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WHY INDONESIAN CORPORATE GOVERNANCE FAILED – CONJECTURES CONCERNING LEGAL CULTURE

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I. INTRODUCTION

Indonesia, the fourth most-populous nation in the world, is one of the Asian countries still mired in deep economic problems. For Indonesia, the financial crisis that first hit the Asian region in mid-1997 quickly became a political and social crisis as well. Five years and four presidents later,[1] Indonesia is just beginning to show some hopeful preliminary signs of economic recovery.[2]

My goal in this paper is to examine Indonesian corporate governance behavior leading up to the crisis during the 1990s and to discuss some lessons to be learned. This is because corporate governance failure has been highlighted as a key contributing factor to explain why Indonesia suffered so badly from the 1997-1999 crisis, compared to other Asian countries. If poor corporate governance is the culprit, then the more that is known about it the more likely a suitable remedy can be applied to solve the problem and to prevent its recurrence.

In this paper, I begin by briefly sketching the Indonesian corporate governance context in the second half of the 1990s.[3] I also discuss the present state of comparative corporate governance research, especially the convergence debate.

The heart of this paper focuses on actual Indonesian corporate behavior as exhibited in three companies, all of which are banks.[4] The choice of banks for all three case studies is intentional. Banks are among the most highly regulated companies in Indonesia. If the corporate governance of banks is inadequate, then it is likely that the rest of corporate Indonesia will not fare any better.

In an earlier published paper,[5] I described the legal framework for corporate governance of Indonesian banks during the 1990s. That paper showed that significant improvements had been made in the 'hardware' – the rules, institutions and technical framework – of the Indonesian corporate governance system during the relevant period. Yet, as the

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1 May 1998 saw the resignation of former President Soeharto. In contrast to the more than three decades of Soeharto rule from 1966-1998, Indonesia has had four presidents during 1998-2002: Soeharto, B J Habibie, Abdurrahman Wahid and Megawati Soekarnoputri.

2 *See, e.g.*, the recent rather upbeat forecast by Japan's respected Institute of Developing Economies which predicted an economic growth of 3.8% for Indonesia in 2002: MITSURU TOIDA, 2002 ECONOMIC OUTLOOK FOR EAST ASIA (2001).

3 For a fuller picture, *see* my earlier article, Benny S. Tabalujan, Corporate Governance of Indonesian Banks: The Legal & Business Contexts, 13 AUSTL. J. CORP. L. 67 (2001).

4 In this paper, I use 'corporations' and 'companies' interchangeably. The former is used more frequently in North America while the latter is more often used in the United Kingdom, Australia and parts of Asia.

5 *Supra* note 3.

present paper shows, actual corporate governance behavior during the 1990s was far from the standard to be expected. In this paper, I suggest that one possible reason for this state of affairs is the absence of one critical element of 'software': a supportive legal culture. Unfortunately, policy-makers, academics and commentators have largely neglected the role of legal culture in corporate governance systems. As a result, the corporate governance system formed in Indonesia throughout the 1980s and 1990s – much of it with the assistance of generous overseas aid and technical assistance – failed to function as it should.

Finally, I draw three critical conclusions concerning the importance of legal culture in corporate governance reform. Although the conclusions are derived from the Indonesian experience, they may be applicable to varying degrees in other developing or transitional economies. The lessons drive home one basic point: the legal culture of a community must be included in any future discussion, policy formulation or research on corporate governance.

II. ASIAN CRISIS AND INDONESIAN KRISMON

The Asian financial crisis was precipitated by the devaluation of the Thai baht on 2 July 1997.[6] This devaluation was unexpected and quickly spread to neighboring countries. Indonesia was hit especially hard.[7] By mid-August 1997, the rupiah had lost 27% of its value against the US dollar.[8] The nadir was reached in June 1998, one year after the

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6 On the Asian financial crisis generally, see: EAST ASIA IN CRISIS: FROM BEING A MIRACLE TO NEEDING ONE? (Ross McLeod & Ross Garnaut eds., 1998); and H. W. ARNDT & HAL HILL, SOUTHEAST ASIA'S ECONOMIC CRISIS: ORIGINS, LESSONS, AND THE WAY FORWARD (1999). The material is this section is drawn and condensed from my earlier article. *See supra* note 3.

7 For the possible causes and subsequent effects of the crisis on Indonesia, *see*: David C. Cole & Betty F. Slade, *Why Has Indonesia's Financial Crisis Been So Bad?* 34 BULL. OF INDONESIAN ECON. STUD. 61 (1998); HAL HILL, THE INDONESIAN ECONOMY IN CRISIS: CAUSES, CONSEQUENCES AND LESSONS (1999); D. S. Simandjuntak, *An Inquiry into the Nature, Causes and Consequences of the Indonesian Crisis* 4 J. ASIA PAC. ECON. 171 (1999); and Ross H. McLeod, *Indonesia's Crisis and Future Prospects*, *in* ASIAN CONTAGION: THE CAUSES AND CONSEQUENCES OF A FINANCIAL CRISIS 209 (Karl D. Jackson ed., 1999).

8 *Indonesia: No Laughing Matter*, FAR E. ECON. REV., Oct. 9, 1997, at 83. On 14 August 1997, in an effort to halt the rupiah's slide, the authorities did away with the controlled float of the rupiah – which had been in place for many years – and allowed the rupiah to float freely, a state of affairs which has continued until today: J. Thomas Lindblad, *Survey of Recent Developments*, 33 BULL. OF INDONESIAN ECON. STUD. 3, 5 (1997). *See also* Bobby Hamzar Rafinus & Wismana Adi Suryabrata, *Tinjauan Triwulan Perekonomian Indonesia*, 45 EKONOMI DAN KEUANGAN INDONESIA 372, 377 (1997); Hill, *supra* note 5; Hadi Soesastro & M. Chatib Basri, *Survey of Recent Developments*, 34 BULL. OF INDONESIAN ECON. STUD. 3 (1998). In the rest of this paper, to facilitate comparison, I provide US dollar equivalents for monetary sums denoted in rupiah. The exchange rate used is the rate prevailing at the relevant time. In the case of rupiah amounts found in legislation, I used the average exchange rate for the calendar year during which the legislation was enacted. Adopting this practice side-steps the problem of the gyrations of the rupiah throughout

onset of the crisis, and one month after former President Soeharto resigned. From a pre-crisis exchange rate of about US$1 = 2,500 rupiah, the exchange rate bottomed at US$1 = Rp16,900 on 17 June 1998.[9] This was a fall of approximately 575%.

The crisis had severe negative repercussions on Indonesian business, especially the stock market and the banking sector. In the decade prior to the crisis, the performance of the Jakarta Stock Exchange (JSX), the premier stock exchange in Indonesia, was admirable.[10] Then, the Asian financial crisis pummeled the JSX. By mid-December 1997, the stock market price index had fallen from a high of over 740 in July 1997 to 339; while the 270 listed entities had an aggregate market capitalization of Rp 134 trillion (US$15 billion), compared with 265 listed entities six months earlier with an aggregate market capitalization of Rp 260 trillion (US$106 billion).[11] Thus, the crisis had effectively halved the value of the securities listed on the JSX in rupiah terms and reduced it to one-seventh of its value in US dollar terms.

The impact of the crisis on the banking sector was even more debilitating. On 1 November 1997, barely three months after the crisis hit Indonesia, the authorities revoked the business licenses of 16 unlisted private general banks.[12] In effect, the revocation was a forced liquidation of the banks. The government's primary reason for the closure of these banks was that their non-performing loans had far exceeded their assets.[13]

In January 1998, as the crisis worsened, the authorities created the Indonesian Bank Restructuring Agency (*Badan Penyehatan Perbankan Nasional* or BPPN / IBRA), to restructure ailing banks and manage their assets.[14] By early August 1998, 54 out of the total 222 banks in Indonesia

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1997-2002.

9 *Rupiah Makin Terpuruk*, KOMPAS, June 18, 1998, at 1. *See also* J. Soedradjad Djiwandono, *The Rupiah – One Year After Its Float*, *in* POST-SOEHARTO INDONESIA: RENEWAL OR CHAOS? 144 (Geoff Forrester ed., 1999). By this time in Indonesia, the crisis was not only a financial one, but had engulfed the social, economic and political spheres as well. Hence the Indonesian acronym changed from *krismon* (*krisis moneter* or monetary crisis) to *kristal* (*krisis total* or total crisis). *See* Bruce Wallace, *Krismon Becomes Kristal – Total Crisis*, ASIA TODAY, Oct., 1998, at 26.

10 There is a much smaller stock exchange, the Surabaya Stock Exchange (SSX) in Surabaya, Indonesia's second most-populous city located in East Java.

11 *Kilas Balik Pasar Modal 1997*, WARTA EKONOMI, Dec., 1997, at 12; *Bursa Saham Semakin Kritis*, KOMPAS, Aug. 2, 1998, at 28.

12 *Pemerintah Tutup 16 Bank*, KOMPAS, Nov. 2, 1997, at 1.

13 *Keterangan Pemerintah Soal Perekonomian: Tetap Pada Kebijakan dan Segala Konsekuensinya*, KOMPAS, Nov. 11, 1997, at 17.

14 BPPN was formed pursuant to Presidential Decree No 27 of 1998 dated 26 January 1998. Under this decree, BPPN has a fixed life-span of 5 years; hence, unless its lifetime is extended, it will have to disband in January 2003. The legal status of BPPN was subsequently strengthened with the enactment of the Banking Law 1998.

were under BPPN supervision.[15] By late 1998, BPPN and Bank Indonesia directly controlled about 70% of total assets held by all Indonesian banks.[16]

To cope with the crisis of confidence over specific banks caused by panicking depositors during 1997 and 1998, Bank Indonesia also provided large amounts of emergency liquidity loans (*Bantuan Likuiditas Bank Indonesia* or BLBI) to various banks. In November 1998, these loans reportedly totaled around Rp 111 trillion (US$12 billion).[17] By this time, the Indonesian banking crisis was acknowledged to be one of the worst, if not the worst, in modern world history, overshadowing the 1994-1995 Mexican debt crisis.[18]

III. WHITHER CORPORATE GOVERNANCE?

With hindsight, various commentators have pointed to poor corporate governance as a key factor in the Asian financial crisis – especially in the case of Indonesia.[19] Countries which have consistently been viewed as having difficulties in implementing good corporate governance concepts – such as Thailand, Indonesia and, to a lesser extent, South Korea and Malaysia – were the ones most adversely affected.[20]

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15 *Bank Takut Masuk BPPN*, KOMPAS, Aug. 8, 1998, at 1.

16 Michael Bennett, Banking Deregulation in Indonesia: An Updated Perspective in Light of the Asian Financial Crisis, 20 U. PA. J. INT'L ECON. L. 1, 51 (1999).

17 *Silakan Bebas, Pokoknya Uang Kembali*, FORUM KEADILAN, Nov. 30, 1998, at 67. There are significant discrepancies in the reports concerning the aggregate BLBI outstanding, ranging up to Rp 155 trillion (US$17 billion). *See Sementara, Tapi Minta Undang-undang*, TEMPO, Oct. 19, 1998, at 44.

18 *See* Hill, *supra* note 7, at 94-95. Hill noted that the 'resolution costs' of the crisis, as estimated by various sources, would amount to between 50% - 80% of Indonesia's GDP, whereas the resolution of the Mexican debt crisis required about 15% of Mexico's GDP. The US credit rating agency, Standard & Poor's, estimated that the resolution costs amounted to 82% of Indonesian GDP. *See S&P Puts Jakarta Bailout of Banks at 82% of GDP*, ASIAN WALL STREET JOURNAL, June 11-12, 1999, at 3.

19 *See generally* EAST ASIA ANALYTICAL UNIT (EAAU), ASIA'S FINANCIAL MARKETS: CAPITALISING ON REFORM 63-65 (1999); Simon Johnson et al., *Corporate Governance in the Asian Financial Crisis 1997-98*, at 53 (Stockholm Institute of Transition Economics and East European Economies, Working Paper No. 137, 1998); Kenneth E. Scott, *Corporate Governance and East Asia: Korea, Indonesia, Malaysia and Thailand*, *in* FINANCIAL MARKETS AND DEVELOPMENT: THE CRISIS IN EMERGING MARKETS 335 (Alison Harwood et al. eds., 1999); Michael Pomerleano & Xin Zhang, *Corporate Fundamentals and the Behavior of Capital Markets in Asia*, *in* FINANCIAL MARKETS AND DEVELOPMENT: THE CRISIS IN EMERGING MARKETS 117 (Alison Harwood et al. eds., 1999); Arndt & Hill, *supra* note 6; Daniel Fitzpatrick, *Indonesian Corporate Governance: Would Outside Directors or Commissioners Help?*, *in* INDONESIA IN TRANSITION 293 (Chris Manning & Peter van Diermen eds., 2000); and Bennett, *supra* note 16, at 19-23.

20 Thus, the EAAU report, *supra* note 19, at 63, states:

Weak corporate governance, or a failure to run companies in an open and honest manner, significantly impedes regional capital market development and has undermined regional banking systems. Lack of corporate transparency, investor protection and effective board oversight were

Places such as Singapore, Hong Kong and Australia, known for their better corporate governance standards, appeared to have fared better and were least affected by the crisis.[21]

Nevertheless, considering poor corporate governance as the culprit may not be helpful for analytical purposes. The United Kingdom Cadbury Committee defined corporate governance as 'the system by which companies are directed and controlled'.[22] In other words, corporate governance is about the governance of corporations. This is the definition of corporate governance used in this paper. However, to then assert that Indonesian companies failed during the Asian crisis largely because of poor corporate governance is akin to saying that people died during the plague largely because of poor health. Such logic brings us no closer to diagnosing the true cause of death.

What is needed is a more rigorous analysis addressing the specific factors that caused Indonesian companies to be poorly governed, rather than simply conclude or assert that they are poorly governed. Policy makers need to know which aspects of the Indonesian corporate governance process failed. With this knowledge, improvements can be made with the goal that Indonesian companies (and perhaps those in other developing and transitional economies) can be governed better in future.

Unfortunately, there has not been much published work on Indonesian corporate governance.[23] To make matters worse, despite the exponential growth of literature on the topic, there appears to be no universally accepted definition of corporate governance.[24] There also

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severe in Korea, Thailand, Malaysia and Indonesia.

For similar views from officers of the Asian Development Bank, *see* Arvind Mathur & Jimmy Burhan, *The Corporate Governance of Banks: CAMEL-IN-A-CAGE, in* ASIAN REVIVAL: RISK, CHANGE AND OPPORTUNITY 7 (1999).

21 EAAU, *supra* note 19, at 57.

22 CADBURY COMMITTEE, REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE ¶ 2.5 (1992). The Cadbury Committee may be considered the mother of all corporate governance committees. Granted, in the United States, the American Law Institute (ALI) commenced its Corporate Governance Project in 1978. But its report, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS, was published only in 1994. The first North American law book I could find which bears the term 'corporate governance' in its title was published in 1993: DOUGLAS BRANSON, CORPORATE GOVERNANCE (1993).

23 Among the works available are my own article, *supra* note 3; Djisman Simanjuntak & Felia Salim, *Transition to Good Corporate Governance in Post-Crisis Indonesia: High Barriers and Windows of Opportunities* (Paper presented at the Corporate Governance Forum, Conference on Indonesian Economic Institution Building in a Global Economy, Jakarta, Indonesia, Sept. 6, 2001); Daniel Fitzpatrick, *supra* note 19; and Daniel Fitzpatrick, *Corporate Governance, Economic Crisis, and the Indonesian Banking Sector,* 9 AUSTL. J. CORP. L. 178 (1998). For an early article on Indonesian corporate law *see* Benny S. Tabalujan, *The New Indonesian Company Law,* 17 U. PA. J. INT'L ECON. L. 883 (1996).

24 *See* Kevin Keasey et al., *Introduction: The Corporate Governance Problem – Competing Diagnoses and Solutions, in* CORPORATE GOVERNANCE: ECONOMIC AND FINANCIAL ISSUES 1, 2 (Kevin Keasey et al. eds., 1997).

appears to be no general theory of the subject – in the words of one commentator: there is a 'lack of a unifying paradigm.'[25] Even the leading scholars in the field appear to be cautious about postulating a general theory of corporate governance.[26]

Within the more limited field of comparative corporate governance there is a vigorous debate as to whether corporate governance systems are converging. On one hand, some argue that, given the dominance of the United States economy and financial markets – compounded by weaknesses in other governance systems, as revealed by the 1997-1999 Asian financial crisis and Japan's continuing poor economic performance throughout the 1990s and to date – the American model of corporate governance should or will be the final destination in the evolution of national corporate governance systems.[27] If so, then the 'end of history' for corporate governance may already be in sight.[28]

On the other hand, others argue that path dependency – formed by factors including 'sunk adaptive costs, complementarities, network externalities, endowment effects' and the self-interest of rent-seeking groups – will constrain the future of corporate governance systems and hinder convergence.[29] Thus, the argument that the US model represents

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25 Robert Tricker, *Editorial: Corporate Governance - On Papers and Paradigms*, 4 CORP. GOVERNANCE 199, 200 (1996).

26 In an anthology on corporate governance edited by a number of leading US, European and Japanese scholars, COMPARATIVE CORPORATE GOVERNANCE: THE STATE OF THE ART AND EMERGING RESEARCH (Klaus J. Hopt et al. eds., 1998) at ix-x, the editors stated:

The editors have consciously chosen to refrain from going beyond this introduction and trying to extract a general theory of corporate governance. While the contributions to this book yield important parts of such a theory and offer many new insights into both the different systems and their parts, they also show that there are many different approaches to the problems, both from one discipline to another and internally, and that our understanding of how each single system works and how they compare to each other is still at an early stage of research and understanding.

27 *See, e.g.*, Brian R. Cheffins, *Current Trends in Corporate Governance: Going from London to Milan via Toronto*, 10 DUKE J. COMP. & INT'L L. 5 (1999), and Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GA. L.J. 439 (2001). This preference for the US model was also implicit in the actual responses of the IMF to the Asian financial crisis when they recommended substantive corporate governance reforms to various Asian countries, including Indonesia, along the US model. *See, e.g.*, Timothy Lane et al., *IMF-Supported Programs in Indonesia, Korea and Thailand*, 72-73 (International Monetary Fund, Occasional Paper No. 178, 1999).

28 John C. Coffee, *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641 (1999). Hegel's term 'end of history' was made famous by the widely read work, FRANCIS FUKUYAMA, THE END OF HISTORY AND THE LAST MAN (1992).

29 Lucian Ayre Bebchuk & Mark J. Roe, A *Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127, 169 (1999). *See also* Amir N. Licht, *International Diversity in Securities Regulation: Roadblocks on the Way to Convergence*, 20 CARDOZO L. REV. 227 (1998); Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 Harv. L. Rev. 641 (1996); Thomas J. Courchene, *Corporate Governance as Ideology*, 26 CAN. BUS. L.J. 202 (1996); and William R. Bratton & Joseph A. McCahery, *Comparative Corporate Governance and the Theory of the Firm: The Case Against Global Cross Reference*, 38 COLUM. J.

'the evolutionary pinnacle of corporate governance' is discredited.[30]

Between these two positions, Ronald Gilson of Stanford University Law School appears to offer a middle ground.[31] In simple terms, Gilson holds the view that national corporate governance systems may be converging in function, but not necessarily in form. He cites evidence that suggests convergence in specific corporate governance functions, for example, in the way management performance is monitored in the US, Germany and Japan.[32] He notes, however, that evidence of institutional or formal convergence is relatively scarce, concluding that this is because formal convergence is 'costly'.[33]

In this paper, I offer no final answer to the convergence debate. However, convergence or not, participants in the corporate governance debate generally appear to recognize two basic models of corporate governance systems in developed economies.[34] The first model is the 'market-based' model, which emphasizes the maximization of shareholder value while the second model is the 'relationship-based'

TRANSNAT'L L. 213 (1999). For the debate on convergence in Europe, *see* Pierre Legrand, *European Legal Systems Are Not Converging*, 45 INT'L & COMP. L.Q. 53 (1996).

30 Ronald J. Gilson, *Corporate Governance and Economic Efficiency*, *in* ASPECTS OF CORPORATE GOVERNANCE 131, 132 (Mats Isaksson & Rolf Skog eds., 1994). For recent salvoes from the non-covergence proponents, *see* Amir N. Licht, *The Mother of All Path Dependencies: Towards a Cross-Cultural Theory of Corporate Governance Systems*, 26 DEL. J. CORP. L. 147 (2001), and Douglas M. Branson, *The Very Uncertain Prospect of "Global" Convergence in Corporate Governance*, 34 CORNELL INT'L L.J. 321 (2001). For yet another perspective, see John H Farrar, *In Pursuit of an Appropriate Theoretical Perspective and Methodology for Comparative Corporate Governance*, 13 AUSTL. J. CORP. L. (2001).

31 Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, (John M. Olin Program in Law and Economics, Working Paper No. 192, 2000). *See also* Gilson's earlier work: Ronald J. Gilson, *Corporate Goverance and Economic Efficiency: When do Institutions Matter?*, 74 WASH. U. L.Q. 327 (1996).

32 Gilson (2000), *supra* note 31, at 12-13.

33 Id. at 13: Functional convergence is likely the first response to competitive pressure because changing the form of existing institutions is costly. New institutions require new investment, and existing institutions will have developed related interest groups that render more difficult any necessary political action.

34 *E.g.*, Donald H. Chew, *Introduction*, *in* STUDIES IN INTERNATIONAL CORPORATE FINANCE AND GOVERNANCE SYSTEMS 1 (Donald H. Chew ed., 1997), and Keasey, *supra* note 24. *See also* N.H. Dimsdale, *The Need to Restore Corporate Accountability: An Agenda for Reform*, *in* CAPITAL MARKETS AND CORPORATE GOVERNANCE 13, 14 (Nicholas Dimsdale & Martha Prevezer eds., 1994) (referring to the US & UK systems as 'market-based systems' and Japan & Germany as 'bank-based systems'); Allen Sykes, *Proposals for a Reformed System of Corporate Governance to Achieve Internationally Competitive Long-Term Performance*, *in* CAPITAL MARKETS AND CORPORATE GOVERNANCE 111, 114 (Nicholas Dimsdale & Martha Prevezer eds., 1994) (referring to the 'British/US system' and the 'Continental system' which encompasses 'most of Western Europe, Japan and the newly industrializing Pacific Rim countries'); and Maria Maher & Thomas Andersson, *Corporate Governance: Effects on Firm Performance and Economic Growth* 5-10 (Paper presented at the Tilburg University Law & Economics Conference on Convergence and Diversity in Corporate Governance Regimes and Capital Markets, Eindhoven, Netherlands, Nov. 4-5, 1999).

model, which emphasizes the maximization of the interests of a broader group of stakeholders.[35]

The market-based model focuses more narrowly on the interests of the shareholder. According to this model, corporate governance is the process of administering adequate controls over management to ensure the maximization of shareholder wealth. On the other hand, the relationship-based model views the company as a productive entity in which the public interest, as well as the interests of multiple stakeholders such as shareholders, employees and creditors, are vested.[36]

Although the shareholder and stakeholder models of corporate governance are useful stereotypes, it is doubtful as to whether they can be used effectively when analyzing Indonesian corporate governance or, indeed, the corporate governance systems of transitional and developing economies generally. This is because the underlying assumptions which are fundamental to these two models may not be valid in developing economies (like Indonesia) or in transitional economies. For example, it has been noted that the existence of a 'functioning civil and criminal justice system' is an important assumption in the two models.[37] Yet many developing and transitional economies lack a justice system which is functioning in a sufficiently proper and credible manner. More specifically in the case of Indonesia, there are significant doubts concerning the very impartiality and integrity of the judicial system, let alone its efficiency.[38]

In any event, the market model appears to be inapplicable in jurisdictions where, for many companies, a dominant owner supplies the financing and maintains control.[39] Following this line of thinking, a third model covering family-controlled and closely-held publicly listed companies might be useful. This will reflect the pervasiveness of such companies in many East Asian countries, including Indonesia.

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35 Chew, *supra* note 34, at 1.

36 The market-based model is also referred to as the 'contract model' or 'shareholder model,' while the relationship-based model is also referred to as the 'stakeholder model.' *See* Simon Deakin & Giles Slinger, *Hostile Takeovers, Corporate Law, and the Theory of the Firm, in* ENTERPRISE AND COMMUNITY: NEW DIRECTIONS IN CORPORATE GOVERNANCE 124 (Simon Deakin & Alan Hughes eds., 1997).

37 Erik Berglöf & Ernst-Ludwig von Thadden, *The Changing Corporate Governance Paradigm: Implications for Transition and Developing Countries* 5-6 (Paper presented at the Annual World Bank Conference on Development Economics, Washington D.C., June, 1999).

38 *See, e.g.*, HANS THOOLEN, INDONESIA AND THE RULE OF LAW: TWENTY YEARS OF 'NEW ORDER' GOVERNMENT (1987); BENNY K HARMAN, KONFIGURASI POLITIK & KEKUASAAN KEHAKIMAN INDONESIA (1997); and, for an assessment of the post-Soeharto Indonesian judicial system by an outspoken retired judge, see: Adi Andojo Soetjipto, *Legal Reform and Challenges in Indonesia, in* INDONESIA IN TRANSITION: SOCIAL ASPECTS OF REFORMASI AND CRISIS 269 (Chris Manning & Peter van Diermen, eds., 2000).

39 Berglöf and von Thadden, *supra* note 37, at 4-5.

Meanwhile, the research on this third model is still emerging.[40] Additional research on this topic is critical if there is to be greater understanding regarding how companies are governed in Asia. This paper can be viewed as a contribution to this research.

IV. INDONESIAN CORPORATE GOVERNANCE BEHAVIOR IN THE 1990S

The absence of a satisfactory theoretical framework for analyzing Indonesian corporate governance leads me to forsake theory temporarily and instead to focus on actual behavior. Below I examine three Indonesian companies which faced critical junctures in their corporate lives. I discuss what happened, what their corporate officers did, and how the regulatory authorities responded. I chose three banks as the subjects of these case studies simply because banks are among the most highly regulated companies in Indonesia and may thus be considered the bellwether of the Indonesian corporate governance phenomenon.

A. Bank Duta

When the Bank Duta debacle unfolded in 1990, the bank was one of 12 private banks listed on the JSX and was the fourth largest private bank in Indonesia.[41] At listing in June 1990, Bank Duta was majority owned and controlled by three wealthy and influential foundations (*yayasan*) whose chairman was then President Soeharto. Throughout the debacle, the three foundations chaired by Soeharto remained as majority shareholders holding, in aggregate, about 73% of the bank's issued shares.[42]

The Bank Duta saga began with the public revelation in September 1990 of a staggering Rp 782 billion (US$419 million) foreign exchange loss. At that time the loss – equivalent to about one-third of the

40 *See, e.g.*, Haider A. Khan, *Corporate Governance of Family Businesses in Asia* (Asian Development Bank, Working Paper No. 3, 1999); Stijn Claessens et al., *Expropriation of Minority Shareholders: Evidence from East Asia* (World Bank, Policy Research Working Paper No. 2088, 1999); and Fitzpatrick, *supra* note 19, at 296. *See also* the brief comments by Branson, *supra* note 30, at 346, referring to 'the dominant form of capitalism in many countries – family capitalism.'

41 *Govt Steps in as Crisis Hits Bank Duta*, JAKARTA POST, Sept. 5, 1990, at 1.

42 The names of the three foundations and details of their representatives and shareholdings are found in: *Tiga Kemungkinan Untuk Mengatasi Kasus Bank Duta*, BUSINESS NEWS, Sept. 21, 1990, reprinted in CENTRE FOR STRATEGIC AND INFORMATION STUDIES (CSIS), DOCUMENT CLIPPINGS SERVICE NO. 223/E/X/1990 KASUS BANK DUTA (hereinafter, KASUS BANK DUTA CLIPPINGS) 65 (1990). *See also supra* note 41. Prior to listing, the three foundations owned 90% of Bank Duta's issued shares, with the remaining 10% held by the bank's employees cooperative. BANK DUTA, BANK DUTA PROSPEKTUS 62 (1990).

bank's paid-up capital – was the largest single banking loss ever announced in the Indonesian capital market. The loss was made more embarrassing because it came barely five months after Bank Duta had issued a glossy prospectus containing a glowing financial report, and only three months after it was successfully listed on the JSX.

Two aspects of the Bank Duta case invite comment. The first aspect relates to the accountability of the bank's corporate officers for the loss. Indonesian companies generally adopt the two-tier board system from continental Europe, with each company being governed by a board of directors and a board of commissioners.[43] In the Bank Duta case, as a result of the huge loss, the board of commissioners exercised its right to dismiss the entire board of directors and temporarily assumed management control before a new board of directors was appointed. My research indicates that this was the first time the commissioners of a JSX-listed company have exercised this right.[44]

Although the commissioners took decisive action, only one of the company officers was made personally accountable for the loss. The Indonesian Attorney General's Office subsequently prosecuted the vice-president director, Dicky Iskandar Di Nata. He was convicted and jailed. Remarkably, it seems that no other civil or criminal proceedings were issued. In particular, I found no reference to any legal proceedings being issued by shareholders or the company against the bank's officers or the public accountant whose report appeared in the prospectus.

The second aspect of the Bank Duta case that invites comment revolves around the way the loss was dealt with. Shortly after the loss was revealed, the bank announced that the three foundations as major shareholders would inject US$419 million cash into the bank as 'pure grants' (*hibah murni*) in order to cover the loss. The grants were not given in exchange for existing or new shares or any other valuable consideration. The grants were not loans and did not have to be repaid. They were a gift in the purest sense of the word.

Such an occurrence is highly unusual and probably unheard of elsewhere.[45] A substantial loss of the kind suffered by Bank Duta typically would cause the shareholders to minimize their losses either by selling the bank or allowing the bank to be liquidated. The former was what happened to the venerable British merchant bank, Barings, when it

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43 On Indonesian corporate structure, *see generally* BENNY S. TABALUJAN, INDONESIAN COMPANY LAW - A TRANSLATION AND COMMENTARY, ch. 2 (1997).

44 *Pengakuan Bustanil*, EDITOR, Sept. 15, 1990, reprinted in KASUS BANK DUTA CLIPPINGS, *supra* note 42, at 60.

45 *Mengapa Hibah itu tak Kena Pajak?*, TEMPO, Oct. 13, 1990, at 85.

collapsed in early 1995.[46] The latter was what happened to the Hong Kong-based Asian financial dynamo, Peregrine, when it fell from grace in late 1997.[47] Alternatively, if shareholders wish to re-capitalize their company, they will inject fresh funds but this will be in consideration for new shares or as fresh loans to be repaid at a later date. The pure grants for Bank Duta were therefore exceptional.

The above two aspects of the Bank Duta case leave a set of unanswered questions. Why were there no civil actions against the company officers and public accountant of Bank Duta? Why did the majority shareholders make the grants? Where did they obtain such large amounts of money? Little information was available to answer these questions.[48] In these circumstances, what actually happened seemed illogical and inconsistent with the prevailing rules and underlying concepts of corporate governance. This divergence between practice and principle appeared to be a key dilemma of Indonesian corporate governance during the 1990s. The same dilemma also arose in the next two case studies.

B. Bank Summa

In 1992, Bank Summa was controlled by the Soeryadjaya family, one of the most prominent business families of South East Asia. The family patriarch was (and still is at the time of writing) William Soeryadjaya.[49] At that time, the Soeryadjaya business empire was the second largest in Indonesia, second only to the well-known Salim (Liem Sioe Liong) conglomerate.[50]

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46 On the Barings collapse, *see* JOHN GAPPER & NICHOLAS DENTON, ALL THAT GLITTERS: FALL OF BARINGS (1996).

47 *See* Broken Wings: *Peregrine's Collapse Raises Troubling Questions*, FAR E. ECON. REV., Jan. 22, 1998, at 52.

48 Writing about a decade later, Ross McLeod from the Australian National University commented in *Control and Competition: Banking Deregulation and Re-regulation in Indonesia*, 4 J. ASIA PAC. ECON. 258, 278 n. 34 (1999):

The [Bank Duta] rescue operation was non-transparent, however, and whether there was any *quid pro quo* for the individuals concerned remains a matter for speculation.

49 According to reports, William Soeryadjaya, a *peranakan* Chinese, was born on 20 December 1922 in Majalengka, West Java. *See Haruskah Oom Willem Dibiarkan*, KOMPAS, Nov. 20, 1992, at 1. He is often referred to as 'Om Willem' – '*Om*' (or *Oom*) being a respectful but friendly Dutch honorific which means 'uncle,' and 'Willem' being the Dutch equivalent of the English 'William.' His Chinese name is reputedly 'Tjia Kian Liong.' *See* Leo Suryadinata, *Chinese Economic Elites in Indonesia: A Preliminary Study*, *in* CHANGING IDENTITIES OF THE SOUTHEAST ASIAN CHINESE SINCE WORLD WAR II 261, 272 (Jennifer W. Cushman & Wang Gungwu eds., 1988). The publication which appears to come closest to a biography of William Soeryadjaya is AMIR HUSIN DAULAY ET AL., WILLIAM SOERYDJAYA: KEJAYAAN DAN KEJATUHANNYA (1993).

50 *See* Daulay, *supra* note 49, at 5. For a short description of Liem Sioe Liong (Sudono Salim), *see* Suryadinata, *supra* note 49, at 270-271. For fuller descriptions, *see* SORI ERSA SIREGAR

In 1992, the Soeryadjaya flagship was PT Astra International. Among other assets, Astra International held (and still holds) the lucrative licenses for manufacturing and distributing Toyota vehicles and Honda motorcycles in Indonesia.[51] In late 1992, Astra International was the largest company on the stock exchange, accounting for 11% of total JSX market capitalization.[52]

William Soeryadjaya has four children: Edward, Edwin, Judith and Joice. Together, at the start of the Bank Summa debacle, they reportedly held around 171 million Astra International shares,[53] or 70% of the issued capital of Astra International.[54] Prior to the Bank Summa crisis this stake would have a market value of approximately Rp 1.851 billion (US$974 million).[55] One report estimated that more than 90% of the Soeryadjaya family's assets was in the form of Astra International shares.[56]

The Summa Group, headed by Edward Soeryadjaya, was one of the private arms of the Soeryadjaya empire.[57] Throughout the early to mid-1980s, Bank Summa grew rapidly. During a one-year period between late 1988 and the end of 1989 – the same year that Astra International first listed on the JSX – Bank Summa's assets increased more than

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& KENCANA TIRTA WIDYA, LIEM SIOE LIONG: DARI FUTCHING KE MANCANEGARA (1988), and EDDY SOETRIYONO, KISAH SUKSES LIEM SIOE LIONG (1989). The growth of the Salim group is described by Yuri Sato, *The Salim Group in Indonesia: The Development and Behavior of the Largest Conglomerate in Southeast Asia* 31 THE DEVELOPING ECON. 408 (1993).

51 In addition, Astra International also distributed Daihatsu, BMW, Renault and Isuzu vehicles. *See* PT ASTRA INTERNATIONAL, 1992 ANNUAL REPORT 3 (1993).

52 *Effect of Bank Summa's Problems and the Economy on the JSE Index and Transactions*, VI(1) INDONESIAN CAPITAL MARKET JOURNAL, Jan., 1993, at 6.

53 *Haruskah Soeryadjaya Meninggalkan Astra?*, TEMPO, Nov. 28, 1992, at 19. However, a JSX commemorative publication cited a different figure of 168 million shares: PASAR MODAL INDONESIA: RETROSPEKSI LIMA TAHUN SWASTANISASI BEJ 60 (Jasso Winarto, ed., Pustaka Sinar Harapan, 1997).

54 *Haruskah Soeryadjaya Meninggalkan Astra?*, *supra* note 53.

55 On 12 November 1992, just before the Bank Summa crisis exploded, Astra International shares were trading at Rp 10,825 per share: *Effect of Bank Summa's Problems and the Economy on the JSE Index and Transactions*, *supra* note 52, at 6. In May 1992, Astra International shares were trading even higher, at around Rp 12,500 per share: *RUPS AI Diduga Bahas Rencana Ubah Manajemen*, BISNIS INDONESIA, 20 November 1992, in CENTRE FOR STRATEGIC AND INTERNATIONAL STUDIES (CSIS), CLIPPINGS SERVICE NO. 335/E/III/1993 BANK SUMMA JILID II (hereinafter, the CSIS clippings collected into 3 volumes are referred to as BANK SUMMA CLIPPINGS VOL. I, VOL. II, and VOL. III, respectively) 2 (1993).

56 *Haruskah Soeryadjaya Meninggalkan Astra?*, *supra* note 53. Another report estimated that the family's Astra International shares represented around 87% of the family's wealth: *Menghitung Hari-Hari Akhir Kejayaan Oom Willem*, WARTA EKONOMI, Nov. 30, 1992, in BANK SUMMA CLIPPINGS VOL. II, *supra* note 55, at 26, 29.

57 At the time of its collapse, the Summa Group had more than 70 subsidiaries in activities ranging from banking (the flagship Bank Summa), hotels, construction, real estate, insurance, textiles and transportation: Daulay, *supra* note 49, at 162-164.

fourfold to Rp 874.5 billion (US$490 million).[58] By December 1990, Bank Summa assets had virtually doubled again to Rp 1,763 billion (US$970 million).[59] It was then one of the ten largest private banks in Indonesia.[60]

After two years of very rapid growth, 1991 saw the start of Bank Summa's decline. The decline was partly caused by external factors. In February 1991, the Indonesian authorities had issued a new banking regulation revising the legal lending limit (the '3L' rule) prohibiting banks from lending more than 30% of their paid-up capital to parties related to shareholders.[61] Around the same time, there was a sudden tightening in monetary policy, causing interest rates to rise sharply.[62] Internally, Bank Summa also suffered from what some alleged to be poor management decisions and lax administrative controls.[63] In particular, its ratio of non-performing loans began to rise. By July 1991, Bank Summa was categorized as 'unsound' (*tidak sehat*) by the central bank.[64]

One of the first formal occasions when the Soeryadjaya family publicly acknowledged Bank Summa's problems was on 27 May 1992, after the annual general meeting of Astra International.[65] At a press conference after that meeting, William Soeryadjaya was accompanied by his younger son, Edwin, then vice-president director of Astra International. William confirmed that Edwin's brother, Edward, would be stepping down from the board of commissioners of Astra International.[66] He also affirmed his commitment to handle the Bank Summa crisis and stated:

> [T]he crisis which has befallen upon Summa does not

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58 Daulay, *supra* note 49, at 171.

59 Ibid.

60 Daulay, *supra* note 49, at 14. By the time of its collapse in late 1992, Bank Summa had more than 2,200 employees; 180,000 depositors; and 80 branches located in 16 Indonesian cities: *Kisah Dibalik Bank Summa: Pelajaran Yang Terlalu Mahal* SUARA PEMBARUAN, Nov. 21, 1992 in BANK SUMMA CLIPPINGS VOL. III, *supra* note 55, at 46.

61 On the 3L rule, *see* Binhadi, Financial Sector Deregulation, Banking Development and Monetary Policy: The Indonesian Experience 1983-93 92 (1995).

62 Binhadi, *supra* note 61, at 138. The February 1991 tightening was commonly known as the 'Sumarlin Shock II' (*Gebrakan Sumarlin II*), after Minister of Finance J B Sumarlin who announced the changes.

63 *Lilu-Liku Krisis Bank Summa*, INFO FINANSIAL, Nov. 25 1992, in BANK SUMMA CLIPPINGS VOL. I, *supra* note 55, at 43.

64 A bank is classified under one of four categories: sound (*sehat*), sufficiently sound (*cukup sehat*), poor (*kurang sehat*) and not sound (*tidak sehat*): *see* Hendrobudiyanto, *Bank Soundness Requirements: A Central Bank Perspective* in INDONESIA ASSESSMENT 1994: FINANCE AS A KEY SECTOR IN INDONESIA'S DEVELOPMENT 158, 166 (Ross H McLeod, ed., 1994).

65 *William: Saya Tanggung Jawab Cegah Keruntuhan Summa-Edward*, SUARA KARYA, May 29, 1992, at 1.

66 *Edward Mundur Dari PT Astra International*, KOMPAS, May 29, 1992, at 1.

> involve a loss arising from wrong business operations because when Edward undertook the asset purchases [for Summa], the economy was booming and prices were good. Now, Edward cannot sell [these assets] easily. This is also happening everywhere, in Hong Kong and elsewhere. So, really, Summa has not suffered a loss... As an older member of the family, I affirm fully my commitment towards handling the Summa crisis. No one will be made to suffer loss.[67]

In another newspaper, William Soeryadjaya is reported to have stated: 'The [Soeryadjaya] family will be responsible and is capable of facing this responsibility.'[68]

On 1 June 1992, William Soeryadjaya apparently issued a written undertaking in favor of the central bank, in which he undertook to repay all loans and other credit facilities extended to Bank Summa and other family creditors. He also agreed to sell his family's Astra International shares if necessary in order to fulfill this undertaking.[69] On 5 June 1992, with the approval of the central bank, the shareholders of Bank Summa signed a Memorandum of Understanding with the Panin Group, another leading Indonesian financial group, to implement a rescue plan.[70]

On 12 November 1992, as a result of insufficient liquidity, Bank Summa was unable to fulfill its local inter-bank clearing obligations.[71] The central bank immediately suspended Bank Summa's clearing rights effective Friday, 13 November 1992.[72] Shortly thereafter, it was reported that Bank Summa had non-performing loans totaling Rp 1.7 trillion (US$850 million), of which Rp 1.4 trillion (US$700 million) was owed by related entities in the Summa Group.[73] If this figure is correct, then this meant that Bank Summa had grossly contravened the central bank's 3L rule as it stood at the relevant time, even before the rule was tightened in 1991.

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67 *William: Saya Tanggung Jawab Cegah Keruntuhan Summa-Edward*, SUARA KARYA, May 29, 1992, at 1-2.

68 *Belum Diketahui, Berapa Saham AII Milik William Akan Dijual*, ANGKATAN BERSENJATA, May 29, 1992, at 3.

69 Daulay, *supra* note 49, at 211-215.

70 *Panin Group Segera Tangani Bank Summa*, BISNIS INDONESIA, June 10, 1992, in BANK SUMMA CLIPPINGS VOL. I, *supra* note 55, at 5.

71 *BI Blokir Bank Summa Ikut Kliring*, KOMPAS, Nov. 14, 1992, at 1.

72 Ibid.

73 *Utang Dibayar Utang*, TEMPO, Nov. 28, 1992, at 36; and Daulay, *supra* note 49, at 172. In another report, Minister of Finance Sumarlin was quoted as stating that approximately Rp 1.1 trillion (US$550 million) or 70% of Bank Summa loans was extended to shareholders and directors of the bank and related parties: *Bank Swasta Tak Dipercaya Lagi?*, FORUM KEADILAN, Dec. 24, 1992, at 80-81.

Following the suspension of clearing rights, William Soeryadjaya re-iterated his family's commitment to rescuing Bank Summa and pledged that no depositor would be allowed to suffer loss:

> What is clear is that we [the Soeryadjaya family] have made maximum efforts to return Bank Summa into a reasonable condition. The fact is that fresh capital reaching Rp 700 billion [US$350 million] has been injected. If we do not have good faith to rehabilitate Bank Summa, there is no way the Soeryadjaya family would extend such a large amount of funds... However, I do acknowledge that such large funds are still not sufficient.
>
> The principle in our family is that a member's issue is a family issue. If one person becomes ill, we will obtain medicine for him even if this requires every sacrifice.... As the captain of the family ship, I shall make every effort to resolve the crisis. What is clear is that I continue to guarantee that depositors' funds will be returned intact.[74]

After the loss of clearing rights, William Soeryadjaya sought out parties to bail out Bank Summa. The rescue attempts did not work. On 14 December 1992, the Minister of Finance revoked Bank Summa's banking license and ordered the directors of Bank Summa to liquidate the company under the supervision of the central bank. This was the first time since the banking sector was deregulated in 1988 that the government had revoked the license of a private bank, resulting in the bank being liquidated.[75]

There are two corporate governance aspects of the Bank Summa saga which invite comment. First, it raised questions regarding the accountability of the bank's company officers. The question on many people's minds was: who would be blamed for the collapse? There was talk of possible criminal prosecution.[76] One prominent Jakarta lawyer, O. C. Kaligis, was reported to have explicitly raised the issue of corporate crime (*kejahatan korporasi*), noting that management errors would not necessarily preclude criminal wrongdoing.[77] Other lawyers, economists

74 *William: Keluarga Soeryadjaya Tidak Akan Lepas Tangan*, KOMPAS, Nov. 16, 1992, at 1.

75 *Cost of Indecision: Indonesia Closes Crisis-Ridden Bank Summa*, FAR E. ECON. REV., Dec. 24-31, 1992, at 75.

76 *Mungkinkah Edward Dituntut Pidana?* FORUM KEADILAN, Dec. 10, 1992, at 93-94; and *Celah Jalan ke Penjara*, FORUM KEADILAN, Jan. 7, 1993, at 88.

77 *Kejaksaan Harus Selidiki Kemungkinan Ada Kejahatan Korporasi dalam Kasus Bank Summa*, PELITA, Dec. 19, 1992, at 1.

and legislators expressed similar views.[78] However, my research found no media report of any criminal prosecution initiated or any criminal sanctions imposed by the authorities against Bank Summa, its corporate officers or its shareholders as a result of the breach of the 3L rule or the collapse generally.

Similarly, there appears to have been no civil proceedings issued. There was, however, talk concerning the potential civil liability of the bank's officers and shareholders.[79] For instance, Gani Djemat, a senior Jakarta lawyer, was quoted as opining that, in the context of the Bank Summa collapse, the directors could be personally liable in certain circumstances.[80] Frans Hendra Winarta, another well-known Jakarta lawyer, was quoted as stating that, in the United States, a similar situation could have resulted in criminal prosecutions against bank directors for bank fraud as well as civil actions against bank shareholders.[81] However, my research found no report of any civil action initiated by depositors or the regulatory authorities against Bank Summa corporate officers or shareholders.[82]

The second aspect of the Bank Summa collapse that requires consideration is the role of family relationships. The remarkable fact was the extraordinary lengths to which the Soeryadjaja family sought to save Bank Summa. William Soeryadjaya, in particular, made a valiant effort to save the bank. Yet, the Soeryadjaya family could have as easily taken precisely the opposite course. They could have abandoned Bank Summa and allowed it to collapse much earlier.

Granted, the directors, commissioners and shareholders of Bank Summa owed legal duties to the bank. However, these duties did not extend to bailing out the bank with fresh capital in cases of loss. Although they could do so, there was no legal obligation to that effect. Indeed, one of the main reasons why individuals all over the world use corporate

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78 *Kejaksaan Agung Diminta Usut Masalah Bank Summa*, MERDEKA, Nov. 16, 1992, in BANK SUMMA CLIPPINGS VOL. I, *supra* note 55, at 110.

79 *Bank Summa Dan Tanggung Jawab Pengurusnya*, SUARA KARYA, Jan. 4, 1993, in BANK SUMMA CLIPPINGS VOL. III, *supra* note 55, at 104.

80 *Simpanan Tak Dilunasi, Nasabah Bisa Klaim Bank Yang Dilikuidasi*, SUARA KARYA, Dec. 19, 1992, in BANK SUMMA CLIPPINGS VOL. I, *supra* note 55, at 119.

81 *Mungkinkah Edward Dituntut Pidana?*, *supra* note 76.

82 Thus, the seasoned Asian correspondent of the ASIAN WALL STREET JOURNAL, Richard Borsuk, in *Reforming Business in Indonesia* in POST-SOEHARTO INDONESIA: RENEWAL OR CHAOS 135, 140-141 (Geoff Forrester, ed., 1999) wrote:

> Indonesia does not lack laws, but it certainly has lacked credible administration of business law. There has been plenty of crime without punishment. In 1992, [the]...monetary authorities revoked the license of Bank Summa, which had grossly violated limits on how much it could lent to its owners. But the correct action of shutting the bank, which rattled the whole banking system, was not followed up with prosecutions of any of the shareholders or directors. The main owner, Edward Soeryadjaya, simply stayed out of Indonesia for years while people forgot about Summa.

entities to undertake business is to minimize personal liability in cases where their corporations, like Bank Summa, suffer heavy losses. In other words, had the Soeryadjaya family simply allowed Bank Summa to collapse, there was very little possibility that any creditor or affected party could have had any recourse against the family or made any claim against the family's assets.[83] Also, the Soeryadjaya other family assets would have remained unaffected by Bank Summa's collapse. This was because Bank Summa was incorporated as a separate legal entity.

Through their efforts in bailing out Bank Summa, and the express comments of William and Edwin, it became clear that the family viewed the Bank Summa crisis as the responsibility of the entire Soeryadjaya family. They assumed responsibility when there was no legal – as opposed to moral or ethical – obligation to do so.

If so, this raises an interesting paradox on the issue of accountability and corporate governance. Why was no one – the bank's officers, shareholders or professional advisers – implicated in Bank Summa's collapse? On the other hand, why did William Soeryadjaya and his family strive so hard to bail out Bank Summa when they had no legal obligation to do so? Thus, the Bank Summa case again exemplifies the key dilemma of Indonesian corporate governance: why actual practice diverges so much from corporate governance principles.

C. Bank Pikko

The third case study focuses on PT Bank Pikko Tbk, a private bank listed on the JSX. It revolves around the alleged manipulation of Bank Pikko shares by certain parties in April 1997. The purpose of the case study is to evaluate how the regulatory authorities such as the JSX and Bapepam (*Badan Pengawas Pasar Modal*), the powerful Indonesian securities watchdog, responded in this instance.[84] Whereas the Bank Duta and the Bank Summa case studies focused on the actions of shareholders and company officers, the Bank Pikko case study shifts the spotlight to Indonesia's corporate regulators in order to ascertain the contribution of the regulatory authorities and judicial system towards Indonesian corporate governance.

Bank Pikko was first listed on the JSX in January 1997. Among

83 This point was specifically mentioned by one commentator: *Krisis Bank Summa Dan Tanggung Jawab Terbatas*, ANGKATAN BERSENJATA, Dec. 1, 1992, in BANK SUMMA CLIPPINGS VOL. III, *supra* note 55, at 87.

84 There are many other rumours of alleged stock market manipulation. However, the Bank Pikko case is possibly the most spectacular case and is useful for this case study because, unlike several other cases of alleged share manipulation, this one was widely publicised and subsequently came to a firm conclusion.

the 25 banks listed on the JSX at that time, Bank Pikko was one of the smallest in terms of capitalization and business operations. After its debut, its share price during January – March 1997 was unremarkable, fluctuating within a comfortable range of Rp 800 – 1,050 (US 35-45 cents).[85]

Despite its unremarkable size and beginnings as a listed public company, Bank Pikko has become a landmark in Indonesian capital market history. Its claim to fame lay in the alleged manipulation of its shares on 8 April 1997 when its share price increased sharply from Rp 1,300 to Rp 4,050 (US 54 cents – US$1.70) within about 204 minutes of trading. That day has been dubbed 'Bloody Tuesday' (*Selasa Berdarah*) and is considered to be one of the most controversial days in the recent history of the JSX.[86] It also resulted in Bapepam imposing its most severe administrative sanction at that time upon an individual investor – in the form of a fine of Rp 1 billion (US$415,000) – for an alleged case of market manipulation.[87]

At the commencement of trading on 8 April 1997, Bank Pikko shares opened at Rp 1,300 (US 54 cents), having increased from Rp 1,100 (US 48 cents) the day before.[88] By lunchtime, its price had jumped further to Rp 1,800 (US 78 cents).[89] As with all cases of rapid share price movements, the JSX issued a standard inquiry to the management of Bank Pikko seeking an explanation for the price increase.[90] In response, the management of Bank Pikko issued a statement that the bank was not contemplating any significant corporate action and they were unaware as to the reasons for the significant rises in the bank's share price.[91] In turn, this announcement was released by the JSX as a public announcement around mid-day on 8 April 1997.[92]

Having heard the public announcement, a significant number of investors, including speculators, began selling Bank Pikko shares at prices ranging between Rp 1,675 – Rp 1,800 (US 73 – 78 cents).[93] It was subsequently revealed that a number of the speculators were short-selling the shares, expecting the price to decline further after the announcement

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85 Share prices as quoted in *Bursa Efek Jakarta*, KOMPAS, Jan. 9, 1997, at 2 and 31 March 1997, at 2.

86 *"Selasa Berdarah" dari Saham Bank Pikko*, KOMPAS, May 19, 1997, at 2.

87 *Benny: Saya Rela Bayar Rp 1 Miliar Karena Salah*, KOMPAS, May 16, 1997, at 2.

88 *BEJ "Suspend" Bank Pikko Dan Multibreeder*, SUARA PEMBARUAN, April 13 1997, at 4.

89 *Buntut Saham Bank Pikko, Empat Broker Sementara Disuspensi*, SUARA PEMBARUAN, April 24, 1997, at 5.

90 Ibid.

91 Ibid.

92 Ibid.

93 Ibid.

was made.[94] Unexpectedly, however, several brokers implemented large buy orders and, during early afternoon trading, the share price continued to jump to Rp 2,500 (US$1.09), then to Rp 3,000 (US$1.30), and Rp 3,500 (US$1.52) and ultimately reached Rp 4,050 (US$1.76).[95] At 2:24 p.m., the JSX suspended trading in Bank Pikko shares when it stood at Rp 4,000 (US$1.73); by this time, the shares had jumped 208% within 204 minutes of trading, during which approximately 22 million shares were traded.[96]

There were two steps taken by the JSX as a result of the sharp rise in Bank Pikko shares on 8 April 1997. First, the JSX temporarily suspended trading in these shares.[97] Secondly, on 23 April 1997, the JSX temporarily suspended four brokers from trading on the JSX because they failed to fulfill their obligations to deliver Bank Pikko shares within the nine-day settlement period.[98] Presumably, these brokers were acting for short-sellers who could not purchase shares in the market when the price unexpectedly rose sharply.

Meanwhile, three weeks after Bloody Tuesday, Bapepam announced that it had initiated its own investigation into alleged irregularities associated with the Bank Pikko transactions.[99] On 15 May 1997, barely five weeks after Bloody Tuesday, Bapepam announced that its investigations revealed that two individuals had allegedly created a false market (*gambaran semu*) in an attempt to manipulate Bank Pikko shares in contravention of prevailing capital market regulations.[100]

Bapepam simultaneously announced a string of sanctions imposed upon various parties linked with the Bank Pikko transactions.[101] Two men, Benny Tjokrosaputro and Pendi Tjandra, were fined Rp 1 billion (US$416,000) and Rp 500 million (US$208,000) respectively for allegedly masterminding the attempted manipulation in Bank Pikko shares. Two brokers received administrative sanctions in the form of monetary fines. Fifty-four brokers received written warnings because they allegedly contravened other trading regulations. The board of directors of the JSX also received a written warning and was asked to improve its

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94 *Benny Didenda Rp 1 Milyar Dalam Kasus Bank Pikko*, KOMPAS, May 15, 1997, at 2.

95 *Buntut Saham Bank Pikko, Empat Broker Sementara Disuspensi*, *supra* note 89. The large buy orders and the consequential rise in market price of Bank Pikko shares were clearly unexpected by the market. The steep rise in market price obviously meant that short-sellers eventually suffered huge losses.

96 Ibid.

97 *BEJ "Suspend" Bank Pikko Dan Multibreeder*, *supra* note 88.

98 *Buntut Saham Bank Pikko, Empat Broker Sementara Disuspensi*, *supra* note 89.

99 *Bapepam Atur Pembiayaan Fasilitas "Margin Trading"*, KOMPAS, May 1, 1997, at 2.

100 *Bapepam Ambil Tindakan Terhadap Kasus Bank Pikko*, SUARA PEMBARUAN, May 15, 1997, at 5.

101 Ibid.

market surveillance system.

When the Bapepam sanctions were announced, Tjokrosaputro, a youthful 28-year old businessman, responded by acknowledging his readiness to comply with the sanction imposed upon him. He stated:

> As a good Indonesian citizen, I wholeheartedly surrender the profit of Rp 1 billion [US$416,000] gained through the Bank Pikko share transactions to the state... I consider the Bapepam decision which requires me to surrender the profits...as a fair decision. That is why I am complying with it wholeheartedly.[102]

The speed with which Bapepam undertook its investigations and the firmness of its sanctions in the Bank Pikko affair have been widely praised.[103] However, there remains one nagging question surrounding the legitimacy of Bapepam's sanctions: did Bapepam have the legal authority to impose the sanctions it did and, if it did not, why did no one challenge it?

Pursuant to Arts 100-101 Capital Market Law 1995,[104] Bapepam clearly had the power to initiate inspections and investigations. This included investigations into suspected criminal offenses. But it could only impose administrative sanctions, not criminal sanctions. The prosecution of criminal offenses was to be undertaken by the Attorney General's Office, consistent with the general procedures of Indonesian criminal law, and the imposition of criminal sanctions was the prerogative of the courts.

In the Bank Pikko case, Bapepam imposed a range of administrative sanctions upon the alleged manipulators. The problem, however, was that the alleged manipulation appeared to constitute a criminal offense.[105] Moreover, even if it was argued that the alleged manipulation constituted a non-criminal offense, there was still some doubt as to whether Bapepam had authority to impose administrative sanctions upon an individual investor.[106] Those who had the administrative

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102 *Buntut Lonjakan Saham Bank Pikko Benny Tjokro Ikhlas Serahkan Rp 1 Milyar Kepada Negara*, SUARA PEMBARUAN, May 16, 1997, at 1. It is unclear whether the Rp 1 billion (US$416,000) he paid represented part or all of his profit from the alleged stock manipulation exercise.

103 *Transaksi Semu Tindakan Kriminal*, KOMPAS, May 16, 1997, at 2.

104 For a brief summary of the Capital Market Law 1995, see: Benny S Tabalujan, *Indonesia's New Capital Market Law*, 15 ASIA BUS. L. REV. 14 (1997).

105 *Transaksi Semu Tindakan Kriminal, supra* note 103. This point was noted by Hasan Zein Mahmud, a former president director of the JSX.

106 Article 102(1) of the Capital Market Law states:

Bapepam may impose an administrative sanction for a contravention of this Law and/or its implementing regulations committed by any Party who has a license or approval from or

sanctions imposed upon them theoretically could have challenged Bapepam's authority in court. Yet none did so. Tjokrosaputro and Tjandra made no indication of challenging Bapepam's jurisdiction to impose the sanctions. Neither did any of the securities firms which had sanctions imposed upon them. This case highlights once again the key dilemma of Indonesian corporate governance: why actual practice diverges so much from corporate governance principles.

V. LEGAL CULTURE

How can the discrepancies between corporate governance as legislated and corporate governance as practiced be explained? Why did the foundations inject US$419 million into Bank Duta for what appears to be no consideration whatsoever? Why did the Soeryadjaya family sacrifice so much of their personal assets for Bank Summa when they had no legal obligation to do so? Why did the alleged perpetrators of the Bank Pikko stock price manipulation not challenge Bapepam's jurisdiction when there seemed to be good grounds for doing so?

I suggest that the answer lies with the concept of 'legal culture' – a somewhat neglected notion first championed by Lawrence M Friedman in the 1960s. Friedman, a legal sociologist at Stanford University Law School, postulates that a legal system comprises of three sets of basic components: legal structure, substantive law, and legal culture.[107] Structure refers to the institutions and processes within a legal system; it is 'the body, the framework, the long-lasting shape of the system.'[108] It includes elements such as the court system, the legislature and the banking and corporate system. Substance refers to the laws – both the substantive and procedural rules – and norms used by institutions which bind the structure together.[109]

The tendency among lawyers and comparative law scholars is to confine their analyses to the structure and substance of the legal system

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registration with Bapepam.

The official explanatory memorandum (Elucidation) to Art 201(1) extends the scope of the provision to apply to any person who owns at least 5% of the shares of a listed public company. The available facts indicate, however, that Tjokrosaputro at the relevant time held less than 5% of the issued shares of Bank Pikko.

107 Friedman's earliest exposition of these concepts appears in Lawrence M Friedman, *Legal Culture and Social Development*, 4 LAW & SOC'Y REV. 29 (1969) and Lawrence M Friedman, *On Legal Development*, 24 RUTGERS L. REV. 1 (1969); *see also*: LAWRENCE M FRIEDMAN, THE LEGAL SYSTEM: A SOCIAL SCIENCE PERSPECTIVE 11-16, ch. 8 (1975) and LAWRENCE M FRIEDMAN, LAW AND SOCIETY: AN INTRODUCTION 6-9, ch. 7 (1977).

108 Friedman (1977), *supra* note 107, at 6.

109 Friedman (1975), *supra* note 107, at 14.

110 Ibid, 15.

that they study. Friedman criticizes this tendency:

> Structure and substance are real components of a legal system, but they are at best a blueprint or a design, not a working machine. The trouble with...structure and substance was that they were static; they were like a still photograph of the legal system...The picture lacked both motion and truth...and is like an enchanted courtroom, petrified, immobile, under some odd, eternal spell.[110]

According to Friedman, the missing element which gives life to a legal system is 'legal culture'. Legal culture refers to the 'attitudes, values, and opinions held in society, with regard to law, the legal system, and its various parts'.[111] It is 'those parts of general culture – customs, opinions, ways of doing and thinking – that bend social forces toward or away from the law and in particular ways'.[112] As such, legal culture is part of the overall culture of a society. Among the three components of a legal system, legal culture is the most elusive to describe and yet the most important:

> [I]t is the legal culture which determines when, why and where people use law, legal institutions or legal processes; and when they use other institutions or do nothing. In other words, cultural factors are an essential ingredient in turning a static structure and a static collection of norms into a body of living law. Adding the legal culture to the picture is like winding up a clock or plugging in a machine. It sets everything in motion.[113]

Friedman's concept of legal culture is not without its critics. Roger Cotterrell in Britain has argued that Friedman's concept 'lacks rigor' and is 'ultimately theoretically incoherent'.[114] Friedman responded by pointing out that the lack of precision in the term 'legal culture' did

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111 Friedman (1977), *supra* note 107, at 76.

112 Friedman (1975), *supra* note 107, at 15.

113 Ibid, 76. Writing almost two decades later, Friedman further defined legal culture to mean 'the ideas, values, attitudes and opinions people in some society hold, with regard to the law and the legal system... Legal culture is the source of law – its norms create the legal norms': Lawrence M Friedman, *Is There a Modern Legal Culture?*, 7(2) RATIO JURIS 117, 118 (1994). According to him, from legal culture 'flow lines of force, pressures, and demands that envelop legal institutions and ultimately define their shape': LAWRENCE M FRIEDMAN, THE REPUBLIC OF CHOICE: LAW, AUTHORITY AND CULTURE 4 (1990).

114 Roger Cotterrell, *The Concept of Legal Culture*, *in* COMPARING LEGAL CULTURES, at 13-14 (David Nelken ed., 1997).

not necessarily make it incoherent; indeed, the term shares a similar lack of precision with other equally important concepts such as 'structure,' 'legal system' and 'public opinion.'[115]

I think Cotterrell is partly right and partly wrong. He is right to highlight the difficulties in handling the concept of legal culture. But he is wrong to conclude that the concept is incoherent because of its lack of specificity. As I see it, a concept as complex as legal culture, by its very nature, tends to be somewhat elusive. This is evidence of its social pervasiveness rather than a sign of its conceptual weakness.

The concept of legal culture becomes especially important for developing and transitional countries. These countries often import codes or even entire legal systems from Western nations legislation in their attempt to modernize their domestic legal frameworks. Problems, however, arise when such legal transplants are effected without due consideration of the domestic legal culture. If the domestic legal culture is not receptive to the imported foreign legal structure or substantive law, it is likely that these imports will not be implemented properly.

With respect to Indonesia, this point had been recognized as early as 1972 by foreign commentators[116] and expressly highlighted in 1982 by the former Indonesian Minister of Justice, Mochtar Kusumaatmadja.[117] However, it appears to have been forgotten by Indonesian policy-makers in the past two decades. It is only now beginning to be recalled by those involved in Indonesian law reform.[118] However, two recent analyses of Indonesian corporate governance reform by still ignore the role of legal

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115 Lawrence M Friedman, *The Concept of Legal Culture: A Reply*, *in* COMPARING LEGAL CULTURES, at 33 (David Nelken ed., 1997).

116 Daniel S Lev, *Judicial Institutions and Legal Culture in Indonesia*, *in* CULTURE AND POLITICS IN INDONESIA, at 246 (Claire Holt ed., 1972). Lev in fact acknowledged the work of Lawrence M Friedman on legal culture, *id* at 247.

117 Mochtar Kusumaatmajda, *Law and Development in the ASEAN Region: The Indonesian Experience*, 1(1) ASEAN LAW JOURNAL 1, 6 (1982):

> The law development process here [ie. in young nations with a colonial past, like Indonesia] embraces the development and strengthening of institutions, processes as well as attitudes, besides revision of existing laws. Law development here in effect means the development of a new legal culture.

118 My research reveals that, apart from Lev's 1972 article, *supra* note 116, little (if any) additional work was published in English on Indonesian legal culture until Timothy C Lindsey, *Paradigms, Paradoxes and Possibilities: Towards Understandings of Indonesia's Legal* System, *in* ASIAN LAWS THROUGH AUSTRALIAN EYES, at 90, 101-103 (Veronica Taylor ed., 1997). Thereafter, interest on this issue grew. *See* William Neilson, *The Rush to Law: The IMF Legal Conditionalities Meet Indonesia's Legal Culture Realities*, *in* PROSPECTS FOR REFORM IN POST-SOEHARTO INDONESIA, at 4 (Drew Duncan & Tim Lindsey eds., 1999); *see also* Tim Lindsey, *Black Letter, Black Market and Bad Faith: Corruption and the Failure of Law Reform*, *in* INDONESIA IN TRANSITION, at 278 (Chris Manning & Peter van Diermen eds., 2000). Lindsey uses the terms 'hard law' to refer to black letter law and 'soft law' to legal norms and everyday practices. Lindsey, *id.* at 284. Clearly, Lindsey's 'hard law' can be equated with Friedman's legal structure and substantive law while his 'soft law' is equivalent to Friedman's legal culture.

culture.[119]

The next obvious question is: what exactly is Indonesian legal culture? Answering this question is fraught with difficulty. Friedman himself noted that 'statements about legal culture rest on shaky evidence at best.'[120] The task becomes even more problematic when the subject is a nation as large and complex as Indonesia – a mélange of 210 million people from over 250 ethnic groups with equally numerous languages and dialects – as well as a chequered history which included almost 350 years of Dutch colonial rule.[121]

Although a thorough exposition of Indonesian legal culture is beyond the scope of this paper, it is possible to mention at least one potentially key element of Indonesian legal culture which appears capable of directly affecting corporate governance behavior. I venture to suggest that this element is patrimonialism. Patrimonialism, as a sociological concept, owes much to the ideas of Max Weber and refers to a patriarchal system of relationships where a father-figure, similar to that found in a family, exerts authority in social, business or political contexts.[122] Commentators have noted the influence of patrimonialism upon many aspects of Indonesian affairs, including Indonesian legal development.[123] Is it possible that patrimonial tendencies also affect Indonesian corporate governance, such that corporate institutions and relationships are viewed through a familial, as opposed to legal, perspective?

If patrimonialism does in fact influence Indonesian corporate governance such that a corporation is viewed as existing within a network of familial relationships rather than legal relationships, then the giving of the US$416 million grant to Bank Duta by its three shareholder foundations potentially becomes less enigmatic. Similarly with the case of the Soeryadjaya family's ill-fated attempt to bail out Bank Summa. The

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119 Neither Simandjuntak & Salim, *supra* note 23, nor Fitzpatrick, *supra* note 23, refers to legal culture in their respective analyses of Indonesian corporate governance.

120 Friedman (1975), *supra* note 107, at 204.

121 For an introduction to Indonesian culture, see: MANUSIA DAN KEBUDAYAAN INDONESIA (Koentjaraningrat ed., 1971). For insights into Indonesian legal history, see: JOHN BALL, INDONESIAN LEGAL HISTORY 1602-1848 (1982); G J Resink, INDONESIA'S HISTORY BETWEEN THE MYTHS: ESSAYS IN LEGAL HISTORY AND HISTORICAL THEORY (1968); and, for a brief but more recent survey, David K Linnan, *Indonesian Law Reform, Or Once More unto the Breach: A Brief Institutional History*, 1(1) AUSTL. J. ASIAN L. 1 (1999).

122 MAX WEBER, ECONOMY AND SOCIETY, at 1006 (Guenther Roth & Claus Wittich, trans. & eds., Vols 1 & 2, 1978). For a general introduction, see: MAX WEBER ON LAW IN ECONOMY AND SOCIETY (Max Rheinstein, ed., 1967).

123 E.g, Harold Crouch, *Patrimonialism and Military Rule in Indonesia*, 31(4) WORLD POLITICS 571 (1979); Andrew MacIntyre, *Power, Prosperity and Patrimonialism: Business and Government Indonesia*, in BUSINESS AND GOVERNMENT IN INDUSTRIALISING ASIA, 224 (Andrew MacIntyre, ed., 1994); Bernard Quinn, *Indonesia: Patrimonial or Legal State? The Law on Administrative Justice of 1986 in Socio-Political Context*, in INDONESIA: LAW AND SOCIETY, 258 (Timothy Lindsey, ed., 1999).

reasoning is that, in a family context, when one family member suffers, others come to his aid. Thus, a father who sees his child weighed down by excessive debt may choose to repay the debt using the father's funds without requiring any compensation from the child. Such an act is motivated by a sense of family obligation, responsibility and honor which can be quite different from the notions of legal obligation or legal duty.

In the case of Bank Pikko, the alleged mastermind of the market manipulation on the JSX in April 1997, Benny Tjokrosaputro, appeared deeply repentant over the affair. Such an attitude is remarkable. It is not at all consistent with the image of the typical rogue investor who seeks to manipulate the market for personal gain. Tjokrosaputro's attitude is reminiscent of a schoolboy caught by his teacher or father playing truant, rather than the response of a sophisticated market manipulator. Again, such a response becomes more understandable if there is an assumption that patrimonial attitudes to law and punishment pervade Indonesian society generally.

Of course, much more detailed research is required before any suggested linkage between patrimonialism and Indonesian corporate governance as described above can be substantiated. Moreover, the broader question of how and the extent to which patrimonialism may be affecting Indonesian legal culture must also be researched. Nevertheless, it would appear at first glance that the dilemmas raised by the Bank Duta, Bank Summa and Bank Pikko case studies can conceptually be resolved by resorting to the concepts of legal culture and patrimonialism. People part with US$419 million for apparently no consideration. People place personal wealth at risk when there is no legal obligation to do so. People accept punishment even if the punishment may not have a legal basis. The reason for the seemingly illogical behavior in each of these cases is that it was the right thing to do in a patrimonial culture, regardless what black-letter corporate governance principles state.

If legal culture is as important as suggested above, then any law reform initiative which focuses on legal structure and substantive law and glosses over legal culture can lead to major gaps. In other words, the success of Indonesian law reform (and this may also apply to other developing and transitional economies) is dependent not only upon sound institutions, but also upon the appropriate mental attitudes and behavior among those who staff, supervise and utilize these institutions. Successful law reform is thus dependent upon legal culture as Friedman defined it. Hardware without software is useless and reform of legal institutions without reform of legal culture will ultimately be ineffective.

Thus, when examining Indonesian corporate governance, the temptation is to focus on structural matters such as the two-tier board

system and the substantive black-letter provisions of the Company Law 1995 and compare them with those of other jurisdictions.[124] However, this approach often ignores how company law actually works in real life – questions such as why a shareholder declines to initiate legal proceedings against directors and commissioners when he has the right to initiate them, or why company officers in Amsterdam act differently from their counterparts in Jakarta when, in fact, their company law provisions share some resemblance with each other.[125]

Unfortunately, a corporate governance study which focuses on culture runs contrary to mainstream corporate governance thinking. Mainstream corporate governance literature largely ignores the role of culture in corporate governance. For example, a recent 1,238-page tome on comparative corporate governance omitted mentioning culture explicitly as a key factor in corporate governance systems.[126] Cultural factors in corporate governance studies, if mentioned at all, are generally regarded as a 'black box' of imponderables and tended to be touched upon only in passing without rigorous analysis.[127]

However, the tide appears to be turning. There appears to be a renewed interest among legal scholars,[128] multilateral institutions[129] as well as the private sector[130] in the view that culture may play a significant role

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124 For a discussion of the Company Law 1995, see *supra* note 43.

125 For an introduction to corporate governance in the Netherlands see Ad van Iterson, *The Development of National Governance Principles in the Netherlands, in* GOVERNANCE AT WORK: THE SOCIAL REGULATION OF ECONOMIC RELATIONS 49 (Richard Whitley & Peer Hull Kristensen eds., 1997).

126 *Supra* note 26. Compare Robert I. Tricker, *Corporate Governance: A Ripple on the Cultural Reflection, in* CAPITALISM IN CONTRASTING CULTURES 187 (S.R. Clegg & G.S. Redding, 1990), for an early attempt at connecting corporate governance and culture.

127 Ronald J. Mann & Curtis J. Milhaupt, *Foreword*, 74 WASH. U. L.Q. 317, 323 (1996).

128 Among scholars, this interest tends to revolve around path dependence theories concerning the development of corporate governance systems. *See:* the articles referred to in *supra* note 29. Also see Amir N. Licht et al., *Culture, Law and Finance: Cultural Dimensions of Corporate Governance Systems* (June 2001) (unpublished SSRN Working Paper) *available at* (http://www.papers.ssrn.com/sol3/papers.cfm?abstract_id=277613).

129 The World Bank states: "[t]hese internal and external features [of corporate governance] have come together in different ways to create a range of corporate governance systems that reflect specific market structures, legal systems, traditions, regulations, and *cultural* and societal values". [Italics added]. WORLD BANK, *Overview, in* CORPORATE GOVERNANCE: A FRAMEWORK FOR IMPLEMENTATION (2000). Similarly, the OECD (Organization for Economic Cooperation and Development, Paris) states: "[t]he [corporate governance] principles are non-binding and do not aim at detailed prescriptions for national legislation...They can be used by policy makers, as they examine and develop their legal and regulatory frameworks for corporate governance that reflect their own economic, social, legal and *cultural* circumstances". [Italics added]. OECD AD HOC TASK FORCE ON CORPORATE GOVERNANCE, OECD PRINCIPLES OF CORPORATE GOVERNANCE 3 (1999). For similar views echoed by IMF staff, see Licht, *supra* note 30, at 155.

130 *See* Licht, *supra* note 30, at 153. Licht points out that CalPERS (California Public Employees Retirement System) — the largest pension fund in the United States with well over US$100 billion in assets — recognizes that "[t]he modern corporation is influenced by the legal,

in determining the shape of a corporate governance system. One Japanese scholar sees a community's 'cultural tradition' as one of the factors which determines how it views the nature of a corporation.[131] This fresh interest in the role of culture in corporate governance is to be welcomed. It is consistent with recent scholarship which highlights culture as a key element in the economic development of nations throughout history. As Harvard historian David Landes puts it: 'If we learn anything from the history of economic development, it is that culture makes all the difference.'[132]

VI. SOME CRITICAL LESSONS

There are at least three important and inter-related lessons for the future. These lessons must be borne in mind by policy-makers working to restore credibility to the battered Indonesian corporate governance system. They may also be relevant to other developing and transitional economies seeking to improve their corporate governance systems.

The first lesson is that corporate governance reform cannot focus on changing the black-letter law and institutions without seeking to change legal culture. Indonesia has enough laws and legal institutions. In a sense, Indonesia does not need more law, but less. What is needed is a changed legal culture that will put to work these laws and institutions as they are designed to be used.

It follows that much of the current effort at improving Indonesian corporate governance is defective. Too much attention (and aid money) is channeled towards drafting new laws, creating new systems and providing superficial, short-term staff training. Are these efforts designed to provide quick, tangible results to justify the fees of expensive consultants and other so-called experts? What evidence is there that creating more legislation, more legal institutions and more legal processes actually create more legality and legitimacy within the system?

In contrast, it seems that too little attention has been focused on studying the mindset of the key players or creating and implementing a sustainable strategy by which this mindset can be changed permanently for the better. Such neglect bodes ill for the future of Indonesian corporate governance. Even the newly drafted Indonesian Code for Good

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economic and *cultural* traditions that are unique to each market. These traditions must affect the corporate governance structures and principles that are appropriate for the different markets". [Italics added]. *Id.* at 153.

131 Katsuhito Iwai, *Persons, Things and Corporations: The Corporate Personality Controversy and Comparative Corporate Governance*, 47 AM. J. COMP. L. 583, 586 (1999).

132 David S. Landes, THE WEALTH AND POVERTY OF NATIONS: WHY SOME ARE SO RICH AND SOME SO POOR 516 (1999).

Corporate Governance[133] may end up poorly implemented if people's mindsets do not change.

The second lesson is that global convergence of corporate governance systems is not likely to happen soon. This flows from the basic premise that corporate governance is embedded in a society's culture. Of course, one may be tempted to think that the post-Cold War economic, political and military dominance of the Unites States will force corporate governance systems worldwide to gravitate towards the American model. But it is doubtful whether this will happen in a wholesale way. Granted, there may be some convergence in certain areas – what Ronald Gilson dubs functional convergence. But if culture changes, it changes slowly. This means that convergence, if it happens at all, will be slow and be limited, at least initially, to certain functional areas.

The *New York Times* columnist, Thomas L. Friedman, made a similar point when he coined the term "glocalisation."[134] What he meant was that globalization is forcing a certain degree of uniformity in economic and financial systems worldwide; at the same time, the fiercely tribal and communal part of societies resists this process and creates a backlash. Glocalisation is the conciliating process through which these two conflicting trends can be accommodated. Through glocalisation, useful aspects of globalization can be assimilated into a local culture without overwhelming it.

If global convergence of corporate governance is not likely to occur soon, one practical consequence is that much of the current corporate governance convergence debate among academics may, ultimately, be of little value. Instead of wasting more time and resources on the debate, perhaps the leading academics in this area should direct their efforts towards more in-depth country studies. Sweeping, conceptual and theoretical arguments may have to be forgone in favor of detailed case studies and other empirical work. The results of such work will steer academic discussion into more concrete and less abstract terrain. Such a re-focusing may help yield fresh empirical data from which, subsequently, a more accurate and reliable methodology and a richer and more insightful theoretical framework for comparative corporate governance can be created.

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133 The Code is the work of the high level National Committee on Corporate Governance Policy (*Komite Nasional Kebijakan Corporate Governance)* set up by the Indonesian authorities in August, 1999. It was chaired by Jusuf Anwar, a former chairman of Bapepam. A copy of the Code (March 2000 version) is on file with the author.

134 Thomas L. Friedman, THE LEXUS AND THE OLIVE TREE: UNDERSTANDING GLOBALIZATION 236 (1999).

The third lesson flows from the second. If global covergence of corporate governance systems is not likely to happen soon, then any attempt to improve a country's corporate governance system must, in the meantime, respect the local culture. Not doing so simply invites failure. The attempt at rapid privatization in Russia can be cited as one example.[135] The simple reason why local culture must be respected is that there is a substantial amount of deep cultural programming within each society. This is especially relevant to corporate governance because how companies are governed touches on culturally and socially sensitive issues such as: the society's notion of corporate identity; what is correct and improper behavior by corporate officers; the rights of and obligations towards family members in family-owned or family-controlled companies; what constitutes corporate social responsibility; who are the stakeholders of a company; and how disputes are to be resolved. Failure to respect the culture of a community will invite failure and, worse, resentment.[136] As noted by Mary Hiscock, the founding chairperson of the Asian Law Center at the University of Melbourne:

> Law is a plant that grows out of the roots of the people, and it is an important way of educating people to change. If what is sought is a ready-made law, it can be bought "of the peg" from any consultant. But all there is then is a law. People still do the same things they always did. Nothing changes. That is the lesson of Asian history.[137]

One practical impact of this conclusion is that future attempts to reform a country's corporate governance system requires input from sociologists, political economists and anthropologists. Corporate governance must be viewed as a phenomenon which is framed within the broader social sciences arena. To date, much of the corporate governance literature is dominated by lawyers and economists and, to a degree, finance and management experts as well as accountants. Some have scant or no familiarity (or worse, respect) for disciplines such as sociology which can provide rich insights into the behavior of key individuals in

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135 *See* Bernard S. Black et al., *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 STAN. L. REV. 1731 (2000); Merrit B. Fox & Micheal E. Heller, *Corporate Governance Lessons from Russian Enterprise Fiascoes*, 75 N.Y.U. L. REV. 1720 (2000).

136 Thomas L. Friedman quotes Yaron Ezrahi, a political theorist, who made the pungent observation that '[t]here are two ways to make a person feel homeless — one is to destroy his home and the other is to make his home look and feel like everybody else's home'. Friedman, *supra* note 134, at 234.

137 Mary Hiscock, *Contemporary Law Modernisation in Southeast Asia: A Personal Perspective*, *in* ASIAN LAWS THROUGH AUSTRALIAN EYES 31, 46 (Veronica Taylor ed., 1997).

any corporate scene. Yet such insights from the social sciences may be especially important in the field of comparative corporate governance.[138]

If mainstream corporate governance proponents abandon the prevailing compartmentalized, silo-like analysis and instead adopt a wider approach embracing various social science disciplines, then corporate governance studies will become more cross-disciplinary in nature. As a typical example, consider two recent attempts by a respected multilateral agency, the Asian Development Bank, when it commissioned studies into legal development and corporate governance in selected Asian jurisdictions. The relevant reports were published in 1999 and 2000, respectively.[139] Both reports provide various useful insights but they pay relatively scant attention to the social and cultural issues involved in legal development and corporate governance. This is not surprising given that the 1999 study was undertaken by a team of lawyers and economists while the four co-authors of the 2000 study comprised of three economists and a professor of finance. The concern here is that, by not considering the impact of social and cultural factors, the studies may be inadvertently overstating the rate of progress in the growth of legal and corporate governance systems in these countries, while understating the actual problems faced by development initiatives and the time required to implement them.

In other words, viewed from a broader perspective, this paper makes one basic argument – that culture matters to legal development. More specifically, the three case studies of Indonesian corporate governance in the 1990s have highlighted the possibility that legal culture plays a significant role in the corporate governance phenomenon. If this proposition is correct, then not only should the current academic debate on comparative corporate governance change course, but also current corporate governance initiatives in Indonesia (and, possibly, other developing or transitional economies) should pay much greater attention towards changing legal culture. A fresh set of cultural lenses must be added to the usual set of legal, economic, and financial lenses commonly used to view corporate governance. It is only then that the corporate governance phenomenon, with all its subtleties, can be better understood.

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138 *See* Farrar, *supra* note 30.

139 Katharina Pistor & Philip Wellons, THE ROLE OF LAW AND LEGAL INSTITUTIONS IN ASIAN ECONOMIC DEVELOPMENT 1960-1995 (1999); and Juzhong Zhuang et al., CORPORATE GOVERNANCE AND FINANCE IN EAST ASIA: A STUDY OF INDONESIA, REPUBLIC OF KOREA, MALAYSIA, PHILIPPINES, AND THAILAND (2000).