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Coalitions, convergence and corporate governance reform in Indonesia

ANDREW ROSSER

ABSTRACT *This paper argues that Indonesia's corporate governance system is unlikely to converge on the outsider model of corporate governance, at least in so far as this means an exact replication of this model. While the Indonesian government has introduced a range of corporate governance reforms aimed at bringing in key elements of the outsider model since the mid-1980s, and especially since the onset of the Asian crisis, there have been serious problems with the implementation and enforcement of these reforms. Underlying this outcome, it is argued, has been the structure of power and interest within Indonesia: the balance of power between the main coalitions of interest has been such that the political preconditions for the proper operation of the outsider model have not yet been established.*

In recent years, many scholars have claimed that globalisation is leading to increasing convergence in the nature of corporate governance systems across the globe. In a number of cases, they have argued that these systems are converging on the Anglo-American or 'outsider' model of corporate governance. The defining features of this model are a high reliance on equity finance; dispersed ownership; strong legal protection of shareholders, including minority shareholders; strong bankruptcy regulations and courts; little role for creditors, employees and other stakeholders in company management; strong requirements for disclosure; and considerable freedom to merge or acquire. Hansmann and Kraakman (2000) have even gone so far as to argue that a global consensus has now emerged 'that corporate managers should act exclusively in the economic interests of shareholders' and that, as a result, all jurisdictions will inevitably move towards the outsider model of corporate governance. Borrowing Fukuyama's (1992) notion of the 'end of history', they suggest that we have reached the 'end of history for corporate law'.

Other scholars have argued that corporate governance systems are converging on a hybrid model of corporate governance—one that combines the outsider model with the 'insider' model characteristic of Germany and Japan (Rubach & Sebora, 1998; Prowse, 1999; Nestor & Thompson, 2001). In contrast to the outsider model, the insider model is characterised by a high reliance on bank

Andrew Rosser is at the Institute of Development Studies, University of Sussex, Falmer, Brighton BN1 9QN, UK. E-mail: A.Rosser@ids.ac.uk.

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finance; concentrated ownership; weak legal protection of minority shareholders; a central role for stakeholders (eg creditors and employees) in the ownership and management of companies; weak disclosure; and limited freedom to merge or acquire. Yet scholars who argue that corporate governance systems are converging on a hybrid model generally suggest that far more change is involved for countries currently employing the insider model than for countries employing the outsider model. As such, their argument is similar to that of the first group of scholars.

Claims that corporate governance systems are undergoing convergence have intensified in the wake of the Asian crisis. Weaknesses in Asian corporate governance systems were widely seen as a primary cause of the Asian crisis and its after-effects (Johnson *et al*, 2000; Dickinson & Mullineux, 2001; Capulong *et al*, 2000; Summers, 1998; Greenspan, 1999; Gregory 2000). In the wake of the crisis, the OECD, the World Bank and the Asian Development Bank (ADB) have launched a range of initiatives to promote corporate governance reform in developing and transition economies.[1] At the same time, the International Monetary Fund (IMF) has made the adoption of corporate governance reforms a condition of its assistance programmes for Thailand, South Korea and Indonesia. Some commentators have seen these developments as further evidence of a trend towards convergence (Hansen, 2001).

This paper examines Indonesia's experience with corporate governance reform. Contrary to the convergence thesis, it argues that Indonesia's corporate governance system—which has been a variant of the insider model—is unlikely to converge on the outsider model of corporate governance, at least in so far as this means an exact replication of this model within the country. While the Indonesian government has introduced a range of corporate governance reforms aimed at bringing in key elements of the outsider model since the mid-1980s, and especially since the onset of the Asian crisis, there have been serious problems with the implementation and enforcement of these reforms. In short, what appears to be emerging in Indonesia is a corporate governance system that resembles the outsider model of corporate governance in form but not in substance. Just as some scholars have suggested that at the macro level different forms of neoliberalism can exist simultaneously (Jomo, 2001: 44–45), so the Indonesian case suggests that different forms of the outsider model of corporate governance can exist simultaneously at the micro level.

Underlying this outcome, it is argued, has been the structure of power and interest in Indonesia. The pattern of corporate governance reform in Indonesia over the past two decades has been a function of shifts in the balance of power between two coalitions of interest. The first consists of the controllers of financial capital and their allies in Western governments and international financial institutions (IFIs) such as the World Bank, the IMF, and the ADB. The second consists of the strata of politico-bureaucrats that has occupied the state apparatus and the owners of the major domestic conglomerates. Whereas the first coalition has been supportive of corporate governance reform, the second has sought to block or subvert reform. While the economic crisis has shifted the balance of power away from the second coalition and towards the first, these shifts have not been sufficient to make thoroughgoing corporate governance

reform possible. In short, the political preconditions for convergence have not yet been established.

Understanding corporate governance reform

Underlying convergence arguments is a belief that convergence of corporate governance systems is both desirable and inevitable. As O'Sullivan (1999: 3–4) has pointed out, convergence arguments are underpinned by the neoclassical idea that the creation of liberal markets—which corporate governance reform is seen as facilitating—leads to optimal economic outcomes and, in particular, maximum efficiency in terms of the allocation of scarce economic resources. At the same time, these arguments suggest that growth and efficiency concerns are the driving force behind corporate governance reform. Hansmann and Kraakman (2000), for instance, argue that the victory of the outsider model of corporate governance has stemmed from the failure of alternative models to produce the same levels of efficiency and growth, the persuasiveness of arguments that the outsider model provides greater efficiency, and the tendency for mobile capital to locate itself in countries that have efficient corporate governance systems.

The view taken here, by contrast, is that corporate governance reform needs to be understood, not in terms of the extent to which it promotes growth and efficiency, but in terms of the extent to which it serves or harms particular political and social interests. Corporate governance systems are an 'institution' in the sense that Douglass North has used the term (North, 1981; 1990): that is, a particular configuration of rules, regulations and enforcement mechanisms that govern economic behaviour. More specifically, they are an institution that governs 'who makes investment decisions in corporations, what types of investments they make, and how returns from investments are distributed' (O'Sullivan, 1999: 2). As such, they embody particular political and social interests: they reflect the balance of power within society between the various elements that have an interest in corporate performance and behaviour. This in turn means that corporate governance reform requires a prior shift in the balance of power away from coalitions that are opposed to corporate governance reform and towards coalitions that support reform.

In this view, there is no reason to assume that, just because a particular corporate governance system may result in greater economic efficiency than alternative models, it will eventually be adopted and implemented, even in the long run. The nature of corporate governance systems in particular countries will ultimately depend on the balance of power between competing coalitions of interest within those countries at particular junctures in time. As such, to properly understand the nature of corporate governance systems and reform processes in particular countries, it is important to identify which actors have an interest in the nature of a country's corporate governance system, what that interest is, and how they seek to influence corporate governance policy and implementation.

At the global level two sets of actors have played a key role in promoting corporate governance reform in recent years. The first of these has been the controllers of financial capital.[2] As financial capital has become increasingly mobile, controllers of financial capital have sought harmonisation of financial

sector regulations and practices in order to facilitate access to and exit from foreign markets and thereby to reduce the risk and increase the profits associated with foreign investments. This has included harmonisation of corporate governance regulations and practices because these have determined whether controllers of financial capital have access to good quality information on which to base their investment decisions and how well their interests are protected once they invest. One way in which they have sought to promote harmonisation of corporate governance regulations and practices has been through funding international standard-setting bodies such as the International Accounting Standards Board. This body produces International Accounting Standards (IASs) that individual countries can adopt instead of developing national accounting standards. At the same time, controllers of financial capital have also made use of their structural power[3] to promote harmonisation. With enhanced mobility, controllers of financial capital have been able to threaten states that they will relocate their capital to alternative jurisdictions if states do not put in place corporate governance arrangements that suit their interests. This has placed significant structural pressure on states to pursue harmonisation, especially in developing countries: if they do not, they risk reduced access to international financial markets and the economic benefits that go with this.

Western governments and the IFIs have been the other set of actors that have played a key role in promoting global corporate governance reform at the global level in recent years. As already mentioned, the OECD and the IFIs have introduced a range of programmes to promote corporate governance reform in developing countries in the wake of the Asian crisis. In part, this reflects widespread concern within the industrialised countries that corporate governance systems in developing countries constitute a threat to the stability of the international financial system.[4] But it also reflects the close relationship that exists between the US government and the IFIs. With the USA having by far the dominant voice in the IMF and the World Bank, the US Treasury's line on economic policy matters has often had a strong influence on the policies of the IFIs (Bhagwati, 1998; Wade, 2001).

Beyond controllers of financial capital, Western governments and the IFIs, the actors that have been involved in corporate governance policy making and implementation have varied from country to country depending on the structure of power and interest that has existed in these countries. For instance, in Germany, where labour has been a relatively powerful political force, company employees have been the principal opponents of corporate governance reform. As Ziegler (2000: 198) has pointed out, a century of political struggle between workers and employers in Germany has produced a corporate governance system in which employees in many companies are represented on supervisory boards and are consequently able to play a role in company management. They have thus opposed adoption of the outsider model of corporate governance because this would shift influence over companies away from employees (and other stakeholders) and towards outside shareholders. Yet company employees have not been a key actor in corporate governance policy making in Indonesia, where labour has been much weaker politically (Hadiz, 1997) and company employees have not generally had representation on company boards.

Actors and interests in Indonesia

In Indonesia, the main actors in corporate governance policy making since the New Order came to power in 1965—in addition to the controllers of financial capital, Western governments and the IFIs—have been the strata of 'politico-bureaucrats' who have occupied the state apparatus; the owners of the major domestic conglomerates; and the small group of liberal technocrats based in the Ministry of Finance and other key economic ministries and agencies.[5] The first two of these elements—the politico-bureaucrats and the owners of the major conglomerates—have constituted the dominant coalition for much of the New Order period (ie 1965–99) (Rosser, 2002: 33–47). The politico-bureaucrats have been able 'to appropriate the offices of the state apparatus and in their own right exercise authority over the allocation of resources and access', effectively fusing political and bureaucratic power (Robison, 1996: 82). At the same time, the owners of the major domestic conglomerates have exploited their strong connections to individual politico-bureaucrats to secure privileged access to state bank loans, trade and investment licences, forestry concessions, and other forms of state largesse and protection (Robison, 1986; Schwarz, 1994). Among the most successful business people under the New Order, for instance, were several of President Suharto's children, his half-brother, his step-brother, and some of his close associates. In short, the politico-bureaucrats and the owners of the conglomerates have exercised a form of instrumental control over the state: it has been their occupancy of senior political and bureaucratic positions, or their connections to individuals in these positions, that has given them influence over state policy.

Both the politico-bureaucrats and the owners of domestic conglomerates have been strong opponents of corporate governance reform in so far as this has meant the full implementation of the outsider model of corporate governance or a hybrid variant of this model. The owners of major domestic conglomerates have had an interest in maintaining an insider system of corporate governance because it has made it possible for them to avoid disclosure of sensitive information, to keep control over the companies they founded both in terms of ownership and management, to abuse minority shareholders with impunity, and to avoid bankruptcy. In a booming capital market they have thus been able to reap the benefits of listing on the stock market—eg raising cheap capital—without incurring any of the costs. Similarly, the politico-bureaucrats have had an interest in maintaining this system because it has made it easier for them to hide the precise nature of their connections to leading business groups and to exploit state-owned enterprises (SOEs) for their own benefit. In the absence of adequate corporate governance systems, senior government officials have been able to secure lucrative positions within SOEs, to ensure that supply contracts for these enterprises are awarded to private sector companies with which they have close connections, and to use SOEs to raise extra-budgetary revenue for sections of the military and government departments (Robison, 1986: 211–249; Crouch, 1978: 273–303).

The technocrats, by contrast, have been strong advocates of corporate governance reform. Before the Asian crisis they saw corporate governance reform as

necessary to ensure that the country continued successfully to mobilise investment capital from non-oil sources through the capital market (Prawiro, 1991; Muhammad, 1995; 1996). Since the Asian crisis they have seen it as a precondition for the revitalisation of the private sector and economic recovery more generally (Herwidayatmo, 2000; World Bank, 2002). Their support for corporate governance reform has reflected their general commitment to liberal market reform: they have seen the development of a stronger framework for corporate governance as crucial to the development of a more market-based economy in Indonesia.[6]

In contrast to the politico-bureaucrats and the owners of the major conglomerates, their influence over policy has stemmed from the apparent ability of their policies to attract financial and other forms of mobile capital and foreign aid into Indonesia. At a number of key points in Indonesia's recent history—most notably during the mid-1960s and the mid-1980s—the technocrats were able to devise economic policy programmes that brought financial and other forms of mobile capital as well as increased foreign aid into the country (Rosser, 2002; Winters, 1996; Robison, 1986). The technocrats' primary concern has always been to ensure the continued health of the Indonesian economy. But there has always been a strong correspondence between their policy preferences and the interests and agendas of mobile capital controllers, the IFIs and Western governments.

In sum, then, the nature of Indonesia's system of corporate governance since the beginning of the New Order period has reflected the balance of power between two competing coalitions of interest. The first of these has consisted of the controllers of financial capital and their allies in Western governments and the IFIs and has been represented within the Indonesian government by the technocrats. And the second has consisted of the politico-bureaucrats and the owners of the major domestic conglomerates.

Corporate governance in Indonesia up to the mid-1980s

Before the mid-1980s Indonesia's corporate governance system was characterised by a high reliance on bank finance; low levels of transparency and disclosure; concentrated ownership; owner-management; weak protection of creditors and minority shareholders; and limited ability to merge or acquire.

Corporate finance

Before the mid-1980s private sector conglomerates and SOEs relied primarily on the banking system to finance their investments. When the New Order came to power in 1965, it made revitalisation and growth of the then unhealthy banking system one of its main priorities. During the oil boom years of 1973–82 the banking system became one of the primary conduits through which the country's newfound wealth was invested, resulting in a further expansion in the banking system. Annual credit growth for the banking system averaged 53% between 1968 and 1974, 35% between 1974 and 1978, and almost 17% between 1978 and 1982 (Rosser, 2002: 52–60). But while the banking system grew strongly, the

stock market developed little. Sukarno's Guided Democracy government had nationalised all Dutch companies in 1958 and suspended trading in shares of Dutch firms in 1960, making it impossible for the country's stock market to survive. It was eventually closed down in 1968. When the New Order government re-established the Jakarta Stock Exchange (JSX) in the late 1970s, it did so to primarily to provide a mechanism by which wealth could be redistributed—or at least be seen to be redistributed—to indigenous Indonesians in order to placate those sections of Indonesian society that were concerned about what they perceived to be foreign economic domination (Rosser, 2002: 87). Reflecting its redistributive purpose, the stock market was highly regulated—restrictions were imposed on the extent to which share prices could fluctuate, foreign investors were prevented from owning shares, and PT Danareksa, the state investment trust, was required to purchase up to 50% of all new share issues. This discouraged both financial capital controllers from investing in Indonesian stocks and Indonesian conglomerates from going public (Suseno & Tarihoran, 1989: 81–83). Between 1977 and 1988 only 24 companies listed their shares on the Jakarta Stock Exchange (JSX) and market capitalisation only rose to 449 billion rupiah.

Transparency and disclosure

Before the mid-1980s the regulatory framework governing financial reporting was poorly developed. In 1973 the central bank, in conjunction with the professional accounting institute—the Indonesian Accountants' Association (IAI)—had produced Indonesia's first set of accounting standards, known as Indonesian Accounting Principles (*Prinsip Akuntansi Indonesia* or PAI) (Sumantoro, 1990). But these standards were flimsy by international standards. They were a compilation of basic accounting principles, practices, methods and techniques and were intended to address general accounting issues rather than provide detailed prescriptions for accounting practice (Prawit, 1988). At the same time, they were not given legislative backing. At that time Indonesia's company law, which had been inherited from the Dutch colonial period, simply required that 'adequate accounts' be kept (World Bank, 1993). It did not contain a specific requirement that financial reporting be done in accordance with the PAI or any other prescribed set of standards. For this reason, and because the PAI permitted companies to refer to other countries' accounting regulations where the PAI did not deal with a particular accounting issue, companies had enormous latitude in the way in which they accounted for their financial affairs.

Ownership concentration and management

In this period ownership of private Indonesian companies was concentrated in the hands of founding families. Even though many private Indonesian conglomerates had achieved considerable size and become involved in a diverse range of businesses by the mid-1980s, most were run as family businesses. Positions on boards of directors and commissioners were generally given to family members or close relatives rather than professional managers (Robison, 1986; Sato, 1993).

Because the stock exchange was so underdeveloped, very few private Indonesian companies had sold shares to the public. Most of the private companies listed on the JSX in 1985 were foreign joint venture firms that had gone public solely in order to fulfil minimum local ownership requirements (Drake, 1986: 103). At the same time, ownership of SOEs remained concentrated in the hands of the state. With SOEs providing a key source of rents for the politico-bureaucrats and the owners of the major conglomerates, there was strong political resistance to their privatisation. Hence, by the mid-1980s, only one SOE had been privatised through the JSX—PT Semen Cibinong, a cement manufacturer, which went public in 1977 (Rosser, 2002: 87).

Protection of creditors and minority shareholders

Creditors received little protection under Indonesian law before the mid-1980s. The country's bankruptcy system was based on a 1904 Dutch colonial regulation that, as one commentator put it, 'was biased in favour of debtors and made it almost impossible for creditors to seek court resolution when debtors defaulted' (Husnan, 2001: 17). Minority shareholders fared little better. They were granted some very basic rights under the Commercial Code, another colonial era piece of law that remained in force following independence. This code guaranteed minority shareholders the right to vote in general meetings of shareholders and provided them with certain voting rights. It also granted them the right to object to a decision by the general meeting of shareholders. But it did not grant them protection in cases where majority shareholders had a potential conflict of interest or guarantee them representation on company boards (Gautama, 1995: 298–299). The 1952 Capital Market Law and the government regulations issued in the 1970s to re-establish the JSX—which between them provided the legal basis for the stock market during this period—provided no further protection for minority shareholders (Sumantoro, 1990: 132–151).

Mergers and acquisitions

There were no regulations restricting mergers and acquisitions during this period. As Gautama (1995: 330) has pointed out, the Commercial Code was completely silent in relation to mergers and acquisitions. But the ability of firms to merge with or acquire other firms was restricted by the fact that few companies had listed their shares on the stock exchange (which made hostile takeovers through stock market purchases impossible) and the lack of competition in many domestic industries (which meant that there was little incentive for firms to merge or acquire in order to make themselves more competitive).

This system of corporate governance reflected the structure of power and interest within Indonesia up to the mid-1980s. The economic crisis of the mid-1960s strengthened the position of the controllers of financial capital, Western governments and the IFIs. With the country desperately needing to renegotiate its debts, secure foreign aid, promote private investment and stimulate economic growth, the state was under enormous pressure to shift away from the radical populist and nationalist interventionism of the previous regime and towards the

sort of market-orientated economic policies advocated by the technocrats. But before the technocrats could make much progress in re-establishing the capital market and reforming the country's system of corporate governance—their main achievements in the late 1960s and early 1970s were the creation of teams within the central bank to provide advice to the government on capital and money market policy and the formulation of the PAI (Sumantoro, 1990: 36–41)—their influence over policy began to wane. The main reason for this was the dramatic increase in oil prices during the 1970s. With the country awash with petrodollars, the Indonesian state had little need to adopt policies designed to attract financial capital or foreign aid. As Jeffrey Winters (1996: 95–96) has explained, 'although the *ability* of mobile capital controllers to withhold or relocate their investment resources was not affected [by the oil boom], the state's direct access to substantial replacement resources meant that investors' threats and actions were not nearly as constraining on policy-makers' (emphasis in the original). The state now had the resources to fund much of the country's industrial and infrastructural development without substantial private investment or foreign assistance. This, in turn, meant that the politico-bureaucrats and the conglomerates were free to shape the country's economic policies to suit their own narrow interests. For reasons outlined above, this meant a halt to corporate governance reform.

The political economy of corporate governance reform in Indonesia from the mid-1980s to mid-1997

The collapse of international oil prices in the mid-1980s, however, was to shift the balance of power back in favour of financial capital controllers, Western governments and the IFIs and to see greater progress made in corporate governance reform. The collapse of oil prices led to a fall in Indonesia's oil and gas exports from US$18.4 billion in 1982 to $8.3 billion in 1986 and a drop in government oil and gas revenues from 8.6 trillion rupiah in 1981/82 to 6.3 trillion rupiah in 1986/87. This in turn dramatically increased the country's need to attract financial capital and foreign aid to help promote the development of non-oil export industries and improve the government's fiscal position. For this reason, it also increased pressure on the government to meet the demands of financial capital controllers and their allies in Western governments and IFIs for a range of market-orientated policy changes, including stock market deregulation and regulatory reform (Rosser, 2002: 90–120). Within this context, the technocrats were able to exercise a much greater influence over economic policy than they had previously. Significantly, however, the politico-bureaucrats and conglomerate owners were able to maintain their control over the state apparatus through the late 1980s and most of the 1990s. The government's electoral vehicle, Golkar—which embodied their interests—continued to win elections and, despite evidence of growing opposition to Suharto's rule within sections of the military, his position as president was never seriously threatened. As a result, the politico-bureaucrats and the conglomerates were able to ensure that the technocrats' market-orientated economic reforms did not go so far as to seriously threaten their interests. In terms of corporate governance, this was to mean a partial process of reform.

The technocrats were able to make significant progress in promoting the development of the stock exchange and, in doing so, increasing the role of equity capital in corporate financing. Through a series of policy packages in the late 1980s they completely deregulated the capital market, suddenly making capital market investments and stock exchange listings much more attractive for investors and conglomerate owners respectively. In response to deregulation, financial capital controllers injected trillions of rupiah into Indonesian stocks.[7] At the same time, most of Indonesia's major domestic conglomerates and a small number of SOEs lined up to go public: over 200 companies listed their shares on the JSX between 1988 and 1996. Importantly, however, most of the conglomerates and SOEs that went public during this period only sold a fraction of their shares to investors, usually between 20% and 35%. So, while this period saw a dramatic increase in the role of equity capital in corporate financing in Indonesia, Indonesian companies still remained heavily dependent on banks for finance (Rosser, 2002: 90–97).

The technocrats were also able to push through a series of financial accounting reforms. In late 1994 the government introduced a new set of financial accounting standards known as Financial Accounting Standards (PSAKs) to replace the PAI. Based on IASs and issued formally by the IAI, the PSAKs were a much more comprehensive set of accounting regulations. In March 1995 the government provided legal backing for these standards and introduced a series of other regulatory reforms related to accounting in its new Companies Code. The Code made it mandatory for all companies to prepare their annual financial accounts in accordance with PSAKs; required publicly listed companies to have their accounts audited by public accountants; and made company directors and commissioners personally liable for any losses incurred by any persons as a result of untrue or misleading information contained in financial reports (Cole & Slade, 1996). Later in 1995 the government introduced further accounting-related reforms in its new Capital Markets Law. This law specified the format of financial reports; forbade public companies from providing untrue or misleading information to the public; and required public accountants to report companies that had breached the law or that were experiencing financial problems to the Capital Market Supervisory Agency (Bapepam) (*Info Finansial*, October 1995; *Jakarta Post*, 18 January 1996).

At the same time, however, the government did little to ensure that these new accounting regulations were properly enforced. The quality of auditing in Indonesia was widely believed to be poor, even that done by the domestic affiliates of the large international auditing firms.[8] Yet few Indonesian auditors were prosecuted or suspended for negligence, incompetence or corruption during this period. Nor was the auditing market opened up to foreign entrants—in the mid-1980s the government had officially prohibited foreign accountants from practising in the country, forcing international auditing firms to operate through domestic affiliates rather than set up their own offices—something that, it was widely thought, would improve auditor independence. In early 1997, following World Bank calls for Indonesian auditors to be more independent, the government decided to permit foreign accountants to practise within the country on an individual basis. But it continued to prohibit them from establishing their own

auditing firms. The government also did little during this period to reform the country's notoriously corrupt judiciary. In the absence of an independent judiciary the Companies Code provision concerning the personal liability of company directors and commissioners for losses incurred as a result of misleading information was effectively unenforceable (Rosser, forthcoming).

The technocrats were to make similar progress in the area of minority shareholder protection and participation. The years following deregulation were to see a large number of 'internal acquisitions'—that is, acquisitions of other companies within the same group—involving companies listed on the JSX which were structured in such a way as to transfer wealth from minority to majority shareholders. Public criticism of these acquisitions generated concern within the government that the confidence of financial capital controllers would be seriously undermined unless it provided better protection of minority shareholders. Hence, in January 1993, Bapepam issued a new regulation requiring companies to get the approval of at least 50% of minority shareholders for transactions where company directors, commissioners or majority shareholders had a conflict of interest. The 1995 Companies Code gave minority shareholders further protection by granting them the right to call shareholders' meetings, demand court investigations into illegal activities at companies, and have their shares in companies repurchased at a fair price if they disagreed with these companies' actions. The hostile takeover of PT Bank Papan Sejahtera in 1995—which also generated claims of minority shareholder abuse—led to a similar response by the government. This time Bapepam introduced a regulation requiring investors who were planning to take over a company through the stock exchange to make a tender offer and to publicise this through the Indonesian media (Rosser, 2002: 111–116).

At the same time, however, the government did not seek to give minority shareholders a greater role in corporate decision making. For instance, it did not introduce any requirements for companies to have independent directors or commissioners. In 1996 Bapepam made it compulsory for companies to have corporate secretaries to provide information to investors but it did not require them to be independent. Furthermore, it soon became apparent that there were serious obstacles to enforcing many of the new rights that minority shareholders had acquired. Majority shareholders were able to circumvent the 50% approval requirement for internal acquisitions by buying public shares through proxies and having these proxies vote on acquisition plans (*Kompas*, 26 June 2000). In addition, the nature of Indonesia's judicial system meant that minority shareholders had little chance of securing a fair price for share repurchases or a court's agreement to launch an investigation into corporate corruption if they wished to pursue these options.

In the area of mergers and acquisitions, the government introduced little real reform. It included a series of new legal provisions relating to mergers and acquisitions in its new Companies Code in 1995 but these essentially provided a legal basis for existing practice (Gautama, 1995: 330–331). More significant in facilitating mergers and acquisitions during this period was the fact that deregulation of the capital market and the boom it generated created the possibility for hostile takeovers as the Bank Papan Sejahtera case demonstrated. In the area of

creditor protection, the government made no significant changes to the existing regulatory framework. The 1904 bankruptcy regulation remained in force.

This pattern of corporate governance reform reflected the balance of power within Indonesia in the post-oil years. With the politico-bureaucrats and the conglomerates maintaining their control over the state apparatus, they were able to ensure that corporate governance reform was selective, notwithstanding the greater structural power of financial capital controllers and their allies in Western governments and the IFIs in the wake of the oil price collapse. The technocrats' success in deregulating the capital market reflected the fact that capital market deregulation did not pose a serious threat to the interests of the politico-bureaucrats and the conglomerate owners and, in fact, promised significant benefits to the latter. While deregulation of the capital market meant that the politico-bureaucrats in the state investment fund, Danareksa, lost their monopolies in underwriting and the mutual funds business, it allowed the conglomerates to gain access to cheap equity capital, opened up new opportunities for them in share broking and underwriting, and reduced their political vulnerability by diversifying their ownership structures (Rosser, 2002: 86). The technocrats' relatively limited success in other areas of corporate governance reform, by contrast, reflected the fact that reform in these areas posed a more significant threat to conglomerate owners. Stricter financial reporting requirements and auditing, a stronger bankruptcy system, better protection of minority shareholders, and increased participation by minority shareholders in corporate decision making all required the conglomerates to be more transparent and accountable. Hence, although some significant changes were introduced, on the whole reform in these areas was to be much less extensive.

The political economy of corporate governance reform in Indonesia since mid-1997

The onset of the Asian economic crisis in mid-1997 was to place enormous pressure on the Indonesian government to move ahead with the process of corporate governance reform, particularly in those areas where there had been strong resistance before the crisis. The crisis produced a further shift in the balance of power away from the politico-bureaucrats and the owners of the conglomerates and towards the controllers of financial capital and their allies in Western governments and the IFIs. The impact of the crisis was severe: the value of the rupiah fell by more than 80% against the US dollar in the space of a few months; major conglomerates defaulted on their foreign and domestic debt repayments; inflation, unemployment and interest rates soared; and political stability began to crumble. With the country desperately needing to regain the confidence of financial capital controllers, the government decided to call in the IMF in late 1997 and begin negotiations on a rescue package, effectively surrendering control over economic policy to that organisation. The IMF was to use its structural power to force the government to adopt reforms. At a number of key points, it withheld financial assistance from the government when the latter appeared to be baulking at or delaying on reform. As noted earlier, the IMF was to include corporate governance reform in its list of required reforms.[9]

At the same time, the crisis seriously undermined the position of the politico-bureaucrats and the owners of the major conglomerates. Many conglomerate owners were forced to surrender assets to the Indonesian Bank Reconstruction Agency (IBRA) because their banks could not repay liquidity credits borrowed from the central bank in the early stages of the crisis. Some owners agreed to debt for equity swaps with foreign and domestic creditors, dramatically reducing their ownership stakes.[10] Most large conglomerates were demoted to a secondary board on the JSX, limiting their ability to raise new equity capital (*Jakarta Post*, 4 July 2000). Others were de-listed (*Jakarta Post*, 29 July 2000). Most importantly, the politico-bureaucrats and the owners of the conglomerates lost their absolute control over the state apparatus. In May 1998 Suharto was forced to step down as president after widespread violence in Jakarta and the capture of parliament by student groups. At the national election in July 1999, Golkar was beaten into second place by Megawati Sukarnoputri's Indonesian Democratic Party of Struggle (PDI-P), dramatically reducing its representation in parliament and damaging its chances in the forthcoming presidential election. In October 1999 BJ Habibie, a close confidant of Suharto who had succeeded him as president, failed to have his accountability speech accepted by the People's Consultative Assembly (*Majelis Permusyawaratan Rakyat*, or MPR). This paved the way for the election a few days later of two former opposition figures, Abdurrahman Wahid and Megawati Sukarnoputri, as president and vice-president respectively.

Within this context, the technocrats were able to introduce a range of new corporate governance reforms. One of the most significant of these was the preparation of a Code for Good Corporate Governance by the National Committee on Corporate Governance, a body established by the Co-ordinating Minister for Economy Finance and Industry in 1999 to promote corporate governance reform. Funded by the ADB, the code outlines a series of corporate governance principles and practices for the country that are broadly in line with the outsider model of corporate governance. These include equitable treatment of shareholders, the appointment of independent directors and commissioners, timely and accurate disclosure, the appointment of a corporate secretary, and the establishment of an independent audit committee.[11] The primary weakness of the Code is that it has no legal backing: it is simply a point of reference for Indonesian businesses trying to improve their systems of corporate governance. But the government has suggested that the Code will be incorporated into Indonesian law over time.[12] Already, the JSX Company, the private firm responsible for managing the JSX, has included a number of corporate governance requirements similar to those in the code in its listing regulations.[13] Bapepam has also stated that it will include a requirement for companies to have independent directors and commissioners in the Capital Market Law as part of forthcoming revisions to this law (Bapepam, nd).

The government also strengthened the regulatory frameworks for mergers and acquisitions, minority shareholder protection, financial reporting, and bankruptcy. In February 1998 it issued a regulation on mergers, consolidations and acquisitions, facilitating implementation of the provisions in the Companies Code on these matters (Eddymurthy & Rasmin, 2000). In 2000 Bapepam amended its regulation on conflicts of interest to make it more difficult for majority share-

holders to circumvent the requirement for at least 50% of minority shareholders to approve transactions in which there is a conflict of interest (*Kompas*, 25 August 2000).[14] In February 1998 the government announced that all limited liability firms with assets of 50 billion rupiah or more would be required to publish financial statements and have them audited by external auditors (*Jakarta Post*, 23 February 1998).[15] From 1998 onwards the IAI issued a series of new PSAKs and revised several earlier ones, dramatically increasing the total number of Indonesia's accounting standards.[16] During 1998 the government introduced a new bankruptcy law and created a new commercial court, thus establishing a framework for foreign and domestic creditors to sue Indonesian conglomerates that had failed to repay their debts.

However, corporate governance policy making and implementation was not to be completely one-sided. The crisis did not eliminate the politico-bureaucrats and the owners of the major conglomerates as a political force. Although Golkar's representation in parliament and the MPR fell dramatically as a result of the July 1999 election result, it held the second largest block of votes in both institutions and, as such, continued to have significant influence on law making and the election of the president and vice-president. Indeed, Golkar's support was crucial in delivering the presidency to Abdurrahman Wahid in October 1999. Likewise, the military continued to be a player in Indonesian politics by virtue of its continued representation in parliament and the MPR,[17] its extensive business network, and its role in maintaining security in three provinces: Ambon, Aceh and West Papua. At the same time, as Golkar's fortunes waned, a number of politico-bureaucrats and conglomerate owners shifted their loyalties to Megawati and the PDI-P.[18] Conglomerate owners were also able to wield influence through bribery and intimidation, the best example of the latter being the assassination in 2000 of a supreme court judge who had sentenced Tommy Suharto, one of the former president's sons and the head of Humpuss conglomerate, to 18 months jail for corruption. In short, the politico-bureaucrats and the conglomerate owners were to retain sufficient power to frustrate key reform initiatives.

One area in which they were able to do this was auditing. In contrast to the US government's response to recent accounting scandals involving Enron, WorldCom, and Xerox, the Indonesian government has not launched any major court cases against Indonesian auditors,[19] nor introduced any major regulatory changes to force Indonesian auditors to be more independent since mid-1997. During 2000 the Agency for Financial and Development Supervision (BPKP) launched an investigation into auditors which had given clean bills of health to Indonesian banks that had subsequently had their operations frozen following the onset of the crisis. But while this investigation found that several auditors had failed to adhere to Indonesian accounting standards in conducting their audits, the government took little action against them. The auditors concerned were sent 'warning letters' rather than fined or prosecuted and the auditing firms for which they worked were not penalised in any way (*Gatra*, 19 April 2001; *Koran Tempo*, 28 April 2001). In this case, it appears that the connections between Indonesian auditing firms and key parts of the Indonesian bureaucracy were strong enough to get the former off the hook.[20]

The other area in which the politico-bureaucrats and the conglomerates have

been able to frustrate reform has been the protection of creditors. Within weeks of the establishment of the new commercial court, questions were already being raised about its effectiveness as a means for creditors to recover unpaid debts (*Far Eastern Economic Review*, 22 October 1999). Roughly 30 bankruptcy cases were filed with the court in 1998 and another 100 were filed in 1999. But very few of these cases were successful. According to George Fane (2000: 35), creditors only won about 20% of all cases they brought against Indonesian companies, far fewer than they should have according to a number of commentators (see, for instance, *Asiaweek*, 31 March 2000). At the heart of the problem for creditors appears to have been a combination of judicial favouritism towards debtors and judicial corruption. While a new bankruptcy law and court had been introduced, the nature of the Indonesian judiciary, and its relationship to powerful business people, had not changed at all.

Conclusion

Over the past two decades Indonesia's system of corporate governance has undergone significant change. Deregulation of the capital market has increased the role of equity capital in corporate finance and, in doing so, broadened the ownership base of many Indonesian firms. The debt-for-equity swaps that have been arranged since the onset of the crisis in mid-1997 have led to a further broadening of the ownership base of Indonesia's conglomerates. The regulatory framework for corporate governance has been substantially revised and strengthened, especially in areas such as financial reporting, protection of minority shareholders and creditors, and mergers and acquisitions. If the Code for Good Corporate Governance is translated into law over the next few years, Indonesia's corporate governance regulations will be broadly similar to those that exist in the USA, the UK and other countries where the outsider model of corporate governance prevails.

Notwithstanding this change, however, Indonesia's system of corporate governance has remained distinct from the outsider model of corporate governance. Indonesian conglomerates remain heavily dependent on banks for finance. Indeed, the big problem for Indonesia's conglomerates at present is how to get themselves out of debt. In addition, with financial capital controllers avoiding the Indonesian stock exchange and with many founding families apparently determined to retain majority control of their businesses, it is unlikely that there will be a significant shift towards increased equity financing in the near future. At the same time, while the country's corporate governance regulations have become increasingly similar to those in countries which apply the outsider model of corporate governance, as we have seen, there have been serious problems with implementation in areas such as auditing and the bankruptcy system. In this sense, in so far as convergence has occurred, it has been convergence in form rather than in substance.

As such, this paper suggests that we should not expect the universal adoption of the outsider model of corporate governance at any point in the near future, at least not in so far as this means an exact replication of this model in countries not currently applying it. Just as some scholars have suggested that globalisation has

led to different reform outcomes depending on the nature of domestic political systems (Jayasuriya & Rosser, 2001; Deeg & Perez, 2000), so this paper suggests that domestic politics will mediate the impact of globalisation on national corporate governance systems. Where coalitions that favour the adoption of the outsider model of corporate governance are dominant, one can expect corporate governance reform to be relatively extensive. Where coalitions that oppose the adoption of the outsider model of corporate governance are dominant, one can expect either substantial resistance to corporate governance reform or the pursuit of reform in a selective manner that serves the interests of these coalitions. Where pro-reform and anti- reform coalitions of interest are of roughly equal strength, one can expect intermediate outcomes.

Further, the paper suggests that, even where political conditions facilitate reform in accordance with the outsider model of corporate governance, outcomes may still vary to a certain degree. In the Indonesian case, as we have seen, increased conformity with the outsider model at the level of regulation has not been matched by conformity in terms of corporate financial structures or in terms of the implementation of corporate governance regulations. Some scholars have argued that, rather than producing absolute conformity in the nature of economic systems across the globe, globalisation is leading to the simultaneous existence of different forms of neoliberalism. Jomo (2001: 44), for instance, has argued that 'just as the acceptance of Islam has resulted in a great variety of Muslim cultural expression and behavioural norms, a twenty-first century Anglo-American global capitalism may still be quite diverse'. This paper suggests that part of this diversity may be the development of the different forms of the outsider model of corporate governance.

Notes

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[1] In May 1999, for instance, the Organisation for Economic Cooperation and Development (OECD) adopted a set of non-binding corporate governance principles intended to act as a reference point for countries trying to evaluate and improve their corporate governance systems. In conjunction with the World Bank, the OECD has also established a Global Corporate Governance Forum (GCGF) to encourage discussion about corporate governance issues and co-ordinate assistance; arranged several regional roundtables aimed at disseminating what it considers to be 'best practice' in corporate governance; and organised a series of investor surveys on the success of corporate governance reform efforts. The World Bank and the Asian Development Bank (ADB) have carried out 'self-assessment' exercises to measure the quality of corporate governance in selected countries and assess these countries' progress in reforming their corporate governance systems. A number of bilateral donors have also contributed to the global corporate governance reform effort, in many cases by supporting the work of international and regional organisations in individual countries.

[2] 'Financial capital' should be taken here to refer to *private* financial capital.

[3] 'Structural power' refers to the power that derives from control over investment resources.

[4] See *The Economist*, 24 April 1999.

[5] It should be noted that 'the technocrats' as used here includes not only senior economists within the Ministry of Finance and other parts of the government—the group usually identified by the label—but also officials within the Capital Market Supervisory Agency (Bapepam) who have postgraduate business qualifications such as MBAs. Because corporate governance matters have fallen within Bapepam's area of responsibility, the latter group has played a particularly important role in the formulation and implementation of corporate governance policy.

[6] It is important to note, however, that the technocrats' commitment to market-orientated economic policies has varied somewhat over time. For instance, during the 1960s and 1970s, many technocrats were strong supporters of import-substitution industrialisation and the restrictive trade and investment

regimes that that strategy involved. It was not until the mid-1980s that, as Robison and Hadiz (1993:17) have pointed out, 'neo-classical, free market theories began to dominate the liberal element in Indonesian economic thinking'.

[7] This investment came from a variety of sources: foreign financial institutions established special Indonesia country funds, local banks lent money for share purchases, middle class Indonesians used their personal savings for the same thing, and the large government pension funds—PT Astek and PT Taspen—were instructed to support a number of struggling initial public offerings (IPOs). While it was foreign investment that drove trading on the JSX, most of the investment during this period came from domestic sources.

[8] Interviews with informed parties. See also Backman (1999: 42–51).

[9] See the Indonesian government's Letter of Intent to the IMF in January 2000.

[10] According to the World Bank (2001: 2.5), 16 debt-equity swaps have been agreed through the Jakarta Initiative Task Force (JITF). It also points out that IBRA has converted some of the debt owed to it into equity.

[11] The Code also draws on elements of the insider model in recognising that stakeholders should be protected. But while the Code is quite specific about what rights shareholders have and how they can exercise these rights, it is vague in relation to stakeholders' rights and the mechanisms through which these can be exercised.

[12] See the preamble to the Code. See also Mulyadi (2001).

[13] See JSX Company regulation, Peraturan Pencatatan Efek Nomor I-A/05/31/01/3:49PM: Tentang Ketentuan Umum Pencatatan Efek Bersifat Ekuitas di Bursa.

[14] The amendment broadened the definition of 'conflict of interest' to cover not only transactions involving company directors, commissioners and majority shareholders but also transactions involving parties affiliated to these individuals; and the definition of 'independent shareholders' to specifically exclude parties affiliated with company directors, commissioners and majority shareholders.

[15] Previously only publicly listed companies and certain financial institutions were required to provide public audited financial statements.

[16] See http://www.akuntanpublik.org/standard/standard_ak.html.

[17] At the end of Suharto's rule, the military was guaranteed 75 seats in parliament and, because parliamentary representatives were automatically members of the MPR, in the latter institution as well. Following the fall of Suharto, this was reduced to 38 seats.

[18] Key examples in this respect are Bambang Kesowo, a senior bureaucrat within the State Secretariat under the New Order, and Arifin Panigoro, a tycoon who made his fortune under the New Order.

[19] Interestingly, legal action has been taken against Indonesian auditing firms for corruption or collusion in the USA. In one case, the Indonesian affiliate of KPMG has been prosecuted for allegedly paying a bribe to an Indonesian tax official on behalf of Baker Hughes Incorporated, an American oil services company (*International Accounting Bulletin*, 28 September 2001). In another, US shareholders in Asia Pacific Pulp and Paper Company have launched legal action against Arthur Andersen's Indonesian affiliate for its part in allegedly covering up around US$230 million in APP's losses made as a result of two derivatives contracts (*International Accounting Bulletin*, 28 September 2001; Backman, 2002).

[20] According to one former employee of Arthur Andersen's Indonesian affiliate, that firm has very strong connections to the Ministry of Finance and, in particular, BPKP. In part, this stems from the friendship between Utomo Josodirdjo, one of the founders of the affiliate, and Radius Prawiro, a former Minister of Finance and Co-ordinating Minister for the Economy, Finance, Industry and Development Supervision. In part, it is because a number of Andersen's affiliate's partners were formerly BPKP officials. Interview, Perth, mid-1998.

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