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Corporate Governance in Indonesia: Business Ethics Prespectives and Challenges in Globalization Era

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Abstract: This paper discussed specific features of corporate behavior in Indonesia related to corporate governance issues. Since corporate governance structure in Indonesia is also characterized by the fact that most companies are managed and owned principally by founding family members, there exists potential conflict of interests between the governance participants. This paper argues that business ethics play as a key role in mitigating the conflicts in order to facilitate healthy business practices that accommodate various interests of stakeholders. Moreover, any effort to promote sound governance practices should consider the country's specific factors such as cultural issues that relates to business practices. Appropriate regulatory environment, therefore, is necessary to determine the rights and obligations of governance participants and the incentive to promote sound governance practices and business sustainability.

Key words: Corporate Governance • Business Ethics • Globalization • Culture

INTRODUCTION

Competition in global business is increasing sharply, especially in the last decade of the 21st century. This condition requires companies to establish their competitive advantage in order to win the competition. Recent companies are operated in global environment along with severalexternal stimulation such as tax incentives, labor costs and government regulations [1]. Internal motive to seek more efficient resources has also stimulated companies to compete in global market.

Recent government policies tend to reduces many barriers to enter the international market. Such approach has become significant incentive to extend companies market and operational [2]. Many nation associations such as the ASEAN Economic Community (AEC), G20, APEC and others, have agreed on strategic issues to ease their members to participate in each country's market. AEC agreement, for example, allows their members to provide free flow of goods, services and labor among countries. Consequently, companies in every country have to compete with those from other countries.

Increasing global competition may trigger the company to perform a series of market and non- market action [3]. However, increasing competition, particularly those reaching the limit of hyper competition, has forced companies to conduct unethical moves [4]. Various other incentives such as weak regulations and a lack of code of conduct which can firmly control the action, may strengthen the possibility of such behavior [5].

Companies have to respond to variety of influential stimulants, especially those in the environments with high-level competition [6, 3]. Previous studies noted that being proactive toward environmental changes will increase the probability of companies in gaining high performance. To operate in such way, companies are required to shape their ability to adapt in environmental changes. More specifically, companies need to be internally flexible, especially in the context of strategic decisions that will affect competitiveness.

Scholars believed that the absence of conflict of interests among various parties in the company will increase the flexibility and speed in making decisions [7]. The most influential conflicts of interest that could appears is conflict between shareholders (principal) and managers (agent). According to agency theory, both parties were likely to have different interests which may lead to agency-principal conflict [8]. Principal tend to increase their wealth through maximize dividend pay out while agent would prefer to increase their payoff and benefit. Adoption and implementation of sound corporate governance practices are expected to mitigate the various parties' interests in the company to reduce conflict [7].

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Although it is various in each distinct country, general corporate governance (CG) philosophy provide guidance for companies to increase CG practice in the dimensions of accountability, responsibility and integrity [9]. Dimension of accountability assists the shareholders in monitoring the activities of management continuously, responsibility and integrity are regarded as the basic foundation for the behavior and actions of each party in the company. It is believed that these three aspects would make companies more stable, low agency conflict and could have respond to the competition quickly.

The implementation of CG should be based on prudency, which reflected the behaviors that free from ethical misconduct [10]. Such principle served as accord for companies to implement a variety of actions, in accordance with the ethical standards. It means, in order to keep up with CG code, companies should maintain its operation and action in particular and high level of ethical standard. Lukviarman [5] confirmed that the major cause of poorly implemented of CG in Indonesia prior 1998 crisis was poor level of business ethics among companies. Lack implementation of such CG conduct in public and private institutions in had led to the acceleration of the 1998 financial crisis in Indonesia.

Implementation of CG has placed as imperative subject since two last decade [5]. In the United States, the Sarbanes-Oxley Act has been ratified in 2002 in order to strengthen the implementation of CG after the reveal of major business ethics scandals. Afterward, scholars has extensively used CG as primary issues and as an answer for preventing unethical business practices. The popularity of CG was not linier with actual implementation and benefits for ethical business practices. There were tendencies among companies to establish on paper and normative structure of CG, but they lack of internal culture and knowledge on how to implement such normative conduct.

Although it has been studied in various context and has been implemented in high discipline, the practice of CG principles cannot guarantee that the unethical behaviors and moves are vanished [11, 12]. Both in the private and the public sectors, ethic scandals are easy to find. For example, in 2010, The Wall Street Journal released 10 top company executives unethical scandal. Steven J. Heyer who was dismissed from the chief executive of Starwordl Hotels & Resorts Worldwide Inc. in 2007 because of creating a hostile atmosphere and performing immoral and inappropriate relationship with one employee of the company. Another example of ethics scandal is the case Patricia Dunn, Chief Executive Hawlet-Packard, who was forced to resign after being convicted of leaking company secrets.

Such condition appeared as indicators for effectiveness of various regulations related to corporate governance. It also could be presumed that CG principles has not been implemented comprehensively. This paper is intended to discuss the weakness of the implementation of CG especially in from the perspective of business ethics and proposing several attempts to increase such implementation through strengthen business ethics practices.

Agent-Steward Behavior Continuum: It is generally understood that the grounded concepts of corporate governance were derived from agency theory and stewardship theory. Both theory used as foundation by researchers and practitioners to formulate their CG strategies. Although it rests on different assumptions, even opposite to each other, these theories gained same popularity. In many studies, both theories were often contrasted [13] and compared [14]. Despite of its distinctive features both have the same goal that was to reduce conflict of interests within companies.

Agency theory views manager as *hired hands* which were believed to be more interested in the effort of private welfare than the welfare of the principal/shareholders [7, 15, 16]. This assumption will potentially led to the conflict between owners and managers. In this context, corporate governance is needed to mitigate the conflicts of interest between such parties. At least there are two kind of conflict appeared and therefore required companies to design CG strategy.

Agency problems arise when owners and management have different objectives and it was difficult for owners to verify various actions taken by the manager as agent [17]. The second problem was the distribution of risk and return for each parties which often misalign with each responsibility [3]. Executives tend to avoid high risk moves if it will affect their position or reputation, hence the opportunity cost was paid by shareholder by losing potential return of investment.

According to Stewardship theory, executives are more motivated to maximize the benefit of the company compared to their own interests on the basis of the fulfillment of higher order needs, such as achievement and self-actualization [18]. In the perspective of Stewardship theory, the company's senior executives hold the view that the companies' existence are attached to the existence of themselves, the company's reputation is attached to their reputations, so it should be maintained as good as possible. With such logic, corporate executives will not take advantage for their own benefit, but more interested in maintaining the viability and the success of the company in the future.

Within the framework of stewardship theory, the relationship between the owner and executive manager is principal-agents relationship, but rather as the principal-steward/guard relationship. In this context, the guards take care of the interests of companies just like taking care of their own interests [18]. According to this perspective, even for companies with fragmented ownership structure, corporate executives will not consider who own the shares. The executives will prioritize the interests of the company rather than their personal interests. The failure of the company will consider as their fail and in turn will affect their personal reputation.

Martynov [13] proposed a concept with the perspective somewhere in between agency theory and stewardship theory. Martynov's proposal is based on the positions of the two conflicting variables, which view that each of the variables can be an option in the implementation because they have same purpose from the standpoint of corporate governance.

The composition of the companies' ownership in Indonesia tends to be dominated by structures that are concentrated and owned by family [5]. The owners of firms with concentrated structure have a greater power so they have more flexibility than those in the company with widely dispersed ownership. In this condition, it would be more suitable if the company emphasizes the implementation of stewardship theory rather than agency theory. This approach is believed to reduce non-ethical business practices within company because relationship between management and shareholders tend to be more personal. Especially if this condition is related to the involvement of the owner or the family of dominant owner in the board or directors of the company [5].

Clear concentrated ownership structure could facilitate the alignment between management and shareholders [19, 20]. The interests of shareholders is clear since it was dominated by members of the family, so conflicts between management and shareholders could be reduced easily.

Adjusting to the Cultural Differences: The CG concept has helped companies to mitigate conflicts among stakeholders within company. Many companies in various industries and countries gain significant benefit from CG implementation, especially in the context of achieving long term goals. Studies conducted by independent agencies (such as KPMG) showed trend that investors are willing to pay higher for companies which have better CG practices.

Although conducted in various contexts, previous studies tend to neglect the cultural differences. Every country has different characteristics of its cultural dimension, especially the dimensions related to the management of organizations such as collectivisms, uncertainty avoidance and power distance [21]. It is believed that various cultural variables can influence ethical business practices, mainly due to the fact that cultural factors also distinguish ethical standards in a particular context. The understanding of cultural characteristics of a country also influences corporate behavior which will lead to different implementation of corporate governance.

Collectivism is associated with a cultural trend that emphasizes the cultural life of the group [21]. This dimension is in contrast with individualism that tends to prioritize individual rather than group. Countries with high collectivism such as Mexico, Malaysia and Indonesia tend to be more suited to the group and family management. The implementation of the principles of corporate governance needs to adjust to the value of the cultural differences. In Indonesia, for example, the ownership structure should be more institutionalize which reflected similarity group attachment such as management ownership, employees ownership, society ownership and among others.

Cultural differences in the context of uncertainty avoidance also need to be considered in the formulation of corporate governance. Countries with high levels of uncertainty avoidance, such as Japan and Indonesia are less tolerant to uncertainty, therefore CG mechanism in such culture should be more detailed, clear and specific. On the contrary, countris with low level of uncertainty avoidance could design its CG mechanism in guidance mode. In the context of Indonesia, the absence of detailed, clear, specific regulations could be authority hazard. In addition, such condition could also be multi-interpretation for evaluate ethical or unethical business.

The distance of power is also an important dimension to be considered in the implementation of corporate governance. Countries with high power distance are more likely to have more frequent hidden conflict than in countries with low power distance [21]. In countries with low scores, the debate between leaders and followers are open and considered as a common practice. Conversely, countries with high scores consider the debate with the leader as something unnatural and tend to be avoided.

Indonesia, which has a high power distance, needs to consider this aspect before implementing corporate governance. However, the important aspect that must be considered whether for high or low power distance is how to increase transparency and accountability to avoid conflict high and low power holding

The adoption of corporate governance which were conducted by many companies in Indonesia were collided with the issue of cultural adoption [5]. Preparation of the company's internal regulations as an effort to increase accountability, transparency and professionalism are often confronted with a cultural context. This might be resulted by the basic laws and regulation book of Indonesia was adopted from legal tradition created by Dutch. Although from the perspective of legal structure of CG (in the form of structure and mechanisms) are sufficient in, the culture of Indonesian was not supporting in examining such legal structure [5].

Strengthening the Implementation of Corporate Governance: High competition in the international market which reinforced by globalization, required companies to actively seek out new competitive tactics to survive. The efforts include variety ways to penetrate foreign market. However, multinational companies that were operating in foreign markets face negative sentiment from preferring domestic product campaign. On the other hand, similar pressure was also experienced by domestic companies because they have to compete with foreign competitor. Such competitive situation especially that achieve hyper competition, could attract companies to engage with non-ethical behavior.

In order to maintain ethical standard, it is important for companies to strengthen the implementation of corporate governance. In addition, such attempt is not only aimed to regulate companies to behave ethically, but also to shape and establish each companies competitiveness [25]. Involving stakeholders outside the company such as independent directors and committee members into the structure, could encouraged management for more transparent and accountable [26, 27]. Since management was monitored by an independent party, the possibility of non-ethical behavior could be reduced.

The efforts to strengthen the implementation of corporate governance can also be done through the preparation of design and clear rules to guide behavior and decision making [28]. Important regulations such as clear boundaries of power and structures, fairness in measuring performance and design of appropriate remuneration would assist to reduce non-ethical behavior. Such attempt could lead to clarity of roles which relied on strung foundation. In the case of implementation of corporate governance in Indonesia, these three regulations are considered important in ensuring employees to act in balance both for their interests and companies.

Set up a "Control Tower": Corporate behavior is a dimension that was influenced predominantly by the various contingency factors, particularly environmental organizations and environmental changes [29]. Although the company has developed a series of mechanisms to regulate their member behave in correct path, such behavior will not last long if it is not internalized and formed as corporate culture. The corporate culture which grows and develops as positive value due to habit and repetition could be regarded as internal control mechanism in maintaining behavior. It means, companies should crystalized their role, code of conduct and other policies to form their own and unique corporate culture.

Accordingly, formal regulations which were designed to strengthen CG, not only can directly help to reduce unethical behavior, but also serve as a tool to shape corporate culture. Regulation obligated individuals and organs within company to act redundantly and consistently, so the likely behavior arising from the regulation could crystallize as the corporate culture [30]. Arriving at this point, companies have has certain culture that can be used as a tool of internal controls on an informal basis.

Next, companies need to design role model behavior within companies as "control tower" [22]. Control tower could be an individual or group that can serve as behavior benchmark. They could be used as comparison, as evaluated object and as example for entire members. Such learning process – by experience through hands-on approach by designated individuals – was believed more effective in transformed and shaped corporate culture.

In accordance with the company's governance structure, control tower could be implied stronger effect if the individual are spread at each managerial level. Senior manager as control tower indicated high level of commitment toward cultural transformation [23]. However, influential employees from each levels and departments need to be involved in the process [24]. This involvement helps to bring control functions and strengthening the organization's overall commitment to the implementation of ethical behavior.

CONCLUSION

Implementation of corporate governance is a crucial factor to face the competition in globalization. The application of its principles comprehensively would help companies to survive and win competition. However, factors such as high levels of competition and moral hazard could lead the company to perform non-ethical behavior, although it has adequate corporate governance tools and have implemented them. In order to achieve long-term competitive advantages, implementation of CG should be followed with high commitment to ethical code of conduct.

In the era of globalization, at least there are four aspects need to be considered in efforts to strengthen companies CG practice in Indonesia. The implementation of stewardship theory is recommended in the context of Indonesia. Various adjustments to cultural differences in Indonesian context should be also considered to make the process run well and avoided additional conflict. From the internal point of view, the structure and mechanism of corporate governance, including strengthening ethical behavior in the company also need to be considered.

This study has several limitation. First, it lacks of empirical evidence to support such proposing argument. Next, this paper reviews on the Indonesia setting in general impression. It might be neglected some important issues, particularly those related to industrial specific context.

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