A Qualitative Analysis of Corporate Governance in Indonesian State-Owned Enterprises: An Internal Stakeholders Perspective

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This thesis is presented in fulfilment of the requirements for the degree of Doctor of Philosophy

School of Management and Governance
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I declare that this thesis is my own account of my research and contains as its main content work which has not previously been submitted for a degree at any tertiary education institution.

Signed

Frederik Gerard Worang
Abstract

Poor corporate governance practices in Indonesian State-Owned Enterprises (SOEs) have been blamed for being significant causes of the Indonesian financial crisis in 1998. A significant number of SOEs went financially bankrupt at that time. Currently, the effort to organise the SOEs by the Government of Indonesia, as the majority shareholder, is still ongoing. This study is concerned with corporate governance practices in Indonesian SOEs.

The research examines the behaviour of internal stakeholders of the SOEs in question. These included members of the Boards of Directors and members of the Boards of Commissioners in a state-owned bank, a state-owned power company, and a state-owned airline. There have been previous studies of corporate governance in Indonesian private companies but little research focusing on SOEs. This study investigates management and directors’ behaviour in the three SOEs using a qualitative research approach. This differs from previous research studies that primarily employed quantitative methods.

In-depth interviews were conducted with thirty-eight respondents from the managerial level upward in the three SOEs. In addition, to make the study more comprehensive, interviews were conducted with two respondents from the Office of the Ministry of State-Owned Enterprises, and one respondent from the Anti-Corruption Commission. Most interviews were conducted in 2005, a few in 2009, and these were updated in 2013.
Qualitative analysis was used to analyse the data from the interviews and archival data in the form of publications from the main Indonesian mass media, and journal publications.

It was found that the boards of directors and the boards of commissioners were not properly implementing good corporate governance (GCG) practices. They do, however, practise what is known as KKN or Korupsi, Kolusi, and Nepotism (corruption, collusion, and nepotism). Most of the time, SOEs are subject to significant intervention from the ruling government including politicians who have their own self-interest in SOEs. As stated by respondents, and supported by data in the mass media, SOEs have become “cash cows” or “automatic teller machines” to serve the government of the day. The government is interested in the performance of SOEs, because the government itself is a major shareholder. This is different from the private sector where people are the shareholders who hold the boards and management to account.

Another significant finding is that the adoption of wholesale corporate governance practices from the West is difficult to implement due to differences in the culture and legal structure of Indonesian SOEs. Indonesian society is mostly influenced by prevailing Javanese culture that has also been embedded in these SOEs. Another relevant factor is that the first two Presidents of Indonesia were Javanese. These factors have hindered the implementation of GCG.

Another finding is that the adoption of the concept of independent directors (independent commissioners in SOEs) from a Western based one-tier governance structure has been adopted blindly and unquestioningly in Indonesian SOEs.
A range of recommendations to ensure sound GCG are also presented in this thesis. For example, the establishment of whistleblower protection mechanisms, and appropriate GCG guidelines.

This study also finds that the shareholders’ approach arising from the agency theory is not suitable for GCG in Indonesian SOEs. The stakeholder theory approach is the more appropriate base from which SOEs should operate. This is because according to Indonesian law, the SOEs are the backbone of the Indonesian economy, and therefore, SOEs should satisfy the needs of the Indonesian public, a major stakeholder.
Table of Contents
1 Chapter – Introduction ........................................................................................................... 1
  1.1 Introduction .................................................................................................................. 1
  1.2 Background and Initial Literature Review ..................................................................... 4
    1.2.1 Definition of Corporate Governance .................................................................. 4
    1.2.2 Global Issues of Corporate Governance ............................................................ 5
    1.2.3 Principles and Elements of Corporate Governance ............................................. 5
    1.2.4 Indonesian State-Owned Enterprise .................................................................... 7
    1.2.5 Corporate Governance in Indonesian SOEs ....................................................... 8
    1.2.6 Current Behaviour of Corporate Governance in Indonesian SOEs ..................... 11
    1.2.7 Accountability of SOEs’ Stakeholders ................................................................. 12
  1.3 Importance of the Research ............................................................................................ 13
  1.4 Research Objectives and Research Questions ............................................................... 15
    1.4.1 Research Objectives ............................................................................................ 15
    1.4.2 Research Questions .............................................................................................. 15
  1.5 Overview of Research Methodology ............................................................................... 16
    1.5.1 Data Collection .................................................................................................... 16
    1.5.2 Interviews ............................................................................................................. 16
    1.5.3 Samples ................................................................................................................ 17
  1.6 Organisation of the Thesis .............................................................................................. 17
  1.7 Conclusion ...................................................................................................................... 19
2 Chapter - Corporate Governance: The Global Practices ..................................................... 20
  2.1 Introduction ................................................................................................................... 20
  2.2 Importance of Good Corporate Governance (GCG) ..................................................... 23
  2.3 Corporate governance: System versus Act ................................................................. 26
  2.4 The Agency Theory ....................................................................................................... 27
    2.4.1 The Board of Directors ....................................................................................... 29
    2.4.2 The Board’s Role: the Rationale for Having Boards of Directors ......................... 30
    2.4.3 Effective Boards .................................................................................................. 31
    2.4.4 Independent Directors and the Paradox .............................................................. 32
  2.5 The Stakeholders and the Shareholders ........................................................................ 34
  2.6 Checks and Balances of Good Corporate Governance ................................................. 36
  2.7 Corporate Governance System: The Experiences in Other Countries .......................... 37
    2.7.1 The United Kingdom .............................................................................................. 37
    2.7.2 China .................................................................................................................... 39
<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.7</td>
<td>The 2000 Code for Good Corporate Governance: “Knee Jerk” Phenomena</td>
<td>83</td>
</tr>
<tr>
<td>4.8</td>
<td>The National Committee on Governance 2004</td>
<td>84</td>
</tr>
<tr>
<td>4.9</td>
<td>The Board of Commissioners (BOC)</td>
<td>90</td>
</tr>
<tr>
<td>4.9.1</td>
<td>Selection Criteria for Independent Commissioners</td>
<td>91</td>
</tr>
<tr>
<td>4.9.2</td>
<td>The Role of Independent Commissioners</td>
<td>92</td>
</tr>
<tr>
<td>4.10</td>
<td>The Board of Directors (BOD)</td>
<td>93</td>
</tr>
<tr>
<td>4.11</td>
<td>Audit Committee (AC)</td>
<td>94</td>
</tr>
<tr>
<td>4.12</td>
<td>Nomination and Remuneration Committee (NRC)</td>
<td>96</td>
</tr>
<tr>
<td>4.13</td>
<td>Corporate Governance Committee (CGC)</td>
<td>96</td>
</tr>
<tr>
<td>4.14</td>
<td>Conclusion</td>
<td>96</td>
</tr>
<tr>
<td>5</td>
<td>Chapter - Research Methodology</td>
<td>98</td>
</tr>
<tr>
<td>5.1</td>
<td>Introduction</td>
<td>98</td>
</tr>
<tr>
<td>5.2</td>
<td>Research Approach</td>
<td>100</td>
</tr>
<tr>
<td>5.3</td>
<td>Research Sample</td>
<td>103</td>
</tr>
<tr>
<td>5.3.1</td>
<td>Sample Size</td>
<td>104</td>
</tr>
<tr>
<td>5.3.2</td>
<td>Sample Collection Method</td>
<td>104</td>
</tr>
<tr>
<td>5.4</td>
<td>Reliability and Validity</td>
<td>106</td>
</tr>
<tr>
<td>5.5</td>
<td>Data Triangulation</td>
<td>109</td>
</tr>
<tr>
<td>5.6</td>
<td>Data Collection</td>
<td>110</td>
</tr>
<tr>
<td>5.6.1</td>
<td>Interviews</td>
<td>113</td>
</tr>
<tr>
<td>5.6.2</td>
<td>Strategy for Interviews with Respondents</td>
<td>117</td>
</tr>
<tr>
<td>5.6.3</td>
<td>Trial to data production</td>
<td>119</td>
</tr>
<tr>
<td>5.6.4</td>
<td>Media</td>
<td>121</td>
</tr>
<tr>
<td>5.7</td>
<td>Data Processing</td>
<td>121</td>
</tr>
<tr>
<td>5.8</td>
<td>Research Question Rationale</td>
<td>122</td>
</tr>
<tr>
<td>5.9</td>
<td>Epistemology and Interpretivism</td>
<td>124</td>
</tr>
<tr>
<td>5.10</td>
<td>Generalisation</td>
<td>125</td>
</tr>
<tr>
<td>5.11</td>
<td>Conclusion</td>
<td>125</td>
</tr>
<tr>
<td>6</td>
<td>Chapter - Findings</td>
<td>126</td>
</tr>
<tr>
<td>6.1</td>
<td>Introduction</td>
<td>126</td>
</tr>
<tr>
<td>6.2</td>
<td>State-Owned Bank</td>
<td>129</td>
</tr>
<tr>
<td>6.2.1</td>
<td>Introduction</td>
<td>129</td>
</tr>
<tr>
<td>6.2.2</td>
<td>Corporate Governance: Participant Insights</td>
<td>129</td>
</tr>
<tr>
<td>6.2.3</td>
<td>Disadvantages of Corporate Governance</td>
<td>131</td>
</tr>
<tr>
<td>6.2.4</td>
<td>Organizational Culture</td>
<td>132</td>
</tr>
</tbody>
</table>
6.4.7 Government Intervention in Purchasing Capital Items .................................. 176
6.4.8 Union ........................................................................................................ 177
6.4.9 Career and Development .......................................................................... 178

6.5 The Minister of SOEs .................................................................................. 178
6.5.1 Corporate Governance Adopted from the Western System? ..................... 179
6.5.2 Government Intervention .......................................................................... 179
6.5.3 Privatisation ................................................................................................ 180

6.6 The Deputy Director of Corruption Eradication Commission ...................... 180

6.7 Conclusion ..................................................................................................... 181

7 Chapter – Analysis of Indonesian SOEs – The Internal Stakeholders Behaviour and Perspective ......................................................... 185

7.1 Introduction .................................................................................................... 185
7.2 Good Corporate Governance Equates to Greater Bureaucracy? .................... 191
7.3 The Adoption of One Tier System into Two a Tier System-Quo Vadis? ...... 192
7.4 Corporate Governance inside SOEs: Form over Substance? ......................... 195
7.5 One Size Does Not Fits All: Practical Implications ....................................... 196
7.6 Indonesian and Javanese Society and Cultural Practices that Influence Business Culture ........................................................................................................ 197

7.7 The Dilemma of Independent Commissioners .............................................. 200
7.7.1 The Busy Corporate Life of Independent Commissioners in the SOEs . 200
7.7.2 Independent Commissioner in the State Power Company ......................... 200
7.7.3 Independent Commissioners in the State Bank Company ......................... 201
7.7.5 Double Standards for Independent Commissioners in the SOEs ............... 204
7.7.6 Audit Committee in the SOEs ................................................................... 205

7.8 Corporate Governance Practices of Two Boards Members ......................... 206
7.8.1 Decision Making Powers: Corporate Cultural Aspects within Organization ........................................................................................................ 206

7.8.2 Strange Issues at Board Meetings ............................................................. 207
7.8.3 Unscheduled Board Meetings ................................................................ 208
7.8.4 Domination of the Two Boards : Supporting the Study ......................... 209
7.8.5 Lack of Accountability and Transparency in Remuneration Decision ...... 211
7.8.6 Two Fold Problems in Accountability ...................................................... 212
7.8.7 Collusion between Two Boards and Government .................................... 215

7.9 The Ruling Government’s Interests ............................................................... 215
7.9.1 The Final Evaluation Team: The Government Intervention ...................... 215
7.9.2 Bureaucrats and Non-Active Army Personnel ......................................... 220
9.2 Discussion and Conclusion in each Chapter ........................................... 263
9.3 Contribution .................................................................................................. 266
9.4 Limitations ...................................................................................................... 266
9.5 Future Research Directions ........................................................................ 267
9.6 Concluding Comment .................................................................................... 267
Appendices

Appendix A:  List of Tertiary Participant Interviewees .......................... 309
Appendix B:  Sample of Transcribed Interview ................................. 311
Appendix C:  Sample of Request for Interview ................................. 316
List of Figure

Figure 1: Chapter 1 Outline .................................................. 3
Figure 2: Chapter 2 Outline .................................................. 22
Figure 3: Chapter 3 Outline .................................................. 46
Figure 4: Chapter 4 Outline .................................................. 76
Figure 5: Chapter 5 Outline .................................................. 99
Figure 6: Chapter 6 Outline .................................................. 127
Figure 7.1: Chapter 7 Outline .................................................. 187
Figure 7.2: Factors that Influence Corporate Governance in Indonesian SOEs.... 190
Figure 7.3: A Problem of Agency Theory in a Private company .................... 214
Figure 7.4: Two Fold Problem of Agency Theory in a SOE ....................... 214
Figure 7.5: Current Model of Corporate Governance Practices .................... 240
Figure 8.1: Chapter 8 Outline .................................................. 242
Figure 8.2: Recommendation Model of Corporate Governance Structure ....... 243
Figure 8.3: Whistleblower Protection Act of Stakeholders .......................... 250
Figure 9: Chapter 9 Outline .................................................. 260
List of Tables

Table 5.1: Data Collection of Qualitative and Quantitative Research .......... 112
Table 6.1: Emerging Corporate Governance Issues in Indonesian SOEs .......... 184
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABRI</td>
<td>Angkatan Bersenjata Republik Indonesia (the Indonesian Army)</td>
</tr>
<tr>
<td>ABS</td>
<td>Asal Bapak Senang (as long as the “sir” happy)</td>
</tr>
<tr>
<td>AC</td>
<td>Audit Committee</td>
</tr>
<tr>
<td>BAPEPAM</td>
<td>Badan Pengawas Pasar Modal (the Indonesian Investment Supervisory Body)</td>
</tr>
<tr>
<td>BI</td>
<td>Bank of Indonesia (the Indonesian Central Bank)</td>
</tr>
<tr>
<td>BIN</td>
<td>Badan Investigasi Nasional (National Investigation Body)</td>
</tr>
<tr>
<td>BLBI</td>
<td>Bantuan Likuiditas Bank Indonesia (Bank of Indonesia liquidity assistance program)</td>
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<tr>
<td>BOC</td>
<td>Board of Commissioners</td>
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<tr>
<td>BOD</td>
<td>Board of Directors</td>
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<tr>
<td>BPK</td>
<td>Badan Pemeriksa Keuangan (the State Auditor)</td>
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<tr>
<td>BUMN</td>
<td>Badan Usaha Milik Negara (SOEs)</td>
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<tr>
<td>DPR</td>
<td>Dewan Perwakilan Rakyat (House of Representatives)</td>
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<tr>
<td>GCG</td>
<td>Good Corporate Governance</td>
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<tr>
<td>GOI</td>
<td>Government of Indonesia</td>
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<td>KKN</td>
<td>Korupsi Kolusi Nepotisme; Corruption Collusion Nepotism</td>
</tr>
<tr>
<td>KORPRI</td>
<td>Korps Pegawai Republik Indonesia (the corps of Indonesian government employees)</td>
</tr>
<tr>
<td>KPK</td>
<td>Komisi Pemberantasan Korupsi (Corruption Eradication Commission)</td>
</tr>
<tr>
<td>LPSK</td>
<td>Lembaga Perlindungan Saksi Korban or Witness and Victim Protection Body</td>
</tr>
<tr>
<td>MA</td>
<td>Mahkamah Agung (the Supreme Court)</td>
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<tr>
<td>MP</td>
<td>Member of Parliament</td>
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<tr>
<td>NED</td>
<td>Non-Executive Directors</td>
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<tr>
<td>Abbreviation</td>
<td>Description</td>
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<tr>
<td>SBY</td>
<td>Susilo Bambang Yudhoyono, the President of Republic of Indonesia</td>
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<td>SOEs</td>
<td>State-Owned Enterprises</td>
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<tr>
<td>TPA</td>
<td>Tim Penilai Akhir (team of final evaluation)</td>
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<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>USA</td>
<td>United States of America</td>
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<tr>
<td>UU</td>
<td>Undang Undang (law)</td>
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<td>UUD 1945</td>
<td>Undang Undang Dasar 1945 (the Indonesian Constitution)</td>
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Glossary

Amar ma’ruf nahi munkar (Arabic):
Islamic concept of to do good deeds and prevent ill deeds.

Corporate Culture:
A company’s values, beliefs, business principles, traditions, way of operating, and Internal work environment.

Epistemology:
Refers to the way of knowing and carries implicit assumptions in the way we know (or discover) the way the world is. In simpler words it is the theory of knowing-the way we know what we know (Holloway, 2006, p. 19).

Ewuh pakewuh (Javanese):
Uneasiness; obedient or attentive an excessive or servile degree. In the organisation this is practiced by the subordinate with his/her superior, or children to parents amongst family members (Poerbo, 2014).

Gotong royong:
Working together cooperatively

Hukum adat (adat law):
Refers to the law based on the customs of Indonesia

Independent Commissioner:
Please see Independent Director

Independent Director:
A director who is independent of management and free from any interest and any business or other relationship which could or could reasonably be perceived to, materially interfere with the director’s ability to act with a view to the best interests of the corporation” (Reiter, 1999). This is similar with which called independent commissioner in Indonesia which adopt two-two tier system.

Jalan damai or path of peace:
A Social phenomenon that hinders the application of the law in Indonesia. It often occurs with “jalan tengah” or middle path.

Jalan tengah or midway:
People take the middle ground in resolving an issue.

Legal Culture:
Refers to the shared values, attitudes, standards, and beliefs that characterize members of the legal profession and define its nature.

Mafia peradilan:
Mafia in the judicial system (in Indonesia).
Mikul dhuwur, mendem jero (Javanese):
To protect the good names of family or superiors in the organisation (in this study), to worship family or management, and to conceal deeply family faults or management faults (Poerbo, 2014).

Mohon petunjuk:
Begging and waiting a direction from the top.

Ontology:
The assumptions we make about the way the world is influenced by deep and often unstated personal and intellectual assumptions about the way the real world is. In simpler words the nature of existence or being or things (Holloway, 2006, p. 20).

Orde baru:
New order or New era

Orde lama:
Old era

Organizational culture:
Refers to the ongoing adaptive process that determines what the organizational values and “virtues” are within an enterprise and to what extent these should legitimately inform and influence the operations and financial outcomes of the organization (Holloway, 2006, p. 20).

Qualitative Research (five features):
1. Studying the meaning of people’s lives, under real-world conditions;
2. Representing the views and perspectives of the people (or participants);
3. Covering the contextual conditions within which people live;
4. Contributing insights into existing or emerging concepts that may help to explain human social behaviour; and
5. Striving to use multiple sources of evidence rather than relying on a single source alone (Yin, 2011, pp. 7-8).

Research:
An intensive and purposeful search for knowledge and understanding of social and physical phenomena (Kumar, 2011, p. 1).

Research method:
The actual techniques used or steps taken to collect the data pertinent to the research problem and then the process used to analyse that data (Holloway, 2006, p. 33).

Research methodology:
Is a way to systematically solve the research problems (Kumar, 2011, p. 5).

Societal culture:
Culture based upon one’s identity and ideas, which are usually associated with a certain social group.
**Tepo seliro (Javanese):**
Keep feelings to yourself and do not say what you think.
Acknowledgement

Praise be to God for His Mercy.

I am greatly indebted to my Supervisor, Associate Professor David Holloway, who always encouraged me to complete my thesis. There were times when I was despairing and that was when he lent his gentle support. This thesis would not have been completed without his kind and generous assistance. David always found time to counsel me and to give his invaluable advice. I would like to use this opportunity to register my sincere appreciation. Having worked under his guidance and tutelage I also learned a very valuable lesson. Something that I would like to apply in my relationship with my own students, as a lecturer and supervisor back home at Sam Ratulangi University.

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I wish to apologise to my family for my absences that prevented us leading a normal family life during the long time needed to finalise my thesis. I realize that I would not be able to fully repay their love and kindness. I can only pray that the good Lord will be with us all and bless us abundantly.
1 Chapter – Introduction

1.1 Introduction

This thesis is a qualitative investigation of corporate governance practices and approaches in Indonesian State-Owned Enterprises (SOEs). Prentice defines corporate governance as being concerned with the relationship between the stakeholders in a company and the board of directors (cited in Baxt, et al, 2002). Problems in corporate governance occur when this relationship is adversely disturbed. A good relationship means that both the supervisory board and the management boards are working closely together to achieve agreed corporate goals\(^1\).

Monks and Minow (2004) stated that the primary groups involved in determining company goals, and implementing corporate governance system within SOEs are the shareholders, senior management and the board of directors. Wieland (2011) goes on to state that from the perspective of economic governance, a company is defined as a group of contractual arrangements between stakeholder resources and stakeholder interests, the function of which is governance.

Significant empirical research primarily quantitative with some qualitative has been published internationally in the corporate governance area (Holloway and van Rhyn, 2003; Leblanc, 2003; Holloway, 2004; Wong, 2004; Boden, 2005; McGee, 2010; Spitzbeck and Hansen, 2010; Jo and Harjoto, 2011; Kwee, van Den, and Volberda, 2011; Erkens, Hung, and Matos, 2012). There is also empirical research on Indonesian corporate governance. These additional studies generally investigate specific corporate

\(^1\) Indonesia adopts a two-tier system or two-board system (European Continental system) for the limited liability companies which are Board of Commissioners (BOC) and Board of Directors (BOD) (Kurniawan and Indriantonoro 2000; Husnan 2001).
governance practices such as the legal and regulatory framework, and ownership structure based on empirical data (empirical/quantitative) in wide-ranging corporations in Indonesia (Kurniawan and Indriantoro, 2000; Husnan, 2001; Patrick, 2001; Lukviarman, 2004; Setiawan, 2006; Nuryanah, Islam, and Sardar, 2011; Prabowo and Simpson, 2011; Solomon, 2011; Utama and Utama, 2013). However, there is little qualitative research analysing board behaviour within Indonesian SOEs (Rosser, 2004; Indreswari, 2006; Worang and Holloway, 2007; Wicaksono, 2009).

Current notions of ‘best practice’ in corporate governance are found in developed western countries such as Australia, America, and the UK, and these will be used to analyse and compare the Indonesian SOEs’ corporate governance systems (Cadbury, 2002; ASX, 2003; Romano, 2004; Holloway and van Rhyn, 2005; Holloway, 2006; Mizuno and Tabner, 2009).

The issues to be analysed include whether the SOEs have an independent director and audit committee, and protection of whistleblowers. The relationships within the corporation that determine how boards and senior management conduct business inside the organizations will also be analysed.

Issues such as the board’s role in making strategic decisions, the behaviour of the two boards, the Indonesian Government's intervention in SOEs, the (Javanese) culture that is prevalent in SOEs, and the adoption of corporate governance practices in Western countries are analysed.

The initial section of this chapter presents the reason why this research needs to be conducted. It also details the reasons for choosing corporate governance as a topic, and Indonesian SOEs as subjects for this study. There is also a brief introduction to the theories and specific background literature used in corporate governance studies.
The last section sums up the research questions. In addition, there is a brief explanation of the research method approach used in order to address the research issues. Figure 1.1 provides an outline of the chapter.

Figure 1: Chapter 1 Outline

- Introduction
- Background and Initial Literature Review
- Importance of the Research
- Research Objectives and Research Questions
- Overview of Research Methodology:
  - Data Collection
    - Interviews
    - Samples
- Organization of the Thesis
- Conclusion
1.2 Background and Initial Literature Review

1.2.1 Definition of Corporate Governance

Some definitions of corporate governance emphasize the importance of corporate returns. In this context, the corporate governance issue is then concerned with the return on shareholders’ investment (Shleifer & Vishny, 1997; Baxt et al., 2002, p. 160; Reyna, Vazquez, & Valdes, 2012). Friedman points out that corporate governance deals with the generation of maximum funds to the owner(s) (cited in Sison, 2008, p. 2). This interpretation is applicable to Indonesian private/family businesses where shares are less dispersed but not to Indonesian SOEs where the main goal is as an activator and pillar of national economic priorities (Kementerian BUMN, 2004; Rivai, 1994).

The applicable definition of corporate governance used in this study is the definition given by the Cadbury Committee of the UK. The Committee defines corporate governance as giving direction and control to an organisation (Flanagan et al., 2004, p. 2). On the other hand, Holloway (2004) insists that the task of Boards is not to control but to keep an eye on what management is doing or in other words, to monitor management. Supervisory Boards do not get involved in controlling the company operation, but they do observe and monitor how the management operates a business. There are three main tasks of supervisory Boards: (1) to oversee management operation and decisions (2) to oversee the company’s financial performance (3) and together with management, provide strategic direction decisions (Holloway, 2004). For that reason, corporate governance involves a relationship between boards and senior management and other stakeholders (Baxt et al., 2002, Organization for Economic Co-Operation and Development, 2004). Moreover, Monks and Minow define these stakeholders as
employees (internal stakeholders), customers, suppliers, and the community (external stakeholders) (2004, p. 120).

1.2.2 Global Issues of Corporate Governance
Concerns about corporate governance have emerged over time due to the corporate failure of companies such as One Tel, Ansett, HIH, the National Australia Bank in Australia, Parmalat in Italy, and Enron and Worldcom in the United States (Holloway and van Rhyn, 2003; Leblanc and Gillies, 2005). These corporate failures are not all recent, as they have also occurred in other parts of the world such as the Nick Leeson bank scandal in Singapore which caused the bankruptcy of the Barings Bank in 1995, and the corporate governance disaster in Polly Peck and BCCI in the early 1990s (Krawiec, 2001; Holloway and van Rhyn, 2004).

This failure has occurred again, and the financial crisis of 2008-2009 raises further questions about the assumptions that underpin corporate governance. Shareholder value (approach) and private ordering may not in fact be the best means of promoting efficiency and corporate responsibility and the mechanisms used to ensure management accountability may not be effective. This acknowledgement that our understanding of fundamental questions of corporate governance is still developing and demonstrates that the corporate governance debate is far from over (Vasudev and Watson, 2012).

1.2.3 Principles and Elements of Corporate Governance
Significant series of studies and enquiries have determined that the principles of corporate governance in a company are fairness; transparency; accountability; and responsibility; minority investor protection measures; and enforced regulations (Dallas and Bradley, 2002; Mobius, 2002; Organisation for Economic Co-operation and Development, 2004).
The corporate governance elements identified by some scholars, policy makers, and corporate governance institutions are varied, but their content is similar from one institution to another. These elements include independent directors; an audit committee; a remuneration committee; and, a nomination committee are currently dominant issues in the global practice of corporate governance. The issue about whether corporate boards should have independent members has been recommended by the Cadbury Committee (1992) as a response to major corporate failures in the UK (Holloway and van Rhyn, 2003). The committee proposed that each board have at least three independent directors. The Government White Paper on the Conduct of Company Directors stated that independent directors would provide the breadth of knowledge and independent decisions to the boards that company management cannot provide (Tricker, 1984). The existence of independent directors inside the organisation will reduce collusion among board members. According to Lipton (2002), an independent director is one who has not been an executive in the past few years; is not a professional adviser; not a supplier or customer; and, one who has no other significant contractual relationship with the company.

In Australia, according to the Bosch Committee, a majority of independent directors should be used on important sub-committees including audit and remuneration committees (Lipton, 2002). Similarly, the UK government- commissioned Higgs Report recommended that “…the key sub-committee memberships of the board (audit, remuneration and nomination) should comprise solely of independent directors” (cited in Holloway, 2004). The existence of audit and remuneration committees helps to increase corporate accountability. In the United States (USA), the issue has been raised by CalPers (California Public Employee’s Retirement System). For example, CalPers is
one of the largest shareholders in the Grace company and has insisted that the company place independent members on the audit, compensation and nominating committees (CalPERS, 1999).

1.2.4 Indonesian State-Owned Enterprise

Initially, the Indonesian State-Owned Enterprises were the result of the nationalization of a number of companies owned by the Dutch colonial regime in the revolution era. The existence of a SOE is based on the Constitution of 1945, Article 33. Approximately 600 foreign companies were nationalized. Of these approximately 300 companies were plantations, around 100 companies were involved in the mining industry and the balance was found in supporting businesses such as trading, banking, insurance, communication, and construction.

SOEs were the backbone of the Indonesian economy. “SOE is an important actor in national development”, said Firmanzah, an expert staff member of the President in economics and development (Tempo, 2012). Sitalaksmi and Zhu (2010) comment that Indonesian SOEs are an important part of the economy’s machinery. However, these SOEs have been connected with politics since the first restructuring by Soekarno. This political influence has continued and has caused SOEs to suffer financial loss in competition with private companies. This is because there are many vested interests in the controlling of SOEs. Directors of SOEs should focus on business performance and should not become involved in any political activity (Choir, 2006). Good Corporate Governance (GCG) is far from the practices that currently exist in SOEs. The central problem for this outcome is based on managerial and other internal issues (Rafick and Amir, 2010)
The profitability of an SOE is very low relative to its assets. The capability of SOE to be profitable is questioned. In 2004 the total asset of all SOEs reached IDR 1,313 trillion (equivalent to AUD 1,313 billion)\(^2\) while the profit amounted to only IDR 25 billion (equal to AUD 25 million) (Rachbini, 2010). Profits declined from 2005 to 2007. In 2005 SOEs generated profits of IDR 23.3 billion, but this fell to IDR 21.7 billion in 2006, and fell further in 2007 to IDR 16.2 billion. But there is another version according to the data on the SOE website that displayed increasing profit from 2005 to 2007 (respectively) IDR 25.9 billion, 49.3 billion, and 63.6 billion (Kementerian BUMN, 2009).

Nowadays, from 141 companies, 18 companies were privatized and listed on BEI (Bursa Efek Indonesia), previously known as the Jakarta Stock Exchange (Bisnis, 2012). Since 2005 SOEs have been attempting to prepare the businesses prior to going public with the aim of getting a maximum offering price. The SOE Ministry is currently waiting for the House of Representatives (Dewan Perwakilan Rakyat or DPR) to pass an act for State-Owned Enterprise privatization. However, privatization has occurred without the relevant legislation. Since the first privatization event, there has always been controversy from both the public and from within the government. This is because there has been no transparency in the procedures that were used to privatise.

**1.2.5 Corporate Governance in Indonesian SOEs**

In Indonesian SOEs, the government is the main shareholder and has been blamed by the public for the failure to give direction to directors, in addition to a perceived lack of control; corruption; collusion and nepotism when appointing directors positions in SOEs. The indications of corporate governance failure amongst SOEs are the alleged

\(^2\) AUD 1 is equivalent of IDR 10,000
misuse of power, both by government regulators and by supervisory and management boards of SOE, self-enrichment by directors through misuse of company facilities, acceptance of bribery for the advantage of a particular party, asset mark-up, and lack of information disclosure (Kurniawan and Indriantoro, 2000; Patrick, 2001). The notion and the need for good corporate governance have been well recognised amongst SOEs stakeholders as can be identified from the following quote by the General Director of PT JAMSOSTEK, a state-run superannuation company,

“… the implementation of good corporate governance would be successful if all staff had a strong commitment to comply with company regulation” (Kementerian BUMN, 2004).

Also, Kristiono, the General Director of PT TELKOM, a state telecommunication company, argued that it is more likely for good corporate governance to take place in PT TELKOM if the company remained listed on both the Jakarta Stock exchange (JSE) and the New York Stock Exchange (NYSE) (Kementerian BUMN, 2004b). Meanwhile, Sembiring, one of the union leaders of PT PERTAMINA (a state oil company), pointed out that the appointment of Goldman Sachs as a consultant of the company is a breach of one of the principles of good corporate governance (i.e. transparency), as there was a non-existent tender process (Kementerian BUMN, 2004c).

The aforementioned statements affirm that the notion of corporate governance has been well recognized amongst all levels of management within Indonesian SOEs. In other words, management has ticked all the ‘boxes’ stating their agreement with and acceptance of the concepts of sound corporate governance. Even though Indonesian regulators claim that corporate governance has been adopted, this lacks substance or real action as implementation by the boards’ members and senior management cannot
be readily seen. Therefore, what still requires investigation are the boards’ actual behaviour and best practices of corporate governance.

The corporate governance failures in Indonesian SOEs have occurred before and after the Asian crisis. In the beginning of 1990’s there were the cases of Bank Bali, Indover Bank, BULOG (The National Logistics Body), PERTAMINA (the state’s oil company), and the latest, the case of Bank Negara Indonesia, one of the listed state banks which lost Rp.1.7 trillion (equivalent to A$ 170 million) in late 2003 (Goodpaster, 2002; Cahyono, 2003). These failures are losses for the public and the country since the assets belong to the government.

This unethical behaviour has become the established norm and culture within SOEs\(^3\). According to Siagian (2006) the Indonesian culture tends to hinder the progress of the country. In this case, Siagian interprets Michael Porter’s statement regarding the factors that hinder investment in Indonesia, from both outside and within Indonesia. One of the factors is the short-term mentality of a rent seeker to make a quick profit. In practice, that factor has also become the factor that influences the entire Indonesian legal system. That problem leads to the recommended solution to privatize the SOEs in order to increase transparency, so that the board members and senior management performance can be supervised and will create the increasing performance.

In addition, before SOEs were privatized, debt financing was the preferred method of financing (this holds true for private-owned companies as well). However, debt financing has its own set of problems in the Indonesian setting, such as conflicts of

\(^3\)As defined by Richard Posner (cited in Patrick, 2001, p. 21) a norm is a rule that has not been legally established and not enforced by the threat of legal sanctions, yet is regularly complied with.
interest, collusion, and vested interest groups. These have proven to be the cause for large losses and bankruptcy of private and state companies and banks (Kurniawan and Indriantoro, 2000; Husnan, 2001).

1.2.6 Current Behaviour of Corporate Governance in Indonesian SOEs
Unethical behaviour has been significant in Indonesian SOEs. The Government as a shareholder of 165 SOEs⁴ (Husnan, 2001) has placed its representatives on Supervisory Boards and management boards. It has proven to be intrusive on SOEs through a variety of involvements such as: appointing directors and commissioners on the basis of relationship or close connections; forcing SOEs to make a contract with a particular company owned by family or friends of a regulator; selling/buying assets that trigger conflicts of interests; and, getting commissions by increasing the board of commissioners’ remuneration (MT, 2005; Putro, 2009; Rachbini, 2010; Republika, 2012). Patrick points out that powerful individuals have misused the relationships between shareholders and supervisory and management boards (Patrick, 2001). In addition, there were indications of misuse of power by SOEs directors during specific SOEs privatisation processes such as: PLN (the state’s electricity company); PAM (the state’s water company); and INDOSAT (one of the state’s telecommunication companies) (Ardyanto, 2002; MYS, 2009; Samad, 2013). This phenomenon of corporate fraud is called KKN⁵ or corruption, collusion, and nepotism. Furthermore, Turnbull points out that these are serious threats to ethical decision-making by company boards (cited in Flanagan et al., 2004, p. 7).

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⁴ The number of SOEs amounted to 600 in 1945, and has kept changing due to the new SOEs or merger
⁵ KKN is an Indonesian acronym that stands for Korupsi (corruption), Kolusi (collusion), Nepotisme (nepotism).
Nestor’s theory of corporate governance is in line with the perspective of the Organization for Economic Co-operation and Development (OECD)’s principles. He divided corporate governance into two aspects which are the behavioural side and normative side. The first one includes the relationships and resulting model of behaviour among a variety of agents within a limited company which involves the way management interacts with stakeholders to determine the company’s strategy. The normative side of corporate governance covers the way these relationships and individual behaviours are shaping up in the set of rules such as company law, securities regulation, and listing requirements (Nestor, 2001). According to Mobius, good performance depends on the character of the people in that system (Mobius, 2002). Do they behave positively, negatively, or indifferently towards the system?

### 1.2.7 Accountability of SOEs’ Stakeholders

The ownership structure in state-owned enterprises is different from the private company ownership structure. Wei (2003) stated that SOEs are owned by the State, and therefore the public. Hence, ownership could be considered as an abstract concept. Additionally, the separation between the owners of SOEs and the managers is less apparent in Indonesia because of the traditional culture which still exists in Indonesian SOEs.

In the private or public sectors in other countries such as the USA, the UK, and Japan the agents receive full authority from the shareholders to operate the companies, and agency costs are incurred. The corporate governance problem in Indonesia is not merely about the matter of separation of owners and agents, and the high costs that might be incurred due to the power of agents, but instead it has its own unique set of problems.
The most significant problem is higher authority (i.e. members of Boards of Directors and Boards of Commissioners) using their power to influence the SOEs’ managers for the personal benefit of the President, Cabinet members, Commissioners, and Directors, and sometimes even Members of Parliament. This political consideration will be discussed in more detail in a later chapter.

1.3 Importance of the Research

The reason for choosing SOEs as the subjects for this study is the call by the Indonesian government for SOEs to be privatized and become public companies listed on the Indonesian stock exchange\(^6\) (Rivai, 1994, p. 58). The Indonesian government has stated that they will not subsidise the funds to any SOE to be publicly listed. An SOE is expected to sell its shares to the public and not rely on debt financing. The consequence of becoming a public-owned company is the need to make a commitment to a greater degree of transparency and accountability in complying with the requirements of the Supervisory Board for publicly-owned corporations. In other words, it must be shown that corporate governance codes have been established/in place within its operations. Top management has to prepare the fledgling company for public offering to both local and foreign investors. The supervisory and management boards should exercise their roles in bringing an SOE to the marketable stage effectively. The board could bring an SOE to this stage by complying with the required corporate governance system. As a consequence, there will be more investors willing to invest in SOEs, and more profit can be generated from SOEs.

Only a few studies have been carried out on corporate governance in Indonesia. For instance, the study by Wibowo (2008) investigates the impact of organisational culture

\(^6\) Based on government decree no. 55 of 1990 (or PP Nomor 55, 1990), SOEs were permitted to go public.
and internal corporate governance on company performance in the private sector. Indreswari (2006) studied the effectiveness of corporate governance systems and the boards’ role in Indonesian SOEs in general. Lukviarman (2004) researched the relationship between ownership structure, monitoring and firm performance. Setiawan (2006) investigated the corporate governance in a listed public company. The motivation behind all the theses mentioned above was the lengthy financial crisis in Indonesia starting from 1997 onwards (Husnan 2001; Herwidayatmo 2002; Yonnedi, 2003), and how it has affected and influenced the corporate governance in the companies under scrutiny.

This thesis will examine the interaction and practices of these issues such as the board’s role in making strategic decisions, its role and behaviour in supervising corporate finances and in supervising daily management tasks will be analysed. Furthermore, the behaviour of member of the two boards, that is the board of directors and the board of commissioners is investigated. In addition, their perspectives about the government of Indonesia as a shareholder is examined. In-depth interview methods for data production, and qualitative analysis methods are used to investigate the behaviour of SOE boards in performing their corporate governance role and functions.

In this thesis, two boards and also external factors such as Indonesian legal institutions, DPR, and Ministers of SOEs, have been examined. However, this research will focus more on investigating the supervisory and the management boards’ behaviour towards corporate governance which falls under the act category that (according to Flanagan and Little, 2004) is still deficient. So far, there have been no empirical investigations into the behaviour of the supervisory boards of SOEs in Indonesia. These are the subjects of this study. In addition, the Indonesian government’s approach is also explored in this
study. This is because SOEs are owned by the government and SOEs are important elements in the Indonesian economy.

1.4 Research Objectives and Research Questions

1.4.1 Research Objectives

1. To document and evaluate the actual corporate governance practices utilised by the supervisory boards and management boards of Indonesian SOEs;

2. To ascertain the purposes of the Indonesian government’s corporate governance policies and structure;

3. To provide recommendations for the improvement of the effectiveness of the corporate governance policies and practices of Indonesian SOEs.

1.4.2 Research Questions

The five main research questions to be investigated in this study are:

1. How is corporate governance currently being practiced in SOEs in Indonesia?

2. What are the problems that hinder the implementation of GCG in business practices in Indonesia, and why?

3. What are the national and international imperatives driving current changes of corporate governance in Indonesian SOEs, and, what are the effects?

4. In view of Indonesian corporate culture and business practices, how appropriate to Indonesian SOEs are the current corporate governance policies being promulgated by the government?

5. What recommendations can be made to improve the effectiveness of the corporate governance policies and practices of Indonesian SOEs?
1.5 Overview of Research Methodology
The purpose of this thesis is to analyse the implementation of good corporate governance in Indonesian state-owned enterprises. Qualitative research design is used in this thesis. There will be primary data and secondary data. The primary data collection is conducted by using semi-structured interviews, while the secondary data is conducted by browsing data from various archival resources. This thesis uses the qualitative research method because it is the most suitable method to achieve the objectives of the research. After collecting primary data through interviews, the data was transcribed manually.

1.5.1 Data Collection
The data in this research was collected by conducting in-depth semi structured interviews with 38 participants from three SOEs and related institutions/policy makers by spending approximately one hour on each interview. After finishing the interview stage, the researcher transcribed the data. Besides collecting primary data through in-depth interviews, there was also secondary data collected from various resources such as SOEs’ code of conducts, journals and the public press.

1.5.2 Interviews
Interviews were conducted in order to collect the primary data from the state-owned enterprises and related institutions/policy makers. According to Berg (1995, cited in Holloway 2006), the interview as the method chosen to collect the primary data consists of three types, those are: a standardized interview which uses formally structured questions, a non-standardized interview which does not use formal questions and a semi-standardized (or semi-structured) interview which uses predetermined questions

7 See Appendix A on pages 311 to 312
and topics. Reis and Judd (2000) stated that “the semi-structured interviews provide more latitude for participant response, permit flexibility…and, yield a rich source of information” (cited in Bartholomew, et al, p. 288), Therefore in this research, the semi-standardized interview is found to be the most suitable method to collect the data from the respondents.

1.5.3 Samples
Collecting data for this research purpose used a purposive sampling approach which enables the researcher to choose a sample related to the research purpose due to his/her knowledge of the known characteristics of each selected case (Zikmund, 1997). Purposive sampling is also suitable because this study used the qualitative research method requiring small samples (Babbie, 2002). The small sample requirement meant the researcher chose only three SOEs out of 165 potential Indonesian SOEs from different industries. Data was collected from interviewees employed in a solely state-owned electric power company (unlisted), a state bank (already listed on JSX) and a national airline company (listed in 2012).

In order to answer the research questions and achieve the research objectives, information or data was gathered from internal stakeholders. These ranged from top level management (such as the board of commissioners and directors), independent commissioners and directors, to middle level management such as managers and supervisors, and lastly from a middle level officer of related government institution and regulators from the Ministry of State Owned Enterprise (BUMN).

1.6 Organisation of the Thesis
This thesis consists of eight chapters:
Chapter 1, the introduction, will detail the general contents of the thesis and describe the reasons for choosing corporate governance as a topic and Indonesian SOEs as subjects for this study.

Chapter 2 begins the literature review. This chapter considers global issues related to corporate governance. Further issues to be examined in-depth include the degree of corporate accountability, information system and decision making, transparency, board sub-committees, ethical issues, and issues of board behaviour.

Chapter 3, the second of the literature review chapters analyses societal and cultural issues in relation to corporate governance in Indonesia.

Chapter 4, the final literature review chapter, discusses the evaluation and development of corporate governance best practice outcomes. This began with the emergence of commissions which discussed corporate governance initially.

Chapter 5 explains the research methodology and approach. This chapter explains the qualitative research framework and details the sample determination, data processing, and limitations of the study. Evidence is presented of the validity and reliability of qualitative research.

Chapter 6 consists of the findings from the research conducted in three state-owned enterprises that were the subjects of this study. There are also explanations about the implementation of good corporate governance in state-owned enterprises in Indonesia.

Chapter 7 analyses the research findings across the three SOEs in relation to the participants interviewed utilising a semi-structured interview instrument. Included is a discussion and analysis about state-owned boards and their culture, which is an important aspect influencing the implementation of good corporate governance in
Indonesia. Another factor discussed is the external influence of the Government of
Indonesia.

Chapter 8 provides recommendations in order to make a contribution to the
implementation of good corporate governance in Indonesia. In addition, this chapter
emphasizes the contribution of this thesis to the knowledge of corporate governance.

Chapter 9 presents the conclusions which answer the research questions. It also
discusses the limitations of the research and concludes with suggested directions and
opportunities for future research in the field of corporate governance in Indonesia.

1.7 Conclusion
This thesis will ascertain the practice of corporate governance in Indonesian SOEs.
Unlike previous studies that focus on the structure, this research examined the
behaviour of the supervisory board and the management boards within the corporate
governance system.

The researcher used in-depth interviews to investigate boards’ behaviour and gain a
deeper understanding about what, how, and why such behaviour is being applied in
implementing corporate governance. This study provides insights into the behaviour of
supervisory boards and management boards within the corporate governance system
utilised in Indonesian SOEs. Thus, it contributes to the body of knowledge and the
ongoing effort to improve corporate governance processes and practices in the
Indonesian corporate cultural context.
2 Chapter - Corporate Governance: The Global Practices

2.1 Introduction

Corporate governance in large listed companies can be argued to be a serious public issue. Many people in developed countries are shareholders of companies listed on stock exchanges. Either people hold shares in their own right, or they have their savings invested in financial entities such as superannuation funds which act as shareholders. Individuals would be worried about investing in little known business ventures if they could not place reliance on the corporate governance systems in place in such ventures. It is not only shareholders, but people in general who need to have a culprit to blame should anything go wrong with their invested money. As a result, successes and failures of corporate governance always make the front pages of newspapers. This has particularly been the case in this century, because of a series of financial scandals and a long-lasting financial crisis (Lemmon and Lins, 2003; Kirkpatrick, 2009; Osterloh et al, 2011; Erkens, Hung, and Matos, 2012).

Corporate governance is also at the top of governments’ agenda. However, governance is not only relevant to listed companies, it is also relevant to unlisted companies, non-profit organizations and state-owned enterprises (Osterloh et al, 2011; van Essen, Engelen, and Carney, 2013; Pacces, 2013).

This chapter presents the global practice of corporate governance by starting the discussion with the importance of good corporate governance to elucidate why it is so important to implement effective corporate governance in companies. Besides the positives there are also negatives which shed light on the significant contribution of corporate governance to a company’s and country’s overall economic performance.
Before explaining the implementation of reforms in corporate governance in the United Kingdom, China, Germany and Japan, there are explanations of the agency theory, stakeholder theory and the board of directors as the main features of corporate governance implementation. Figure 2.1 shows the outline of this chapter.
Figure 2: Chapter 2 Outline

Introduction

Importance of Good Corporate Governance (GCG)

Corporate Governance: System versus Act

The Agency Theory

The Board of Directors

The Board’s Role: the Rationale for Having the Boards of Directors

The Effective Boards

Independent Directors and the Paradox

The Stakeholders and the Shareholders

Checks and Balances of Good Corporate Governance

Corporate Governance System: The Experiences in Other Countries:

- The United Kingdom
- China
- Germany
- Japan

Conclusion
2.2 Importance of Good Corporate Governance (GCG)

The existence of GCG is important for every company in every country. A high degree of effectiveness in its implementation causes companies to be efficient in using resources, to be cost efficient and effective in company operations, and successful in reducing the risks of corporate fraud. Companies locally and globally can be more competitive, and attract both local and foreign investors to invest in the company, which can add to the economic wealth of the country (Mizuno, 2013). On the other hand, when GCG is not effectively implemented, companies could be unprofitable (take for instance the National Australia Bank scandal in early 2004), or face corporate frauds and scandals that may lead to the bankruptcy of the companies (Enron in late 2001 and Worldcom in 2003 in United States). They may possibly become targets for acquisition by bigger companies (Barclays Bank in the United Kingdom). If there are too many corporate fraudulent practices and scandals occurring in one country due to lack of GCG, this country becomes less attractive for investors, as has been experienced in Indonesia.

According to Backman, the Asian financial crisis in the 1990s was due to the lack of good corporate governance practices (cited in Wong 2004). Husnan and Herwidayatmo\(^8\) have confirmed and extended Backman’s claim by arguing that poor corporate governance has also contributed to the depth of the economic crisis in Indonesia (Husnan 2001; Herwidayatmo 2002).

There is no single accepted definition of corporate governance. One basic principle of corporate governance is given by Cadbury. He argues that corporate governance is the system by which companies are directed and controlled (cited in Organization for

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\(^8\) Herwidayatmo is a chairman of Badan Pengawas Pasar Modal (BAPEPAM) or Indonesia Capital Market Supervisory Agency (the formal regulator and supervisory board of capital markets).
Economic Co-Operation and Development, 1998; Solomon & Solomon, 2004). This study uses corporate governance principles developed by the Cadbury Committee in the UK which concerns the direction and control of companies. This basic principle is also used by OECD’s experts in developing the corporate governance system among OECD countries. Therefore, it can be argued that corporate governance is a term used to emphasize the relationships between a company’s board of directors, the senior management team and other stakeholders. This statement is supported by Baxt and Ramsay (2002), who stated that corporate governance involves a relationship between boards and senior management and other stakeholders. The substance of this principle is the distribution of responsibility in the relationships between managers, the board, shareholders and stakeholders. Furthermore, Monk and Minow (2004) comment that the important actors in corporate governance structure are (1) shareholders, (2) management, led by the board of directors, and (3) the board of commissioners who control the internal company. There are two types of stakeholders: 1) internal stakeholders, which includes customers, suppliers, and 2) external stakeholders which includes the community (Monks & Minow, 2004).

Corporate governance issues are becoming a major concern for both profit and non-profit organizations, since practising good corporate governance should bring positive benefits to a company. Therefore, companies will become globally competitive (OECD, 2004); investors will be attracted; there will be a positive impact on share price; the company value will increase; and, corporate fraud will be minimized (Low 2002; Mobius 2002). A sound company will be created. All of those benefits accrue when companies adopt good corporate governance systems (Mobius 2002). These types of benefits would be beneficial for a country such as Indonesia that has yet to
recover from recent economic crises and needs to attract investors, both domestic and foreign. Although the OECD report of 2004 (revision of 1999) states that corporate governance systems in every country should be adapted to legal, economic and cultural circumstances, its report strongly recommends that each company have independent directors and committees such as the audit committee and remuneration committee.

Corporate governance has become one of the most commonly used phrases in the current global business vocabulary. This raises the question, “is corporate governance a vital component of successful business or is it simply another fad that will fade away over time”? (Solomon and Solomon, 2004). To answer this question, one can examine what the relevant scholars have said about the relationship between GCG and company performance. Some of the studies that examine the relationship between corporate governance and company performance indicate contrasting findings.

Good corporate governance does not necessarily mean good corporate performance. Results of some of the studies in the area of corporate governance argue that there is no direct relationship between corporate governance and company performance. Leblanc (2003) points out that several studies have failed to show a definite relationship between board structure and company financial performance. Researchers have not yet proved that good boards contribute positively to company profits. A research study on corporate governance in China suggests that bad corporate governance has not adversely reflected on the country’s economic performance. For example, the economic growth of China registered at 11.2% as the best in the world in the 1990s (Charles, Fontana, Srivastava, 2011) although China does not have good corporate governance systems and practices (Yu, 2004). The reasons for corporate failures may be found in other factors rather than corporate governance systems. These include factors such as
bad economic conditions, macroeconomic policies and the degree of competition (Organization for Economic Co-Operation and Development 2004).

Several researchers have pointed out, however, that good corporate governance is one of the major ingredients that helps to underpin good corporate performance. Leblanc (2003) states that one cannot deny the absence of a relationship between corporate governance and corporate performance. Therefore, the role of boards, senior management and other stakeholders as the important aspect of good corporate governance needs to receive proper attention. Furthermore, a recommendation by Husnan (1999) stated that the Indonesian Government needs to address the weaknesses identified in his study of corporate governance in Indonesia. These weaknesses lie in problems with the rights of the minority shareholders, the legal and regulatory framework, creditors’ rights, and transparency (Husnan 1999). In addition, the practices of good corporate governance will help to reduce corporate fraud and attract potential investors (Organization for Economic Co-Operation and Development 2004).

2.3 Corporate governance: System versus Act
Corporate governance consists of both system and act (Flanagan and Little., 2004). System refers to the operation of a company which is controlled management and the elements of a corporate governance system. The boards, regulators of stock exchange and governments, and most researchers have emphasized changes to the system, which is, getting the rules and elements of corporate governance right. However, there is less exploration, evaluation, and analysis of the behaviour of boards as a team and as individuals. “Act” refers to the way boards and management operate the company in accordance with desired direction. This includes the board’s behaviour which covers motivations, practices, and ethics.
2.4 The Agency Theory

A major issue associated with corporate governance is the separation of ownership and management. It has been long discussed by scholars starting with Adam Smith (1776), to Berle and Means (1932) and Jensen and Meckling (1976) and the dominant theory related with it is agency theory (Lukviarman, 2004; Smith, 2011, p. 3; Christopher, 2012, p. 3). Agency theory is characterised by agents acting according to the instruction of their principals to whom they have a duty to act in their best interest. The shareholders are the principals of the company and management and effectively the board of directors is their agent. A problem arises when the board has the power to manage the company and the shareholders have no authority in the company management. However, the shareholders can intervene in the management by voting directors off or on the board at the AGM.

In most Western countries management is separated from ownership. The owners are essentially the shareholders of the company, but the control or the management of the company is vested in the managers. Hence, management is separated or divorced from ownership thus management is effectively acting as agent for the owners. This is the central element and background of agency theory.

A problem arises when there is a conflict, or conflicts, between what is in the best interests of the owners and what is in the best interests of their agents that is, to say, the managers. For instance, managers may maximize profit in the short term at the expense of long term profitability to maximise their bonuses, whereas long term profitability may be in the best interest of the owners. Another example occurs when company executives manipulate the company share price so they can maximize their shareholdings in the company at minimum cost through their share options.
The need for separation between ownership and control is highlighted by large cases of corporate fraud such as that committed by Enron, Worldcom, Barclay Bank, and the National Australian Bank. As a result of these, corporate governance has come under the spotlight and is debated by scholars and the popular press. One problem of agency theory appears to be that maximization of the owners’ benefits and maximization of the managers’ benefits are mutually exclusive. According to Williamson (1985, cited in Donaldson and Davis, 1991, p. 50), in order to restrain opportunistic behaviour by executives, the board of directors are appointed by the shareholders. So the control of the executives and the company policies is theoretically in the hands of a majority of shareholders. Lukviarman (2004) has considered the analysis of Shleifer and Vishny (1997) of agency theory. They examined at the conflict that arises between shareholders, creditors and other stakeholders. Donaldson and Davis, and Lukviarman are focused on shareholders assets and how to maximise the value of these assets in face of the problems arising from the conflicts between the owners and their agents i.e. the managers in the agency theory. However, the work of Lukviarman and Shleifer and Vishny relate to studies in the private sector only, and the issues of corporate governance arising from the agency theory. This thesis on the other hand, studies State-Owned Enterprises, in other words companies owned by the public sector.

Although many researchers have conducted corporate governance studies within the agency theory framework, this theory is not entirely applicable to this study. Lukviarman (2004, p. 21) stated that “the dominant view of corporate governance hinges on the issue of separation and control within the firm which is modelled by the

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9 Later in Donaldson and Davis’ paper discuss “stewardship theory” which will not be discussed in this literature review. Similarly, Lukviarman’s thesis which later discusses the ownership structure in depth will not be discussed in this chapter.
agency theory”. The study of corporate governance in SOEs contrasts with his statements. The shareholders in the agency theory are an uppermost group that can influence and determine the company’s policies. While this can be done successfully in the private sector, it is different in the public sector and in Indonesian SOEs, the majority shareholder being the Government of Indonesia. The characteristics of fraud and opportunistic behaviour such as the misuse of authority by executives in SOEs is different from that in private companies. This is because a developing country such as Indonesia has feudalistic practices where there are greater distances between levels in hierarchies. The members of the government in power are able to treat the SOEs as if they were their personal property. They intervene in the operations of the company by prevailing on management to provide jobs for their relatives or cronies. Another example has occurred when government officials were appointed to management positions in SOEs to channel funds to the ruling political party for the next election campaign and routine political party operations. In an SOE, fraud and opportunistic behaviour can be organized and committed by a conspiracy of more than one person because the government (as the owner) is not an individual person or a single entity which makes decisions. In addition to this, the constitution and regulations, the existing corporate culture, society’s culture, and politics all influence the government’s decisions regarding SOEs.

2.4.1 The Board of Directors

The first writer to introduce the concept of corporate governance into theoretical economics literature was Adam Smith who studied the separation of ownership and control in business that existed in his time. He was aware of some of the agency issues. Smith argued that managers of other people’s money, rather than their own, cannot be
expected to watch over it with the same anxious vigilance as the owners (Smith, 1776, cited in Clarke, 2007; Denis, 2001).

Adam Smith appears to have identified the boards of directors as a mechanism for controlling managers. In 1932, Berle and Means postulated a similar view. They state that control will tend to be in the hands of those who select the proxy committee and by whom, the election of directors for the ensuing period will be made. Since the proxy committee is appointed by the existing management, the latter can virtually dictate their own successors (Hermalin and Weisbach, 2003). Also, Berle and Means continued that the separation of ownership from control produces a condition where the interests of owner and ultimate manager may, and often do, diverge, and where many of the checks formerly operated to limit the use of power disappear” (Learmount, 2002).

2.4.2 The Board’s Role: the Rationale for Having Boards of Directors

The corporate law of various countries specifies that boards of directors are a legal requirement (Hermalin and Weisbach, 2003). Similarly, they may be required by stock exchange regulation as a listing requirement. Many companies have dispersed ownership, that is to say, they have a relatively large number of shareholders but not large enough to exercise control of the business on a day-to-day basis (Hart, 1995). This is another rationale for the existence of boards of directors.

In the absence of the board of directors it is unlikely that dispersed shareholders will monitor management performance and because of the separation of ownership and control (Berle and Means cited in Hart, 1995) agency problems can arise. If managers’ pursuance of their own goals or agendas is to be stopped or minimized there has to be a
system of control, or checks and balances of their management action. According to Hart, one of the checks and balances is the board of directors\textsuperscript{10}.

Regarding the functions of the boards in two tier systems, the supervisory boards do not get involved in controlling the company operations, but they do observe and monitor how management operates the business. Several authors have argued that the principles of corporate governance of public companies are based on fairness, transparency, accountability and responsibility, minority investor protection measures, and enforcing regulations (Dallas and Bradley 2002; Mobius 2002; Organization for Economic Co-Operation and Development, 2004). The corporate governance elements identified by some scholars, policy makers, and corporate governance institutions are varied, but their contents are similar from one institution to another. These elements including independent directors, the audit committee, the remuneration committee, and the nomination committee are currently dominant issues in the practice of corporate governance.

### 2.4.3 Effective Boards

According to research conducted by LeBlanc (2003), the effectiveness of Boards of Directors is determined by several factors including the natures of the directors. There happen to be five types of directors, which sit on the most effective boards. These are change agents, consensus builders, counsellors, challengers, and conductors. The change agent type is important because it provides strength for the board to disagree and is the impetus for change. The consensus builder is important as a facilitator in resolving disagreement. Counsellors have important negotiation skills and especially in dealing with one on one situations, and external bodies (such as government institutions

\textsuperscript{10} Some other mechanisms include proxy fights, large shareholders, hostile takeovers, and financial structure (Hart, 1995). These will not be discussed in this thesis.
and regulatory bodies). The challengers ask the difficult question at the appropriate time and in the appropriate manner. The conductor is arguably the most important type of board member. They act as conduits for reaching decisions and make highly effective board leaders.

In addition, there are five types of directors that sit on the most ineffective boards. These are controllers, conformists, cheerleaders, critics and caretakers. Controllers are highly critical but in negative sense they tend to be manipulative and power seeking. The conformist directors are just going along for the ride and really do not contribute anything. They tend to be long-term directors and good at forming alliances to protect their positions. A Cheerleader is an under-or non-performing director, who fails to impress his fellow directors. His attendance is nothing to write home about. When he does show up meetings, he is either ill-prepared or not prepared at all. A Critic criticizes and complains. He or she is more often than not critical of the management. The critic is incapable of constructive criticism, an essential component in making progress. A Caretaker is an ineffective, under-performing, non-executive chair (or lead director) of the board. A caretaker has no real leadership skills to offer (Le Blanc, 2003).

2.4.4 Independent Directors and the Paradox

An independent director is “… a director who is independent of management and free from any interest and any business or other relationship which could or could reasonably be perceived to, materially interfere with the director’s ability to act with a view to the best interests of the corporation” (Reiter, 1999).

As Reiter pointed out, “the truly independent or outsiders directors must scrutinize and question corporate activities and management proposals objectively. To me, the issue is less about being independent, than it is about having the integrity, strength and realistic
opportunity to express truly held views and to question management, its plans and performance. Because inside directors are not in a position to express their independent opinions about the activities of the company or management and as officers, their loyalty is to the CEO” (Reiter, 1999). Lipton (2002) puts it differently, he says that the necessary characteristics of an independent director include: not having been an executive in the past few years; not being a professional adviser; not being a supplier or customer; and, having no other significant contractual relationship with the company.

The need for corporate boards to have independent members was recommended by the Cadbury Committee (1992) as a response to major corporate failures in the UK (Holloway and Van Rhyn 2003). The committee proposed that each board have at least three independent directors. Tricker (1984) writes that the British Government White Paper on The Conduct of Company Directors’ claimed that independent directors would provide a breadth of knowledge and independent decision making to the boards that the executive members could not provide. The existence of independent directors inside the organisation will reduce collusion among board members. However, Turnbull (2005) does not agree with this notion. He cogently argues that it is irrational for shareholders to rely on the independent directors, and doubts that the independent directors will perform in a contradictory way to that of the majority shareholders’ representatives (p. 12). A similar notion is given by Solomon and Solomon (2004) in relation to the downfall of Enron. They stated that the non-executive directors (or independent directors) cannot fully perform their corporate governance task because they do not want to lose their positions on the board (Solomon & Solomon, 2004). They quoted from one of the directors they interviewed: “There is a feeling that somebody ought to exercise constraint on boards. I do not think the system of non-executive directors is
terribly successful. It is very difficult being a non-executive director because you actually have got to let the chief executive run the show-you cannot keep interfering, and that is the trouble. You don’t want to interfere - you will get yourself voted out if you are too awkward” (Solomon & Solomon, 2004).

In Australia, according to the Bosch Committee, a majority of independent directors should be appointed members of important sub-committees including the audit and remuneration committees (cited in Lipton 2002). Similarly, the UK government-commissioned Higgs Report recommended that “…the key sub-committee memberships of the board (audit, remuneration and nomination) should be comprised solely of independent directors” (cited in Holloway 2004, p. 24). Cohen, Frazzini, and Malloy (2012), on the other hand, argued that independent directors are overly sympathetic to management, while still technically independent according to regulatory definitions.

2.5 The Stakeholders and the Shareholders

Currently, the world is a place in which there is a growing demand for businesses to demonstrate greater social responsibility and for more sustainable businesses. It can be argued that these are legitimate demands because society notionally licenses businesses to operate subject to businesses not maximising profits whatever the costs to society (Holloway, Paull, and Burnnet, 2011). Stakeholder theory has been accorded increasing credence in the field of corporate governance recently. In stakeholder theory, businesses are regarded as having more significance than merely maximizing returns to their shareholders. Current stakeholder theory includes a wider range of stakeholders other than just shareholders. These groups include, for instance, employees, suppliers, interest groups from communities in which businesses operate. Stakeholder theory promotes
greater company activeness in protecting the interests of these groups (Vasudev and Watson, 2012).

Stakeholders theory stems from the ancient desire of people to satisfy members of their family, clan, or tribe (Jensen, 2001, p.14). Membership of such groups made it more likely that individuals would survive through the sharing of food, shelter, and the like. Jensen states that individuals were unlikely to survive without membership or association with such groups. To remain members they had to satisfy these groups.

According to Jensen, the stakeholder theory is consistent with a business maximizing the benefits to stakeholders. However, managers and board directors or decision makers have to decide between the competing interests of various stakeholders, leading to trade-offs, and this leads to conflict among stakeholders and the managers/decision makers. Companies which followed the stakeholder theory could go bankrupt. Because managers or decision makers are not accountable for maximizing the shareholders’ value, then they are free to pursue their own interest. He gives an example of managers who have strong social interests. Therefore, stakeholder theory is contrasted against shareholder theory. Similar view is given by Carney (1997) that in the private sector managers are made accountable to the shareholders and by market forces. These force businesses to operate more efficiently and maximize return to shareholders.

In a study analysing administration of public land in the US, Carney (1997), discusses the problems that have occurred. He contrasts what occurred under public administration with what might have occurred if its administration had been carried out by the private sector. According to Carney, there are many conflicting demands on Government officials who are acting as agents in administering public resources, with the result that the best interests of the public are not always served. Carney suggests that
in this case one solution is to give stakeholders more opportunities to state their opinion. Agents in the private sector have more control placed on them than in the public sector. They have to meet the demand placed on them by the shareholders and market forces. On the other hand, these controls are absent in the public sector while public officials have to satisfy so many conflicting demands that they are often without clear controls. In the private sector there is greater accountability because managers and directors are held accountable to the shareholders. Meanwhile, in the public sector managers are accountable to the Government and not directly to the public (tax payers, or shareholders). This is analogous to the situation found in Indonesian State-Owned Enterprises discussed and analysed in this research.

Although agency theory is particularly relevant to private companies, the stakeholder theory is more relevant in the case of SOEs because they are owned indirectly by the public who are stakeholders. They have a “stake” in the business rather than just a share. There is an exchange between the company and the stakeholders.

2.6 Checks and Balances of Good Corporate Governance

According to Lessing, good corporate governance requires a system of checks and balances which might also be described as mechanisms for it to operate effectively. Usually, if one of the checks or balances fails then the whole system fails. Lessing listed these mechanisms as including: duties of directors, shareholder remedies, disclosure, auditors, independent directors (and independent commissioners in Indonesia), securities laws, the regulators, and lawyers. Many of these checks and balances are relatively new to Indonesian corporations.

Lurie and Frankel (2003) advance the idea that because corporate governance in the business is essentially a political process, political governance theories can be applied to
business. Thus, they see the corporate checks and balances as being analogous to the political checks and balances in civil society.

However, in Indonesia a problem arises because of the inadequacy of the political checks and balances, thus it is not ideal or appropriate to adopt the political model of checks and balances in the corporate world. Therefore, Indonesia needs to learn from other countries that are currently implementing good corporate governance so there will be proper comparison in order to create better performance of the companies in Indonesia, whether they be private or state-owned.

2.7 Corporate Governance System: The Experiences in Other Countries

The laws relating to corporate governance in individual countries are drawn up according to the economic, social and legal frameworks that exist in each country (Solomon and Solomon, 2004; Haskovec, 2010).

2.7.1 The United Kingdom

The significant development of corporate governance in UK received more attention when the Maxwell case broke. Furthermore, the development of corporate governance reforms in UK followed in the wake of a number of public inquiries.

In 1991, the Maxwell affair occurred, which has been called the greatest fraud of the 20th century (Financial Reporting Council, 2006; Styles and Taylor, 1993 cited in Solomon and Solomon, 2004). The Maxwell case raised a number of corporate governance issues following public concern over the Maxwell case, the Cadbury Committee was established in 1991. In 1992, the committee produced a report and the Cadbury code (Keay, 2012). The Cadbury code was a code detailing best corporate governance practice. The code was not legally binding but the stock exchange required public listed companies to state if they had implemented the code in their annual report.
If there was not complete compliance, justification had to be provided. This aligns with the voluntary “comply or explain” approach that had been popular in UK (Keay, 2012, p. 8). The code covered the Board of Directors (BoD), Auditing, and the Shareholders. The Cadbury report focused on the BoD supposedly being the most important aspect of corporate governance but the accounting and auditing functions were also seen to be important aspects of corporate governance. The Cadbury code emphasizes that institution investors are the most important groups of shareholders. These institutional investors have in their control a significant proportion of a company’s issued capital, hence they can exert pressure on the boards. Essentially, institutional investors can be seen as a mechanism for keeping a company’s board honest.

The Greenbury Report 1995 emanated from a committee formed as a result of concern about directors’ remuneration. The aim of the report was to establish the relationship between directors’ salaries and their performance. The report acknowledged that salaries had to be sufficiently high to attract directors of appropriate calibre.

The Hampel committee considered both financial aspects of corporate governance and directors’ remuneration. The report published in 1998 gave rise to the Combined Code which covered all the issues from the Cadbury Report and the Greenbury report. One emphasis of the Hampel report was that GCG should not be prescribed by authorities but instead should be voluntarily adopted. This approach is the opposite of the US approach to GCG where a prescriptive approach has been used.

In the Combined Code, there was a provision that company directors should review their internal control system and report the findings to shareholders. The Turnbull Committee was established specifically to deal with the issue of internal control and the provisions relating to this in the Combined Code. The report of the Turnbull committee
gave an insight into internal control system utilized in UK companies and made recommendations for voluntary improvements. According to Solomon and Solomon (2004) the Turnbull report was seminal in corporate governance reform because it was an attempt to formalize a structure for internal control company. The report focused worldwide attention on internal control.

The Higgs Report (2003) recommended changes to the Combined Code relating to the role and effectiveness of Non-Executive Directors (NED), specifically that boards should include a great proportion of NED and more appropriate remuneration for NED. The report also recommended that there should be greater communication between NED and a company’s major shareholders. This would enable NED to represent shareholders interest better, and thus monitor the agency problem.

The Smith Report (2003) made recommendations regarding the role of the Audit Committee (AC) in corporate governance in the UK (Financial Reporting Council, 2006; Solomon and Solomon, 2004). The report examines the relationship between the external auditors and the companies they audit as well as the companies’ audit committee. The report recommended a voluntary approach. Also, in 2003 the UK Government made the Financial Reporting Council (FRC) responsible for disseminating and updating the code. The FRC updated the combined code in 2006.

2.7.2 China

The development of corporate governance in China is marked by the nationalization, modernization or privatization of State-Owned Enterprises in China. Prior to the 1950s, China had traditional companies but with the nationalization process in the 1950s these were replaced with state-owned and collectively owned enterprises. However, SOEs dominated the economy (Wei, 2003; Wang, 2012). In 1978, reform of the Chinese
economy started to decentralize government authority in enterprises and increase the autonomy of managers in operating their enterprises. Managers were given more freedom in the allocation of profits and resources. The government encouraged diversification in the ownership of businesses. They began the corporatization and privatization of SOEs.

China introduced a code of corporate governance for listed companies in 2001. According to Tomasich, (2005) it was adopted mainly from the OECD principles. However, China SOEs are inefficient for various reasons. These include lack of autonomy and government interference, and government protectionism of SOEs’ mismanagement. SOEs are protected from bankruptcy. Employees cannot be dismissed by the state; and there is low quality management. The managers are not entrepreneurs but are in fact bureaucrats. They are appointed by the government not according to their business ability, but based on their rankings in the bureaucratic hierarchy (Nakagane, 2000, p. 3). This shows how a business loses managerial independence and this is similar with the phenomena observed in Indonesia.

The Chinese code allows that the board of director may establish the following committees: a strategy committee, an audit committee, a nomination committee, remuneration and appraisal committee and other committees according to the resolution of shareholders. Chinese company law partly adopts the two-tier board system of Germany (Firth et al, 2007; Yu, 2012). Listed companies must have a Supervisory Board but limited liability companies which are not listed may or may not have a Supervisory Board depending on their size and the number of shareholders. A provision of the Chinese corporate governance code is that a listed company has independent directors on its board. In addition, the Chinese code provides for the Supervisory Board
which oversees the board of director. In 2001, China became a member of the World Trade Organization. As a condition of that entry China was to adopt good corporate governance practices.

2.7.3 Germany

Germany reformed its corporate governance in order to attract more foreign investors to invest in German enterprises.

According to Monks and Minow (2004), German companies have not been able to attract investment capital from institutional investors because of old fashioned governance practices that have hindered the rights of shareholders. The improvement of corporate governance was the subject of a report by the German Government in 1998 (Solomon and Solomon, 2004). A code of corporate governance was produced in 2000 with an updated version in 2001. The purposes of the code were to provide regulation for the management and governance of listed German companies. The achievement of agreement with internationally accepted standards was the main impetus for change in corporate governance in Germany.

Germany’s corporate governance system differs from that in England and America in several ways. Usually, German companies have a two-tier board structure and significant shareholders include employees. Germany has a two-tier board system like Indonesia. The ownership structure of companies in Germany is generally dispersed, similar to ownership companies in other OECD countries such as the USA, the United Kingdom, Australia, and Japan.

The supervisory board is supposed to play a monitoring role but the appointment of supervisory board members is often not transparent and has often led to poor monitoring and governance, and has the power “to appoint or remove directors” (Solomon and
Additionally, in Germany there is high degree of company-cross ownership, and this has affected corporate governance. In addition, the unique case affecting the corporate governance system in Germany is that there is a high degree of employee representation required by legislation, but companies have resisted this on the grounds that it infringes the rights of owners, and thus deters potential new investment. Employee representation in Germany arises from a different culture with regard to corporate governance as practiced in England and America.

2.7.4 Japan
Traditionally, Japanese businesses have been insider-dominated with credit based on the financial system. Companies often had a cross-company holding, cross-company directorship and often substantial involvement of banks. Prior to World War II, the Japanese economy was dominated by the Zaibatsu, which was a group of family businesses that effectively controlled the majority of the Japanese economy. As a condition of surrender, the Zaibatsu were prohibited and have developed into the Keiretsu, which are owned by banks with cross-ownership, and the banks are owned by families. The shares in these banks are usually not traded in the open market and there are fewer takeover activities. After 1997, there has been a trend to a more market-dominated economy.

A new trend emerging in Japan that has emerged in many other countries is that the economy is becoming more market oriented. The keiretsu system protected companies from shareholders’ influence because the complex system of inter-company ownership. However, there has been a series of bank liquidation of businesses that have reduced the traditional links between business and banks in Japan. Also, there has been a change in business ownership, since institutional investors own approximately 75% of the equity
businesses in Japan these days. Additionally, Japanese investors have seen that financial benefits may accrue from improvements in corporate governance (Solomon and Solomon, 2004).

The UK, Japan, Germany, and China all have some unique characteristics in their corporate governance practices. Many of these characteristics (for instance the involvement of unions in company management, the privatisation of state-owned enterprises, and self-regulation of corporate governance practices) are all phenomena that occur in Indonesian SOEs. The different implementation of corporate governance in different countries proves that there must be different implementation and adaptation of practices in every country.

2.8 Conclusion

This chapter has discussed the importance of practising good corporate governance, whether it be in private or state-owned enterprises, because it will have an impact on the enterprises’ performance. Although there is no undeniable scientific proof, most facts and theories mentioned in this chapter demonstrates that good corporate governance is essential for every company. Unfortunately, the conflict of interest between stakeholders and agents is a significant obstacle to the implementation of good corporate governance. There are solutions such as supervisory boards, and shareholders electing the members of Board of Directors. Transparency for all shareholders/stakeholders is another important factor.
3 CHAPTER – The Societal Culture, Javanese Culture, and Legal Culture: The Corporate Governance Case of Indonesia

3.1 Introduction

This chapter presents corporate governance from a cultural, societal and legal perspective and begins with the explanation and analysis of two important eras in Indonesia, namely: the Soekarno era/ Old Order and the Soeharto Era/New Order. The Soekarno era started to introduce State-Owned Enterprises to the military culture which continued in the Soeharto era and, the fact that approximately 80% of Indonesians are Javanese, including Soekarno and Soeharto themselves who introduced State-Owned Enterprises to Javanese Culture. Then, the dominance of the Military Culture and Javanese Culture has lead to corruption, collusion, and nepotism or popularly known in Indonesia as KKN. Finally this chapter describes the current (and on-going) events and corporate governance issues in 2012 such as whistle-blowing by the former Managing Director of State Power currently serving as a Minister of SOEs, and in 2013, a Police officer who asked for bribes and drank a beer with the victim. Figure 3.1 shows the outline of this chapter.
Figure 3: Chapter 3 Outline

Introduction

Cultural Aspects Affecting Corporate Culture in SOEs

- The Soekarno Era: the Foundation of SOE Corporate Culture
- The Soeharto Era: Further Influences on SOEs’ Corporate Culture
- Sketch of Indonesian Bureaucrats

The Indonesian Legal System, Legal Culture and Issues

- The Indonesian Legal System
- The Indonesian Legal Culture
- Illustrations of the Indonesian legal culture
- Mafia Peradilan or mafia in judicial system

Aspects of Social Culture that hinder the Implementation of Law

The Whistleblowers in Indonesia: Quo Vadis?

- Whistleblower Protection versus Social Culture
- Minister of State-Owned Company as a Whistleblower
- The Consequences of being as a Whistleblower in Indonesia

House of Representative Members Acting Like Pre-elementary Kids: Abdurrahman Wahid’s Comment

- Corruption Eradication Commission or Komisi Pemberantasan Korupsi (KPK)

Conclusion
3.2 Cultural Aspects Affecting Corporate Culture in SOEs

Corporate governance is often defined as the interaction between owners and managers in controlling and directing a company. Different countries have different systems of governance which reflect their legal and institutional frameworks, historical practice and the structure and function of their financial markets (Organization for Economic Co-Operation and Development, 1998). Article 33 was the basis for the foundation of several new SOEs soon after Indonesian independence in 1945. For example, the government established the Central Trading Company and USINDO. It also established several banks such as Bank Industri Negara, Bank Rakyat Indonesia, and Bank Negara Indonesia as well as businesses in the manufacturing sector (Abeng, 2001).

The first and second Indonesian presidents significantly influenced and contributed to the development of present day SOE corporate culture. Soekarno, the first president, reigned for twenty-one years and his successor, Soeharto, a four-star army general, ruled for thirty-two years. They were both born in Java (Tugiman, 1998), therefore, the Javanese leadership style and military business style have penetrated deep into the social, political and corporate lives of the Indonesian people and the State. These leadership styles have understandably also been practised 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.

3.2.1 The Soekarno Era: the Foundation of SOE Corporate Culture

The establishment of Indonesian SOEs started during the revolutionary era of Soekarno, the first president of the Republic of Indonesia (Usman, 2005). During this period, the government nationalized companies owned by the Dutch. 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, 1996). Well educated manpower is required to effectively manage SOEs. However, during this era the only educated manpower available was derived from the pool of public servants and members of the Indonesian Armed Forces (ABRI) (Usman, 2005). The management of SOEs started to involve military officers and civil servants who had no training or aptitude for running commercial enterprises. Patronage became a significant factor (Habir, 1990. cited in Abeng, 2001). Overstaffing was common and many SOEs suffered loses (Worang and Holloway, 2007).

As a result of this historical influence it is currently still common to have directors and commissioners with bureaucratic and army backgrounds serving within SOEs. Historically, public servants and ABRI officers are not oriented to producing commercial results hence they are not suitable to be involved in the corporate management since they have not been trained to make a profit for the organization.

The similarity between ABRI officers and KORPRI (Korps Pegawai Republik Indonesia or Indonesian Government Employee Corps) members can be found in their oath which states that they must be loyal to the upline in their hierarchy. This means that employees are loyal to their superiors. The way they operate in the organization is analogous to bureaucrats who fully (sometimes blindly) comply with their superiors. They are inflexible, have difficulties in making decisions, and always tend to wait for directions given by the superior. The popular term in Bahasa Indonesia (the Indonesian language) for this phenomenon is mohon petunjuk which means waiting and begging for a direction from the top. On the one hand, mohon petunjuk is an effective phenomenon when the superior is giving appropriate direction to their subordinates to carry out tasks. However in some cases, corrupt superiors (who could be the directors, or
commissioners of SOEs) give flawed direction because they just do whatever the corrupt stakeholders such as the relevant Minister’s Office or even the President order them to do\textsuperscript{11}. The combined recruitment of senior personnel from ABRI and KORPRI has shaped significantly the Indonesian SOEs’ corporate culture. As a result of this, many internationally accepted business practices and principles have been either overlooked or deliberately ignored in managing SOEs.

The day-to-day business working relationships between the highest authority and the subordinate is very similar to the chain of command 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—which were often merely the extended hands of the State Minister of SOEs—exhibited traits of total obedience to the senior leader (the higher authority).

The way management and employees operate within the SOEs is also similar to the public servant mentality—understandable given that many were previously government employees—with many inefficient and non-competitive business practices (Priambodo, 2004). Koentjaraningrat (1985) also argued that this critical element of ‘total obedience’ is embedded throughout the civil-service approach in Indonesia. Koentjaraningrat’s statement contrasts with that of Tanri Abeng, the former Minister of SOEs. He was appointed minister late in Suharto’s New Order reporting that many SOE directors went to see him to ask for directions or advice from him before submitting the official proposals of their SOEs. His response was that they should weigh up the alternatives and make a recommendation that best served the interests of the

\textsuperscript{11}The case of the selling of a Very Large Crude Carrier (VLCC/oil tanker) of Pertamina (the State monopoly oil company) has brought Laksamana Sukardi, the former General Commissioner of Pertamina, and later a former of Minister of SOEs to court. He was also treasurer of Megawati’s PDIP political party.
corporation. In his view, this must have been a culture shock for many of them (Abeng, 2001). For it was a departure from the old way of doing things. It can be argued that historically directors and senior managers of SOE looked after their own interest by looking after the interest of their superior whether or not this was in the best of interest of the SOE. In reality, it was not.

Currently, there are still bureaucrats and non-active army personnel who hold key positions and are members of the board of directors and commissioners of SOEs. The fact that there may be more appropriate people with professional business backgrounds from external sources (non-bureaucratically or non-army) for these positions is often ignored.

3.2.2 The Soeharto Era: Further Influences on SOEs’ Corporate Culture

The role of the military in the economy continued during Soeharto’s era (Robison, 1986). Former-army generals managed and ran SOEs such as Pertamina (oil company) and Berdikari (trading company), which played major roles in the Indonesian economy. Later, more positions at the director and commissioner level in SOEs were occupied by former-members of the armed forces. It was easier for members of ABRI to hold positions in ministry offices and later SOEs because of the development of a program referred to as *dwi fungsi* (dual function) ABRI.

Management positions in SOEs were also held by former-government employees. These types of practices have led to the current situation where many members of the boards of directors and boards 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.\(^{12}\) Each

\(^{12}\) KORPRI is closely associated with the ruling political party GOLKAR in the Soeharto era.
government ministry had its own related KORPRI, and the head of the ministry was also the head of the related KORPRI. This applied to positions in all public and statutory offices. For example, the Minister of Finance was the head of KORPRI for the Department of Finance or the General Director of Perusahaan Listrik Negara or PLN (State Power Company) was the head of KORPRI of PLN. There was also a National KORPRI body of which Soeharto himself was the leader.

During this and the earlier Soekarno era government bureaucrats were effectively acculturated into an organizational setting where it was deemed appropriate to always (excessively?) obey higher authority (commissioners/directors of SOEs and Ministers). Directives from these “superiors” were executed without question\(^\text{13}\). These business cultures and practices have been prevalent during the past thirty years. The existing corporate culture in Indonesia, especially in SOEs, is not conducive for the implementation of GCG practices that have been adopted from the West.

Indonesian business culture derived largely from Indonesian society culture which in turn is dominated by Javanese culture because Java is the most densely populated of the Indonesia islands (80% of Indonesia’s population is Javanese). Thus, Javanese culture has a major influence on Indonesia business culture. In addition, the majority of businesses are based in Java which is another factor in the dominance of Javanese culture in Indonesia business culture.

### 3.2.3 Sketch of Indonesian Bureaucrats

“*Our bureaucracy is a moustache bureaucracy. It stands up when it looks down, and it droops when it looks*” (Buchori, 1994, p. 61).

\(^{13}\text{For instance, in an interview for Australian SBS TV, about the poisoning of the human rights activist Munir on a Garuda flight, the General Director of Garuda (Indonesia’s flag airline carrier), stated when asked if Garuda knowingly allowed the killer to be on board, that, “it is all up to the government that owns the company.”*}
The bureaucracy in Indonesia has its own history of shaping the corporate culture in Indonesia SOEs. According to Buchori, once a person becomes a government official, no matter how stupid/lazy he or she might be, no matter how much he or she might steal from the office she or he will never get dismissed. It is un-Javanese to dump someone right away (Buchori, 1994). This practice is still prevalent, although Indonesia has entered a period of reformation. For example, there was a case when three state public prosecutors were found to be negligent by a senior public prosecutor. They were not dismissed but transferred to smaller and less important jurisdiction (Gatra, 2008).

The business culture pervading SOEs in Indonesia has been stained by inappropriate use of many aspects SOEs of Javanese culture for more than three decades. As a result, this has created and cultivated the notion of managerial hegemony—senior management decides ‘all things organizational’ without any active questioning of their actions. According to Hamengku Buwono X, the King of Java, a counter culture is needed to eliminate the long established corrupt culture (Hamengku Buwono X, 2003). Indonesia 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. Sometimes the wrong behaviour becomes the right thing to do. This has become the values, beliefs and practices of Javanese culture that have moved stealthily into mainstream Indonesian life. Siahaan (2007), supporting this viewpoint, argued that Soeharto had misinterpreted the Javanese culture during his reign. This has helped to contribute significantly to the prevalence of endemic corruption in the Indonesian bureaucracy.

The high level of tolerance of others practised in daily life has been taught and spread within wider Javanese social culture from early school years. The characteristics of
obedience, respect for seniors and superiors are the principles of human relations among
the various social classes of the 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
Similarly, Priambodo (2004, p. 59) posited that paternalism and “the leader is always
right” culture prevails within SOEs. Another term prevalent in government institutions
including SOEs is asal bapak senang (ABS)\(^{14}\). This overall situation has been abused
resulting in cases of fraud and corporate misconduct referred to earlier in this thesis.
Nevertheless, some of the Javanese style of leadership and cultural practices could be
beneficial for the running of business entities. Management can 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 to
such an extent that poor corporate practices and management misconduct are publicly
perceived to occur regularly within SOEs.

3.3 The Indonesian Legal System, Legal Culture and Issues

3.3.1 The Indonesian Legal System

The Indonesian legal system is complex because of the cultural background and history.
The legal system has developed in three main streams (Tabalujan, 1997). Firstly there is
adat law. Adat law refers to the law based on the customs of Indonesia and is still

\(^{14}\text{ABS is the acronym means that “as long as Sir is happy”}.$
practised in some areas, but has been much less important since Indonesia’s independence. Secondly, there is Dutch law which was introduced during the period of Dutch colonization from 1600 to 1945 (the year of Indonesia’s independence). At the time of independence Indonesia adopted the Dutch laws that were in force at the time. The third is National law. This refers to laws which have come into force since independence. Some national laws have replaced adat law and Dutch law, and some completely new laws have been introduced. For example, a new Commercial Law was passed in 1995 and came into effect in 1996.

Lack of knowledge of the Indonesian law making process is often a problem for outsiders as well as many native Indonesian people. In this context, people from outside Indonesia are often investors. It is important to appreciate, as Tabalujan (1997) postulates, that Indonesian laws are made from the general to the specific in descending order. Normally the higher the law making body, the more general are the laws it makes. The highest ranked law is the Indonesian Constitution (Undang Undang Dasar 1945, UUD’45).

When there is a dispute in a lower court the presiding official always refers to the Constitution in adjudicating the matter. Another problem that has to be understood is that the President and Ministers of Indonesia can issue decrees. This creates uncertainty in the judicial system, because there may be overlapping or conflict between such decrees and the legislation. The contents of these decrees may vary from administration to administration, for instance when there is a change in cabinet ministers, creating further uncertainty.
3.3.2 The Indonesian Legal Culture

A third problem is that the regional authorities, for instance, may issue their own regulations which may affect the implementation of legislation. A provincial governor may issue regulations in compliance with regional conditions that may conflict with legislation or decrees. The problem is that this low level regulation may not be published and there may be inconsistencies and overlapping. This can be observed in laws giving greater regional autonomy implemented in 2001, for instance. This has created more difficulties for potential investors because they must deal with more levels of government in obtaining the various approvals necessary for their investment.

A broad explanation of governance is given by Lindsey (2004). Indonesia (which has the fourth largest population in the world, and the largest Muslim population), has changed from an authoritarian and military-backed state, to the third largest democratic country in the world (Lindsey, 2004). In his understanding governance is also included in the process of democratization. Lindsey argued that governance spans the legislature, the judicial system, and the public sector. Thus, governance is required to be multi-disciplinary, including legal, political, ethical, and sociological considerations as well as economic ones (Lindsey, 2004).

Another researcher, Friedman (cited in Carrillo, 2007), said that the legal structure and legal culture cannot be separated in the application of the law in any country. A country’s legal culture has norms embodied in it just like the culture of the country. Legal culture can be found in the cases and rules used to apply the law (cited in Carrillo, 2004). Friedman also extended the term of legal culture to legal popular culture in
where it is not written in the book of law but it popularly occurs in the daily life of lay people (cited in Carrillo, 2004, pp. 4-12).

One aspect of the legal culture in Indonesia is that the legal process is different from that in America, for example, where the judges are truly neutral. An American judge just waits for the result of the jury’s decision in the case that the lawyers have argued. In Indonesia there is no jury system, so judges have the sole power to decide cases and pass sentences. This system is open to abuse and makes it possible for people to bribe the judges. Raharjo (2005) explained that judges in Indonesia come to subjective verdicts. The judicial power is largely focused on the judges who often give decisions merely according to their personal opinions, rather than on legal argument. This arises because of the way members of the judiciary are appointed, which is not necessarily based on their legal qualifications, skills, and experience, but rather their career paths. In other countries, members are appointed to the judiciary based on a number of factors including their legal competency. For instance, they might have had a successful career in legal practice or as a public prosecutor. Often in Indonesia members of the judiciary have experience in law enforcement or the military but not necessarily in the administration of justice.

3.3.3 Illustrations of the Indonesian Legal Culture

The legal culture that exists in Indonesia can be demonstrated by several events related to the legal practices of the government, police, public prosecutors, judges, and society. Discussion of some examples of these follows:

Research conducted by the Indonesian Commission for Eradication of Corruption or Komisi Pemberantasan Korupsi (KPK) showed that the Indonesian Department of Law
and Human Rights had the lowest score for integrity and level of corruption in serving the public. A department such as this should have the highest ranking, that is have high integrity and be free of corruption in serving the public. In addition, the data from the Indonesian Corruption Watch (ICW)\textsuperscript{15} stated that the Head of the Supreme Court had admitted that the legal institutions such as the Police, Supreme Court, and Attorney General are still dominant in corruption practices in Indonesia (Indonesian Corruption Watch, 2004).

The factor which most influences the operation of the law is the legal culture of society (Friedman, 1969). According to Friedman, legal culture is translated as the characteristics and values connected with the law and its apparatus. The public evaluation of the performance of legal institutions will be influenced by the public perception of the law. The perception of the legal institutions becomes better as the public evaluation of the law improves, or if the public evaluation of the law becomes worse then the public evaluation of the legal institutions deteriorates (Setyowati and Toengkagie, 2006).

3.3.4 Mafia Peradilan

Mafia \textit{peradilan} means mafia in the judicial system. This often occurs in the legal institutions in Indonesia where the judiciary has become notorious because of the mafia \textit{peradilan}. The main players in the mafia \textit{peradilan} are the police, public prosecutors, judges, and lawyers (Neumann, 2012; Prakoso, 2012; Sodikin, 2012). It is said that they conspire to set up the outcome of a case in advance of the court proceedings.

\textsuperscript{15}Indonesian Corruption Watch (ICW) is a watchdog for corruption in Indonesia. ICW is the most impartial and respected anti-corruption watchdog in Indonesia.
For example, there is a case of the mafia *peradilan* happened early in 2008 when the KPK recorded the conversation of a chief prosecutor from the Attorney General’s Office, Urip Gunawan, in a case involving the Bank of Indonesia Liquidity Assistance program or Bantuan Likuiditas Bank Indonesia (BLBI) in Indonesia. He was arrested red-handed receiving a bag containing Indonesian Rupiah valued at US$660,000 in an expensive housing estate in South Jakarta from a woman named Artyla (Haryadi, 2009). The BLBI case had previously been investigated and closed with no prosecution, and re-opened as a result of the ensuing public outcry.

Another aspect of the legal culture is that the legal profession is not safe in Indonesia. Consider the case of the shooting of a Supreme Court judge in connection with the case of Tommy Suharto (the youngest son of the former President). It is said that Tommy Suharto had masterminded the assassination of the judge and then fled to escape justice (BBC News, 2002). Tommy had already been convicted on other criminal charges and should have been held under guard in custody before this case.

Yet another aspect of the legal culture in Indonesia is that various parts of the legal apparatus act independently. Elements of the apparatus which include police, prosecutors, and judges still focus on their own interests and importance. They often compete to show who is more influential or more powerful in a given case (Lev, 1990). They do this to get plaudits from the public or to receive a payment to stop the case.

There is often competition within the legal apparatus for various cases because interested parties want to demonstrate their importance or power. In important cases of national interest, the legal process is often interrupted with decisions being made by state officials in the interests of those who are more powerful.
An example of mafia *peradilan* also reared its head in connection with Bank of Indonesia (BI), dating from the time of Suharto’s regime. This has a connection with the BLBI case. In 2007 a case emerged about the channelling of US$100 million in funds away from Yayasan Pengembangan Perbankan Indonesia (YPPI) which was a Bank Indonesia foundation for the development of the banking industry in Indonesia. The amount of US$3.2 million was paid to the Committee of Banking of Commission IX of the House of Representative (DPR), in order to settle (bribe) the case of BLBI and for bribes to smoothe the passing of amendments to legislation (UU, Undang Undang no 23 of 1999) concerning the Central Bank (MYS, 2009). The rest of the money was used to settle the cases of the former Governor of Bank Indonesia and several directors who had problems with their legal cases (Nasution, 2008, p. 5; BOB, 2009).

The KPK was interviewing members of the House of Representatives in relation to the channelling of funds from YPPI when another case emerged. Agus Condro, one of the members of the DPR, representing the Indonesian Democratic Struggle Party (PDIP), revealed under questioning that he had received US$50,000 for supporting the appointment of Miranda Gultom as Deputy Governor of Bank of Indonesia (Pikiran Rakyat, 2008a). Later, Condro was excluded by the leadership of PDIP because he blew the whistle on the Gultom affair. As Putro said, the KPK should not ignore what Condro had blown the whistle on. As he said, “there is no free lunch for the House Representative members when it comes to matters connected with BI” (Pikiran Rakyat, 2008b). Various other legal matters have arisen in relation with members of the DPR. Most of these occurred during the period of transition from the autocratic regime of Suharto to democracy.
From the several occurrences discussed above it can be identified that the inconsistencies in the application of the law in Indonesia arise because of several reasons (Edyana, 2008):

Firstly, the legal process can be bought by the rich or at least, those who are willing to pay (Marta, 2012). For instance the police investigators, the public prosecutors or the judges, or prison officials (examples of these have been previously discussed).

Secondly, the more highly ranked an accused and convicted person in Indonesian society the less severe the sentence is likely to be.

The writer himself has experienced and observed this sort of phenomenon in Indonesian society. Different classes in Indonesian society are distinguished by the ownership of motor vehicles. Higher socio-economic groups own cars. The cost of a car in Indonesia usually amounts to more than the cost of a house. The majority of people who are in the lower socio-economic classes ride motorcycles. The regulation about wearing seatbelts in a motor vehicle and helmets on a motorcycle came into effect about twenty years ago. The wearing of seatbelts was not strongly policed and enforced by the judicial system. This is partly due to the difficulties for the police in observing people not wearing seatbelts. Most police in Indonesia have lower socio-economic backgrounds and are reluctant to pursue the offenders because of their perceived higher status in society. On the other hand, the wearing of motor cycle helmets has been strongly enforced. From this phenomenon it can be argued that it is easier to implement the law in the lower classes compared to wealthy classes. The lower classes become an easy target for law enforcement. It is commonly said in Indonesia that someone who steals a chicken to feed his family is sentenced to three months in prison, the same sentence as someone who has obtained thousands of dollars through acts of corruption.
A recent case occurred in Denpasar, Bali, in April, 2013. A traffic police officer threatened a Dutch tourist, Kees van der Spek, demanding a bribe of IDR 200,000 (the equivalent of US$20). He was given the alternative of going to court and paying a fine of IDR 1,250,000. It is very rare that a bribery case involving a traffic violator makes the headlines in the National media. This case came about because of footage of the incidents posted on YouTube. The unexpected response came from the Chief of Bali Police. He said that the alleged traffic violator would be questioned because he is the one who offered the bribe (Mahendra, 2013).

The incident above demonstrates the hegemony of the Police Chief. The researcher perceives that the Chief of Police has felt that his sovereignty was ridiculed by this YouTube footage. Now, he wants to show to the public that no one should impugn his dignity.

Thirdly, nepotism in the legal system occurs where there is a relationship between the various parties in the legal process and this relationship influences the outcome of the legal process. One example occurred when the son of the current President of Indonesia was accused of giving money to voters in an area in East Java where he was a candidate for the 2009 general election for the House of Representatives. It has been suggested that the head of police in East Java had become personally involved in the case because of the family connections of the accused, and wanted to curry favour with the President.

In addition, a high ranking Police officer from Jakarta (Headquarters of the National Police) had become involved in the case. Erlangga, a law expert from the University of Indonesia, protested that this was relatively minor case and should not involve such a senior ranking officer (www.mediaindonesia.com, 2009). According to the media the person reporting the matter (i.e. the whistleblower) had been arrested for libel. Erlangga
said this was premature and that the general public should await the outcome of the money politics matter. Sundari (2009), a member of the House of Representatives from the Indonesian Democratic Party of Struggle, supporting Erlangga’s view that if Ibas, the son of current President who is also the MPs member of Democrat Party (the ruling party), had filed a complaint report, the Police of Indonesia would respond quickly. In addition she said that the Police of Indonesia was not independent.

Fourthly, the power of an individual in society in Indonesia may influence the implementation of the legal process. This power may arise through an individual’s position in society, or his/her wealth, or his/her political or other connections, or combination of these. For example, in a case familiar to the writer, four people were arrested and charged with defrauding the State of Indonesia of US$100 million in a matter relating to land tax. In the subsequent legal proceedings three received the support of the leaders in a political party in the ruling coalition. In fact one of the three was a Golkar party candidate for a governorship (and later successfully elected). These three people remained free. The fourth person was made a scapegoat and was sentenced to imprisonment because he had no powerful connections. This case is the real case of legal uncertainty and supported by the fact that most Indonesians are not so knowledgeable with the law.

3.4 Aspects of Social Culture that hinder the Implementation of Law

According to Samad (2013), a Chairman of KPK, the way to resist KKN is not to accept as guests people who have any connection with a legal case. What he said is relevant to the prevailing culture. He understands clearly that this kind of culture may become a barrier for the implementation of law in Indonesia.
Ignorance of the law is another aspect of the legal culture of Indonesia. It can be argued that most Indonesian are still unfamiliar with the law. They do not know their rights or how the law works. This means that members of society often want to take short cuts in settling legal matters quickly to remove uncertainty even if there is a price to pay. This phenomenon is called *jalan damai* or path of peace (Lev, 1990). *Jalan damai* is a social phenomenon that hinders the application of the law in Indonesia. It often occurs with “*jalan tengah*” (in Indonesian) or middle path where instead of using the exact rule of law people compromise or take the middle ground in resolving an issue. In Western culture, taking the middle ground usually has good connotations. However, in Indonesia it often has a bad connotation. These practices open opportunities for members of the legal apparatus to take advantage, for instance by offering their services or even sometimes by threatening litigants to use their services to settle a case. A common example is that of a driver bribing a policeman when he jumps the red light. This is a middle ground because the driver does not want the police to take him to court, and the police officer is happy to receive the money. In this case, the finding of middle ground is illegal.

In the application of the law, the public must refuse the advances of the legal apparatus for bribes. However, people who have been subjected to the legal process know that seeking justice in Indonesia is not easy. They take short cuts because they know that although they might be innocent they will have to pay a bribe to be acquitted. This is a very pragmatic approach to avoid the difficulties associated with the legal process. Some severe cases of misconduct have been revealed in the legal apparatus. The way these are often handled is simply to transfer the perpetrators to remote areas where they have a much smaller domain of power and hence they become a burden to those small
regions (especially from Jakarta to outlying regions). This process does not bring rigour or discipline to the administration of the law, but merely transfers problems to less significant areas. This has been identified as an aspect of the social culture in Indonesia called *tepo seliro* (in Javanese) or *tenggang rasa* (Indonesian). In English it means not wanting to offend another person’s feelings. Because of this practice employees who break the rules in performing their duties are not brought to justice. In an organization, sometimes people do not want to disagree with an opinion of others for a variety of reasons including that they do not want to hurt other people’s feelings. These cultural practices are related to legal practices. This is common in Indonesia. An example of this occurred when President Suharto did not prosecute his predecessor President Sukarno for various alleged crimes. Similarly, President Megawati Sukarno Putri did not prosecute former President Suharto for his alleged crimes. Since the culture has been rooted in Indonesia, the existence of proper whistleblower protection is expected can reduce this such phenomenon.

There are other practices of society culture in Indonesian society. These include:

- *Gotong royong* or working together cooperatively, which could serve to address a problem in society or an individual’s problem. According to Lukviarman (2002) this practice is about helping each other in every dimension of life. However, this practice also occurs when people work together on an issue which has a negative impact such as an act of corruption inside the organization.

- *Asal Bapak Senang* (ABS) or “keeping the boss happy”. Wanting to please a superior is a common phenomenon in government organizations, including SOEs. Subordinates tend to give a favourable report about a situation to the superior, even though it may not be what actually happened. This is hypocritical behaviour that is
embedded in the people of Indonesia by those of high ranking government office (Lubis 2001).

- Not dissenting: dissenting with the boss does not commonly occur. Dissent rarely occurs, even during meetings. This practice deters accountability which truly is a significant factor in the success of any organization.

- *Ewuh pakewuh* (Javanese) uneasiness; obsequiousness being obedient or attentive to an excessive or servile degree.

All the practices above are analogous with the life of the kings of Java in Indonesian history. The king is unlikely to be given a dissenting opinion but rather an opinion or report that will please him. Sukarno and Suharto who effectively reigned in Indonesia were closely aligned with Javanese customs (Husodo, 2008). For that reason, they were practising Javanese culture when they ruled Indonesia. As a consequence, the bureaucratic culture in Indonesian government offices including in SOEs is shaped by Javanese customs and will never be free from its influence.

According to Lubis (2001), people in Indonesia have been oppressed by their kings. The kings assumed themselves to be representatives of gods. Therefore, they could do anything to their people, including taking people’s lives. The influence of this oppression has moulded Indonesian society. Lubis (2001) states that feudalism occurs at all levels of Indonesian society. It can appear in a large organization such as a SOE or at the community level. The idea of feudalism existing inside an organization forces a subordinate to obey in any way. The superior wants the subordinate to give them respect, to fear them, to be humble, to know their place, and do everything that will please the superior, and hide something if necessary. This is not in line with modern western business culture.
3.5 The Whistleblowers in Indonesia: Quo Vadis?

Whistleblowers are part of the mechanism to ensure good governance in organisations, in both the public and private sectors. In many OECD countries there is legislative protection for whistleblowers, however this is not the case in Indonesia. The phenomenon of whistle-blowing is not generally accepted in Indonesian culture, because it contravenes the social norms of *tenggang rasa* and *jalan tengah*. As argued by Daniri (Komite Nasional Kebijakan Governance, 2008) whistle-blowing is in contradiction with Indonesian culture and is disruptive to organisations. In fact he believes whistleblowers are considered to be slanderers who can reduce the organisation’s performance. There have been several cases in Indonesia where whistleblowers have been disadvantaged by the legal and corporate systems. For instance, in America, whistleblowers are protected by not having to appear in person in court to give evidence but this is not so in Indonesia, where evidence is required to be given in person. The Indonesian law UU 13 of 2006 deals with the protection of witnesses and victims, but it only protects the witnesses who become victims of intimidation in the legal process. The agency to protect both the victim and witness is called *Lembaga Perlindungan Saksi Korban (LPSK)* or Witness and Victim Protection Body. This law is the closest law there is to whistleblower protection in Indonesia, but there is no law which solely gives whistleblowers protection. Being a whistleblower in Indonesia is a daunting task, because there is no effective system to ensure whistleblower protection. The witness protection legislation is insufficient to protect whistle blowers.

A case occurred in which the Head of Komisi Pemberantasan Korupsi or KPK (the Indonesian Corruption Eradication Commission) named Antasari had been implicated.
Someone threatened to blow the whistle on Antasari’s alleged corrupt activities. This whistleblower was found dead, the subject of a murder. The police found a short message from Antasari in the mobile phone of the murdered victim. The message had advised the murdered man that if he blew the whistle in the case involving a woman’s affair that he would bear the consequences. Antasari said that the case had been fabricated to libel him so that he would be forced to step down as head of the KPK. In other countries the whistle blower would have received protection.

In March 2008, there was a focus group in which discussion conducted by the Indonesian National Committee for Corporate Governance (KNKG), proposed a mechanism for whistle-blowing and protection of the whistleblower in its draft code of conduct (Komite Nasional Kebijakan Governance, 2008). According to Mulyadi (one of the members of the committee), the proposed system is just a copy of Western practices. However, he said that there are several benefits of whistle-blowing. They are the reduction of budget leaks, the easy adaptability to the GCG system, and higher efficiency because the control systems will function better. What Mulyadi said about the benefits of whistle-blowing is a reflection on poor corporate governance in Indonesia. Many cases of corporate fraud both in the private sector and SOEs are the result of budget leaks, in other words the misuse of funds and poor control systems.

To make the whistleblower system function, there has to be a strong commitment from top management to the implementation of whistle-blowing with a follow-up procedure, said Isyanto, another member of KNKG who also participated in this discussion. These two requirements are also major problems arising from poor corporate governance in Indonesia.

16 Antasari has been relieved of his position as chairman of the Corruption Eradication Commission, and is in police custody awaiting trial.
Indonesia. Top management in Indonesia is often implicated in corporate fraud, hence they are reluctant to commit to implementing good corporate governance.

Some might argue that if GCG is to become reality in Indonesia, shareholders and other stakeholders must be involved in the implementation of GCG. In addition, the resistance to implementing GCG comes largely from the Javanese culture which affects Indonesian business culture. According to Subagja, one member of the KNKG, *ewuh pakewuh*, a Javanese phenomenon, where people do not want to say bad things about other people (especially friends and colleagues) is a major hindrance to the implementation of whistle-blowing. This is in line with another committee member, Daniri, who argued that Indonesian culture has to be considered in the implementation of the whistle-blowing process.

3.6 The Consequences of being a Whistleblower in Indonesia

Manoeuvring Dahlan Iskan as the Indonesian Minister of State-Owned Enterprise was applauded and appreciated by the Indonesian public in October 2012. He took a brave action to reveal extortion of Investment Fund perpetrated by some Indonesia legislators which happened in three SOEs namely PT. Merpati Nusantara Airlines Persero, PT PAL Persero, and PT Garam Persero. These legislators allegedly extorted or received commission from SOEs. In his report, there are ten names that appeared and were involved in the scheme, which are Sumaryoto and I Gusti Agung Rai Wirajaya of PDI-P; Idris Laena of the Golkar Party; Achsanul Qosasi, Linda Megawati, Saidi Butar-Butar and Andi Timo Pangerang of the Democratic Party; Zulkieflimansyah of the Prosperous Justice Party (PKS); and Muhammad Hatta and M. Ichlas El Qusdi of the National Mandate Party (PAN) (Sihite, 2012). He later retracted the allegations levied against Andi Timo Pangerang and Muhammad Ikhlas el Qusdi, apologizing for the
mistake he had made. It has been acknowledged as a general issue that a State-Owned Enterprise is a cash cow in Indonesia. This is not the first time that a whistleblower appeared in public, but this is the first time a Minister showed the courage to be a whistleblower, despite the fact that he might be mistaken with some names.

However, in the researcher’s opinion, the Minister is not in error. In some cases bribery cannot be legally proven. The MPs who denied receiving bribes demanded that Mr Iskan show evidence to a court. In the absence of evidence, bribery can only be demonstrated if the beneficiary is able to provide admission of guilt. Almost no one voluntarily admits accepting a bribe until the KPK proves it by producing the recording of a conversation before the court. The failure of people to make voluntary admissions resulted in some of the anti-corruption activists, led by Ery Ryana Hardjapamekas to take a banner stating berani jujur hebat or translated in English “it is awesome to be honest” to the top of the KPK building. Hardjapamekas was a deputy of KPK in 2005.17

There are several counteractions from some MPs aimed at Mr. Iskan, the Minister of SOEs. First, after he reported to the President, that some MPs had dug up the financial statement covering 2009-2010 when he was a Managing Director of the state’s power company. The MPs asked the President to warn his cabinet minister, Mr. Iskan because there was no proof of his allegations about these MPs. Mr Iskan had to apologize to some of them because there was indeed no proof of the accusation. However, the public was on his side. The public opinion is that if there had been acts of corruption perpetrated in that period, they should be investigated that year, because the DPR still includes the same members from that period until the present. Also, the researcher believes Mr Iskan’s revelations as a whistleblower (Daslani, 2012). This is because

17He is also one of the participants who was interviewed in this study when he was active in KPK in 2005.
these are similar to respondents identified in this study (in the findings chapter) about the behaviour of some MPs.

In addition, there have been some other related corruption and unethical cases of sex scandals that have involved MPs going to jail or has forced them to resign. It is not easy to have these perpetrators imprisoned. Compared to some cases of corruption, company failure or sex scandals in Japan or some Western countries, the high ranking officers or management showing their responsibilities to the public and shareholders have voluntarily resigned.

The above case shows that some MPs wanted to harm Mr. Iskan’s image, so that society would be distracted from the news of corruption by DPR.

The phenomena of retaliation from DPR members aimed at Mr Iskan who had blown the whistle also occurred when the three stars General Susno Duadji had blown the whistle about some of the corrupt high ranking police officers. Widoyoko (2010) from Indonesian Corruption Watch, stated that “a person who uncovers a crime like Duadji should be protected and had a right to be protected, although he was a part of the corrupt system”. Instead of receiving protection, Mr Duadji had been accused by his colleagues (police officers accused of corruption cases) back when he was a Chief of Police in West Java (Badriyah, 2013).

Also, a recent case of a whistleblower in 2013 is that of Ms. Yulianis the treasurer of one of the companies owned by Mr. Nazarudin, the treasurer of the ruling Democrat Party. Ms. Yulianis testified before the KPK that Baskoro Yudhoyono (popularly known as Ibas), as son of the President of the Republic of Indonesia and Secretary of the Democrat Party had received US$200,000 from her to facilitate some government projects. Ibas denied her statement and reported her to the police, accusing her of
criminal libel. Regarding this case, one of the members of LPSK, the witness protection agency, said that “someone like Yulianis [the whistleblower] would be afraid to deliver a confession before the public in open court, if she could be accused of libel by the person she reported” (Ismail, 2013; Sagita, 2013). In addition, Neta Pane, the Chairman of the Indonesian Police Watch [a watch dog], requested that the Jakarta Police not process the Ibas report. Pane said, “She [Yulianis] was a key suspect in a graft case…” (Parlina, 2013).

It is difficult for whistleblowers in Indonesia to achieve success and be protected when they make a report because the law in Indonesia is administered by people who are corrupt, including judges, public prosecutors, and police officers (Christanto, 2009; YPS, 2012). This researcher would argue says that Mr. Iskan is the bravest whistleblower that has emerged to date in Indonesia, and Mr Duadji is pioneer whistle blower in Indonesia. The handling and completion of issues that they blew the whistle on will determine the direction of improvement systems or mechanisms for whistle blowers. The question arises as to whether or not the Indonesian Government will stand by and protect whistleblowers.

### 3.7 House of Representative members acting like pre-elementary Kids: Abdurrahman Wahid’s Comment

Mr. Putro, the Managing Director (MD) of RNI, (a state-owned trading company) had made a public statement in the media about the blackmail of RNI by a DPR member. Erik Wardana retaliated by questioning Putro immediately prior to a meeting to discuss palm oil and rubber. Putro declined to answer questions about the issue of blackmail and was ejected from the meeting room just before the meeting started (Jefriando, 2013). Wardana urged Putro several times to reveal the names of those who had alleged
the blackmail. He also wanted Putro to apologize regarding his statement to the media that the DPR members had blackmailed RNI. Putro only said that he had already explained the case to the Badan Kehormatan (literally meaning courtesy/honour council) of the House of Representatives. So he assumed that he did not need to reveal the names and explain to Wardana and colleagues at a meeting (Jefriando, 2013; Putri, 2013). Actually, Putro was not the first SOEs MD who had been ejected from a meeting at the DPR. There were four other SOEs’ MDs who had previously been ejected by the Members for unclear reasons (Aliya, 2013).

The news story above shows the hegemony and power of DPR members. It was not an appropriate measure to eject the SOE Managing Director. Why then were they ejected? No wonder Abdurrahman Wahid, former President of Indonesia said that the members in that building were like kindergarten pupils.

3.8 Corruption Eradication Commission or Komisi Pemberantasan Korupsi (KPK)

Palmier (1985, p. 280; cited in Quah, 2011, p. 463) finds that corruption is embedded and widespread in Indonesia because it is tolerated as a result of corrupt officials seldom being punished. The Indonesian Corruption Eradication Commission, better known as KPK, was established in 2003. KPK is independent from the executive, legislative, judiciary and any other powers. Financially, KPK is audited by the Indonesian State Auditor Board (Badan Pemeriksa Keuangan or BPK) and should be responsible to the public. The impetus to create KPK was the economic crises during 1997, which subsequently also led to the downfall of President Soeharto. KPK was established to combat the extraordinary crime of corruption in Indonesia, which is rampant, systemic, and affecting the lives of practically everyone in the country. During the crises, there
was a sense that drastic measures were needed to tackle corruption, which contributed to the country’s difficulties.

In carrying out its work, the KPK has the authority to conduct investigations. This authority is broad because KPK can investigate any public official for corruption, including members of parliament, police officers, judges and even the military (Pramudatama, 2012a). Although the KPK can investigate members of the military, it cannot prosecute members of the military. The KPK has, to date, already succeeded in convicting several members of Parliament and officials of the Judiciary, as will be elaborated in the next section. The KPK essentially has all the investigative powers of a law enforcement agency. It can conduct wiretaps on suspects, examine their bank accounts and tax records, as well as freeze their assets, issue orders and make arrests. Through its website the KPK allows anyone to submit information about alleged corruption in confidence. There is even an English language version available.

Looking at the results, the KPK has made a significant breakthrough in eradicating corruption in Indonesia. For those people who are corrupt the KPK is of serious concern because of their clandestine activities. Take for example the case that occurred in April 2009, when the KPK confronted the Indonesian Police who were angry that KPK had taped an Indonesian Police Chief Detective’s phone while investigating the case of *Bank Century* bailing out one of its customers, Boedi Sampoerna (Koran Tempo, 2009; Neumann, 2012). Susno Duadji compared the KPK to a gecko fighting with a crocodile (Police) because the KPK was bold enough to intervene in the Police investigation (Haryadi, 2009; Neumann, 2012).

In the middle of 2012, KPK found an alleged corruption case regarding the purchasing of driving simulators by the National Police Traffic Corps. Inspector General Djoko
Susilo has been identified as the chief suspect by the KPK. It is alleged he had received bribes of IDR2 billion (equivalent to A$200,000) from the project worth IDR 200 billion (A$20 million) (Cahyadi and Amelia, 2013).

The police had earlier attempted to delay proceedings by arguing with the KPK over details of the case handover (Pramudatama, 2012b). The police used the Criminal Code to defend their stance to not allow the KPK to handle the case. In the end, after support from the public through the media (TV, newspapers, and the Internet’s social networks) for the KPK, President Yudhoyono appeared on TV and was quoted in newspaper saying that KPK had the authority to handle the case of driving simulator purchases (Wahono, 2012). Previously, President Yudhoyono was reluctant to comment on or otherwise become involved in corruption cases. It seems Mr Yudhoyono does not want to be involved in public trouble. He wanted to maintain his image (as a Javanese King). The public and media said that he was more suited as an observer (Kompasiana, 2012).

3.9 Conclusion

This chapter has discussed how culture can have a wide-ranging influence on all aspects in one country, including state-owned enterprises. The military culture and Javanese culture have formed the keep-the-boss- happy (fawning) culture that makes every member of state-owned enterprises become over-respectful to their superior and allow the superior to do anything, including illegal activities. There is also Javanese culture whose positive aspects are being abused. The wrong implementation of military culture and Javanese culture then opens the door for KKN which destroys Indonesian law enforcement and creates uncertainty. As one effort to reduce KKN, there is whistleblower protection but unfortunately, implementation is still ineffective and KKN has seemed to have stronger roots inside SOE as time goes by.
4 CHAPTER – The Development of Corporate Governance in Indonesian SOEs

4.1 Introduction

This chapter deals with the development of corporate governance in Indonesia. It begins with the Government being the main shareholder of Indonesian SOEs which creates a dependency of the Board of Directors on the government and barriers to the implementation of good corporate governance. It reveals some issues such as privatization cases and KKN that emerge when corporate governance becomes a hot public issue. The role of Badan Pengawas Pasar Modal or BAPEPAM (Capital Market Supervisory Board) in the development of corporate governance is discussed as well. In this chapter, there are also explanations of the development of SOEs in Indonesia, starting from the formation of the National Committee on Corporate Governance and also Indonesia’s Code of Good Corporate Governance, both of which emphasize transparency, accountability, responsibility, independence and fairness. The following figure 4.1 presents the chapter outline.
Figure 4: Chapter 4 Outline

Introduction

The Government of Indonesia as Shareholder of SOEs

Role of Politics Influence on SOEs

Privatisation of SOEs: International and National Imperatives

Badan Pengawas Pasar Modal or Capital Market Supervisory Body

The (Indonesian) National Committee on Corporate Governance 1999

The 2000 Code for Good Corporate Governance: Knee Jerk Phenomena

The National Committee on Corporate Governance 2004

The Board of Commissioners (BOC)
Audit Committee (AC)
The Board of Directors (BOD)
Nomination and Remuneration Committee (NRC)
Corporate Governance Committee (CGC)
Independent Commissioners
The Role of Independent Commissioners

Conclusion
4.2 The Government of Indonesia as Shareholder of SOEs

Shareholders have little to do with running the company, as this is the function of the company directors, to whom they entrust their funds (Solomon & Solomon). This shareholder mechanism and its role are more appropriate for the common private companies and is different from the mechanism and role of shareholders in Indonesian SOEs. The shareholder/owner of Indonesian SOEs is the Government of Indonesia (GOI). The GOI through the Minister of SOEs at shareholder meetings has the full authority to appoint and remove both commissioners and directors (Parliament Law Number 19, 2003). Also, the GOI has a significant role in influencing the policies in SOEs. For example, the GOI is highly involved in determining the increases in the price of electricity, air fares and fuel (Gatra, 2006). Also, the GOI determines the financing of SOEs through the Minister of SOEs and the Minister of Finance. The misuse of GOI’s status as a main shareholder limits directors and commissioners and their ability to make decisions or policies independently. As a consequence, the directors and commissioners of SOEs are fully compliant with the directions of government.

4.3 Role of Politics Influence on SOEs

Indonesian SOEs have been infiltrated by their government and its political agenda (MT, 2005; Khaerudin, 2011; Umam, 2012). This can be seen from the appointment of the three former SOEs Ministers from 1998 to 2007, who have a political party background or enjoyed support from political parties. Wicaksono (2009) revealed their names: Laksamana Sukardi (former treasurer of the Indonesian Democratic Party in Struggle), Rozy Munir was backed by National Awakening Party, while Sugiharto was a member of the United Development Party, and later was backed by the Prosperous Justice Party.
Currently, SOEs have become a cash cow for their managers, and the place for fulfilling politicians’ and government bureaucrats’ interests (Firdaus, 2011; Goodpaster 2002; Iskan, 2012b; Yulianis, 2013). Indications of corporate governance problems in SOEs are: the alleged misuse of power both by government regulators and by supervisory and management boards of SOEs, self-enrichment by directors through misuse of company facilities, acceptance of bribery for the advantage of a particular party, insider trading, and lack of information disclosure.

4.4 Privatisation of SOEs: International and National Imperatives

During the era of Suharto’s Orde Baru (Indonesia’s New Order, following Sukarno’s Orde Lama (Old Order), a plan was drawn up to privatise SOEs when crude oil prices fell to world lows in the 1970s. This plan was never implemented after world oil prices started increasing again (Pangestu, 1996). Following the Asian monetary crisis of 1997, the World Bank, IMF, and ADB recommended that Indonesia implement the privatisation of its SOEs (IMF, 2002). These three institutions had recommended privatization of as many SOEs as possible, as quickly as possible. This international imperative was not necessarily in the best interests of the Indonesian economy. At that time, the Indonesian economy had almost ground to a halt, and it was necessary for the government to restructure and privatize many of the SOEs, so that government subsidization of the unprofitable ones was no longer necessary. Part of the restructuring of the Indonesian economy involved accepting financial assistance from the IMF. A condition agreed by Suharto as part of the third IMF agreement was to privatize 12 SOEs within twelve months (Abeng, 2001). This included five SOEs already listed on the Jakarta Stock Exchange (JSE).
The purpose of this internal imperative was to eliminate US$1.5 billion deficit in the government budget. The privatization of SOEs with outside investment capital would release the government funds tied up in the capital of these SOEs which in turn contributes to the government national budget. Abeng and his team believed that restructuring and privatization should be carried out in accordance with the circumstances of each business and the interest of the country as a whole. Abeng’s rationale was that SOEs had to be made attractive to potential investors. SOEs which have returned to efficiency and profitability can be floated at a better price. Also, given the general economic situation prevailing at the time it was prudent to postpone privatization because of uncertainties in the investment market. Another factor that had to be considered was that pragmatically, there would be a time lag before an SOE became privatized. During this time it would remain State-Owned and it was in the national interest that these SOEs improve their performance in the interim.

Another internal imperative was the public outcry in the media that this was political pragmatism on the part of government. The public perceived that the process of privatisation of several SOEs was not transparent. For example, PT Indosat as one of the State telecommunication companies, had been trading profitably but was then sold. The public perception was that PT Indosat should not have been sold to the private sector. Demonstrations were held to attract the attention of the DPR. Also, there was plenty of opposition to the privatization of SOEs because of the concern that ownership of assets important to the national economy would fall into foreign hands. Later, there were accusations that privatization was not being carried out transparently (Rajasa, 2010; Syailendra et al, 2012).
The process of privatization has started but progress is slow because of political considerations since the fall of Suharto. Subsequent governments have consisted of coalitions of parties, and there has been much political horse trading. Hence, the issue of privatisation of SOEs is often left hanging while other issues are negotiated.

4.5 Badan Pengawas Pasar Modal (BAPEPAM) or Capital Market Supervisory Body

The significant number of recent corporate failures has meant that corporate governance issues have lately received more attention by the regulators, not only in developed countries but also in Indonesia. Company failures were due to significant misuse of power by executive officers, quantitative as well as qualitative. In response to these incidents, and to improve the implementation of corporate governance into the Jakarta Stock Exchange (JSE)’s listed companies, the Capital Market Supervisory Body or Badan Pengawasan Pasar Modal (BAPEPAM) has issued 5 new rules and revised 17 others to ensure that Indonesian securities trading meets international standards (Herwidayatmo, 2002).

After the financial crisis of 1997 the BAPEPAM set a new vision of a future i.e. to develop strong and globally competitive markets as a key driver in the national economy. Based on this earlier vision, BAPEPAM will now focus over the next five years on the (1) enhancing commitment to the development of the capital market; (2) enhancing the accessibility of small medium size enterprises and cooperative to the capital market; (3) encouraging regional government to raise funds through the capital market; (4) enhancing the participation of domestic investors; and (5) developing the infrastructure of the Indonesian capital market.
BAPEPAM also has to carry out strategies to respond to global competition. The first strategy is to improve compliance with good corporate governance (Setiawan, 2006). This strategy should be supported with improvement and capital market regulation and socialization, and implementation of good corporate governance. The next strategy is the alignment of rules and institution. The regulation and institutions within the country should be aligned with foreign regulation and institutions. This alignment is not only intended for the capital market institutions but also includes the banking and public sector institutions. The third strategy is the integrated development of IT and HR. This should ensure an acceptable level of knowledge and readiness of institutions in the capital markets. The next strategy is the implementation of safety and service quality conforming to international standards. This strategy is implemented to attract foreign investors to participate in the capital markets. The last strategy is the development of market and capital market instruments. However this strategy is perceived as a lack of implementation, and significant government/political involvement in BAPEPAM. BAPEPAM needs to strengthen domestic investment and improve the status of the over the counter market (Setiawan, 2006).

The rapid development of the Indonesian capital market has created problems specific to the stock exchange. More complex issues need to be addressed, especially disputes between market participants. The latter prefer to settle matters by an alternative arrangement rather than resorting to a court of law or legal settlements. Hence, in 2002 the Indonesian Capital Market Arbitration Council was founded. This provides a fast clear independent and equitable way of settling capital market disagreements.
4.6 The (Indonesian) National Committee on Corporate Governance 1999

The publication of the Cadbury Report in the UK in 1992 has led to publication of the code of good corporate governance best practices (Hooghiemstra, 2012, p. 1). This report had influenced the establishment of NCCG in Indonesia in 1999. The National Committee on Corporate Governance (NCCG) issued a document in the year 2000 titled “code of corporate governance practices for Indonesian entities” to enhance the effectiveness of the implementation of GCG. The plan is that this code will help improve attractiveness of the investment climate in Indonesia to foreign companies (National Committee on Corporate Governance, 2000).

The NCCG, a non-governmental body, was established in 1999 by the Coordinating Minister for Economy, Finance and Industry (National Committee on Corporate Governance, 2000). The committee has received on-going 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 is intended for use by corporate business executives as a direction and guide for the future conduct of business in Indonesia (Rosser, 2004). 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’s Sarbannes Oxley Act Corporate Governance Principles and Recommendations (Bank BNI, 2003; Sato, 2003). The NCCG code, therefore, is closely based on the international developments towards a global convergence model of corporate governance (Clarke, 2011). The result is a ‘one size fits all’ approach.

There are a large number of critics of the Sarbannes Oxley Act who assert that legislation alone is insufficient to address the issue of poor corporate governance
throughout the world. This criticism applies to Indonesia. “Honesty and integrity in business cannot be mandated” according to Sison (2008, p. 30). Perhaps interaction of human may change corporate culture gradually.

Much attention has been directed to the Sarbannes Oxley Act section 406 which promulgates a code of ethics for high-ranking financial officers. Under this Act companies are required to report whether or not a code applies to senior financial officers and if not provide an explanation. The Sarbannes Oxley Act appears to have unintentionally disregarded the cost of implementing such a code through the extra cost in hiring legal consultants (Sison, 2008)

4.7 The 2000 Code for Good Corporate Governance: “Knee Jerk” Phenomena

The foundation of the NCCG emerged from a Ministerial decree from the Minister of Economic Affairs. In mid 2000, the National Committee on Corporate Governance introduced the Code for Good Corporate Governance to corporate business executives as a set of guidelines for conducting business in Indonesia (National Committee on Corporate Governance, 2000). An updated code was introduced in 2006. This independent committee consists of members from BAPEPAM, lawyers, accountants, bankers, and representatives from government offices.

In developing the code, the committee received assistance from World Bank experts. The code is still significantly similar to the code of best practices of corporate governance applied in several developed countries and is also similar to the OECD’s Corporate Governance Principles (Kurniawan & Indriantoro, 2000, p. 10;
Herwidayatmo 2002). This code includes: guidelines for the equitable treatment of shareholders, the role and tasks of supervisory and management boards, directorate composition (at least 20% of directors should be outsiders), a remuneration system, external auditors and an audit committee, and transparency and disclosure. However, this code was arguably prepared hastily, in other words, it was drawn up just as a quick response from Indonesian regulators. The code issued by the National Committee on Corporate Governance (2000) ignores fundamental elements of Indonesian corporate conditions and culture. It seems that the code has been rashly adopted from the general best practices of corporate governance from around the world, and is not tailored appropriately to the culture of the Indonesian corporate world. Holloway (2004, p. 25) used a knee-jerk term describing the political reaction towards the scandal of major companies failing all over the world (Enron US, NAB Australia, Parmalat Italy, etc). “Knee jerk” can be applied to the Indonesian regulatory reaction as well.

However, since the crisis in 1997 the Indonesian government has passed several laws and improved regulations in business sectors, followed by the prosecution of non-compliers. This indicates that the Indonesian government is serious about enhancing corporate governance to facilitate the improvement of economic recovery (East Asia Analytical Unit 2000, p. 113; Economic Analytical Unit 2002, p. 107).

### 4.8 The National Committee on Governance 2004

In 2004 another Ministerial decree was issued and the name of the Committee was changed although the English translation remained the same (Wibowo, 2008). The role of NCCG is developing, spreading, and promoting GCG principles in both the private and public sectors. In 2002, the Minister of SOEs issued a Ministerial decree regarding

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18 The 1999 and 2000 codes of Indonesian Corporate Governance Code did not changed much.
implementing GCG in SOEs. It has become compulsory for SOEs to consistently implement GCG and to utilize GCG as a basis for operations.

The development of GCG cannot be seen solely in the context of these Ministerial decrees. For instance, the Law on the Limited Liability Company, Law Number 1 of 1995 states in article 97 that the Board of Commissioners has the responsibility to supervise the Board of Directors in operating the company as well as advising the Board of Directors. In 2000, The Jakarta Stock Exchange (JSE) issued the decree regulating Independent Commissioners (IC). According to this decree, IC do not have any affiliation with majority shareholders, do not have any affiliation with the BOD or other members of BOC of the Company and are not directors of other companies affiliated with the company. Regarding Audit Committees (AC), the BAPEPAM or the Stock Exchange Supervisory Body in 2000 recommended listed companies and public companies have an AC. The function of this committee was to assist the board of commissioners by providing independent professional opinion to assist in raising the quality of management standard. The Board members of Jakarta Stock Exchange endorsed this recommendation which states as well that listed companies should have an audit committee of at least three members one of them would be an independent commissioner who would also chair the committee (Wibowo, 2008).

Indonesia’s Code of Good Corporate Governance (Komite Nasional Kebijakan Governance, 2006) closely follows the OECD corporate governance model. It is based on five principles and according to the code every Indonesian company must implement these principles in all aspects of its business and throughout the company. There are five principles, namely:

1. Transparency
A company must provide information which is relevant and readily available and that can be understood easily by stakeholders. There is an onus on a company not only to make the minimum disclosures required by law but also to provide other information required by the stakeholders. The code requires that the company provides timely and accurate information to stakeholders according to their rights. The code lists the information to be disclosed and includes items such as the mission statement, financial report, and the like, but also includes shares owned by members of the Boards of Directors and Commissioners, and also members of their families in a company and other companies. The code states that the transparency principle does not lessen the legal obligation for confidentiality as required by law in various areas. Transparency policies must be written and communicated to stakeholders. Transparency is not an inherent part of Indonesian business culture, especially in making information available to the media for reporting to the public. In fact, there have been some cases in which the government has shut down media outlets e.g. Tempo magazine, and the Sinar Harapan newspaper, because the government has been dissatisfied with the reporting of public interest issues.

2. Accountability

A company must be accountable for its results transparently and fairly, for instance in reporting to shareholders. Thus, there is an obligation that a company is managed in a manner that aligns with the interests of the company, but also the interests of shareholders and other stakeholders. According to the code, accountability is the prerequisite for achieving sustainable performance. Job descriptions and responsibilities for each part of the company and its employees should be defined. All employees must be aligned with the vision, mission statement, values and strategies for the company. All
parts of the company and its employees have the appropriate qualifications, responsibilities, and roles in the implementation of the GCG. An effective internal control system is required, along with performance indicators for both Boards as well as employees that are consistent with the company’s goals and have a reward and punishment system. Each part of the company and all employees are required to uphold the business ethics of the company and agreed code of conduct. This is a formal statement of the requirements. In reality, the situations in SOEs is that of a culture of jobs for the boys (Tempo, 2011, p. 32) which places accountability at risk in various ways.

3. Responsibility
A company must abide by the rule of law and discharge its responsibilities to the community and environment to be sustainable in the long term and to be a good corporate citizen. There is required to be prudent decision-making and actions to ensure compliance with the rule of law and the company’s articles of association. The company should meet its social responsibilities in dealing with environmental and social issues in the communities in which the company operates. In a SOE the level of responsibility is very low because of a different ownership structure (concentrated ownership) compared to the private sector (dispersed ownership). There is little incentives for executive to be responsible. In addition, the social responsibility of SOEs is limited because of the bureaucratic background of management having difficulty in adapting to modern business practices outside government.

4. Independence
Being independent means that a company must be operated independently in such a way that no part dominates another, and there is no outside interference. This is to accelerate
the implementation of GCG. The company should not be dominated by any party. It must not be influenced by sectional interests and must be free from conflict of interests and influence of pressure groups, so that decision-making can be carried out freely. Each part of the business carries out its function in accordance with the rules and regulations without dominating each other or shifting responsibility. Independence in SOEs has been an issue because the historical interference of the Indonesian government in their operation.

5. Fairness

In its operation the company must always consider the interests of all stakeholders based on principles of fairness. The company should accept input from stakeholders and make company information available to them in accordance with the principle of transparency. Stakeholders must be treated fairly and equitably in accordance with their contributions to the company. The company should be an equal opportunity employer and there should be no discrimination in career development and for employees carrying out their duties.

In addition to the GCG General Principles, the Code deals with Business Ethics and Codes of Conduct. In Indonesian SOEs these areas of ethics and conduct have been of concern in the past. There are many examples of misconduct and lack of ethics in Indonesian SOEs. The provisions for company values require that a company has a vision and mission statement. These provide a moral base for a company according to the code. The vision and mission statement must be drawn up before the values. Many company values are universal but there are those unique to each company, company values that are universal include reliability, fairness and honesty.
Additionally, ethics are the basis for the company and the carrying out of business including the relationships with stakeholders; the application of company values and ethics is the genesis of a company’s culture. The ethics should be embodied in the company’s Code of conduct. The Code provides guidance for the various parts of the company and its employees in carrying on the business for the company, and should include guidance relating to conflicts of interest, giving and receiving gifts or donations, confidentiality and reporting of unethical behaviour.

Conflict of interest may arise for the board of commissioners, board of directors and employees of the company. Parties with conflicts of interest are prohibited from participating in decision-making processes. Where shareholders have conflicts of interest they must cast their votes at the AGM in accordance with the vote of the majority of shareholders having no conflict of interest.

The organs of a company are considered to be the AGM, the Board of Commissioners and the Board of Directors. These are said to have an important function in implementing the principles of GCG in their independent roles in a company. Members of the Board of Commissioners and the Board of Directors should be fit and proper people appointed by the AGM. Also, decisions relating to bonuses, gifts (gratuities), and dividends must take into account the company’s financial situation. Limited liability companies in Indonesia have adopted a two-tier system that has a Board of Commissioners and Board of Directors each of which has clear authority and responsibility based on their functions as written in the company’s articles of association and rules.

The Indonesian National Committee on Governance which developed this Code of Good Corporate Governance in 2004 aims to transform Indonesia into a country with
one of the best applications of good governance and be among the top quartile (Asian Corporate Governance Association, 2009). As Lim says (2010) “…there is a little progress in this direction and nothing to suggest that these objectives will be achieved any time soon”.

4.9 The Board of Commissioners (BOC)

According to the Code the composition of the board of commissioners should be such that it can affect independent and timely decisions. The BOC members (of the Board of Commissioners) must have integrity and the ability to enable them to carry out their functions such as observing the interests of all stakeholders. Commissioners are prohibited from using the company for personal, family, business or other parties’ interests (NCCG, 2006).

In fact there are several examples of commissioners having conflicts of interest. For instance, Sutanto (a former chief of Indonesian National Police) is the chairman of the board of commissioners of Pertamina (State-Owned Oil Company) and was appointed as the leader of the team to have Susilo Bambang Yudhoyono (SBY) re-elected (Jawa Pos National Network, 2009; Kompas, 2009). Putro (2009), an NGO leader said this is a conflict of interest because he used Pertamina facilities to support SBY’s re-election campaign. Also, another example during the SBY’s first presidency (from 2004-2009), the chairman of board of commissioners of INOSAT (a majority State-Owned telecommunication company) was elected to the SBY re-election campaign team. These examples demonstrate that the Code is simply not complied with.

In addition, the Code requires that the BOC will be appropriate to the scale and nature of the operation of the business. Commissioners may be independent commissioners, not affiliated with any other party (individual/group) or affiliated commissioners. In
some cases, the board of commissioners is not independent of the board of directors, merely rubber stamping the directors decision, because commissioners’ remunerations are determined by the board of directors.

Affiliated commissioners often have business or family relationships with majority shareholders, members of the BOD or other members of BOC, or possibly with the company itself. The Code requires that there be a sufficient number of independent commissioners and that one of the independent commissioners have an accounting or finance-related background. Members of the BOC are to be appointed and dismissed at the AGM through a transparent process, and they can only be dismissed after they have been given the opportunity to defend themselves.

In practice, the Board of Commissioners are not independent because they have to satisfy the interest of majority shareholders who appoint them. The power of a powerful party is also proved by the fact that the Board of Directors determines the remuneration of the Board of Commissioners (Kurniawan & Indriantoro, 2000).

4.9.1 Selection Criteria for Independent Commissioners

The Indonesian situation contrasts with that of Germany, in that the outside director could be recruited from bankers, financial institutions, or union representatives. According to Indonesia Law Number 19 of 2003 regarding SOEs, at least 20% of the members of boards of commissioners must be from outside the SOE concerned. Commissioners must conform to certain other criteria, namely

- They must not be a director of an affiliated business;

- They cannot work for the government, nor have worked for the government for the last 3 years;
- They cannot work for the SOE concerned, nor have worked for the SOE in the last three years;
- They cannot have any financial connection with the SOE or suppliers of goods and services to the SOE;
- They must be independent from business interests or other connections with the SOE concerned.

Under Indonesian company law there are offences for which an individual can be barred from being company commissioner (and also director) for a certain period.

In Indonesia, it is common for new employees to be required to supply a Police clearance obtained from the Police of the Republic of Indonesia. Thus, it is known at the beginning of individual careers that they do not have a police record. But later as they progress through their careers, crimes committed after the initial police clearance may never be included in their employment record. In the company they may be influenced by the corporate culture. Thus, an initial clean police record may not be a good indication or measure of an individual fitness to be an employee/director.

4.9.2 The Role of Independent Commissioners

The role of independent commissioners (supervisory board) in a two-tier system which exists in Indonesian SOEs is similar to the role of independent directors in a single-tier system. Although, the board of commissioners has to perform and act independently (Bank BNI, 2003, p. 6; Kementerian BUMN, 2003a, p. 15), in reality there are still cases of corporate fraud after independent commissioners have been appointed. For example, the case of excessive executive bonuses in PT PLN (the State-Owned Power company); the US$25 million corruption case at PT JAMSOSTEK (the monopoly of State-Owned Social Welfare/Insurance Workers Company).
However, appointing independent commissioners in SOEs is merely the adoption of an outsider corporate governance model. Currently under BAPEPAM regulation publicly listed companies must have an audit committee. In addition, under regulations issued by Bank Indonesia (the Central Bank) banks must have a compliance director. The responsibility of this person is to ensure that the bank institutes measures to adhere to the current rules and regulations. According to Kurniawan and Indirantoro (2000) of the Indonesian Institute of Accountants, there has been criticism of the replacement of the audit committee by a compliance director in the banking sector. Firstly, the compliance director was responsible to the CEO, but the audit committee was responsible to the Board of Commissioners. This change may compromise the independence of the compliance director. Secondly, the responsibility of the compliance director is more limited than the responsibility of the audit committee ever was. The compliance director deals mainly with issues of compliance, but the audit committee dealt with internal audit issues, external audit issues, and organizational effectiveness. Thus, the compliance director is not a complete substitute for an audit committee.

4.10 The Board of Directors (BOD)

According to the Code, the board of directors is collectively responsible for the overall management of the company. The members of the board of directors are required to be professional and have the integrity, experience and ability necessary for carrying out their respective duties. Also, the Board must be sufficiently large to suit the nature and complexity of the business. Members of the Board are appointed and dismissed by the AGM through a transparent process. For public listed companies, SOEs, provincially and regionally owned companies, companies that raise and manage public funds, companies whose products or services widely used by the public and companies which
have an extensive influence on the environment, the process of evaluating candidates for membership of the board of directors is carried out by the nomination and remuneration committee prior to the AGM. Dismissal of a member of the board of director can be carried out by the AGM for reasonable cause only after the opportunity has been given to present a defence. Directors cannot use the company for their personal, family, business or other parties’ interests.

During recent developments in company law in Indonesia there may be too little protection for board members acting in good faith. According to Article 90 (2) and Article 90 (3) of Indonesian Company Law (1995), board members can be held jointly or individually liable for losses caused through the boards fault. The example of Nello, comes to mind the Managing Director of Bank Mandiri, one of the State banks, who was sentenced to prison and his assets seized for ill-advised loan decisions. It is desirable that board members are released from such liability if they satisfy certain criteria such as: making decisions in good faith, not having any undeclared personal interests, making informed decisions (getting all the information; having accountable management), and making decisions in the best interests of the company.

Arief Poyuono as the Director of the Legal-Aid Association of State-Owned Enterprises states that Nello had already performed his best to the company, so it was not suitable to relate the non-performed loan with corruption. That kind of punishment will discourage the director of SOEs to make a decision related with loan and will make the SOEs face difficulties to improve (Rit, 2006).

4.11 Audit Committee (AC)

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 of 2003 (Kementerian BUMN, 2003b, p. 30; Tumbuan, 2005). Once the audit committee is implemented, it is accountable to the board of commissioners which consists primarily of a majority government shareholder representation compared to the minority shareholder representation. Unlike American companies, where ownership is dispersed, Indonesian SOEs ownership is concentrated primarily through the GOI as the majority shareholder.

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

The NCCG code 2006 requires that there be an audit committee formed by the board of commissioners of public listed companies, SOEs, provincially and regionally owned companies, companies that raise and manage public funds, companies whose products or services are widely used by the public, and companies which have an extensive influence on the environment such as mining, forestry, oil, and utilities companies. Other committees are formed as required.

The functions of the AC are to ensure that financial reports are prepared in accordance with generally accepted accounting principles, internal control is sufficient, audits are conducted according to generally accepted audit standards, and audit findings are acted
upon by the management. The AC reviews potential external auditors and makes recommendations to the BOC. The composition of the AC is determined by the nature and complexities of the operation of business. The audit committee is to be chaired by an independent commissioner and members may be commissioners or professionals from outside the company. One member must have an accounting or finance-related background.

4.12 Nomination and Remuneration Committee (NRC)
This committee assists the BOC and determines criteria for selecting candidates for membership of the BOC and BOD and the remuneration system. The BOC may propose candidates and their remuneration for approval by the AGM according to article association. As with the AC, for the companies listed above the NRC must be chaired by an Independent Commissioner.

4.13 Corporate Governance Committee (CGC)
This committee has a function of assisting the BOC in reviewing policies proposed by the BOD and of checking how effective the GCG practices are. Members of CGC consist of members of the Board of Commissioners but outside professionals may be appointed.

4.14 Conclusion
This chapter has discussed the dynamic change of implementation of good corporate governance in Indonesia which occurs because of the urgency to attract investment and the awareness that the implementation of good corporate governance will increase the performance of the company and significantly contribute to the performance or economic condition of the country. Transparency is the most important aspect in
implementing good corporate governance but it has barriers because government is the main shareholder of Indonesian State-Owned Enterprises controlling everything and this includes influencing the decision of board of directors and effectively allowing the growth of KKN in the body of Indonesian SOEs. The solution to this problem is privatization so that there will be transparency to ensure that all stakeholders (and not only shareholders) supervise the board of directors.
5 Chapter - Research Methodology

5.1 Introduction

The purpose of this chapter is to discuss the research methodology used to answer the research questions. It begins by discussing ontology, that is, how the researcher views the phenomena; and epistemology, that is, the assumptions implicit in the researcher having or gaining the knowledge. Secondly, there is discussion about choosing between the two main research paradigms which are quantitative and qualitative. Lastly, the research methods or techniques used to answer the research questions are described. Figure 5.1 presents an outline of the chapter.
Figure 5: Chapter 5 Outline

Introduction

Research Approach

What is Qualitative Research?

Qualitative Research and Quantitative Research

Sample of the Research

Reliability and Validity

Data Triangulation

Data Collection

Data Processing

Research Questions Rationale

Epistemology and Interpretivism

Generalisation

Conclusion
5.2 Research Approach

This thesis analyses the practice of corporate governance and the behaviour of individual decision-makers in Indonesian SOEs. The words and actions of these individuals will be used in this study. Thus, they reflect the requirements of the qualitative paradigm (Maykut and Morehouse, 1994) rather than utilization of a purely quantitative approach. Social research is qualitative in nature. It endeavors to find out what is behind the numbers (statistics) and aims to arrive at a more complete picture of complex phenomena (Maykut and Morehouse, 1994).

Denzin and Lincoln (2005) cogently argue that qualitative research emphasizes that the characteristics of the real world are built socially, that there is a close relationship between the researcher and what is being investigated, and the context of the situation that molds the investigations into what is studied. According to Maykut and Morehouse (1994), qualitative research attempts to understand situations from the perspectives of the people involved. Qualitative research is used to record the actions and communication of people. In other words, it shows the results of their participation in the world around them. The function of the qualitative researcher is to record the interpretation of peoples interaction with the world around them. Bogdan and Taylor (1975, p. 13) states that “to do this requires an emphatic understanding or the ability to reproduce in one’s own mind the feeling, motives, and thoughts behind the actions of others” (cited in Maykut and Morehouse, p. 17). On the other hand, traditional quantitative academic research goes beyond considering the interaction of people with the world around them and examines such interactions mathematically (Maykut and Morehouse, 1994). Denzin and Lincoln (2005, p. 10) put it differently by arguing that
“quantitative studies emphasize the measurement and analysis of causal relationships between variables”.

Qualitative research describes the world from the view point of the people who take part in it. By so doing, it aims to contribute to a better understanding of social realities and to draw attention to processes, meaning patterns and structural features of the world (Flick, von Kardoff, & Steinke, 2004; Yin, 2011). This thesis opts for qualitative research because it is the most suitable research method to achieve the stated research objectives. This section will discuss and compare qualitative research and quantitative research and the phenomenology of case study research. It will also discuss features of the research sample, the reliability and validity of qualitative research, data collection, data processing and the time context.

Qualitative research is appropriate for this study because it uses the in-depth interview technique. The study explores the phenomena in greater depth than is possible quantitatively. It will answer the “what”, “why”, and “how” but not “how many” questions. The study uses a small non-random sample drawn from a large population. It is difficult to use quantitative research methods and techniques in achieving the primary objectives of this type of research project (Suprapto 2003; Lacey and Luff 2001).

Basically, there are two research methods, namely, quantitative research and qualitative research. Quantitative research answers questions in a measurable fashion which involves counting and measuring (Gillham, 2000, p. 9; Thomas, 2003, p. 2). Often statistical tools such as cross tabulations, calculation of means and standard deviations, and regression analysis are utilized (Lacey & Luff, 2001; Gillham, 2000, p. 9). The results emphasize causal relationships (Denzin & Lincoln, 1998).
depicted on graphs or charts, with simple descriptive statistics (Bogdan & Biklen, 1998; Lacey & Luff, 2001).

According to Strauss and Corbin (1990, p. 17) qualitative research means “any kind of research that produces findings not arrived at by means of statistical procedures or other means of quantification”. Patton (2001, p. 39) wrote that it is the sort of research that results in conclusions from real life situations where the “phenomenon of interest unfolds naturally”.

There are three elements to an inquiry paradigm namely ontology, epistemology and methodology (Phillimore and Goodson, 2004). These elements might be explained by answering the following questions.

Firstly, there is the ontological question: what is the form and nature of reality? And, what can be known about reality?

Secondly, there is the epistemological question: What is the nature of the relationship between the researcher and what can be known?

Thirdly, there is the methodological question: How can the researcher finds out what they believe can be known?

Denzin and Lincoln (1998, p. 185) postulates that “ontology is the study of being which raises questions about the nature of social reality while referring to the claims or assumptions that a particular approach to social inquiry makes about the nature of social reality”. How the researcher managed their being so as to not influence the results is an ontological consideration. Holloway (2006, p. 97) states that ontology deals with the way the researcher views the world. In simple terms, the generation of knowledge depends to a large extent on the ontology of the person doing the research, that is how they view the world (Phillimore and Goodson, 2004).
Epistemology is the theory of knowledge (Audy, 2011). It is concerned with the origins and nature of knowing and the construction of knowledge. It is also concerned with the claims and assumptions that are made about the nature of knowledge (p. 279). According to Holloway, epistemology is how knowledge is gained or advanced (2006, p. 93), it therefore refers to the behaviour of the researcher in determining or finding knowledge. In this study, determining the sample size, choosing the respondents and data collection methods are epistemological considerations.

The epistemology of the researcher depends on what they want knowledge about, while the kind of knowledge that they seek determines their methodology (Jones, 1993, cited in Phillimore and Goodson, 2004). The reliability and validity of research is influenced by epistemological and ontological considerations.

5.3 Research Sample

Vissak (2010) realized that case studies are not used in business research as often as quantitative methods but in fact, if it is conducted properly, these can be very useful to understand complex phenomena. According to Creswell (2007, p. 52) there are five major traditions in qualitative research, namely: narrative, ethnography, phenomenology, grounded theory, and case study. Yin (2003) comments, “You would use the case study method because you deliberately wanted to cover contextual conditions, believing that they might be highly pertinent to your phenomenon of study (cited in Creswell, 2007, p. 74).

Thirty-eight respondents from three SOEs and related institutions/policy makers were interviewed as part of this study. The data collection process used in-depth semi structured interviews. Also, secondary archival data was collected from a wide range of
resources including SOEs’ internal and public bulletins as well as reports in the national media.

5.3.1 Sample Size

Only a small sample size is required in qualitative research (Malhotra, 2007). Phenomenology itself requires only in-depth interviews with 10-15 people to collect the primary data. However, Flick (1998) and Morse (1995) (cited in Onwuegbuzie & Leech, 2007, p. 202) argues that “the sample should not be so small that it is difficult to achieve data saturation. This is followed by Mason (2010) who suggests a range number of samples in qualitative inquiry of between 15-50 participants.

Thirty-eight respondents were interviewed in this study. There are three state-owned enterprises as the samples and interviews with several key people with the necessary information in order to provide sufficient information about their perspectives related to the implementation of good corporate governance. Besides conducting interviews, the researcher also following the news which showed the changes from the first time the researcher interviewed the respondents until the present.

5.3.2 Sample Collection Method

The purposive sampling method has been used to determine the selection of the sample. This method enables the researcher to choose a sample related to the research purpose based on their knowledge of the known characteristics of each selected respondent (Zikmund 1997, p. 430). In addition, Zikmund argues that snowball sampling can be used effectively for the selection of interviewees to provide comprehensive information about their organisations.
In addition, Babbie (2002, pp. 178-179) argues that purposive or judgemental sampling can be used to study a small subset of a larger population. Therefore, three SOEs (out of 160 potential Indonesian SOEs) were chosen as the object of investigation comprising three different industries. The researcher has assumed that the data obtained from each of these three SOEs will be comprehensive and comparable across the three industries.

Purposive sampling is also related to the way a convenient sample can be obtained. The researcher chose these three organisational cases because they were readily accessible due to their location in the main Indonesian cities compared to other SOEs located on remote islands or in other remote areas. The researcher had direct access to a number of potential respondents in the three SOEs chosen.

Miles and Huberman, 1984 (cited in Cobb and Hagemaster, 1987) state that judgemental sampling is not only interested in sampling the insights of respondents but also the events and processes that occur inside the organisation. The same applies to the main research objectives of this study about the current state and development of corporate governance in Indonesian SOEs. Therefore, the information supplied by the respondents will be influenced by and related to the events and processes of organizational change during the data collection and data production phase.

After conducting purposive sampling, the researcher obtained recommendations from interviewed respondents about other suitable persons to interview in relation to the research. Thus snowball sampling was also used. Zikmund argued that snowball sampling can be used effectively for the selection of interviewees to provide
comprehensive information from their organizations. The process of recruiting the respondents was initiated by writing letters to known potential respondents, identifying the purpose of this study, and requesting them to give the names of other potential respondents eligible to be interviewed. Besides that, a letter was sent to the Office of the Minister of SOEs office requesting the names of potential respondents from within SOEs. The sample was drawn from three State Owned Enterprises, comprising the following organisations:

1. Company X, a state-owned electric power company (unlisted)
2. Company Y, a state bank (previously listed on Jakarta Stock Exchange)
3. Company Z, a national airline company (listed in February of 2012).

Data was also gathered from related external sources:

1. The Office of the Minister of BUMN (the Minister of State Owned Enterprises)
2. Komisi Pemberantasan Korupsi (Corruption Eradication Commission)
3. National Media

5.4 Reliability and Validity

The long-running argument over the comparison of qualitative and quantitative research means that it is crucial to have accurate validity and reliability in qualitative research (Huberman and Miles, 2002, p. 39). According to Cosmin (2012), there are significant differences between quantitative and qualitative research in regard to reliability and validity. Qualitative research is the more complex. It is necessary for the researcher to

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19 Snowball sampling is a probability sampling method in which additional respondents are then obtained from information provided by initial respondents (Zikmund 1997).
assess and discuss the validity and reliability in this study in order to erase any doubts about the level of impartiality.

According to Silverman, a totally impartial researcher with certain characteristic ways of viewing the world would be able to exactly mirror reality objectively (2006, p. 271). Silverman makes a number of observations. Firstly, “recognize what it means to describe a study as “scientific”. Secondly, “to understand the nature and basis of reliability”. And, thirdly, “see how validity may be achieved”.

He continues by stating that “if qualitative research is to be judged by whether it produces valid knowledge, then we should properly ask highly critical questions about any piece of research. And these questions should be no less probing and critical than the ones we ask about any quantitative research study” (Silverman, 2006, p. 274).

Bosk (2008) discovered when carrying out fieldwork that he (like other researchers) was not without bias

Reliability and validity are important to ensure a study is rigorous (Lacey and Luff, 2001). Although historically these measures have been important in quantitative research, they are becoming equally important in qualitative research (Phillimore and Goodson, 2004). According to Zikmund, reliability is the degree to which measuring instruments are free from error and therefore yield consistent results. He defines validity as the ability of a scale or measuring instrument to measure what it is intended to measure. Holloway (2006, p. 50) and McKinnon (1988) perceive that qualitative data is reliable and valid. There is an increasing acceptance of qualitative research in the world of academia.

In this thesis, the writer argues a high level of reliability by gaining a high degree of similar and triangulated responses from respondents.
McKinnon (1988) discusses the issues of reliability and validity in qualitative research. According to her, the use of field study methods in accounting has two barriers. The first is a lack of experience of accounting research in this area, and the second is that the issues of validity and reliability are often not addressed. According to McKinnon, there are four major types of threats to validity and reliability. Firstly, there are observer-caused effects, which are reactions to the presence of the observer. In the case of this research, observer-caused effects were minimized by the researcher telling the participants that the interview would merely be an academic exercise to compile material for a doctoral thesis. Further, that interviews were not intended for political consideration in the three SOEs of the study. The interviewer convincingly guaranteed that the participants’ response would not be explicitly published. Secondly, there is observer bias. This occurs when the observer (researcher) consistently makes observations that differ from what is accurate (Simon and Burstein, 1985; McKinnon, 1988). Thirdly, data access limitations, for a variety of reasons, may restrict the researcher’s reliable access to documents, occurrences or people (Zelditch, 1962 as cited in McKinnon). Fourthly, a threat to the validity and reliability of qualitative research is posed by the complexities and limitations of the human mind. For instance, respondents may deliberately attempt to misrepresent information to the researcher or information may merely be influenced by natural human tendencies such as the tendency to forget and misinterpret things, and know-it-all attitudes.

The researcher was aware of the risks associated with these four pitfalls, and utilised the strategies and tactics outlined by McKinnon to maximize reliability and validity. To overcome the above threats, McKinnon suggests spending sufficient time in the
research field\textsuperscript{20}. As a result, participants will be familiar with the presence of the researcher and hence information will be given naturally by the participants. As Patton states, the goal of qualitative research is to get phenomena of interest to unfold naturally (2001 cited in Golafshani, 2003).

Additionally, the attitude of the researcher is also important in obtaining accurate information. To do so, researcher should pose unsophisticated questions to the participants. Then, a humble and friendly attitude towards the participants is essential to obtain important and or even confidential information. This kind of information is very important to help understand and analyse the real phenomena. McKinnon (1988) also suggested using multiple methods. In this case, the researcher used data triangulation in order to increase validity and reliability.

5.5 Data Triangulation
Data triangulation is important to ensure data reliability and validity (Lacey and Luff, 2001). Data triangulation has many forms and sources such as digital data, hard-copy or printable form and sources, and so on. It derives from, and circulates in many ways such as interviews, academic research or research literature, and so forth. In terms of academic research, data triangulation is needed to check validity (Lacey and Luff, 2001).

As stated by Golafshani, triangulation is a strategy for improving the validity and reliability or evaluation of findings (Golafshani, 2003). Flick (2009, p. 444) has a similar opinion. He explains that triangulation needs a suitable process which is deliberate to achieve the verified result.

\textsuperscript{20}Researcher has spent more time in these three SOEs by having lunch together in the cafeteria, and chatting in researcher’s colleagues office.
In this study, the researcher used a number of sources to obtain data. These included participant interviews, academic journals, selected public media, and company website information. Data from these sources was compared in the triangulation process to check their validity and reliability.

5.6 Data Collection
Quantitative research is concerned with numbers or statistics. According to Lacey and Luff (2001), quantitative research generates a mass of numbers that need to be summarized, described, and analyzed. The data may be represented by drawing some charts, there may be cross tabulation and calculation of means, standard deviations or other statistics. There may be further analysis involving regression of variance analysis (Lacey and Luff, 2001; Golafshani, 2003). According to Leblanc, quantitative research is the traditional research method used almost exclusively in natural sciences, and strongly favoured in social sciences. Quantitative research requires that the world can be observed, measured and explained (Leblanc, 2003). The results are extrapolated from a sample to the population.

On the other hand, qualitative research is used where reality is believed to be constructed through our social interactions, beliefs and culture (Leblanc, 2003). A key tool in qualitative research is the use of interviews and discussion between the interviewer and interviewee. Language and dialogue are the vehicles by which information is transferred from the respondents to the interviewer.

According to Leblanc, the purposes of qualitative and quantitative research are very different. Creswell (cited in Leblanc, 2003, p. 51) explained that the intention of
Qualitative research is to understand a particular social situation, event, role, group, and/or interaction.

In quantitative research interviews may be conducted, but only limited to assisting the respondents in answering questions on the questionnaires with some range of numbers (or intervals). Therefore, quantitative research is characterized by the collection of data with numbers. As a result, quantitative research observes variables that can be measured (Glesne and Peshkin, 1992, p. 6). Thus, a researcher selects a case study design because of the nature of the research problem and the questions being asked. A case study is the best plan for answering the research questions; its strengths outweigh its limitations. The case study offers a means of investigating complex social units consisting of multiple variables of potential importance in understanding the phenomenon (Merriam, 2009).

According to Creswell (2005, pp. 202-209), “qualitative data collection consists of collecting forms with general, emerging questions to permit the participant to generate responses, gathering word or image data, and collecting information from a small number of individuals or sites” (Creswell, 2005, pp. 202-203). Creswell draws several comparisons between qualitative and quantitative data collection.

**Table 5.1. Data Collection of Qualitative and Quantitative Research**

<table>
<thead>
<tr>
<th>Quantitative</th>
<th>Qualitative</th>
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<tbody>
<tr>
<td>- Systematically identify participants and sites through random sampling</td>
<td>- Identify participants and sites based on places and people that can best help us understand our</td>
</tr>
<tr>
<td>central phenomenon</td>
<td>- Need permission to begin the research, but need greater access to the site because in qualitative research typically one goes to the site and interviews people or observe them</td>
</tr>
<tr>
<td>Collect data such as interviews, observations and documents</td>
<td>Collect data such as interviews, observations and documents, but relies on general interviews or observations so that (we) do not restrict the views of participants</td>
</tr>
<tr>
<td>To record the information supplied by the participants using predesigned instruments or instruments that the researcher designed</td>
<td>To record the information supplied by the participants, the researcher records information based on self-designed protocols that helps the researcher organized information reported by participants to each question</td>
</tr>
<tr>
<td>Quantitative researcher may not be present, he/she may mail out the procedure of qualitative data collection</td>
<td>Qualitative researcher administers procedure of qualitative data collection</td>
</tr>
</tbody>
</table>
questionnaires to the respondents with sensitivity to the challenges and ethical issues of gathering information face-to-face and often in people’s home or workplaces. Studying people in their own environment creates challenges for the qualitative research.


Similar to the analysis of qualitative data, the answers of interviewees and observations need to be characterized (Lacey & Luff, 2001). The researcher may want to investigate trends that have been recognized or relate various responses to the characteristics of respondents, such as their position in the hierarchy of seniority in their organization. Conclusions can be drawn from the data and tested using analytical methods. The researcher is an active agent in the investigation by collecting data from interviewing participants (McCabe, 2002) and by observing the phenomena in the place where the research is taking place and in the media.

5.6.1 Interviews

“The qualitative research interview is a construction site of knowledge” (Kvale, 1996, p. 2). One of the purposes of this thesis is to collect genuine and authentic information first-hand from participants within the three selected SOEs. In qualitative research, conducting interviews is an indispensable and vital function of collecting data. Interviewing is a key part of the methodology to examine the nature or originality or authenticity of facts being studied (Creswell, 2003; Fontana & Frey, 2000).
Furthermore, interviews allow researchers to understand and recognize respondents’ thoughts, ideas, feelings, perceptions, opinions, knowledge and experiences based on their verbal explanations (Hartono, 2010; Seidman, 2013). More significantly, by virtue of the interviewing process, phenomena can be investigated independently without changing them. Therefore, the originality of the data can be exposed (2010). Kvale says, “An interview is literally an inter-view, an inter change of views between two persons…” (1996, p. 2). Similarly, Berg (2007) states that an interview is not a random, subjective or partial exchange. According to Kvale an interview has its basis as a discussion on everyday life and is a structured exchange with “rules and techniques” (1996, p. 5).

Berg (1995, cited in Holloway 2006, p. 35) holds the view that an interview or conversation with a purpose is an art rather than a skill. In regard to utilizing interviews as a data collecting method, Berg refers to three types of interviews. Firstly, there is the standardized interview in which the questions scheduled are formally structured. A researcher uses this type of interview when they already possess a good understanding of the object of study. Secondly, there is the non-standardized interview which does not have a schedule of formal questions. This is utilized when the researcher does not yet possess a good understanding of the object of study, and does not know what primary questions to ask. Thirdly, there is the semi-standardized, or semi-structured, interview. This type allows the researcher to use predetermined questions and topics (Berg 1995, cited in Holloway, 2006).

This thesis utilizes the last mentioned type of interview. However, this researcher deviates from the predetermined questions to let new themes emerge. Also, a researcher is usually advised to avoid unfamiliar words or terminology. This strategy seems
effective when the interviewer encounters an interviewee who tends to use local colloquialisms in conversation. The semi-structured interview is applied in this research to keep the conversations within the framework of the subject of study. In using this type of interview, the same planned questions are utilised as much as possible, instead of boundary questions coming out of what the interviewer is thinking at a given moment (Easterby-Smith, Thorpe et al., 2002). Also, a semi-structured interview gives an opportunity for a respondent to raise relevant additional themes suited to the study purpose and to the research questions (Holloway 2003). In addition, compared to observation and questionnaire surveys, interviews allow participants to provide detailed information, including personal information. However, the interviewer can retain control over the information received by asking specific questions (Creswell, 2005). For example, some participants informed the researcher of their various backgrounds of work experience. This included a respondent who had retired from the Central Bank of Indonesia before sitting on the board of one of the State Banks as a Senior Management. This information demonstrated to the interviewer that the respondent had the detailed knowledge to answer and discuss the questions.

In interviewing, the researcher proposes question in general and additional questions with more specificity (Miles & Huberman, 1994). In this researcher’s experience, general questions assist discovering what are the first things that cross participants’ minds; specific questions lead to answering the main research question and to finding out the phenomena existing in the SOEs studied. For example, considering the question, “what do you know about corporate governance?”, some respondents answered by associating governance with corruption. More specific questions of governance relating to transparency, accountability, and responsibility initialized distinct discussion with
respondents concerning these matters. However, the issue of corruption cannot be ignored because it has been quite a phenomenon according to participant perception.

Cannel and Kahn have identified a number of drawbacks in using this interview approach (cited in Brown 2002, p. 151). Firstly, there is researcher bias where the researcher interprets the conversation based on their own judgment. Secondly, there is the inability of the respondent to provide information, which can limit the investigation. Lastly, there can be memory bias by the respondent which might lead to the wrong interpretation of data by the researcher. This can occur, for instance, when the interviewee does not give permission to be tape-recorded and the information supplied by the respondent is too extensive to record manually (by writing it down). In this situation the researcher asked respondents to speak slowly and/or repeated and confirmed the information with the interviewee at the end of interview. In addition, the researcher asked questions on related issues to confirm what had been stated.

Creswell (2005) holds the view that interview data could be deceptive, therefore the data triangulation needs a verification process in order to make it reliable and valid.
5.6.2 Strategy for Interviews with Respondents

The target group for this qualitative thesis is thirty-eight participants from three SOEs and related institutions or policy makers. Data was collected through the use of in-depth semi-structured interviews. Each interview was planned to last approximately one hour. However, the duration of interviews ranged between 20 and 120 minutes. After the interviews were completed the data was transcribed, and group them in three SOEs, and coding the similar themes that emerge before analyzing them.

A difficult situation is often encountered by a researcher in Indonesia in obtaining data by interviewing respondents. There is often a reluctance to respond because potential respondents perceive no self-interest. Research is generally not common in the business world of Indonesia, and even less so in SOEs, and so it is often viewed with suspicion. It is even more difficult when attempting to gain access from the managerial level up to the directors and commissioners for interviews\textsuperscript{21}. This arises from a variety of sometimes complex cultural reasons that exist in Indonesian business enterprises in the private and public sectors. There are two main reasons: Firstly, it is considered taboo to discuss governance. Governance is often associated with corruption, collusion, and nepotism or KKN in the Indonesian business world, and potential respondents are fearful of discussing this because of the perceived risk to their job security. This goes to the extent of refusing to have interviews recorded and insisting on anonymity by declining to sign research documents. Secondly, there are strong influences of Javanese cultural practices in business in Indonesia which make the gap between a subordinate

\textsuperscript{21} Indonesian limited liability companies (\textit{Perusahaan Terbatas} or PT) are required by legislation to have two tiers at the top, i.e. a Board of Directors and a Board of Commissioners.
and superior similar to the gap between a king and servant in a monarchy\textsuperscript{22}. As a consequence of these factors, the writer was able to interview only two directors and two commissioners.

Strenuous efforts were made to gain interviews. Firstly, fifty formal business letters requesting interviews were sent to potential respondents. This formal approach often fails in Indonesia because people are often reluctant to respond to a formal letter with no perceived self-interest. For example, a letter from someone who is known to be relative of a director is likely to be responded to but one from an unknown research student is not. Hierarchal relationships are much more important in Indonesian business culture than in Western business culture.

From the initial mail sent only one reply was received. This respondent, a Director of one of the SOEs was interviewed. Subsequently, the writer contacted three people he knew in the target businesses in regional offices at manager level and interviewed them. Following these interviews the writer requested to be referred to other appropriate people in the companies that first three respondents knew or thought would be open to be interviewed. This resulted in another three interviews. Other efforts involved contacting friends and people of the same ethnicity working in SOEs. This resulted in an additional seven interviews.

The balance of the interviews, apart from those with directors, resulted from previous respondents being asked to refer the researcher to potential respondents. Barriers to accessing these were often the need to negotiate business security, receptionists, and secretaries.

\textsuperscript{22} Up to the present, there is a Javanese monarchy led by the Sultan in Indonesia.
Leblanc and Schwarz (2007, p. 843-845) state that access to high-ranking management is best achieved by other high-ranking managers. Similarly, Pettigrew and McNulty (1995, p. 197) state that, “Access to managerial elites may be forthcoming if approaches are made through high status members of such elites”. This is in accordance with the experience of this researcher. At the directorial level, the researcher requested a favour from a fellow director known to the researcher to make an appointment for an interview. This strategy is commonly encountered in Indonesia. The formal procedures taught in business communication classes do not work well when applied in practice in Indonesian SOEs because of cultural reasons. Another, more pragmatic, reason is because office communication equipment such as telephone, fax, and internet are not well integrated yet in Indonesia. For this reason, often each department within an organisation has its own independent communication equipment without any central control. In addition, there is the risk that respondents have physically moved because of organisational restructuring or relocating to a different building.

In order to elicit responses it was necessary at the beginning of the interviews to reassure respondents that the information was being collected for scientific research purposes only, and that their anonymity was guaranteed.

5.6.3 Trial to data production

Prior to generating data, the researcher tested the semi-structured questions out on trial respondents. The purpose of this was to become familiar with the interviewing situation with respondents so as to be comfortable interviewing real respondents later. There were two participants who were willing to be interviewed during this trial investigation. The first person had previously been a director of a family business and was currently
working with one of the electricity suppliers in Perth, Western Australia. The other participant was working in an Indonesian State-owned airline operating in Australia.

A unique situation arises when research is conducted in a different context and a different place. The researcher was able to learn from the experience of Hartono (personal communication, 2010) in carrying out research in Indonesia. In both cases there was the need to make appointments with respondents. This researcher had been informed that the formal office procedures for contacting and making appointments with respondents such as sending a fax or email were ineffective. Hartono suggested going directly to the potential respondent’s office and explaining what the research is about and why they had been chosen for the sample.

In order to anticipate the situation above, for this study, the researcher used any source of initial potential contact with respondents such as friends and relatives. This strategy is commonly used in Indonesia. Therefore, this researcher decided to contact his former postgraduate students who are working in Indonesian SOEs at the managerial level, at a later stage, intending to employ them as respondents.

The researcher had to anticipate that some recipients of the faxed letter would not respond. Some potential respondents declined to be interviewed because the researcher was unknown or unfamiliar to them. This is in accordance with a popular proverb in Indonesia which states, *Tidak kenal maka tidak disayang* which means that if a person is not known, that they should not be loved. In other words, it is hard to be fond of stranger.

The families of respondents were contacted to arrange initial interviews with the respondents nominated by the researcher’s family. After this stage, the snowball sampling method was used. After an initial interview, a respondent was requested to
provide the names of several potential respondents from different departments for interviews.

### 5.6.4 Media

Secondary archival data will be collected from resources such as SOE bulletins, journals, prospectuses, and national media. The national media such as television and newspapers are very useful in unveiling cases of SOEs frauds, Indonesian Government and KKN scandals related to SOEs. There is little literature available on corporate governance in Indonesia since only a few studies have been conducted in this area. Studies of SOEs especially, are very rarely found in the literature. The media can be a very useful source in this aspect of the study.

### 5.7 Data Processing

A large amount of qualitative data was collected in this study. The nature of qualitative research and interview methods requires the researcher to group or categorize the data after data collection and data production. The same applies to the topic of this study dealing with Corporate Governance, in which the researcher has to sort out the responses from interviews conducted on different sub-topics.

This reason is supported by Hartono (2010) who provides the example that in an interview, even if the Javanese people say “Yes”, it does not mean that they agree with the given statement. Coffey, Holbrok and Atkinson (1996) and Lonkilla (1995) in Hartono (2010) also emphasize that dependency of a researcher on the software’s formulated keywords has the possibility of making a researcher ignore the notes written in the interview process. Easterby-Smith (1991) in Hartono (2010) also states that the participation of a researcher in interpreting the results cannot be replaced and that the
primary part of interpretation such as themes, patterns and categories must be done by
the researcher in person.

5.8 Research Question Rationale

The following are the explanations for the researcher arriving at the five research
questions.

In essence, Indonesia SOEs were and are currently being established in order to provide
an economic boost to the nation and provide 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 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 and weak enterprises, cooperation,
and people” (Kementerian Badan Usaha Milik Negara, Parliamentary Law number 19
of 2003).

The statement above is a formal statement which has become the law for the
government apparatus to adhere to and accomplish.

The question arises as to why SOEs are being blamed by the Indonesian public as
the cause of the monetary crisis in Indonesia in 1990s. Husnan (2001) says that
SOEs lack good corporate governance practices. This researcher intends to explore
the stakeholders’ perspective toward the implementation of corporate governance in
Indonesian SOEs. Creswell and Clark (2011) cogently argues that good research
questions consist of the main question which is the most general question the

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23 The purpose and goals of the establishment of SOEs have been changed. In the first place, the
establishment of certain SOEs were: a) pilot project, b) price stabilizer, c) the role of a strategic industry,
and d.) agent of economic development.
researcher could ask; and the sub-questions in order to find the specific answer of
that main research questions.

There are five main research questions to be answered in this study, followed by
some of the sub-questions.

The first main research question is:

1. How is corporate governance being currently practiced in Indonesian SOEs?

A sub-question would be: what is the behavior of stakeholders that is to say, the
board of directors, the board of commissioners, shareholders, and employees in
carrying out their tasks in relation to corporate governance?

If corporate governance is a good concept to implement, this leads to the second main
research question:

2. What are problems that hinder the implementation of GCG in business practices in
Indonesia?

A sub-question would be: why do those problems occur?

After the Asian monetary crisis of 1998, international financial institutions became
involved in the Indonesian economy. This leads to the next question:

3. What are the national and international imperatives driving current changes of
corporate governance Indonesian SOEs? Moreover, what are the effects?

The culture of society, corporate culture and legal culture are the factors that determine
the development of corporate governance (La Porta et al, 2000; Gill, 2012). This leads
to the next main research question:
4. In view of the culture in Indonesian society, Indonesian corporate and legal cultures, how appropriate to Indonesian SOEs are the current corporate governance policies being promulgated by the government?

Given the apparent ineffectiveness of the implementation of GCG in Indonesian SOEs, the next question that arises is:

5. What recommendations can be made to improve the effectiveness of the corporate governance policies and practices of Indonesian SOEs?

Creswell (2003) as cited in Paull (2007) suggests the qualitative researcher use exploratory verbs, non-directional language, begin with “what” or “how” in the main questions, and use open ended questions, especially in interviews.

5.9 Epistemology and Interpretivism

According to Paull (2007), interpretive epistemology has several important bases. Included is the basis that interactions between the participants and their environments form socially constructed meaning systems. Another basis is that it provides a story of the social context and behaviour of the participants it provides a narrative and the researcher needs “first-hand knowledge of the subject under investigation” (p. 96).

In this study, the interpretive qualitative research paradigm is used in studying and answering the research questions. The interpretive paradigm has a research basis which is responsive to the environment in which the participants perform. It uses a number of different methods to investigate and inquire how participants view the world in which they operate.
5.10 Generalisation

A limitation of qualitative research is that it relies on generalisation. When a number of cases are used an important aim of the researcher is to compare and contrast the selected cases (Onwuegbuzie & Leech, 2007, p. 243). It represents a thematic analysis across cases (Creswell, 2007). In this study, the data is processed in a two-step procedure. Firstly, data is generated from each of the three Indonesian SOEs. Secondly, this data is analysed across the three SOEs.

5.11 Conclusion

This chapter examined the research methods and approaches that have been used in this research. It began by discussing ontology, that is, how the researcher views the phenomena, and epistemology, that is, the assumptions implicit in the researcher finding out about or gaining the knowledge. A discussion followed about choosing between the two main research paradigms (quantitative and qualitative), of which the latter more specifically uses data triangulation to show that validity and reliability are capable of being proven in qualitative research. Lastly, the research methods or techniques to answer the research questions are described.

Interviews and discussions as a part of the qualitative method have been used to establish and achieve the goals and the aims of this study. Interviews and discussions have been utilized to understand participant’s thoughts, knowledge and perceptions about the research questions in relation to the research topic.
6 Chapter - Findings

6.1 Introduction

This chapter provides the findings from the three SOEs researched. They are a state-owned bank, a state-owned power company, and a state-owned airline. Apart from the respondents from these three SOEs, there were two respondents from the Ministry of State-Owned Enterprises, and one from the KPK. The communication has been carried out by face-to-face interviews and some followed up by email.

The researcher found several recurring issues while interviewing respondents in this study. They are:

1. Emergence of corporate governance
2. Organizational culture in SOEs
3. Appointment of managing directors from outside the company
4. Javanese culture within the organizations
5. Directorial domination and communication
6. Government intervention
7. Privatization processes
8. Whistleblower protection
9. Unions Involved
10. Career and development

The following figure 6.1 presents the chapter outline.
Figure 6: Chapter 6 Outline

- State-Owned Bank
  - Corporate Governance: Participant Insights
  - Disadvantages of Corporate Governance
  - Organizational Culture
  - A New Managing Director
  - Javanese Culture within the Organization
  - Directorial Domination and Communication
  - Government Intervention
  - Privatisation
  - Whistleblower
  - Bribes or Gifts
  - Union

- State-Owned Power Company
  - Corporate Governance: Participant Insights
  - Transparency
  - Corporate Governance Adopted from the Western System?
  -Privatisation
  - Privatisation from the Perspective of Directors
  - Javanese Culture within the Organization
  - Management Behaviour and Culture
  - Government Intervention
  - Government Intervention in Purchasing Capital Item
  - No Option Left
  - Union

- State-Owned Airline
  - Corporate Governance: Participant Insights
  - Disadvantages of Corporate Governance
  - Javanese Culture
  - A New Managing Director
  - Privatisation
  - Government Intervention in Purchasing Capital Item
  - Union

Union
Figure 6: Chapter 6 Outline (continued)

State-Owned Bank (continued)

- Independent
- Career Development

State-Owned Power Company (continued)

- Excessive Bonus Case (Popularly Known as the *tantiem* Case)
  - Sterilization of Frauds
  - Whistleblower Protection
  - Independent Commissioners
  - Career Development

State-Owned Airline (continued)

- Career Development

Conclusion

The Ministry of State-Owned Enterprises

- Corporate Governance Adopted from the Western System?
- Government Intervention
- Privatisation

Corruption Eradication Commission (KPK)
6.2 State-Owned Bank

6.2.1 Introduction

The company was founded by the Indonesian Government in 1946. In 2012, it stands as the fourth largest bank in Indonesia judging by the value of assets, loans, and deposits (State-Owned Bank website, 2012). It has approximately 24,000 employees and, operates widely in 1,364 branches in Indonesia and 5 overseas branches in New York, London, Tokyo, Hong Kong, and Singapore. This bank has been listed on the Jakarta Stock Exchange (JSE) since 1996. More than 70% of the shares of the company are owned by the Government of Indonesia (Pikiran Rakyat, 2010).

During the researcher’s visit to the bank in this study, many respondents raised the issue of a major corporate fraud in late 2003 involving a fictitious letter of credit in the amount of US$1.9 billion. This case implicated a number of senior staff including a branch manager. At that time the code of conduct and the manual were in existence, but the letter of credit case arose because the people involved in the fraud case lacked integrity and did not have any heart or feeling of ownership for the bank (Yani, Feny, Sony, personal communication, 2005).

6.2.2 Corporate Governance: Participant Insights

In the headquarters of the State-Owned Bank researched, framed copies of the four pillars of corporate governance i.e. responsibility, accountability, fairness, and transparency were found by the researcher in the corridors and offices of Management. Although the concept of corporate governance sounded good to some respondents, for many the message about corporate governance was not clear. They could see that corporate governance was a conceptually good thing but the concept was too abstract for them. Some impressions of respondents follow:
For respondents at the senior level, good corporate governance has already changed what is accepted as the standard of quality of a company (Sony, Yani, Burhan, personal communication, 2005; Bode, personal communication, 2010).

According to Sony, “…In the global market it is necessary to have a rating from a recognized rating institution such as Moody’s or S&P, which is important for the way the company is perceived. The SOEs also want to enter the world market to attract investors or in other words to go public because there are insufficient local investors. Hence, GCG must be implemented. Generally GCG, with its variables, constitutes good and sound management practice” (Sony, personal communication, 2005).

According to Yani (one of the regional managers), in 2002 there was a workshop on GCG led by foreign consultants. At that time, the Minister of SOEs announced that all SOEs had to implement GCG. While there are clear manuals and procedures with tight monitoring, the question arises as to whether or not it would be followed through. The success depends on the employees themselves, who have to understand the issues and put GCG into practice (Yani, personal communication, 2005).

From the head office, Sony (one of the senior management), revealed that from the early 2000s the employees have had to comply with corporate governance, and that the bank has provided the code of conduct, and closely supervised its implementation. However, the understanding of good corporate governance practices was minimal, and is just considered as a slogan currently popular in politics. This occurs at all levels of management.

To some degree his comments aligned with those of Fenny. Fenny said that the philosophy of GCG was not clear. According to him the only guidance the staff had about GCG was in the “form of a pocket-sized manual“ (Fenny, personal
communication, 2005). Furthermore, he stated that they had not been involved in the planning of the implementation of GCG, and they would merely implement it on a day-to-day basis.

The branch was uninformed about the concept and process of corporate governance. Feny said, “Everything comes from the company’s headquarters”. According to Feny’s understanding, good corporate governance was the code of conduct which had been provided in a pocket-size book. The contents deal with the way a well-run public company should be operated. The branch was not involved in the planning process, only in its implementation. Bisma (one of the managers), succinctly asked “what are the parameters of measuring GCG?” (Bisma, personal communication, 2005).

### 6.2.3 Disadvantages of Corporate Governance

From the viewpoints of some participants, corporate governance has its disadvantages. Kade, one of the branch managers in Jakarta, cogently argued that the way the system of corporate governance has evolved adds to the bureaucracy and makes the system cumbersome. He continued by saying that due to the existence of GCG the management is more rigid in making decisions about credit. From the risk side, GCG is good but not from the point of view of customer service (Kade, personal communication, 2005).

Perry, one of the branch managers in Manado, shared Kade’s view with Kade. Both argued that in the area of customer complaints with GCG, if a customer makes a complaint he currently experiences slow service even if he is a long time or loyal customer. The system existing before GCG for assessing credit risk, called four eyes and four Cs was sufficient. Besides the internal control, the company has the Central Bank and State Auditor, as external control. Corporate governance creates restrictions in
their decision-making. In addition, they are afraid of being blamed for making wrong decisions based on GCG (Perry and Kade, personal communications, 2005).

### 6.2.4 Organizational Culture

According to Feny, the code of conduct and going public have changed the culture in this company. In the past, the management treated employees disrespectfully, but now they are supposed to treat the employees as valuable assets. For example, in the past, the employer did not want to pay overtime, but now it is paid. Now, the management pays attention to the employees, and the employees must respond with responsibility to the business.

The code of conduct does not have a legal status. However, when employees do not comply with the codes, the management will ask them to take early retirement. This is equivalent to punishment (Feny, personal communication, 2005). Finally, she said that the new work culture reflected in the codes has changed the behaviour of the employees including the management. However, there are a few employees who have resisted the change, and they will be gradually replaced over time.

Joko agreed with Fenny’s statement that to a certain extent the culture of this company has changed. He said that in the past, whenever the employees’ superiors need to get into their cars, the subordinates were required to open the doors. Also, when the superiors from the head office visited regional offices, it was compulsory for the subordinates to do everything to please them. These all occurred before the company went public. After the company went public this corporate behaviour was embedded in the corporate culture change. The company regulation forbade this behaviour from happening, and stopped the expenses and the associated activities, including entertainment expenses of head office staffs visiting the regional offices.
When the company went public, there was a change in the behaviour of the staff. They became more customer-orientated. They became more courageous in giving their opinions and asking questions (Fenny, Joko and Jones, personal communication, 2005). However, the new managing director wanted the old culture, and did not want staff to ask questions (Joko and Bode). This will be discussed further in the section on Managing Director’s Hegemony.

6.2.5 A New Managing Director from Outside

The letter-of-credit case was the reason behind the ruling government appointing the new managing director of the business from outside the bank.

According to Yani and Kade, the appointment of the new managing director is the impact of the letter-of-credit case. However, he said that this was just like “burning the barn to find a rat”. Yani explained that the fraud was really just of a technical nature, and there was still sufficient time for it to be honoured. The ruling government used the fraudulent letter-of-credit as an excuse for dismissing the managing director of this SOE bank.

“This was a political matter”, stated Yani (personal communication, 2005). Later, this case became known as the fictitious letter of credit case24. In line with Yani, Joko said the newly appointed MD has a strong position because essentially he has been politically appointed as an extension of the government.

Also, Joko said, “the government’s appointment of a new managing director from outside was just overkill”. He said that in a meeting with branch managers, the new managing director said angrily “all bank employees are broken”25. Bode confirmed what

24 This case in itself is not analysed in this study but its impact on corporate governance is.
25 Broken is a translation of the Indonesian word used. Possibly an equivalent in English is to be of “no use”.

133
Joko said. According to him, in another meeting, the new managing director said that the bank’s employees are morally corrupt. Bode, Joko, and Yani did not like these comments.

Strong resistance to some outside directors, including the managing director, came from some senior level managers, including Yani and Joko. Yani said that the new managing director is close to the ruling party. In addition, Joko said that he is a member of the family of the ruling party’s leader, who at that time had influence over the commissioners and directors of SOEs. In addition, the new MD was just “deposited” (parachuted) to in the job by the ruling party, added Bode.

The competence of the new managing director was brought into question. Yani gave the illustration, “he [the MD] usually only takes care of saucers, and now he takes care of buckets of water.” The new MD was from a smaller private bank which has fewer branches across Indonesia and no branches outside the country, said Yani and Bode.

A different perspective was given by Kade. He said that there were too many directors from outside. Bode suggested that the composition of the Board of Directors should be 70% from inside the business and 30% from outside. If there were too many outside directors it will damage the company. He gave the example that the outside MD would not understand the business and would make a mess of the existing system. After going public and before the new MD was appointed, the bank had implemented a good policy for carrying out change. However, the new MD liked to make many changes arbitrarily and unilaterally and, this was just wasting time and money, stated Bode (personal communication, 2010).

26 In Java, when people drink coffee they usually pour the hot drink into the saucer, and sip from that. Previously the new MD had metaphorically looked after a small saucer of liquid, but now was in charge of buckets of liquid.
In addition, Yani and Bode described the new MD as not being ignorant. One specific example from Bode stated:

The MD thinking that the company had made a profit of 1 trillion rupiah (US$100 million), and proudly stating this in meetings internally and in public. He did not know that in fact the company usually made a profit of 3 trillion rupiah (equal to US$300 million). This demonstrates that the MD does not know anything about the bank. The ranking of this bank fell when he occupied the position of MD. All the new MD could do was to change the logo of the company which cost hundreds of billions of rupiah (personal communication, 2010).

However, according to Feni the new MD from outside the company just has a different style of managing the company due to having a different style from the previous MDs.

6.2.6 Javanese Culture within the Organization

Feudal Javanese culture can also be encountered in this business. Joko explained that personnel with a Javanese background dominated the newly appointed board of directors. He said, it is a fact that Javanese culture will become embedded in the operation of this business”.

On the other hand, Feny put it differently. He argued that “Javanese culture is on the wane. In the past, employees had to be subservient to their superiors. This means that employees were just waiting to be told what to do. It was unusual for us to initiate a conversation with the managing director, but now we can, we even have his cell phone number, so we can chat informally. This has come about because the atmosphere and culture have changed, feudalism is disappearing” (personal communication, 2005).

The old (Javanese) culture is identified with the Suharto era. As Perry pointed out: “…in the Soeharto era before this company was listed many employees were too tolerant of their superiors” (Perry, personal interview, 2005). This tolerance is a feature of Javanese culture called ewuh pakewuh. Joko agreed with Perry. The tolerance can be seen in the matter of not protesting. The employees are less likely to protest to their
superior if they have different views or if they feel their superior is not doing the right thing such as colluding in approving loans which do not meet lending criteria to clients. However, Joko said that he would not be tolerant to the wrongs of employees, because if he were tolerant to one employee, he would have to be tolerant to others, and this is not good for the bank.

Tolerance did not suddenly disappear altogether when the business went public. It still can be seen in day-to-day business. Kade claimed that tolerance resulted in employees being left in grey areas (personal communication, 2005), which resulted in weak decision-making. The Javanese tend to accept whatever there is, the trend is they do not show any ambition, which results in them not flourishing. The Javanese phrase is *nrimo in pandum*, said Joko. Joko and Kade agreed that the advantage of being highly tolerant is that it is easier to gather opinions, there is greater acceptance, and less conflict because of high respect for the superior (personal communication, 2005).

In addition, Bode explained another aspect of Javanese culture that influenced this company is Mikul dhuwur, pikul tinggi, mendhem jero” (Javanese). This phrase refers to protecting the good names of superiors, to worship management, and to deeply conceal management faults (personal communication, 2010).

These signs of the changing culture from the old traditional business culture to the modern one have appeared in this company since the business went public and issued the code of conduct. However, it is not possible to make Javanese culture disappear, because this culture has been embedded in the state-owned bank for such a long time from the Suharto era.
6.2.7 Directorial Hegemony/Domination and Communication

According to Joko the MD had commented that the bank was in critical condition. The MD said this to justify operating the business in a military fashion which Joko called his “commando line”. The problem with this was that it was unclear when this would become more democratic. According to Joko, many of the bank’s employees did not agree with what the MD stated. The employees no longer have the right to express any opinion. If it is different from the MD’s it is automatically dismissed. In addition, Joko said that the MD is known as immature and having an emotional character. So, when he found there were opinions disagreeing with his he became emotional. Joko experienced this at the meeting of the branch managers, and MD and directors when he gave a dissenting opinion, the MD became very angry and undermined the employees.

Bode agreed with Joko and added that most of the time the audience was being told not to ask many questions (in other words “do not ask any questions at all). Although in a meeting, the MD was being a vulgar person (Bode, personal communication, 2010). Joko was rebuked more than once by the MD when he tried to give an opinion. Joko said this was to demonstrate that the MD had power, absolute power.

In terms of communication, after the new MD was appointed the mentality of having the courage to express dissenting opinions which was considered good by the employees, changed. This attitude was stamped out. In addition, it was often explained that in forums, the MD was like a religious leader with everything having to flow from him and everyone just following him. According to the MD’s concept, there is a time for a leader to be like a commander and behave in an almost regal manner (Joko, personal communication, 2005).
According to Yani, in this bank there is a lack of open two-way communication. If suggestions are made by the employees, the MD simply does not want to listen. This is because he does not know anything about the bank. There is no two-way communication in this bank. Even, after the employees explained in many different ways, the MD said “just do it”. This is really a top-down approach due to perhaps his strong ego or lack of knowledge about the bank because he came as an outsider, restated Yani. Yani also said, “I have already worked here for tens of years”, I can look at “things” and already know where the symptoms of problems are. It is different with the new MD, because the new MD is a person from outside lacking inside knowledge. Yani continued,” if the MD wanted to open his ears and eyes and wanted to listen there was bound to be a good result”.

Sony raised another issue about the event of the annual general meeting (AGM) of shareholders. He said that there must be an agenda for the AGM, and criticized the announcement of the agenda for the AGM of JAMSOSTEK (a state-owned insurance company) one hour before the meeting. Notice of the meeting was received only a couple of days before hand. This shows the managing director’s power. It could have come about because the Government wanted to replace the bank’s directors and instructed the MD to hold a meeting quickly (Sony, Personal Communication, 2005). This suggests that the MD is a tool of the Government, which is the source of his power. Joko stated that there are political games in decision-making by those in power. He described the phenomenon of backdoor deals made through political persuasion. It is fair to use persuasion in an official forum to get support, because in meetings we persuade members of management to support our proposals, not through backdoor deals. He was relating his work experience in several places in Indonesia. He
understood that in every region in Indonesia there were major customers of the bank who were supported by the government and in turn supported the government for their mutual benefit. These customers had their credit applications rubber-stamped without being subject to standard due diligence procedures. Normally such applications would be considered at meetings of the bank’s credit committee. However, in the case of politically affiliated customers, the credit committee is not independent; the committee knows in advance what the decision has to be. Bode (personal communication, 2010), Joko (personal communication, 2005), and Brian (personal communication, 2009) do not support this view because they always consider proposals in a professional manner with a feasibility study rather than in a political fashion. The credit committee is supposed to be independent, but this is difficult because all matters depend on the MD (Joko, personal communication, 2005).

Credit approvals require acknowledgement of the board of commissioners, who are supposed to be independent. However, they automatically accept approvals for credit for political favourites (Joko, personal communication, 2005). It is difficult for the board of commissioners to be independent, because the board of directors determines their salaries.

Additionally, Joko said that the political games also occurred in determining appointees in the bank (this will be discussed in the next section). This arises from the fact that the chairman of commissioners of the bank happens to be a close friend of the Finance Minister. This phenomenon of political game-playing occurred in determining the members of the board of directors and the board of commissioners of the bank. Joko also explained that an alternative to be promoted is through family connections. He gave an example, “if I am the brother of the Governor of the central bank, I will fast-
track through the levels of this State-Owned Bank. It is often like this… many board members do not have sufficient skills, as I see it they do not understand the bank’s problems” (personal communication, 2005).

6.2.8 Government Intervention

Government intervention occurs in the appointment of the boards of directors and the boards of commissioners of SOEs. According to Joko, Perry, and Bode, the new managing director was appointed by the ruling party that governs the state. The appointments of the boards of directors and boards of commissioners contain political nuances. Several political parties are vying for their candidates to win representation on boards. “These are all backdoor deals”, said Bode. Sony explained this phenomenon by saying that the SOEs are majority-owned by the Government of Indonesia.

Government intervention can also be discerned in the purchasing of company assets. Brian expressed his disappointment that his recommendation for purchasing a new computer system for the state-owned bank was not accepted by his managing director. According to Brian, his recommendations were rarely accepted. As a result, he resigned from the bank. Joko supported Brian’s comments by saying that the purchasing of the new computer system had already been determined by the country’s ruling political party. Perry explained that the system used in the bank is also used by the nation’s leading bank. However, the system was changed by the new MD. This was a massive project, and changing the system was merely for generating funds for the party (Brian, personal communication 2009). Joko is in agreement with Brian, and said that the top leader of the ruling party acted as a sponsor to realize this Project. He said that it is analogous with persuading the selling of a product in a newspaper which has a sponsor. The sponsor is a ruling political party, the difference is that there is external pressure.
Joko’s experience above shows evidence of collusion between the ruling government, which intervenes in this bank, and the management of the bank.

6.2.9 Privatization

Burhan, a member of the Board of Commissioners of this bank, revealed that before the presidency of Susilo Bambang Yudhoyono (popularly known by his initials SBY) the discussions about the matter of privatization were very intense. This was because of the contribution of the sale of state-owned assets to the National Budget. It became less important during SBY’s first presidency, because the policies of the political parties changed. He elaborated that the privatization process contravenes regulations. An example of the contravention of regulation is seen in the privatization of PT Indosat (an Indonesian telecommunication company). According to the Government Guidelines (taking precedence over national laws) in place at the time, privatization should take place through the open capital market. However, in the case of PT Indosat, privatization took place through the strategic sales of capital. This occurred because the government wanted a quick sale in order to meet budgeted revenue for the national account. This is why Burhan said that the privatization process contravenes regulations.

The Indonesian Constitution is a source of one of the issues of privatization. The Constitution states that the resources of the nations should be used for the benefit of the people. This makes it unclear for the Government of Indonesia which particular companies should be privatized and which companies should not.

Burhan explained the appropriate process for choosing which SOEs should be privatized. He illustrated this by mentioning the State Power Company, “it must be decided what this company is going to be, either profit-oriented or a service company”. Pertamina, the State Oil Company should make a profit, the State-owned Hospitals
should be service-oriented, and BULOG, the State Logistic Body should provide sufficient rice for the general public. If it is profit-oriented, it must be by counting the associated cost, and benefits. If the company is service-oriented, it should not be ordered to seek profit. He stated that the Government of Indonesia must be clear and decisive in regulating the SOEs, and avoid ambivalence in their position (personal communication, 2005).

The pros and cons of privatization have been discussed in the media and by employees of the SOEs. Sony and Boy (personal communication, 2005) have similar views regarding the advantages of the SOEs going public. According to them, there is likely to be more government intervention in board appointments and the operation of companies. For example, Sony said, “there is a big possibility of government intervention for those state-owned enterprises that have not gone public yet.” Boy said that the government can even still intervene in listed SOEs, so government intervention is even more likely in those that have not yet gone public.

6.2.10 Whistleblower Protection
Some managers did not quite grasp the concept of a whistleblower. After it was explained to them, they said that there is no whistleblower protection in this particular bank (Burhan, Perry and Sony, personal communication, 2005). The curt response from participants poses a big question mark to the researcher, since the role of whistleblowers is an important issue in developing good corporate governance practices.

6.2.11 Bribes or gifts
In the state bank studied, there is included in the code of conduct a provision that employees may accept gifts valued at up to one million rupiah.
The respondents were asked about this matter. Some of them agreed with accepting gifts because this is part of the business culture in Indonesia. As the respondent, Yani, (one of the branch managers) explained “we must not be rigid, it is not wrong to accept Christmas or New Year gifts”. He continued by telling his experience when he went to Hong Kong and was asked to accept the angpao (or money) on the occasion of the Chinese New Year. He said that, without cultural understanding it would not be possible to conduct business in Asian countries, as long as there is no accepting commissions from buying and selling. If the police investigated he said that he would say to the police “you also accept this type of gift”. In addition, he said that he never refused to have dinner if invited by his staff. Joko supported Yani’s arguments by saying that reluctance to refuse a gift is also a typical form of behaviour in Javanese culture. In addition, Yani said that the post for this budget item is commonly called “facilitating fees”. He and the management cannot get rid of these practices, as there is a fee needed for the underlying transaction.

Feny and Boy, also agreed with the provision without going into details. However, Feny revealed that the bank provided credit cards for its management to pay for the entertainment of company clients. In the past, when a superior and a subordinate in the bank met socially, with the purpose of the subordinate wanting to gain favor from the superior, such meetings were usually paid for by the subordinate. However, since the introduction of management credit card these activities are usually paid for by the management. In this case, the risk of bribery is minimized. A different opinion was given by Sony, senior management, who said that the maximum gift of Rp 1 million is an internal crime.
In addition, he said that if the management is invited by clients to play golf or tennis, in the past, equipment was provided as a permanent gift by the clients. Later, this was changed. The bank makes budget provision for these expenses. A different view was expressed by Kade, and Bisma regarding the acceptance of gifts. They said that the acceptance of small gifts will help to trigger corruption.

Yani on the other hand explained that corruption is making money by any means possible. For example Yani said, that if the Director was assigned by PDI (one of the political parties in Indonesia), then the director has to earn money for PDI. Yet he said, in the past, there were no limits on accepting gifts, but now there are limits because there are rules. However, there are still people who give gifts.

### 6.2.12 Union

According to Sony, the current activity of the union is aimed at controlling management. The union can also support the implementation of good corporate governance in the organization. In this activity, the Union functions are better than those of KORPRI (State Employees Union of Indonesia).

Perry agreed with this point of view, saying that union officers had their personal view points which were not necessarily those of the union and that they should not meet alone with members of management, so that there was some certainty that the views of the union were presented and not those of the individuals. This sort of occurrence is common in the unions of SOEs.

### 6.2.13 Independent Commissioners

Due to the regulation by the Capital Market Supervisory Agency, a company that goes public must have independent commissioners (Badan Pengawas Pasar Modal, 2004).
This state bank has independent commissioners who came from the Central Bank and various private companies.

In SOEs, there are no independent directors, only independent commissioners. In the state-owned banking enterprise, the appointment of the compliance director is determined by the Bank of Indonesia. The incumbent director should be independent from any operational decisions and be of good character. Sony explained by giving this example, “if he disagrees with a board decision which he considers illegal then he should report it to the Bank of Indonesia (BI). If the compliance director disagrees with the board because of perceived illegality, then he must report to BI” (personal communication, 2005).

According to Sony, the tasks of a compliance director include not participating in operational decision-making, but rather participating in board deliberations on general policy issues. However, he is under the managing director in the hierarchy, and must comply with the decisions of the higher hierarchy.

Sony also discussed the tasks of independent commissioners which are not different from the task of the other commissioners, only that they represent non-shareholders. Sony was confused about the existence and the role of independent commissioners. The independent commissioners are proposed by shareholders (Indonesian government through the Minister of SOE, and the Minister of Finance) with the approval of BI. Sony said that the benefit of this is not clear.

Different views were given by Bisma, who cynically questioned whether the weekly attendance at the office by the independent commissioners was in accordance with good corporate practice. “There is no system of measurement to gauge the success or failure of corporate governance”, stated Bisma (personal communication, 2005).
6.2.14 Career Development

Some respondents raised concerns about promotions and study leave. They felt that there have been discrimination and lack of fairness in these areas, and in the area of career development generally. This was common to the three SOEs. For instance, in the banking sector SOE, Perry claimed that he was disadvantaged by the management. He questioned that a junior colleague was promoted to a position above him. Perry asked what criteria have been used in assessing the merits of candidates for promotion. He believed that he should have been promoted because of his years of service, higher authority to authorize loans, and his performance. Senior management responded that it was a matter of fate or what was written in the lines of the candidates’ palms. According to him this answer was ridiculous, given that other senior management decisions were made on the basis of logic. He assumed that the junior colleague was promoted above him because of religious considerations, and because the junior had closer connections to the head office. The junior’s office was physically located closer to head office in Jakarta while Perry’s branch office was much more remote (personal communication, 2005).

Kadek had a different experience. He put forward his notion of unfairness in this organization. He explained that they were still searching for graduates from the same universities as the directors for candidates for employment and promotion. As a consequence, he thought that he had less opportunity to be promoted to the position of director.

Bode and Joko (who are already in senior level management) gave different perspectives regarding the career development in this company. Joko said that before the new MD was appointed, this company had been run by a system where a committee
would have to determine the senior level positions. However, there was now strong
intervention in the process by the new MD and the ruling government. The new board
consists of eight members. Five of them are from outside the bank. Joko, Kadek, and
Bode agreed that if it is only one outsider it could be considered an exception, but five
members from outside is a large deviation (personal communications). In addition, they
said that if most of the board members come from outside, then internal career
advancement becomes very difficult.

The rewards and punishments are unclear in this business. Joko said even though we
have performed well, it does not mean that the appropriate reward has been received.
As a result, he resigned from this company after working there for more than twenty
years.

6.3 State-Owned Power Company

6.3.1 Introduction

This SOE had its beginning in the Dutch sugar and tea companies which owned their
electric power plant in the early 1900s. In 1942, during World War II, Japan took over
these Dutch companies. In 1945 when Japan surrendered to allies, the youth workers
lobbied the President to establish a State Power Company. On 27 October, 1945 the first
President of the Republic of Indonesia, Soekarno established the State Power and Gas
Company. In 1972, according to Indonesian Law no. 17, the status of this company
changed to the State-Owned Power Company as separate from the gas company.

The concept of corporate governance had been heard of in this company by some
participants, but was not regarded as anything special. Connie, one of the participants
said corporate governance was just a new concept that management has picked off a
menu just like previous techniques such as re-engineering or management by objective, had been chosen by SOE officials previously (Connie, personal communication, 2005). This is in line with comments made by Edi (one of the internal auditors), who put it differently by saying that GCG was just a slogan imposed from the top by the owners of the country who hired outside consultants to formulate GCG and did not know about the culture of the company. According to him, it has not been thoroughly promoted to levels below management. There is no system of measurement to gauge the success or failure of corporate governance, proposed Edi (personal communication, 2005). Also, Benny, Head of the Human Resources Division, had similar views to many of the other participants, but in addition he believed that auditing was necessary from top to bottom (personal communication, 2005). He said that corporate governance practices have been implemented at the top to middle management levels, including branch managers, but not at the lower levels (Benny, personal communication, 2005).

These are some perspectives from the participants:

“Corporate governance serves only to fulfil the interests of some parties, such as the Asian Development Bank and World Bank, but I don’t know whether we have found the root problem in this company. GCG practices do not touch the problems of this SOE” (Connie, personal communication, 2005).

“Corporate governance must be adjusted in line with the culture in state-owned power. It is going to be different if they are not in our shoes” (Rino, personal communication, 2005).

“The corporate governance was promulgated in 2003, but we have not felt the effect yet. They should provide regular guidance on what to do. It seems that they are using external consultants” (Zull, personal communication, 2005).
Umi, one of the Union leaders who is a post graduate student in Australia was confused about the implementation of corporate governance. He understood that the appointment of independent commissioners in the State Power Company occurred because of the adoption of GCG from the West. However, he acknowledged that independent commissioners have no say in delivering communications to shareholders. In this case, the shareholders are the Ministry of State-Owned Enterprises and the related ministers’ offices such as that of the Minister of Finance and Minister of Energy and Natural Resources. Umi stated that the independent commissioners are “less critical” (personal communication, 2009). In the view of the writer, independent commissioners merely act as rubber stamps.

Charlie argued that the state-owned power company had already started implementing the GCG practices, but the implementation was still slow. “The implementation needs to be sped up”, claimed Charlie. He identified GCG practices can be purely implemented if the system has already been well established. At this stage, the researcher has doubt about what he said about GCG practices being implemented as a whole because it is impossible to implement GCG practices one hundred per cent in the Indonesian context\(^\text{27}\) (personal communication, 2005).

Charlie explained that the system is not well established yet and not connected (with the people) yet because the usual practice of auditing and the resultant findings are not transparent in this company. According to him this is a matter of form over substance. This is because the proper auditing procedure already exists but people simply do not

\(^{27}\) As revealed by the respondent, one of the management from Telkom (state-owned telecommunication company) in the pilot study of this research, complying with GCG practices of the New York stock exchange, “all of the management in Telkom is going to heaven” (analogous with the Western expression “pigs might fly”). This metaphorical statement indicates that implementing GCG practices one hundred per cent as in the West is very difficult if not impossible in Indonesia. This is because NYSE listing regulations require transparency in information such as project tenders which would be impossible in the Indonesian context.
follow it. Additionally he said, this is not a matter of Western or eastern GCG practices, but whether or not we are ready and able yet to examine/audit transparency? The argument whether or not Western GCG practices should be adopted in Indonesia will be discussed in the next chapter.

6.3.2 Corporate governance: Participant Insights

The introduction of corporate governance is a good idea, according to Rino. From Rino’s perspective, there is a new paradigm. Company will be more transparent to the public. Under the old paradigm, the SOE business was part of government and the Government did not care whether it made a profit or loss. However, under the new paradigm everything has to be calculated mathematically. “Cost is everything to us. If we don’t get paid based on cost, let’s ask first who will be paying? If no one will pay, we begin to make people understand that no payment means no electricity”, stated Rino (personal communication, 2005).

Barry, Head of Internal Auditing at the branch of North and Middle of Sulawesi is satisfied with the rules, regulations, and standard operating procedures the company currently has. Especially, that the control and audit system is running properly (personal communication, 2005). He did not provide any controversial arguments about corporate governance. However, he recommended some of his colleagues’ names at headquarters in Jakarta to the writer to became involved in this study. Those names that he recommended such as the auditors and Union leaders, the writer found out later in this study to be ignorant of the GCG concept. The Union leaders were against the Board of Directors, Board of Commissioners and shareholders in other words, the government.
6.3.3 Transparency

Transparency has become a controversial term in this organization. As stated by Edy, if an employee talks about transparency, then people move away from him. Rino’s comments did not align with those of Edy. He disagreed. He said, “we are already striving to be completely transparent, especially to stakeholders. If there is a problem, we will tell the truth to society” (Rino, personal communication, 2005).

However, this was disputed by Ellen: “in the example of the tantiem case, we got to know about it from a journalist. They are good at finding things out. If it was transparent it would be in the financial report, but it was not. Leaking information will lead to public exposure. Transparency in this company is only a formality, not reality” (personal communication, 2005).

6.3.4 Corporate Governance Adopted from the Western System?

Charlie, the Dean of Faculty of Economics of a state university, and an independent commissioner in the State Power Company, admitted that not all commissioners could be independent. In some situations, non-executive directors (independent commissioners in Indonesia) should be independent. He gave the example of Ford in America where there is more dispersed ownership than SOEs which are majority-owned by the State. He said that Telkom (an Indonesian listed telecommunication company still majority-owned by the government) must have government representation on the board. He believes the government representative should bring the government views to the board meetings, but the audit committee should be independent. “This is not a matter of East versus West, but whether we can afford to be, and are ready to be examined in a transparent manner” (Charlie, personal communication, 2005).
6.3.5 Privatization in the State-Owned Power Company

Connie (one of the Union leaders), argued that the privatization program by the government in SOEs is not that simple. She questioned: “In which sector does the State Power Company operate? It is not right to generalize especially about the State Power Company, to which I would strongly disagree”. She continued, “It is very simple. As long as electricity is still viewed as an important production branch utility to the nation and a vital resource to the majority of the people (as stated in Article 33 of the Indonesian Constitution), it has to be controlled by the state. The definition controlled by the state means that it should not be privatized (Connie, personal communication, 2005).

Connie discussed her involvement in opposing the privatization:

“I have been deeply involved in the process... including opposing the government because the government wants to liberalize the energy sector. They even strive under the pressure of World Bank, ADB, and others to get the liberalization legislation going. I have sued when the Labor Union was afraid to make any move, and I was the one preparing the draft. The point is as simple as Chapter 33 above. This sector is of an infrastructural type, not a commodity. Other reasons than Chapter 33, the government can also give such an excuse as inefficiency at PLN. We can’t see it as separate issues. Who said that privatization is the solution to inefficiency? From experience, we know that after private investors came aboard, PLN came to be financially worse off and made a loss.”

Both Connie and Ellen put forward their notions of the inefficiency of privatization.

One matter raised by the PLN Union of Workers relates to the compulsory purchase of electric power by PLN from Paiton (Connie and Ellen, personal communications, 2005). Paiton, located in East Java, is a privately held company, which generates electric power. Under contractual arrangements imposed on PLN by the Government, the SOE must purchase electric power from Paiton at an inflated price. PLN sells the electricity at a lower price determined by the Government. PLN’s deficit is
compensated for by the Government.

According to Connie, since the 1990s private investors have begun to enter the industry due to Soeharto's policy which allowed them to invest in the electricity sector (personal communication, 2005). The State-Owned Power Company has 27 contracts in total; one of the most popular ones is Paiton. It deals with electricity energy supply. There are a few unfair conditions, though. One of them is “take or pay”, which means whether we use it or not, we have to pay. This condition does not favour the State-Owned Power Company. The Union rejected the concept of the take or pay clause but this company acquiesced to the demands of the ruling government. Therefore, the entry of private investors into the electricity sector did not guarantee greater efficiency and lower prices, in the case of the arrangement between Paiton and the State’s Power Company. However, according to Johny, privatization in other areas of Indonesia resulted in greater efficiency and lower cost (personal communication, 2005).

As a result of conditions imposed on financial aid for the restructuring of the Indonesian economy by the IMF, the Indonesian government has already passed legislation for the privatization of the electric power sector (Law Number 20 of 2000). This legislation triggered protests by the Union and several NGOs because they realized that if there was privatization of the electricity sector, then the industry would fall outside the control of government. This would breach the Constitution of Indonesia which states that: “Sectors of production which have a strategic role [importance] for the country and influence the livelihood of the people [the general population] shall be controlled by the state” (Article 33, verse 2).

The union leaders with the support of members, retirees of the business and several NGOs took this matter to the Mahkamah Konsitutsi (MK) or Constitutional Court
which repealed the privatization legislation relating to the electric power sector in 2004.\footnote{This case was the first case before the MK since its establishment in 1999.} “This took four years of self-funded work by the Union and NGOs. In 2005 the Indonesian Government introduced regulations, “Peraturan Pemerintah” (or Government Regulation) Number 3, of 2005. These were more or less the same as the legislation that the MK had repealed”, proposed Connie, while she showed me the news about her and this case in the main media newspaper, Kompas. There was support from the Ministerial level as demonstrated by a Ministerial Decree relating to the implementation of the new regulations. These contravene the decision of the Constitutional Court.

The management has accused Connie and Ellen of being too confrontational. Rino (one of the directors) said that the Union (of which Connie and Eddie are the leaders) should have a dialogue with the management. However, Connie refuted this statement. She cogently argued that:

“...this matter had previously been raised with the management of the State-Owned Power Company. It had been a prolonged matter running for six years. Earlier the electric power industry restructuring was Government policy. The Government had issued the white paper in which it stipulated that the electricity sector must be reformed hence it was necessary to enact legislation to support this. Parties who opposed this had taken the matter to the House of Representative (DPR), but the DPR sided with the Government. The government clearly mismanaged the privatization of State-Owned Power Company because it related to it as a commodity rather than part of the nation’s infrastructure, and thus of importance to the nation’s security and economic welfare which should be controlled by the Government and not allowed to come under the control of the private foreign sector.

These assertions were backed up by Ellen (participant interview, 2005) who said, “characteristics of the energy industry are like the human body with hands, legs, and a head. The Energy industry should also have its generator, distribution, transmission, and
sales sections”. She means that it is a bit like a body whose organs cannot be separated or else it dies; the power generation is now managed by a foreign company, distribution by the State’s Power Company, and sales by local private businesses. She explained, “the business chain process is getting longer because each part is controlled by a different person, and the government wants to privatize this company so as to create as many transactions as possible. Each transaction is taxed. This creates revenue for government but dumps a burden on the end consumers.”

Ellen categorized SOEs like the state electricity provider as necessities of life for many people. She said that “it is okay for other BUMNs like banks to go liberal because they are not as vital a resource as energy.” She argued that the old government was nationalistic which was more thoughtful of the nation than the current one, which is more capitalistic.

In the past the government and people could not manage until the electricity companies were nationalized. The government did it because they had a national vision, whereas the present government is capitalist and hence the business should be run highly efficiently, which excludes the use of top of the range vehicles.

“Originally [in the past] international businesses were nationalized, so the question arises why can the state-owned enterprises not be retained and liberalize? This would not be such an extreme measure. Electricity should be benefit-oriented, not profit-oriented. Profits are acceptable but not at the expense of social benefit,” posited Ellen.

Ellen and Connie asserted that those who agree with privatization are usually only at the level of director and immediately below it. The rest would just follow suit due to fear.

Ellen cast a different slant on the matter. She said that the privatization may lead to disintegration of the country because the removal of government subsidies that will
accompany privatization will result in an escalation in the price of electricity in regional areas, for instance in Sulawesi or Papua. She said that the vision adopted should be that of Bung Karno (the first President). Foreign privately owned enterprises should become domestically or nationally owned.

“SoEs are involved in a diversity of businesses from banks to airlines; from electricity to staple foods; from telecommunication to agriculture. The reasons for the establishment of SOEs are: to set up pioneering industries, to operate as market balancers, to manage strategic industries, and act as agents of development”, said Ellen (personal communication, 2005).

Ellen connected privatization with the disintegration in Indonesia saying that there was not a clear reason for privatization. The Unions consider that selling the stocks of a company is equal to selling the country itself. She gave the example of the city of Manado where the writers come from to demonstrate, calling attention to the plight of regional areas. In Manado, the price of electricity is expected to increase considerably if privatization occurs. Ellen provided a profound and thoughtful explanation. “This may well lead to disintegration. With liberalization/privatization, the government will not intervene further for provincial development, which will give rise to a distinct provincial spirit instead of a national spirit”.

In addition, to addressing union concern, there has to be caution when dividing and restructuring SOEs for sale because this causes uncertainty for union members as far as their employment is concerned.

6.3.6 Privatization from the Perspective of Directors

If the union leaders reject privatization absolutely, Rino said that it was necessary to move to a new paradigm. He said that the old paradigm was “We are part of the
government, and the government agency would never care if we gain or lose, but the new paradigm is that everything should be calculated”.

According to Rino, the privatization or the going public of the state power sector is not a new idea. His aim is to liaise with the capital market. In fact, at that time he was preparing two subsidiaries for privatization. In order to make a successful initial public offering, Rino said “we should be more prudent and avoid any slips of the tongue,... these will put the company at a disadvantage” (personal communication, 2005).

6.3.7 Javanese Culture within the Organization

The issues of Javanese culture were raised in this organization. The majority of the employees and management have Javanese cultural backgrounds. Decky explained that basically, Javanese culture is a good practice for the daily life outside the company. When these practices are brought to a company they will be in contradiction to the company’s operation. He gave the example that in Javanese culture it is considered impolite to refuse what a superior orders. The subordinate must obey even if the order is to the disadvantage of the company. Another example of bad Javanese practice is to hide what the superior has done wrongly. This does not support whistleblowers and transparency. Decky admitted that these Javanese practices occurred in a State Power Company branch in Province of Central Java (personal communication, 2009).

Also, it is perceived that Indonesian Army culture occurs in this SOE. Umi said that one member of the board of commissioners who had just been elected in 2009 had just retired from the Police29. He had been the Head of Jakarta Police Region. In addition, the researcher found that the Head of Internal Control of a State Power Company was a retired Police officer.

29 In Indonesia, the Police used to be a branch of the Army until 1999
The Soeharto regime had been in power for more than thirty years. This influenced many institutions in Indonesian society, including SOEs. Connie discussed this by saying what had occurred in the past was the cultural process, because the one regime had been in power for a long time. This had resulted in the acculturation of the nation (personal communication, 2005). Connie postulated that it was necessary to dismantle the culture that had been in existence for more than thirty years in order to introduce modern day corporate governance into SOEs a key to the development of a modern approach to good corporate governance in SOEs, and to change the culture that has existed for more than thirty years (personal communication, 2005).

Ellen explains the misuse of these Javanese practices as:

“…from my point of view it (ewuh pakewuh practices) is good if it used positively…the employee’s loyalty…but the leader is don’t be an… like Soeharto,…when he effectively succeeded [to] lead those who obeyed him, he made a crony and serve the project 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, mal-appropriation and distortion of Javanese culture and practice thrived during Soeharto’s reign in power. Charlie agreed with Ellen that during the decision-making process, there are still many bureaucrats who applied a top-down approach. Charlie explained that the reason for this is that the first order in SOEs is from the Army. Charlie used the words first order, reflecting the military culture embedded in this company. In addition to this, it was coincidently revealed that the union leader

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30 The participant used a taboo word. The researcher thinks this word should not be stated in this thesis.
(Ellen), and the commissioner (Charlie), who normally conflicted with each other\textsuperscript{31}, agreed that the operation of this company has a militaristic and bureaucratic style.

Charlie postulated that the SOEs’ culture is between that in the purely private sector and that in the government sector. It could be argued that an SOE is a company run by bureaucrats. An extreme example is that the Head of Internal Auditing in this State-Owned Power Company is a position reserved for retired police officers. Until now, there is still a system of reserving positions in SOEs by the government (Charlie, personal communication, 2005).

The researcher checked this information with Edi and Zull who confirmed it is accurate. They cynically suggested with giggles that he could be trained for the job. Inquiries of the Deputy Minister of SOEs, Sompi, revealed that the SOE required a military profile for the incumbent of the office of internal auditor.

\subsection{Management Behaviour and Culture}

It has become common in the government administration that decision-making is directed from above. This has flown on to the management structures in SOEs. However, since the downfall of Suharto efforts have been made to transform this.

According to Rino, his SOE could be changed from a top-down organization to a bottom-up organization as long as there is integrity and people trust each other (personal communication, 2005). However, in this SOE, it is not possible because people talk about each other, humiliate one another, and the company is not progressing. The culture in the company is akin to crabs in an aluminium pot with every one scrabbling and scurrying around, he explained angrily.

\textsuperscript{31}It is usual for commissioners, directors, or head of division level to not give the contrary statement against the shareholders or ruling government. Charlie is one of the commissioners.
At that time, the Minister of SOEs and the managements of SOEs travelled on a road show overseas with the intention of attracting foreign investment. Rino put the problem as follows: if the situation in his SOE continues it will be hard for the company to find investors.

Connie who had not been promoted for eight years and who is anti-management said that the culture in this company is not good. There are so many thieves that theft has become part of the culture. We know that until now, this company has remained unprofitable, many KKN practices have not been halted. The business behaviour is similar to the past, and still accommodates the interests of powerful people.

According to her, this bad culture has been building over a long period and is not easily broken down (she said decultured). She did not see the culture of this company changing, because the directors are government appointees. Management have the wrong mind set and frame of mind. She said that this is the craziness of corruption, collusion and nepotism. This is a cultural problem, and not the problems that are solved with management tools and techniques. In the beginning of the conversation she said that good corporate governance practices are no more than a different menu of management tools.

“I am happy with GCG, but to find out if it is going to be effective, we must know precisely the root of the problems”, said Connie. She gave the analogy of people having a cough because of the weather or because it is hereditary. This is a cultural problem that we have not touched.

6.3.9 Government Intervention

According to Charlie, Tim Penentu Akhir (TPA) or the Team of Final Approval is an organ of the Presidential office. The Annual General Shareholders Meeting of the
company recommends the appointment of directors to this TPA, however AGSM also take instructions from the TPA (Charlie, personal communication, 2005). Charlie admitted also that there are several politicians working inside the SOEs. Some of the respondents were agreed that most directors and commissioners, includes independent commissioners who sit on the boards, owe their positions to friendships and politics (Perry, Benny, and Rino, personal communication, 2005). Benny cannot refuse by stating that the Directors position belongs to the shareholders who are the ruling government (personal communication, 2005).

6.3.10 Government Intervention in Purchasing Capital Items

Even though this state-owned power is a separate business entity, the decisions are made by the government. This system of decision-making is already part of the culture in the state-owned power company. The government is the decision-maker and not the management of the company. Connie questioned the development of an 800-megawatt electricity generator in East Java that was completed in 1996. “It is not usable anymore because there is no gas supply. This is a crazy thing. How could someone build a mega project without a feasibility study? It is due to the project being built by the government only to benefit particular parties associated with the ruling power”, explained Connie.

This phenomenon is in line with the explanation given by Joko, one of the managers from the Central Java. He said that “this way the relationship between the government and business works where the government makes the business decisions has become part of the culture. The decisions are called policy meaning we must implement them. Even if feasibility studies have been made by the company, the decisions are in the hands of the government”.
This company is responsible to many government agencies such as the National Planning Agency (BAPENAS), the Minister of Mining and Energy, the Ministry of Finance, and the Ministry of SOEs, and the management is even proud of it, said Connie employing a cynical tone (personal communication, 2005).

A deeper and more thoughtful response came from Olly, who said the administration and even members of the government’s lower House of Representatives interfere with purchasing decisions in this company. In addition, he stated cynically that “…in this country many people want to own things that they are not entitled to”. Therefore, he insisted that the tender process for purchasing must be transparent. Umi gave similar views of government intervention. She said that the related ministers play directly in arranging and determining the procurement process (personal communication, 2009).

This is regardless of what Charlie has mentioned above regarding the implementation of e-procurement or e-auction. There is still government intervention during and at the end of the process.

Ellen, chairman of the labor union in the state’s power company, provided a different view of government intervention. Government intervention must exist in terms of responsibility for the people’s welfare. Therefore, she said it must be government intervention in terms of providing an overall benefit for the Indonesian people, not the making of profit for a group of individuals. The directors must be professional in attitude and behavior. What has happened up until now, is that there has been government confusion, where the SOEs’ directors have been ‘ridden like horses’ by the politicians. She gave an example. The candidates for directors’ positions are proposed by various political parties. If these are not approved by the government, then these parties would not support the government politically.
6.3.11 No Option Left

In the 1970s and 1980s, bribery grew rapidly and still exists in the government today. The ruling party asks for fees. SOE boards manage the tender processes so that the government received fees (Zull and Yunaedi). There are many opportunities to improve the State Power Company, but the culture has not changed at all. According to Connie, just like many participants in the television game show “Who Wants to be A Millionaire”, State’s power company has no more options which will enable it to be saved.

According to Connie, previously it did have options. These included stopping corruption, collusion, and nepotism (KKN), with financial assistance of 28.1trillion rupiah, and increasing the base electricity tariff. Connie said that the Malaysian electricity industry is profitable with a base electricity tariff of US$ 5.5cents/unit; but the Indonesian state power company loses US$ 7cents/unit. “It is due to high production costs rooted in KKN”, said Connie (personal communication, 2005).

6.3.12 The Union in the State-Owned Power Company

The Union is a significant factor in this company because they funded a legal case to the Constitution Court (it was the first case for this Court). No other union has taken such an action in Indonesia. The legal matters are usually resolved by internal arbitration in the case of disputes between the union and management. This path of compromise named jalan damai or path of peace (as explained in chapter 3).

According to Ellen, the union generally exists because of the legacy of legislation. The vision of the Union movement was to achieve a state of peace and welfare for all employees. Union members’ welfare should be in balance with the company’s profitability, basic wages, and pension pay. Under legislation Act No. 21 of 2000, there
are regulations about the relationship between the union, the company and the government. The union was supposed to be an equal partner in this relationship. However, one of the directors of this state-owned electricity company said that the union movement in Indonesia was “way over the top” (Rino, 2005). In this company, the union has developed a fierce and confrontational attitude and had become political. The Union said that they were a partner (as stated in the legislation) of management but Rino did not think this was or should be the case.

Rino complained that the union is still based on reformation-era rhetoric. The union still lacks understanding of the professional aspects and rationale behind professional business. They demand more and more and forget their obligations as partners of the management. He raised the issue that “in order to advance their own interests, the union was not hesitant in running a campaign utilizing the well-known saying *Amar ma’ruf nahi munkar* [Islamic concept of to do good deeds and prevent ill deeds]. This included giving the company a bad public image, which was completely outrageous,” said Rino (personal communication, 2005).

This particular labor union was officially protected by the law. The management cannot ignore them without some risk of legal proceedings being initiated by the Union. Rino compared the union in this SOE with unions in the United States, where union members are mostly well educated. If the union members are dismissed, they have a good chance of becoming an MP (Member of Parliament) or a politician in the Senate. The members have a view that politicization is a personally rewarding process. The idea of overt antagonism to achieve rewards was a worrying concept (Rino, personal communication, 2005).

Both the management and the Union have their respective duties and responsibilities.
For instance, a union leader said that when she was elected as a union leader she had to carry out the full range of duties of her position which did involve opposing the views of management as and when required (Ellen, personal communication, 2005). An example of this was when she disagreed once with a management staff member saying, “Hey, you should go to Irian [Province of Papua]”32. This is not the way issues are resolved traditionally in Indonesian culture. The tradition is that the two parties sit together to try and resolve the issue in face-to-face discussions. However, in many cases the management wants to demonstrate that they have the power in the decision-making process to prevail in any dispute. This does not accord with what is regarded as the checks and balances of good corporate governance. There should be a mechanism operating in the decision-making process where there is an examination of the arguments raised by opposing points of view. This example does demonstrate that management primarily operates in a top-down command and control approach and in effect often ignores the legal role of the union in the company.

On the other hand, the union has been accused of playing overt politics. For instance, it has been argued that employees have used the union as a political vehicle for opposing the management’s business strategies for the company. The employees are not board directors, according to Charlie (personal communication, 2005) and therefore are not the key decision makers in determining corporate strategy.

Ollie and Edy agreed with Charlie who cogently argue that the union members’ actions and behavior are basically confrontational. Rino put it differently by arguing that they ought to attempt to mediate before taking any matter to the media and/or police. They

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32 Irian (now called Papua) is very isolated area and threatenig to send someone there is a serious insult to them. It is common for civil servant to be transfer from the hub of Jakarta to a remote area if they transgress.
simply do not perform well upon securing “…a certain seat” in organizational matters (Rino, personal communication, 2005).

Surya, the Manager of Law Division, had a similar opinion about the extent of union involvement in the State power company. “Ideally, the union should have a good partnership with the company as a social control and be more understanding of employee needs such as a workplace that conforms to occupational health and safety requirements” (personal communication, 2005). It is not a union role to protest against the company projects. It is not good if the union is politicized. “Politicisation makes management uncreative and unsettled…”, said Surya. He gave as an example of this politicisation the situation where the union had reported unsubstantiated allegations about inappropriately authorized Board bonus payments to the Public Prosecutor office and the House of Representatives. If the union still had a true spirit of partnership it would not have made these unsubstantiated reports. In doing so, the union distanced itself from the business. He closed by saying that this type of action was primarily motivated by politics. However, this viewpoint was rejected by Connie (one of the key union leaders). She said that the current directors had been “…our friends” before they became directors. The board bonus called case was discussed formally in an official meeting with management as well as informally. However, the end result was that the directors did not want to withdraw their decision to award the bonuses detailed above (Connie, personal communication, 2005).

One of the managers states that it has become a well-known secret that people join the Union in order to obtain positions in Management. “If we don’t join the Union it is difficult to be heard and recognized because management looks to the union if there are matters involving workers”, said Johny (personal communication, 2006). These days,
the union wants to participate in the meetings of management. In the meetings, Union members are protesting against management policies or decisions. This will result in management giving a position to keep an employee quiet. It is not necessarily because management has made a mistake, but because management does not want the inconvenience of protests. This notion was supported by Charlie who more specifically explained that prospective members joining the Union are actually after senior job positions in the company (personal communication, 2005).

However, there are protests which do not result in positions in management but are punished by the management involved. For instance, Ellen, the head of the Union in this SOE, was removed from her position in Jakarta and transferred to Papua (Johny, personal communication, 2006 and Connie, personal communication 2005).

6.3.13 Excessive Bonus Case (Popularly Known as the tantiem Case)
There was a unique case during this study relating to the awarding of bonuses to the members of both boards and staff in the State Power Company in the study. This phenomenon resulted in protests, mostly from the Union in this SOE. Ellen, a Union leader complained that the bonuses should not be awarded when the company is in a position of bankruptcy. Also, Zull, (an internal auditor) explained that the bonus could be awarded because of collusion between the board of directors and board of commissioners. Those who set the salaries are RUPS (Rapat Umum Pemegang Saham or General Shareholders Meeting). According to Benny, the financial bonuses had already been agreed on by the directors and commissioners (personal communication, 2005). For salary, it may be fair between middle management and lower staff with the directors. However, as for bonus payments, this is not fair. Companies may go bankrupt. This is not right, there should be a legal process, Ellen
said. Each member of the board received the equivalent of US$ 40,000, and commissioners also received a bonus. This sense of disappointment and protest was reflected across a majority of the respondents. They did not agree with the awarding of bonuses. A complaint relating to the *tantiem* case was filed with the Police and the Public Prosecutors office by the Union. There was a subsequent lawsuit file in the courts.

Rino (Finance Director of this SOE) angrily expressed that this *tantiem* case should not have been brought outside the company. Benny supported Rino. He refused to accept what was said about the awarding of bonuses to the commissioners and directors. He said there are no rules or regulations relating to the awarding of bonuses. “So, why do those against the awarding of bonuses try to relate the awarding of bonuses to non-existing regulations/rules?” (Benny, personal communication, 2005). In addition, he concluded that all staff had also received bonuses.

Ellen (personal communication, 2005) postulated that it was setting a good example and strong leadership is required to eliminate corruption. For example, the current President needs to start with small matters. For instance the case of bonuses (i.e. *tantiem*) has already gone to the Public Prosecutor’s office. In this case, the company was clearly facing bankruptcy, but still paid bonuses, but there was no action by the Public Prosecutor’s office. “Well, it’s just another hollow slogan corruption eradication, said Ellen.

### 6.3.14 Sterilization of Frauds

Zull also raised the issue of the internal audit department. He cogently argues that the internal auditor had white washed some cases of fraud in this company. Cases of fraud had been found in the company and reported to the head of internal audit (the retired
policeman) and after investigation to the board of commissioners and board of directors meetings.

As explained by Zull:

“…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 with government officers, collude with internal auditors, checking by board of directors, and the report has been sterilized” (personal communication, 2005).

Elvy also referred to this issue in the following way: “…the directors will eliminate the corporate fraud if it involved the shareholders and/or influence stakeholders such as members of the MPs” (personal communication, 2005).

Some of the findings of the internal auditor will not be investigated any further. The common term for this situation is sterilization in which the financial report including the findings has been sterilized (cleaned up) before it is released. Sterilization is mostly used in the Amy to clear and save the area for the higher ranking officer interests including when there is an inspection or whenever the need arises.

6.3.15 Whistleblower Protection

The researcher raised the issue of whistleblower protection with participants by asking if there is any protection available for whistleblowers.

Charlie simply responded that there were no rules yet. Olly agreed with Charlie. She said that there was no whistleblower protection. These assertions were backed up by Connie. She continued to explain, that if employees kept complaining they would never get promoted.

Ellen gave a more profound and even more thoughtful response by telling about her
experience. She said that when an internal auditor makes a report concerning management fraud to the Directors, the directors happily receive the information. After this, they discuss the fraud with the regional general managers (who may well have perpetrated the fraud) with the result that the whistleblowers are transferred.

Johny, a postgraduate student in Australia, sent by this company to study abroad, supported Ellen’s information. He said that Ellen had personal experience of this. Additionally, he revealed that due to her opposition against the management in the liberalization of the energy sector Ellen was to be transferred to a geographically remote area. However, she resisted, and management has taken no further action up until this time. Ellen retired from this company, but retains a senior position in the company’s union. Recently (January 2010), Ellen and the union members refused to accept the appointment of a Managing Director from outside the company.

6.3.16 Independent Commissioners

According to Charlie, commissioners cannot be entirely independent in SOEs. He explained that it can be applicable in a company like Ford because it has dispersed ownership. However, in an SOE the government is the owner. Telkom, (a State Telecommunication Company that has already gone public) is government majority owned and there should be a government representative on the board of commissioners. In addition, he said that the laws relating to state owned enterprise stipulate that the audit committee should be independent. In other words, the commissioners do not need to be independent but the audit committee does.

6.3.17 Career Development

The system for career advancement is not clear in this State’s power company. Although there are employees who deserve to be promoted they have not been because
they have not been recognized by their superiors, on the other hand, there are those who have been rapidly promoted (Edy, personal communication, 2005). “Our rules are not clear, and are floating” said Edy. In addition, he said that those at the helm are always ITB (Institute of Technology Bandung) graduates, and that only once an ITS (Institute of Technology Surabaya) graduate has been promoted. There is an obvious primordial factor in this company. Decky agreed with Edy. Decky said that the management is alumni-minded, and the personnel department is not transparent in promoting employees (personal communication, 2008). This is an example of cronyism in this company that has been in existence for decades.

Zull and Edi said that if there is a graduate from a particular university in a senior management role he will favor graduates from the same university in career advancement and recruitment opportunities. This phenomenon may cause the changing of company’s policies because of changes in terms of directors and management (Personal communication, 2005). The promotions are determined by Human Resources personnel. According to Zull, people who are promoted have to be close to the HR.

If good employees are not promoted to management then “deculturalisation” cannot occur, said Connie (personal communication, 2005). “The road to that way is full of obstacles. It is not easy because the one at the top is the result of the culture that has developed for decades. The problem is management will appoint their cronies who will support them”, explained Connie (personal communication, 2005).

6.4 State-Owned Airline

6.4.1 Introduction

At the time the researcher visited this SOE for collecting data, the assassination of a human rights activist had recently occurred on a flight of this company to Amsterdam.
Some participants in this study and the security guard thought that the researcher wanted to investigate this case. It was later found that the company and its Managing Director (MD) were implicated in this matter. It was reported in the media that the involvement of the MD was investigated as well as the involvement of the national intelligence agency (Badan Inetelijen Nasional or BIN). Finally, after much debate about their involvement in the media, it was decided in the courts that the head of the BIN at the time of the murder was innocent of any involvement. However, the managing director of the airline at the time was found to be implicated in the matter.

The arrival of researcher in these companies made many of the personnel suspicious that the researcher was going to investigate these matters. There were different reactions shown by employees at each of the SOEs. In the State-Owned Bank and State-Owned Power Company were more responsive to the researcher than the employees at the State-Owned Airline. It was necessary for the researcher to explain to respondents that this study deals with corporate governance. However, the response from participants at the state-owned airline remained less than enthusiastic. As a result, the responses from participants in the State-Owned Bank and State-Owned Power Company are more detailed than those from the State-Owned Airline. In addition, there were greater numbers of willing respondents from the former two SOEs. However, in qualitative research, according to Professor David Tripp, a limited or no response at all is in itself a response (personal communication, 2006).

6.4.2 Corporate Governance: Participant Insights

Although there are signs of GCG in the organisation and there have been training seminars at various times the existence of GCG practices is not strongly felt (Opy, personal communication, 2005), or even forgotten (Karen, personal communication,
2005). “However, it will become a must in our business world now, especially with the new management”, (Opy, personal communication, 2005).

Although Karen is aware that the company has promoted GCG she did not remember what corporate governance is all about.

A meeting about GCG has been held in this company, and there was no objection to GCG. “We really want it to be implemented, especially the transparency” said Nova, one of the auditors (personal communication, 2005).

6.4.3 Disadvantages of Corporate Governance in the State-Owned Airline Company

Similar to some of participants in the State bank, some participants in a State Airline company also gave views regarding the disadvantages of the implementation of GCG. Hotma, a senior manager and Kathy, the legal officer at Head office in Jakarta stated that the implementation was just to make their operation more rigid. They said that it is difficult to take action or make a decision within the organization.

6.4.4 Javanese Culture

According to Tony, ewuh pakewuh (a Javanese term referring to high levels of tolerance) cannot be implemented by those in positions of authority in the government and the private sector. It occurs only in the family situation. In the Suharto era, a phenomenon occurred called iduku geniku (Javanese), meaning what Suharto said had to happen. There is an instance where the managing director of this company refused to follow Suharto’s instructions and was dismissed.

6.4.5 A New Managing Director from Outside

When the researcher visited the State airline company for the study, a new managing director had just been appointed. He used to be the finance director in this company
who was brought to the company by the previous managing director who had a
background in banking. These two managing directors both came from outside the
company. According to Tony, the reason that the government through the Minister of
SOEs appointed outside directors to the board of this company was “to save the
company from its debt” (personal communication, 2005). They appointed a managing
director with a banking background. He succeeded in restructuring the company’s
finances. Those in favor of his appointment as managing director were in fact in favor
because they were included in his management cabinet. Those against his appointment
were not included.

Later, the managing director sold off company divisions such as catering and
maintenance that were not operating profitably. As a consequence of this, some
employees were made redundant. This was unsatisfactory to these employees even
though they received golden handshakes. This became a major issue in the company
and was ascribed to the managing director having come from outside the company and
not appreciating the family-like culture in the company. The managing director who
separated some functional departments of the company and incorporated them into new
business entities with the intention of making them public companies. This situation
caused a divide between management and the workers.

Another view comes from Karen, a sales manager for the airline. According to Karen, it
is not a matter of whether the managing director comes from inside or outside the
company. It is how they achieve the goals in making a profit. It is obvious that, for
example, the managing director from outside the company is good, but this does not
mean that an MD from inside the company is not good (personal communication, 2005).
She admitted that there are weaknesses in some issues. “In my personal opinion, we are too far removed from the market, so we are not market-oriented enough. We need to improve sales. So our planning, organization, and coordination concerning management strategies should be directed at achieving better sales results. It was not like that in the past”, said Karen. In addition, she stated that the airline in the past claimed to be market-oriented but in fact was not.

Roy likes the MD who came from outside the business. He cogently argued that the employment of a professional such as Robby Djohan, a professional banker who was the first outside MD, is really conducive to the process of change.

6.4.6 Privatization

Similar to the State Power Company, the issue of privatization is significant in this company. According to Tony, the priority should be given to offer new businesses to other SOEs and employees. The restructured company is profitable so why not sell inside the business? He compared the business to a Malaysian SOE, namely Malaysian Airline System (MAS) which is three times less profitable than this company, which is underwritten by the Malaysian Government and not being publicly floated.

Roy agreed with privatization because of globalisation. He said that the institution of the airline company is not about the ownership; with privatization there is a chance of better management that will result in a more professional and competitive company, but if it is state-owned it will not be competitive. He continued by giving the reason that SOEs are influenced by macro-conditions: social; political; and economic conditions, but if it is a public company responsibilities are more clear and there is transfer of knowledge (Roy, personal communication, 2005).
6.4.7 Government Intervention in Purchasing Capital Items

There are some forms of government involvement in each of the three SOEs. Kathy (personal communication, 2005), from the legal department of this company stated that a tender process is determined by those who owned this republic (i.e. the Government of Republic of Indonesia). Even the technical department, the Department of Transportation, which is run by bureaucrats determined the fleet plan and thus which aircraft we will purchase or not purchase, the problem is that if they formulate a flawed fleet plan, it will have disastrous effect for the airline’s business. This is because the airline business is dependent on the routes, and a suitable fleet must be selected.

In addition, she described that in the past, this company was managed independently. The company had reported on an ad hoc basis to the Ministry of Transport only, not to the Ministry of SOEs or Parliament. However, now it must report formally to the Ministry of Transport. Also, the Ministry of Transport and other related Ministries having a connection with this interfering in the management of the company. According to Kathy, the involvement of other Ministries should be for the purpose of granting permits or licenses only. Now, even just for small purchases, the company has to have permits from the other ministries. Finally, we have to bribe high ranked officials in other Ministries, and the purchasing and selling of assets is not done freely.

According to Opy, there is a regulation for controlling the awarding of free tickets. The government cannot give out tickets as freely as it did before. Opy gave the example of how previously the Minister of Transport had ordered the company to release many free tickets to several organizations of women that had connections to the Minister of Transport. Another example, from Karen, was the managing director of the business giving free tickets to people in the offices of various Ministers for political reasons.
Under the new management the situation is changing. Instead of free tickets they issued discounted tickets to high-ranking officials, as an incentive to develop further business (Nova and Karen, personal communications, 2005).

6.4.8 Union

After the reformation in 1997, the employees in an airline SOE left the KORPRI or state union (formed by Suharto) and formed their own union. According to Heny, one of the managers and union member, the employees are more free to express differing opinion compared to when they were members of KORPRI, which was dictated by the management and the shareholders. She continued that the members of the union can call the board of directors when there is a case that requires response. In this SOE, the union has a representative from senior level management, usually the Director of Human Resources (personal communication, 2005). In this SOE, the union is strong and highly structured. There are various departments in this SOE for example for pilots, for cabin crew, ground crew and the like, and each has its own union. This contrasts with the other SOEs in this study where there is only one union for each SOE.

Heny posited that the union is needed to control senior management, because according to Indonesian culture it is not considered correct behaviour for subordinates to criticize their superiors. However, with the union the gap between subordinate and superior disappeared. The problems can be brought to meetings between management and union. In these meetings, subordinate can sit alongside managers (who are their day-to-day superiors), on the same level. Heny said “hence the union neutralizes the gap” (personal communication, 2005).

However, Karen has a different view of the union’s members. She said that the union sometimes misrepresents the members’ views to the management. In fact, the executive
of the union presented their own views as being the views of the union to management in order to obtain positions (Karen, personal communication, 2005).

6.4.9 Career and Development

Regarding the Career and Development issue, Roy (newly appointed as a public relation manager) shared his bad experience. He believed he was being treated unfairly by his previous manager in respect of study leave. Although he had been selected for study leave by the company, his manager declined to authorize it. According to Roy (who was very upset) this was unfair.

The unique case experience in this SOE features in a certain floor of the head office building, where there is a group of employees who use this floor to meet. According to Hotma and Kathy, this group of employees is popularly known as “the Malvinas gang”. They are a group of employees who have no position or job (jobless within company). They are the outsiders Managing Director. Their career is stagnant. However, only Hotma and Kathy bring up this issue, other participants are reluctant to give comments. Hotma and Kathy or other participants are not sure where this name (Malvinas) come from. This indicates that this phenomena has existed for quite a long time in this SOE.

6.5 The Minister of SOEs

In addition to collecting information from the three organizations, data was also gathered from the Ministers of SOEs. There were two participants interviewed: Gina and Sompie.

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33What the researcher understands about the name “Malvinas” is after the Malvinas or Falkland war which was a popular news item in Indonesia. Also, for the certain Indonesians the perception of Malvinas is used for the marginal people. In this case, “Malvinas gang” is a derogatory phrase signifying a group of unpopular people.
6.5.1 Corporate Governance Adopted from the Western System?

Gina said that she had seen the practices that had been implemented in Indonesia, and considered them as too much aligned to the West, especially the OECD and America. The code of conduct issued by NCCG supported by legislation and Ministerial decree specified which system from outside the country should be adapted to suit local conditions. When it is implemented in Indonesia’s SOEs there are many aspects that do not match these local conditions. For instance, the code of conduct for the audit committee talks about commissioners in English (i.e. using the plural form) but in Indonesian SOE there is only one independent commissioner. In the audit committee, there should be more than one independent commissioner according to the OECD model. It does not match the Indonesian model, which requires 20% of the commissioners to be independent. For example, there are five commissioners in each SOEs and this means only one independent commissioner.

Another point concerns salaries. If the standard is followed, salaries have to be transparent. This is fair, however if the salaries of highly paid executives are generally known there may be a problem of family safety, and this needs to be considered.

In America there is a one-tier board of director system while Indonesia there is a system involving two-tier board. In the latter, the board of commissioners functions in an advisory and supervisory role only. The members of the board of directors are executives of the company. In a one-tier system, members of the board can be executives as well as having an independent supervisory role.

6.5.2 Government Intervention

Sompi 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, meaning that
there can be no grey area. Frankly, I also know only a person who has a military background who is able to do that” (personal communication, 2005). Similarly, the rationale behind the placements of bureaucrats in SOEs is that they (the bureaucrats) have gained the experience in their field (e.g. state finance budget) and it is assumed that they are more capable of managing SOEs (Sompi, personal communication, 2005).

6.5.3 Privatisation

The support for privatization and liberalization comes from middle and senior management as well as the Deputy Minister of SOEs and her staff. Sompi (Deputy Minister of SOEs) and Gina (a Ministry of SOE middle manager) both argue that privatization is the only way to change what has been identified as the traditional corporate culture and government interference in SOEs (Sompi, personal communication, 2005; Gina, personal communication, 2005).

Gina puts this succinctly as: “The State no longer runs the business; therefore privatization is important to bring professional business people into the organization” (personal communication, 2005).

6.6 The Deputy Director of Corruption Eradication Commission

There are many participant responses about corruption relating to SOEs. Therefore, the researcher decided to collect data from the Corruption Eradication Commission or Komisi Pemberantasan Korupsi (KPK) office. To get the participation of the KPK, the researcher requested a colleague to arrange an appointment with one member of the KPK who became a participant named Ferdy. He was Deputy Director of KPK at the time. He had worked in several SOEs over a period of 12 years. His last position was Managing Director of a State-owned mining company before joining the KPK.

Ferdy explained that the main problem for the implementation of good corporate
governance was to develop a good working culture. It takes a long period of time to establish a good working culture. This is more difficult than the adoption and establishment of a system. Ideal leadership in government offices including SOEs should reduce the levels of corruption. He gave the example that a leader should firmly commit to, and not accept money from a supplier. If it is consistent, this measure can contribute to good working culture.

In addition, Ferdy expressed the view that the corporate governance concept should not be like a template. If it is, it results in a top-down approach and would not be suitable for the different type of SOEs. There should be a bottom-up approach, the stakeholders, mainly employees, need to be involved in designing the corporate governance concept (personal communication, 2005).

6.7 Conclusion

The findings in these three SOEs’ study are similar, although each SOE has its unique issues. This chapter has discussed issues from the three SOEs, the Minister of SOEs, and the KPK. Conclusions relating to case studies of the three SOEs are:

1. The understanding of corporate governance in the three SOEs is not particularly strong at the lower level in the three businesses. However, at the senior levels there is already good understanding of GCG practices, but in the implementation there are still weaknesses. This can be seen from the cases of corporate fraud that have been described in this chapter.

2. The organizational culture occurs in these three organizations is still influenced by Javanese culture.
3. The code of conduct in the state-owned bank allows the acceptance of gifts valued at less than one million rupiah (A$100). This leads to the opportunity to accept bribes.

4. The hiring of the new managing directors from outside the organization resulted in various responses. In the State-Owned Bank, strong resistance came from the senior and middle level management. In the State-Owned Power Company, the appointment of an outside MD was not an issue until the recent case of appointing a new MD from outside who has a background in private business and politics. This strong resistance came from the union. In the State-Owned Airline, the appointment of the MD from outside the company met no resistance.

5. The MD’s hegemony was felt strongly in the State-Owned Bank and State-Owned Power Company, but not in the state-owned airline.

6. A variety of government interventions occurred in the three SOEs. These occurred in the appointments of the boards of directors and commissioners, the purchase of assets, and some pricing decisions.

7. The privatization of the State-Owned Power company met with strong resistance from the union, but this did not occur in the State-Owned Bank and the State-Owned Airline.

8. Intervention in management decisions and protests by union members occurred in each of the SOEs studied.

9. The need to have a compliant approach to management is a factor in career development, and this is felt to be unfair by employees in each of the SOEs.

10. There have been no whistleblower protection rules yet in the three SOEs.
Table 6.1 shows the emerging issues that occur within the three SOEs in the study according to the in-depth interviews of respondents. These issues will be analysed in Chapter 7.
Table 6.1 Emerging Corporate Governance Issues in Indonesian SOEs

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<thead>
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<th>Emerging Themes of:</th>
<th>State-Owned Bank</th>
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Notes: The emerging themes are rated by the number of symbols.
7 Chapter – Analysis of Indonesian SOEs – The Internal Stakeholders Behaviour and Perspective

7.1 Introduction

The purpose of this chapter is to answer the four research questions presented in chapter one of the thesis. They are:

1. How is corporate governance currently being practiced in SOEs in Indonesia?

2. What are the problems that hinder the implementation of GCG in business practices in Indonesia, and why?

3. What are the national and international imperatives driving current changes of corporate governance in Indonesian SOEs, and, what are the ramifications of these changes?

4. In view of the Indonesian corporate culture and business practices, how appropriate to Indonesian SOEs are the current corporate governance policies being disseminated by the government?

The researcher analysed the main findings from the participants from three SOEs. It comprises two parts. Along with the analysis, the theoretical background, stakeholder theory, the societal culture, corporate culture and legal culture in the previous chapters are taken into account in analysing the findings. The researcher also established the main factors that have direct bearings on and then influence current corporate governance practices in Indonesia (Figure 7.2). In this chapter, it is also discussed that the stakeholder theory is the more appropriate approach compared to agency theory in

34 The 5th research question is to be covered in Chapter 8.
analysing the corporate governance in SOEs. The following Figure 7.1 presents the chapter outline.
Figure 7.1: Chapter 7 Outline

Good Corporate Governance Equates to Greater Bureaucracy?

The Adoption of One-Tier System into Two-Tier System - Quo Vadis?

Corporate Governance inside SOEs: Form over Substance

One Size Does Not Fits All: Practical Implications

Indonesian and Javanese Society and Cultural Practices that Influence Business Culture

The Dilemma of Independent Commissioners

- The Busy Corporate Life of Independent Commissioners in the SOEs
- Independent Commissioner in the State Power Company Case Study
- Independent Commissioners in State Bank Company: a case study
- Board of Commissioners in the SOEs: Are they independent?
- Double Standards for Independent Commissioners in the SOEs
- Audit Committee in the SOEs
Corporate Governance Practices of Two Boards Members

- Decision Making Powers: Corporate Cultural Aspects within Organization
- Strange Issues at Board Meetings
- Unscheduled Board Meetings
- Domination of the Two Boards: Supporting the Study
- Lack of Accountability and Transparency in Remuneration Decision
- Two Fold Problems in Accountability
- Collusion between Two Boards and Government

The Ruling Government’s Interests

- The Final Evaluation Team: The Government Intervention
  - Bureaucrats and Non-Active Army Personnel

Privatisation issues in the Indonesian SOEs

- Privatisation and the Indonesian Constitution
  - Privatisation: Is It Another Form of Collusion?
  - For and against Privatization
Figure 7.1: Chapter 7 Outline (continued)

- **Stakeholder Theory**
  - The Implication
    - Stakeholder Approach to Change Corporate Culture

- **Union**
  - Transforming KORPRI to Union
    - Union Members’ Behaviour
    - Those not favouring the Union
    - Supporters of the Union
    - Opportunistic Supporters

- **Lack of Mechanism to Guard GCG Implementation**
  - Whistleblower versus the Javanese Culture
  - Checks and Balances: the Implications in SOEs

- **Conclusion**
Figure 7.2 Factors that Influence Corporate Governance in Indonesian SOEs

Corporate Governance in Indonesian SOEs

- External Factors:
  - Government Intervention
  - Political Intervention
  - Societal Culture
  - Legal Culture

- Internal Factors:
  - Corporate Culture (Javanese Cultural influences)
  - Board Behaviour
  - Employee Behaviour
  - Union Role

- International Pressure:
  - Transparency
  - Accountability
  - Fairness
  - Whistleblower Protection Mechanism
  - Independent Directors
  - Committees that Assist the Board

- Does One Size fit all?

- Stakeholders
7.2 Good Corporate Governance Equates to Greater Bureaucracy?

According to some of the participants across the three SOEs studied, the implementation of GCG is creating greater levels of bureaucracy in the organisations. These participants were senior management of the State Airline company, one of the branch managers of the State owned bank company, and one of the managers of the State Power Company who claimed implementation of GCG is just creating increased bureaucracy in the organisation.

A different view was given by one participant from the State power company who said that GCG practices from the West is just another “menu of management flavour”.

The researcher postulates that the management in the three of SOEs studied have the wrong perception about GCG. GCG is not about creating greater levels of bureaucracy, but about eliminating mismanagement and corporate frauds in SOEs. Solomon and Solomon (2004) argues that the key determinant of GCG is good behaviour on the part of boards. If there is good behaviour on the part of board members there will be good corporate governance. If there is bad behaviour on boards there will be bad corporate governance. This is because the attitude and the behaviour of the board helps to create the organisational environment in which their behaviour will be mirrored by other employees. This impacts on corporate culture.

Businesses in Indonesia which are majority owned by families are in some respects analogous to the Indonesian SOEs in this study. The State owned bank company is 73% Government owned, the State Power Company 100%, the State Airline company, 64%.

Prabowo and Simpson (2011) find that in listed family companies in Indonesia there are ineffective independent commissioners. This is because independent commissioners in these situations are usually family members. This is analogous with the situation of
independent commissioners in Indonesian SOEs where there is a political relationship between the commissioners and directors, and those responsible for their appointments.

7.3 The Adoption of One Tier System into Two a Tier System-Quo Vadis?
The Indonesian Government is intent on implementing the best of good corporate governance practices in Indonesian SOEs. The government equates this with the adoption of the principles of GCG from the West in SOEs. Gina, one of the respondents said that this is an overkill on the part of the government. The principles of GCG are sound but, she is of the opinion that not everything from the West is applicable to the Indonesian situation. The adoption of GCG practices from western countries entails the adoption of the one-tier system commonly in use in the west into the Indonesian context where all limited companies by law must employ a two tier system. The task of the board of directors in a one-tier system is the supervision of the executive directors and senior management, meanwhile in Indonesia the term board of directors refers solely to the executive directors whose tasks are to operate and manage the company in its day to day activities. Furthermore, the chairman of the board of directors in a one tier system could also be the chief executive officer. Such a situation cannot occur in an Indonesian company. In the Indonesian context the position of chairman of the board of directors (managing the company) and of the board of commissioners (supervising the directors) must respectively be held by a different person (Indonesian Company Law Number 40, 2007).

In the one tier system, it is highly desirable to have independent directors to ensure that GCG practices are adhered to because there is no independent supervisory board to ensure that checks and balances are carried out properly. In a two tier system company, on the other hand, the presence of an independent supervisory board dispenses the need
for independent directors for the management board. Checks and balances in corporate
governance are ensured by the supervisory board that is known in Indonesia as the
Board of Commissioners.
One of the respondents from the Ministry of SOEs pointed out a problem in adopting
the OECD code of GCG practice designed for a one-tier system without modification
for Indonesia’s two-tier system. She stated that under Indonesian legislation (in 2005),
20% of the members of the Board of Commissioners must be independent. If 20% of
the members of the board of commissioners must be independent, it means that up to
80% or 4 of the members are not independent. Eighty percentage points are deemed to
be a majority for the board of commissioners. If they are not independent, the question
arises as to whose interest they act in. The stakeholders may wonder for whom the non-
independent commissioners work for. Do they work for the government or the
incumbent president who appointed them? Or, do they work only for their own benefit.
The intention of the legislation is unclear.
One could argue that the adoption of the OECD code of conduct of GCG practices in
the Indonesian code of GCG by the National Committee of Corporate Governance is
without merit. The Indonesian legislation clearly stipulates that the independence of the
members of the Board of Commissioners and the specification of independent directors,
at the management level, is unnecessary.
Another phenomenon of ‘over kill’ occurs in the adoption of the OECD code of conduct
of GCG practices in the Indonesian code of GCG by the National Committee of

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35 Before year 2007, the Indonesian legislation required 20% of members of the board commissioners
must be independent as stated by one respondent in 2005 when data was collected. But, in 2007 the
legislation is changed to 30%.
36 Much Indonesian legislation is unclear or ambiguous. In addition, Indonesia has Adat (customary) law.
One of the principles of Adat law is decision making through consensus (Tabalujan, 2002). This principle
is mostly used by the society in solving some legal problems.
Corporate Governance. This code specifies the appointment of independent directors in a one tier system, that at least two thirds of directors must be independent. In the Indonesian two tier system this provision is redundant because under Indonesian legislation members of the supervisory board i.e. the board of commissioners must be independent. Indonesian SOEs adopt the provision of ‘independent directors’ in one tier system as ‘independent commissioners’. It is not necessary to have independent commissioners, since all members of the Board of Commissioners must be independent according to legislation.

According to Yu (2012, p. 211-229) there are two major styles of corporate board structure around the world: the Anglo-American style and the German style; also known as ‘one-tier system and two tier system’ respectively. Generally, in the Anglo-American style the board of directors and several sub committees watch over the management. The German style utilizes a supervisory board to watch over the management board which is directed at operating the business (p. 212).

According to Indonesian company law, Indonesia adopted the German two tier system. However, in reality, in SOEs’ the development and implementation is like the one tier Anglo-American model. Indonesian SOEs have installed independent commissioners and created several sub committees to watch over the management. It is an over kill and a knee jerk reaction in response to GCG practices demanded by the IMF and World Bank. A study by Kato after the financial crisis in the economy of Japan in 2008, discovered that only approximately 100 companies or about 5% of those listed on Tokyo Stock Exchange implemented board sub committees (Kato, 2012, p. 1)\(^3\).

\(^3\)Kato’s study indicates that there are more companies in Japan that want to use stakeholder approach rather than shareholder approach.
7.4 Corporate Governance inside SOEs: Form over Substance?

Can the importation and implementation of GCG from the West replace the current SOE practices which have existed for a long time in the Indonesian Republic? The external consultants who were involved in formulating GCG did not fully appreciate the business culture of SOEs. This culture has largely hindered the adoption of GCG practices. The new corporate governance model is not being effectively absorbed into the corporate culture of the SOEs. It is an ‘outsider’ model that has been transplanted into SOEs by the government without first studying thoroughly the existence of the real problems that are more closely related to management misbehavior and the need to eradicate KKN. However, the current directors and commissioners are supportive of the implementation of this new corporate governance system. This was clearly evidenced in their responses during the interviews that were conducted in this study. It must be appreciated that these directors and commissioners are appointed by the government representative during General Shareholder(s) meetings. As such they are merely an extension of the government’s hand.

It can be argued as well that corporate governance reforms in Indonesia are simply knee-jerk political reactions. Knee-jerk political reactions are discussed by Holloway and van Rhyn\(^{38}\) in the case of the Sarbannes-Oxley Act in the USA in 2002 (2003,). By imposing the adoption of GCG, politicians can be seen by the public as making a large contribution to reforming the Indonesian corporate culture. The reform of corporate governance in Indonesia has occurred, at least in part, because of public demand for greater transparency and accountability in Indonesian public companies. Wong (2004) posits that there are three significant problems in corporate governance

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\(^{38}\) Holloway and van Rhyn argued that the corporate governance reforms in USA were a mere political reaction that needed to be seen as such by the public (Holloway and van Rhyn, 2003, p. 2).
SOEs in Indonesia. These include “conflicting objectives, political intervention and lack of transparency” (Cited in Wicaksono, 2008,). The findings of this study suggest that while corporate governance has strengthened, there is still the problem of misbehavior by management. Fraud and even failures continue to occur. Rosser (2004,) suggested that Indonesian companies may well have converged towards the international GCG practices but only in form not in substance (Worang and Holloway, 2006).

7.5 One Size Does Not Fits All: Practical Implications

As a result of the IMF providing assistance to Indonesia, it imposed conditions on these assistance packages. These included the adoption of good corporate governance practices adopted from the OECD model. This model is based on four pillars of responsibility, accountability, fairness, and transparency.

The Government of Indonesia instructed SOEs to adopt the OECD model. According to one of the participants, the SOEs hired a consultant to conduct training, information seminars, even to the extent of placing framed posters of the four pillars on the walls of offices and corridors. However, the OECD model is based on Anglo American corporate culture and this one size fits all model does not necessarily transpose readily to other business cultures.

In order to implement GCG that is adopted from the West various obstacles need to be overcome. The obstacles to the implementation of GCG have their source in SOE corporate culture. These cultural practices do not fit with the four pillars of good corporate governance practices in the OECD model.
7.6  **Indonesian and Javanese Society and Cultural Practices that Influence Business Culture** 39

The current culture in Indonesian businesses, particularly in Indonesian SOEs does not support the adoption and implementation of good corporate governance practices from Western nations. As has been discussed in the previous findings chapter, some respondents expressed in interviews that Western good corporate governance practices cannot be implemented in Indonesian SOEs because the corporate culture is different to that which exists in business in the West.

According to Sultan Hamengku Buwono X (the King of Java) 40, Indonesia is submerged under 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). Thus, inappropriate behavior often becomes the accepted way of doing things. This has come about because key elements of Javanese society and culture have been absorbed (and perhaps taken over) into Indonesian society and culture as a whole.

It has been argued that the former president of Indonesia, Suharto misused Javanese culture during his 30 year tenure. Further, this led to the wide spread corruption that developed in the fabric of Indonesian society during his tenure as president.

Ellen expressed the opinion that Indonesian leaders have wrongly used some aspects of Javanese culture out of self-interest (personal communication, 2005). This enables

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39 This section draws heavily from “corporate governance in Indonesian State-Owned Enterprise: Feeding with Western Ingredients” (Worang and Holloway, 2006).

40 Although Indonesia is a republic with an elected president, a large portion of the Javanese society still recognizes the ancient kingdom of Java. Hamengkubowono X, the current Sultan of the Sultanate of Yogyakarta also holds the elected position of Governor of the Special Territory of Yogyakarta.
exploitation to occur because in this culture subordinates are completely obedient to superiors. This exploitation has resulted in a lack of transparency in Indonesian SOEs. Another aspect of Javanese culture existing in Indonesian SOEs is a relatively high degree of acceptance among employees of the supposed high status of various senior people in SOEs. This arose under Suharto’s regime (Polce, personal interview, 2005). In addition, in the Suharto era many employees developed a tolerance towards their superior. This acceptance arises from the phenomenon of *Nrimo* (Javanese language). This is an aspect of Javanese culture which means just accepting one’s fate. This may be akin to fatalism in western society. *Nrimo* hinders the introduction of good corporate governance practices in Indonesian SOEs.

Obedience and respect for seniority in management are regularly practiced in the various castes of Javanese society (Koentjoroningrat, 1985). Thus, in business organizations it is difficult for stakeholders inside the organization to be critical of their fellow employees and members of the management. In addition, according to Tugiman (1998) the word no is not in common use in Javanese culture and especially not common in respect of government business.

Priambodo (2004) suggested that in SOEs a culture of paternalism and “the leader is always right” prevails. The management treats employees as if they are children. The employees do everything to concur with their superiors’ wishes and thus keep them happy. This phenomenon is known as *asal bapak senang* (ABS or as long as you’re happy, sir), and still exists in SOEs. With a culture of ABS, employees are motivated at every level to keep their superiors happy. So this may and does result in employees concealing the truth from their superiors if it is likely to make them unhappy. The consequences of these phenomenon become apparent in board meetings and day to day
business operations of the SOEs in Indonesia. Javanese culture is good in society, but it
is definitely not appropriate in business. The modern business practices demand high
levels of accountability, not merely in accordance with cultural responsibility and
feelings.

To some extent, 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
compliant to the culture of the management that often includes managerial misconduct
within the company. The Javanese management style is entrenched in SOE corporate
culture. It has been abused and twisted to such an extent that ‘poor’ corporate practices
and management misconduct is publicly perceived to be the normal way of doing
business within SOEs. Respondents agreed that Javanese culture is deeply embedded in
SOEs (Polce, Johny, Opy from a State owned airline, Kade and Yani, from a State
owned bank, Roy and Ben from a State owned Power Company, personal interviews,
2005). This is in line with the following comments about Indonesian business and
bureaucratic practices:

“Our bureaucracy is a colonial and feudal legacy. The employees and staff wanted to
serve the kings’ or Dutch (occupiers) interests rather than the society’s. It has not
changed and it is the same now” (Birokrasi & Feodal, 2007).
7.7 The Dilemma of Independent Commissioners

7.7.1 The Busy Corporate Life of Independent Commissioners in the SOEs

One of the issues facing independent commissioners in Indonesian SOEs is whether they have sufficient time to make useful contributions to the company’s affairs. It is unlikely for an independent commissioner who serves on a large number of boards that he/she will have sufficient time to contribute meaningfully to each company.

In Germany, someone who sits on a supervisory board is permitted to sit on a maximum of nine others; the average is 2-3 seats (Baums and Birkenkaemper, 1998). External directors who have three or more seats contribute little monitoring to the companies (Fich and Shivdasani, 2006). Independent or non-executive directors (or independent commissioners in Indonesian companies) may be busy people sitting on many boards and having little time to act truly independently of management (Andres et al, 2011; Hart cited in Nowak and McCabe, 2003; Kakabadse et al, 2010). Another reason why a commissioner, who does not sit on a number of boards, and not make a meaningful contribution is because he/she may have a very demanding job in other arenas. In conclusion, Fich and Shivdasani (2006) state that boards that have a high proportion of directors from outside the company, who also serve on multiple boards, are likely to have a reduced quality of corporate governance processes.

7.7.2 Independent Commissioner in the State Power Company

In this study it was discovered that one of the independent commissioners of the State Power Company of Indonesia that enjoys monopoly on power generation and distribution was also the dean of a faculty at one of Indonesia’s largest public universities. This is an example of a commissioner who has a very demanding job in another arena.
In the researcher’s experience as a member of a faculty in an Indonesian university, the demands on a faculty dean’s time in their university role does not allow sufficient time for him to sit on a company board. The particular situation of this dean of the university requires a considerable amount of his time to attend to government matters as well as his academic responsibilities. As a consequence the dean of the university in question does not really have enough time to devote to his academic duties let alone to be an effective independent commissioner.

Furthermore, university deans or academics in general may not have the required skill and experience that allow them to make a useful contribution as independent commissioners in a business or industry. Therefore, the contribution to companies by academics may be minimal.

In addition, this energy company is the only company which distributes power across Indonesia which had a population of 234 million as of 2010. By comparison Australia with a population of around 21 million is served and managed by a different Power Company in each state. The Indonesian State Power Company is a huge company that requires capable commissioners who can fully devote their time and energy to their duties as independent commissioners.

7.7.3 Independent Commissioners in the State Bank Company

The contribution of independent commissioners is also being questioned in the State owned bank studied. A complaint of the Head of Internal Auditor in one of the State owned banks relates to the fact that one of the independent commissioners has never been present in his office. This situation creates jealousy among permanent management.

41 The dean is often consulted by relevant government departments for advice
staff who rightly thinks that the independent commissioners receive a handsome remuneration but contributes very little to the company.

There is an understanding in Indonesian business circles that independent members of the board of commissioners are similar to other commissioners and members of the management boards and there is an expectation they should attend the office on a regular basis to carry out their duties as commissioners. The two of the respondents from the internal audit department in the State power and State owned bank companies were critical of the fact that the independent commissioners did not regularly attend the office. They believed that this state of affairs has implications for the amount of expertise which independent commissioners could bring to their roles. Moreover, the independent commissioners would not be fully up to date with the company’s current situation. If the independent commissioners do not come regularly to the office and just come for meetings held in the office or venues such as a restaurant or a golf club\(^\text{42}\) that are arranged by a phone call or on the whim of the chairman. Regretfully the spontaneous telephone calls to arrange for a meeting is entrenched in the Indonesian business, government and social culture. The failure of independent commissioners to regularly attend the office brings into question the source of the knowledge upon which they base their deliberations and decisions.

The headquarters of the three SOEs studied are located in Jakarta. According to Tedjasukmana (2009), the city of Jakarta is notorious for having sense of the worst traffic snarls in Asia. It is likely this situation limits the movement and time of those independent commissioners who have their main office outside the SOEs. This situation might have influence on the performance of commissioners. Video conferencing is

\(^{42}\) The researcher discovered during the interviews that a board meeting is often called on an ad hoc basis.
generally still not acceptable in Indonesian major businesses because of the importance placed upon face to face meetings.

7.7.4 Board of Commissioners in the SOEs: Are they independent?

Boards of commissioners are often considered to be ineffective. This may be attributed to the fact that some commissioners have failed to maintain their independence by protecting the interests of majority shareholders over the interests of all stakeholders. In many cases members of boards of commissioners are appointed on the basis of their relationship with majority shareholders, including family or bureaucratic ties.

The researcher found on the State-Owned Bank website (2013) one particularly disturbing piece of information. One of the members of the Board of Commissioners in this bank currently also serves as a Senior Advisor to the President of Republic of Indonesia in the area of Political Communications. The two respondents, Komeng and Donny (personal communication, 2012) agreed that commissioners’ functions and activities are often the embodiment of the extended hand (reach) of the ruling government. The ruling government or the ruling party has significant interests in SOEs and it used the appointment process to ensure that its preferred candidate(s) is appointed as a board member. In this way the appointees are in a position to influence and protect the ruling government’s interests (Komeng and Donny, personal communication, 2012). This situation is not surprising since it has been exposed in the media. The media in fact describes the SOEs as the automatic teller machine (ATMs) and cash cows for the ruling government (Republika, 2012; Iskan, 2012a).

Perry and Gina accused the government of embedding its interests within SOEs’ board decisions (personal communication 2005). This fact makes it very difficult for commissioners to be independent since they are expected to wear two hats. In this
predicament, in certain situations they are expected to be completely independent whilst in others they are expected to show favours to benefit particular interests. This suggests the acceptance of double standard in the expectations of commissioners. Naturally it is inappropriate and contrary to the letter and spirit of the law.

The issue of lack of independence appears again when remuneration of the board of commissioners is determined by the board of directors (Kurniawan & Indriantoro, 2000). If an independent commissioner’s salary package is determined by the board of directors, it is possible that if the commissioner is motivated by money and thus he will act in the interest of directors in order to maintain his income.

### 7.7.5 Double Standards for Independent Commissioners in the SOEs

There are no independent directors in SOEs, only independent commissioners. This is a regulation of the Ministry of SOEs and the Capital Market Supervisory Body. Some people believe it is acceptable, for instance, that government representatives on the board of commissioners not being completely independent. If there is a conflict of interest then a commissioner should withdraw from deliberations and decision making in relation to the matter of conflict. This is necessary to avoid situations that occurred previously in SOEs where the Indonesian Government directly interfered both politically and administratively in many ways with the Boards’ decisions. The statement by Charlie (personal communication, 2005) that in some circumstances it is acceptable for an independent commissioner to serve the interests of the government which is self-serving. It justifies his own actions, and his lack of independence. This is of course inappropriate for independent commissioners.

According to the principles of good corporate governance, appointees to the role of commissioner must act in the best interest of all stakeholders, not merely serving the
interests of the government and promoting the government views as this commissioner did. This is an example of poor adherence to the principles of good corporate governance in practice.

In that sense they are not completely independent. Such commissioners are still an extension of the hand of Government observed Connie of the State Power Company, Perry of the State owned bank, Karen of the State Airline, and Gina from the Ministry of SOEs (personal communications 2005). Government interests are often embedded in SOEs’ board decision. The above suggests that there is a double standard in what is expected of commissioners. Obviously, this is inappropriate in the role of a commissioner. Commissioners must be one hundred percent independent. This would then be consistent with Indonesian legislation law number 13, year 2003 (Bank BNI, 2003; Kementerian BUMN, 2003a, p. 15).

### 7.7.6 Audit Committee in the SOEs

The existence and use of audit committees is one element of corporate governance that has been proposed by the IMF and that needs to be adopted in Indonesia companies. Apart from the independent commissioners, NCCG of Indonesian recommends that corporations have an Audit Committee (AC). The AC people are recruited from outside the company. Their task is to audit independently and report to the board of commissioners to whom they are responsible. AC can be useful to challenge the findings of the internal auditor who is responsible to the board of directors. It is difficult to have AC members who are truly independent since they are appointed by the Government of Indonesia. However, the functions of the audit committee in the two tier system overlap with those internal auditors. This could result in the business not running efficiently.
7.8 Corporate Governance Practices of Two Boards Members

7.8.1 Decision Making Powers: Corporate Cultural Aspects within Organization

In the day to day operations of SOEs, board domination is seen for instance in purchasing decisions, and on the other side the employees just exhibiting the influence of Javanese culture by obeying boards’ decisions. Respondents from various SOEs in the study complained that the tender process for purchasing capital items such as power generation equipment (at the State Power Company), computer systems (at the State owned bank), aircraft (State Airline) did not align with the appropriate tender process mechanism. In most cases, the directors had already decided who would be awarded the tender before the formal process was carried out. In committee meetings with directors to discuss project tenders employees merely listened to the decision of the managing director, despite being well informed about the pros and cons of the various alternatives. This is a further example of culture influencing business practices. The employees showed their tolerance, obedience, and acceptance. The ignoring of the tender mechanism process causes problems in the implementation of projects, because the most appropriate tender is often not awarded the contract. This could easily result in high cost, inefficiency and high failure rates. The directors and commissioners who sign off on projects are often not accountable for their actions. There is a lack of transparency in tendering process where the stakeholders are not informed. Hotma, one of the branch managers argued “a report presented and discussed between superior and subordinate at a meeting must please the superior” (personal communication, 2005).

A further example of the board of director’s domination occurred in the State owned bank, which had just had a newly appointed MD. During a senior level management meeting attended by representatives from all branches across Indonesia the new MD
made it very clear to all present that he was arrogant towards subordinates and belittled the employees at the meeting. He acted just like a prayer leader during a prayer session at the mosque. When he bowed everyone else had to bow too. The director acts with domination because he knows he has been appointed by the president. A similar story occurred with his replacement who was the brother in law of the current new president (Tribun Batam, 2010; Auliani, 2010).

The domination of directors has resulted in then being able to do whatever they want. This can lead to instances of corporate fraud.

Members of boards of directors and boards of commissioners ignore the input and decision-making talents of their employees who should merely remain loyal to one’s superior and passively follow their orders. Thus, these SOE employees continue to act as servants to their superiors. They have no right to have input or discussions about the company’s current or future activities or programs. The traditional dominant culture within SOEs is no longer relevant in today’s modern and turbulent business environment. These attitudes and prevailing corporate culture need to be significantly reformed.

7.8.2 Strange Issues at Board Meetings

In board meetings, the domination of the board becomes apparent. This is seen in several ways across various SOEs. At a meeting of commissioners, directors, and senior managers from all over Indonesia, a manager asked a pertinent question that was responded to by the managing director by rudely saying “just carry out my instructions” (Joko, personal communication, 2005). This typical situation leaves managers believing that they have no right to question the decisions of their superior or participate

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43 This MD was appointed because he has a strong relationship with the President and his Party (Joko and Perry, personal communication 2005).
meaningfully in the decision making process. Thus the creativity of managers is killed off. This is consistent with the Javanese cultural practices which make employees “just accepting” and being non-creative (Elvy and Johny, personal communications).

In meetings with directors, employees just attend to hear the directions mainly of the managing director. Dissenting opinions are discouraged. In some cases, employees with dissenting opinion have been punished by relocation, as happened to the head of the union in the State Power Company or restriction on career advancement as happened to some managers in the State owned bank. Rather than such meetings being venues for exchanges of use they are often used as opportunities for applauding the work of the directors. The result is that the directors reward the compliant employees with advancement and hinder the advancement of those who dare to give dissenting opinions. Advancement within SOEs really depends on how close employees get with those above rather than performance and ability.

7.8.3 Unscheduled Board Meetings

Holding meetings on spontaneous whims is an aspect of Indonesian business culture especially in Indonesian Government organisations. In the experience of the researcher, during teaching in one of the public universities in Indonesia, it was common to be called by the Dean to have a meeting. As a consequence, the students, who are the main customers of the university, are abandoned.

Similar situations also occur in the three SOEs studied. During the process of conducting interviews the researcher often caught conversations between the participants/interviewees and third parties cancelling meetings. For example, during an interview with the commissioner in a State owned bank, someone entered the office and advised that a meeting had been cancelled. A short time later, the person returned to
advise the meeting was scheduled to be held. Another example occurred when the researcher was interviewing the Finance Director of the State Power Company. He received a telephone call informing him that a meeting was to be held after office hours. Several times the researcher’s appointments with the President Commissioner of the State Airline Company were postponed due to sudden meetings.

These constant sudden meetings are not in accordance with good governance practices. These meetings do not demonstrate professional management and should be eliminated for the following reasons. Firstly, meetings called at short notice by the chairmen of the boards, Minister of SOEs, or even the President gives inadequate time for board members to prepare themselves by reading and bringing documents to the meeting. If an agenda is circulated in advance of a meeting members of the board of commissioners have sufficient time to organize their ideas before the meeting. Secondly, scheduled meetings minimize the potential arrogant domination of the chairman, Minister or President. Thirdly, intervention by the majority i.e. the government is minimized. Spontaneous meetings are usually held because of intervention by the government. In addition, dissenting opinions cannot be expressed openly.

According to Claessens (2003) governance is linked with the actual behaviour within corporations such as management efficiency and the treatment of shareholders and stakeholders. It appears, from this study, that inappropriate culture and behaviour of boards hinders the implementation of GCG practices.

7.8.4 Domination of the Two Boards: Supporting the Study

Prayogi (2012) and Wijaya (2012) reported that Baskoro, a Director of Perusahaan Gas Negara (PGN) or the State Gas Company was terminated on January 20, 2012 without any reasonable cause. The press reported that this Director found there was corporate
fraud in this company. The media reported that he discovered that PGN had more production than normal, and sold these below the list price. He reported this occurrence to the Head Commissioner of PGN. The press alleged that because of his report he lost his position as the Business Director.

The press investigated the reason why this director was terminated during an Extraordinary Shareholders Meeting attended by the board of directors and board of commissioners. Journalists questioned one of the directors about the dismissal. He explained that the Business Director was dismissed for unspecified misconduct and disciplining a worker on the site (Prayogi, 2012). According to the press, these two reasons are insufficient to terminate a member of the board of directors. According to company regulations, members of boards must receive three warning letters before being terminated, and the Business Director had received none of these. Pakpahan and Bathoeguna, two members of the House Representatives said that they regret the dismissal of the Business Director which was not carried out according to proper procedure, illogical and that the case should go to the Anti-Corruption Commission (Indopos, 2012).

From the researcher’s point of view, board domination and collusion among top management that has occurred in the study, currently is still alive and well in other SOEs, such as the State Gas Company.

It is inappropriate for the board to dismiss the Business Director with insufficient reasons. It appears that the board has used the extraordinary meeting to further their own interests. The board should have followed the prescribed procedure to dismiss the Business Director. No warning letters and insufficient reasons plus lack of transparency point to board domination.
It must be questioned as to how the commissioners and audit committee failed to discover the fraud in the State gas company. The task of the commissioners includes overseeing the finances of the company. It is suggested that the skills and/or honesty of commissioners must be questioned. It appears that the Business Director could have been seen as a whistle blower. The way he has been dealt with is typical of the way whistle blowers are treated in Indonesia. There is no whistle blower protection legislation in Indonesia.

7.8.5 Lack of Accountability and Transparency in Remuneration Decision

In Indonesia salaries for the directors, that is members of the management board (i.e. the board of directors as opposed to the board of commissioners), are fixed at the AGM. In this study, a number of respondents from the State owned power company said that they were concerned about a policy of directors awarding bonuses even though the business had been performing badly for a number of years. This situation arises because the bonuses are approved by commissioners. For this reason the commissioners appear to be merely rubber stamping the board’s decision. This does not demonstrate the accountability required of commissioners and directors who are supposed to act in the best interests of shareholders. These commissioners and directors instead act in their own self-interest. Both directors and commissioners are recipients of bonuses, and they act in collusion with one another. This would not occur if the board of commissioners was truly independent and there was an independent remuneration committee. The issue of accountability must be questioned. The two boards approved the bonuses, but it was not appropriate for the two boards to take this action.

Certainly, the arbitrary awarding of bonuses unrelated to executive performance is not an example of good corporate governance because bonuses have been awarded even
when the business has been making losses. The awarding of bonuses in this situation are not in the best interests of all stakeholders. In such a situation, the government as the major shareholder and ultimately the Indonesian society in general is being disadvantaged because of the poor conduct of commissioners and directors that does not conform with the fundamentals of good corporate governance practice.

In SOEs, the independent commissioners receive a monthly salary regardless of their regular attendance in the office or not. This is a source of jealousy among the employees as they believe that independent commissioners are not useful in the organization. According to Solomon and Solomon (2004) independent directors find it difficult to participate actively since their salary is determined by the executive.

**7.8.6 Two Fold Problems in Accountability**

In a private company, the shareholders appoint the management to operate the company. The management is accountable to the shareholders. However, the management can indulge themselves at the company’s expense. Berle & Means (1932) (cited in Lewis, 2010) call this phenomenon an agency problem (See figure 7.3) that leads to agency costs. The costs are born by the shareholders.

In the case of SOEs, the agency problems may occur in two stages (see figure 7.4). In the first stage, agency problems occur when the management of a SOE indulge themselves. The second stage occurs when the government misuses their power in order to gain benefits from the operations of a SOE. The ruling government, as a majority of shareholders is who is elected by public may easily changed the two board members that can fulfill the Government needs. The Government is supposedly accountable to the public. However, a public-owned enterprise is different from a privately owned one. The public are a large group in society; whilst private shareholders are only a small
group of people. The public effectively experiences loss twice. The first is at the board level, the second is within the ruling government level.
Figure 7.3 A problem of Agency theory in a Private Company

Figure 7.4 Two fold problem of agency theory in a SOE
7.8.7 Collusion between Two Boards and Government

The collusion between two boards and government can be seen in a number of examples. This occurs when the government interferes in tender processes. Sometimes the government will direct an SOE through the Board of Directors or the Board of Commissioners to award a contract to a particular tender submitter in order to receive a commission from that particular company.

Thus, the government and successful tenderers receive an economic advantage at the expense of more competitive tenderers. Other stakeholders are also disadvantaged.

Another example occurs when a state owned bank approves loans to family members of a government official or to private companies. Although the loan requirements such as collateral cannot be fulfilled by the client, the management of the banks approves the loan because they are directed to do so by a high government officer. By assisting this high government officer, management keeps their positions safe. The act of rent seeking can sometimes be seen in the acts of members of the two boards. This arises because there is a weakness in the mechanism of electing the boards.

7.9 The Ruling Government's Interests

7.9.1 The Final Evaluation Team: The Government Intervention

According to law number 40, 2007 boards of directors and boards of commissioners are elected at a company’s AGM. In 2005 President SBY issued Presidential Decree number 8 about the appointment of directors and commissioners. The main part of this decree concerns the role of the Presidential team known as the Final Evaluation Team in the appointment of commissioners and directors.

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44 Previously it was Law no. 1, 1995 states that AGM is the highest.
The role of the team is to evaluate commissioners and directors after their legal election at AGMs but prior to their appointments to boards of commissioners and boards of directors. This is illegal because under the Indonesian Constitution legislation has precedence over presidential instructions. The legislation does not allow for post-election evaluation of commissioners and directors.

The decree includes in the Final Evaluation Team the President, the Vice President, several Ministers and the National Intelligence Agency.

The owner, which is effectively the Government of Indonesia (GOI), has full control over the SOEs. The President and Vice-President, Finance Minister and other Ministers who are related to the business of SOEs are involved practically in determining and appointing the supervisory and management boards of SOEs. The head of the GOI is an elected president from a specific political party. The Ministers are often from coalition parties which supported the elected president during the presidential election campaign.

In the case of Indonesian private sector businesses with two tier structures, commissioners and directors are elected by shareholders at the AGM. In the case of Indonesian SOEs, however although directors and commissioners are elected at the AGM the process leading to this can be argued to breach the principles of good corporate governance.

What in fact happens is that all candidates for board positions required the President’s approval. The President issued an instruction in 2005 that the candidates must have the approval of the team called Tim Penilai Akhir or The Final Evaluation Team which is chaired by the President himself. Initially, this team was used to evaluate candidates for high level government positions only. But later, the team’s functions were expanded to include the evaluation of candidates for positions on SOE Boards.
These appointments should be made by the respective annual general shareholders meetings, and the President has his representatives (the commissioners). The Final Evaluation Team must be disbanded because it destroys the impartiality and the independence of the election of directors at the AGM. This Team undermines the Annual General Shareholders Meeting mandated by Indonesian company law which is supposed to regulate the system to determine and appoint the supervisory and management boards. Collusion and nepotism have become a norm and part of the culture within corporations in Indonesia including SOEs. However, the real implementation of that of Indonesia company law is opaque since there is no effective law enforcement and law makers and the law apparatus are corrupt (Economic Analytical Unit, 2002).

This study has shown that a consequence of government intervention in the appointment of boards can lead to the destruction of employee morale and the displacement of executives from their career paths caused by the parachuting in of Government appointees.

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 board system of good corporate governance. However, problems arise in practice when directors and commissioners are effectively colluding to protect corrupt individual government interests in SOEs.

There are many examples of this collusion. For instance, the two boards can inflate the value of projects, appoint contractors without the appropriate tender process, and award
excessive bonuses and salary increases. As a consequence, similar acts do occur due to the collusion and involvement not only by management but also by members of the two boards. Most of the time, the appointed directors and commissioners are appointed to represent the interests of the ruling political party, which itself is strongly influenced by powerful individuals with key roles in government.

Another relevant factor is the parliamentary coalitions which frequently occur in Indonesia. This has resulted in the President appointing the coalition party members to positions on boards of directors and commissioners in exchange for political favours, and as a way of thanking appointees for their support in the election process. Unfortunately, the interests of these individuals are not necessarily consistent with the interests of the public.

There does, however exist a mechanism where the candidates for boards of directors and boards of commissioners have to be approved by the Indonesian House of Representatives (DPR). As Baswir (2005) argued, there is institutional chaos in managing the relationship between parliament, and the government, and SOEs, which makes it more difficult for independent individuals to exert their power. It is not uncommon for individuals to bargain for their positions on boards of commissioners and boards of directors. This minimizes the occurrence of the direct, unopposed appointment of commissioners and directors. Therefore, this mechanism may help to minimize, if not eliminate the abuse of power in SOEs.

Cronyism is yet another factor affecting independence in the appointment of directors and commissioners. There is still cronyism in the appointment of commissioners to SOEs (Putro, 2009). According to government regulations, the House of Representatives should conduct a fit and proper test for candidates for membership of
boards of commissioners, but there is evidence that the current government of SBY is bypassing the House of Representatives in appointments to boards of commissioners. For example, the recent case when SBY appointed Dahlan Iskan as the new General Director of State Power Company (PLN). Iskan admitted that when the President asked him to take the position, he could not refuse (Iskan, 2013; Sutianto, 2013). Strong resistance came from the union of this State Power Company (PLN). Supriyanto, the union leader said that the appointment of Iskan was clearly a political decision by the President. In addition, he said that recruiting a new general director from an outside company was not the appropriate decision. Another strong objection was expressed by Effendi Simbolon a member of the House of Representatives. Mr Simbolon asked, "What is the criteria for the Iskan appointment?" (Gandhi et al, 2009). Iskan is the owner of *Jawa Post* Group. This newspaper group has a distribution network that reaches most of the remote areas all over Indonesia. It was generally known that *Jawa Post* network was on the SBY side during the presidential campaign in 2008.

There is ambiguity in the establishment of boards of SOEs. On the one hand, the President can use his prerogative right in the appointment of the board. On the other hand, there are rules and regulations, and mechanism processes such as Annual General Shareholders Meeting (AGSM) in determining the boards’ composition.

It can be argued that the President has a vested interest in the appointment of board members. The trend is that the president will choose members of his election campaign team to become commissioners and directors of SOEs. This does not fit in with modern business practices. The practice of nepotism or job for the boys perhaps is not against the law but it is unethical. It will have a negative influence on the development of SOEs because not all board members appointed this way have business capabilities. Nepotism
is hard to eliminate when it starts at the top. It is a common occurrence that the appointments of Boards of Directors and Boards of Commissioners are based on political considerations rather than business considerations.

As can be seen from the last cabinet reshuffle, the Minister of Ocean and Fisheries is from the Golkar Party, the Minister of Public Housing is from the PPP Party, the Minister of State Apparatus and Empowerment is from the PAN Party. The Minister of Transportation is from the Democrat Party. These parties all support the current president (Tempo, 2011). These ministers all owe their allegiance to the President. One could argue that the *quid pro quo* for their appointments to the ministries is unquestioned following of the President’s wishes.

In Indonesia, under the Constitution, Ministers do not have to be appointed by the President from among the elected representatives to the parliament. They can in fact be appointed from outside. For instance, the current Minister of SOEs, Dahlan Iskan comes from the private sector.

### 7.9.2 Bureaucrats and Non-Active Army Personnel

Currently there are still many bureaucrats and non-active army personnel who hold key positions and are members of the board of directors and commissioners in SOEs. The placement of retired military and police officers in positions of responsibility in SOEs result in making high ranking government officials (including their families) safe from being discovered or implicated in frauds.45

The positions of commissioners, directors, internal auditor and financial officers should require appropriate training and financial skills. The appointment of military personnel

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45 In the Suharto era many members of the military were installed as senior government officials. These included the office of the Governor of a Province and members of the upper house of parliament. Up to and including the present time, high ranking military officers can be found on most if not all boards of commissioners of SOEs.
without any appropriate qualifications to positions of responsibility in SOEs still continues to this day.

In a similar manner, bureaucrats continue to be appointed to positions of responsibility in Indonesian SOEs. The reason behind these appointments is that the bureaucrats are experienced in making a SOEs budget fit the state finance budget. The fact that there may be people with more appropriate professional business backgrounds from external sources (non-bureaucratic or non-army) for these positions is generally disregarded. There are still a number of bureaucrats and retired members of the armed forces within management circles and also acting as board directors and commissioners in SOEs. These people need to accept and participate in the changes and reforms to business practices and new corporate governance approaches that are occurring within the SOEs.

7.10 Privatisation Issues in the Indonesian SOEs

The 1997/1998 Asian financial crisis severely impacted Indonesia and other regional countries. As a result, Indonesia sought the assistance of the World Bank and IMF. The IMF recommended that Indonesia should privatize its SOEs in order to help balance the State’s budget. Subsequently, the Indonesian Government had targeted 150 SOEs of a total of 158 SOEs for privatization in the near to medium future. The expectation was that these would increase their economic contribution to the national income and budget outcomes.

There are two main problems for the government in the privatization process. Firstly, there is strong resistance by the stakeholders of SOEs based on constitutional and other objections. Secondly, corporate governance practices and corporate culture require reform in order to attract investors, both local and foreign.
7.10.1 Privatisation and the Indonesian Constitution

The Indonesian Constitution states: “Sectors of production which have a strategic role [importance] for the country and influence the livelihood of the people [the general population] shall be controlled by the state” (Indonesian Constitution, Article 33, verse 2).

This constitutional clause is used as the primary support for their argument by those who oppose privatisation. Connie, a middle manager and study participant, feels that the company’s products come under the edict of Article 33. She argues that being “…controlled by the State means that this SOE cannot be privatised” (Connie, personal communication, 2005). The Constitutional Court, citing Article 33, has repealed one of the SOE Privatisation Bills passed by the Indonesian Legislature.

7.10.2 Privatisation: Is It Another Form of Collusion?

The primary purpose of privatization must be for the benefit of the public as well as the State. However, privatization of a SOE is not just a BOD and BOC decision. Any privatization decision of a SOE is a political decision. When a country is in a prosperous state, privatization is not a major issue. Previous concerns about privatization have resulted in many stories/issues/scandals that privatization is only a means to generate money for the ruling government. This is possibly due to: 1). no fixed rules on the process of privatization; and 2). the lack of transparency about the ways/process of privatization. Bad corporate governance practices make SOEs unattractive to potential investors and thus difficult to privatize. For instance, in January 2012, GOI attempted to privatize Garuda Airlines, the national flag carrier. Investors shunned the airline because they said the Initial Public Offering was over-priced. Investors have alleged that it is unfair to sell shares before the IPO (Dewi, 2011). One
of the investment companies owned by Nazarudin, the Treasurer of the Democrat Party (the ruling party) had bought large number of shares in allegedly improper transactions (Syailendra et al, 2012).

7.10.3 For and Against Privatization

The privatisation process in a company could face resistance from its employees, managers, politicians, or other stakeholders (Nahadi & Suzuki, 2012). There is strong resistance to privatization by the respondents in the State Power Company. They said that privatization is against the Constitution and that the tariffs for electricity will increase as a result of privatisation. The support for privatization comes from respondents from the State owned bank in the study. This bank is already privatized. They said that the bank had become more customer oriented as a result of privatization. Respondents from the State owned airline generally support privatization because privatization will lead to improved management with greater responsibility and transparency, and would result in increased transfer of knowledge. One respondent favored shares being offered to employees and other SOEs in the first instance. The respondents from the Ministry of SOEs were also strongly in favour of the privatization of SOEs. Their arguments were that bureaucratic and the so-called Javanese cultural practices had become embedded in SOEs. They said that privatization was needed to change these practices.

In the researcher’s view, privatization, where appropriate\(^46\), is essential to reduce the intervention of government in the operation of SOEs. With privatization, SOEs must report to all shareholders including the shareholders from the public. This is a condition of being listed as a public company. The report must include financial details, details of

\(^{46}\) In the next chapter of recommendations, the writer distinguishes the categories of SOEs to be privatized and not privatized.
bonuses, and information about company activities. The government will be reluctant to engage in misconduct in SOEs because the chances of being caught out by the public are greater. This includes the risk of the government’s unethical intervention in the mechanism for the election of directors and commissioners being discovered.

From the above discussion, one can argue that the current privatization process is not in line with good corporate governance practices.

7.11 Stakeholders Theory:

7.11.1 The Implication

In agency theory, the senior management and the board are agents of the shareholders, and accordingly should act in the best interest of the shareholders that is by maximising shareholder value. However, in practice, agency theory postulates that managers may act in their own self interest at the expense of shareholder value. More recent models of good corporate governance have been expanded to include a wider range of stakeholders than considered historically, in particular the interests of the community or society in which the firm or business operates.

SOEs more readily fit with the concept of stakeholder theory in that their first obligation is to Indonesian society rather than just to maximising profit. This is seen for instance in the State Power Company, PLN, where tariffs are set by the Government, taking into account a balance between the needs of Indonesian society for electric power and the need to recover the cost of production. This conflicts with the normal business practice of maximising profit or shareholder value. Another example is seen in the State oil company, Pertamina. The price of fuel is uniform throughout Indonesia bearing no relationship to distribution costs. These examples, clearly illustrate that the stakeholders
are being considered as well as shareholder’s financial interests in the long term. This serves the shareholders long-term political interests.

Having harmony between the demands and requirements of the various stakeholders groups is fraught with difficulty (Solomon & Solomon, 2004). The tendency for government appointed directors is to act in the interests of the government only and not the interests of all stakeholders. This arises out of fear. Government appointed directors tend to regard their directorship as automatic teller machines. Money is an important motivating factor for government appointed SOE directors because they are rent seeking. They are afraid that if they do not follow government lines they will lose their directorships. This phenomenon has its roots in Indonesian, specifically Javanese, culture regarding the relationship between a king and his subjects.

Jansson (2005) argues in shareholder theory managers are assumed to act in the interest of the owners of the business that is the shareholders, in creating value. However, in stakeholder theory managers create value for other stakeholders not just shareholders. He gives an example, “for employees, creditors, suppliers, consumers and the community in which the firm is located” (Jansson, 2005).

The shareholders in agency theory are the uppermost group that can influence and determine the company’s policies. While this can be done successfully in the private sector, it is different in the public sector and in the Indonesian SOEs; the majority shareholder is the Government of Indonesia. The characteristics of fraud and opportunistic behaviour such as the misuse of authority by executives in SOEs are different to that in private companies. This is because in a developing country such as Indonesia that has feudalistic practices where there are greater distances between levels in hierarchies. The members of the government in power are able to treat the SOEs as if
they are their personal property. They intervene in the operations of the company by prevailing on management to provide jobs for their relatives or cronies. Another example has occurred when government officials were appointed to management position in SOEs to channel funds to the ruling political party for the next election campaign and routine political party operations (Subkhan, 2013; Yani, personal communication, 2005). In a SOE, fraud and opportunistic behaviour can be carried out by a conspiracy of more than one person because the government (as the owner) is not an individual person or a single entity which makes decisions. In addition to this, the constitution and regulations, the existing corporate culture, society’s culture, and politics all influence the government’s decisions regarding SOEs.

7.11.2 Stakeholder Approach to Change Corporate Culture

The Government of Indonesia through the Minister of SOEs should attempt to make changes by adopting a new system, policies or technology from outside Indonesia or from the West. However, this may be ineffective because the culture has been entrenched in SOEs for more than 30 years. “What we need is a change in the work culture” stated Connie, Polce, Roy, Ben, from across the three SOEs and Gina from the Ministry of SOEs.

What has transpired is a cultural process. One regime that was in power for such a long period has acculturated the nation. This regime was called the new era and led by Soeharto, and it is his values that have influenced the culture. The key for the development of a modern approach to ‘good’ corporate governance in SOEs is to change this culture that has existed for more than thirty years.

The Indonesian corporate culture that has been formed over more than thirty years cannot be easily undone. Good corporate governance could only be introduced
gradually over a period of time. The current conditions that prevail in SOEs do not benefit the stakeholders including the public and employees. Only the ruling party and its cronies, namely the management obtains any advantage.

It is proposed that theory of stakeholders should be implemented intensively so that a wide range of stakeholders could begin to receive benefits. There are two aspects of change; as Quin and Jones (1995) (cited in Solomon & Solomon, 2004) questioned how directors could promise to maximize shareholders value at the expense of the rights of other stakeholders for instance, and the moral obligation not to harm others. This mentality of maximizing shareholders value irrespective of the consequences on other stakeholders must be changed in SOEs. According to stakeholder’s theory, ethical behavior of the boards must be established as part of a healthy institutional culture (Quin and Jones, 1995, cited in Solomon & Solomon, 2004).

A second aspect of change which was postulated by Sonnenfeld (2002) is that the rules, procedures and mechanism, introduced as part of the good corporate governance process is less important than the way teams in the organization work together which is vitally important. (cited in Holloway, 2006).

If these changes are required to bring about good corporate governance in SOEs then, the government itself must change by becoming more conscious of all stakeholders in society and engendering a more inclusive team approach in society. These are necessary by virtue of the government being the majority shareholders in SOEs.

7.12 The Union

Under Indonesian law, the unions are required to be a partner with management in the operation of Indonesian businesses including SOEs. The unions fear that the
privatization of SOEs will result in significant proportions of their members being made redundant. As the result, they have tended to involve themselves in the management of the businesses with the justification of protecting their members’ interests. This has been interpreted by management as interference in the role of managers. Legislation needs to define more clearly the level of the required partnership between management and the unions.

7.12.1 Transforming KORPRI to Union

As indicated in chapter 3, before the fall of Suharto, SOE’s employees were compulsory members of KORPRI, the Indonesian national union of public servants. SOEs have had their own Unions; these had small memberships and no significant power, and were put under microscope by various government security agencies including the National Intelligence Agency (BIN/Badan Intelejen Nasional). After Suharto resigned, Korpri was dissolved and the SOE unions increased in membership and power significantly without interference from government agencies.

A major issue in the State Power Company was that the Union was against privatization. According to the Union chairman in the State Power Company, under Indonesian law, the union is a partner being involved in the mechanism of making company policy. However, this transition in union power was not yet accepted by management who interpreted the union’s newly found power as a threat and interference in the role of management.

After the fall of Suharto in 1997 the era of reformation started. The unions become brave and more vocal in challenging management. The unions wanted a more important role in developing SOEs and improving employee benefits. As the participants argued, the union is a partner of management and it is important for the union’s opinion to be
heard by management. They even suggested that it is a union role to control management (Henny from State own airline, Ellen from State Power Company, Perry from State owned bank).

However, from the perspective of management this was a very controversial development. One of the directors of the State-Owned Power Company said the unions were not a true partner because they have very critical opinions, which destroy the image of the business projected to outsiders. In addition, their activities inhibit the programs of SOEs to go public. Some respondents also said members of unions search for opportunities to obtain positions in management. Unions are often found to be destructively critical with respect to Indonesian SOEs. They criticize management directly to the media outside the formal channels.

7.12.2 Union Members’ Behaviour

The Union case can be seen across the SOEs studied and they play an important role in the organizations. It is important to have an understanding of the roles of the members. There are several clear categories: whistleblower, opportunist, supporters, and non-supporters of the current management. Management should be actions when responding to the union’s demands.

7.12.2.1 Those not favouring the Union

The union may oppose members of management from the time of their appointments. This depends on whether or not they agree with the appointment. For instance, in the state-owned bank surveyed, the appointment of the boards was perceived as being more political than in the commercial interest of the bank. This perception led to strong opposition to the directors from amongst the employees. This was demonstrated by the
protest of union members against the inappropriate statement of a managing director who said that the business is rundown and the morale of the staff is rundown. Staff also protested because of their perception that the qualifications of the newly appointed managing director from outside the business were inadequate for the position (Yani and Joko, personal communication). They felt because he came from a small private bank that he was not qualified to manage a large State-owned bank. As a result, several competent staff left the bank (Polce and Kade, personal communication). The lack of support for the managing director and management as a whole could impact regularly the performance of the bank. This may be seen in the falling ranking of the performance of the State-Owned Bank from being second to third.

As reported in the findings chapter, strong objections arose from the union in the State Power Company when the issue of privatisation was raised by management. Connie and Ellen cogently argued that privatisation was against the Indonesian Constitution (in Indonesian called Undang Undang Dasar 1945 or UUD ‘45) specifically Chapter 33. The factors of production, which affect the lives of members of Indonesian society, must be controlled by the state. Privatisation of these factors conflicts with this chapter of the Constitution. Union members brought this issue to the Constitutional Court of Indonesia and won the case. However, the management found another way to plan the implementation of privatisation47. This annoyed union members. According to the union, management does not talk about corporate governance; they do not comply with the constitution. A similar notion is given by Megawati on her speech in National Congress of PDIP in 2013 saying that the Indonesian Constitution Law number 33 is only good on paper, and implementation is very bad (Megawati, 2013).

47 This is discussed in detail in the previous findings chapter section 6.3.5 and 6.3.6 of this study.
As a consequence, management faced further action by the union against their policies, including the distribution of bonuses. Subsequently, in the process of managing the business, management faced difficulties as identified by Rino, one of the directors, and this affected the performance of the business. Rino said, the union is not a business partner. In this matter, management had not complied with the constitution. This raises suspicion about how management can comply with the principles of good corporate governance. For instance, how can there be effective transparency and accountability to the stakeholders?

One could argue that this conundrum has roots in Indonesian corporate culture. Traditionally, there is a top down approach in Indonesian business culture. However, after the start of reformation, the increasing outspokenness of the unions has changed the way they interact with management. Management, on the other hand has not accepted the changes that have come with reformation and still cling to their traditional culture. As a consequence, management are increasingly in conflict with the union.

7.12.2.2 Supporters of the Union

Union members may support members of management from the time of their appointments. These supported fall into two categories, those that genuinely support management and opportunists.

In the State-Owned Bank, some respondents agreed with the appointment of the new Managing Director from outside. They supported the appointment because they believed every leader has a different style and employee must accept changes in the style of leadership. In the State Power Company, supporters believed that strategic policy decisions come from the direction of senior management rather than from junior

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48 This matter was reported to the Indonesian Police and Public Prosecutor as discussed in the findings chapter section 6.3.13.
management. Similarly, in the state-owned airline, some respondents agreed that the unions should be more accepting and less confrontational with management. They are the employees who genuinely support the management.

7.12.2.3 Opportunist Supporters

In these cases, in the judgement of the researcher, there were also supporters who were motivated by fear or self-interest, or just being opportunist. Those respondents motivated by fear were perhaps afraid that they may lose their positions. Union members may use support for management as a bargaining tool to gain better positions. This can be seen for instance in the occurrence of members who covertly meet the management to make deals to exchange their support for a better position. This unhealthy phenomenon was occurring across all the three SOE’s surveyed in this study. Another example of opportunism occurs when employees start protests which are not legitimate against certain actions and policies of management in order to gain a bargaining leverage. On the other hand, there are those who would argue that it is a legitimate role for unions to protest using any opportunity against management in order to get a bargaining advantage.

SOEs do gain some benefit when unions challenge flaws in management policy and direction. However union members who take advantage of this out of mere self-interest undermine the SOE and its stakeholders. This undesirable practice by union members is not in line with good corporate governance practice, because arrangements are made in secret. Hence, transparency is missing.

These employees/union members who become full supporters for the management, however are opportunists who don’t act out of the general interest of employees and the

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49 All the respondents hold manager level position.
union but become servants of management. In this case, the unions across the three SOEs surveyed are only platforms to protest from in order to obtain better positions.

7.12.3 Union Representatives in the Boards?
Should Indonesian SOEs follow the examples of other countries such as German and France, which have provided for union representation at the board level? In Germany, Denmark, Japan, France, Sweden, and Finland businesses that have more than 25 employees must have at least 2 members representing the union at the board level (Wharton, 2007). They are then directly involved in the board decision-making process. They are acting in the interest of employees and other stakeholders, which is in the interest of the company as a whole.

Indonesian SOEs would benefit if union representation was allowed at the board level for several reasons: Firstly, SOEs are owned by the public. SOEs are behaved to only act in the interest of the ruling government/political party. It is important for the union which is constructively critical to participate at the board level to oversee the management in order to ensure that the management acts in the best interest of the stakeholders. Many corporate fraud cases are found to have white washed actions (especially when involving high-ranking government officials) at the board level. If union members are represented on the boards of SOEs they can influence the board to act against cases of corporate fraud and other management misdemeanours such as nepotism or favouritism in career advancement. The involvement of the union at the board level increases the accountability of the union to their members and to society as a whole. The public outcry that SOEs lack good corporate governance has also highlighted the issue of unions having insignificant roles. In addition, the accountability
of the board is also increased. This is because there are more parties involved in the board deliberations.

Secondly, union representation in the decision process at the board level reduces opportunism. This is because the elected representatives are the result of democratic choice by the union. This reduces the possibility of members making secret deals for support in exchange for better position. This can happen when the process of electing union representative to the board is open and honest.

Despite this transition period, management domination still exists in SOEs. For example the arbitrary and subjective punishment of employees who the managers perceive are making personal attacks on them rather than merely disagreeing with decisions or policies.

7.13 Lack of Mechanism to Guard GCG Implementation

7.13.1 Whistleblowers Versus the Javanese Culture

Whistle blowing is considered a contradiction to the Javanese culture which still exists in SOEs. In Javanese this is known as mikul dhuvur mendem jerro or in English to protect and maintain the good name of the superiors and to bury deeply their mistakes and unethical dealings. Being a whistleblower is not part of Javanese culture. In addition, whistle blowing is still considered taboo in organizational culture as discussed in the findings chapter and reporting about negative internal matters externally is still considered to be unacceptable. This is considered to be against the unity of the organization, and an offence to the management.

Whilst in fact blowing the whistle when it is done honestly could be beneficial to the organization. Although whistle blowing is not popular with management, it does produce benefits for stakeholders. Whistle blowing can stop long term and systematic
fraud that has been occurring in SOEs. As described by Zull and Johny from the State-owned Power Company, there have been many fraudulent acts already. These acts of fraud have been previously reported to SOE managements and taken to board meetings without any further actions taken because of the involvement of high-ranking State officers. As a result, employees resort to blowing the whistle to authorities outside the SOEs. These authorities include the police, public prosecutors, and the anti-corruption commission.

By becoming whistleblowers, union members put their own positions at risk. Management may discriminate against whistleblowers for instance by hindering their career growth or relocating them to geographically remote locations. This can occur because no whistleblower protection mechanisms have yet been developed within Indonesian SOEs. If there is no whistleblower protection there is no effective system of checks and balances in these State-Owned Enterprises. Whistle blowing is foreign to Indonesian culture and is thus inhibited in Indonesian SOEs.

In the three SOEs, there was no well-publicized whistle blower protection, and no mechanism or system established for whistle blowing. Although the management has given verbal assurances about whistleblower protection, there are no written guarantees. Outside of the SOEs, the government has established legislation for eyewitness protection. In some situations this legislation is being used for the protection of a whistleblower.

Whistleblowers are necessary to help address the issue of reducing corporate fraud (Lee & Fargher, 2012; Dyck et al, 2010). Currently, there is still no infrastructure to establish whistleblower protection legislation in Indonesia. There are many obstacles to having whistleblower protection in place. Firstly, to whom should the whistleblower blow the
whistle? Who can they trust? The top management which is the two boards? What if the fraud is conducted by the shareholder who is the government? This blowing will then not be effective, because the two boards are elected (most of the times appointed) by the Government. If a report is made to the House of Representative or Police or Public Prosecutor, there is likely to be no effective outcome. These three institutions may have conspired among themselves. The only government agency the public still trusts is the KPK. However, the KPK can only handle corruption cases involving more than one billion Rupiah or equal to one million Australia dollars. The researcher argues that whistleblower protection mechanisms in Indonesia are non-existent.

### 7.13.2 Checks and Balances: The Implications in SOEs

For the system of checks and balances of corporate governance to operate effectively all the elements such as the regulators, independent directors, auditors, lawyers, duties of directors, disclosure and so on must not breakdown (Lessing, 2009). An effective checks and balances system ensures that no one part in the corporate governance system is dominant. The failure of one of the mechanisms can result in the failure of the whole system. Lessing’s arguments apply also to the Indonesian SOEs, because there are many breakdowns in the mechanisms and thus the corporate governance system as a whole is in crisis. This dilemma can be seen in the financial bail outs provided to SOEs by the government when they have made losses because of the ineptitude of the directors and commissioners. Although government bail outs help in the short term, the government does not address the breakdown in the checks and balances which would rectify the situation in the longer term. The government is still interfering in the SOEs in order to promote their own political interests.
However, there is public optimism that the KPK will lead to the improvement of the system of checks and balances. Also, the media can help to highlight any breakdowns of the system of checks and balances. Members of the House of Representatives, the Indonesian Police, Judges, public prosecutors often do not contribute to the checks and balances system, because there are many examples of misconduct in these institutions. Recent examples include budget gate in the House of Representatives, legal mafia in the Judiciary, fat account (excessive deposits made to police officers’ bank accounts).

7.14 Conclusion

The best practices of good corporate governance recommended by the IMF and World Bank have been promoted and adopted by Indonesian SOEs. Independent directors (and later independent commissioners in Indonesian SOEs), and audit committees have been installed in Indonesian SOEs. However, these measures have not been effective because of the societal and cultural practices such as high tolerance and excessive obedience to superiors that has existed for a long time in Indonesian SOEs. These have largely come from the Javanese culture. These societal and cultural practices are barriers to SOEs practising as modern professional businesses.

SOEs can not be truly independent business enterprises because of the government interference in operational management and the appointment of members of boards of commissioners and directors. This government interference means that directors and commissioners can not be truly independent because the interests of the government is being promoted not the interests of shareholders or other stakeholders. The government interests are in effect the interests of the ruling political party. It has become a stigma on Indonesian society that SOEs are the virtual ATMs for the ruling party.
There are five types of government intervention in SOEs. Firstly, there is intervention in the privatization process. Secondly, the government intervenes in the appointment of Directors and Commissioners. Thirdly, the government intervenes in commercial decisions relating to the purchase of capital items. Fourthly, there is a history of Indonesian Government involvement in the management of SOEs. Fifthly, the government intervenes in price setting for products and services of SOEs. On the other hand, government intervention is presumably needed to stabilize the economy and, also, to regulate prices to meet social objectives.

Legal breaches still occur at this point in time like bribery and blackmail of SOE’s Directors. These underpin the argument that the law is not yet being enforced. This state of affairs presents opportunites to those in power to break the law. The situation is made worse by the reality that there is no effective whistleblower protection.

A mechanism which could support the practices of good corporate governance is whistle blowing. Whistleblower protection does not exist under Indonesian law. In many cases, this leads to whistle blowers being disadvantaged such as being sent to branches in remote areas, dismissed, and even charged with serious legal offences.

Unions also have a role to play in good corporate governance. Management is often questioned by the unions which often criticise management, hold demonstrations, and even file legal cases in the courts. As a consequence management finds a way out by giving special favours to those union members who are perceived as troublemakers.

The involvement of several Ministers and the National Intelligence Agency in the Final Evaluation Team in the appointment of members of the two boards also creates opportunities for ministers and the candidate to collude. It has to be understood that Indonesian politics is unlike that in Western countries. Coalitions, both formal and
informal are very much part of the Indonesian political scene. Ministers from coalition parties may owe their allegiance to the incumbent president. Further, these very ministers are the ones who sit on the final evaluation team. Thus, they may, out of political expediency, vote for candidates to the boards according to the preferences of their political masters.

The next chapter recommends a model of corporate governance for changing the culture of SOEs in the future.
Figure 7.5  Current Supervision Model of Corporate Governance Practices
8 Chapter - Recommendations

8.1 Introduction

This chapter offers recommendations for improved implementation of good corporate governance in Indonesian SOEs. The researcher proposes fourteen recommendations aimed at delivery improvement of good corporate governance practices in Indonesian SOE. The recommended model of corporate governance - which is basically simpler yet more robust than the current one – is highlighted in figure 8.1.

The first set of recommend changes are as follows:

1. Elimination of the President’s Final Evaluation Team
2. Removing independent commissioner (IC)
3. Establishment of a Nomination Committee
4. Establishment of Remuneration Committee
5. Establishment of a Governance and Whistleblower Protection Committee
6. Establishing a Whistleblower Protection Act

Below are six other recommendations that would help reduce corporate governance problems:

1. Promoting a congruent/relevant good corporate governance
2. Providing effective guidelines for SOEs to implement good corporate governance
3. Dismantling existing Corporate Culture (Javanese culture influence)
4. Fairness and Respect for Employees
5. Determining which of SOEs need Privatization
6. Strengthening of the legal infrastructure

The following figure 8.1 presents the chapter outline.
Figure 8.1: Chapter 8 outline

- Introduction
- Elimination of the President’s Final Evaluation Team
- Removing Independent Commissioners (IC)
- Establishment of a Nomination Committee
- Establishment of Remuneration Committee
- Establishment of a Governance and Whistleblowers Protection Committee
- Internal Auditors: Report to Two Boards
- Union Representative in Board of Commissioner
- Establishing a Whistleblower Protection Act
- Promoting congruent/relevant good corporate governance
- Providing Guidelines for SOEs to Implement GCG
- Improving Board Culture in Indonesia SOEs
- King’s Report II and the Javanese Culture
- Dismantling of Existing Corporate Culture (Javanese Culture Influence)
- Fairness and Respect of Employees
- Strengthening of Legal Infrastructure
- Determining which of SOEs need Privatization
- Conclusion
Figure 8.2 Recommendation Model of Corporate Governance Structure

General Shareholders Meeting
(Law No. 1, 1995; Law No. 40, 2007)

Board of Commissioners
(Supervisory Board)
- President of Commission
- Union Representative
- Commissioners
- Members of Commission
- Nomination Committee
- Remuneration Committee
- Governance Committee
- Whistleblower Protection Committee

Board of Directors
- President of Director or Managing Director
- Vice President of Director
- Member of Directors

Internal Auditors
8.2 Elimination of the President’s Final Evaluation Team

According to Indonesian Company Law, the only mechanism for the election of members of the board of directors and the board of commissioners is through the AGM. However, in reality the AGM for SOEs is not the final stage in the appointment of board members. In addition to the AGM, there is the Presidential Decree of the Republic of Indonesia number 8/2005. The decree establishes that candidates for the board of commissioners and the board of director will be evaluated by the Final Evaluation Team, chaired by the President, post-election by the AGM. The evaluation of legally elected commissioners and directors by the Final Evaluation Team post-election must discontinue, as not only is it in direct violation of what has been legally processed and established, but is also undermining both the law and the rights of elected members.

Directors and commissioners are elected according to Indonesian law; and the Indonesian Constitution, establishes that the law must take precedence over Presidential Decrees.

The implementation of the Presidential Decree number 8/2005, is nothing less than a vehicle of government intervention over the appointment of members of boards of directors and boards of commissioners. This decree enables the government to further exert its political influence within SOE, which effectively usurps the governing autonomy and the independent nature of the boards of directors and boards of commissioners that is essential to them fulfilling their tasks. The Final Evaluation Team should be focused on exclusively the appointment of high-ranking governmental officials and ministers, and not the appointment of commissioners and directors in SOEs, which are statutory bodies.
The Minister of SOEs and the management of SOEs must not belong to any political party or any related group with vested interests. The reduction of political and governmental intervention in regards to the appointment process and the operation of SOEs will help to strengthen the governing autonomy of the boards of commissioners and the boards of directors.

8.3 Removing Independent Commissioners (IC)

The position of an independent commissioner as stated in Indonesian Company Law, 2007, is a misappropriation of GCG practices borrowed from OECD. It is nothing less than a panic reaction (a knee jerk reaction) by politicians to the public outcry over bad corporate governance practices.

The appointment of independent directors in the West has been a response to the public outcry in regards to bad corporate governance practices in private sector, whereas such appointment in Indonesia is done in SOE, which makes the exercise grossly inappropriate.

To sum up the above argument, the utilization of the western model of independent directors by the government of Indonesia on State Owned Enterprises is a case of misappropriation of practice. The prerequisite for utilizing such model is that members of the board of commissioners must be independent by law. To have the government appoint independent commissioners in SOE, therefore, is another misappropriation of practice and an unnecessary piece of regulation. The deletion of this regulation is strongly recommended.

The OECD itself has pointed out that “There is no single model of good corporate governance” (Organization for Economic Co-Operation and Development, 1999, p. 12). Not only is the aforementioned model incongruent to the context of Indonesian SOEs,
the required effective strategies and infrastructure required to support such a reform are not in place. Conclusively, it is a futile exercise for the Government of Indonesia, in particular the Minister of SOE, to adopt the above element of Western style corporate governance.

8.4 Establishment of a Nomination Committee

A further recommendation is that for the purpose of electing candidates of the highest caliber to the board of commissioners and the board of directors, that a nomination committee be established within Indonesian businesses. This is a common practice in Western countries. See for example the Australian Stock Exchange (ASX) where matters related to nominations and recommendations in regards of its committee members are internally processed.

According to the concept promulgated by the ASX, the responsibilities of the nomination committee should include determining the criteria and assessing the essential competencies required of potential board members (2003); establishing a board succession plan and evaluating the board’s performance (ASX, 2003); making recommendations for the appointment and dismissal of directors. The ASX also recommends the utilization of a formal and transparent selection process for directors which would help to promote investors’ confidence in the company. One crucial factor to be considered in the process of selecting potential new directors is whether or not they are prepared to devote sufficient time for the company.

Indonesian SOEs should adopt the ASX model of a nomination committee, adapting it to the Indonesian two-tiered system with the inclusion of commissioners. Furthermore, I would recommend that the nomination committee incorporate management consultants to evaluate the experience, competencies, independence and psychological profiles of
potential boards members. The nomination committee will then have the task of nominating potential candidates for directors and commissioners to the AGM. The purpose of establishing a nomination committee is to ensure that directors and commissioners appointed to the tasks are qualified and competent professionals and to eliminate external intervention in the nomination process.

Having full-time commissioners on the board is by far more relevant and functional than having part-time members, whose involvement is not much more than in name only, and who are not genuinely independent in decision making.

8.5 Establishment of Remuneration Committee

The purpose of a remuneration committee is to provide an oversight over remuneration packages, ensuring that these are aligned with the strategic direction of the firm and that such packages provide enhanced motivation towards the employment and retention of senior management. This committee would function on the basis of fairness and propriety, rightly balancing the interests of shareholders and the rewards of their executives. This will reduce the risk of collusion between the board of directors and the board of commissioners which, as this study shows, has occurred in one particular SOE.

In the case where the Union is represented on the board of commissioners, they can then take part in the process of determining executives remuneration, thus provides a greater measure of transparency for the benefit of all employees.

8.6 Establishment of a Governance and Whistleblowers Protection Committee

The governance and accountability committee would have two main roles. Firstly, it is to implement GCG with its three–pronged governance task, which is comprised of overseeing the business operation, overseeing the finances, and making strategic
decisions along with the board of directors. Included in the referred task is making recommendations to the board. Secondly, it is to protect whistleblowers and to report to all relevant parties, including shareholders and other stakeholders, of any signs of malfeasance or other inappropriate conduct within the business.

8.7 Internal Auditors: Report to Two Boards
The existing practice only requires the internal auditors to answer and to report to the Board of Directors. In the recommended model, internal auditors are to report to Board of Commissioners as well as to the Board of Directors. Being accountable to the two separate boards ensures the impartiality of internal auditors. In this way, the risk of the internal auditors being dictated to the board of directors will be reduced.

8.8 Union Representative on Board of Commissioner
The Union representatives in three SOEs, expressed the desire to participate at the board level. Some writers have suggested that there should be a great diversity in the composition of company boards, for instance, by appointing Union representatives to sit on the boards (Lessing, 2009, p. 3). I recommend appointing Union representatives onto the board of commissioners, based on the following reasons:

1. Having Union representation on the board of commissioners provides an official forum for resolving grievances. The absence of such formal forum, forces Union representatives to turn to the media in order to be heard, thus internal employment problems are spilled out into the public domain unnecessarily, a highly detrimental situation to the company’s reputation and image.

2. Having Union representation on the board of commissioners increases transparency, as relevant information, especially in regards to finance and
strategies will be appropriately communicated to all employees. Therefore, unnecessary lapses regarding the basics are prevented from happening, such as the situation that occurred within the state airline company where employees had no idea how much had been allocated in the budget towards clients entertainment expenses.

3. The union’s involvement on the board minimizes the need for the individual-union-member approach to management. In this way, any opportunistic behaviour from members would be greatly reduced if not eliminated.

8.9 Establishing a Whistleblower Protection Act

Any GCG practice that does not ensure the protection of whistle-blowers is ineffective. The reality in Indonesia’s corporate world, there is absolutely no protection provided for a whistle-blower. The current legislation ensures the protection of witnesses in legal cases only.

I recommend strongly, therefore, that effective whistle-blower protection be legislated (figure 8.3). The researcher encourages the Indonesian press to apply pressure to the House of Representatives to start a discussion towards establishing a new law that provides protection for whistle-blowers. The reason it must begin with the press, is because the press has long been exposing and discussing the fact that the SOEs are being used as the political parties’ income machine.

In the United States whistle-blower protection is guaranteed under the Sarbanes Oxley Act. Some salient features of this legislation include the right of the employees to be informed of the provision of whistle-blower protection; and the guarantee that there are no ramifications for whistle-blowers who act in good faith but abuses may have
disciplinary or legal consequences (Baumgartner, 2007). Indonesian legislation could be modelled on the above, but adjusted to the Indonesian context.

Figure 8.3  Whistleblower Protection Act of Stakeholders

8.10 Promoting congruent/relevant good corporate governance

As with China (Roche, 2005), the concept of corporate governance is important to Indonesia. Promoting or disseminating information about Good Corporate Governance (GCG) is urgently needed by all companies, including SOEs. Unfortunately, as shown by the interviews in this thesis, several respondents are confused about the concept relevance, and philosophy of GCG. The confusion lies in their misunderstanding that GCG is a mere formality, a menu of management flavor and even negatively thought of as a major factor that would add to the web of bureaucracy which would seemingly lead
to a reduction of customer service performance. This misunderstanding obviously has been the result of what many have experienced in regards to corporate governance. As Kade (personal communication, 2005) pointed out, “The system of corporate governance that has evolved adds to the bureaucracy and makes the system cumbersome.” The true purpose of GCG is to enhance transparency and accountability which will effectively reduce the ruling elite party’s involvement and nepotistic practices within SOEs.

There is an old Indonesian proverb which clearly depicts how these recommendations of GCG are looked at, “we do not love what we do not yet know”. The implementation of GCG has often failed due to the failure to involve all stakeholders, especially the particular SOE’s employees, and the absence of appropriate process in introducing and familiarizing them with the GCG model. How is it possible for employees to implement a GCG which they have no understanding of and are not familiar with? A sound process of introduction, training and familiarization with the GCG model, will help to establish an appropriate supervision system over the operation of SOEs. This will also promote a sound corporate culture for the current business operation.

There are various ways to promote and introduce GCG concept, such as conducting regular seminars or workshops, writing about it on the company’s website, and publishing it as part of a company’s code of conduct. Another possibility is to have a corporate governance center established in some Indonesian universities as had been done by Singapore in the National University of Singapore (NUS). The NUS conducts studies/research on corporate governance, disseminating the results and practical implications of the studies/research to practitioners and policy makers. One aspect that
characterizes a good promotion of GCG is a two-way communication process that welcomes discussion and employees’ opinions - for and against.

8.11 Providing Guidelines for SOEs to Implement GCG

It is imperative that SOEs have a standard guideline of GCG practices. The standard GCG recommended here is the King’s Report II on Corporate Governance (cited in Vettori, 2005, p. 143). This guideline posits that stakeholders are an important factor in running the business. A corporation must run its business by taking the interest of the stakeholders into consideration as well as that of the shareholders.

Indonesian SOEs should adopt the King Report II as guidelines in running the business in view of the underlying SOE mission to serve the Indonesian public, and not merely to make a profit. King’s Report II has a more complete set of guidelines than the one used by the National Committee on Corporate Governance in Indonesia (the compulsory guideline for Indonesian SOEs issued by the Indonesian Minister of SOEs. The eight principles in implementing GCG based on King’s Report II (described in chapter 2) are, discipline, transparency, independence, accountability, responsibility, fairness, and social responsibility. This guideline may then counter the strong Javanese cultural undercurrent within the SOEs corporate culture.

8.12 King’s Report II and the Javanese Culture

King’s Report II - the second version of King’s Report - has been viewed as the standard of good corporate governance implementation (Vettori, 2005). The focus of King’s Report II is the importance of the board’s role in the practice of good corporate governance. King’s Report II emphasizes that risk management is the responsibility of the board, and emphasizes the importance of the role of a whistleblower. This report is

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50 This study does not cover the topic of social responsibility.
referred to in regards to the stakeholder theory. There are six important principles and characteristics of good corporate governance described by the report as discussed below:

1. Discipline

In the discipline principle, the King’s Report requires full commitment from the board to the standard of behaviour recognized and accepted in the company. It also discusses the notion of the “license to operate”, in that the activities of the company must be legitimized not only by its shareholders but also by the stakeholders. This also implicitly states that the board must work hard to the satisfaction of all stakeholders. Hard-work is, in itself, evidence of the commitment of the board or senior management level to the practice of good corporate governance.

In Indonesia, the appointment or position of any board member in SOEs is usually a favour granted by the government or ruling party, hence the tendency of board members to gain approval from a particular party at the expense of others, including the stakeholders.

This entrenched practice is a direct result of the culture of nepotism and collusion, in that board members, who make decisions in opposition to the ruling party line, would likely be eliminated. On the other hand, the legacy of the Javanese cultural influence of Soeharto era may have also contributed to the practice as it predisposes people to be subservient to their superiors, at the expense of the stakeholders interests.

2. Transparency

In regards to the transparency principle, King’s Report II requires that the board provide transparent and accurate information so that outsiders, in particular potential investors may be informed of the operational reality of the company, enhancing their sense of
confidence in making a financial investment. Transparency in SOEs is urgently needed, being a key to reducing the practice of nepotism (KKN) and over-involvement of the government in operational activities. A culture of transparency will cause all parties to think twice before committing any illegal practice; and to start aligning their conduct with the standard of good corporate governance practices. Therefore, the idea of privatization appears to be for the purpose of supporting the practice of transparency, but unfortunately, because it has been imposed on all SOEs, the idea has conjured up much negative response.

Once again, Javanese cultural influence and the pressure from certain sections have created obstacles towards the practice of transparency. Transparency will certainly expose illegal practices and everyone involved in them. Any hindrance to the implementation of transparency coming from this culture is also due to the way it predisposes subordinates to accept everything from and respect their superiors without question. True to this cultural inclination, the board would be reluctant to implement transparency if it would put them in the position of opposing their superiors or those they deem as their leaders.

3. Independence

In regards to the independence principle, King’s Report II requires a framework that will ensure that all board decisions are not influenced by the dominant parties, such as the significant shareholders or in the case of Indonesian SOEs, controlling parties that impose threats on board members’ positions if they do not follow certain orders. King’s Report II suggests that a fair composition of the board and the incorporation of external auditors as strategies to support this principle. This principle, however, is difficult to apply in the context of Indonesian SOEs since the appointment of board members are
influenced significantly by the government which owns the majority share of these SOE companies. Also, incorporating an external auditor may prove ineffective considering such an auditor would have neither sufficient knowledge nor understanding of the company. Another factor to be considered is the possibility that external auditors are also influenced by certain related parties with vested interests in the company. The practices of nepotism and collusion, which are obstacles to autonomy, have made the ruling parties superior to the board members and with that they demand respect and subordination.

4. Accountability

As for the accountability principle, King’s Report requires a framework that holds every individual, in this case the board members, responsible for all their actions. Accountability and transparency are related concepts and they do overlap each other. One cannot do without the other. In the context of Indonesian SOEs, transparency is still difficult to implement and the same goes for accountability. In the case where board members collude with the dominant party, deeming them as superior, any wrong-doing can be made to disappear easily.

5. Responsibility

In regards to the responsibility principle, King’s Report II requires the board members to be responsible to all the stakeholders, because not only is the company affected by the shareholders or a few stakeholders, but by all, including the employees. This principle is closely related to the license to operate maxim in the discipline principle. The aforementioned pattern of Javanese cultural influence shows up once again here, where the practice of nepotism predisposes the ruling party as the superior who
everyone else is expected to obey and answer to, at the expense of the rest of the stakeholders’ rights.

6. Fairness

In the fairness principle, King’s Report II requires all stakeholders to be treated with fairness, their rights acknowledged and respected. This principle goes hand in hand with the independence principle which refuses the making of any party to be superior above all others. The fairness principle is yet another principle that is difficult to implement in Indonesia due to the now familiar stronghold of the Javanese cultural influence that protects the privileged elite as the dominant party, and as explained above, assumes respects from everyone else and the right to make major decisions.

8.13 Improving Board Culture in Indonesia SOEs

It may be beneficial to have independent commissioners on supervisory boards. However, merely having independent commissioners, does not bring about good corporate governance. Good corporate governance is born out of the culture that permeates from the members of boards down. Through the organisation a culture does not arise solely by the application of a certain structure or model.

Sonnenfeld (2002) suggests that to minimize corporate fraud it is necessary to improve board culture. He points out that there are many who have proposed various necessary elements for a successful corporate governance, however, these elements deal mainly with structural matters. A paradigm shift in corporate culture to bring about good corporate governance is what is needed, according to Sonnenfeld. Changes in organizational culture in Indonesian SOEs could be initiated by higher levels of management who are motivated to be agents of change. They are the ones who care
about the development of the organization. However, for some reason, it seems difficult for these people to bring about such change.

If the government intervenes with the appointment of members of boards of directors and boards of commissioners, promotion of potential change agents to positions of seniority will be greatly hindered. Board members appointed by the government would likely place their loyalty with the government and its political agenda, thus making it difficult to bring about appropriate change to the organizational culture. The domino effect continues whereby the board in turn would expect the same type of blind loyalty from the employees. Such practice cannot be the basis for sound professional business conduct.

Furthermore, professional business managers employed by SOEs would not usually last long due to the sense of frustration in regards to the organizational culture that sees continual appointment of government nominees to the boards. Professional business managers are the potential impetus for cultural change in any organization, including in SOEs. These managers have been trained to professionally manage organization; and many have the spirit and determination to bring about improvements or changes in their respective businesses. SOEs would face losing their human capital as a consequence if such professionals decide to leave. Furthermore, managers who deal with clients face to face may take valuable customers with them if they relocate to another company.

8.14 Dismantling of Existing Corporate Culture (Javanese Culture Influence)

The corporate culture of Indonesian SOEs has been pervasively soaked in the misappropriation of many aspects of the Javanese culture for over 30 years now. As a consequence it has created an entrenched managerial hegemony—in that senior management exclusively makes all organizational decisions with hardly any
accountability for or challenge to their actions. Two steps are needed towards eradicating this exclusively top-down approach (Worang and Holloway, 2007). Firstly, a deculturization process needs to take place. Connie explained her notion of corporate culture: “In my view, people [internal stakeholders] has been culturized\(^{51}\) [been forming] to misbehave for certain years, therefore, de-culturized\(^{52}\) process is needed” (Connie, personal communication, 2005). A similar view is given by HamengkuBuwono X who cogently argues that a counter culture is needed to eliminate the long established corrupt culture (Hamengku Buwono X, 2003). Connie stated his approach: “…if we want to truly implement GCG, we have to correct the insider people, those who operates this company have truly corrected…” (personal communication, 2005). Secondly, following the deculturization stage is the promotion of a sound governance form. A sound governance practice can only be achieved through the development of a healthy relationship between government, the SOEs management, and employees. Superiors and senior managers ought to have an open mind that accepts and welcomes the different perspectives and arguments from their subordinates which would enhance active participation and mutual respect at all levels. Such an atmosphere would create a more conducive and effective internal governance and corporate culture within the company (Holloway and van Rhyn, 2005).

Sonnenfeld (2002) postulates that to build a good board, requires an atmosphere of trust, honesty, and openness. In saying that, it is also necessary to allow dissenting opinions. Dissent should not be confused with disloyalty. Dissent does not equate to disloyalty. In a healthy board dissent is encouraged, not punished.

\(^{51}\) Connie uses the word *culturized* to mean *having been formed*, and 
\(^{52}\) *deculturized* to mean dismantled.
8.15 Fairness and Respect of Employees

Human resource is one of the most valuable assets of a company. Retaining the employees is as important as hiring them. Take the example of the manager who resigned due to his perception that employees were no longer treated with respect by the managing director (Joko, personal communication, 2005). Many companies have lost staff because of bad communication and disrespectful treatment of employees. To prevent or correct the trend/phenomena, it is advisable that the management adopt the guideline proposed by Commonwealth Business Council group, which promotes respect and fair treatment of employees. One main factor towards respecting employees is by developing an awareness of cultural sensitivity.

8.16 Strengthening of Legal Infrastructure

In the introductory chapter it was explained that a flaw in the governance practiced in Indonesia is its indecisiveness in the face of malfeasance, in terms of legal action. Such legal indecisiveness has reduced the confidence of both foreign and domestic investors in Indonesia. La Porta et al (2002) argued that “the legal protection of investors in a country is an important determinant of the development of its financial markets”. Where foreign investors have properly enforced legal protection they will be more willing to invest. On the other hand, Shleifer and Vishny (1997) continue, where strong legal protection is lacking, investors will be less likely to invest, and economic development will be stunted as a result. The paralysis may cause an economic crisis similar to that of 1998. Therefore, Lindsey’s statement (2004), strengthening of legal infrastructure as a key activity of governance programs” must be heeded. He pointed out that State institutions, such as the Indonesian Supreme Court and House of Representatives, and
State agencies such as Police Department and Attorney-General’s Department, and Anti-Corruption Commission are examples of major weak points in the Indonesian legal infrastructure in relation to governance. Lindsey’s concerns are in line with the findings of this research. These institutions identified by Lindsey have failed to meet the standard of good governance in regards to transparency, accountability, and fairness.

8.17 Determining which of SOEs need Privatization

Privatization of Indonesian SOEs is essential. The purpose of privatization in this case, is mainly to reduce government intervention into the internal operation of SOEs. Privatization will likely bring winds of change to the traditional corporate culture, transforming it into an updated and professional business culture. However, it is important that the Indonesian government separates and determines which SOEs have a ‘community service obligation’ (CSO) focus from those that are business oriented with a profit-making focus. Only those SOEs with a ‘profit focus’ should be considered for privatization. Clarifying the differentiation will eliminate the ambiguity of Chapter 33 verse 2 of the Indonesian Constitution. The category of those with a CSO focus, such as Pharmaceutical and Hospital sectors should remain within public control. This category could even be extended to certain public utilities that deal with natural resources, such as Water and Power. SOEs in the category of a ‘profit focus’ such as banks, tourism oriented companies and airlines can then be privatized with a clear rationale and straightforward process to support the change, thus minimizing unnecessary public concerns. In closing, the outcomes of privatization should not be narrowly defined into matters of economic contribution, but should also encompass the aspects of efficiency, sustainability, and good corporate governance.
**8.18 Conclusion**

This chapter mainly contains the recommendations to form good corporate governance practices in Indonesian SOEs. These recommendations are derived after thoroughly studying the current practices of corporate governance in Indonesian SOEs. This is different from the approach by the NCCG (Indonesian corporate governance committee) which just copy the corporate governance concept from the West and directly apply it to Indonesian companies particularly SOEs.

These recommendations are expected to improve the current corporate governance practices. These are achieved primarily by minimising the government and political parties intervention, improving the behavior of two boards by respecting the subordinates, allowing dissenting opinions, and not bringing the traditional Javanese practices inappropriate to the modern business practices. Not all subcommittees who adopt from Western can be applied in SOEs. This concept needs to be modified which is then fit to SOEs two-tier corporate structure. The establishment of whistleblower protection mechanism that I would strongly recommend is basically to reduce corporate frauds.

Lastly, the corporate governance model that I am putting forward needs to be evaluated after every certain period of years. This is simply because companies are growing and changes are just inevitable.
9 Chapter – Conclusion: Thesis Contribution, Limitations and Further Research

9.1 Introduction

This chapter consists of three parts. The first part provides discussion of the conclusions drawn from each chapter. Secondly, the limitations of this research are discussed. Thirdly, this chapter provides suggestions for future research to develop a more comprehensive knowledge of corporate governance practices in Indonesia. The following Figure 9.1 presents the chapter outline.

Figure 9.1: Chapter 9 Outline
9.2 Discussion and Conclusion in each Chapter

Chapter One discusses the background of the researcher’s choice for this study. The main reason is that corporate governance (CG) is a new concept with a new vocabulary for corporations in Indonesia. These have been introduced by international financial institutions such as the World Bank and the IMF to the Government of Indonesia (GOI) to implement in Indonesian SOEs. This is because SOEs, as the backbone of the Indonesian economy, lack good corporate governance.

Chapter Two analyses the background culture about corporate governance. There are many definitions given but there is no one size fits all. Four principles of corporate governance (namely transparency, accountability, fairness, and responsibility) are well accepted in most countries. It was also found that agency theory is the root of corporate governance. The shareholders are the main concern of agency theory. However, the shareholder approach has been replaced by the stakeholder approach in which most companies around the world give more concern to the society in which they operate.

Chapter Three presents the cultural, societal, and legal culture from the first two eras under Presidents Soekarno and Soeharto. Both of these Indonesian leaders were Javanese. Javanese culture influences strongly the corporate culture in Indonesia. Also, from the examples analysed, Indonesia has been shown to have a weak legal culture.

Chapter Four discusses GOI as a shareholder of SOEs. This shows that there have been many cases of corporate fraud in Indonesian SOEs arising from ignoring the principles of corporate governance. For example the privatization process in SOEs has shown a lack of accountability and transparency. There was also the government intervention through the Final Evaluation Team which provides evidence of the existence of Korupsi Kolusi and Nepotisme. This chapter also discussed the emergence of the Indonesian
corporate governance committee, the National committee on Corporate Governance. This committee was formed by the GOI. However, the resulting corporate governance practices produced by the NCCG were simply a copy-and-paste approach from the corporate governance practices from Western countries which are inappropriate for the company structures in Indonesia.

Chapter Five explains why the qualitative research method as opposed to quantitative research is appropriate to this study. The relevant ontology and epistemology for the thesis are discussed. This chapter also argued that qualitative research is reliable and valid. The choice of interpretivism to build the social construct and generalisation are described. The strategies to have participants respond naturally and freely are discussed. Data collection had been conducted by face-to-face interviews, in some cases followed by email between 2005 and 2010, both in Australia and Indonesia.

In chapter Six, the findings from the three SOEs in this study are presented. The responses from the three SOEs turned out to be similar, but some unique points of difference emerged. It was found that the adoption of corporate governance in the SOE studied is adopted or a-copy and-paste approach from Western corporate governance practices. This aligns with the theoretical background described in Chapter Four. Javanese culture pervades Indonesian SOEs, and this culture is not in line with GCG practices. The two boards and managers in each SOE admitted that the GOI often intervenes in company operations. Also, political interests, mainly from the ruling party are found to exist in these three SOEs. Significant resistance to privatisation is found to exist in the State-Owned Power Company. The union took this to the Constitutional Court, and won, and this was the first case for the Constitutional Court. The responses
of participants reveal that whistleblower protection mechanisms are missing in these SOEs.

Chapter Seven analysis the findings from Chapter Six, taking into account the literature review of the issues and practices of corporate governance in several countries (in Chapter Two). It also analyses the legal and societal culture in relation to corporate governance in Indonesia (in Chapter Three and Four). In this chapter, I argue that GOI has made a wrong decision by requiring independent commissioners (similar to independent director) in every SOE. Also, the heavy intervention of GOI leads to bad corporate governance practices. Regarding privatisation, GOI must clarify what the Indonesian Constitution means by the “factors of production affecting the lives of members of the Indonesian public must be controlled by the state”. This is in order to avoid the controversy associated with privatisation. The GOI also needs a good legal and corporate culture in place prior to implementing GCG in SOEs.

Chapter Eight provides recommendations. The recommendations made are in accordance with the empirical data findings from internal stakeholders’ perspectives and corporate governance issues that have been discussed by the public in the media. The writer strongly recommends that the Government of Indonesia should not intervene in the appointment of members of the board of directors and the board of commissioners. The author further recommends that the influence of traditional Javanese culture practices in Indonesian SOEs that hinder the practices of GCG should be reduced, and then eliminated. The professional modern business corporate culture practices must be established. This can be achieved by establishing the independent committees, building the whistleblower protection mechanism, and educating and promoting GCG practices in Indonesian SOEs.
9.3 Contribution
This study is an attempt to investigate the corporate governance practices in Indonesian SOEs by using a qualitative approach. Previous studies of corporate governance in Indonesia mostly occurred in private companies and they employed a quantitative approach. Only a couple of studies investigated the corporate governance practices in SOEs. This study, it is hoped, contributes to and become an extension of previous studies concerning the corporate governance in Indonesia.

The findings of this thesis unveil the inappropriate corporate governance practices in Indonesian SOEs. The results can explain the huge gap between the corporate governance theory and its practices in Indonesian SOEs. Finally, this study makes recommendations that could be used to improve the model and practices of corporate governance in Indonesia.

9.4 Limitations
This study uses qualitative research to study corporate governance in three Indonesian SOEs. Qualitative study does have several limitations. Data collected in face-to-face interviews is open to bias such as memory lapses and a social desirability bias. The participants may have answered questions falsely because they may have been unwilling to admit to unacceptable behaviour. The sample of the respondent can be considered as opportunistic sample which could lead to bias in the interpretation of the findings (Salleh & Ahmad, 2012).

The result of this study should not be generalized to include private companies or other institutions such as non-profit organizations. This is because the study is based on three Indonesian SOEs. In addition, the result cannot be extended to include SOEs in other countries due to cultural, political and legal differences.
9.5 Future Research Directions

The researcher intends this paper to serve as a starting point in investigating the behaviour of internal stakeholders, including the behaviour of the two boards, employees, unions, and regulators.

It is recommended that future research on corporate governance in Indonesian SOEs focus on the behaviour of other stakeholders such as the legal institutions, the House of Representative, and the Indonesian police regarding the handling of the corporate scandals or frauds that have emerged. The issue of privatisation in Indonesian SOEs is also interesting to be studied since there is no guidelines yet have been set up by the Government of Indonesia. In addition, since there is no whistleblower protection in Indonesia, it is necessary to examine the steps that need to be taken to establish a whistleblower protection mechanism in Indonesia and weather this would be effective. Finally, mixed methods of research are recommended to be used in future research. By using both qualitative and quantitative research approaches the result can be more generalizable. This is because the results come from both qualitative in-depth interview analysis and statistical analysis.

9.6 Concluding Comment

The present qualitative study of corporate governance in Indonesian SOEs has identified flagrant disregards of the rules of proper company management. Over the last few decades the following corporate governance malpractices have been entrenched:

1. The systemic intervention by the ruling government or regime as the majority shareholder of the SOEs to advance its own political interests.

2. The government decision to adopt corporate governance system from the West proves to be incompatible with the corporate structure in Indonesia.
3. The prevalence of the so-called ‘Javanese culture’- feudalistic subservience - in the
day to day operations of the SOEs. This state of affair tends to diminish the ability of
staff members to correct let alone criticise their superiors.

In the present study, I have proposed corporate governance model and made a number
of recommendations on how to institute Good Corporate Governance in the SOEs. The
implementation of the recommendations, however, need to be closely monitored and
modified as required to accommodate the changing of business culture.
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Appendix A: List of Tertiary Institution Interviewees

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<thead>
<tr>
<th>No.</th>
<th>Name</th>
<th>Age</th>
<th>Position</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Benny</td>
<td>46-50</td>
<td>Senior Management in HR Department</td>
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<tr>
<td>2.</td>
<td>Edy</td>
<td>50</td>
<td>Internal Audit</td>
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<tr>
<td>3.</td>
<td>Barry</td>
<td>50</td>
<td>Head of Internal Audit</td>
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<tr>
<td>4.</td>
<td>Bisma</td>
<td>36-40</td>
<td>Head of Internal Audit</td>
</tr>
<tr>
<td>5.</td>
<td>Bode</td>
<td>40-45</td>
<td>Head of Compliance</td>
</tr>
<tr>
<td>6.</td>
<td>Boy</td>
<td>30-35</td>
<td>Operation Manager</td>
</tr>
<tr>
<td>7.</td>
<td>Brian</td>
<td>36-40</td>
<td>Manager</td>
</tr>
<tr>
<td>8.</td>
<td>Burhan</td>
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<td>Senior Management</td>
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<tr>
<td>10.</td>
<td>Connie</td>
<td>50</td>
<td>Manager</td>
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<tr>
<td>11.</td>
<td>Decky</td>
<td>46-50</td>
<td>Manager</td>
</tr>
<tr>
<td>12.</td>
<td>Donny</td>
<td>36-40</td>
<td>Manager</td>
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<tr>
<td>13.</td>
<td>Ellen</td>
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<tr>
<td>14.</td>
<td>Elvy</td>
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<tr>
<td>15.</td>
<td>Feny</td>
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<td>16.</td>
<td>Ferdy</td>
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<td>17.</td>
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<td>18.</td>
<td>Heny</td>
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<td>19.</td>
<td>Hotma</td>
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<td>Senior Management</td>
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<td>20.</td>
<td>Johny</td>
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<td>Manager</td>
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<td>21.</td>
<td>Joko</td>
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<td>23.</td>
<td>Karen</td>
<td>40-45</td>
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<td>Kathy</td>
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<td>Senior Management in Legal Department</td>
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<td>25.</td>
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<td>Nova</td>
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<td>27.</td>
<td>Ollie</td>
<td>46-50</td>
<td>Corporate Secretary</td>
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<td>28.</td>
<td>Opy</td>
<td>40-45</td>
<td>Manager</td>
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<td>Rino</td>
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<td>31.</td>
<td>Roy</td>
<td>40-45</td>
<td>Public Relation</td>
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<tr>
<td>32.</td>
<td>Sompi</td>
<td>50&lt;</td>
<td>Deputy Minister of SOEs</td>
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<tr>
<td>33.</td>
<td>Sony</td>
<td>50&lt;</td>
<td>Senior Management</td>
</tr>
<tr>
<td>34.</td>
<td>Surya</td>
<td>40-45</td>
<td>Head of Legal Division</td>
</tr>
<tr>
<td>35.</td>
<td>Tony</td>
<td>46-50</td>
<td>Senior Management</td>
</tr>
<tr>
<td>36.</td>
<td>Umi</td>
<td>30-35</td>
<td>Manager</td>
</tr>
<tr>
<td>37.</td>
<td>Yani</td>
<td>50&lt;</td>
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<tr>
<td>38.</td>
<td>Zull</td>
<td>50&lt;</td>
<td>Internal Audit</td>
</tr>
</tbody>
</table>
Appendix B: Sample of Transcribed Interview

Name: Burhan
Length of service: 27 years.
The male interviewee used to work for Bank of Indonesia (the Central Bank) before being appointed as a commissioner.

What’s the implementation of CG at this bank like?
In terms of implementation, there is a kind of ambivalence due to the two-tier system that we adopted. Some provisions given by BAPEPAM (Indonesia Capital Market Supervisory Agency) and Bank Indonesia (Central Bank) have not distinguished between the actual tasks and functions of the Board of Commissioners (BoC) and the Board of Directors (BoD). This is because they have just taken these provisions directly from the corporate system in the US (most of them) that employs the one-tier system and which differs from Indonesian corporate law (UU PT). There is no adjustment when applied to the Indonesian corporate system. For example, regarding internal control, there is no difference between the BoD and BoC judgment of the management in general.

One should distinguish between the role that the workload (portion) plays in BoC and BoD. He continued, “The function of BoC is advisory and controlling (overseeing), and it doesn’t have the executive function”. Actually, those provisions must be adapted to the local ones. The given policies by BI are sometimes made in a rush and for practical considerations. They said, “Take things as they are for a while.”

In your perspective, what is independency?
Independent or not independent, basically commissioners must be independent. Perhaps in our context if (commissioners) are to close with the shareholders (government) there would be this…and that (can be interpreted as a potential collusion). It can be assumed that the element of independence will be disturbed by this type of situation. As a consequence, there is a provision stating that there must be 30% independent commissioners placed in a public (listed) company. Personally, if I am a commissioner (not an independent commissioner), I would still be independent as a provision of the profession. Well, I can learn its corporate law, its rules and regulations inside the corporation, and learn how the rules should be implemented.

How about the government’s involvement?
BUMN or SOE consists of two types of state-owned corporations/BUMN, namely Perum (Public Corporation) and Persero (Corporation of Shareholders). The latter consists of ones referred to as Terbuka/ibk or those listed on the stock exchange, and those that have not been listed yet. If it is Persero, it falls under Corporate Law (or UU PT) and BUMN (UU BUMN). In general BUMN (or SOE) is still searching for the right form. The form (constitution) of BUMN is still unclear or unsettled in terms of how we view the SOE based on the constitution (UUD’45) For example, the divestment in Indosat’s case.

First, we have to refer to chapter 33 of UUD’45: “…sectors of production which are important for the country and affecting people’s lives shall be controlled by the state”.

310
So, in its implementation by the state, it is still not firm established yet whether ruling has been sufficiently covered by the regulations only or included in the state’s ownership, or perhaps even both. It is still unclear what this kind of state control looks like. The Corporate Law (UU BUMN) is ambivalent as well.

Secondly, what are the examples of important sectors of production? In my view, adequate principles and guidelines should be in place. For example, there was an oil & gas regulation that was cancelled by the court of institution for the reason that the regulation was not in harmony with “UUD”. There should be a standard guideline to the interpretation of the terms “sectors of production that are important for the country” and “controlled by the state”. As long as this basic principle (UU) is still not solid, there will be a lot of inconsistent operational policies. For example, BNI, Mandiri, or BRI, do they fall under the “important sectors of production” category? Do they “affect the life of the common people”, and hence, should they be “controlled by the state”? These issues are still open to interpretation. Furthermore, what is the form of control? Does control mean the majority, and therefore, in the context of ownership, a 51% ownership? In the example of divestment, there a lot of debate as to how many percent of ownership can be sold? If there is a clear guideline, there shouldn’t be any room for debate and arguments. This has implications for the way the government runs the SOE. If an SOE is considered as falling under the category “important sector of production that affects the life of common people”, a high level of government intervention is expected. Pertamina, for instance, falls under the category of “important for the country and affecting the life of the common people”, so what is the form of government control?

If there is no strong and clear guideline from the government/DPR (House of Commons), any given management may misinterpret the law, which includes the appointment of directors and commissioners. On the other hand, if the entity is a PT/Persero, it will all depend on the shareholders; in other words, if the government still forms the majority, it will depend on the government. Having said that, the minority shareholders cannot be overlooked because there are listing rules that have to be complied with.

In relation to this, I see that the government has not fully implemented the principles of its regulations into practice, hence, change of directors and commissioners may take place due to poor performance. Ideally, when an entity has a clear form, performance is measurable, transparent, and objective. Sometimes we see changes in directors and commissaries for obscure reasons. Failure is often used as a reason, when the terminology “failure” is more qualitative. In “GCG”, it is in the process of finding its form.

When there are changes (in directors and commissioners), are these reported in the media as a result of intervention by the government or political parties? If we follow the media, it looked as if there is still intervention from the government and political parties. However, there are too many parties that interpret the changes, when the parties and many times the intervened party have their own interpretation. This should not be the case. There should be clear criteria. Firstly, what is the basis of performance? Let’s take Pertamina and PLN, for example. Pertamina is still subsidized by the government, although sometime the subsidy comes in late. The
selling price of oil is also still governed by the government. Perhaps the measurement of performance is based on the availability of petrol and not on financial measures. In the case of PLN, charges for electricity usage are determined by the government, hence, financial performance is merely one indicator. The same problem exists in SOE Banks, they still receive subsidy and receive interest, hence, performance can not be based on financial measures because it is misleading. For instance, Bank Mandiri reported a 5-billion-rupiah profit. But how much is the government’s subsidy from debt interest? In my view, there should adjustments, because out of the 5-billion profits, the directors and commissaries receive a 1% bonus. It’s not proportional.

Second, there should be a clear appointment period. Hence, there is a well-defined period of accountability. Annually, there is a “general meeting” of stockholders, and upon presentation of the year’s performance, owners will determine whether they are satisfied or not. If in the annual general meeting (AGM), it turns out that the stockholders have accepted/are satisfied with the performance, then the directors shouldn’t be sacked.

In the Indonesian context, there are instances where directors are relieved from their position in the middle of their appointment period. Bank Mandiri for instance, will have their AGM, while BNI will have their 5th AGM.

Does Bank Indonesia intervene?

Formally, BI cannot intervene. However, BI could give informal advice. Basically, owners have the right to change directors, as long as it is done through the proper/legal channels, such as the AGM or the special General Meeting. Changes of directors for unclear reasons and without transparency might negatively influence stock price and result in wild interpretations. A new director will have to go through a fit-and-proper test from BI. BAPEPAM only complements the requirement.

Ideally, there should be an evaluation from the commissioners to the directors and by owners to the commissaries. BNI has a nomination and remuneration committee. But in practice, it hasn’t been optimized, because in various aspects, the government doesn’t seek advice from the committee. The government does ask for names, but in the end, the result/decision does not suit the committee’s evaluation. When a commissioner gives his/her opinion to the director and high officials, there should be clear criteria that are developed by the committee. If “A” is considered unfit, there should be a clear reason as to why. The board of commissioners discuss qualitative as well as quantitative performance measures. In the previous case of changing directors, the outcome was not optimal.

Does a change in minister result in a change of direction/policy?

Some time ago, there is hype for divestment, but now it has slowed down. It’s related to government policy, particularly when it’s been used as part of a political campaign. However, in its process, politics is not homogeneous, it changes all the time. Every political party has its own colour and ideology. This in turn is reflected in their policies. In the past, the reason for divestment was to balance the government’s budget, but in its
practice, often it goes against various regulations. For example, in the case of INDOSAT, GBHN is still in place. GBHN states that when privatization becomes necessary, it should be done in a selective manner, it should involve an in-depth study, and it should go through the stock exchange. The reason behind this is that ownership may be less concentrated, and a chance is given to citizens for ownership. However, in the case of INDOSAT the sale is a strategic one, because the government is under pressure to balance the government budget. In this case, the sale of INDOSAT is conducted under “budgetary” regulations. Under the budgetary regulation, revenue from divestment is allowed, and in the case of INDOSAT, it was passed by the “House of Commons”. Having said that, although the strategic sale of INDOSAT was in line with “budgetary” regulations, it broke GBHN, which has a higher level compared to “budgetary” regulations.

Now divestment activity has slowed down, the argument is that the political climate is not conducive (“the timing is not right”). However, this proves that there is no continuation in the SOE policies, regardless of whether this is right or wrong.

Is it true that in SOE policy, the main focus is privatization/divestment?

BNI was scheduled for divestment last year; they have even gone through a “road show” process. But last year the country had to go through three election processes. Political and social conditions are not conducive for divestment. There is no green light yet in the first semester of this year. This makes it difficult for the management to schedule the divestment. It is not easy to manage changes in policy or attitude. If divestment is slow (behind schedule), the management shouldn’t be blamed, because they have the political will, but unless the government/owner gives the green light, there is nothing they can do.

Is the Remuneration and Audit Committee independent?

Firstly, the audit committee exists, and it has been widely accepted because BAPEPAM requires it. Since 2004, (BI) established the risk and compliance committee, because there is a need for it. At the director’s level, there is a director for compliance and one for risk. At the commissary level, we have established the committee for risk and compliance. Last year, I was the chairman of this committee. But because the charter and programs were relatively new, we perfected it as we went along. In other words, from the beginning, the commissary had identified risk and compliance. We also observed how sufficient the regulations are and how the director implements them. It is also crucial to ensure that the man on the job is sufficient. I was once the chairman of the risk committee, but now, I’m the chairman of the audit committee. Each committee and chairman is independent, having their own charter & program and being chaired by a commissary. The output from each committee is channelled to the board of commissioners.

Each committee may be independent of each other, but how independent is the end decision? Input from the audit committee to the directors has to go through the board of commissioners. The audit committee provides 1) information; 2) advice/input for the commissioner board; the board subsequently makes decisions that will be passed on to
the directors. In general, it seldom happens that a committee’s input/recommendation is being disregarded by the board of directors.

374. Is the commissioner a member of the committees?

The chairman is a commissioner and there are commissary and non-commissary members. We have human resource problems that need improvements. The committee consists mostly of external members, however, because of compensation considerations, most of them are recruited as part-timers instead of full-timers. They are recruited from other government offices, the Central Bank, retired BNI staff, anyone that has ability in the field of auditing, risk management, and remuneration management. The ideal formation is not yet fulfilled because of limitations in the charter. The charter states that the appointment period of the committee members is similar to the appointment period of the related commissioner. However, in my point of view, the important thing is that the appointed member has the integrity and competence for the position. When there is a change in the commissioner, the previous members could still be employed. The audit committee has 5 members. A commissioner cannot be a member in more than one committee. None comes from BNI executives, they are only called to provide input. Members of the commissioner board are elected by members through a general meeting. The government is provided with recommendations by the deputies. If we follow media reports, the commissioners board and the director of SOE are elected in the same manner as the top echelon public workers. So the nomination goes through TPA (Tim Penilai Akhir or the team that make the final judgement for the nomination. It is currently chaired by the President). Hence, there is a recommendation from the minister in charge of SOE, and the recommendation is taken to the TPA members chaired by the President himself, the vice president, and a number of ministers. For Bank SOEs, the nominated will have to go through fit- and-proper tests.

The salary to be received by the commissioners is decided upon by the general assembly of stock holders. Hence, the remuneration committee was unable not do their job properly, all they could accomplish was recommend. Usually it is based on (a certain percentage of) the salary of the directors, because the directors are full-timers. In a single board system, both are employed full-time.

495. Does the commissary have any direct line of command vis-a-vis employees? Not directly. But the commissioner could ask the presence of certain employees for reasons of coordination. For instance, when a commissioner meets the legal division, we ask about or confirm certain legal matters. When we find evidence suggesting possible fraud, we request the presence of SPI (Satuan Pengawas Internal or Internal Control Task Force). In terms of organization, SPI fall under the general director, however, the audit committee could be summoned in urgent/critical matters. Even the position of Chairman of the SPI division is decided upon by the commissary.

What’s the Relationship with the Labour Union? There is none. The Labour Union only provides input/recommendations.

Does the Labour Union function effectively? No.
Appendix C: Sample of Request for Interview

Kepada Yth.
Bapak Abdulgani
Komisaris Utama
PT. Garuda Indonesia

Hal: Permohonan Wawancara

Perth, 22 April, 2005

Research Title: “A qualitative analysis of corporate governance in Indonesian State-Owned Enterprise: an internal stakeholders perspective.

Saya mahasiswa program Doktor (PhD program) dari Murdoch Business School, Murdoch University, memohon kesediaan waktu dari Bapak untuk diwawancarai. Adapun topik penelitian saya adalah 'Pelaksanaan Corporate Governance di Badan Usaha Milik Negara (BUMN) di Indonesia.

Tujuan dari penelitian ini adalah:
1) Mengidentifikasi pelaksanaan corporate governance oleh badan komisaris dan badan direktur di BUMN.
2) Menyelidiki dan mengevaluasi elemen utama dari corporate governance di BUMN.

Penelitian ini memerlukan kurang lebih 40 respondents yang mempunyai kedudukan sebagai Komisaris, Direktur, dan Manajemen tingkat tengah di enam BUMN, dan 4 respondents dari instansi yang terkait. Lama waktu wawancara diperkirakan tidak lebih dari 45 menit. Walaupun demikian, lama waktu wawancara bisa dipersingkat sesuai dengan ketersediaan waktu Bapak. Dan, atas seizin dari Bapak terlebih dahulu wawancara ini akan direkam hanya untuk kepentingan akurasi data saja. Tetapi jika tidak berkenan untuk di rekam, pencatatan data hanya dengan ditulis tangan.

Untuk mendapatkan keterangan lebih lanjut mengenai penelitian ini kiranya dapat menghubungi saya, Frederik G. Worang dengan telpon 61-8-9360 6020.
Sebelum dan sesudahnya saya ucapkan terima kasih atas kesediaan Bapak, dan mengharapkan dapat bertemu sesuai dengan waktu dan tempat yg disediakan.

Hormat Saya,

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