Dealing with the Principals Dilemma: A Proposal for the Governance of Indonesia’s State-owned Enterprises

Abstract

The primary problems of SOEs, including in Indonesia’s SOEs, are conflicting objectives, political interference and lack of transparency. My previous studies on Indonesia’s national code of corporate governance and state-owned enterprises conclude that the code and existing laws and regulations have failed to be a problem solver for the existing problems, especially the political interference. There is no the code’s principle that deliberately attempts to cope with the political interference problem. Instead Indonesia’s regulation legitimizes the political interference by putting the rights of electing both board of commissioners and directors in the hands of Final Assessment Team chaired by the President of the Republic of Indonesia. By using data of empirical study in six Indonesia’s pure SOEs the study attempts to propose blueprint governance for Indonesia’s SOEs, which focuses on the role of board of commissioners (to some extent this is equivalent to board of directors in common law countries system). It can be a tool to deal with the political interference faced by Indonesia’s SOEs.

Keywords: Agency Theory, Principal-Agent Relationship, Corporate Governance, Board of Commissioners, and Indonesia

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Chapter Six

Dealing with the Principals Dilemma: A Proposal for the Governance of Indonesia’s State-owned Enterprises

6.1 INTRODUCTION

This article looks at the ownership dilemma facing state-owned enterprises (SOEs) in Indonesia. Some researchers argue that the main problem with SOEs is state ownership.¹ The standard response is therefore to advocate privatization;² one of the official objectives of the corporate governance for Indonesian SOEs is to promote the privatization agenda.³ Others argue that the inefficiencies of SOEs are completely unrelated to the ownership issue.⁴ That is, even if a company is owned by a state, it can be managed well and can achieve the company’s goals.⁵ The question to ask when examining problematic SOEs is not ‘who is the owner’ but rather ‘how are the SOEs governed’.⁶ By focusing on the SOEs principal-agent relationship this article attempts to move debate away from the problems of state ownership.

¹ Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, ‘Government Ownership of Banks’ (2002) 57 (1) The Journal of Finance 266
³ Art. 72, Para 2, Point d Law No. 19 of 2003
This article argues that the intermingling of politics and business is central to Indonesia’s SOEs’ problems, rather than the state ownership dilemma. The intermingling of business and politics in Indonesian SOEs has been legitimised by Presidential Instruction No. 8 of 2005 on the Appointment of Members of Boards of Directors and Boards of Commissioners of SOEs. This was amended under the Presidential Instruction No. 9 of 2005. According to the Presidential Instruction the final decision when electing members to a board of directors and commissioners is to be undertaken by the government through the Final Assessment Team (*Tim Penilai Akhir*, hereinafter TPA). The TPA is chaired by the President of the Republic of Indonesia with the Vice President, the Minister for Finance, the Minister for SOEs and the Cabinet Secretary as the team’s vice chairman, members and secretary respectively. Consequently, the potential intermingling of business and politics, and the possibility of political interference in Indonesian SOEs, can be clearly seen. This is as a major reason why Indonesian SOEs have difficulties competing against private companies. This article proposes that by positioning the board of commissioners as representative of ultimate owners of SOEs, the government power to Indonesian SOEs will be undermined and the government will be positioned as SOEs’ agent rather than their principal. The SOEs’ professional agents will better placed to achieve the best performance possible as the separation between principal and agent will result in more effective level of control over SOEs’ managements.

Strengthening the role of the board of commissioners is another approach that would assist in undermining the power of the government to oversee SOEs and positioning board of commissioners as representative of ultimate owners of SOEs. The board of commissioners, as one of the major operating centres in Indonesian two-tier boards,
should be given due attention as its supervisory and advisory roles can be utilized in
order to improve a company. Moreover, the board of commissioners can be a strategic
comp company vehicle in representing the general public as the SOE’s ultimate owners, and
in scrutinizing the SOEs, ensuring they present profit maximization, thereby
contributing more to society at large. At a practice level, the notion of positioning the
board of commissioners as public’s representative could be encompassed by
introducing a board of trustees, as a board that has responsibilities in electing and
discharging SOEs’ members of board of commissioners.

The importance of this topic is attested by a recent study conducted by the World
Bank, which found that SOEs still play an important role in national economies,
notably in the Middle East, Africa and Asia. The role of SOEs around the world in
the global economic downturn, the success story of Singapore’s SOEs, and the lack
of study on Indonesian SOEs governance particularly in the legal perspective, also
make the present study timely.

There is a dearth of studies examining the governance of SOEs from an objective
point of view, as corporate research into SOE governance has approached the topic
from the perspective of private listed firms. This study hopes to partially fill this gap.
Although the article focuses on the Indonesian context, it might be relevant to other
countries where SOEs exists.

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8 Daniel Sokol, D, 'Competition and Comparative Corporate Governance of State-Owned Enterprises'
(2009) 2009 Brigham Young University Law Review 1723
9 Sajid Anwar and Choon Yin Sam, 'Private Sector Corporate Governance and the Singaporean
This article comprises six sections, including an introduction. The second section states the theoretical framework and introduces the agency problems and corporate governance issues, SOEs and corporate governance, and the ownership structure of SOEs. Methods used and data collected is outlined in section three. Section four discusses agency issues in Indonesia's SOEs, the intermingling of politics and business, SOEs and their objectives, whether corporate governance equals privatisation and the neglect of the board of commissioners’ role. Discussion and proposals are put forward in section five. Section six concludes.

6.2 THEORETICAL FRAMEWORK

6.2.1 Agency problems and corporate governance in private companies

The agency problem is a common issue for corporations that are derived from agency relationships. In general, such agency problem occurs whenever a company’s principals are separated from its agents.\(^{10}\) Eisenhardt defines the agency relationship as being between business principals and agents, when agents are appointed by principals to carry out certain works.\(^{11}\) Similar to this, Jensen and Meckling describe agency relationship as 'a contract under which one or more persons (the principal[s]) engage another person (the agent) to perform some service on their behalf which involve delegating some decision making authority to the agent'.\(^{12}\) Such agency relationships then transform into agency problems when the relationship is not running smoothly as a result of a conflict of interest between the principals and the


\(^{11}\) Kathleen M. Eisenhardt, 'Agency Theory: An Assessment and Review' (1989) 14 Academy of Management Review 58

agents\textsuperscript{13} or results when the principal and agent have dissimilar objectives and disagree over the division of work when performing the agreed work.\textsuperscript{14}

Scholars argue that corporate governance is a means to deal with agency problems when information asymmetry between the principal and agent exists\textsuperscript{15} or when contracts involving members of a business institution, like owners, managers, employees or consumers, are incomplete.\textsuperscript{16} In other words, corporate governance will not be essential when there are no agency problems or when a contract is complete. Oliver Hart provides some examples of when agency problems can cease to exist. For example, when a company’s association can be easily ordered to capitalise on profit or net market value or reduce costs, all expenses can be reimbursed directly to the agents and there is no disagreement within the company.\textsuperscript{17} But Hart states that such cases can only happen in a 'black box' company, as described in the standard neoclassical theory of the firm. Thereby, he concludes, there is no company that will ever be free from agency problems.\textsuperscript{18}

Hart therefore views corporate governance as necessary in all types of companies, regardless of size. However, corporate governance becomes more important in large companies or public companies where the following two issues are prevailing: the company’s shareholders are scattered and controlling processes do not run well. When shares are fragmented, the shareholders are not able to control daily company

\textsuperscript{14} Ibid
\textsuperscript{17} Ibid, 678
\textsuperscript{18} Ibid
activities and have to appoint a board of directors, which in turn employs professional management to run the company. This leads to the so-called separation of ownership and control.\footnote{Ibid, 680}

In terms of company control, company monitoring can be seen to be for the public good. This means that if at least one of the shareholders is monitoring the company’s managers, this will positively impact on other shareholders. In the case of scattered ownership, the shareholders have little or no motivation to control what the hired managers do. One shareholder will hope that the other shareholders do the monitoring, but it will probably be more likely that all shareholders are hoping this and no one is doing any monitoring.\footnote{Ibid, 681}

Such issues, however, are not germane to a small, closely-held firm.\footnote{Ibid} When there is a single shareholder or the shares are concentrated, the company’s shareholders can directly operate or closely control the company’s daily activities. Also, in closely-held firms, low motivation to control the company’s managers is rare because there is no reason for the shareholder to hope another shareholder will be expected to perform this task.

\textit{6.2.1.1 Separation of ownership and control}

As discussed above, the separation of ownership and control are central issues in corporate governance and a significant topic when examining large companies or

\footnotesize{\textsuperscript{19} Ibid, 680 \textsuperscript{20} Ibid, 681 \textsuperscript{21} Ibid}
public companies. The idea of separation of ownership and control is in many ways best expressed by Adam Smith in his seminal work *The Wealth of Nations*:

The directors … of companies … being the managers of other people’s moneys and not their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partner in a private co-partnery frequently watch over their own… Negligence and profusion therefore must always prevail more or less, in the management of affairs of such a company.22

Smith argues that a company manager who manages 'other people's money' will not be as serious in this work as he or she is when managing his or her own money.23 Smith’s work is extended by Adolph A. Berle and Gardiner C. Means24 who, in their influential book *The Modern Company and Private Property*, are often credited as founders of this notion.25 Jensen and Meckling26 are more contemporary promoters of Berle and Means’ separation of ownership and control idea.27

From reading Berle and Means’ scholarship, we can see that American corporate governance practices have changed in response to the evolution of the corporate atmosphere28 where United States (US) capitalism has moved from the entrepreneurial owner model to 'managerial capitalism'.29 The histories of American entrepreneurs like Vanderbilt, Rockefeller, Morgan and Harriman, who handed over their companies’ control to professional agents, are seen as the cornerstone of the

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25 Hovenkam, above n 23, 374
26 Jensen and Meckling, above n 12, 305
separation of ownership and control era. The change in the American corporation situation has been attributed to the evolution of concentrated ownership into dispersed ownership. In other words, dispersed ownership directly results in the separation of ownership and control whereby a firm is run by hired persons or professional managers in place of the firm’s owner.

Such scattered shares and the separation of ownership and control can be seen in countries where institutional investors have strong positions, for example, in the US and the United Kingdom (UK). In these countries, public companies’ shares are scattered in the hands of so-called institutional investors or institutional shareholders, rather than in the hands of individuals or groups, or even in the hands of government.

One scholar argues that the US and UK’s institutional investors began to develop in the 20th century, when the number of institutional shareholders grew while individual shareholders steadily shrank. More specifically, academics claim that the percentage of institutional shareholders in the US has increased from 6.1 percent of all shareholders in 1950 to over 50 percent by 1999. In the UK, the ownership of shares by insurance companies (one form of institutional investor) has grown from 10 percent in 1963 to 17 percent in 2004. In addition, the triumph of the US and the UK’s institutional investors are not limited to these countries alone but can be seen

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30 Anwar and Sam, above n 27, 43
31 Ibid
32 Ibid
33 Gillan and Starks, above n 28, 1
34 From Wikipedia’s definition we can see that institution investors are defined as “organizations which pool large sums of money and invest those sums in securities, real property and other investment assets”.
35 Chris A. Mallin, Corporate Governance (Oxford University Press, 2004), 76
36 Gillan and Starks, above n 28, 2
37 Mallin, above n 35, 77
elsewhere in the world as time passes. Nowadays, institutional investors own most of the equity in countless companies around the globe, thereby playing a significant role in corporate governance issues.38

6.2.1.2 Key areas of corporate governance

There are four key areas to be traversed when discussing corporate governance, namely the separation of ownership and control, large companies or listed companies, institutional investors and the stock market. Specifically, the division between ownership and control has existed since Berle and Means first noted that modern companies’ shares are owned by a large number of small shareholders, which mostly consist of members of institutions. Because the shareholders are scattered, they are not able to manage the listed companies directly. The emergence of such institutional shareholders during the 1990s coincided with the growing internationalisation of the stock market and the deregulation agenda.39

It could be argued that this issue of corporate governance concerns with listed companies –that is, companies with shares that are owned by more than one shareholder regardless of whether these shareholders are concentrated or dispersed.40

In more precise words, corporate governance occurs within pure or quasi-privately listed companies, with the stock market acting as a main player by scattering shares. The stock market has been considered to be an instrument to improve corporate

38 Ibid, 76
40 Sam Choon Yin, Corporate Governance and Public Sector Management in Singapore (PhD Thesis, University of South Australia, 2003), 43
This is clearly illustrated by Simeon et al in their study on corporate governance, which essentially argues that corporate governance cannot be separated from the stock market since corporate governance’s major purpose is to protect outside investors’ assets that are dispersed through the stock market from the expropriation of insiders.42

La Porta and colleagues therefore state that the investors’ interests are more secure in Anglo-Saxon countries, which are characterized by large and liquid stock markets, and shares are dispersed in the hands of institutional investors, as opposed to European Continental countries with smaller and less liquid share markets and more concentrated shares in the hands of families, corporate investors and the government.43 Corporate governance therefore becomes a means to protect outsiders from insiders’ expropriation.44 This view is reasonable, as no outsiders would need to be protected in non-listed companies or companies, who are owned by a sole shareholder, like small companies owned by single owner.

6.2.2 Agency and corporate governance in SOEs

Given the key areas of corporate governance within the context of privately-owned firms – the division of ownership and control, large companies or listed companies, institutional investors and the stock market – countless scholars have myopically discussed the corporate governance of SOEs from these viewpoints. Scholars tend to

discuss SOEs’ governance as if they were privately-owned and listed firms. Thus, most discussions of corporate governance by scholars such as Davies\textsuperscript{45} and Parker\textsuperscript{46} to name a few have cynically criticised the state ownership of SOEs. For them, SOEs will not outperform their privately-owned enterprise counterparts due to their state ownership, especially in terms of the efficiency issue.\textsuperscript{47} The key problems facing SOEs, such as multiple goals and multiple principals,\textsuperscript{48} political interference and a lack of transparency,\textsuperscript{49} all of which have led to SOEs becoming inefficient, have all been assumed to be a result of the state ownership.

- **Multiple goals.** According to Aharoni, multiple goals and multiple principals are two main characteristics of SOEs which are attributable to the state ownership.\textsuperscript{50} Such multi-objective problems means SOEs, as a government business entity, cannot be expected to outperform private firms. This is because the government directs SOEs to meet the so-called public service obligations of being job providers, developers of laggard regions, producers of unprofitable product in non-profit plants, creators of national technological capabilities, holders of down prices and earners of foreign exchange, in addition to business players.\textsuperscript{51} Simply stated, unlike their private company counterparts, an SOE’s goals are not only to maximize profits.

\textsuperscript{45}David G. Davies, 'The Efficiency of Public versus Private Firms, the Case of Australia’s Two Airlines' (1971) 14(1) *Journal of Law and Economics* 149
\textsuperscript{47}Varouj A. Aivazian, Ying Ge and Jiaping Qiu, 'Can Corporatization Improve the Performance of State-owned Enterprises Even Without Privatization?' (2005) 11 *Journal of Corporate Finance* 793
\textsuperscript{49}Simon C. Y. Wong, 'Improving Corporate Governance in SOEs: An Integrated Approach' (2004) 7 *Corporate Governance International* 6
\textsuperscript{50}Aharoni, above n 48, 1341
- **Multiple principals.** With regards to this principal issue, one scholar argues that the owners of SOEs are not identifiable. In comparison, as stated by Davies, within privately-owned enterprises the principal is clearly identifiable. The person who holds the company’s shares equals the company’s principal, and there is no doubt that every share can be transferred.\(^{52}\) Moreover, one scholar argues that private companies’ shares can be transferred, which means that shareholders can put up for sale shares they hold when they, the shareholder, is unhappy with managers’ decisions.\(^{53}\) In contrast, Trebilcock and Iacobucci argue that, the SOEs’ residual claimants are unclearly designated. Further, they opine that within the context of SOEs, there is no residual claimants come to control the company’s performance as keen as a private firms’ individual residual claimant when it comes to monitoring the company’s performance.\(^{54}\)

- **Political interference.** Political interference is also considered as a result of state ownership. Because SOEs are owned by government, politicians and bureaucrats become involved with the SOEs’ activities. In practice, they manage the SOEs in accordance with their own interests rather than the public’s interests. For example, politicians persuade SOEs’ managers to undertake unprofitable actions in their constituency in order to win votes in the next election.\(^{55}\) Also, politicians and bureaucrats are not as motivated as they might otherwise be when performing their duties as they do not benefit directly or financially from SOEs. On the contrary, they are also likely to be

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\(^{52}\) Davies, above n 45, 151

\(^{53}\) Sokol, above n 8, 1729

\(^{54}\) Trebilcock and Iacobucci, above n 4, 1427

\(^{55}\) Wong, above n 49, 9
blamed if SOEs make large profits because such an operation would be regarded as too commercial.\footnote{Ibid}

- \textit{Lack of transparency}. The lack of transparency is also an issue regarded as a result of the state ownership of SOEs. As SOEs are owned by government, a lack of transparency is supposed to be an intentional agenda of politicians and bureaucrats. This occurs presumably to shield the bureaucrats’ and politicians’ own culpable actions in the SOE’s activities.\footnote{Agung Wicaksono, \textit{Corporate Governance of SOEs: Investment Holding Structure of Government-Linked Companies in Singapore and Malaysia and Applicability for Indonesian SOEs} (PhD Thesis, The University of St. Gallen, 2009), 149-153}

Based on the above discussion, it can be summarized that scholars in discussing the governance of SOEs have stopped at the simple and narrow conclusion that the so-called state ownership is considered as ownership by the government. The shortcomings of this approach will be discussed in the next section.

\textbf{6.2.2.1 Ownership structure of SOEs}

This study regards shareholders as the owners of a company, given that there are differing views of who owns a corporation from legal and economic perspectives. From a lawyer's viewpoint, a company’s shareholders cannot be regarded as company’s owners because a corporation is a ‘legal person’ that has own assets and name, while economists state that a corporation is owned by shareholders since a corporation is considered as a 'nexus of contract'.\footnote{Muhammad Zubair Abbasi, ‘Legal Analysis of Agency Theory: An Inquiry Into the Nature of Corporation’ (2009) 51(6) \textit{International Journal of Law and Management} 402} For present purposes, persons who legally hold a company’s shares are considered the owners of private companies, while within the SOEs a country’s citizens are considered to be owners.\footnote{Sokol, above n 8, 1729} Zhou and
Wang, when they examine China’s SOEs, also point out that the principals of SOEs are Chinese citizens.\textsuperscript{60} Given this the ownership structure of SOEs are slightly different to that of private firms.

In their study on Singapore’s SOEs, Anwar and Sam divide the structure of SOEs’ ownership into two layers. The first layer treats ordinary publics are assumed as SOEs’ principals, while government is deemed as SOEs’ principal in the second layer.\textsuperscript{61} Further, Anwar and Sam argue that, in contexts where the public are viewed as the SOEs’ owners, and then the government, including cabinet ministers and/or members of parliament, can be considered to be acting as the public’s agents as well as the agents of the SOE. Accordingly, the government acts as the agent of its citizens in looking after SOEs and has a responsibility to run SOEs in accordance with the public’s interests.

In practice, the government is not only the citizens’ agent but also constitutes a SOE’s owner, since the government is acting on behalf of the country’s citizens when running SOEs. In order words, as an agent, the government has the role of running day-to-day SOE activities, while, as a principal stakeholder, the government is also under an obligation to perform in the ultimate owners’ best interests. Given that the government has two roles in SOEs, namely as agent and owner, then two types of owners can be seen to exist in the SOEs: actual owners (government) and ultimate owners (public at large). Quoting Sam, Anwar and Sam summarise a SOE’s principals as follows:

\textsuperscript{60} Mi Zhou and Xiaoming Wang, ‘Agency Cost and the Crises of China's SOE’ (2000) 11 China Economic Review 299
\textsuperscript{61} Anwar and Sam, above n 9, 67
Table 1: Governance Structure in the Public Sector[^62] [SOEs]

<table>
<thead>
<tr>
<th>Principal(s)</th>
<th>Agent(s)</th>
</tr>
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<tbody>
<tr>
<td>1. General Public (Voters)</td>
<td>State (Members of Parliament; Members of the Cabinet)</td>
</tr>
<tr>
<td>2. State (Members of Parliament; Members of the Cabinet)</td>
<td>Managers (Civil Servants in the Public Sector)</td>
</tr>
</tbody>
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### 6.2.2.2 Agency problem in SOEs

Continuing on from the ownership structure discussed above, the principal-agent relationship in SOEs is unique. Unlike their private company counterparts, the relationship exists not only between the government and SOE managements (agents), but also between the public and the government. Thus, the uniqueness of the SOE’s principal-agent relationship creates certain agency problems. In terms of the public-government relationship, Sokol states that 'there is a potentially significant agency costs problem in the arrangement in which citizens’ interests are not aligned with SOE management, directors, and regulatory overseers'.[^63]

Further, Anwar and Sam see two relationships that exist within SOEs which create agency problems. These are the relationship between the ordinary public as the principal and the government as the agents, and the relationship of government as the principal and the public servants as the agents.[^64] Anwar and Sam argue that this first relationship results in an agency problem when a conflict of interest between the public and the government arises. This may occur when it is difficult to ascertain what the public interest actually is. The agency problem that exists in the second relationship results from the incomplete contract between the government as the

[^62]: Ibid, 70; Sam, above n 40, 168  
[^63]: Sokol, above n 8, 1723  
[^64]: Anwar and Sam, above n 9, 67-68
SOE’s actual owner and the public servants. This incomplete contract arises from the difficulty of making a specific contract that can precisely outline what should be done, for instance allocating workers’ working hours, tasks and targets.

6.3 METHOD AND DATA COLLECTION

Document analysis is the method utilised in this study. The selection of documents to be analysed was made by identifying a set of laws, regulations and soft-regulations relating to SOEs. From this identification process, some relevant laws, regulations and soft-regulations were obtained, namely:

- Law No. 19 of 2003 on State-owned Enterprises;
- Law No. 40 of 2007 regarding Company Limited Liability;
- The Government Regulation No. 45 of 2005 on the Establishment, Management, Supervision and Liquidation of State-owned Enterprises;
- The Presidential Instruction of Republic of Indonesia No. 8 of 2005 on the Appointment of Members of Board of Directors and Board of Commissioners of State-owned Enterprises (revised by Presidential Instruction of Republic of Indonesia No. 9 of 2005);
- The Decree of the Minister for State-owned Enterprises No. KEP-117/M-MBU/2002 regarding the Implementation of Good Corporate Governance on State-owned Enterprises;
- The 2006 Indonesian code of good corporate governance.

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65 Ibid, 68
66 Ibid
6.4 ANALYSING THE AGENCY PROBLEM

6.4.1 The blurring of a SOE’s principal

Under the Indonesian two-tier board structure, as stated in Law No. 19 of 2003 and Law No. 40 of 2007, a general meeting of shareholders, a board of directors and a board of commissioners are all classified as company organs. The general meeting of shareholders is a company organ with special authority that is not granted to the boards of commissioners and directors. Thus, the laws divide the organs’ connections into three relationships: the relationship of the general meeting of shareholders represented by government to the board of commissioners (hereinafter 'board'); the relationship between the general meeting of shareholders and the board of directors (hereinafter 'management') and the connection between the board and the management.

The legal description of these three relationships is as follows: the relationship between government and board, government and management and board and management. The basic rules of the government and board relationship can be learnt in the articles of the two laws which state that the appointment and the firing of a member of a board of commissioners is to be undertaken by the general meeting of shareholders. The board of commissioners is elected by the general shareholders meeting and its role is to undertake supervisory and advisory roles in regards to the board of directors. In short, the laws position the board of commissioners as an agent of the government to act in the aforementioned supervisory and advisory roles.

67 Art. 1, Para 2 Law No. 40 of 2007; Article 1, paragraphs 7, 8 and 13 Law No. 19 of 2003
68 Art. 1, Para 4 Law No. 40 of 2007; Article 13 Law No. 19 of 2003
69 Art. 111, Para 1 Law No. 40 of 2007; Art. 27 Para 1 Law No. 19 of 2003
70 Art. 108, Para 1 Law No. 40 of 2009; 31 Law No. 19 of 2003
The SOEs’ management is the government’s agent in the executive field. As with the board of commissioners, the laws stipulate that the government through general meeting of shareholders elects and discharges the members of management,\textsuperscript{71} who in turn have the responsibility of managing the company and representing the company both outside and inside court.\textsuperscript{72} Meanwhile, in the board and management relationship, the board of commissioners, which has been elected and dismissed by the government, has power to act for and on behalf of the company in overseeing and advising the board of directors.\textsuperscript{73} In other words, the board and management relationship is a result of the board of commissioners being mandated by the shareholder to supervise and advise the SOE’s management.

From an agency theory standpoint, the firm’s internal relationships can create agency cost problems. The problems vary according to nature of a company’s ownership and relationship structure. As mentioned above, SOEs’ agency problems differ from the problems of privately-owned firms, either companies with scattered ownership or where shares are concentrated. Unlike a privately-owned company, a SOE has an ultimate shareholder, the ordinary people.\textsuperscript{74} This determines the nature of a SOE’s agency cost problem. Thus agency problems can take place when the SOE’s actual owner’s actions are not aligned with the ultimate owner’s interests.\textsuperscript{75} Consequently, the significant issue in a SOE’s principal-agent relationship is that it takes place between ordinary people as ultimate owner and the government, as opposed to taking place between the government and the SOE’s board.\textsuperscript{76} Unfortunately, neither

\textsuperscript{71} Art. 94, Para 1 Law No. 40 of 2007 and Art. 15, Para 1 Law No. 19 of 2003
\textsuperscript{72} Art. 1, Para 5 Law No. 40 of 2007; Article 1 paragraph 9 Law No. 19 of 2003
\textsuperscript{73} Art. 108, Para 2 Law No. 40 of 2007
\textsuperscript{74} Sokol, above n 8, 1729
\textsuperscript{75} Ibid
\textsuperscript{76} Ibid
Indonesian company law nor SOE laws regulate this relationship, between a SOE’s ultimate owners and the government.

6.4.2 The intermingling of politics and business

The intermingling of politics and business common in Indonesia. This intermingling means that the government in power, including executive bodies plays a major role in directing SOEs through making strategic decisions such as the appointment and dismissal of members of the board of commissioners and the board of directors.

Presidential Instruction No. 8 of 2005 (later revised by Presidential Instruction No. 9 of 2005) on the Appointment of Members of Board of Directors and Commissioners of State-owned Enterprises is a regulation that justifies the intermingling of politics and business in Indonesian SOEs. It states that the appointment of the members of the two boards must go through the hands of the TPA, which is chaired by the President, with the Vice President as a vice chairman, Cabinet Secretary as secretary and two Ministers (the Minister for SOEs and the Minister for Finance) as TPA members.

The intermingling of politics and business can be considered a precursor to direct political interference. Suspicion of political interference from the TPA is reasonable. This is because the government has absolute authority within the SOEs. This includes the authority to appoint and dismiss the two boards and no other parties are able to oversee this function or provide checks and balances. Given this, the government can use the TPA to appoint anyone they like as members of the board commissioners and board directors by merely neglecting the professional qualifications of potential candidates.
One academic argues that such political interference, in addition to conflicting objectives and a lack of transparency, is one of the fundamental issues regarding SOEs at large.\textsuperscript{77} Political interference can operate in many ways. According to Shleifer and Vishny, for instance, politicians can persuade a SOE’s management to employ more people than they need in order to win votes.\textsuperscript{78} Another possible example is that politicians could demand that SOEs undertake unprofitable but popular actions in their electoral region, with the intention of being re-elected in the forthcoming election.\textsuperscript{79}

In the context of Indonesia, one could argue that Shleifer, Vishny and Wong’s examples would not happen due to certain laws and regulations regarding the election of a board of commissioners and directors. These laws guide the TPA in selecting and appointing qualified and professional commissioners and directors. In article 16 paragraph 1 Law No. 19 of 2003, for instance, members of a board of directors are only to be appointed based on a consideration of skills, integrity, leadership, experience, honesty, good behavior and a dedication to advance the company.\textsuperscript{80} Article 22, paragraph 1 of the Government Regulation No. 45 of 2005 similarly states that a political party organizer, candidate or member of a legislative body is not allowed to be a member of a board of directors.

In other words, it might seem that the TPA cannot act arbitrarily because its works are guided by the above-mentioned rules. Nevertheless, given the absence of regulation over the relationship between ultimate owner and the government, these rules are

\textsuperscript{77} Wong, above n 49, 6
\textsuperscript{79} Wong, above n 49, 6
\textsuperscript{80} Art. 16 Para 1 Law No. 19 of 2003
effectively meaningless since nobody can legally sanction the President if the TPA breaks the rules.

6.4.3 Indonesia’s SOEs and their objectives

Generally, scholars argue that in terms of company objectives, SOEs are different from privately-owned firms. As business entities are wholly or partly owned by the state, making profit is not the most important objective of the SOEs, although it is one of several objectives. SOEs have the main task of operating in the so-called 'public interest' or 'national interest', which can mean creating job opportunities, assisting to develop poor districts, making unprofitable goods in uneconomic plants, building up national technological capabilities, controlling prices, or bringing in foreign exchange.

Indonesian SOE objectives can be found in Law No. 19 of 2003. In accordance with the views of the scholars cited above, it seems that the pursuit of profit is not the only goal when establishing SOEs. In addition to pursuing profits, there are another four goals, namely to contribute to the national economic development in general and particularly state revenues; to operate to the public’s benefit by providing high-quality and adequate goods and/or services to meet the community’s needs; to be pioneers in business activities which cannot be executed by private sectors and corporations; and to actively participate and provide guidance and assistance to groups of small entrepreneurs, co-operatives and the community.

81 Ramamurti, above n 51, 876
82 Ibid
83 Art. 2 Para 2, Law No. 19 of 2003
In theory, lawmakers seem to be aware of the difficulties arising from SOEs’ multiple objective problems and have sought to solve them by classifying SOEs into two forms: business-oriented SOEs and SOEs whose main objective is serving the public. The former category is described as limited liability SOEs and is divided into listed and non-listed SOEs. The latter category is general company SOEs or PERUM. The limited liability SOEs, regardless of type (listed or non-listed), are charged with making profits, while the general companies are responsible for social missions and unprofitable activities. This does not mean PERUM are forbidden from operating from a business motive. They may engage in business activities after they have completed their primary duties as SOEs to execute activities and programs in the public interest. This situation can occur in Indonesia because under Law No. 19 of 2003 a company is categorised as a SOE when at least 51% of its shares are owned by government as public’s representative. In other words, a SOE can be a listed company as long as 51% of its shares are belong to public through the mechanism of government ownership.

6.4.4 Corporate governance requires privatisation

The implementation of corporate governance in Indonesian SOEs is established through the Decree of Minister for State-owned Enterprises No. KEP-117/M-MBU/2002 on the Implementation of Good Corporate Governance Practice in the State-owned Enterprises. According to the decree, SOEs are obliged to consistently apply the concept of corporate governance and/or establish corporate governance as their operational basis. Consequently, the concept of corporate governance applies to all Indonesian SOEs regardless of category.

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84 Art. 2, Para 2, the Minister for SOEs’ degree No. KEP-117/M-MBU/2002
As noted earlier in this article, commentators state that one significant role of the stock market is to promote corporate governance. By listing in a stock market, the threat that follows regarding corporate action – for example, takeovers,\(^5\) leveraged buyouts, proxy contests, and legal protection of minority shareholders rights\(^6\) – can increase a company’s standards of management and efficiency. Stated differently, to improve SOE management quality and efficiency, state ownership problems should be dealt with and the way forward is in privatisation.

This attitude is widely held in Indonesia and is clearly outlined in a decree which states that one of the goals in implementing corporate governance in Indonesian SOEs is 'to make a success of the privatisation program'.\(^7\) Moreover, the desirability of privatization is also clearly stated in Article 72, Paragraph 2, Point (d) of the Decree, which states that one of the goals of restructuring SOEs is 'to facilitate the implementation of privatization'. This means that the SOE restructuring program is the first step towards a privatisation program.\(^8\)

It is worth mentioning that the application of the concept of corporate governance is considered a fundamental step to improve SOEs, and many scholars argue corporate governance is achieved by privatising companies, although this is not explicitly stated in the decree’s definition of corporate governance. The degree defines corporate governance as:

\(^{85}\) Wei, above n 41
\(^{87}\) Art. 4 Point f, the Minister for SOEs’ degree No. KEP-117/M-MBU/2002
\(^{88}\) According to Art. 72, Para 1, Law No. 19 of 2003, the restructuring carried out with the intention to improve SOEs in order to be efficient, transparent and professional companies
“a process and structure used by the SOEs’ organs to improve the success of the business and corporate accountability in order to increase shareholder value for the long term while taking into account the interests of other stakeholders, based on legislation and ethical values”.

This seems to be a result of the misguided paradigm of many corporate governance scholars, who approach corporate governance from the perspective of privately-owned companies. Plainly, a SOE's performance can be improved when its shares are privatized.

6.4.5 Neglecting the role of boards of commissioners

In theory, the board of commissioners, with supervisory and advisory powers, can be credited as a vital company organ. With these two tasks, a board of commissioners can position itself as a watchdog of an SOE’s management. Regrettably, empirical research into six non-listed SOEs, using the methods of interview and document analysis, suggests that the role of a board of commissioners has been neglected in the current law. The study found that regulations categories the board of commissioners as a part-time SOE organ. The law only requires a board of commissioners to meet once a month or twice a month at best, as was discovered when researching some SOEs’ self-regulations. Furthermore, the result of my empirical study of boards of commissioners in the companies M, A, C, Q, K, and L, indicates that neglecting the board of commissioners is a common practice as most of the members of the board hold multiple positions and commitments.

89 The Degree of Minister for State-owned Enterprises No. KEP-117/M-MBU/2002
90 Empirical research of 6 non-listed SOEs was conducted in Jakarta from January to May, 2009. In this research 27 interviewees were interviewed in which 18 of which were members of a board of commissioners of the 6 researched SOEs.
91 Art. 11, Para 1 of the Minister for State-owned Enterprises’ degree No. KEP-117/M-MBU/2002
92 Company C’s code of corporate governance, letter G, point 1
93 The study found that the largest percentage (45.16%) of the researched companies’ commissioners are public servants, followed by skilled workers and pensioners (19.35%), academics (9.67%) and big fish (6.45%)
Studying the boards of commissioners’ processes also shows that it is, in fact, an unimportant SOE organ. Unlike the board of directors’ recruitment process, there is no fit and proper test required when appointing members of a board of commissioners. Specifically, according to law No. 19 of 2003\textsuperscript{94} and the Government Regulation No. 45 of 2005,\textsuperscript{95} there are three steps in the electing process, all of which are informal, political and pro forma processes. The informal process is a stage where the Minister for SOEs receives input from parties, for example, from a minister of a department related to the particular SOE, when proposing potential commissioners. The political process constitutes the procedure of selecting candidates for the board of commissioners as submitted by the TPA or proposed by the Minister for SOEs. The pro forma process is when the minister for SOEs endorses the elected or approved candidates by way of the official general meeting.

The existence of the board of commissioners under the two-tier board system was originally imposed to serve the shareholders’ interests. In the context of Indonesian SOEs, because the government is positioned as SOEs’ acting shareholder with the power to appoint and discharge both members of board of commissioners and board of directors, the board of commissioners serves the government’s interests.

6.5 DISCUSSION AND PROPOSAL

This article has argued that the main issues within Indonesia’s SOEs are four-fold: the blurring of the principal-agent relationship; the intermingling of business and politics; that corporate governance requires privatization; and that the board of commissioners is neglected. The issue of an SOE’s objectives is not included because the existing

\textsuperscript{94} Art. 16, Para 2, Law No. 19 of 2003
\textsuperscript{95} Art. 16, Para 1, the Government Regulation No. 45 of 2005
Indonesian SOE law has dealt with the subject by clearly demarcating business-oriented SOEs and social-oriented SOEs and given that, in practice, some business-oriented SOEs have operated at a loss. The 2009 SOE ministry data proves this. Among the ten SOEs shown to have the greatest losses, nine of these were limited liability SOEs.96

This study sees that the prevailing issues in SOEs are actually derived from the first issue: the absence of a clear conceptual approach to the SOEs’ ultimate principals. The blurring of principals facilitates the intermingling of business and politics, since the government perceives itself entitled to govern all of aspects of a SOE. Hence, under Presidential Instruction of Republic of Indonesia No. 8 of 2005 regarding Appointment of Members of Board of Directors and Board of Commissioners of State-owned Enterprises (revised by Presidential Instruction of Republic of Indonesia No. 9 of 2005), the government puts the rights of appointment of an SOE’s commissioners and directors into the hands of the TPA.

Furthermore, a strong desire to privatize all SOEs can also be found to be a result of the blurred relationship between the SOEs’ principals. This obscurity has led to government frustrations and has in turn made state ownership a scapegoat. Also as a result of the principal problem, the role of the board of commissioners in supervising and advising the board of directors is neglected, leading to a weakening of the board of commissioners. In light of this finding, this study proposes two solutions, the first being at the theory level, while the second is more practical.

6.5.1 The SOEs principal-agent relationship

As noted earlier in this article, in their study on Singapore’s SOEs’ corporate governance, Anwar and Sam divided the principal-agent relationship into two types. The first type is the relationship between the general public and state officers, such as members of parliament and members of cabinet. The state officers assume the role of the public’s agent as they run the country on their behalf.97 Thus, as agents of Singapore, the public officers are mandated to run all sectors in Singapore, including the management of SOEs.

The second type of principal-agent relationship in the Singaporean context is the relationship between state officers and managers or civil servants.98 While the former group is considered the principal, the latter is their agent.99 The state officers have a responsibility to make sure the agents work diligently and ethically. As with the first principal-agent type, the public servants, as the state officers’ agents, have the responsibility to operate all Singaporean economic sectors including SOEs.100

The first principal-agent relationship model mentioned above is referred to in this study as the 'the SOEs principal-agent relationship' model. It is so called because most scholars discuss the second model of a principal-agent relationship in the context of private listed companies. In fact, the relationship between the public and the government, the first model, is described by many commentators as a deciding factor in SOE agency problems.101

97 Sam, above n 40, 164
98 Ibid
99 Ibid, 165
100 Ibid, 165-166
101 Davies, above n 45, 149; Aharoni, above n 48, 1342; Wicaksono, above n 57, 155; Parker, above n 46, 48
Broadly speaking, within the context of the public sector, the public choice theory introduced by Buchanan and Tullock\(^{102}\) is credited with theoretically explaining the problem. Essentially, the public choice theory warns us that politicians and bureaucrats in power tend to satisfy their own interests as opposed to the public’s interests that they are purportedly representing.\(^{103}\) This warning by the public choice theorist is reasonable because, in general, as individuals, politicians and bureaucrats 'opportunistic and are prone to self-interest with guile'.\(^{104}\) The tendency towards self-satisfaction is then made worse as society’s control over these mandate holders is imperfect.\(^{105}\) According to Anwar and Sam, the imperfect control of society is in part due to members of society seeing their personal say as trivial and unable to reform the existing problems.\(^{106}\)

It can be said that, in the context of SOEs, the government as the public’s agent often acts otherwise than in accordance with the will of the general society. The government may direct the activities of SOEs towards certain political purposes rather than in the interests of society as a whole, which can then lead to the SOEs becoming inefficient and operating at a loss.

Anwar and Sam do not discuss the SOEs principal-agent relationship in more detail. Instead, they seem to think it is not an important factor in the Singaporean SOE context because corruption is not a major issue in Singapore. As Transparency International discovered, Singapore’s corruption perception index score has


\(^{103}\) Anwar and Sam, above n 27, 44


\(^{105}\) Ibid

\(^{106}\) Ibid
constantly rated well and in the top ten positions. For instance, in 2009 Singapore was ranked third out of 180 surveyed countries. This means that as a country with a low level of corruption, the lack of clarity in the relationship between the ordinary public and the government does not become a serious problem in the operation Singaporean SOEs. However, using the same data, Transparency International positions Indonesia as one of the most corrupt countries in the world, where in 2009 it was ranked 111th out of 180 surveyed countries. Thus, due to the corruption problem, it is important that in Indonesia the SOEs principal-agent relationship issue is resolved.

Table 4: Comparison of Corruption Perception Index Scores 2009 (Singapore – Indonesia)

<table>
<thead>
<tr>
<th>Countries</th>
<th>Rank</th>
<th>CPI Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore</td>
<td>3 of 180</td>
<td>9.2</td>
</tr>
<tr>
<td>Indonesia</td>
<td>111 of 180</td>
<td>2.8</td>
</tr>
</tbody>
</table>

The problem of a self-serving deviation of a SOE’s assets is a reasonable concern when in the midst of corrupt state officials. Different goals between the public and the government when running SOEs are typically found in countries where massive corruption is in existence. In Indonesia, the problem of corruption is worsened by the shortcomings of laws and regulations which too much power to the government when running SOEs. The government has the right to elect and appoint both the board of commissioners and the board of directors since they make up the entire general meeting of shareholders and are the sole rulers of the SOE.

108 Ibid
109 Ibid
The situation is made worse since there is no certain mechanism that can control the government’s power and especially no mechanism of control from the ordinary public as the ultimate owners of the SOEs. Furthermore, the problem is exacerbated by the weak legal position of the board of commissioners. The board of commissioners does not have the right to appoint and discharge the members of the board of directors, and the board of commissioners’ fate depends on the good will of the government, since all of members of the board of commissioners are appointed and discharged by the government through the general meeting of shareholders.

To make a comparison, in Germany, a country with a system similar to Indonesia, companies can be placed into specific categories whereby up to half of members of the supervisory board are elected by the company trade union. This goes some way to solving the obscurity of the SOEs principal-agent relationship and the weak legal position of the board of commissioners, which positions the government as the SOE’s sole controller without giving control to the public as ultimate owners. The inability of the ultimate owners to monitor the actions of the agents causes agency problems, justifying the fears of agency theorists. From the viewpoint of agency theory, as stated by Eisenhardt, agency problems occur when the principals and agents have different objectives as well as when the principal cannot see what task the agent is actually performing.


111 Eisenhardt, above n 11, 58
Given the above reasons, the proposal of undermining the power of government over SOEs by clarifying the SOEs principal-agent relationship is worthy of consideration. The SOEs principal-agent relationship would demarcate the roles of the supervisory and executive boards of SOEs. In this way, the board of commissioners would be positioned as a representative of the public as the SOE’s ultimate owners, rather than representative of the government. The government, through a SOE’s management, would be responsible for the running of day-to-day SOEs activities, which will be discussed in detail below.

6.5.2 The board of commissioners as the public’s representative

Seen from the agency theory stance, there are problems with the conception and execution of governance regarding Indonesian SOEs. By giving full authority to the government, through the general meeting of shareholders, to select, appoint and dismiss members of the board commissioners and board of directors, the existing laws and regulations position the government as both principal and agent in SOEs. With these two positions in the hands of government, the role of the public as owners of SOEs blurs. The public, who are entitled to control the SOEs, cannot therefore properly perform their role.

In accordance with the SOEs principal-agent notion, the position of the board of commissioners and the board of directors should be legally separated by clear and unequivocal regulations. The board of commissioners, as a company’s supervisory body, could be legally and logically positioned as the public’s representative. However, at the present moment, Indonesia’s two-tier board structure does not legally acknowledge the concept of the SOEs principal-agent relationship, and the SOEs’
boards of commissioners are representatives of the government. However, by positioning the board of commissioners as pure representatives of the public, it will be more conceptually and practically clear exactly who the principals and agents are within SOEs. Thereby, potential conflicts of interest between the government (agent) and the ordinary public (principals) can be resolved.

Broadly speaking, the board of commissioners has two roles, which are supervising and advising the board of directors. In addition to these roles, the existing laws give a board of commissioners the power to suspend a board of directors. The suspension by the board of commissioners is then discussed in the forthcoming general meeting of shareholders, where it is decided whether or not the suspension is accepted or rejected. More details on the role of Indonesian boards of commissioners can be found in my article published elsewhere.¹¹²

In holding the right to suspend but not dismiss, the board of commissioners are not positioned strongly enough in terms of representing the interests of the ultimate owners. Thus, this study proposes that the board of commissioners is granted the rights to permanently dismiss any member of the board of directors who takes an action that is against the public’s interests. However, such power should only be achieved by the board of commissioners after obtaining written approval from the board of trustees. In addition, as proposed in the cross control section below, the dismissal of members of the board of directors by the board of commissioners can be reviewed in a court.

6.5.3 The board of trustees

This article recognizes that in order to ensure the SOEs principal-agent concept works, a new SOE’s governance model needs to be introduced. This is to answer certain question that might rise, for example: if a board of commissioners is the public’s proxy, then who or what kind of institution can be responsible for selecting, appointing and dismissing the board of commissioners? This study proposes that, in order to guarantee that the board of commissioners is completely independent from the government, a board of trustees must be introduced. In addition to the main tasks of the board of trustees in selecting and dismissing members of the board of commissioners, it also has authority to approve the dismissal of members of the board of directors by the board of commissioners.

Moreover, a special law would need to be proposed in order for there to be a legal basis for the establishment of the board of trustee. This is necessary to put the board of trustees in a legally strong position. The law must ensure that persons who will become members of the board of trustees are individuals with personal integrity and competence in the corporation matters.

The model of selection and appointment of Indonesian Corruption Eradication Commission (Abbreviated to KPK in Indonesian) leaders as stated in Law No. 30 of 2002 regarding Corruption Eradication Commission can be partially applied. Members of the board of trustees are elected by the People’s Representative Council (Dewan Perwakilan Rakyat, abbreviated to DPR). Granting the authority of election of the board of trustees members to the DPR is rational and can be accountable by law, because according to Indonesian political system, DPR is a state agency that has
supervisory duties in addition to budgeting and legislation functions. In other words, the election of members of board of trustees is part of the supervisory functions of the DPR.

Furthermore, to help the DPR select the prospective members of the board of trustees, the government could establish a selection committee through a Presidential Regulation. Members of the selection committee would consist of elements of society and government; the number of representative from society at large should be greater than the number of government representative. The committee should be chaired by the member who is society representative as opposed to the representative of the government.

The process of selection of members of board of trustees should be done in transparent fashion, involving widespread public participation. For example, the selection committee should announces the candidates’ names to the public for feedbacks. The selection committee’s tasks are then three: to publicly announce the selection process of the election of the board of trustees’ candidates; to select and decide the names of candidates of board of trustees’ members; and to submits the selected candidates to the DPR for a fit and proper test. The DPR would then submit the elected candidates (candidates who pass the fit and proper test held by the DPR) to President to be enacted.

Art. 20A, Para 1 the 1945 Constitution of the Republic of Indonesia; Art. 69, Para 1 Law No. 27 of 2009
6.5.4 Reforming the TPA

As it has been proposed that the role of electing, appointing and dismissing the board of commissioners should no longer be performed by the TPA, the TPA is thereby only entitled to elect, appoint and dismiss the board of directors. This is a legal consequence of the government acting as an SOE’s agent. A board of directors (management in the context of the one-tier board) is an SOE executive which, in agency theory, acts as the agent. By giving the rights of election, appointment and dismissal of members of a board of directors, it can be assumed that the government is carrying out its duties to appoint and dismiss its proxy in the SOEs. In light of this, reforming the TPA would mean purifying the role of the government as the public’s agent.

6.5.5 Cross control

To ensure the government and the board of trustees perform their respective duties and in keeping with the spirit of checks and balances, cross control between the two institutions is proposed. Cross control means that one institution can control the policies of another institution. For example, if the government appointed a political party member to an SOE’s board of directors, then the board of trustees could ask for the cancellation of the appointment in the district court where the SOE is legally domiciled. The domestic court’s verdict can only be appealed in the Supreme Court. In this way, there are only two levels of legal processes that can be undertaken by the conflicting parties. This is an important measure to ensure that legal processes do not hamper the company’s business.
By introducing the board of trustees, the reform of TPA and the cross control the governance structures of SOEs will be changed in the ways described below.

**Figure 6: existing model**

![Existing Model Diagram]

**Figure 7: proposed model**

![Proposed Model Diagram]

Given the above proposals –namely the proposals on positioning the board of commissioners as public’s representative, the establishment of the board of trustees and the reformation of the TPA-- the shape of SOEs’ general meeting of shareholders will be changed. The government as SOEs’ sole shareholders will not exist. Rather, both board of trustees and the government are two SOEs’ organs that will act as a general meeting of shareholders. Consequently, a single law for SOEs should be introduced where SOEs do not comply with the general company law that places the authority over a SOE in the hands of government as acting shareholders.

**6.6 CONCLUSION**

This study has focused on Indonesia’s SOEs. It has found that scholars have overlooked discussions about SOE governance. Instead, scholars tend to discuss corporate governance from the standpoint of privately listed firms, and have consequently regarded poor governance of SOEs as being the result of state ownership problems. However, these alleged state ownership problems are debunked...
by of the success of Singapore’s SOEs. Although Temasek Holding Limited’s shares are owned by the Singaporean, its performance outperforms its private company counterparts.\textsuperscript{114}

In this article I have argued that the main problem in SOEs, at least in the context of Indonesian SOEs, is the lack of clarity regarding the definition of the SOE’s principals and their relationship with the government as an agent. Therefore, inspired by Anwar and Sam’s study of Singaporean SOEs, this study argues for a new conception of the principal-agent relationship for SOEs. In practical support of this reconceptualisation, this study proposes undermining of the government's power over SOEs by way of making board of commissioners stronger, and legally positioning the board of commissioners as representative of society as ultimate owners of SOEs. A new model of cross-control concept is also introduced in order to maintain the functioning separation of business and politics.

By introducing the SOEs principal-agent relationship concept, this study has tried to conceptually solve the SOEs’ principal problem that has been superficially looked at by scholars. As has been discussed in this study, most of scholars consider that the government is the principal of SOEs and therefore the discussion on the principal-agent relationship is limited to the relationship between government and managers or board members.

Practically speaking, the study has attempted to answer the problems of the disproportionate government power on SOEs by suggesting that the board of

\textsuperscript{114} Anwar and Sam, above n 9, 66; Fang Feng, Qian Sun and Wilson H.S. Tong, 'Do Government-linked Companies Underperform?' (2004) 24 Journal of Banking and Finance 2463
commissioners be positioned as a public representative as opposed to a government proxy. The government powers will be reduced and thus the board will be able to improve its supervisory functions. In other words, the fear of dismissal by the government as the board of commissioners’ boss will not exist anymore. As a result, if the government tries to direct SOE activities out of the public interests—for instance if the government wants a SOE to do non-business activities for political purposes— the board of commissioners will oppose the government’s plan for the sake of society at large.

The above proposals not only seek to resolve the excessive power of the government over SOEs, but also aim to undermine political intervention by the DPR as occurred, for example, in February 2009 when the Commission of Seven of DPR convened PT Pertamina’s President Director. If the board of commissioner is positioned as public representative—rather than being beholden to the government, this would mean the DPR only has the authority to convene the SOE’s board of commissioners rather than SOE’s management. Political intervention by DPR potentially disrupts the business activities of SOEs, in addition to creating opportunities for inappropriate political deals between members of DPR and the SOE’s management.

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115 Kamal, above n 112, 361