25 M ha, or 11.1% of privately held forest concession area
  - 5.43 T Rp, nearly a quarter of IBRA's total forest sector debt

Capacity of Mills

- DFID data account for 24.5 M m3/yr of saw & ply mill capacity
- IBRA-indebted mills matched to DFID data account for:
  - 5.3 M m3/year, or 21.7% of capacity of this sub-sector
  - 3.3 T Rp, about 15% of IBRA's total forest sector debt

Basic Description
Summary and Questions

- Quick data linking provides clearer picture of half the IBRA firms and half the debt
- IBRA controls a quarter of Indonesia's forest concessions & wood processing capacity (partial match only).
  - Determining the status of these firms will have an important impact on future structure & organization of forest sector.
- Some estimates indicate that Indonesia's wood processing capacity is 2 to 3 times greater than sustainable & legal timber supply
  - Even closing indebted firms (or just matched ones) would not fix the large imbalance between timber demand & supply
- What policies and incentives can allow this industry to evolve and adjust to a more efficient situation?

Preliminary Analysis

- Illustrates types of analysis that could contribute to transparent, empirically-based restructuring plans & criteria
  - Data are secondary and incomplete
  - Intended as illustrations of questions and approaches
  - Could be used as a guide for data improvement
  - Could be used in targeting later investigations or audits
- This quick data linkage allows examination of:
  - Locations of firms and debts by province
  - Debt relative to “years of life” left in forest concessions
  - Ratio of debt to forest area of concessions
  - Ratio of debt to productive capacity of saw & ply mills
- How can these data & approaches be refined to contribute to inter-departmental restructuring plans?

Preliminary Analysis:
Locations of Indebted Mills and Concessions

Province	No.	Debt	Province	No.	Debt
NOT IDENTIFIED	**72**	**9,660.09**	**JAVA**	**2**	**2,758.16**
SUMATRA	**10**	**1,477.82**	West Java	1	29.02
Aceh	1	296.51	Central Java	1	2,729.14
N. Sumatra	2	112.21			
Riau	3	406.76	**SULAWESI**	**3**	**213.44**
S. Sumatra	3	165.29	North Sulawesi	1	64.25
Lampung	1	497.04	South Sulawesi	1	16.79
KALIMANTAN	**29**	**6,669.72**	SE Sulawesi	1	132.40
W. Kalimantan	6	2,628.36	**MALUKU & IRIAN**	13	**1,103.00**
C. Kalimantan	7	892.56	Maluku	4	79.35
S.Kalimantan	5	218.31	Irian Jaya	9	1,023.65
E.Kalimantan	11	2,930.50			

- Can we identify locations of indebted firms relative to forest resources?
- Should debt burden factor into regional government development plans?

Preliminary Analysis:
Physical Condition vs. IBRA "Recovery" Rankings

- IBRA has ranked firms based on recovery potential: 'high' to 'none'
  - Criteria used to establish categories not available for this analysis
- Assume: recovery classifications should be related to firm viability…
  … which should be related to physical condition of resource base
- The following simple measures are offered as examples
  - More sophisticated measures could be developed
  - Should be based on more complete data

Preliminary Analysis:
Years Remaining in Concessions

Assumes:
- Concession period 25 yrs; Cut plan uses available land in available time
- After 25 years, first cut would be well in progress or completed
- Productivity of forest will be lower, affecting viability & resale potential

Calculating remaining license period, we find:
- Of 31 IBRA HPHs matched with information on license date:
- 11 have > 10 years of license period remaining: 3.1 T Rp. debt
  - 7 of the 11 are classified as "high" or "medium" recovery potential
- 15 have < 10 years remaining and hold 1.4 T Rp. of debt
  - 11 of the 15 are classified as "high" or "medium" recovery potential
- 5 have no years left (but may have been extended): 0.85 T Rp. debt
  - 4 of these are classified as "high" or "medium" recovery potential
- Should concessions with short license periods be targeted for review of the extent & quality of remaining forest?

Preliminary Analysis:
Ratio of Debt to Forest Area

Assumes:

- Recovery potential should be related to the operational capacity (area)
- Only 75% of concession area is harvestable

Looking at debt burden per hectare of concession area, we find:

- IBRA's recovery ranking is not closely related to state of physical assets
- The range of debt to concession area is very wide
- This could be because debt is related to equipment & capital, not concession land area …
- Of 5 firms with highest debts per hectare:
  - Debt per hectare ranges from 3 to 17 million Rupiah per hectare.
  - The highest and lowest are ranked as 'high' recovery potential

- Is this a useful measure, or misleading? (capital vs. land area)
- What is status of GOI property (concessions) in IBRA sales of private assets?

Preliminary Analysis:
Ratio of Debt to Productive Capacity

Assumes:

- Recovery potential should be related to operational capacity (m3/yr)
- Wood processing firms operate at about 85% capacity

Looking at debt per cubic meter/year of mill capacity, we find:

- Of 6 firms with highest debts per m3/yr of capacity:
  - Debt per m3/yr ranges from 7 to 32 million R/m3/yr.
  - 3 highest debt/m3/yr firms ranked as only 'low' or 'med' recovery
  - 3 other firms with lower debts/m3/yr are ranked 'high' or 'medium'
- 36 other firms' debts range from 100,000 to 3,000,000 Rp/m3/yr, with various recovery rankings

- How can we judge when debt-to-capacity ratio is "too high"?
- Should recovery rankings be related to measures of debt-to-capacity?

Preliminary Analysis:
Summary and Questions

- Examination of *(some)* IBRA firms' debt burden relative to physical factors shows little relationship to IBRA's recovery potential classes
  … Recovery potential may be based on financial factors, instead

- Some physical measures & field verification would be useful in later investigations and classification of indebted forest sector firms
  …Though, simple measures here may be conceptually flawed or distorted by poor data

- This linked data set indicates some kinds of analyses that could contribute to forest sector restructuring discussions
  …Inter-departmental working groups on industry restructuring should have access to better, more comprehensive data

Progress Toward Restructuring:
Review of Actions Toward Commitment

- Inter-departmental working groups & collaboration procedures established
- Inventory of indebted forest sector firms established
- Basic data sharing initiated among primary government agencies
- Plan proposed for audit of firms to establish viability for resale, though not publicly reviewed
- Approach drafted for "technical covenants" (including environmental rules) for restructured companies, though not publicly reviewed
- Some info & procedures shared with limited publics

Progress Toward Restructuring:
Review of Tasks Remaining

Public Involvement
- IDCF Technical Team has held some meetings.
- Loose alliance of NGOs formed to offer sound policy options
- Need wider review,agreement on basic principles & criteria

Data Conformance & Verification
- IBRA, Deperindag & DepHut consolidated info on indebted firms
- Still need info on forest status, compliance status, legal timber supplies

Process & Transparency
- TT plans to establish a web site for data, actions & progress
- Technical covenants need to be publicly reviewed & improved
- Field level audits & third party verification should support decisions

Responsibility
- Need plans for issues outside IBRA scope, between agencies
- Need to monitor compliance after firms leave the nest of IBRA.

Integrated Approach
- Needed for debt/closure, restructuring, illegal logging, & conversion

Progress Toward Restructuring:
Important, Complex Issues to be Addressed

Political Pressure vs. "Due Process"
- SR political pressure to close some firms for violations
- Resistance to quick action because legal process takes time
- Need process that balances these concerns

"Restructuring" vs. "Closure"
- Debt "haircuts" & "fire sales" could subsidize poor & uneconomic FM
- Society ultimately bears full, true cost of poor FM practices

Political Pressure vs. Organized Planning
- Political & financial pressure on IBRA to raise money by selling assets
- Political & environmental pressure to "close heavily indebted firm"
- Early, inconsistent, damaging decisions could impede later progress
- Need to recognize & balance these conflicting forces

Progress Toward Restructuring:
Important, Complex Issues to be Addressed

Industry Restructuring vs. Debt Restructuring

- Need clarification of terms used too loosely. Important distinction:

- "Debt Restructuring" – IBRA/Bank language – means:
  - Rearrange debt payment to reduce cash flow burden
  - Discount ("haircut") principal & interest owed
  - Goal: make *individual firms* more <u>financially</u> viable

- "Industry Restructuring" – language of IDCF & Kepres 80 – means:
  - Plan strategically to balance timber demand with supply
  - Promote growth in appropriate, legal, sustainable sectors
  - Transition out of uncompetitive or unsustainable sectors
  - Goal: make *entire forest industry* more viable & <u>sustainable</u>

- Please, use these terms precisely, clearly, and responsibly