

## CORPORATE GOVERNANCE IN INDONESIAN STATE-OWNED ENTERPRISES: FEEDING WITH WESTERN INGREDIENTS

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### **Abstract**

Corporate frauds and failures in Indonesia have continued despite the corporate governance principles of Indonesia's State-Owned Enterprises (SOEs) which have been strengthened following the Asian financial crisis of 1997/1998. This appears to indicate that corporate governance principles primarily adopted from developed Western nations are not adequate to address problems faced by SOEs in Indonesia. This primarily analytical paper evaluates the current corporate governance practices in Indonesian SOEs in light of the prevailing political and corporate culture. Given the complexity of Indonesia's political and corporate culture the adoption of corporate governance principles from Western nations as promulgated by the OECD and/or the Cadbury report are inadequate to reduce corporate mismanagement and failure among SOEs. The study also utilizes some qualitative interview data from thirty respondents at managerial level within three SOEs to aid the assessment of corporate governance practices and principles in the Indonesian context.

**Keywords:** corporate governance principles, shareholders, Indonesia

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### **Introduction**

There has been a history of corporate governance failures in Indonesian State Owned Enterprises (SOEs) both before and after the Asian crisis as has also occurred in other nation-states. There have been many instances of management problems as well as corporate failures that can be traced back to ineffective or poor corporate governance practices. At the beginning of 1990's these included the cases of Bank Bali; Indover Bank; BULOG (The National Logistics Body); PERTAMINA (state oil company); Bank Negara Indonesia—one of the listed state banks in the late 2003 which lost Rp.1.7 trillion (A\$ 283.3 million); and, management remuneration packages in PLN (State power company) (Goodpaster, 2002, p. 12-13; Cahyono, 2003, 7; Polce, 2005; Zainal, 2005; Oliver, 2005).<sup>1</sup> Indications of corporate governance malpractice amongst Indonesian SOEs include the alleged misuse

of power by government regulators through their representatives within SOEs. These nominees serve as directors and commissioners on the SOE governing bodies. Similar abuses of power and privilege are promulgated by Indonesia's diversified power elite: those social categories that are powerful politically, economically, militarily, or traditionally within Indonesian society (Patrick, 2001, p. 5).

This paper focuses on the actual behaviour of Indonesian SOEs shareholders—which in this instance is government of Indonesia—and its stakeholders who include board directors/commissioners; senior managers; employees; and, related parties such as parliament members and other parties who have the power to influence policy making process. The study examines the interaction and practices of these parties in implementing corporate governance systems within SOEs. Issues such as the board's role in making strategic decisions; its role in supervising corporate finances; and, in supervising daily management tasks will be analyzed in line with the board's behaviour (Holloway, 2004).

Herwidayatmo argued that one of the main factors that exacerbated and prolonged the East Asian financial crisis was the inadequate

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<sup>1</sup> All these cases have been prosecuted in the courts. However, this paper will not be analyzing these individual cases because the focus is instead on Indonesian SOEs.

implementation and practice of 'good' corporate governance (2002, p. 6). Indonesia, in which the research for this paper took place, was impacted the hardest when compared with other countries in the region (Herwidayatmo, 2002). Shiroyama posited that 'bad' corporate governance, which is colloquially known within Indonesia as KKN (corruption, collusion, and nepotism) is a primary cause of the ongoing Indonesian economic crisis (2003, p. 28). Tabalujan also argued that 'weak' corporate governance practices are a major factor in the prolonged financial crisis in Indonesia (2002, p. 2). The cost of this economic and financial crisis to Indonesia has been extensive. The Indonesian currency—the rupiah—has been depreciated approximately 575%, and wealthy local business people have transferred large tranches of funds out of Indonesia in a quest for safer places for investment.

This paper is organised as follows. The first part provides a brief background and justification for the study of these SOEs. The second part locates the paper within the broader—Western and European based—literature on corporate governance and its many contested definitions. It then proceeds to analyse and critique the main elements of the Western-developed corporate governance model which is being advocated as the preferred 'global convergence' model (Solomon and Solomon, 2004). The development of corporate culture within Indonesian SOEs is also analysed within the larger context of Indonesian political and historical developments. It concludes with an assessment of the current state of corporate governance practices within the latest political and business developments. The latter half of the paper also incorporates insights from the qualitative interview data from ten of thirty Indonesian respondents—obtained in 2005—within SOEs and other Indonesian institutions. In addition to these interviews, this study utilizes current news releases published in mass media to update and confirm the information supplied by participants in these interviews.

## **Background**

The existence of 'good corporate governance' (GCG) is important for two main reasons. At a corporate level it is importance to ensure business entities are managed in such a way that "...business behaves honestly, equitably, and transparently towards all their stakeholders" (Patrick, 2001, p. 22). At the nation-state level, the existence of GCG will ensure a continued confidence in the interaction among economic agents within the business domain. This degree of confidence is paramount for a country such as Indonesia in its quest for achieving sustained improvements in economic wellbeing and the future prosperity of its citizens. Any sustained loss of confidence, among economic agents within a system

that is supposed to guarantee GCG, will negatively impact the entire economy as evidenced by what happened during the Indonesian economic and financial crisis in 1997/98.

One unique characteristic of Indonesia corporate structure to date which differentiates it from other nation-states—especially the 'developed' Western countries—is the existence of many large and small corporations owned and/or controlled by the State. These State Owned Enterprises (SOEs) have existed side by side with other public corporations—in private shareholders hands—for the past half century. There are about 158 SOEs with total assets of US\$150 billion (Ministry of State Owned Enterprises, 2005). Following the financial crisis in 1997/1998 SOEs were and are expected to increase their contribution to the national income and budget outcomes. For example the target for 2005 budget is US\$1,100 million and will be doubled in 2006<sup>2</sup> (Asian Development Bank, 2005, p. 1-2; Supriyanto, 2005).

These SOEs can be broadly categorized into two main types. The first is those SOEs which have been publicly listed on Jakarta Stock Exchange including PTTelkom (Indonesian telecommunication company); PT Bank BNI (State bank); and, PT Timah (Mining company). This has occurred as part of a privatization 'push' by the Indonesian government. The shareholders within these privatized corporations are other companies, institutional investors as well as the general public. The second category consists of SOEs which are still fully owned by the State such as PT PLN (State power company); PT Pertamina (State oil company); and PT Garuda Indonesia (National airline company). Whilst SOEs belonging to the first category are now subject to the rules, regulations and corporate governance practices of publicly listed companies, the second category of SOEs are subject to different set of rules, regulation and governance. A special government ministry, the Ministry of State-Owned Enterprises exists to regulate, govern and monitor the management and business activities of SOEs which fall within this latter category.

In essence, SOEs were and are established in order to provide an economic boost to the nation and provides specific goods and services not supplied by the private sector and to:

contribute to the development of national economic, especially to the national revenue; be a profit oriented; perform its public functions of fulfilling the needs of the masses in the form of the provision of high quality goods and services; be a pioneer in business ventures where the presence of private sector and cooperation is yet to be realized; and actively provide guidance and assistance to small

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<sup>2</sup> 1 US\$ equal Indonesian Rupiah (IDR) 10,000

and weak enterprises, cooperation, and people (Kementerian Badan Usaha Milik Negara, Undang-Undang (or Parliamentary law) number 19, 2003).<sup>3</sup>

However, as the result of weak corporate governance practices in SOEs, there is a growing perception that most SOEs have become personal 'gold mines' for corrupt individuals. Consequently, the operation and management of SOEs has become the centre of public attention. SOEs are being publicly scrutinized because of the belief that KKN is entrenched in this sector. There exists a public perception that GCG practices may provide a useful development to help eliminate KKN because this foregrounds the critical elements of transparency and accountability. If these elements of transparency and accountability are present in the operation and management of an enterprise the risk of KKN practices is reduced.

This paper poses the following question: What are the main problems faced in efforts to adopt the internationally-developed GCG characteristics and system for Indonesian SOEs? It is clear from the earlier analysis that SOEs are vital to the Indonesian economy.

There is a 'wealth' of literature on issues associated with the corporate governance of publicly listed companies but there is, however, a gap in the literature on corporate governance issues and practices specifically associated with SOEs in Indonesia and other nation-state domains. This paper will help to redress that imbalance and provides insights into the specific issues and difficulties facing the Indonesian regulators and corporate governance reformers.

### **International Corporate Governance Definitions and Developments and the Indonesian Context**

The objective of corporate governance according to Patrick (2002) is that "business<sup>4</sup> behaves honestly, equitably, and transparently toward all their stakeholders". An earlier distinction by Berle and Means in the early 1930s (cited in Sato, 2003, p. 89) posited that corporate governance is about the separation between the shareholders and those who run the business—the notion of the emergence of a professional management class in organizations. This raises a critical issue of how to 'control' management behaviour and the associated problem of the alignment of owners' versus senior managers' expectations of firm performance.

<sup>3</sup> The purpose and goals of the establishment of SOEs has been changed. In the first place the establishment of certain SOEs were as: a) pilot project, b) price stabilizer, c) the role of a strategic industry, and d.) agent of economic development.

<sup>4</sup> The term business in this case is defined as directors, commissioners, owner/government and other stakeholders.

More recently the Organisation for Economic Co-operation and Development (OECD, 1999) has developed a set of corporate governance principles that can be adopted by the OECD member and non-member countries which would help to ameliorate this particular problem if implemented effectively.<sup>5</sup>

There are, however, many different definitions of corporate governance that have been developed internationally through a series of reports and recommendations following a series of high profile corporate failures and scandals throughout the 1980s and 1990s. For example the Cadbury Committee defined corporate governance as the system by which companies are directed and controlled (Baxt, Ramsay & Stapledon, 2002, p. 160).

A definition developed by Claessens (2003) divides corporate governance into two categories. First, governance is linked with the actual behaviour within corporations such as management efficiency and the treatment of shareholders and stakeholders.

Second it is seen within a normative framework consisting of the rules, legal and the judicial system. According to Claessens, the first category is more appropriate for studies of single firms in one country such as would be the case in this paper on State-Owned Enterprises (SOEs) in Indonesia.<sup>6</sup> Prentice (1993) on the other hand defined corporate governance as being concerned with the relationship between the stakeholders and the board of directors.<sup>7</sup> Given the aim of this paper the corporate governance definition given by Prentice which is concerned with the relationships between the stakeholders in a company and the board of directors/commissioners is deemed to be the most appropriate for this study.

### **Corporate Governance and the Indonesian Context**

The significant numbers of recent corporate failures has meant that corporate governance issues have received more attention by the regulators not only in developed countries but also in countries such as Indonesia. One way of recovering from a lengthy financial crisis as happened in Indonesia from 1997 onwards is to bring capital investment into the country (Shiroyama, 2003).

Utilising the International Monetary Fund's economic reform package recommendations, direct

<sup>5</sup> The principles include for example: the rights of shareholders; the equitable treatment of shareholders; the role of stakeholders; disclosure and transparency; and, the responsibilities of the board of directors (OECD, 1999, p. 13).

<sup>6</sup> The second category of definitions is more logical for comparative studies (Claessens, 2003, p. 4).

<sup>7</sup> Indonesia adopts two tier system or two-boards system (European Continental System) for the limited liability companies which are Board of Commissioners (BOC) and Board of Directors (BOD) (Kurniawan and Indirantonoro 2000; Husnan 2001).

foreign investment can be achieved through the privatization of SOEs and the overseas purchases of listed Indonesian companies' shares.

These types of financing activities can facilitate Indonesia's economic growth and assist Indonesia out of its ongoing financial crisis. However, this can not be realized unless investors' confidence—both overseas and domestic—is strong, hence these foreign institutional and personal investors demand good corporate governance regimes and practices (Patrick, 2001, p. 7).

Consistent with the International Monetary Fund's requirements, SOE shareholders and senior management are pinning their organizational future hope and faith that GCG within the SOEs can and will be established.

Without the implementation of effective and internationally acceptable corporate governance practices, ongoing privatization will not be viable for the remaining Indonesian SOEs. If such privatization initiatives or other forms of foreign investments can not be achieved then the Indonesian recovery from economic and financial will be further retarded.

The National Committee on Corporate Governance (NCCG) has issued what is called "code of corporate governance practices for Indonesian entities" to enhance the effective implementation of GCG. The plan is that this code will help improve the attractiveness of the investment climate in Indonesia (National Committee on Corporate Governance, 2000, p. i).

The NCCG, a non-governmental body, was established in 1999 by the Coordinating Minister for Economy, Finance and Industry (NCCG, 2000). The committee has received ongoing funding from the Asian Development Bank and assistance from World Bank experts in helping to develop and promulgate the 'Code for Good Corporate Governance'. This code for good corporate governance is intended for use by corporate business executives as a direction and guide for the future conduct of business in Indonesia (Herwidayatmo, 2002, p. 7; Rosser, 2004, p. 133).

The code is very similar to the 'best-practice' codes of corporate governance that have been applied by several developed countries. It is also similar to the British, OECD and American corporate governance approaches including the USA Sarbanes Oxley Act Corporate Governance principles and recommendations (Bank BNI, 2003, 3; Sato, 2003, p. 88).

The code is, therefore, closely based on the international developments towards a 'global convergence' model of corporate governance. The result is a 'one size fits all' approach.

### **Contradiction within Western Corporate Governance Models in the Indonesian Context: One Size Does Not Fit All**

Some of the principles and practices that are highlighted in the Indonesian code are equitable treatment of shareholders; the appointment of independent directors and commissioners; timely and accurate disclosure; the appointment of a corporate secretary; and, the establishment of an independent audit committee (Rosser, 2004, p. 133). This section evaluates three of the above practices, namely, the appointment of independent commissioners; establishment of an independent audit committee; and, timely and accurate disclosure.

#### ***Independence of Commissioners***

The Indonesian government and the Indonesia Capital Market Supervisory Agent (Badan Pengawas Pasar Modal/BAPEPAM) has responded positively to the development of corporate governance practices and regimes in Western nations. Indonesian company Law no. 1 (1995) resulted in Indonesia adopting a two-tier system (cited in Tumbuan, 2005, p. 1). Companies must have both a Board of Directors/Board of Management charged with the management of the company and a Board of Commissioners or Supervisory Board who 'supervise' the way the board of directors manage the company (Tumbuan, 2005, p. 2).<sup>8</sup> From the above statement it is clear that the board of commissioners has to perform and act independently. For example the Bank BNI website—which is consistent with law number 13, year 2003 chapter 28 verse 2—states that "...commissioners must be independent" (Bank BNI, 2003, 6; Kementerian Badan Usaha Milik Negara, 2003a, p. 15). This provision is confirmed by Benny, one of the interview participants, who as one of the commissioners stated during the interview that: "...commissioners basically must be independent" (personal communication, 2005).

Unlike a two-tier corporate governance regime, a one tier system—which is the popular model in most Western countries—requires the appointment of independent director(s) on the board of directors. Their role then becomes the equivalent of the independent commissioners in a two-tier system. This function of 'independence' is a key element of the corporate governance reforms recommended by the Cadbury committee and the OECD (Holloway and van Rhyen, 2003, p. 2; OECD, 2004). Independent director(s) on boards—in regimes where these constitute the only governing body—is a necessity because a one tier system does not have an

<sup>8</sup> The task of management board is to manage the company under the supervision and the direction of the board of commissioners.

additional governing body that that supervises the board of directors. A two-tier system, as is the case in Indonesia, does have a separate body (in the form of a board of commissioners) that provides and additional layer of supervision over the (behaviour of?) directors.

The principles and practices of an 'outsider' corporate governance model<sup>10</sup> (Solomon and Solomon, 2004) which requires the inclusion of independent directors on boards (or board of commissioners in a two-tier system) is redundant. It is not applicable in Indonesian corporate settings because a controlling governing body is in place in the form of this very same board of commissioners.

### **Audit Committee**

Indonesian company law does not currently have regulations requiring the establishment of a separate audit committee (AC). However, because of the adoption of a Western model of corporate governance, the establishment of ACs was required under BAPEPAM Rule number IX.I.5 and the decree of the Chairman of BAPEPAM number Kep-29/PM/2004, and law number 19, 2003 (Kementerian Badan Usaha Milik Negara, 2003b, p. 30; Tumbuan, 2005). Once the audit committee is implemented it is then accountable to the board of commissioners which consists primarily of a majority government shareholders representation compared to the minority shareholders representation. Unlike American companies, where ownership is dispersed, Indonesian SOEs ownership is concentrated primarily through the government of Indonesia as the majority shareholder.

As the majority shareholder the government appoints the members of board of commissioners during the shareholders annual (or special) general meetings. The members of the board of commissioners are independent of the board of directors. The appointments of AC members are the responsibility of the board of commissioners. This ensures that the AC members are independent of the board of directors. Theoretically this is a stronger provision than currently prevails in a one-tier system of corporate governance.

However, problems arise in practice when directors and commissioners are effectively colluding to protect corrupt individual government interest in SOEs. If there is an internal investigation, the report must be approved by the Main Director, and if there is a problem highlighted in that report it

must be solved by a cultural approach which is top-down oriented. As explained by Zainal:

...the investigation must be done internally (between internal auditor and directors) and/or must be changed of result. Commonly, directors are being back up by big guys, Commissioners (shareholders/government's representation) including the audit committee who are very close persons with government officers, collude with internal auditors, checking by board of directors, and report has been sterilized (personal communication, 2005).

Elvy also referred to this issue in the following way: "...the directors will eliminate the corporate frauds if it is involved the shareholders and/or influence stakeholders such as members of house of representative" (personal communication, 2005). As a consequence similar corporate frauds do occur (often?) due to this protection and intervention not only by management but also by members of the two boards.

This phenomenon is not consistent with the code of GCG practices developed to ensure the effective administration and governance of SOEs. Most of the time, the appointed directors and commissioners represent the interests of the ruling political party, which itself is strongly influenced by powerful individuals with key roles in government. The problem arises when the interest of these individuals are not aligned with the public interest. There does, however, exist a mechanism where the candidates for board directors and board commissioners have to be approved by the Indonesian House of Representative. Baswir (2005) argued that there is an institutional chaos in managing the relationship between parliament, government, and SOEs which makes it more difficult for specific individuals to exert their power. Therefore, this mechanism may help to minimize if not to eliminate the abuse of power in SOEs.

### **Disclosure**

A recent court case was referred to by one of the interview participants: Ellen is a union leader in one of the SOEs in this study. The union took the case to court because it disputed and challenged the payment of significant bonuses to members on both the board of directors and board of commissioners. The information had first emerged in the media. The union membership and leadership concluded that management and directors did not deserve to receive such bonuses when the company was facing large financial losses. The union also felt that management was not being transparent because the amounts in the bonuses were omitted from the financial statements. Ellen argued that: "We knew management giving out of bonus through the reporters...if it's meant transparent, it must be

<sup>10</sup> The 'outsider' model refers to the broad category of corporate governance regimes where the business entity is controlled by the senior managers but owned by outside shareholders (Solomon and Solomon, 2004, p. 150).

appear on financial report...". She interpreted this action as one of the leaking of information. She continued "...leaking information means that there is something is hiding and detected" (personal communication, 2005).

There is a discrepancy between the 'outsider' model—with its one-tier system focus—and the current two-tier corporate governance system in Indonesia SOEs. In addition, the recommendations to have a corporate secretary, independent commissioners and an audit committee overlap existing jobs already established within the SOEs. Therefore, the adoption of the narrower 'outsider' model of good corporate governance practices is "...just like changing the clothes but same person" as argued by Connie one of the managers within these SOEs (personal communication, 2005).

### **Historical Development of Corporate Culture in SOE<sup>11</sup>**

The first and second Indonesian presidents significantly influenced and contributed to the development of present-day SOE corporate culture. When the Indonesian republic was first established in 1945, the first two longest-serving presidents were both born in Java (Tugiman, 1998, p. 3). Soekarno, the first president, reigned for twenty one years and his successor, Soeharto, a four-star army general, ruled for thirty two years. Therefore, the Javanese leadership styles and military business style have penetrated deep into the social, political and corporate lives of the Indonesian people and the State. This leadership approach has understandably also been practiced within state offices including the state ministry of SOEs which has the supervisory role over the day to day operation and future direction of the SOEs.

#### ***Soekarno Era: The Foundation of SOE Corporate Culture***

The establishment of Indonesian SOE's started during the revolutionary era of Soekarno, the first president of Republic of Indonesia (Usman, 2005, 2). During this period, the government nationalized companies owned by Dutch firms. At the time there were not many large private firms, hence, the economy was dominated by SOEs and (the national economy) was effectively governed by the State (Pangestu, 1999, p. 67).

Highly educated manpower is required to effectively manage SOEs. However, during this era the only educated manpower available was from the pool of public servants and members of the Republic

Indonesia Armed Forces (ABRI) (Usman, 2005). As a result of this historic influence it is currently still common to have directors and commissioners with bureaucratic and army backgrounds 'serving' within SOEs.

The combined recruitment of senior personnel from these two sources has helped to initially shape the SOEs' corporate culture. Consequently, there were many internationally acceptable business practices and principles which were either overlooked or ignored in the business process of the SOEs. The day to day business working relationship between the 'highest authority' and the 'subordinate' was very similar to the processes used within a military hierarchy. It is clear that the army leadership style has been adopted in many SOEs and continues to this day. The various management layers—who were often merely the extended 'hands' of the State Ministers of SOEs—exhibited traits of total obedience to their senior 'leader' (the higher authority). The way management and employees operated within the SOE was similar to the 'public servant mentality'—understandable given that many were previously government employees—with many inefficient and non-competitive business practices (Priambodo, 2004, p. 117). Koentjaraningrat (1985, p. 459) also argued that this critical element of 'total obedience' is embedded throughout the civil-service approach in Indonesia.

Currently, there are still bureaucrats and non-active army personnel who hold key positions and are members of the board of directors and commissioners inside SOEs. Samuel argued that the Army's style is still needed within SOEs: "...if the task is about supervision and then the person must be able to say "yes" or "no", but not "or", means that not in the grey area. And frankly I know only a person who has military trained able to do that" (personal communication, 2005).

Similarly, the rationale behind the placements of bureaucrats in SOEs is that they (the bureaucrats) have the experience in their field (e.g. state finance budget) and it is assumed that they are more capable of managing SOEs (Samuel, personal communication, 2005).

The fact that there may be more appropriate professional business background persons from external sources (non-bureaucratic or non-army) for these positions is disregarded. There are still a number of bureaucrats and 'retired' armed forces members within management circles and acting as board directors and commissioners in SOEs. These people will need to accept and participate in the changes and reforms to business practices and corporate governance approaches that are occurring within the SOEs.

<sup>11</sup> Corporate culture refers to a company's values, beliefs, business principles, traditions, ways of operating, and internal work environment.

### **Soeharto Era: Further Influences on SOEs' Corporate Culture**

The role of military in the economy continued during Soeharto's era (Robison, 1986, p. 251). SOEs such as Pertamina (oil company) and Berdikari (trading company), who played major roles in Indonesian economy, were chaired by ex-military generals. Later, more positions at the director and commissioner level in SOEs were occupied by ex-members of the armed forces. A further reason for why so many military officers held positions in SOEs was because a number of the assets of SOEs used to belong to ABRI<sup>12</sup> (Samuel, personal interview, 2005).

It was easier for members of ABRI to hold positions in ministry offices and then SOEs because of the existence of a program referred to as "dwi fungsi" (dual function) ABRI. Management positions in SOEs were also held by ex-government employees. These types of practices has led to the current situation where many members of the board of directors and board of commissioners of SOEs are people who previously held positions within the State Ministry of SOEs and the Ministry of Finance.

In Soeharto's era all government employees were members of KORPRI (Korps Pegawai Republik Indonesia or Corps of Indonesian Government Employee).<sup>13</sup> This applied to positions in all public and statutory offices. The 'head' of the respective departmental KORPRI was effectively the 'head' of those offices. For example, the Minister of Finance was the head of KORPRI for the Department of Finance or the General Director of PLN (State Power Company) was the head of KORPRI of PLN. Soeharto himself was the leader of the national KORPRI.

During this and the earlier Soekarno era government bureaucrats were effectively acculturated into an organizational setting where it was deemed appropriate to always obey (excessively?) higher authority. Orders from these 'higher authority' figures were and are executed without question. This business culture and practice has been prevalent during the past thirty years. Connie illustrated this point cogently: "what has been done is a culture process...because one regime that has been such a long time [in the] lead, this regime that has "culturized" this nation, because his [is] the one dominant [that] cultivate the values. We know that this regime is reign by Soeharto, new era ..." (personal communication, 2005). According to Connie, the key for the development of a modern approach to 'good' corporate governance in SOEs is

to change the culture that has existed for more than thirty years (personal communication, 2005).

The existing corporate culture in Indonesia, especially in SOEs, is not conducive for the implementation of Good Corporate Governance (GCG) practices that have been adopted from the West. The current employees in SOEs, as expressed by the participants in the interviews, felt that GCG practices cannot be implemented because of the existence of a current corporate culture that is different from the one that exists in Western nations.

Indonesian is immersed in what Sultan Hamengku Buwono X calls a 'mud of conformism culture' through the exploitation of symbols and manipulation of idioms of Javanese culture to reassemble the political and social culture of the nation (2003). Sometimes the wrong behaviour becomes the 'right thing' to do. This has become the values, beliefs and practices of Javanese culture that has moved stealthily into mainstream Indonesian life. Siahaan (2002), supporting this viewpoint, argued that Soeharto had misinterpreted the Javanese culture during his reign (cited in Ano, 2002). This has helped to contribute significantly to the prevalence of endemic corruption in the Indonesian bureaucracy.

Ellen argued that leaders in this country have misused some elements of Javanese culture in order to secure their individual or group's self-interest. This behaviour is termed "ewuh pakewuh" (in the Javanese language) which means being fully obedient and loyal to one's superior. The subordinates or employees are reluctant to question the instruction(s) given by their superior. Ellen explains the misuse of these Javanese practices as:

"...from my point of view it (ewuh pakewuh practices) is good if it used positively...means for the employee's loyalty...but the leader is don't be an ... like Soeharto,...when he effectively succeed [to] lead those who obey to him, he make a crony and giving the project to only to certain Chinese - Indonesian born Chinese..." (personal communication, 2005).

The abuse of this particular weakness has led to non-transparency in SOEs. This kind of abuse, malappropriation and distortion of Javanese culture and practice thrived during Soeharto's reign in power.

Another element of Javanese culture that has been found within SOEs is the high tolerance among employees to the perceived superiority of certain individuals. As Polce pointed out: "...in Soeharto era before this company went listed many employees giving the wrong tolerance to his or her superior" (Polce, personal interview, 2005). The high level of tolerance of others practiced in daily living has been taught and spread within wider Javanese social culture from the early school years. The characteristics of obedience, respect for seniors and

<sup>12</sup> The ABRI used to own more business groups at that time – this is no longer the case.

<sup>13</sup> KORPRI is identical to the ruling political party GOLKAR in the Soeharto era.

superiors are the principles of human relation among the various certain social classes of Javanese (Koentjoroningrat, 1985, p.459). It is difficult socially, therefore, for current internal stakeholders to criticize their colleagues and management. Further, there is no such word as “no” that is commonly used within the Javanese society especially within government settings (Tugiman, 1998, p. 95). Similarly, Priambodo (2004, p.59) posited that paternalism and “the leader is always right” culture prevails within SOEs. This paper finds also that “asal bapak senang” (ABS)<sup>14</sup> still exists. Hadi, one of the branch managers stated: “if there is a meeting (discussing the report) between superior and subordinate, the report is just ABS...” (Hadi, personal communication, 2005). This overall situation has been abused resulting in a number of frauds and corporate misconduct referred to earlier in this paper.

To some extent, some of the Javanese style of leadership and cultural practices could be beneficial for the running of business entities. Management can more easily motivate(?) their staff to achieve corporate goals when they so readily comply with the company policy and show no resistance to senior managers’ requests and directions. However, in most cases, these employees are unaware of the ‘bigger picture’ and are simply driven to be part of management misconduct inside the company. In conclusion, the Javanese style that is currently embedded in SOE corporate culture has been abused and twisted such that ‘poor’ corporate practices and management misconduct is publicly perceived to occur regularly within SOEs.

### **Corporate Governance in an Emerging Democracy**

The Western corporate governance system which is being adopted by the Indonesian government and is the primary guidance for the management and operation of Indonesian companies has a ‘liberal democracy’ cultural favour and substance. In fact the normal life of political ‘democracy’ is new in Indonesia. Liberal democracy practices are still far behind the developed Western nations. The practice of democracy in Indonesia is still limited to the election of political positions such as the President, Prime Minister and members of parliament. In the meantime the appointment of boards of directors and commissioners are still in the hand of government with various political parties, powerful individuals and other powers interests interacting and influencing the outcomes. Little has apparently

changed from past self-interested and ultimately abusive business practices.

### **Changes within the Political System**

There have been, however, significant changes to the political system. This political transformation started when Soeharto resigned. During the Soeharto era the government was dominant in making decisions that impact the nation, society and business in general. However, successive Presidents including Abdurahman Wahid; Megawati; and, Susilo B. Yudhoyono have come from different political factions. There are now several political parties and factions that are involved in the decision-making processes as the result of major democratic reform in Indonesia. Patrick (2001, p. 5) depicted this new period as the end of authoritarian regimes and the birth of true democracy with no one person or political party having the majority of power and authority. However, KKN (collusion, corruption and nepotism) practices still take place. KKN does not belong to one particular political, social or business group instead it appears to have been diversified across several powerful groups within Indonesia.

Consequently, the policies and practices within SOEs are now being influenced not only by one all-powerful authority, but by several different factions that have placed their representatives within SOEs. Didi a member of the parliament pointed out that although the appointment of an executive in SOEs is supposed to be based on his/her professional experience and background and no longer to be based solely on which political party s/he comes from (personal communication, 2005). On the other hand, another member of parliament, Suzetta (cited by MT in Kompas, 20 April, 2005) stated that in reality (and this perception has wide public acceptance) the appointment of directors and commissioners of SOEs is still a ‘battlefield’ for politicians and political interests in this emerging democratic nation.

State Owned Enterprises are still targets for the active interplay of political and other vested interests. The politicians have seemingly ignored the main objective for the continued existence of SOEs which is to create economic stability and enhance economic prosperity for the nation as a whole. They are instead still using SOEs to achieve their own political objectives. As a reflection of this President Wahid’s Finance Minister stated openly: “Politics is a means to accommodate various interests” (Putranto, 2000). It appears that every change in the membership of the board of directors and board of commissioners of an SOE will turn into a battle of interests for the political factions in Indonesia.

Another example of this ongoing tension and interplay between vested interests occurred during the Wahid presidency. There was a major conflict

<sup>14</sup> ABS is the acronym which means in Indonesian that “..as long as Sir happy”.

between two major political factions, namely, the Indonesian Democratic Party for Struggle (PDIP) and the Islamic based Central Axis Forces. Sudibjo, the Minister of Finance was backed by the Central Axis Forces while Sukardi the Minister of SOEs by the PDIP. Wahid first stated that the Minister of SOEs had full power for the oversight and control of all the SOEs but six days later he issued another decree stating that the Minister of Finance still had full authority to control the state-owned banks (Putranto, 2000). It should be noted that Wahid became the president due to the support by the Central Axis faction although the PDIP had the majority of votes in the 2000 election.

Another example of what could be classified as 'bad' corporate governance practices took place during President Megawati's regime. The SOE Minister at the time, Laksamana Sukardi who was also the treasurers of PDIP, was criticized by the public during the privatization process of one of the Indonesian satellite companies (PT Indosat). The privatization process was attacked because there was a strong public perception that it lacked transparency in the determination of the ultimate buyer and the appropriate share price. This particular act of privatization was claimed to only benefit the ruling party PDIP. Sukardi was criticized by Limbong and was requested to step down from his position as the President of the Board of Commissioners of Pertamina (cited in Ant/Edj, 2004). This type of incident is consistent with the claim by Baswir (2005) that the current elected president and dominant political party in government will always wants to place his/her nominated or preferred personnel within the senior positions in SOEs.

### **Current Corporate Governance inside SOEs: Form over Substance?**

Can the importation and implementation of GCG from the West replace the current SOEs practices which have existed to date in the Indonesian Republic? As indicated by Elvy, one of auditors that was interviewed: "...the external consultant who involved in forming GCG don't know the culture of this company...because this GCG is make by those on the top who owned this republic" (personal communication, 2005). Oliver also argued that this culture hinder GCG practices. He gives an example: "...the subordinate who make a mistake essentially must be punish due to his wrong doing, he (the superior) is not punish" (personal communication, 2005). The new corporate governance model is not being effectively embedded within the corporate culture of the SOEs. It is an 'outsider' model that has been implemented within SOEs by the government without studying thoroughly the existence of the real problem which is more closely related to management misbehaviour

and the need to eradicate KKN. However, the current directors and commissioners are supporters of the implementation of this new corporate governance system as was clearly evidenced in their responses during the interviews that were conducted in this study. It can also be understood that they are being appointed by the government representative in General Shareholder(s) meetings<sup>15</sup> and are by no means just the extended hands of government (shareholder).

Indonesian SOEs have effectively adopted corporate governance system similar to the one used in developed Western countries. We would argue however that the implementation process has been ineffective. Are corporate governance reforms in Indonesia a mere "knee-jerk" political reaction as argued out by Holloway and van Rhyn<sup>16</sup> in the case of the Sarbanes-Oxley Act in the USA in 2002 (2003, p. 2)? In this way politicians can at least be publicly seen as 'doing something substantial' in the corporate reform process. Corporate governance reforms in Indonesia have occurred partly due to public demands for a higher level of transparency and accountability in the running of public companies. Evidence shows that, although corporate governance frameworks have been strengthened, SOE management misbehaviour, frauds and even failures still continue. As pointed out by Rosser (2004, p. 122) Indonesian companies may well have converged towards the international GCG practices but only in form not in substance.

### **Conclusion and Recommendations**

This paper has analysed three main factors that continue to hinder the effective implementation of GCG practices in Indonesian SOEs. They include the 'naïve' adoption of the Western model of corporate governance practices ignoring the prevalence and historicity of the Indonesian version of corporate governance inside SOEs. The current corporate culture—developed out of the past, dominant influences on Indonesian culture and business practice during the Soekarno and Soeharto eras—is also a significant barrier to reform. The misuse and malappropriation of Javanese cultural practices by management as well as the changing political system which still embeds inappropriate influences over SOEs are additional negative factors.

<sup>15</sup> Two of the sample of SOEs are 100% owned by government. Another one of the sample is already publicly listed on the Jakarta Stock Exchange but the majority are still owned by the government.

<sup>16</sup> Holloway and van Rhyn argued that the corporate governance reforms in USA were just a mere political reaction that needed to be seen as such by the public (Holloway and van Rhyn, 2003, p. 2).

In order to have effective GCG practices implemented successfully in Indonesian SOEs, we would recommend the following actions:

1) The new corporate governance system has to be consistent with the existing social, legal and corporate cultures. So far, Indonesian SOEs have adopted the corporate governance system used in a one-tier system. It should be noted that: "There is no single model of good corporate governance" (OECD, 1999, p. 12). Therefore, the government of Indonesia, in this case the Minister of SOEs must not merely adopt the outsider model of corporate governance without effective implementation strategies and support that can truly tackle the degree and depth of reform required.

2) The corporate culture in Indonesian SOEs has been influenced by the misuse of many elements of Javanese culture for more than thirty years. As a consequence this has created and embedded the notion of managerial hegemony—senior management decides 'all things organizational' without any active questioning of their actions. Two steps need to be taken in order to eradicate this exclusively top-down approach. According to Connie—one of these manager: "In my view, people (internal stakeholders) has been culturized (been forming) to misbehave for certain years, therefore, de-culturized process is needed" (personal communication, 2005). Secondly, A similar view is

given by Hamengku Buwono X who stated that a "counter culture" is needed to eliminate the long established corrupt culture (Hamengku Buwono X, 2003). Oliver explained his notion of this improvement of internal culture approach: "...if we want to truly implement that GCG, we have to corrected the insider people, those who operates this company have truly correct..." (personal communication, 2005). Secondly, after eliminating this inappropriate business culture, a sound form governance culture needs to be promoted. This can only be achieved through the development of a "healthy relationship" between, government, the SOEs management, and employees. Superiors and senior managers should have "a sincere heart" in accepting the different argument and viewpoints from subordinates who then become active and engaged as well as respected followers in modern organizations. This will create a more conducive and effective internal governance and corporate culture (Holloway and van Rhyn, 2005).

3) Finally, reduce the intervention of politicians in the appointment process and the operation of SOEs. The Minister of SOEs and the management of SOEs must not come from any one political party or any one powerful group in Indonesian society.

If all three sets of recommended actions occur then there is a greater chance of effective corporate and internal governance reform in SOEs.

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