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BUSINESS STRATEGY - Sukanto Tanoto

THE PULP & PAPER KING SHARES HIS STORY

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The pulp king of Belawan, Sukanto Tanoto did not finish high school, but became one of the largest pulp and paper manufacturers in the world with products sold in more than 60 countries.

THURSDAY, MAY 10 - The weather was fine in Pangkalan Kerinci, Riau. The sun was shining brightly. We were scheduled to meet Sukanto Tanoto at Unigraha Hotel, which is located in the complex of PT Riau Andalan Pulp & Paper (RAPP) in Pangkalan-Kerinci.

Prior to the interview, Sukanto showed up, accompanied by his wife, Tinah Bingei Tanoto. They smiled and greeted us warmly by giving their hands to welcome us. Fortune Indonesia is the first Indonesia media to successfully interview Sukanto Tanoto exclusively.

It was nothing 25 years ago," said Sukanto, starting the conversation and telling us about the 1,750 hectares of the RAPP complex. "Back then there was nothing here. The locals' livelihoods at that time were either being a fisherman or illegal logging," he added.

Sukanto told how the trip from Pekanbaru to Pangkalan Kerinci would take at least four hours. Since there were no roads built yet, Sukanto had to take a boat through the Kampar River and continued on foot to reach the site. When the flood came, no goods could enter the location. Sukanto and his employees could only eat instant noodles for days. Now, the conditions are very different. The pulp and paper mill stands tall on the location and has a production capacity of 2.2 million tons per year and 840 thousand tons of paper per year. To support the mill's operations, roads were built, an airport and ports deployed to ship RAPP's products to various destinations. Another facility supporting the area is the 550 MW electricity power plant. 87% of the power plant uses the black liquor and wood bark to generate renewable energy, while the rest of its power source relies on gas and coal.

Each time when he returns to Pangkalan Kerinci, Sukanto gets excited and happy. For him, it feels like coming home. He has always felt like one of the plasma farmers there. "Back then, like me, it was also a hard time for them," he said. "I told them, first, not to get married again. Second, not to sell their land. For it is the grace of God. So it must be taken care of.

Sukanto Tanoto is an entrepreneur who has successfully climbed the stairs. He began doing business with just three employees. Today, he has more than 50,000 people worldwide. The RGE group of companies, or Raja Garuda Mas, as it's known in Indonesia, has four business pillars, namely fiber, pulp & paper (APRIL (Asia Pacific Resources International Limited), agro industry (Asian Agri), dissolving wood pulp and viscose staple fiber (Sateri Holdings Limited) and energy (Pacific Oil & Gas), with total assets exceeding US\$ 12 billion.

Sukanto's success in growing his business empire is incredible. In fact, he did not attain higher education and did not even finish high school. He dropped out of school not because of laziness, but rather as a result of being impacted in the era of the rebellion party G30S/PKI's (Indonesian Communist Party), who's uprising in 1965 caused national instability and forced the then government to close the school he attended. But Sukanto's desire to learn never left him. According to Tinah Tanoto, her husband loves reading. He would read anything. "Wherever he goes, he always carries a book," she said. Sukanto also regularly takes short courses in some universities around the world to increase his knowledge and education, such as: INSEAD in France, Harvard Business School, and Wharton in U.S. "Continuous-learning is my motto," said the man who also serves on the advisory board of Wharton.

Being independent has been part of his character since Sukanto was a teenager. As a teen, he helped his father by working in the gas station. When his father was in poor health, he continued to run the business and developed it. He then taught himself how to run a business from books, experiences, and the mistakes he made.

In the early 1970s, Sukanto, a contractor businessman discovered something that didn't make any sense to him. At that time, Indonesia exported raw logs, but had to import plywood from other countries. "How can be? Where's the logic in that?" he asked. And that was how he had the idea of starting a plywood mill. The plant began its operations in 1975 and was inaugurated by former President Soeharto. Once the plant started running, Sukanto got into a tricky situation. He learned that building a plant was very different from trading. In trading, people would simply buy and sell items, and the profit was somewhat predictable. On the other hand, building a plant meant that he had to invest first, prepare raw materials and then sell it via credit. He found it more complicated. To understand the business well, Sukanto went to PPM in Menteng, Central Jakarta to learn all about cash flow and management.

The idea to build palm oil plantations came after Sukanto went to Malaysia in 1979. He learned that land in the neighboring country was getting more and more expensive and they were short of manpower –therefore, many Indonesian laborers made a living in Malaysia. Furthermore, in terms of market size, Malaysia was only 1/10 of Indonesia. In Indonesia, labour was available everywhere and the land was still vast. With conditions like that, he asked, "How is it that we can't beat Malaysia?" From then on, he had the passion to become an Indonesian businessman that competes in the global arena. And if he was to build his palm oil business, it should not just produce for the local market, but also globally.

Sukanto began with 6,000 hectares. It turned out that the palm oil business was not easy. To plant 500 hectares of oil palm alone would take three years. It was so hard that at various junctures, the thought of selling the land crossed his mind. However, he kept his faith that the business would be very competitive and successful in the future and chose to continue. His efforts paid off.

Since 1985, he has planted 30,000 acres of palm oil plantation each year. Asian Agri palm oil plantations spread over three provinces in Sumatra with a total land area of 160,000 hectares. In all, the palm oil mills produce about 1 million tons of CPO per year. In terms of area, Asian Agri plantations are still behind Sinar Mas Group's PT SMART Tbk (480,000 hectares), Wilmar Corp. (210,000 hectares) and PT Astra Agro Lestari (192,000 hectares).

Although less strategic than North Sumatra, Riau was chosen to develop the business because of the size of the land and its strategic position to export. In Riau, Sukanto did not only establish palm oil plantations, he also started the industrial forest plantation (HTI) for pulp and paper business needs. Sukanto's intention to start the HTI was to make the pulp & paper business a sustainable industry. He realized that natural forests would not sustain business growth. He also saw how Indonesia's tropical climate provided a distinct advantage and very good support to master the world's global pulp and paper industry. In Indonesia, trees can produce good timber, which are ready for cutting in only 6-8 years, whereas in other countries, such as Scandinavia or Canada, it would take 70 years, while in Spain, it would take 25 years. "The Scandinavians plant trees for their grandchildren, and the Spanish for their kids," he said.

APRIL's current total production, combining its Indonesia and China operations, is 3.9 million tons of pulp, 1.29 million tons of paper and 170,000 tons of cardboard annually. M. Mansyur, the Honorary Chairman of the Indonesian Pulp and Paper Association, said that Indonesia has potential to grow the pulp & paper business because of the 433 million hectares of forest. Only about 5 million hectares have been used until now. At the moment, Indonesia is the 9th largest producer of pulp and the 11th largest in producer of paper in the world. In 2011, Indonesia's pulp production reached 7.9 million tons, and paper production was at 13 million tons. Globally, the world needs 200 million tons of pulp, and 300 million tons of paper.

Indonesia's pulp and paper production cost is also the lowest in the world. For instance, the production cost in Europe and North America is US\$ 500 per ton and in South America, it is US\$ 300 per ton. In Indonesia, it would cost less than US\$200 per ton. And that has caused many US and European pulp and paper mills to close their plants, Mansyur added that the pulp and paper industry is now moving to Asia. "It's a golden opportunity. We are very competitive. "In Indonesia, there are only two big pulp & paper players - Sinar Mas and RGE. "They say Sinar Mas recently bought factories in Canada, France, and Germany, which closed due to the high production cost," said Mansyur. Although Indonesia has great potential to develop a pulp and paper business, Indosurya Securities' Head of Research -Reza Priyambada - finds that in the long term, the demand for paper will decline as the digital trend increases. More and more people read via computers or tablets. "Now, there are e-papers and e-books. Paper usage is simultaneously eroded by digital products," he said.

Sukanto acknowledged that the presence of e-papers and e-books would affect paper demand. But, he believes that the demand for paper is still great and there is a growing market. For example, he pointed to law firms which still require a lot of paper. There is also a need for packaging, paper towels and disposable diapers. Moreover, in Indonesia, very few schools are implementing the paperless system. To face the challenges and increasingly fierce competition, Sukanto said that the key is research and development (R & D). In May, Sukanto had just completed the construction of the RGE Technology Center in Pangkalan Kerinci. In this laboratory, RGE conducts a series of studies, from evolving the best seeds to developing natural predators that will be suitable to suppress pests. "I invested millions of dollars for R & D," said Sukanto.

According to Sabar Siregar, R & D Program Leader, the current research program is not merely to have superior tree seedlings, but also to anticipate future market needs. Therefore, when markets change, the company would have already anticipated it fully. "We are working in collaboration with the market research team, using the plantation management approach. In the next 22 years, the pulp produced will be a totally different pulp," he said.

Sukanto used to be listed as the owner of PT Adaro Energy Tbk. However, he was forced to let go of the coal mining company after a long legal process. When asked how he felt about losing Adaro, Sukanto simply answered, "Game over." He concluded that in life there would always be tidal waves. "It's a part of life," he said. The President Director of PT Adaro Energy Tbk, Garibaldi Thohir, refused to comment on Sukanto's loss of Adaro. Although Adaro is no longer in Sukanto's grip, he added that if there was a chance to get back into the coal business, he would do it, especially, since he has been intensively developing the energy business in the last 10 years.

The 62-year-old man continues to grow his energy business with Pacific Oil & Gas (PO & G). PO & G has operations in Indonesia and China. In Indonesia, PO & G's exploration area covers North Sumatra, Aceh and Merang, Jambi. It is estimated that the amount of oil and gas reserves could reach 40 MMBOE.

In China, PO & G has built an LNG terminal in cooperation with Kunlun Energy, a subsidiary of PetroChina, in Rudong port, near Shanghai worth US\$ 1 billion. The LNG terminal has been operating commercially in April 2011 and with a capacity of 3.5 million tons per year from the total installed capacity of 10 million tons per year. In China, PO & G is also listed as the first foreign company to develop a large scale dual cycle power plant (combined cycle gas turbine) with an installed capacity of 780 MW. Located in Xiamen, south China, the plant is set to increase its capacity up to 1,560 MW in the future. PO & G will also build a second dual cycle power plant in Rudong in collaboration with PetroChina and Jiangsu Guoxin Investment Group. The power plant in Rudong is estimated to have a 1,560 MW capacity, and will be increased up to 3,120 MW at a later stage. "Through the 10 years of developing the energy business, it is more of an investment. There has been no dividend yet," said Sukanto. He has targeted that in the next 10 years, the energy business assets would reach 50% of the RGE's total assets.

According to Sukanto, from his bitter-sweet experience in the world of business, the 1998 crisis was the hardest time. He likened it to a human being trying to survive through thin oxygen. There was a cash flow standstill and debt piled up to US\$ 2 billion. But, the important thing was how to deal with these issues. He worked closely with all of his employees to overcome the crisis. He tried to remain calm, think clearly and listened to ideas. He was also very grateful to have had loyal employees and the full support of his family. When the company encountered hard times, employees who were at the managerial level were willing not to get paid their full salary. At that time, Sukanto made a decision to cut 30% of the mid-level employees' salary. He negotiated with banks. When the crisis passed, business was back on track. "The crisis gave us many valuable lessons. No matter how good your company is, when your country is in trouble, you are also in it," he said.

Since the 1998 economic crisis, Sukanto grew more serious in investing abroad. He expanded his business to China, Brazil and the Philippines. He entered China because he could see the potential of the huge market and rapid growth. His investment in China reached an estimated US\$ 3 billion. He also ventured into Brazil as a foot-hold to the American and European markets. He figured that from Brazil, he could reach the American and European markets more cost efficiently. Also, he could get the status of land ownership in Brazil. In Brazil, Sukanto controls 160,000 acres of land. He also discovered that timber planting technology was more advanced in Brazil than in Indonesia. RGE's investment in Brazil is around US\$1 billion.

In 1997, Sukanto decided to settle in Singapore with his family and set up his company headquarters. There were three underlying reasons. First, he wanted his children to speak English and Mandarin, two languages which he believed would be very important in the future. Second, Indonesia was hit by a global travel ban. Many countries prohibited their citizens to visit Indonesia. Therefore, to keep the business running, Sukanto opened an office in Singapore. Third, Singapore's banks were more competitive in giving financing services.

Sukanto was born in Belawan, North Sumatra, on December 25, 1949. Although he is already in his early sixties, he still looks fresh and youthful. He has four children, and still has not decided who would succeed him. He gave freedom to his four children to decide whether to join the family business or not. For children who are interested in the family business, Sukanto does not necessarily give a top position. First, they must have the capability. For example, before engaging in the family business, daughter Imelda spent two years working in Citibank. Now she handles the financial affairs.

Imelda's younger sister, Belinda, worked as a forewoman on the plantation. Every day she had to wake up at 4:30am to travel to the plantation. "It's part of the basic training. If it was in the city, there's no way she'd be able to wake up that early," Sukanto said with a smile. Imelda also agreed with her father. According to her, it is not important for the family members to be actively involved in corporate management, since ownership and management are two different things.

Among employees, Sukanto is known to be a strong and firm figure, and he admits to it. He also added that it's the industry which had demanded him to be like that. He is also very careful in selecting the professionals to work for his companies. Sukanto, who admires the Taiwanese plastics industry entrepreneur, Wai-Sze Wang, has several criteria in selecting his team of professionals. Among other things: character, integrity, capability to adjust and apply the corporate culture, and a willingness to plunge right into the field of the business. Economics and management expert, Rhenald Kasali, from the University of Indonesia, observed that Sukanto has the intelligence in keeping his management team. He hires a lot of reliable & smart professionals not only from Indonesia, but also from other countries. In Rhenald's note, Sukanto does not include any Indonesian generals or former state/country officials in the management. "He is the only businessman that did not include any general or former officials of Indonesia in the company. This is different from other companies," he said.

One of the new professionals hired by Sukanto is Bey Soo Kiang. Bey joined RGE about a year ago as the Vice Chairman of RGE Group. He is a former Chief of the Armed Forces of Singapore and spent 10 years as a senior executive with Singapore Airlines (SIA). Bey took three months before deciding to join RGE. He wanted to find out more about Sukanto, the man. One of the information sources was a prospectus of Sateri, one of Sukanto's companies, which is listed on the Hong Kong stock exchange. The prospectus covered all the issues associated with Sukanto's reputation.

Bey visited Pangkalan Kerinci twice. "There, I met with a number of executives who are mostly expatriates. It convinced me that the company practises transparency in its business," said Bey. Sukanto is not someone who likes publicity, or even to have a good image in public. In Indonesia, the news concerning him tended to be negative. Yet, he did not feel the need to appear before the media to clarify the issues.

One particular issue related to him was PT Inti Indorayon Utama. The company, which managed forest plantations and a pulp mill in North Sumatra was accused of polluting Lake Toba. Indorayon then was closed for a certain period. Many doubted Sukanto's commitment to the environment.

A day before the interview with Sukanto Tanoto, Fortune Indonesia conducted an air monitoring. In a two-hour flight, we saw the difference between the protected forests managed by the government and RAPP's industrial forest plantation (HTI). We flew around HTI area which comprises a concession of 350,000 hectares in Riau.

According to Dian Novarina, Head Sustainability PT April Management Indonesia, from the numbers above, only about 150,000 hectares can be planted. The rest of the land is set aside for conservation and community development. What we saw was very surprising. In Teso Nilo National Park, we found some areas that have been burnt and in very poor condition. There were a lot of encroachments, no roads and some settlements could be seen in the area. The conditions in RAPP's HTI were different. There was no visible trace caused by burning. "We made two comparisons. You may write anything, but facts don't lie. You fly and see the difference," said Sukanto.

He then continued that after the Indorayon case, he learned an important lesson - that business must involve the surrounding community. Community development (CD) programs were subsequently undertaken by the company. One of the programs focused on developing small and medium businesses around the factory. We chatted with one of the people who were actively involved in the CD program. Yusar admitted that before he partnered with RAPP, he was involved in illegal logging in RAPP's concession area. Then he met RAPP's Sector Manager who explained how illegal logging would not last and Yusar was invited to become the company's trained partner, specializing in harvesting. "We are trained by the company. We are given the tools that can be paid by installments every month," said Yusar, who now has 10 units of heavy equipment and employs more than 50 employees.

The plasma farmers' role in oil palm plantations is also propagated. From 160,000 hectares of oil palm plantations, 60,000 hectares are managed by the farmers. In Riau, there are 29,600 hectares managed by plasma farmers, while in total area of 40,200 hectares. The success of developing the plasma-core system is also felt by Rudianto. He came to Riau in 1991 as part of the government's transmigration program. When he first became a farmer, Rudianto was earning Rp1,250 per day or Rp 37,500 per month as a casual laborer. This amount was earned only if he worked everyday without any absence.

When Rudianto became a plasma farmer, he acquired 2.5 hectares of land. He used 2 hectares for oil palm plantations and the rest was for his housing and yard. Now, his oil palm fields have extended greatly although he declined to give figures. He only said that he could make Rp 5 million to Rp 6 million per month, and owns a 200 square-meter house. Rudianto's income has increased significantly in line with the rise of commodity prices.

According to Rhenald, Sukanto's public reputation is likely negative due to the minimum use of public relations. As such, his good actions are not being highlighted by the media. "I don't think he would be involved in the United Nation's Environmental Protection when he himself is an environmental offender," said Rhenald.

Another issue concerning Sukanto was associated with a loan to RGE from Bank Mandiri. In 2006, Bank Mandiri, which was led by Agus Martowardojo, announced a list of debtors. RGE was on the list. Before the 1998 crisis, Bank Mandiri provided loans of around US\$ 580 million. The loan was restructured due to the crisis and RGE paid their installments of US\$ 61 million annually. According to Abdul-Rahman, Bank Mandiri's Director of Institutional Banking, RGE never had bad credit. Bank Mandiri simply wanted to renegotiate the debt repayment, as the price of pulp had risen significantly at that time, which pumped up RGE's revenue. "The new agreement was to shorten the loan period and increase the monthly installment because they could afford it," said Abdul Rahman. In 2009, RGE repaid US\$110 million with market interest rates. "Up until now, Raja Garuda Mas regularly services the debt," he added.

Head Director of Bank Mandiri, Zulkifli Zaini, said, "I was involved in the negotiations. It lasted for three days and three nights, non stop." The negotiation process was conducted at Bank Mandiri's office. The results were encouraging. "And, most importantly Raja Garuda Mas complied with all of the agreements of the negotiation," said Zulkifli.

Other news concerning Sukanto's business involved the case of tax evasion allegedly committed by Asian Agri. It is said that the value was estimated at Rp1.3 trillion. The case was started by a report from Vincentius Amin Sutanto, former Comptroller of Asian Agri. Vincent is now being held in jail. He was found guilty by the court because of his actions of taking the company's money worth US\$ 3.1 million. The General Director of Taxation then studied Vincent's report and announced the alleged tax embezzlement by Asian Agri. The media then found out that Sukanto had sent a letter to President Susilo Bambang Yudhoyono. In a letter dated January 7, 2008, Sukanto asked the President to provide the opportunity for his company to discuss and resolve the issue conclusively with the General Director of Taxation. Sukanto admitted that he wrote the letter. "If there was no response, it's still fine with me," he said. At the moment, the legal process for this case is still on going. Who will come out right? Let us wait for the trial process. The result may be what Sukanto has said and that facts don't lie.

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