

Corporate Governance and State-owned Enterprises: A Study of Indonesia's Code of Corporate Governance

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Abstract. In Indonesia, the concept of corporate governance was formally introduced in 1999 when the government established the National Committee on Corporate Governance (NCCG). Indonesia then created its national code of corporate governance in 2000 through the NCCG, later revised in 2006. This code is a reference point for all companies in Indonesia, including state-owned enterprises (SOEs) that are regulated under Law No. 19 of 2003. According to the law, there are two types of SOEs: general companies and limited liability companies. The former are SOEs that have tasks to run social purposes. The latter are business-oriented SOEs, comprise listed companies or companies where shares are fragmented and non-listed companies (pure SOEs), where the government is representative of ordinary public as shareholder. Consequently, Indonesia's code of good corporate governance applies also to pure SOEs. By undertaking a document analysis method, the study attempts to answer a question as to what extent Indonesia's concept of corporate governance conforms to the Anglo-American corporate governance regime. In addition, this article examines Indonesia's code of corporate governance and to determine whether the code is suitable for solving the existing problems of SOEs, including pure SOEs. This study found that the mainstream corporate governance is designed to deal with agency problem that occurs in publicly traded companies with widely dispersed shareholders as opposed to non-listed companies such as pure SOEs with the government as shareholder's representative. It also found that the code has failed to solve two other crucial problems, conflicting objectives and political interference. However, the Indonesia code is currently the best solution in upholding listed companies with fragmented shareholders.

1 Introduction

The Anglo-American or Anglo-Saxon corporate governance system and the Continental Europe system also often referred to as the German-Japanese model are two competing corporate governance regimes. While the former is credited as a dominant model, the latter is its challenger.¹

A fiduciary connection between shareholders and managers is main characteristic of the Anglo-American corporate governance model.² The relationship between shareholders and managers is important as it creates possible agency problems, which typically exist in companies with widely dispersed shareholders and where the influence of shareholders over company's management is not tough.³ These are the main features that underlie the concept of the dominant model of corporate governance. This problem has existed and mushroomed in the United Kingdom and the United States where the majority of the stocks in the biggest public companies are owned by institutional investors.⁴

In contrast, the major feature of the Continental Europe model is that it considers both the shareholders' interests and other stakeholders' benefit, especially the employees.⁵ Within the Continental Europe system, the

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¹ Marry O'Sullivan, *Contests for Corporate Control Corporate Governance and Economic Performance in the United States and Germany* (1978)

² Lucian Cernat, 'The Emerging European Corporate Governance Model: Anglo-Saxon, Continental, or Still the Century of Diversity?' (2004) 11(1) *Journal of European Public Policy* 153

³ Ibid 151

⁴ Lorraine E. Talbot, *Critical Company Law* (2008)

⁵ Cernat, above n 2, 153

employee's representatives are given an opportunity to sit as members of company's supervisory board. This model essentially aims to counteract the misuse of executive power,⁶ which possibly occurs in the model of Anglo-American.

The evolution of corporate governance law in Indonesia has a variety of unique characteristics, notably the application of the model to State-owned Enterprises (SOEs). As seen from Indonesia's code of corporate governance text, the code is a reference point for all companies in Indonesia, including SOEs regardless of types. Indonesian SOEs are regulated under Law No. 19 of 2003. According to the law, there are two types of SOEs: limited liability companies and general companies. The former is divided into two types, and they are listed companies or companies where shares are fragmented and non-listed companies (hereinafter "pure SOEs"), which are companies where the government is representative of public as shareholder. Consequently, Indonesia's code of good corporate governance applies to pure SOEs as well.

The objectives of the present study attempts to determine the extent of how Indonesia's concept of corporate governance conforms to the Anglo-American corporate governance regime. In addition, this examines Indonesia's code of corporate governance and whether the code is suitable for solving the existing problems of SOEs, including pure SOEs. The code is discussed as a national code of corporate governance and is the basis for implementing a country's corporate governance regime. Furthermore, though the discussion is based on Indonesia's non-listed SOEs, it might be applicable to other developing countries where SOEs exist.

The rest of the paper is organised as follows: Section 2 refers to the theoretical development of corporate governance covering the origins of corporate governance, categories of corporate governance, modern corporate governance and codes of corporate governance framework. Section 3 deals with corporate governance in Indonesia covering its short history and the inception of the Indonesian code of good corporate governance. Section 4 examines Indonesian SOEs' problems and section 5 provides a brief overview of Indonesia's latest code of good corporate governance. Section 6 argues that the current Indonesian corporate governance regime is conceptually unsuitable for Indonesia's SOEs, notably pure SOEs. Section 7 concludes the discussion.

2. Theoretical Framework

2.1 The origins of corporate governance

Based on their seminal work on the separation of company ownership, Adolf Berle and Gardiner Means⁷ are considered distinguished scholars in the field of corporate governance. After conducting a study of America's larger companies after the Wall Street crash of 1929, they concluded that the separation of ownership and control is attributable to widely fragmented company ownership.⁸ The dispersed shareholders (principals) have no choice but to hire managers (agents) to manage the company, which has been creating the principal-agent relationship. In effect, an agency problem typically arises from the principal-agent relationship⁹ and as such, agents may expropriate the principals' investments. This can occur when the agents have more information and knowledge than the principals¹⁰ or when information asymmetry between principals and agents exists.¹¹ Further, there are two situations that have been the focus of the principal-agent framework. First, "moral hazard arises when the agent's action, or the outcome of the action, is only imperfectly observable to the principal. A manager, for example, may exercise a low level of effort, waste corporate resources, or take inappropriate risks. Second, "Adverse selection can arise when the agent has some private information, prior to entering into relations with the principal. Individuals with poor skills or aptitude will present themselves as having superior ones, people with low motivation will apply for the positions that involve the least supervision, and so forth".¹²

⁶ Steve Letza et al, 'Corporate governance theorising: limits, critics and alternatives' (2008) 50 *International Journal of Law and Management* 18

⁷ Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (1932)

⁸ Talbot, above n 4, 109

⁹ Brian R. Cheffins, 'Law as Bedrock: The Foundations of an Economy Dominated by Widely Held Public Companies' (2003) 23 *Oxford Journal of Legal Studies* 3, 4

¹⁰ Yuwa Wei, *Comparative corporate governance: a Chinese perspective* (2003), 43

¹¹ Joseph Heath and Wayne Norman, 'Stakeholder Theory, Corporate Governance and Public Management: What Can the History of State-Run Enterprises Teach Us in the Post-Enron Era?' (2004) 53 *Journal of Business Ethics* 252-253

¹² Ibid

As a result, the primary focus of Berle and Means' corporate governance study was on the expropriation of shareholders' assets by managers due to separation of ownership and control.¹³ Simply put, the divorce between ownership and control brings about the likely for considerable free-rider dilemma between agents and principals.¹⁴

Jensen and Meckling's¹⁵ assertion is similar to that of Berle and Means' work. They state that "the aim of all governance mechanisms is to reduce the agency costs that exist due to the separation of ownership and control especially in large public corporations".¹⁶ Fama and Jensen¹⁷ similarly suggest that "the problem of corporate governance mainly arises in large organisations such as publicly held and listed corporations whose ownership and controls are typically separated".¹⁸ In other words, the agency problem typically occurs in a company where shareholders are fragmented includes listed corporations. This is not to say that agency problems prevail in the publicly held and listed companies only. However, agency problems may also occur in other types of companies such as small companies, family firms and non-listed companies but the types and the degree of the agency problems would not be the same.

Moreover, La Porta, Lopez-de-Silanes, Shleifer and Vishny confirm the study of Berle and Means, Jensen and Meckling, and Fama and Jensen. By conducting a series of empirical work on investor protection,¹⁹ La Porta et al. argue that the nature of corporate governance is absolutely to protect outside investors from the diversion of their assets by insiders.²⁰ While both controlling shareholders and managers are classified as insiders, La Porta et al. classify investors and minority shareholders as outsiders.²¹ They affirm that the diversion of outsiders' money by insiders occurs as a result of an asymmetric information problem between outsiders and insiders. The asymmetric information problem typically occurs since insiders as the company's majority shareholders and controlling management do not share the company's vital information they have. Therefore, La Porta et al.'s definition of corporate governance being, "to a large extent, a set of mechanisms through which outside investors protect themselves against expropriation by the insiders"²² is understandable.

Apart from these findings, a study of fifty-two national corporate governance codes, including Indonesia's code, by Steen Thomsen confirms the aforementioned studies, concluding that codes of corporate governance around the world are specifically designed to fill the gap of unbalanced information between investors and companies,²³ so that insiders cannot divert the outside investors' money to their advantage.

To sum up, the system of corporate governance is to resolving the agency problems that occur between principal and agents of company. Conversely the system of corporate governance is not needed when the agency problem does not exist such as the agents' actions are completely clear and all other information is common knowledge.²⁴ Within the context of the modern corporation era, a company is normally owned by dispersed owners through the capital market.²⁵ The dispersed owners do not have the ability to exert direct control over the company. The numbers of shares they own are often not sufficient to direct the company's policies because in addition to the dispersed owners within the company, there is also a major shareholder that often collaborates with the company's management in making policies that are inconsistent with the interests of the dispersed owners.

2.2 Two categories of corporate governance

Scholars generally divide the world's systems of corporate governance into two categories; however, the terminology used to describe these categories differs. While Cheffins employs the outsider/arm's length and the

¹³ Malla Praveen Bhasa, 'Global Corporate Governance: Debates and Challenges' (2004) 4(2) *Corporate Governance: The International Journal of Business in Society* 7

¹⁴ Heath and Norman, above n 11, 252

¹⁵ Michael C. Jensen and William H. Meckling, 'Theory of the firm: managerial behaviour, agency costs and ownership structure' (1976) 3 *Journal of Financial Economics* 305-360

¹⁶ Carol Padgett and Amama Shaukat, 'The UK Code of Corporate Governance: Link between Companies and Firm Performance' (2005) *ICMA Centre Discussion Papers in Finance DP2005-17*

¹⁷ Eugene F. Fama and Michael C. Jensen, 'Separation of Ownership and Control' (1983) 26 *Journal of Law and Economics* 301-325

¹⁸ Jochen Zimmermann, Igor Goncharov and Joerg R. Werner, 'Does Compliance with the German Corporate Governance Code Have an Impact on Stock Valuation? An empirical analysis' (2006) 14 *Corporate Governance International* 434

¹⁹ Rafael La Porta et al, 'Legal Determinant of External Finance' (1997) 52 *Journal of Finance* ; Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'Law and Finance' (1998) 106 *Journal of Political Economy* 1152; Rafael La Porta et al, 'Corporate Ownership around the World' (1999) 54 *Journal of Finance* ; Rafael La Porta et al, 'Agency Problem and Dividend Policies around the World' (1999) 55 *Journal of Finance* .

²⁰ Simeon Djankov et al, 'The Law and Economics of Self-dealing' (2008) 88 *Journal of Financial Economics* 430

²¹ Rafael La Porta et al, 'Investor protection and corporate governance' (2000) 58 *Journal of Financial Economics* 4

²² Ibid

²³ Steen Thomsen, 'The Hidden Meaning of Codes: Corporate Governance and Investors Rent Seeking' (2006) 7 *European Business Organization Law Review* 851, 848

²⁴ Heath and Norman, above n 11, 252

²⁵ Djankov, above n 20, 430

insider/control-oriented terms,²⁶ Moerland chooses market-oriented systems and network-oriented systems to describe the two poses of corporate governance systems.²⁷ Additionally, there are two models utilised to illustrate the division: the Anglo-American model and the German-Japanese model.²⁸

2.2.1 The Anglo-American system

According to Cheffins, the Anglo-American model is categorised as arm's length, since the company's shareholders control their shares at a distance by putting their trust in the company's management to run daily company activities.²⁹ This model exists in the US and the UK because the majority of their large companies are listed in stock exchanges. Moerland notes that 99 percent of the top 400 US companies are listed in a stock exchange, while 67 percent of the top 100 UK firms are listed corporations, for example.³⁰ This means the US and UK's companies' stockholders are scattered as opposed to concentrated. One scholar argues that this model emphasises a company's shareholders' value and shareholder-management relations, and positions the market as a supervising tool. Thus it can be shown to be an outsider model.³¹

The principal-agent or finance model and the myopic market model are two major theories that can be used to examine the Anglo-American corporate governance model. The finance model concerns the maximisation of shareholders' prosperity in which the shareholders' prosperity is regarded as a social function of the corporations.³² As Friedman states, making profits in a free market for the company's shareholders is the only role of a company in community.³³ Consequently, other social functions should not hinder the company in realising its goal, and therefore should be undertaken by other government and charitable organisations.³⁴ To the Anglo-American model's supporters, when corporations are managed properly in order to maximise the value of its shares, the performance of the economic structure at large can be straightforwardly improved.³⁵

Like the finance model, the myopic market model supports the maximisation of shareholders' affluence as the key company target. However, it criticises the financial model by arguing it is too focused on the short-term interests of a company's performance, such as short-term return on investment, short-term corporate profits, short-term management performance, short-term stock market prices, and short-term expenditure.³⁶ In this way it neglects the corporation's long-term value and the corporation's competitiveness.³⁷ As an alternative, the myopic market model suggests that the restructuring of corporate governance reform should be done by encouraging shareholders and managers to share long-term performance horizons. This includes "increasing shareholders' royalty and voice, reducing the ease of shareholders' exit, restricting the takeover process and voting rights for short-term shareholders, encouraging relationship to lock financial institutions into long-term positions and empowering other groups such as employees and suppliers to form long-term relationship with the firm".³⁸

To summarise the above, the Anglo-American model is characterised by the following characteristics: the corporation's shares are owned by small shareholders or fragmented ownership, the maximisation of shareholders' value is the corporation's primary goal,³⁹ and a well-developed financial market is positioned as a firm's supervising instrument.⁴⁰

²⁶ Brian R. Cheffins, 'Law as Bedrock: The Foundations of an Economy Dominated by Widely Held Public Companies' (2003) 23 *Oxford Journal of Legal Studies* 3

²⁷ Pieter W. Moerland, 'Alternative Disciplinary Mechanisms in Different Corporate Systems' (1995) 26 *Journal of Economic Behavior and Organization* 19

²⁸ O'Sullivan, above n 1

²⁹ Cheffins, above n 26, 3

³⁰ Moerland, above n 27, 19

³¹ Irene Lynch Fanon, 'The European Social Model of Corporate Governance: Prospects for Success in an Enlarged Europe' in Paul Ali and Greg Gregoriou, N (eds), *International Corporate Governance After Sarbanes-Oxley* (2006) 424

³² Letza et al., above n 6, 18

³³ Milton Friedman, 'The Social Responsibility of Business is to Increase its Profits' (1970) *The New York Times Magazine* <<http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html>> at 24 March 2010

³⁴ Ibid

³⁵ O'Sullivan, above n 1, 43

³⁶ Steve Letza and Xiuping Sun, 'Philosophical and Paradoxical Issues in Corporate Governance' (2004) 1 *International Journal of Business Governance & Ethics* 32

³⁷ Letza et al., above n 6, 19

³⁸ Letza and Sun, above n 36, 32

³⁹ Yuan Dujuan, 'Inefficient American Corporate Governance under the Financial Crisis and China's Reflections' (2009) 51 *International Journal Law and Management* 140-141

⁴⁰ Moerland, above n 27, 19

2.2.2 The Continental Europe systems

A close relationship between the corporation and its capital providers, including shareholders and bankers and other financial institutions, is the core element of the insider/control-oriented model. Japan and Continental European countries such as Germany are considered representatives of the model.⁴¹ This system is called an insider model because it allows stakeholders, in addition to shareholders, to be members of the company's board (a supervisory board).⁴² Giving employees a room to become members of company's supervisory board of so-called codetermination or betriebliche Mitbestimmung is a company structure model derives originally from Germany.⁴³ In Germany under the Management Relation Act of 1952 and the Codetermination Act of 1976, in a large company up to half members of supervisory board are elected by the company's employees. Moreover, Full Parity codetermination, Quasi-Parity Codetermination and One-Third Codetermination are three types of the Germany's codeterminations.⁴⁴

The major goal of the insider model is to counteract the abuse of executive power in shareholder models.⁴⁵ The abuse of executive power is a criticism levelled at the Anglo-American system, which gives greater power to the executive management who can potentially distort their authority for their own interests, at the expense of stockholders and society at large. One of the examples of the abuse of executive power problem is exorbitant executive overpayments, when the executive managements are allowed set their big salaries in a way that does not reflect the performance of the company.⁴⁶ Those who favour the insider model argue that the executive power abuse problem cannot be resolved, even if the Anglo-American corporate governance model introduces institutional restraints on managerial behaviour, for example non-executive directors, audit processes and threats of takeover.⁴⁷

Proponents of the insider model also doubt whether corporate governance reforms such as non-executive directors, shareholder involvement in major decisions and transparency into corporate affairs are in fact appropriate monitoring instruments.⁴⁸ What is instead proposed is the idea of "managerial freedom with accountability", which involves letting decision-making management build up the longer term plans of the company, while ensuring the board is strictly responsible to all stakeholders involved in the company.⁴⁹ The corporation is seen to have a responsibility to a large number of individuals and groups, who are also considered stakeholders in addition to the company's capital providers.⁵⁰ This approach recognises the existence of non-shareholding company groups, for example employees, suppliers, customers and managers who have a continuing connection with the company.⁵¹

Unlike the shareholder's perspective, this insider stakeholder model regards the aim of corporate governance as maximising the business' values at large.⁵² Thus, from the perspective of stakeholder theory, two groups exist: first, the primary stakeholders such as minority shareholders, lenders, consumers, employees, suppliers and managers, and second, the secondary stakeholders, including the local community, the media, the court, the government, special interest groups and the general public.⁵³

Giving the opportunity for company stakeholders other than shareholders to be on the company board is the key feature of the network-oriented model. Additionally, the stakeholder model recognises and values the involvement of major shareholders and banks as providers of capital and controllers of the corporations.⁵⁴

⁴¹ Fannon, above n 31, 425

⁴² Ibid

⁴³ Gérard Hertig, 'Codetermination as a (Partial) Substitute for Mandatory Disclosure?' (2006) 7 *European Business Organization Law Review* 129

⁴⁴ Jean J. Du Plessis and Otto Sandrock, 'The German System of Supervisory Codetermination by Employees' in Jean du Plessis, J et al (eds), *German Corporate Governance in International and European Context* (2007) 111

⁴⁵ Letza et al, above n 6, 19

⁴⁶ Ibid

⁴⁷ Ibid

⁴⁸ Ibid, 20

⁴⁹ Ibid

⁵⁰ James P. Hawley and Andrew T. Williams, 'Corporate Governance in the United States: The Rise of Fiduciary Capitalism A Review of the Literature' (1996) <<http://www.lens-library.com/info/papers96/first/firstpart2.htm>> at 21 March 2010

⁵¹ Letza et al, above n 6, 20

⁵² Ibid

⁵³ Ibid

⁵⁴ Moerland, above n 27, 19

2.3 Modern corporate governance

The collapse of some huge companies such as Enron, WorldCom and Tyco International in 2001 is considered as a foundation saga for the new era of corporate governance. The firms' catastrophe occurred in spite of the application of the concept of corporate governance. Enron and WorldCom, for example, had non-executive directors at that time. This can be assumed that previous American corporate governance was powerless to prevent these companies from bankruptcy.⁵⁵

In the wake of the disaster on 30 July 2002, the American Congress passed a new law, the Sarbanes-Oxley Act of 2002, which is known as the Public Company Accounting Reform and Investor Protection Act of 2002. This is the most important law reform relating to corporate governance in the US.⁵⁶ The law requires all companies that have registered equity or debt securities with the Security and Exchange Commission (SEC) to adhere to it. Therefore, the listed companies have to meet all the requirements contained in the SOX - the so-called mandatory model, which means "legally mandated, with penalties imposed on those who fail to comply with the legal rule in question".⁵⁷

The advocates of the system claim that it would be a highway to overcoming the crucial problem of corporation. Paul Atkins, the Commissioner of the Security Exchange Commission, argues that the world needs a strict corporate governance regime, which is able to eliminate fraud, corruption and other misdeeds and practices. Furthermore, Atkins argues that using soft law and requiring a company to hire a number of non-executive directors, for instance, would not prevent corporate failures.⁵⁸ This is evident from the experience of Enron and WorldCom – though these companies had non-executive directors, they were unable to prevent these companies from plunging into bankruptcy.⁵⁹

Unlike America, Australia is one of the countries utilising the voluntary model. The Australia Stock Exchange Corporate Governance Council explicitly asserts that the Australian Principles of Good Corporate Governance and the Best Practice Recommendation contain a voluntary system. As a result, while listed companies might not comply with the Principles, they have to provide sufficient and reasonable arguments as to why they don't. The Australian system functions on the basic principle of "if not, why not" as opposed to the "one size fits all" approach.⁶⁰

The underlying concept of the Australian's code is that the market can come to its own conclusions about the significance of non-compliance based on the circumstances of individual companies.⁶¹ The initial drafters of the Australian Principles seem to give freedom to the listed companies to build their own system for running their companies as long as they have reasonable grounds for doing it their way.

The Australian model could have been adapted from the UK's Code on Corporate Governance of 2000, sometimes called the combined code on corporate governance. The execution of the voluntary system in the UK can be viewed in paragraph 4 of the preamble of the combined code, which states two points: firstly, listed companies are free to design the form of disclosure statement because the committee does not provide listed companies with a specific form; secondly, there is no requirement for all listed companies to apply the content of the code. Where listed companies do not adhere to the combined code, they must explain it; this is known as the "comply or explain" approach.⁶²

In the UK the philosophy of the "comply or explain" approach is to pay attention to smaller listed companies. This approach takes into account that there are many small listed companies, for which the substance of the code might not be suitable. Therefore, the smaller listed companies are allowed to conduct their business under the other model by giving substantial reasons.⁶³ To put it simply, the UK combined code and the Australian model provide for the fact that not all of listed companies need the same model.

⁵⁵ Paul S. Atkins, 'The Sarbanes-Oxley Act of 2002: Goals, Content, and Status of Implementation' (2003) <<http://www.sec.gov/news/speech/spch032503psa.htm>> at 20 March 2008

⁵⁶ Larry E. Ribstein, 'Market vs. Regulatory to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002' (2002) 28(1) *Journal of Company Law* 3

⁵⁷ Anita I. Anand, 'Voluntary vs. Mandatory Corporate Governance: Towards and Optimal Regulatory Framework' (2005) *bepress Legal Series. Working Paper* 566 4

⁵⁸ Atkins, above n 55

⁵⁹ Ibid

⁶⁰ 2nd ASX Corporate Governance Council, Corporate Governance Principles Recommendations, (August 2007) <http://www.asx.com.au/supervision/pdf/corp_governance_principles_recommendations_2nd_edition.pdf> at 15 April 2008

⁶¹ Stephen Bartholomeusz, *Governance Changes May Have Unforeseen Effects on Boards* (April 2003) <<http://www.theage.com.au/articles/2003/04/04/1048962935224.html>> at 20 March 2008

⁶² The Combined Code on Corporate Governance (July 2003),

<<http://www.frc.org.uk/documents/pagemanager/frc/Web%20Optimised%20Combined%20Code%203rd%20proof.pdf>> at 15 April 2008

⁶³ Ibid

However, both mandatory and voluntary regulation corporate governance models are designed to uphold companies with shares dispersed as opposed to concentrated ownership. The debate on mandatory and voluntary models is essentially not about which would be most suitable to apply to corporations at large. These are two perspectives that aim to deal with the laws that are needed to support the agency problems facing companies with shareholdings that are fragmented.

From a practical point of view, the Sarbanes Oxley Act of 2002 is a product of the “law matters” thesis, which essentially contends that law is important to protect shareholders, especially minority shareholders, from insider expropriation.⁶⁴ The ultimate goal of the “law matters” thesis is to promote capital markets and economic growth, which can be achieved by upholding shareholders’ property rights.⁶⁵ This thesis therefore considers minority shareholders as primary players of capital markets.

It suffices to mention that there is a significant relationship between capital markets and corporate governance. In effect, corporate governance came into existence during the 1990s when the deregulation and internationalisation of capital markets were started,⁶⁶ and institutional investment through pension funds began to grow in the United States and the United Kingdom. So, borrowing Thomsen’s assertion, it could be said that corporate governance is a primary agenda of institutional shareholders.⁶⁷

2.4 Code of corporate governance framework

Thomseen defines the codes of corporate governance as “sets of recommendations on good corporate governance, primarily concerning the structure, organisation and decision processes of the board, but also to some extent dealing with executive pay, information disclosure and investor relations”.⁶⁸ According to Aguilera and Cuervo-Cazurra, although not all national codes contain the same contents, the prescription for improving the quality of company’s board governance and increasing the corporate accountability to shareholders for the sake of maximizing the values of shareholders or stakeholders are always contained in the codes around the world.⁶⁹ Further, scholars formulate a general characteristic of codes of corporate governance: most of the codes are applying a comply or explain approach, the codes are regarded as soft-laws rather than laws, the majority of the codes prescribe the establishment of an audit committee and remuneration committee, the codes are also concerned with transparency issues, role of board and investor protection in addition to recommend avoiding deception as well as providing a favourable investing atmosphere to catch the attention of foreign capital.⁷⁰ The universal features of the corporate governance codes used to measure whether the Indonesia’s model of corporate governance conforms to the Anglo-American system.

3. Method of data collection

Method is defined as a way utilized to gather and examine data.⁷¹ Several methods are offered in undertaking research in the social science such as case study, questionnaire, document analysis, narrative, interpretative methods and focus group.⁷² For the study, which seeks to do qualitative research, document analysis was method used to gather data. The document that was analysed was that the latest Indonesia’s code of good corporate governance that was created by National Committee on Governance in 2006. The document was downloaded from the National Committee on Governance’s official website.⁷³ Accordingly, the reliability of the document can be accounted for.

⁶⁴ Troy A. Paredes, 'A Systems Approach to Corporate Governance Reform: Why Importing U.S. Corporate Law isn't the Answer' (2004) 45 *William and Marry Law Review* 1057

⁶⁵ Ibid 1056

⁶⁶ Thomsen, above n 23, 850-851

⁶⁷ Ibid 848

⁶⁸ Thomseen, above n 23, 847

⁶⁹ Ruth V. Aguilera and Alvaro Cuervo-Cazurra, 'Codes of Good Governance Worldwide: What is the Trigger?' (2004) 25 *Organization Studies* 423-420

⁷⁰ Ibid

⁷¹ John H. Farrar, 'In Pursuit of an Appropriate Theoretical Perspective and Methodology for Comparative Corporate Governance' (2001) 13 *Australian Journal of Corporate Law* 4

⁷² Ibid

⁷³ National Committee on Governance, 'Indonesia's Code of Good Corporate Governance' (2006) <www.governance-indonesia.com> at 16 December 2008

4. Corporate Governance in Indonesia

4.1 A brief historical overview

The history of Indonesia's corporate governance is closely linked to the South Asian financial crisis. The crisis started in Thailand and spread to the Philippines, Indonesia, Malaysia and South Korea.⁷⁴

A commentator stated that the 1997 Asian financial tragedy was a milestone in the history of corporate governance in Indonesia. He reflected that the financial condition in 1997 was abysmal with the value of the rupiah at mid-August 1997 having lost 27% against the United States (US) dollar.⁷⁵ The crisis impacted severely on a number of Southeast Asian countries. For instance, the Indonesian currency depreciated by nearly 80% and some businesses, especially in the banking sector, collapsed.⁷⁶

The Indonesian government needed financial assistance. The IMF offered a conditional loan, which meant that Indonesia had to meet certain requirements in return for the loan. One of the requirements was to restore the corporate governance system.⁷⁷ From the IMF's perspective, Indonesia's existing corporate governance was a major determinant of Indonesia's vulnerable economic condition. Five letters of intent from the Indonesian government under the Soeharto's presidency indicated that Indonesia concurred with the conditions.⁷⁸

As a result, from the perspective of history, the delivery of corporate governance in Indonesia was not based on local initiative.⁷⁹ It was delivered as a result of the outsider's ordain, which means Indonesia adopted the IMF's corporate governance because it had no other way to overcome the financial crisis.

4.2 The inception of the code

Aguilera and Cuervo-Cazurra's study on codes of corporate governance around the world concludes that there are six types of creators of codes of corporate governance: stock exchange, when the stock exchange publishes a code; government, when the government initiates a code; directors' association, when an association of directors establishes a code; managers' association, when an association of managers issues a code; professional association, when an association of accounting or law professionals issue a code; and investors' association, when an association of investors creates a code.⁸⁰

Indonesia has not chosen any of the above models. It seems to have chosen a middle path. The code of Indonesia's corporate governance was first issued by the National Committee on Corporate Governance (NCCG). The committee was created by the Indonesian government through the Coordinating Minister for Economy, Finance and Industry in 1999. The committee had two main duties, namely to codify corporate governance principles and to develop an institutional framework to implement the code.⁸¹ Subsequently, in March 2000 the committee successfully established the Code for Good Corporate Governance.⁸² This applied to SOEs and companies listed on the Jakarta Stock Exchange.

In 2004 the government changed the NCCG to the National Committee on Governance (NCG), which embraced the Public Governance Sub-committee and Corporate Governance Sub-committee.⁸³ In 2006 the NCG reviewed the Code for Good Corporate Governance under the title Indonesia's Code of Good Corporate Governance.⁸⁴

⁷⁴ Jeremy J. Kingsley, 'Transplantation: Is this What the Doctor Ordered and are the Blood Types Compatible? The Application of Interdisciplinary Research to Law Reform in the Developing World – A Case Study of Corporate Governance in Indonesia' (2004) 21 *Arizona Journal of International & Comparative Law* 501

⁷⁵ Benny Simon Tabalujan, 'Why Indonesian Corporate Governance Failed – Conjectures Concerning Legal Culture' (2002) 15(2) *Columbia Journal of Asian Law* 4

⁷⁶ William E. Daniel, 'Corporate Governance in Indonesian Listed Companies – A Problem of Legal Transplant' (2003) 15 *Bond Law Review* 318

⁷⁷ Dudi M. Kurniawan and Nur Indriantoro, 'Corporate Governance in Indonesia' (2000) *Paper on The Second Asian Roundtable on Corporate Governance* 9 <<http://www.oecd.org/dataoecd/6/62/1931154.pdf>> at 21 March 2008

⁷⁸ Letters of Intent dated October 31, 1997; July 29, 1998; May 14, 1999; July 22, 1999; and January 20, 2000

⁷⁹ Daniel, above n 76, 357

⁸⁰ Aguilera and Cuervo-Cazurra, above 69, 423

⁸¹ The Decree of the Coordinator Minister of the Economic, Finance and Industry No. 1/M.EKUI/08/1999 dated 9 August 1999.

⁸² Daniel, above n 76, 360

⁸³ National Committee on Governance, above n 73

⁸⁴ Ibid

5. Problems with SOEs

In general, conflicting objectives, agency issues (political interference) and lack of transparency,⁸⁵ are considered the main problems of SOEs all over the globe that might be also faced by Indonesia SOEs.

Due to conflicting objectives, SOEs do not only have commercial goals but that they are also under obligation to serve social objectives such as providing jobs, serving public interests and providing basic necessities.⁸⁶ This is different from the conditions faced by private companies where they have a single goal as a business entity, i.e. profit maximization. Simply put, SOEs have the burden of satisfying public needs in addition to pursuing their business activities. Therefore due to these multiple tasks, SOEs can be disadvantaged in competing with their private company counterparts for profits.

Agency issue is considered one of the SOEs' major problems because politicians and bureaucrats as agents tend not to carry out their work in accordance with the interests of society as real owners. The agents run the company for their self-interest as opposed to the owners' interest. For instance, the politicians force companies to perform unprofitable activities in their electoral district in order to be re-elected in the next election.⁸⁷ Likewise, politicians and bureaucrats are not serious in running their task as they do not benefit directly from SOEs. On the contrary, they are also likely to be blamed if SOEs gain high profits because it would be regarded as too commercial SOEs.⁸⁸

The lack of transparency is considered as another problem for SOEs because they do not disclose important information to the public as ultimate owner. Therefore, the public as valid owners of SOEs do not have social control.⁸⁹ The lack of transparency is supposed to be an intentional agenda of the actual principals (politicians and bureaucrats). This is presumably to shield their own interests in the business of SOEs.⁹⁰ The lack of transparency leads to inefficiencies in the SOEs.

In addition, the World Bank identifies other problems faced by SOEs namely unprofessional board of directors. According to the World Bank, members of the board directors are influenced by the government because most of them are public servants. Board members who come from labours also have their own agenda against the interests of the company as a whole.⁹¹ In the context of two-tier board system, board of directors to some extents is equal to supervisory organ or commissioner under the Indonesia system.

5. A Brief Overview of the Indonesian Code

This section examines Indonesia's code of good corporate governance to determine whether or not it is designed to deal with SOEs' problems, especially non-listed SOEs.

The latest version of Indonesia's Code of Good Corporate Governance, which was formally published by the National Committee on Governance on 17 October 2006,⁹² consists of eight chapters. Table 1 summarizes the central points of the Indonesia's code of good corporate governance.

⁸⁵ Simon C. Y. Wong, 'Improving Corporate Governance in SOEs: An Integrated Approach' (2004) 7 *Corporate Governance International* 6

⁸⁶ Ibid 8

⁸⁷ Ibid 9

⁸⁸ Ibid

⁸⁹ Agung Wicaksono, *Corporate Governance of SOEs: Investment Holding Structure of Government-Linked Companies in Singapore and Malaysia and Applicability for Indonesian SOEs* (The University of St. Gallen, 2009), 149-153

⁹⁰ Ibid 153

⁹¹ The World Bank, 'Improving the Corporate Governance of State-Owned Enterprises: The Approach of the World Bank' <[http://www.ifc.org/ifcext/economics.nsf/AttachmentsByTitle/SOE_Brochure/\\$FILE/SOE_brochure.pdf](http://www.ifc.org/ifcext/economics.nsf/AttachmentsByTitle/SOE_Brochure/$FILE/SOE_brochure.pdf)> at 11 December 2009

⁹² National Committee on Governance, 'Indonesia's Code of Good Corporate Governance' (2006) <www.governance-indonesia.com> at 16 December 2008 3-4

Table 1: Summary of the code

The code's Principles	Major Contents
Preamble	<ul style="list-style-type: none"> - To establish a favourable investing atmosphere to catch the attention of foreign capital; - The code applies to all companies in Indonesia
Ensuring the Basis for an Effective Corporate Governance Framework in Indonesia (Part 1)	<ul style="list-style-type: none"> - Inter-related pillars: the government, the business community and the public
Good Corporate Governance General Principles (Part 2)	<ul style="list-style-type: none"> - <i>Transparency</i>; - <i>Accountability</i>; - <i>Responsibility</i>; - <i>Independence and</i>; - <i>Fairness</i>
Business Ethics and Code of Conduct (Part 3)	<ul style="list-style-type: none"> - company's values; - business ethics and; - code of conduct
Organs of the Company (Part 4)	<ul style="list-style-type: none"> - General meeting of shareholders; - board of directors (management); - Board of commissioners (supervisory board) <ul style="list-style-type: none"> - <i>audit committee</i> - <i>remuneration committee</i> - risk committee and - governance committee
Rights and Role of Shareholders (Part 5)	<ul style="list-style-type: none"> - Protecting <i>minority shareholders</i> - Protecting other stakeholders
The Rights and Role of Other Stakeholders (Part 6)	Upholding the rights and roles of stakeholders
Implementation of the Code (Part 7)	Applying the "comply or explain" approach
General Guidelines of Good Corporate Governance Implementation (Part 8)	Stating that the code is a general guideline in building a company's corporate governance code

This code, which comprises the basic principles of good corporate governance in Indonesia, applies to all companies regardless of type or size. This is a minimum standard of Indonesian corporate governance. Therefore, the NCG needs to elaborate on these standards to create specific codes for particular industries. Companies should then follow these specific codes to produce company manuals with detailed codes. .

For success in executing the corporate governance code, the code makers put forward particular companies as pathfinders: listed companies, SOEs, province and region-owned companies, companies that raise and manage public funds, companies with products or services that are widely used by the public, and companies with extensive influence on the environment.

5.1 Ensuring the basis for an effective corporate governance framework in Indonesia

The main idea of the effective corporate governance framework principle is the introduction of inter-related pillars, namely the government as regulator or policy maker, the business community as market players and the public as users of the business community's products and services. Accordingly, the code requires the government, business community and society to work simultaneously as a corporate governance tripod.

The code accommodates the role of the government as regulator or policy maker. Therefore, the government has an obligation to enact and enforce relevant regulations which promote the creation of a healthy, efficient and transparent business climate in addition to enforcing these laws properly. The code mandates that businessmen obey laws and regulations in conducting business and prevent any misbehaviour such as corruption, collusion and nepotism.

As the third party of the tripod, the code prescribes that the public demonstrate their concern and implement social control objectively and responsibly. In terms of implementing social control, the code prescribes that the public communicate any opinions and or objections to the business community and government.

5.2 Good corporate governance general principles

Similar to other national codes, the code puts transparency, accountability, responsibility, independence and fairness as general principles. Except for the principle of fairness, it is no different from other codes, for instance the OECD Principles of Corporate Governance.⁹³ The code prescribes that a company, in running its operations, must consider the interest of shareholders and other stakeholders based on a fairness principle. Fairness means a company must give equal opportunity to stakeholders to have their say for the sake of the company and also treat all employees equally.

5.3 Business ethics and code of conduct

The primary idea behind the code of conduct is that a company should establish company values, business ethics and code of conduct itself in doing business. The code prescribes that a company has a code of conduct that would be a guideline for the company's organs and their employees to implement the company values and business ethics. These are expected to be part of the corporation's culture. The code instils the basic principles that a company should create, which consist of company values, business ethics and a code of conduct.

The code states that a company's basic values should include reliability, fairness and honesty. The code also suggests that the company's values take into account the company's features which include its character, sector of business and geographical location.

The code suggests that a company should provide its business ethics as a reference in running business and in interacting with the stakeholders. Besides, the code perceives that sustainable execution of both company's values and business ethics will support the realization of the corporation's culture. Moreover, the code requires companies to formulate business ethics and elaborate on them in the code of conduct.

According to the code, the code of conduct is the elaboration of the company's values and business ethics. The function of the code of conduct is to guide the company's organs and employees in running the company. Furthermore, the code states that the code of conduct should regulate conflicts of interests, gifts and donations, compliance with laws and regulations, confidentiality of information, and report of unethical behaviour.

5.4. Organs of the company

This principle is to reaffirm the Indonesian civil law model. As a follower of civil law tradition Indonesia applies the two-tier board structure. Consequently, there has to be three entities in a company– general meeting of shareholders, board of commissioners and board of directors. The code makers believe that each organ has significant roles in implementing corporate governance.

General meeting of shareholders

The code deals with the role of the general meeting of shareholders, which is a shareholders forum that makes important decisions on shareholders' investments. The decisions of the general shareholders meeting should be based on the company's long-term interests. However, the general meeting of shareholders cannot intervene in the duties of both the board of commissioners and the board of directors.

The code ordains the general meeting of shareholders to do its job properly and transparently. In appointing members of the board of commissioners and directors, for instance, the meeting must consider the quality of potential candidates. If a company has a nomination and remuneration committee, the appointment will also be based on this committee's opinion.

On the company's bonuses, gratification and dividends, the code prescribes that the decision makers shall consider the company's financial conditions.

Board of commissioners

The code requires the board of commissioners to ensure the execution of corporate governance in addition to the overseeing and advising functions as stated by Law No. 40 of 2007 on Limited Liability Company and Law No. 19 of 2003 on State-owned Enterprises.

⁹³ OECD, OECD Principles of Corporate Governance, 2004

The code limits the board of commissioners' tasks to these three functions so that it does not allow the board to interfere in the duties of the board of directors as an executive company management. The position of all members of the board of commissioners is equal and the chairman is a coordinator of the board members.

The code accommodates the role and function of the board of commissioners. This role is to supervise and advise the board of directors. Hence, the board of commissioners is prohibited from participating in any operational decision making. In the company's interest the board of commissioners may suspend members of the board of directors; further action of the suspension is subject to the determination of the general meeting of shareholders. According to the code, in the absence of directors, the board of commissioners can perform the board of director's functions on a temporary basis.

Apart from the above-mentioned, the code also prescribes companies to establish audit and remuneration committees in addition to risk and governance committees.

Board of directors

The code states that each member of the board of directors, including the president director, is in an equal position and the duty of the president director as *primus inter pares* is to coordinate the activities of the board of directors.

The code requires that the composition of the board shall enable it to act independently and to make effective, right and timely decisions. The code is also concerned with professionalism issues. It requires that the board be professional in terms of possessing the integrity, experience and capability necessary for carrying out their respective duties. With regard to the composition of the board of directors, the code states that it shall be of sufficient size to suit the complexity of the business, having considered the effectiveness in decision-making. In addition, the code states that all members of the board shall be domiciled in Indonesia, at a place where they can execute their daily management functions.

Like with the board of commissioners, the code is also concerned with the issues of capability and integrity of the boards of directors. It states that members of the board shall have the capability and integrity to ensure the proper execution of management functions. Moreover, members of the board of directors are prohibited from utilizing the company for their personal, family, business group and or other parties' interests. The duties of the board of directors have been regulated by the code covering 5 (five) main tasks in the areas of management, risk management, internal control, communication and social responsibility.

5.5. The rights and roles of shareholders

This is the affirmation of shareholders' rights and roles. The code provides that as owners of a company, shareholders shall have certain rights and responsibilities within the company in accordance with the laws and regulations and the company's deed. In exercising their rights and responsibilities, the shareholders shall take into account the sustainability of the company. On the other hand, the company shall guarantee the shareholders' rights and responsibilities based on fairness principles and in accordance with laws, regulations and the company's by-law.

The code also establishes the company's obligations to the shareholders. The company must shield the shareholders' interests in addition to fulfilling other obligations. These obligations include the company's guarantee on maintaining a register of shareholders' issues, disclosure of information, equal treatment of shareholders regardless of type and classification of shares owned and holding of the general meeting of shareholders.

5.6. The rights and roles of other stakeholders

Upholding the rights and roles of stakeholders are the two key ideas of the principle. The code defines stakeholders as "those having an interest in a company and [who] are directly affected by the strategic and operational decision[s] of the company, including employees, resource providers, and communities particularly in which the company operates".

In addition, the code provides that a company should not discriminate against employees on grounds of ethnicity, religion, race, group and gender. Likewise, the code reveals that a company and its resource providers should base the corporation on a mutual benefit principle. With regard to the relationship between company and public, the code holds that a company should take into account the communities' interests, especially that of local communities where the company operates.

5.7. Execution statement of the code

The code employs the voluntary model, the so-called “comply or explain” approach, as opposed to the mandatory model, which can be summarized as primary idea of the principle.

As mentioned earlier, the voluntary model means that a company may not comply with the code as long as it explains its reasons for not doing so. The code provides that the company’s annual report shall include a statement on the execution of corporate governance. This statement shall be supported by a report explaining the company’s structure and work mechanism in addition to other relevant information on the execution of corporate governance.

Other important information regarding the implementation of good corporate governance which the company’s annual report must disclose include the following: company’s vision, mission and values; controlling shareholders; policy and the amount of remuneration of the board of commissioners and the board of directors; transactions with parties having a conflict of interest with the company; the outcome of the evaluation of good corporate governance implementation as reported in the annual general meeting of shareholders; and extraordinary events experienced by a company, especially those that might have an effect on the performance of the company.

5.8. The general guideline on good corporate governance implementation

Finally, the code establishes practical guidance. This guide requires that in implementing corporate governance, each company shall develop its own governance manual based on the code and their particular code. Such a corporate governance manual shall, at least, include:

- the company’s vision, mission and values;
- the position and function of the general meeting of shareholders, the board of commissioners, the board of directors, the committees supporting the board of commissioners and the internal control system;
- policy to ensure the effective functioning of each company organ;
- policy to ensure effective accountability, effective internal control and proper financial reporting;
- the code of conduct based on company values and business ethics;
- instruments for disclosure of information to shareholders and other stakeholders;
- policy on improving various company regulations necessary for implementing corporate governance principles.

Furthermore, the code makers have suggested several prescriptions in implementing the code: building understanding, awareness and commitment to implement good corporate governance by the company’s board; controlling shareholders and all employees; reviewing the company’s current state in good corporate governance implementation and the required corrective measures; developing program and implementation guidance within the company; building a sense of belonging of all parties within the company and an understanding of the implementation of the good corporate governance code in daily activities; and conducting self-assessment or using the service of an independent external party to ensure continuous implementation of good corporate governance. Finally, the code provides that the outcome of such assessment shall be disclosed in the annual report and reported at the annual general meeting of shareholders.

6. Result and analysis

6.1 General

As stated in the previous part of the study, Thomseen’s view on the universal features of corporate governance codes is used to measure whether the Indonesia’s code conforms to the Anglo-American model. Table 2 summarizes the comparison between the key points contained within the Indonesia’s code and the general characteristics of the code of corporate governance.

Table 2: Comparison between Indonesia's code and the general characteristics of the code

The Universal Characteristics	The Indonesia's code
Comply or explain approach	Implementation of the code (Part VII, point 2): "In the event that the GCG Code has not been fully implemented, a company shall disclose the non-conformance aspects and the reasons for such"
Soft-law	Code of corporate governance can be seen as a soft-law rather than a law as no a legal sanction can be imposed when a company does not comply with the code
Audit Committee	Company Organs (Part IV, Point 4.1): "For publicly listed companies, <i>state-owned enterprises</i> , province and region-owned companies, companies that raise and manage public funds, companies of which products or services are widely used by public, and companies with extensive influence on environment, an <u>Audit Committee</u> shall be established, whereas other committees are formed as required".
Remuneration Committee	Company Organs (Part IV, point 4.2, a): "The Nomination and <u>Remuneration Committee</u> shall function to assist the Board of Commissioners in determining the selection criteria for candidates of the member of the Board of Commissioners and the Board of Directors as well as the remuneration system".
Transparency	Principles of Good Corporate Governance (Part II): "...GCG general principles which include <u>transparency</u> , accountability, responsibility, independency, and fairness are necessary to attain a company's sustainability by also considering the interests of stakeholders".
Role of the board	Company organs (Part IV, Letter C): " <u>The Board of Commissioners</u> as an organ of the company shall function and be responsible collectively for overseeing and providing advices to the Board of Directors and ensuring that the Company implements the GCG".
Investor protection	Rights and roles of shareholders (Part V, point 1.2): "the controlling shareholder shall: (i) consider the interest of <u>the minority shareholders</u> and other stakeholders in accordance with laws and regulations"
Avoiding fraud or providing a favourable investing atmosphere to attract attention of foreign investors	Preamble (B. 5.6): "...enhancing the competitiveness of a company, both nationally and internationally, in order to enhance market confidence which may <u>promote investment flow</u> and a sustainable national economic growth".

Table 2 shows that the universal features of codes of corporate governance, including comply or explain principle, soft-laws model, audit committee, remuneration committee, transparency issues, role of board, investor protection and avoiding deception as well as providing a favourable investing atmosphere to catch the attention of foreign capital are consistent with the Indonesia's code of corporate governance.

The code does not resolve the SOEs' problems. Section 5 of this article disclosed the three main problems with SOEs: conflicting objectives, agency issues (political interference) and lack of transparency. The conflicting objectives exist because SOEs' managements in addition to having responsibility for running the business also have a social responsibility. Political interference prevails as politicians and bureaucrats who control the company have their own agendas that deviates the target of company's business. The lack of transparency is intentionally done to cover up the Politicians and bureaucrats' agendas such as agenda of political party from the government in power that are contrary to the company's business agenda.

As above-mentioned code of corporate governance is essentially a bunch of recommendation as to how to govern a company; what should be or not to be done. Therefore it would seem logical therefore that Indonesia's code should include principles to resolve such problems; however, a perusal of the code shows that this is not the case.

The conflicting objectives

One of the unique characteristics of the Indonesian corporate governance code is that the code firmly demarcates the role of government, business community and society separately –the so-called governance tripod, which is not found in similar codes such as the OECD code. The governance tripod is to encourage the government to enact friendly laws and regulations as well as enforcing them in protecting investors' rights in addition to demanding society to be responsible by expressing their objections to the business community and government in a good manner.

However, in terms of conflicting objectives, the code has not provided principles to clearly separate the social and business functions of SOEs. Within the code, there are no principles that expressly request to divorce SOEs' objectives into business and social objectives carried by SOEs.

Political interference

Political inference is not an important issue for the code makers. There are no principles in the code that discuss and eliminate the political interference problems, the most serious problem in Indonesian SOEs, especially in non-listed SOEs. Political interference in SOEs potentially prevents companies from being professional because politicians and bureaucrats have power to use SOEs as tool in carrying out their agenda.

The code makers do not express concern over this serious problem. On the contrary, the code gives official permission to SOEs to get involve in political activities such as giving donation to political parties, candidate of legislatures and bureaucrats.⁹⁴

Political interference can occur in many ways. In the Indonesian context, the holding of consultation meetings between the Indonesian Parliament (represented by Commission of Seven) and SOEs is a best example on that matter. For instance, in February 2009, a meeting with the President Director of PT Pertamina, an Indonesian oil company, was convened by Indonesian Parliament for several consultation meetings. At one of the meetings, the Commission of Seven's Vice Chairman, Sutan Bathoegana, asserts that the position of PT Pertamina's President Director is a political career in addition to a professional business position.⁹⁵

Writing in 2008, Mas Ahmad Daniri⁹⁶ and A Prasetyantoko hold that the SOEs' existing problems have occurred not because of ownership issue but by the excessive intervention from the country's ruling parties and bureaucrats.⁹⁷ They assert that although SOEs are owned by State, they can be well managed to achieve the good performance as in many cases the SOEs' governance problem are frequently not germane to the ownership issue.⁹⁸ Evidently, a case study of three Indonesian SOEs by Mardjana confirms Daniri and Prasetyantoko's view that Indonesia's SOEs problem is nothing to do with the government ownership, it however caused by mismanagement problems.⁹⁹ Indonesia's code of corporate governance should be concerned with governance issue by providing particular principles in addition to laws and regulations that deliberately separate SOEs from political interests.

Unprofessional board of commissioners

In addition to the three main problems, as the World Bank another SOEs' problem is unprofessional board of directors or unprofessional board of commissioners in the context of Indonesia's two-tier board system. Admittedly, one of the current issues for companies in Indonesia is unprofessional board of commissioners. A corporate governance organisation and commentator once stated that bad governance can be cured by introducing professional commissioners.¹⁰⁰

By introducing the term professional, it is a truism to say that the code has attempted to deal with unprofessional board of commissioners' problem as stated in Part IV, point C. 2 of the code.¹⁰¹

The code makers might presume that the problem can be resolved by introducing professional commissioners who have integrity and capability. The code explains that both the principles of integrity and capability are designed to ensure that the supervisory and advisory roles of the board are of high quality. It assumes that a professional commissioner who has capability and integrity would not utilise the company's properties to their personal, family, business group and or other parties' advantage.¹⁰² Furthermore, the code makers believe that a professional commissioner with capability and integrity would comply with the relevant company's deed and laws and regulations.¹⁰³

⁹⁴ Part III, point 3.3. of Indonesia's code of good corporate governance

⁹⁵ Miko Kamal, 'BUMN: Entitas Bisnis atau Politik?' (2009) *Legalitas* <<http://www.legalitas.org/?q=content/bumn-entitas-bisnis-atau-politik>> at 10 September 2009

⁹⁶ Mas Ahmad Daniri is chairman of National Committee on Governance

⁹⁷ Mas Achmad Daniri and A. Prasetyantoko, 'Reformasi Kelembagaan dan Penerapan Governance Menuju BUMN Berdaya Saing Global' (2008) <<http://www.madani-ri.com/2009/06/12/reformasi-kelembagaan-dan-penerapan-governance-menuju-bumn-berdaya-saing-global/>> at 12 November 2008

⁹⁸ Ibid

⁹⁹ I Ketut Mardjana, 'Ownership or Management Problems? A Case Study of Three Indonesian State Enterprises' (1995) 31(1) *Bulletin of Indonesian Economic Studies* 101

¹⁰⁰ Miko Kamal, 'The Indonesian Company Law: Does it Support Good Corporate Governance?' (2009) 6 *Macquarie Journal of Business Law* 348

¹⁰¹ The members of the Board of Commissioners must be professional that possess the integrity and capability to enable them to carry out their function properly including to ensure that the Board of Directors shall observe the interest of all stakeholders.

¹⁰² Ibid

¹⁰³ Ibid

But the existing problems of non-listed SOEs are not only due to the lack of integrity and capability but also due to the commissioners' lack of time in performing their roles because most of the commissioners are busy people such as politicians, ex-army, ex-ministers, academics, big fish and high-ranking officials (also known as public servant commissioners).¹⁰⁴ The result of an investigative report on OkeZone.com is a good example. The report found that there are eleven close colleagues of the current Indonesian President and Vice President who are members of boards of commissioners.¹⁰⁵ It is fair to say that these people are unable to do their jobs properly because they do not have enough time. So the word "professional" can be meaningless in this context.

Protecting outsiders

Like the codes of other countries, Indonesia's code also focuses on minority shareholders' interests, which can be seen from Part IV, C 1.2106 and 1.4107 of the code's principles. "Independent commissioners, controlling and minority shareholders "are three crucial words contained in the principles. The code defines an independent commissioner as a person who is free from business and family relationships with controlling shareholders, members of the board of directors and other members of the board of commissioners. The code recommends a company to have independent commissioners in addition to affiliated commissioners.

The underlying assumption of this recommendation is that Indonesian companies have an agency problem as experienced by listed companies. Therefore the code divides the shareholders into two types: controlling and minority shareholders. While this point is relevant to companies with dispersed shares in order to shield the minority shareholders' money from possible abuse by controlling shareholders, the point is worthless in relation to pure SOEs because they are owned by ordinary public represented by the government.

The pure SOEs have its unique agency problem. Unlike the other companies, such as listed companies, four agency problems are possibly prevailing in the pure SOEs: firstly, the problem between the society as the SOEs' ultimate owner and the government as the actual owner or society agent (ultimate principal-actual principal or ultimate principal-agent relationship problem); secondly, the problem between the government and the board of commissioners (actual principal-board relationship problem); thirdly, the problem between the government and the board of directors (actual principal-management relationship problem); Finally, the problem between board of commissioners and board of directors (board-management relationship problem).

The ultimate principal-actual principal or ultimate principal-agent relationship problem is possible to occur since as the society's agent the government tends to prevent the society from holding a social control. Thus, the government is free to direct SOEs' management in accordance with their wishes, e.g. the government directs the SOEs' management to do activities that benefit themselves.

The actual principal-board relationship problem exists as a consequence of both Indonesian company law and SOEs law that position board of commissioner as an actual principal's agent in terms of overseeing and advising the SOEs' management. Board of commissioners is considered as an agent because it dismissed and appointed by the actual principal.

The actual principal-management relationship problems occur as a consequence of the separation of ownership and control in SOEs. In the context of the pure SOEs, companies run by managers or members board of directors as executive management. The actual principal-management relationship exists since members of the board of directors are appointed and dismissed by the government as actual principal.

The board-management relationship problem is a result of the roles and responsibilities of each agency. The Board of directors is a company organ that has responsibility for carrying out the company activities, while the board of commissioners is responsible of overseeing the company activities as well as advising the board of directors.

Given the uniqueness of the agency problem of pure SOEs the issue of the Anglo-American agency problem, such as the problem of minority shareholders' assets being expropriated by controlling shareholders, will not arise because there is no division of shareholders' types –minority and majority shareholders. Thus, this is fair

¹⁰⁴ My study of 6 pure SOEs found five types of commissioners, and they are public servant, businessmen/skilled worker, academic, pensioner and big fish. The largest numbers of the researched companies' commissioners are public servants (45.16%), businessmen/skilled workers and pensioners come second (19.35%), academic (9.67%) come third and followed by big fish (6.45%). The research result will be published in a journal somewhere.

¹⁰⁵ OkeZone.com, 'Duduk Manis di Kursi Komisaris' (2008) *OkeZone Economy*

<<http://economy.okezone.com/index.php/ReadStory/2008/06/17/20/119674/duduk-manis-di-kursi-komisaris>> at 18 June 2008

¹⁰⁶ 1.2. The Board of Commissioners may consist of Commissioners who are not originated from an affiliated party, known as Independent Commissioner, and affiliated Commissioners. Affiliated means having business and family relations with the controlling shareholders...

¹⁰⁷ 1.4. ...The appointment of an independent commissioner shall have considered the opinion of the minority shareholders which shall be obtained through the Nomination and remuneration committee.

to say that the Indonesia existing corporate governance model (the Anglo-American model) has overlooked the need of Indonesia's pure SOEs.

The uniqueness of Indonesia's corporate governance

Apart from the above-findings, Indonesia, as a civil law country, applies the two-tier structure model where the board of commissioners (supervisory board) and board of directors (management board) are two compulsory organs in a company, including a SOE. But the Indonesia's two-tier structure is not exactly the same model as the other civil law countries as Germany. While Germany applies the codetermination concept where employees are represented in the company's supervisory board –as a main characteristic of the Continental Europe model,¹⁰⁸ Indonesia reject this concept.

Suffice it to say that Indonesia has a range of unique characteristics on the implementation of corporate governance. With regards to the company structure, Indonesia partly follows the model of the system of Continental Europe where two organs (board of commissioners and directors) must exist in a company but workers are not given a chance to become members of the board of commissioners. In terms of the code of corporate governance principles, Indonesia tends to adopt the Anglo-American model, which is actually not in accordance with the fact of Indonesian companies, especially pure SOEs; for instance, the code prescribes a maximum protection to the minority shareholders when in fact there is no a minority shareholder in a pure SOE.

7. Summary and Conclusion

The paper has discussed the origins of corporate governance. It saw that the dominant Anglo-American corporate governance system is designed to deal with agency problem that occurs in listed and or private owned companies with widely dispersed shareholders. As a dominant model, the Anglo-American has successfully spread its influence around the world, although it is not possible to say that convergence exists. The history of the introduction of corporate governance to Indonesia can be regarded as best example of the domination of the Anglo-American model. In Indonesia the concept of corporate governance was formally introduced in 1999 when the government established the National Committee on Corporate Governance (NCCG) following the Indonesian government's letters of intent to the IMF.

This paper has described Indonesia corporate governance concept under the code. Like other countries, the Indonesian code is the best solution in upholding listed and or private companies with fragmented shareholders as opposed to companies pure SOEs. Capital market was instrumental in changing the form of company ownership. The existence of capital markets, which began during the 1990s, led to the forms of corporate ownership in the U.S. and UK and has changed dramatically from a concentrated to a scattered ownership. Agency problem exists when there is a separation between ownership and control of a company.

The primary problem of SOEs has been examined by this paper, covering conflicting objectives, political interference, and lack of transparency as well as unprofessional board of commissioners.¹⁰⁹ By putting transparency as one of the general principles, the code makers have tried to puzzle out the lack of transparency problem. But the code has failed to solve four other crucial problems, conflicting objectives, political interference and unprofessional board of commissioners.

The current Indonesia's code of corporate governance conceptually cannot remedy Indonesia's pure SOEs as the latter's primary needs are particular laws and regulations, in addition to a strong code that is free from political interference and unprofessional board of commissioners and able to cope with the conflicting objectives. The Anglo-American corporate governance model, which is designed to protect investors or outsiders from expropriation by insiders (majority shareholders and management),¹¹⁰ does not serve Indonesia's interest.

¹⁰⁸ Cernat, above n 2, 153

¹⁰⁹ The World Bank, above n 91

¹¹⁰ La Porta, et al., above n 21, 4

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