

## The Role of the Capital Market in Defense Industry Funding from the Perspective of Benefit and Risk Analysis

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### ABSTRACT

The defense industry requires significant funding to achieve self-sufficiency and reducing reliance on imported defense equipment. This research aims to analyze the benefits and risks if the government considers the option of funding the state-owned defense industry through the capital market. This alternative has been successfully implemented in several countries. This research employs qualitative methods by collecting secondary data obtained through a literature study, including journal articles, books, and research-related sources. The techniques used include data collection, data reduction, data presentation, data analysis, and drawing conclusions. The research results indicate that funding through the capital market offers multiple benefits but also poses potential risks that must be mitigated through a series of appropriate policies to safeguard the country's strategic interests.

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## **INTRODUCTION**

The defense industry has a very vital role in supporting a country's defense strength. As part of the national defense system, the domestic defense industry must be optimally developed to ensure the availability of defense equipment and military technology independently. An independent defense industry means the ability to design and produce military goods and services with minimal or no reliance on foreign technology (Irfan et al., 2023). The independence of the defense industry will create a deterrent effect (Irwanto et al., 2022) (Mohamad et al., 2022) and send a signal to potential threats, making them think twice before attempting to attack. This is closely aligned with the classic Latin adage, "si vis pacem, para bellum" which means "whoever desires peace, be prepared to face war".

The independence of the defense industry will strengthen the country's defense amidst the global geopolitical conditions filled with various upheavals and dynamics. Then, another concern also arises from the rapid advancement of military technology, such as artificial intelligence-based defense systems, autonomous systems, and hypersonic weapons, which offer advantages in terms of speed, efficiency, and destructive power. If not accompanied by the application of proper ethics, these technological advancements could lead to an uncontrollable arms race and violations of human rights (Aryati et al., 2024). In addressing this, each country must balance its military power.

In Indonesia, strengthening the national defense industry is a crucial component of the Minimum Essential Force (MEF) policy, which defines the minimum military capabilities that must be achieved (Afrihan et al., 2024). Indonesia has set a target to produce its own defense equipment and achieve independence from foreign suppliers by 2029 (Yudho Wibowo et al., 2022). Recently, the concept of Optimum Essential Force (OEF) has emerged as part of hard defense implementation, focusing on system development, defense equipment modernization, and improving the capabilities of defense components (indonesiadefense.com, 2024).

The self-reliance of the defense industry is essential for Indonesia to reduce dependence on foreign defense equipment and maintain readiness in the face of crises, such as conflicts or embargoes imposed by supplier countries. However, in practice, Indonesia still relies heavily on imported defense equipment (Oemry, 2021). This dependence highlights the limitations in the production capacity and technological capabilities of the domestic defense industry. One of the primary challenges hindering the development of the defense industry is the lack of adequate funding. Without sufficient financial resources, it will be difficult for the national defense industry to compete and independently fulfill the country's defense equipment needs. To address this issue, the government must implement strategic measures to overcome funding constraints and support the growth of the defense industry.

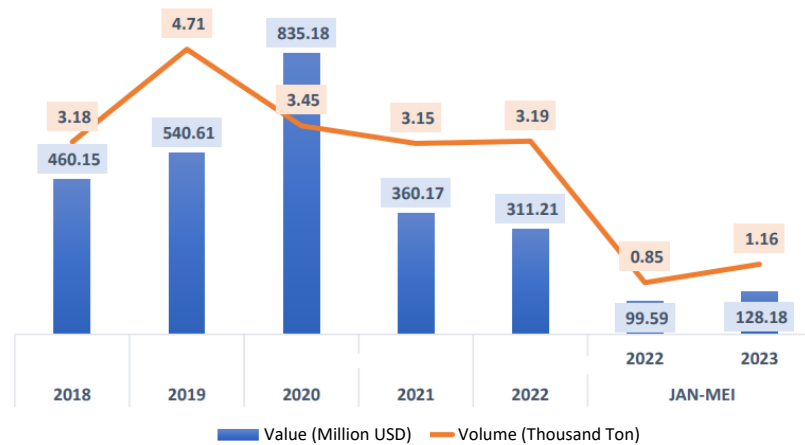


Figure 1. Indonesia's Defense Equipment Imports From 2018 to May 2023  
 Source: Ministry of Trade of the Republic of Indonesia Publication

Actually, in April 2022, the Indonesian government took a strategic step to accelerate the development of the defense industry by launching DEFEND ID (Defense Industry Indonesia). DEFEND ID is a holding company established to manage and integrate state-owned defense enterprises, consisting of PT LEN as the parent company, and PT Dahana, PT Pindad, PT Dirgantara, and PT PAL as members. One of the goals of DEFEND ID is to achieve self-reliance in producing defense equipment for the Indonesian National Army and the National Police (Rahman et.al, 2023). Although DEFEND ID can enhance coordination and efficiency in managing Indonesia's defense companies, the issue of limited funding has not yet been fully resolved.

In facing existing funding limitations, several efforts can be considered, such as increasing the defense budget allocation, establishing strategic partnerships with international partners, strengthening partnerships with private companies, and exploring other financing schemes. One option that has started to gain attention is the potential opening of access to the capital market for state-owned defense industries. This step could become one solution to support the development of production capacity while strengthening the competitiveness of the defense industry in the global market. Therefore, the question arises that needs further examination regarding the benefits and risks if the government considers the capital market for state-owned defense industries.

From the perspective of benefits, the capital market will open up opportunities for the defense industry to obtain larger funding. Then, listing on the stock exchange requires companies to be transparent, which can increase public trust in the company (Fakhrudin, 2013). In addition to the influx of funding, the potential for collaboration with both local and international investors can accelerate technology transfer to support the independence of Indonesia's defense industry. If the government takes the right approach, going public could serve as a catalyst for the transformation of the national defense industry. In advanced countries, defense companies such as BAE Systems (UK)

and Thales Group (France) have leveraged the stock market to enhance their businesses.

However, entering the capital market is not a simple matter for the defense industry. This is due to a variety of considerations, particularly national security concerns, capital market regulations, and public perception of the defense industry. There are worries that opening shares to the public could introduce security risks, such as the leakage of sensitive information or foreign influence through the purchase of shares, which may impact the strategic policies of both the company and the country. Additionally, there is skepticism that the industry might prioritize financial gain over its primary mission of supporting national sovereignty. If the focus shifts solely to profit, it could endanger the country's strategic interests (Hanafi & Soediantono, 2022). We cannot deny that the defense industry is deeply tied to a country's national interests.

The benefits of the defense industry entering the capital market should be considered without compromising national interests. The government needs to implement strict regulations, particularly regarding restrictions on foreign share ownership, monitoring mechanisms, and ensuring that the primary defense priorities are maintained. The research problem in this study revolves around exploring the requirement to enter the capital market, the benefits they might gain from obtaining funding through this avenue, and the factors influencing the success of such endeavors. It also delves into identifying best practices from other state-owned defense companies that have successfully leveraged the capital market, assessing the potential risks associated with this approach and proposing strategies to mitigate these risks. Furthermore, the study seeks to analyze alternative funding options available to Indonesian defense companies beyond the capital market, providing comprehensive insights to inform government policies and decisions.

## **THEORETICAL REVIEW**

### ***Self-Reliance Theory***

This theory emphasizes the importance of self-reliance in the defense industry. A country must have the capability to design, produce, and maintain its own military equipment. The goal is to avoid the risks of dependence on weapon imports, which could negatively impact national defense. Furthermore, this theory also encourages the development of domestic innovation through investment in research and collaboration between the government, academia, and industry.

The Self-Reliance Theory can serve as a foundation for many countries, particularly in building a strong defense industry while generating positive economic impacts (Hanafi & Soediantono, 2022). Strengthening the defense industry can create a multiplier effect, including job creation and expansion, which stimulates economic growth in related sectors such as manufacturing, mining, energy, transportation, infrastructure, and research and development. If the national defense industry achieves sufficient production capacity, it will not only fulfill domestic defense equipment needs but also enable the export, thereby

generating revenue. This, in turn, will reduce the budget needed for importing defense equipment from abroad (Susdarwono, 2020).

### ***Pecking Order Theory***

This theory was proposed by Myers and Majluf in 1984 (Putri, 2016). In this theory, the selection of capital sources is ranked based on the most advantageous options, not merely relying on the targeted capital structure, with the following assumptions:

1. The company prioritizes funding from internal sources, such as retained earnings, before turning to external sources like debt, with issuing new shares as the last option.
2. If external funding is needed, the first choice is the safest security, which is the lowest-risk debt, followed by higher-risk debt such as hybrid securities like convertible bonds and preferred stock, and the last option being the issuance of new common shares.
3. A strict dividend policy with a fixed dividend payout ratio, even though the company's profits may fluctuate.

### ***Defense Industry***

Based on Law No. 16 of 2012, the Defense Industry is a national industry consisting of state-owned enterprises and privately owned businesses, either independently or in groups, that are designated by the government to produce, either partially or entirely, defense and security equipment, maintenance services, to meet strategic interests in the field of defense and security, located within the territory of the Unitary State of the Republic of Indonesia.

Law No. 12 of 2016 on the Defense Industry provides a legal basis regarding government capital participation in the defense industry. Article 51 stipulates that the government provides capital participation for state-owned defense industries for the development and improvement of production capacity. Furthermore, Article 52 regulates the ownership of state capital in the defense industry, stating that the main defense equipment industry is fully owned by the state. Meanwhile, the components and/or supporting industries, supply industries, and raw material industries that are state-owned enterprises must have at least 51% (fifty-one percent) state ownership

### ***Capital Market and Related Terms***

According to Law No. 8 of 1995, the Capital Market refers to activities related to public offerings, securities trading, public companies associated with the securities they issue, and institutions and professions related to securities. The capital market provides various means of long-term business financing where companies can issue bonds, public stock offerings, rights issues, and others. "Go public" is a term used to describe the process of a company offering its shares to the public through the capital market.

A fundamental characteristic of the capital market is Full Disclosure, meaning that companies must provide transparency and disclose information to

the public, which is why they are referred to as Public Companies (Tbk). A public company is a type of limited liability company whose shares are owned by at least 300 shareholders and have a minimum paid-up capital of three billion rupiahs, or any other number of shareholders and paid-up capital as specified by government regulations (wikipedia, n.d.).

There are various investment instruments in the capital market, including stocks, bonds, and mutual funds. Stocks are securities that can be traded either through the stock exchange or over-the-counter, representing ownership of assets (Manurung, 2010). Stockholders are entitled to a portion of the company's profits and assets, usually in the form of dividends (profit-sharing) and capital gains (profits from the difference between the selling price of the stock and the purchase price). There are two main types of stocks in the capital market: (1) Common Stock, where the shareholders have the right to attend the General Meeting of Shareholders (GMS), vote on important company decisions, and receive dividends if the company generates profits. However, if the company is liquidated, common shareholders will only receive a share of the assets after preferred shareholders and creditors. (2) Preferred Stock, where the shareholders have priority in terms of dividend distribution and claims on company assets if the company is liquidated. Bonds are securities that indicate the bond issuer borrows funds from the public and has an obligation to pay interest periodically, as well as repay the principal at a specified time.

## **METHODOLOGY**

This study uses a descriptive qualitative approach. The focus of this research is the analysis of the benefits and risks of funding the defense industry through the capital market. The study utilizes secondary data obtained through literature review, such as journal articles, books, and other sources related to the research. The techniques used include data collection, data reduction, data presentation, data analysis, and drawing conclusions.

## **RESULTS AND DISCUSSION**

### ***The Requirement for Defense Industry Companies Entering the Capital Market***

To build and develop the defense industry, the Indonesian government has established the Defense Industry Policy Committee (KKIP), which is tasked with aligning the national defense industry's master plan with the main defense force development plan and the research and development plan for defense equipment in Indonesia. Through this synchronization, State-Owned Enterprises (SOEs) and private companies can collaborate to support the procurement of defense equipment to meet the future needs of the Indonesian National Armed Forces (Susdarwono et al., 2020). Below is a list of state-owned and private companies recorded by KKIP and their go public status as per the Indonesia Stock Exchange (IDX) website:

Table 1. Go Public Status of State-Owned Enterprises Defense Industry

No	Company Name	Main Product	Go Public Status
1	PT. Pal Indonesia (Persero)	Main defense equipment, warships, etc.	No
2	PT. Dirgantara Indonesia	Aircraft, military planes	No
3	PT. Nusantara Turbin dan Propulsi	Turbines, aircraft engines	No
4	PT. Len Industri (Persero)	Electronics, defense systems	No
5	PT. Inti (Persero)	Electronics, telecommunications	No
6	PT. Dok & Perkapalan Kodja Bahari (Persero)	Shipbuilding, ship maintenance	No
7	PT. Dahana (Persero)	Explosives, defense industry	No

Next, of the 34 private defense industry companies listed in the KKIP (33 PTs and 1 CV), only PT. Sri Rejeki Isman, Tbk is listed on the stock market, while the others have not yet.

Table 2. Private Defense Industry

No	Company Name	No	Company Name
1	PT. Adityatama Perkasa Putra (Construction, defense project development)	18	PT. Lundin Industry Invest (Defense industry investment)
2	PT. Bhinneka Dwi Persada (Defense systems, information technology)	19	CV. Maju Mapan (Construction services, procurement of goods)
3	PT. Citra Shipyard (Ships, maritime construction)	20	PT. Mandiri Putra Muhibbah (Construction, procurement of goods)
4	PT. Daya Radar Utama (Radar, defense equipment)	21	PT. Melati Wahana Raya (Security systems, maritime equipment)
5	PT. Elmas Viana Djaja (Defense systems, electronics)	22	PT. Palindo Marine Shipbuilding, defense systems)
6	PT. Farin Industri Nusantara (Raw materials industry, manufacturing)	23	PT. Ridho Agung Mitra Abadi (Maritime equipment, defense equipment)
7	PT. Garda Persada (Defense equipment, security services)	24	PT. Robomarine Indonesia (Robotic technology for defense)
8	PT. Global Inovasi Informasi Indonesia	25	PT. Sari Bahari

No	Company Name	No	Company Name
	(Information technology, defense systems)		(Shipbuilding, maritime industry)
9	PT. Hariff Daya Tunggal Engineering (Defense tech., communication systems)	26	PT. Saba Wijaya Persada (Defense components, heavy equipment)
10	PT. Indo Pacific Comm. & Defence (Communication systems, defense)	27	<b>PT. Sri Rejeki Isman, Tbk.</b> <b>(Textiles, defense industry)</b>
11	PT. Indoguardika Cipta Kreasi (Security, defense systems)	28	PT. Sembada Karya Mandiri (Construction, development)
12	PT. Indopulley Perkasa (Pulley, defense components)	29	PT. Sentra Surya Ekajaya (Technology, defense systems)
13	PT. Infoglobal Teknologi Semesta (Information technology, defense)	30	PT. Tesco Indomaritim (Shipbuilding, maritime transportation equipment)
14	PT. Infra RCS Indonesia (Infrastructure, defense)	31	PT. T&E Simulation (Defense simulation)
15	PT. Jala Berikat Nusantara Perkasa (Ships, maritime transportation equipment)	32	PT. UAVindo Nusantara (UAV technology, defense equipment)
16	PT. Karya Tugas Anda (Construction, defense technology)	33	PT. Wirajayadi Bahari (Maritime systems, defense equipment)
17	PT. Langit Biru Parasut (Parachute equipment, defense equipment)	34	PT. Carita Boat Indonesia (Ships, maritime transportation equipment)

Source: KKIP and IDX (analyzed)

Both state-owned and private companies in the form of limited liability companies (PT) have the opportunity to enter the capital market if they meet the established requirements. According to the information on the IDX website, stocks are categorized into 3 boards based on the size and stability of the company: the Main Board, Development Board, and Acceleration Board (gopublic.idx.co.id, n.d.).

Criteria	Main Board	Development Board	Acceleration Board
	For established companies with good financial performance that meet the requirements of the IDX	For smaller or newer companies that are still developing, with growth potential but not yet fully stable.	Opportunities for startups or fast-growing companies to go public, with more flexible criteria.
<b>Operating Period (Recording Business Revenue)</b>	>=36 months	≥ 12 bulans	Since its establishment, it has recorded operating income in the last financial year.
<b>Audited Financial Statements</b>	Min. 3 years (2 years with Unqualified Opinion)	Min. 12 months (1 year with Unqualified Opinion)	Min. 1 year or since establishment if established for less than 1 year (Unqualified Opinion)
<b>Capitalization</b>	Earnings before tax in the last fiscal year & NTA ≥ IDR 250 billion; <b>or</b> Cumulative Profit Before Tax for the last 2 years ≥ IDR 100 billion & Market Capitalization ≥ IDR 1 trillion; <b>or</b> Revenue ≥ IDR 800 billion & Market Capitalization ≥ IDR 8 trillion; <b>or</b> Total Assets ≥ IDR 2 trillion & Market Capitalization ≥ IDR 4 trillion; <b>or</b> Cash Flow from Operating Activities for 2 years ≥ IDR 200 billion & Market Capitalization ≥ IDR 4 trillion.	Net Tangible Asset ≥ IDR 50 billion; <b>or</b> Cumulative Profit Before Tax for the last 2 years ≥ IDR 10 billion & Market Capitalization ≥ IDR 100 billion; <b>or</b> Revenue ≥ IDR 40 billion & Market Capitalization ≥ IDR 400 billion; <b>or</b> Total Assets ≥ IDR 250 billion & Market Capitalization ≥ IDR 500 billion; <b>or</b> Cash Flow from Operating Activities for 2 years ≥ IDR 20 billion & Market Capitalization ≥ IDR 400 billion.	None, Follows OJK Regulation  Operating Profit: Loss Allowed Requirement: Based on projections, net profit must be achieved by the end of the 6th year since listing.
<b>Number of Shares</b>	Min. of 300 million shares	Min. of 150 million shares	Not regulated
<b>Free Float</b>	equity < IDR 500 Billion : 20% equity IDR 500 Billion - 2T: 15% equity >IDR 2T: 10%	equity < IDR 500 Billion: 20% equity IDR 500 Billion - 2T: 15% equity >IDR 2T: 10%	Min. 20%
<b>Number of Shareholders</b>	≥1000 parties	≥500 parties	≥300 parties holding SID
<b>Initial Public Offering (IPO) Price</b>	≥IDR 100	≥ IDR 100	≥ IDR 50

Figure 2. The Requirements (Financials, Accounting, and The Public Offering Structure to List Shares on IDX (modified)

Companies that fulfill financial, accounting, and public offering requirements can move forward with the Initial Public Offering (IPO) process to become a publicly traded entity.

### ***Benefits of Funding from the Capital Market***

By going public, a company will gain various benefits and advantages, including (Fakhrudin, 2013):

1. Obtaining a large amount of fresh funds that can be received at once and used for the company's needs.
2. Relatively low costs (low-cost funds) compared to the costs of obtaining other forms of funding such as from financial institutions.
3. No fixed financial obligations since dividend payments are not mandatory. They are targeted based on the profits earned and are determined by the General Meeting of Shareholders (GMS). The company may even make a profit but decide not to distribute dividends if shareholders agree to reinvest them.
4. Becoming a prestigious company by receiving the "Tbk" label, which signifies that the company is part of a group committed to transparency, good corporate governance (GCG), and is more professional and credible.
5. Increased company publicity.

Capital market funding presents multiple strategic benefits for companies. These advantages collectively position companies for sustainable growth and long-term success in a competitive business environment.

## *The Factors Influencing the Success of Going Public for Defense Industry Companies*

The factors that attract the public to buy shares in the capital market include (Fakhruddin, 2013):



Figure 3. The Factor Influencing the Success of Going Public

The success of going public is influenced by the company's ability to attract investors to invest. In addition to financial factors, there are other strategic factors that must be considered to ensure that the defense industry has added value compared to other sectors, including:

### 1. Technological Excellence, Innovation and Product Diversification

Investors will be attracted to companies that excel in technology and innovation, especially with the development of technologies such as artificial intelligence (AI), cyber weapon systems, and autonomous vehicles. Product diversification into the civilian sector, in addition to the military sector, will expand the target market and increase company revenue. Technologies such as drones, navigation systems, communication systems, and vehicles, which were initially developed for defense, can be adapted for the commercial market. This way, the limited market, with the government as the sole buyer, can be expanded into the commercial sector.

Furthermore, one of the challenges faced is the public perception that certain defense industry companies are associated with producing lethal and dangerous goods, such as firearms, ammunition, and other military equipment. These products have very specific and controlled functions, and therefore cannot be freely owned by civilians, as their use is subject to strict government regulations. Although we know that these products are designed for security and protection purposes, the perception that the defense industry only contributes to conflict or violence must be avoided. Diversifying products into the civilian sector serves as a strategy to demonstrate that the technologies developed offer broad benefits to society, not just exclusively for the military.

### 2. Government Policy Support

The defense industry is an imperfect market due to its structured, limited nature, and government-controlled policies, with most demand coming from the government, particularly the military, unlike a perfect market with open

competition. This could be one reason why the defense industry is less attractive. Various uncertainties can arise, such as changes in defense budgets, procurement contracts for defense equipment, or other conditions that can change anytime, following political dynamics and national or global security situations. The defense industry could lose investor confidence if they fail to minimize these risks. Again, diversification (into civilian products) becomes one solution to address this issue because it will reduce reliance on government budgets and contracts.

The government's role as a regulator is crucial. In addition to providing incentives such as tax cuts, subsidies for research and development, or facilitating collaboration between defense industry companies, universities, and research institutions to create innovations together, the government needs to prepare comprehensive and strict policy packages if it eventually decides to open the gates for state-owned defense industries to enter the capital market.

### 3. Collaboration/Partnership with Foreign Entities

Collaboration or partnerships with international defense companies can enhance a company's attractiveness. This serves as an indicator for investors and proof that the company is capable of competing in the international market. This is especially true if the partnership is with a country that has good economic prospects or maintains strong relations with Indonesia. On the other hand, partnerships with companies from countries that have a poor international reputation may lead to a lack of investor interest.

### 4. Leadership Image

The leadership image influences investor interest in the defense industry. Under the leadership of a president with a military background who understands the urgency of defense modernization, investment in the defense industry can have good prospects because it will receive serious attention. This is already evident when reviewing the Ministry of Defense's budget, which reached IDR 165.2 trillion in the 2025 State Budget (RAPBN) (Ferdianto, 2024). Strengthening the defense industry is not only seen as an effort to serve national defense interests but also as an economic development initiative. Conversely, if the government does not show sufficient attention to the defense sector or lacks commitment to strengthening the defense industry, this may reduce investor interest, as they will not see a clear long-term prospect.

### 5. Implementation of ISO in the Defense Industry

The implementation of International Organization for Standardization (ISO) standards in the defense industry can be an attractive factor for investors. This is because companies that have implemented ISO standards are considered to have met international standards such as quality management, information security, or environmental sustainability, which are essential for the defense industry. There are many ISO standards relevant to the defense industry, such as ISO 9001:2015, which is recommended for application in defense industries (Hanafi et. al, 2022).

The success of defense industry companies in going public depends on their ability to attract investors by offering strategic advantages beyond financial

factors. This needs to be managed carefully because the defense industry has unique characteristics that differentiate it from other industries.

### ***Best Practices of Defense Companies in Other Countries***

There is a stark contrast in the objectives behind the establishment of the defense industry between developed and developing countries. Developed countries tend to prioritize domestic budget circulation by strengthening the private defense industry, where the government acts as the consumer, sponsor, and regulator. In contrast, developing countries often rely more on importing ready-to-use defense equipment due to limited domestic components. As a result, the proportion of imported defense procurement is disproportionate to the efforts made in developing the domestic defense industry (Irwanto et al., 2022).

Looking at the defense industry development strategies of developed countries, we can observe the long journey of BAE Systems (London). This company was first established as a national company in April 1977. However, state control over arms trade did not last long under the Thatcher government. In 1981, the UK government sold 51.57% of its shares in BAe after the company transformed into a public limited company (PLC). In 1985, the UK government sold its remaining shares, leaving only a special (golden share) to ensure the company remained under British control (foreign ownership of BAE Systems was limited by law to 29.5%). Over the years, BAE was involved in one of the largest trade scandals, the Al-Yamamah deal with Saudi Arabia. However, BAE Systems continued to expand its business through acquisitions, restructuring, mergers, joint projects, and more (Corporatetwatch.org, 2015).

Currently, BAE Systems is ranked among the top 10 defense companies in the world (Stojkov, 2024). Although this company is public and the UK government no longer holds a majority of shares, the UK government still possesses a golden share in BAE Systems, which grants it control and authority to prevent unwanted acquisitions, particularly in matters related to national security (Haill, 2021). BAE Systems is listed on the London Stock Exchange with a very high share price, which has been rapidly increasing in the last five years, ranging between £900-£1,400 in 2023-2024 (londonstockexchange.com, 2024). On the other hand, a private company that is also ranked among the top 10 defense firms globally is Lockheed Martin, which is listed on the New York Stock Exchange. Its share price has been consistently high, ranging between \$400-\$500 per share in 2023 to 2024 (id.investing.com, 2024). We need to look at countries that have successfully used the capital market as a funding source for state-owned defense industry companies in order to develop a sustainable domestic defense industry.

### ***Potential Risks and Their Mitigation***

In addition to the benefits, the decision to go public also involves a number of risks and challenges that need to be carefully considered, including:

1. Decreased Power/Control of the State

The defense sector and defense technology are vital aspects of national security, so offering shares to the public raises concerns about reducing the state's control over the operations and management of the company.

## 2. Vulnerability in Information Disclosure

As a public company, there is an obligation for transparency, which could potentially expose strategic information related to defense. This disclosure requirement also constitutes a cost for the company.

The government regulates at least three main policies concerning the defense industry's activities: access to classified information, product and export destination provisions, and anti-corruption and anti-bribery regulations. Access to classified information includes innovations or technological advancements obtained through R&D processes, as well as knowledge gained by experts through their research. The government must work to safeguard this information to prevent it from being accessed by other countries by limiting its circulation (Irwanto et al., 2022). Export regulations are also crucial. This is because the government is involved in financing the design and development of defense products, giving it the economic-political legitimacy to grant export licenses for weapons. The goal is to protect technological advantages and prevent the shipment of weapons to importing countries that could pose a threat to national security (Irwanto et al., 2022).

## 3. Foreign Shareholder Intervention

Intervention from foreign shareholders is a concern as it may influence the company's policy direction and potentially conflict with national interests. Additionally, public investors could exert pressure to meet market expectations, which may not always align with long-term needs.

## 4. Capital Market Dynamics

Capital market dynamics can impact the stability of a company. If the market experiences high volatility, this can affect the continuity of strategic projects undertaken by the company. Policies regarding dividend payout ratio have a significant influence on the volatility of market perceptions toward the company (Suteja, 2015).

## 5. Profit and Efficiency Demands

The pressure to generate profits for shareholders can conflict with the company's strategic mission, which is more focused on national interests rather than profitability alone.

Although profitability ( $r$ ) or Return on Equity (ROE) reflects how effectively and efficiently the company operates (Suteja, 2015).

## 6. Reputation Risk

As a publicly traded company, the company's performance will be evaluated by the public and investors, so reputation risk increases if the company fails to meet existing expectations.

The government's decision to open the capital market option must be carefully planned and managed, considering the ability in risk management and preparedness for the maximum impact if the risk occurs. This greatly depends on the decision-makers' risk appetite, whether they will become risk takers or

risk avoiders. Mitigation efforts that can be taken against the above risks include the following:

1. Developing strict regulations and policies, such as setting limits on foreign share ownership, creating a blacklist of foreign investors deemed potentially threatening to national interests, banning acquisitions by foreign parties, and requiring transparent reporting on the use of funds raised from the capital market.
2. Separating strategic and non-strategic business lines, where funding opportunities are only available for non-strategic business lines, such as the manufacturing of dual-use products (civilian and military).
3. Classifying sensitive information by establishing data and defense technology protection standards to prevent leaks to the market.
4. Building a secure ownership structure, such as the Golden Share implemented by the UK government, where the government holds special shares that provide a veto right in the company's strategic decisions.
5. Appointing other state-owned enterprises (SOEs) to be partners in the IPO process.
6. Establishing a special supervisory body to ensure that funds are used in accordance with their intended purpose and do not threaten national security.
7. Benchmarking to study best practices from countries such as the United States or the United Kingdom, which have successfully utilized the capital market for the defense industry.
8. Implementing Good Corporate Governance (GCG) by the company, along with strict financial and operational audits to ensure the company remains in a healthy condition.

The risks associated with the decision to go public for defense industry companies can be reduced with proper mitigation strategies. With careful planning and effective risk management, companies can maximize the potential of capital market funding without jeopardizing their stability and reputation.

### ***Funding Options Other Than the Capital Market***

The decision for a company to go public largely depends on the extent of its funding needs. One of the factors to consider is the company's financial policy, particularly regarding capital structure and the type of investment chosen. Making the right investment decisions will open opportunities for the company to grow and enhance profitability, benefiting shareholders and increasing the company's value (Suteja, 2015).

However, if the capital market is not the option, aside from government equity participation and Foreign Direct Investment (FDI) such as Joint Ventures, Direct Investment, and Technology Transfer, which also have potential risks of espionage threats (Sarjito, 2023), the government could consider other funding alternatives. These can be arranged in order of investment instruments with lighter risks, such as bank loans and financial institutions, as has been done so far, or issuing private bonds and preferred shares.

Private bonds (private placement) are bonds issued by a company and offered only to a limited number of investors, such as financial institutions,

banks, or other large investors. The issuance of these bonds is not conducted through the capital market, so the company does not need to register with the capital market, and the process is simpler than for public bonds.

Similarly, preferred shares can be issued by a company without going through the capital market. Preferred shares are shares that provide certain privileges to the holders, such as priority dividend payments or priority in the event of company liquidation.

Table 3. The Comparison Between Private Bonds and Preferren Stocks

Aspect	Private Bonds	Preferen Stock
Ownership	Does not alter the company's ownership structure (no dilution)	Can cause ownership dilution if new shares are issued
Funding Cost	Pays fixed interest (interest expenses), regardless of the company's performance	Pays dividends if there is profit, flexible (not mandatory)
Company Risks	Risk of default if cash flow is insufficient to pay interest	No default risk because dividends are only paid if profit is available
Flexibility	Term and interest rate can be negotiated according to the company's needs	Dividends can be set flexibly, such as cumulative or non-cumulative dividends
Financial Burden	Fixed interest burden, which may strain the company with weak cash flow	No fixed burden, dividends are only paid if the company has profit
Time Periode	Limited, as bonds have a maturity date and must be repaid on time	No maturity date, ownership of shares continues indefinitely
Funding Objectives	Better suited for financing specific projects with a fixed term	Suitable for raising equity capital without the obligation to repay
Investor Security	Investors are safer since bonds are debt, with higher priority in liquidation	Preferred shareholders are safer than common shareholders, but below bonds in liquidation
Attracting Investor	Suitable for conservative investors seeking steady income	Suitable for investors seeking preferential rights
Investor Influence	Bond investors do not have voting rights in the management of the company	Preferred shareholders typically do not have voting rights, but have higher priority in dividends

Both private bonds and preferred shares have their respective advantages and disadvantages. If a company requires funding with low risk without sacrificing ownership, bonds are more suitable. On the other hand, if the

company needs funding flexibility and long-term investor support, preferred shares are better. The company can also issue convertible bonds, which are bonds that can be converted into shares at a certain time. This instrument provides flexibility for investors.

## **CONCLUSSIONS AND RECOMMENDATIONS**

Based on the research findings, it can be concluded that funding through the capital market offers multiple benefits but also poses potential risks that must be mitigated. To enter the capital market, the defense industry must meet the financial, accounting, and public offering structure requirements set by the IDX. Several factors influence the success of going public for the defense industry, including technological excellence, innovation and product diversification, government policy support, collaboration/partnership with foreign entities, leadership image, and the implementation of ISO in the defense industry.

The benefits of funding through the capital market include access to significant fresh funds that can be used for the company's needs, lower costs compared to other funding sources like financial institutions, and the flexibility of not having mandatory financial obligations, as dividend payments are based on profits and shareholder decisions. Additionally, becoming a publicly listed company enhances its prestige, signaling transparency, good corporate governance, professionalism, and also increases the company's visibility and public profile.

However, in addition to these benefits, there are risks and challenges that need to be carefully considered, including the potential reduction of state control over defense companies, vulnerability in information disclosure due to transparency obligations that may expose sensitive defense-related data, and the risk of foreign shareholder intervention, which could influence company policies or conflict with national interests. Furthermore, capital market dynamics, such as market volatility, can impact the stability of the company, and the pressure to generate profits for shareholders could conflict with the company's long-term national interests, while the risk of reputational damage increases due to heightened public expectations.

The decision of whether the defense industry should remain private or go public should be based on a thorough analysis of the economic benefits, the risks involved, and the risk appetite of decision-makers. If going public is chosen as a strategy, it must be accompanied by planned risk mitigation efforts as outlined above. This approach can provide a balance between the sustainability of the defense industry and the protection of national interests. Furthermore, it is crucial to separate strategic and non-strategic business lines, such as the manufacturing of dual-use products (civilian and military). The government should also consider building a secure ownership structure, such as the Golden Share implemented by the UK government, where the government holds special shares that provide a veto right in the company's strategic decisions. However, if the capital market is not a viable option, the government can consider alternative financing methods, such as issuing private placement bonds or preferred shares.

### **FURTHER STUDY**

Based on the findings of this research, further studies could explore the specific policy frameworks needed to mitigate the risks associated with capital market funding for the defense industry. Future research could also examine case studies from countries where this funding model has been successfully implemented, analyzing the factors that contributed to its success. Additionally, research could investigate the potential long-term impacts of capital market funding on the sustainability and independence of the defense industry, including its effect on national security and technological advancements.

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