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The evaluation of corporate governance practise in Indonesia: a case study

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THE EVALUATION OF CORPORATE GOVERNANCE PRACTISE IN INDONESIA: A CASE STUDY

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CERTIFICATION

I, Agus Setiawan, declare that this thesis, submitted in fulfillment of the requirements for the award of Doctor of Philosophy, in the School of Accounting and Finance, University of Wollongong, is wholly my own work unless otherwise referenced or acknowledged. The document has not been submitted for qualifications at any other academic institution.

Agus Setiawan

28 August 2006

This thesis is dedicated

to my wife, Nur Rahmah Tri Utami

and

to my parents, Mr. and Mrs. Winarna Surya Adisubrata

ABSTRACT

There is a limited published research on corporate governance practise in Asian countries, during and after the Asian economic crisis of 1997, especially the practise within the Indonesian context. Most of Indonesian companies suffered a loss during the crisis, and only a limited number of companies survived and booked a profit.

This study is concerned with the corporate governance practice in a baby milk formula producer and a public listed company, PT Sari Husada Tbk. The company was acquired by Royal Numico N.V. Holland in 1997 and was one of those Indonesian companies which survived and outperformed the market average during the crisis. This research examined the elements of corporate governance system at Sari Husada and the role of each level of the firm, so that it could perform in the best interest of the company, using an ethnographic qualitative approach. Twenty one respondents from inside and outside the company have been interviewed, in order to find out evidences about what happened, how it happened and why it happened. Three cornerstones, corporate governance, corporate culture and strategic management, were used in analysing the data.

The study found that the corporate governance practise in Sari Husada was partly adopted from the literature with some adjustments which included local culture and national interests. The company survived the crisis of 1997 because of the

adoption of a multinational company’s working system, the cultural change toward the attitude of productivity and efficiency, the products with an affordable price and quality nutrient, and the long and enduring effort of its managers and staff. Above all, Sari Husada has been able to transform into a new modern company which produces various related food products for babies.

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I am grateful to the Almighty Allah who gave me the opportunity to submit this thesis. I would like to express my sincere gratitude to Associate Professor Robert Williams who guided and supervised me during this study period. His encouragement, constructive discussion and personal support have greatly contributed to completing this thesis. I also wish to thank Prof. Michael Gaffikin for his valuable help during stages of the study.

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LIST OF ABBREVIATIONS AND TERMS

ADB	Asian Development Bank
AGM	Annual General Meeting
Bapepam	Badan Pengawas Pasar Modal or Capital Market Supervisory Agency; previously Badan Penyelenggara Pasar Modal or Capital Market Executive Agency
BUMN	Badan Usaha Milik Negara or State Owned Enterprise
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CG	Corporate Governance
BOC	Board of Commissioners
BOD	Board of Directors
BPS	Biro Pusat Statistik or National Bureau of Statistic
DPK	Dana Purna Karya; a company owned by Sari Husada’s pension fund
DPR	Dewan Perwakilan Rakyat or Indonesian House of Representatives
EKUIN	Ekonomi, Keuangan dan Industri or Economy, Finance and Industry
EMI	Enterprise Management Incentive
EPS	Earning per Share
ERP	Enterprise Resource Planning
ESOP	Employee Stock Option Program
EVA	Economic Value Added
EXACT	An accounting system for monitoring program at Sari Husada
FA	Finance and Accounting department
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Auditing Standard
GATT	General Agreement on Tariffs and Trade
GCG	Good Corporate Governance
GMP	Good Manufacturing Practise

GMS	General Meeting of Shareholders
HACCP	Hazard Analysis and Critical Control Point
HQ	Headquarters
HRD	Human Resource Development
IAI	Ikatan Akuntan Indonesia or Indonesian Institute of Accountants
IMF	International Monetary Fund
Infes	Institute for Economic Studies
IPO	Innitial Public Offering
Jamsostek	Jaminan Sosial Tenaga Kerja or Social Insurance for Labour
JSX	Jakarta Stock Exchange
KPI	Key Performance Indicator
NCCG	National Committee on Corporate Governance
MT	Management Trainee
MUI	Majelis Ulama Indonesia or Indonesian Council of Ulama
NIS	Nutricia Indonesia Sejahtera
Numico	A new firm established after the Nuticia - Milupa - Cow and Gate merger; the parent company of Sari Husada
OECD	Organisation for Economic Co-operation and Development
PERC	Political and Economic Risk Consultancy
Perkasa	Persatuan Karyawan Sari Husada or Sari Husada Labour Union
PMA	Penanaman Modal Asing or Foreign Investment
PMDN	Penanaman Modal Dalam Negeri or Domestic Investment
Propenas	Program Pembangunan Nasional or Five Year Development Plan
PSAK	Pernyataan Standar Akuntansi Keuangan or Indonesian GAAP
PT	Perseroan Terbatas or Limited Company
QA	Quality Assurance
R&D	Research and Development
SAP	System, Application and Products in Data Processing
SCM	Supply Chain Management
SGM	Sari Husada’s famous brand

SHDA	Sari Husada’s bourse code
SH	Sari Husada
SNI	Standar Nasional Indonesia or Indonesian National Standard
SOP	Standard Operating Procedure
SPAP	Standar Profesi Akuntan Public or Indonesian GAAS
Tbk	Terbuka or Publicly Owned
TICM	Transparency International Chapter Malaysia
UMR	Upah Minimum Regional or Regional Minimum Wages
UN	United Nations
US	United States of America
VAT	Value Added Tax
WHO	World Health Organisation
UNICEF	United Nations International Children’s Emergency Funds

CHAPTER ONE

INTRODUCTION

1.1. Introduction

Corporate governance is a common term and is frequently used in addressing the default of Indonesian companies when the economic crisis hit in 1997. There are many different definitions of corporate governance. This study will employ the definition that corporate governance is the relationship between shareholders, directors and management (Monks and Minow, 1995).

The purpose of this chapter is to provide a brief overview of the study. This study is mainly concerned with the corporate governance practised at a firm level based on an Indonesian company. This study realises that at present, there is limited published research on corporate governance practise in Asian countries during and after the Asian economic crisis, especially the practise within the Indonesian context.

This chapter consists of corporate governance and company survival, the background of the study, the case selected for the study, purpose of the study, research questions, the methodological approach and the structure of the thesis.

1.2. Corporate Governance and Company Survival

Corporate governance practise is affected by external environmental elements as well as the internal elements under corporate control (Standard and Poors, 2001).

These external environmental elements are the legal structure, the regulations, the information infrastructure and the market infrastructure. The internal elements of corporate governance which contributes to good corporate practise are the ownership structure, the financial stakeholder relations, the financial transparency and information disclosure and the board structure and process (Standard and Poors, 2001).

Many scholars state that good corporate governance will lead to better company performance, which in the end will affect the ability of a company to perform better than the other companies and survive during an economic crisis. Studies by Perry (1999), Desai (1998), Rubach (1997), McNabb (1996), Darazsdi (1996), Wahal (1996) Gedajlovic (1993), Mulick (1993), Wang (1991), Daily (1991), Ikkenberry (1990), Rechner (1986), Molinari (1990), Darmawati, et al. (2005) and Faisal (2005) are some of those which tried to reveal the relationship between elements of corporate governance and the firm performance. Although some of these studies have found conflicting result, there were some evidences that the elements of corporate governance affected the company performance.

1.3. Background of the Study

The Asian economic crisis of 1997 has affected most companies in Indonesia. Although most of those companies suffered from losses, some companies did perform well. PT Sari Husada Tbk was one of those companies which outperformed the market average.

McKinsey and Co. (2000) in their Investor Opinion Survey stated that the quality of corporate governance practise in Indonesia was very poor. Political and Economic Risk Consultancy (2000) also placed Indonesia among the worst Asian countries in the practise of corporate governance. McKinsey and Co. (2000) found that investors were willing to pay a 27 percent premium above market price for share investments in well governed companies.

This study wanted to find out what factors differentiated the good from the bad companies from the corporate governance point of view. Good corporate governance practise was suspected to be the driver of survival of the company during the crisis. Therefore, this study focuses on the practise of corporate governance of a private sector organisation in Indonesia which survived and booked profits during the economic crisis.

1.4. Case Selected

This study investigates the corporate governance practise in an Indonesian company context. The previous studies of corporate governance in Indonesia were focused on certain areas, such as the legal and business context and the governance practise in the family-controlled firms and the banking sector. Tabalujan (2001) highlighted the implementation of a two-tier board of the European civil law model to the Indonesian Company Law 1995. In another study, he investigated why Indonesian corporate governance had failed during the economic crisis using three private banks as research sites (Tabalujan, 2002a).

This study chose PT Sari Husada Tbk as the case study for a number of reasons. These reasons are that it is a public listed company, the company outperformed the market average during the Indonesian economic crisis, it is the market leader in its industry, and the uniqueness of the company which evolved from a state owned enterprise, a joint venture, a private company and listed on the bourse, and then became a subsidiary of a multinational company. This study will therefore explore the corporate governance practise in Sari Husada with a broader and deeper analysis through an ethnographic qualitative approach.

1.5. Purposes of the Study

This case study describes the development of corporate governance practise in a leading baby milk formula manufacturer in Indonesia. The purpose of this study is to gain an understanding of the pattern of corporate governance practised at different level of positions within Sari Husada. In this research, the view presented by the human actors, both managers and employees, are important sources of data.

This research attempts to provide empirical evidence of the nature of the corporate governance practise at the subject company. The findings from this study are expected to contribute to the knowledge of corporate governance.

1.6. Research Questions

This research attempts to explore the corporate governance practise which operated across the different levels of staff at Sari Husada using an ethnographic qualitative approach. Furthermore, this study analyses the changing of the corporate culture and the strategic management process which affected the governance practise in the company. The general research question of this study is “How could PT Sari Husada Tbk survive and maintain book profits during the economic crisis when most Indonesian companies were severely troubled?” From this general research question then particular research questions are (1) “How did the company govern itself?”, (2) “What did the elements of corporate governance exist within the company?” and (3) “Why did the company choose to do what they have done?”

These particular research questions were used to guide the researcher during the interviews using a semi-structured interview model. Especially for research question (3) the company chose to do what they have done, was related to three aspects, which are corporate governance, corporate culture and strategic management.

1.7. Methodological Approach

The purpose of the study is to investigate the patterns and elements of corporate governance practised at Sari Husada. This study includes the changing of the corporate culture and the strategic decision making that happened in Sari Husada. A qualitative research approach can be applied in order to discover the socially constructed nature of reality, and not only be strictly explored in terms of quantity, amount, intensity and frequency (Denzin, 1994, p. 4).

To explore the corporate governance practise which operated across the different level of employees, this study used a semi-structured interview to gain valuable information, because the questions are more likely to conform to the native's perception of reality (Fetterman, 1998, p. 481). The study considers representativeness of the object being studied, therefore, different levels of staff, from the top level management down to the labour union representative were interviewed. Interviewees from outside of the company were also included to give a broader view of how the corporate governance process was viewed from an outside perspective.

In analysing the data, the study uses three cornerstones, which are corporate governance, corporate culture and strategic management. From the corporate governance point of view, the analysis of this study uses the fourteen Van den Berghe and De Ridder's (1999) factors that determine a specific corporate governance system. The Sari Husada corporate culture was discussed using Flamholz's (2001) Culture Management Process. Then, the strategic management process in Sari Husada is discussed using the Hunger and Wheelen's (2000) elements.

Further discussion on the research methodology is discussed in Chapter Three, while the analysis of the study is discussed in Chapter Six, Chapter Seven and Chapter Eight.

1.8. Structure of the Thesis

The study consists of ten chapters. The first chapter provides a brief overview of corporate governance, the background of the study, research purposes, research questions, the research approach taken and the structure of the thesis.

The second chapter deals with the review of corporate governance literature. This chapter describes the origin of corporate governance, the comparative model and elements of corporate governance. The relationship between corporate governance and company performance, the international standard of corporate governance, and the corporate governance in the Indonesian context are also discussed.

Chapter Three deals with the research methodology applied in this study. This chapter discusses the research methodology in accounting and corporate governance and the case study research. The research design, including the data collection and data analysis, is discussed in this chapter.

Chapter Four describes the business environment in Indonesia. This chapter looks at the general information on Indonesia, the investment environment, the business regulations and taxation. The condition prior to the economic crisis, the capital market supervisory agency (Bapepam), the Jakarta Stock Exchange (JSX) and the National Committee on Corporate Governance (NCCG) are also discussed.

Chapter Five discusses the organisation of Sari Husada. This chapter explores the history, the transformation and the leadership of Sari Husada. The production facility of the company and the amulets for its success are also discussed. This chapter also explains the management, the board of commissioners, the employees and the labour union, and the pension fund. The chapter ends with a description of the majority shareholder, including the development of its strategy within Sari Husada.

Chapter Six to Chapter Nine deal with the analysis of the study. The presentation of these chapters is sequenced with analysis of the governance system, the corporate culture, the strategic management and the development of Sari Husada.

Chapter Six looks at the corporate governance system of Sari Husada. This involves discussion sections on the governance model, the governance structure, the shareholding structure and the cross shareholding. The discussion on the enterprise, including its stakeholders, the labour market, the anti-takeover mechanism and the disciplinary mechanism are also included in this chapter.

Chapter Seven discusses the changing of the corporate culture at Sari Husada. This chapter starts with the definition of culture and organisational culture, and is followed by a discussion of the changes in organisational culture. Then the discussion on the Sari Husada corporate culture is explored using the Flamholtz's (2001) Culture Management Process.

Chapter Eight discusses the strategic management process in Sari Husada. This chapter begins with the history and definition of strategy, and follows by the strategic management concept and model. Then the step by step strategic management process within Sari Husada is discussed in this chapter.

Chapter Nine deals with the analysis of the development of Sari Husada. This chapter describes the evolution and corner stones of Sari Husada before and after Numico acquisition. Then the discussion on the Numico intervention, crucial board's decisions and the actions of a whistleblower are also explored.

Chapter Ten concludes the major findings of the study, and also discuss the strengths and weaknesses of the study. The suggestions for future research are also described.

CHAPTER TWO

REVIEW OF CORPORATE GOVERNANCE LITERATURE

2.1. Introduction

Corporate Governance has become an important issue in East Asian countries since the economic crisis of 1997. Corporate governance refers to the institutions and mechanisms by which owners of corporations control managers in order to ensure returns on their investment. However in the real world, there is a tendency for managers to pursue their own goals rather than the best interests of the shareholders. The aim of good corporate governance is to create efficient competitive markets, to give solid legal protection for shareholders and creditors, and to enable shareholders to influence directors' and managers' behaviour (TICM and Infes, 2000). In this chapter the corporate governance literature will be discussed with a particular focus on the practise in Indonesian companies.

2.2. The Origin and Definition of Corporate Governance

The origin of the term corporate governance is related to Berle and Means writing of separating ownership and management (1932). The consequence of this separation was ownership dispersion which could mean that the owners of a corporation had difficulties in monitoring and disciplining managers. Jensen and Meckling (1976) state that the separation of ownership and management created an opportunity for managers to behave in their own-interests because the owners of company were unable to properly monitor management.

The definition of corporate governance varies among scholars. Prowse (1998) defines corporate governance as rules, standards and organisations in an economy that govern the behaviour of corporate owners, directors, and managers and define their duties and accountability to outside investors, i.e. shareholders and lenders. While Stone et al. (1998) define corporate governance as the rules and incentives by which management of a company is directed and controlled so as to maximise the profitability and long term value of the firm for shareholders while taking into account the interest of other legitimate stakeholders.

The Finance Committee on Corporate Governance Malaysia defines corporate governance as the process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective being the realization of long term shareholder value, whilst taking into account the interest of other stakeholders. Above all corporate governance is about "a way of ensuring that investors receive a return on their investment by protecting against management expropriation or use of the investment capital to finance poor project" (Iu and Batten, 2001, p.49).

This study will employ the definition of corporate governance proposed by Monks and Minow (1995). They defined corporate governance as the relationship between shareholders, directors and management.

2.3. Comparative Model and Elements of Corporate Governance

There are different governance models in the world. These differences are based on the special attributes which some countries have. Some scholars focus their research on the governance systems in specific countries like the US, Germany and Japan (Shleifer and Vishy, 1997; Hopt et al., 1998; Rubach and Sebora 1998). The Japanese model of governance places emphasises on the development of long-term relationships between investors and management, while the US model uses transparency as a tool so that investors have a better chance to monitor corporations (Rubach and Sebora, 1998).

La Porta et al. (1998, 2000a, 2000b) studied relationships between legal origin, investor protection and finance in a wider sample of regions. They found that investor protection varied depending on the origin of the legal system of a country. In common law countries investors had a better legal protection compared to those in civil law regimes. They also found that in the civil law countries there were tendencies to higher ownership concentration compared to countries with a common law regime. Countries with weaker legal protection were likely to have ownership concentration for investors' protection. Shleifer and Vishy (1997, p.769) support these findings. They state "(b)oth legal protection of investors and some form of concentrated ownership are essential elements of a good corporate governance system…legal protection and large investors are complementary in an effective corporate governance system."

Another study conducted by the Asian Development Bank (ADB) was to investigate the corporate governance structures of countries involved in the Asian economic crisis. In five studied countries, Indonesia, Malaysia, Thailand, Philippines and Korea, ADB found that the governance structures were relatively similar. There was high ownership concentration, a high dependency on bank funding, ineffective shareholders' right and low transparency (ADB, 2000).

Prowse (1998) found common problems in corporate governance practise in East Asia. Those problems were: (i) all institutions that played an important part in disciplining markets were underdeveloped or undeveloped; (ii) the competitive environment was weak resulting in inefficient markets; (iii) the existence of a weak judicial system and the absence of agencies to handle detailed rule-making and non-legal administrative enforcement, e.g. financial disclosure, stock market listing rules and accounting standard and practises.

Prowse's findings are similar to the World Bank conclusions. In its 1999 report, the World Bank stated that the economic crisis in East Asia was caused by systemic failures in implementing corporate governance. According to the World Bank the failures were derived from (i) a weak legal framework; (ii) inconsistency in accounting and auditing standards; (iii) bad banking practises; (iv) ineffective board of directors' supervision; and (v) few protections for minority shareholders (World Bank, 1999).

The same results were also found by the Asian Development Bank (ADB). The ADB 1999 report stated that the economic crisis in five countries, Indonesia, Malaysia, Philippine, Thailand, and South Korea, was caused by the failure to implement corporate governance procedures. The ADB found that the failure was a result of (i) a high concentration of company ownership; (ii) ineffective mechanisms for board of director supervision; (iii) inefficiency and non-transparency in the procedures to acquire company control; (iv) companies highly dependent on external funding, i.e. bank loans; (v) lack of creditor's supervision on the loan.

There are several elements of corporate governance which contribute to good corporate practise. The emphasis, however, differs from one researcher to another. Standard & Poors (2001) employed four components: (i) ownership structure; (ii) financial stakeholder relations; (iii) financial transparency and information disclosure; and (iv) board structure and process. Firstly, ownership structure referred to transparency of ownership and concentration and influence of ownership. The structure consisted of a breakdown of shareholdings which includes director and management shareholdings, and affiliation amongst shareholders. Secondly, financial stakeholder relations referred to the regularity of ease of access to information on shareholder meetings, voting and shareholder meeting procedures, and ownership rights. Then, Standard and Poors (2001) described financial transparency and information structure as the quality and content of public disclosure, timing of and access to public disclosure and the independence and standing of the auditor. Lastly, the board structure and process included board composition, the role and effectiveness of the board, the role and independence of non-employed directors, and board executive compensation, evaluation policies and succession policies.

Corporate governance practise is also affected by external environmental elements as well as those under internal corporate control. Standard and Poors (2001) lists the external environment elements as: (i) legal infrastructure; (ii) regulation; (iii) information infrastructure, and (iv) market infrastructure. Legal infrastructure refers to stakeholder legal rights, effective law enforcement in the event stakeholder rights are abused, company law and bankruptcy and pledge law. Regulation, as an element of the external environment, refers to the legal and regulatory environment in which a firm operates. This is also linked to regulatory bodies that set and enforce standards for public disclosure. Regulatory bodies can be within a government ministry, a central bank or created as an autonomous independent body. Informational infrastructure refers to accounting principles, which differs from country to country, reflecting varying business practises, reporting practises and disclosure preferences. Market infrastructure measures the ability of the public capital market to promote a healthy governance process. Institutional investors have an important role in promoting this process.

2.4. Corporate Governance and Company Performance

Many scholars state that good corporate governance will lead to better financial performance (Berle & Means (1932), Perry (1999), Desai (1998), Rubach (1997), McNabb (1996), Darazsdi (1996), Wahal (1995), Gedajlovic (1993), Mulick (1993), Wang (1991), Daily (1991), Ikenberry (1990), Rechner (1986), Molinari (1990), Darmawati, et al. (2005) and Faisal (2005). For example, Joskow and Rose

(1994) say that the quality of managerial inputs and actions affect the share price and accounting return of companies. Corporate performance provides useful information on managerial achievement.

Scholars have found conflicting results on the relationship between elements of corporate governance and firm performance. For example, Perry (1999) related firm performance with CEO turnover, finding a negative relationship. That is, as CEO turnover increased, firm performance suffered. In contrast Desai (1998) found CEO turnover had no relationship with firm performance. Perry (1999) also found that incentive compensation for directors influences the level of monitoring by the board. Companies with a majority of outside directors are more likely to restructure their assets and layoff employees in response to a performance decline. Those actions will significantly improve the operating performance of the firms. Perry (1999) added that the board composition influences how firms respond to a decline in performance and how quickly the firm recovers from the decline.

Deteriorating firm performance reflects deviation in managerial efforts to satisfy shareholders' interests. That pattern of agency theory was observed by Desai (1998) to see governance mechanism changes and firm performance adjustment following declining performance of firms. Desai (1998) found that an increased number of board meetings and board size are positively related to firm performance. He states that there is no significant relationship between CEO turnover, removal of CEO duality, increases in the proportion of outside directors, and increase in the outside directors' shareholdings with firm performance.

Still by employing almost similar components, Darazsdi (1996) observed the determination of financial performance and variables which influenced a company's performance. Those variables are director ownership of firm shares, separation of roles of chairman of the board and CEO, the absence of prior CEO from the board, board turnover, and the CEO being the only management member on the board. Supporting Desai's conclusions, Darazsdi (1996) found that there were no significant correlations between financial performance and the variables examined, only weak negative correlation was found between equity ownership and financial performance. He suggests that a future study would be on how boards and stakeholders define board effectiveness and how shareholders operate control in a successful company.

McNabb (1996) found another phenomenon. In his study of the appointment of the CEO and its impact on firm performance, he found that CEO appointments only increase short-term return, but found no evidence of improvement in long term firm performance. At least this finding complements the different arguments of previous findings by Perry (1999), Desai (1998), and Darazsdi (1996).

The role of organisational agents in affecting organisational outcomes, such as performance, has been the subject of continuing discussion and debate. These influential organisational agents usually include the chief executive officer (CEO) and board of directors. Daily (1991) in her study examined the effects of corporate governance structure on firm performance. She found that in a relatively small corporation the founder CEO preferred governance structures which did not threaten their control over the firms operation. These small firms were characterized by fewer numbers of outside directors, a lower proportion of outside directors, and a higher CEO domination in firm operation. Moreover she found several firms with more total outside directors achieving a higher performance level, but there was no performance difference with respect to the proportion of outside board members. Another important finding was that firm performance does not deteriorate when the founder remains in the position of CEO. This result suggests that there is no need for founders to transfer management and control of the company to professional managers.

Institutional investors, as shareholders with large stakes, have powerful incentives to monitor managers and improve firm performance. Wahal (1995) in his study found that shareholder activism roles that are played by pension funds were successful in bringing about desired changes in the governance structure. However the changes did not appear to translate into improvement in financial performance. This result raises doubt of the effectiveness of institutional investor (i.e. pension fund) activism as a tool of corporate control.

The same research on shareholder activism was conducted by Forjan (1993). He examined the process of governance reform through shareholder sponsored proposals. Forjan (1993) found that those shareholders actions will not favour stock price reaction on the day of announcement. If managers support the proposal and negotiate with shareholders, the stock price will react positively. But if managers are unwilling to negotiate with shareholders it is believed that severe agency problem exists. The study also finds another important result which is a combination of shareholders right plans and high debt levels construct a powerful defense against a hostile takeover.

Still in the institutional investor area, Rubach (1997) studied the potential power of institutional investors in influencing corporate decisions. He found that most institutional investors followed a passive policy, and only 10 percent were reported as actively practising confrontational activism. Rubach (1997) concluded that institutional investors were not active, and for those who were active, their activism did not benefit their investment and did not improve corporate performance. This result supports the previous findings of Wahal (1995).

In the internal control and auditing area, Koldewey (1995) studied some missing components of corporate governance accountability. Employing an internal control concept, which is commonly used in Canadian companies, it was compared to system theory, he found that the control was too narrow and became a barrier to audits. Chairmen of boards of companies studied preferred board self-evaluation to audit and did not support an external or internal audit of the board. Koldewey concluded his study by saying that the internal control concept and a need for audits of boards of directors were the missing components from corporate governance accountability, especially in companies with concentrated controlling shareholders.

Another investigation conducted by Kochhar (1995) examined the relationship between corporate strategies and the mode of financing. He argued that an absence of a fit between strategy and mode of financing would lead to a decrease in financial performance. Moreover Kochhar said that the presence of representatives of financial institution on the board was likely to lead to a more private financing. The evidence found in his study indicated that the firm managers in the decision making process considered the type of financing (debt versus equity), but did not do so with respect to financing source (public versus private).

In a cross national study of corporate governance Gedajlovic (1993) discovered the relationship between ownership concentration, firm strategy and financial performance. The study found that ownership concentration influenced the strategic behaviour of firms, and indirectly the strategic outcomes influenced corporate performance. Those findings do not support the agency theory – separation of ownership and control hypothesis of a positive relationship between ownership concentration and financial performance (see Berle & Means, 1932).

In the governance structure area, Mulick (1993) in his study of governance structure, product market strategy and firm performance, found a significant relationship between governance structure and strategy. Changes in governance structure brought about closer alignments between owners and managers interests. Those findings in turn were significantly related to financial performance, which was measured both by accounting based and market based measurements.

Still in the governance structure area, a study conducted by Rechner (1986) tried to relate corporate governance structure with shareholder wealth and corporate financial performance. Employing board composition as a corporate governance variable she found that the composition of the board had significant effects on the profit margin, ROI and ROE. Rechner (1996) found that this effect remained stable across both types of leadership, separated or combined leadership. To conclude her study Rechner's findings supported Mulick's (1993) results.

Research on outside directors conducted by Wang (1991) and Molinari (1990) presented complementary findings. Wang (1991) examined the relationship between outside director composition, outsider owners and corporate performance. He found that there were no relationships between the proportion of principal outsiders, the proportion of business outsiders, the proportion of public outsiders and firm performance. Moreover Wang found that board composition was an inadequate predictor of corporate governance success. A different study conducted by Molinari examined the participation of outside executives on board effectiveness. Molinary (1990) found that those boards with outsiders resulted in better financial ratios. Moreover board education and training had a strong favourable influence on board performance.

To complete different angles of governance components, Ikenberry (1990) studied the relationship between a proxy contest and firm performance. He employed conventional performance ratios such as liquidity, leverage and asset utilization ratios, as indicators. Ikkenberry found that a proxy contest as a corporate control mechanism was an effective way to improve firm performance. In the case of firms where re-elected directors dominated the board seats, the firm's operating performance will deteriorate.

2.5. International Standard of Corporate Governance

Another issue in the corporate governance discussion is the convergence of corporate governance systems. Post Asian economic crisis reform pushed the importance of such a unification of corporate governance systems. The Western governance system was introduced as common path towards the convergence of systems. Nestor and Thompson (1999) state that “(d)espite different starting point, a trend towards convergence of corporate governance regimes has been developing in recent years” (quoted in Iu and Batten, 2001, p. 50). The global corporate governance standard is initiated as many countries are working together to bridge gaps in different governance practises which exist among them. One of these global standards, which is commonly adopted, is the OECD Principles.

One size does not fit all. The global standard of corporate governance may not fit with each country needs to formulate its own standard. For that reason some scholars are opposing the idea of the unification of corporate governance standard. For example Heuer et al. (1999) stated that “a recurring theme in national culture research is that while convergence may be seen in practises among managers, these practises do not necessarily signal a convergence in the value embedded in national cultures” (quoted in Iu and Batten, 2001, p. 50). Moreover Iu and Batten (2001, pp. 50-51) added that, “(t)he conduct of commerce between nations on homogeneous terms and conditions does not translate into homogeneous cultural constructs. National identities remain. Cultural differences also remain.”

Rubach and Sebora (1998, p. 2) supported the above idea and said that "(t)he differences in corporate governance system reflect the path by which each (governance system) came to exist." Jordan (1999) also noted that using the OECD Principles in Asia may be dangerous because it could drive ineffective changes. Allen (2000) mentioned that not much change will happen in the short or even medium term when OECD Principles were transplanted immediately.

The convergence of corporate governance system does not mean that they will be implemented identically in each country (Asian Corporate Governance Association, 2000). Each country may find its own path to good corporate governance. There is no single model of corporate governance that can be applied that will solve the governance issues in every situation (see ADB, 1999, 2000; and World Bank, 1999). Good corporate governance should be developed on a contextual basis because the situation faced by each country differs. ADB (2000, p.6) states that, "(e)ach country should formulate its own reform plan and implement measures that suit its condition."

2.6. Corporate Governance in Indonesian Context

Corporate governance practises in Indonesian companies have been explored at the macro level by researchers and international institutions including the Asian Development Bank, the World Bank, Political and Economic Risk Consultancy (PERC) and McKinsey & Co. McKinsey & Co. (2000) in its Investor Opinion Survey stated that the status and quality of corporate governance practise in

Indonesia was very poor. McKinsey rated Indonesia corporate governance practise at 1.1 point (where the rating found ranges from 1 (very bad) to 5 (very good)). Moreover, McKinsey & Co. found that investors were willing to pay a 27 percent premium above market price for share investments in companies that were well governed. For this reason is quite easy to find which companies are better appreciated from the investors view point. The shares of those companies are traded above the average price of shares of a similar industry.

Political and Economic Risk Consultancy (PERC) of Hong Kong in its survey also placed Indonesia among the worst Asian countries in the practise of corporate governance, just slightly better than South Korea and Vietnam (PERC, 2000). The assessment of those who understood corporate governance practise in Indonesia demonstrates that Indonesia is far from adequate in implementing good corporate governance.

At the micro firm level, studies of corporate governance in Indonesia are focused on certain areas. For example, Tabalujan (2001) explored the corporate governance in Indonesian companies within the legal and business context. He investigates the centre of Indonesia's formal legal framework for corporate governance, which is the Company Law 1995 and its implications for governance practises. Tabalujan (2001) highlighted the implementation of the European civil law model which has a two-tier board. The adoption of two-tier board model makes Indonesian companies have a Board of Commissioners (dewan komisaris) and a Board of Directors (dewan direksi). The Board of Commissioners, headed by a

President Commissioner, is responsible for supervising and advising the Board of Directors (which is the executive board) (Tabalujan, 2001, p.8). Directors are to manage the company on daily basis (see Company Law 1995, Art1 (4) and Art 82).

In his another study Tabalujan (2002a) investigated why Indonesian corporate governance had failed during the economic crisis. He examined the Indonesian corporate governance behaviour leading up to the crisis during the 1990s. Tabalujan (2002a) chose to focus his study on three private banks as case studies because he argued that the banking sector prior to the crisis was one of the most regulated industries. He concluded that any attempt to improve a country's corporate governance system should include the local cultures (p.34). He also added that in the past there was too much attention put on drafting new laws, creating new systems, and providing staff training, but too little attention on studying the mindset of the key players in companies and on creating and implementing a sustainable strategy for growth (p.33).

Darmawati, et al. (2005) found that corporate governance implementation in some companies in Indonesia affected its operational performance (ie. return on equity). They also found that there was a time lag between the implementation of corporate governance and companies' performance. This was because of market did not respond immediately.

Faisal (2005) examined the relationship between ownership structure, corporate governance and agency cost measured in terms of asset utilisation and operating expenses. He found firms with high institutional shareholding and large size of board of directors were significantly more efficient than those with low institutional shareholding and small size of boards. The evidence was consistent with the notion that large board of directors were effective to monitor firm performance.

Although the above studies have discovered the weaknesses of Indonesian corporate governance implementation, the studies were still limited and focused on certain elements of governance. There is very little research addressing corporate governance practise at the firm level, especially a firm that performed well during the Indonesian economic crisis. Moreover, there are no studies observing corporate governance practise using an in depth case study strategy.

2.7. Conclusion

There is challenge to build better corporate governance systems in Asia after the economic crisis. Not only because of each country differs in governance practise, but also because they differ in legal and cultural systems. Not to mention that each company also has its owned unique culture and different strategic decision making processes to run its operation.

The idea to bring a convergence of corporate governance system towards internationalisation and globalisation, especially after many countries had been affected by the crisis may be seen as a better way to prevent another crisis in the future. Creating a uniform system across the globe may not be a best solution. It is difficult for a country to change the existing corporate governance system. The nationality and cultural identity of a nation should be taken into account in the effort to craft a better governance system. Each country may have different path under its own specific circumstances. ADB (2000) stated that “(e)ach country should formulate its own reform plan and implement measures that suit its specific condition.”

The discussion of corporate governance review shows that different findings can be brought as a result of different studies. From those diverse findings it could be seen that a study at different places and in different times with different circumstances might result from a specific binding with the environment in which the study was conducted. These findings could be used as a corridor to survey corporate governance practise in a specific country, especially governance practise in Indonesian companies.

The studies of corporate governance conducted in Indonesia are limited. Some of these limited studies have researched the barriers and opportunities for transition to better corporate governance post crisis (see Tabulajan, 2001, 2002a, 2002b; Simanjuntak and Felia, 2001; Fitzpatrick, 1998). The Indonesian banking sector, the legal culture origin and family-controlled companies are the areas which most studies have researched. In depth study at company level which relates corporate governance practise to corporate culture and strategic management process has never been researched.

This study attempts to explore the corporate governance practise which operates across different level of PT Sari Husada Tbk. The literature review discussed above has examined various models and elements of corporate governance in different contexts. In this study those models and elements of corporate governance will be observed to gain understanding of different perspective of corporate governance practise which is happened in Indonesian company context. Furthermore, following the literature review on the unique path which taken by a company to craft its own course, this study will also analyse the corporate culture and strategic management process which affect the practise of corporate governance at PT Sari Husada Tbk.

The next chapter will discuss the research methodology used to describe the subject organisation.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1. Introduction

This study focuses on the practise and experience of corporate governance in an Indonesian listed company acquired by multinational company. As discussed in the previous chapter, a corporate governance system has certain elements. These elements of governance receive different emphasis in different companies. Each level of a firm plays its role in the governance system, so that it can perform in the best interest of the corporation. Thus, the elements and practises of corporate governance in the subject organisation have been studied in order to understand their context in the organisation's governance system and their role in achieving organisational objectives, especially during the period of the Asian financial crisis. The theoretical framework of a corporate governance system was presented and issues relevant to this study were identified in the previous chapter. Those discussions have been used as guiding perspectives in the current study.

This chapter discusses the methodology used to describe the subject organisation. It is divided into three sections, which are: research methodology in accounting and corporate governance; the case study; and the research design.

3.2. Research Methodology in Accounting and Corporate Governance

The objective of doing research in any field of study is to contribute to the knowledge creation process through either developing theory or testing theories. Eisenhardt (1989, p. 532) said that, "(d)evelopment of theory is a central activity in organisational theory." Theories provide guidelines and frameworks which can be deployed in practise, as well, practise supports the generation of theories. Harvey and Myers (1995, p. 13) state that research methods are ways where knowledge is acquired and constructed within a discipline. According to Hart (2003, p. 13) methodology aims "(t)o show the appropriateness of the techniques used to gather data and the methodological approach employed." He adds that relevant references from the literature review used to show the understanding of data collection techniques, its implications and to justify it are preferable to the other techniques. This study is an attempt to provide empirical evidence of the nature of corporate governance practise at the PT Sari Husada Tbk. The findings from this study are expected to contribute to building theories in corporate governance.

There are two general research methods, qualitative and quantitative research. According to Creswell (1994, p. 2) qualitative research is "(a)n enquiry process of understanding a social or human problem, based on a building a complex, holistic picture, formed with words, reporting detailed views of informants and conducted in a natural setting." Denzin (1994, p. 4) has similar view of qualitative research. He states that in the qualitative approach processes and meanings are not strictly explored in terms of quantity, amount, intensity or frequency. He adds that qualitative research gives more attention to the socially constructed nature of reality, the closeness between the researcher and what is studied, and the situational constraints that shape inquiry. This qualitative approach includes case study, participant observation, ethnography and in depth interview. The qualitative approach is commonly referred as critical, naturalistic, hermeneutic, interpretive, participatory or phenomenological.

On the contrary, quantitative research is heavily based on measurements and the analysis of causal relationship between variables, not process (Denzin, 1994, p. 4). This inquiry into social and human problems is based on testing a theory, composed by variables, measured with numbers and analysed by statistical procedures (Creswell, 1994, p. 2). This quantitative approach is commonly referred as mainstream, positivistic or scientific.

The usage of a qualitative approach in the accounting discipline has increased over recent years. Lodh and Gaffikin (1996, p. 331) state that "(o)ver the last two decades a wide range of studies have been conducted using alternative theoretical stances and strategies to the 'mainstream accounting research' (Chua, 1986) which are generally known as critical studies in accounting research." This current study uses a qualitative approach simply because the nature of the research questions request deeper answers complemented by respondents' responses to what is asked.

The case study approach appears as one strategy to answer the "how" and "why" questions when those are being posed. Especially, the case study will be a preferred strategy when a researcher has little control over the event being investigated and when the focus of study is on a contemporary phenomenon within real life context (Yin, 2003, p.1).

In this study, the researcher uses a case study approach to examine the practise of corporate governance exercised by the various levels and players in the organisation being researched. By adopting the in depth case study approach, the researcher has attempted to find out the basis of decisions made by the various levels of management and the reasons behind the chosen corporate governance practise in the company.

3.3. Case Study Research

Case study research is one of the prominent forms of doing social science research (Yin, 2003; Dearstone, 1989; Eisenhardt, 1989). Yin (2003, p. 1) mentions the advantage and disadvantages of using a research strategy in social science, which are depending on the following conditions: (a) the type of research question; (b) the control an investigator has over the actual behavioural events; and (c) the focus on contemporary as opposed to historical phenomena.

For the purpose of this current study, a case study is defined as a description or an interpretation of particular social phenomena in its organisational real life context. According to Kumar (1998, p. 99), "(t)he case study method is an approach to studying a social phenomenon through a thorough analysis of an individual case." Moreover he adds that when using this method of research all data relevant to the case are gathered and organized, and can be used for an intensive analysis of many specific details which are often overlooked by other methods of study.

Yin (2003, p. 13) stated that, "(a) case study is an empirical inquiry that: (a) investigates a contemporary phenomenon within its real-life context, especially when: (b) the boundaries between phenomenon and context are not clearly stated." Dearstone (1989, p.52) mentioned, "(t)he case study examines the 'how' and 'why' of a phenomenon, a person, group, organisation, or other unit."

3.4. Research Design

After deciding the strategy for the research, the next step is to develop a research design. Research design is a link between the research questions of the study, the data to be collected and the conclusion to be drawn. A catalog of research design has not been developed yet in the case study method of research strategy. Campbell and Stanley (1966) and Cook and Campbell (1979) mention that there are no textbooks that summarize various research designs for quasi-experimental conditions. Yin (2003, p. 20) said that the research design was a logical plan for getting from the initial set of questions to answer to a set of conclusions about these answers. The major components of research design are: (1) the study's question(s); (2) the study proposition(s); (3) the unit(s) of analysis; (4) the logic linking the data to the propositions; and (5) the criteria for implementing the findings (Yin, 2003, pp.21-28). Each of those components will be presented in this section.

3.4.1. Research Question

The clarification of the study question was the initial step in designing this research study. As mentioned in the previous section, case study strategy is related to “how” and “why” questions. This study attempts to explore the corporate governance practise which operated across the different levels of staff at PT Sari Husada Tbk. Furthermore, the current study analyses the corporate culture and strategic management process which affected the governance practise in the company studied.

The primary question identified as the research question is “how could PT Sari Husada Tbk survive and maintain book profits during the economic crisis when most Indonesian companies were severely troubled?” From this the following can be asked “how did various levels of position at PT Sari Husada Tbk cope with the economic crisis and why did they do what they have done during that troubled period?” This study attempts to answer those questions using case study research as a channel to understanding the nature and use of corporate governance theory in the subject company.

3.4.2. Study Proposition

A study proposition directs interest to certain areas that should be researched within the scope of study. This study proposition helps a researcher to move in the right direction. Moreover the study proposition reproduces a theoretical standpoint and begins to tell researcher where to collect relevant information (Yin, 2003, p. 22). Yin also mentions that some studies may have reasons for not having any proposition, although in this study the exploration will start with a rationale and direction.

In this study, to make sure its organisation was able to survive during a crisis period PT Sari Husada Tbk began its organisational change with a benchmarking policy with other western companies. Then the company analysed the cost and benefit of building a partnership with a well-known Western multinational company. By doing those actions PT Sari Husada was expected to direct its steps on to a right path to be a market leader in its industry at national level.

3.4.3. Unit of Analysis

The unit of analysis is a component that is related to the basic problem of what the case is that a researcher at the initiation of case study. The researcher should identify the unit to be analysed in the form of an individual, a group, a department or other organisational level at the outset of the case study research. Propositions have a role in identifying the relevant information about individual or individuals (Yin, 2003, p. 23). Without those propositions a researcher may be attracted to cover "everything" which is impossible to do. Propositions help to narrow down the scope of the research ground. Yin (2003, p. 23) adds, "(t)he more a study contains specific propositions, the more it will stay within feasible limits."

In the current study, the unit of analysis is bounded within PT Sari Husada Tbk. The research questions and proposition will be discussed within the context of Sari Husada as a firm. This unit of analysis includes various levels of staff positions, department and functional levels and the organisational level as a whole. In addition, the relationship of the company with its parent company and its connection with its boundaries of national legal and regulatory bodies will also be discussed in the study.

3.4.4. The Logic Linking the Data to Propositions and Interpreting Study's Findings

The fourth and fifth components of research design are the logic linking the data to the proposition and interpreting the study's findings. These two components point to the data analysis step in the case study and the research design sets the foundation for this analysis (Yin, 2003, p. 26). Linking the data to propositions can be done by any number of ways. One of them is an approach called pattern matching (Campbell, 1975). In this approach some parts of the information from the same case may be connected to some theoretical propositions. This pattern matching technique is a way of connecting data to the propositions, even though the entire study consists of only a single case. There is no accurate way of setting the criteria for interpreting the types of findings. Different patterns can be contrasted and findings can be understood in terms of a comparison of two or more different propositions.

3.4.5. The Role of Theory in Research Design

Wrapping those five components of research design above will start to create an opening theory related to the study. Yin (2003, p. 28) states that "(f)or case studies, theory development as part of the design phase is essential, whether the ensuing case study's purpose is to develop or to test theory." The complete research design represents a theory of what being studied. This theory can be considered as a simple blueprint for the study. It will determine what data is to be collected and how those data can be interpreted.

3.4.6. Criteria for Judging the Quality of Research Design

There are at least four criteria for evaluating the quality of research design. Those criteria are: (1) construct validity; (2) internal validity; (3) external validity; and (4) reliability (Kidder and Judd, 1986, pp. 26-29). Construct validity relates to the setting of correct operational measures for the concepts of being studied. To increase the construct validity of doing case study there are three tactics then can be followed (Yin, 2003, p. 36). Firstly is the use of multiple sources of evidence during data collection. Second tactic which is also done during data collection is to establish a chain of evidence. The last one is to have the draft case report reviewed by key informants during composition phase.

The next criterion is internal validity. This criterion relates to the establishing of a causal relationship when certain condition are exposed to lead to other conditions. This internal validity is commonly used in explanatory or casual studies, but uncommon in descriptive or exploratory studies. Yin (2003, p.36) states that "(a) case study involves an inference every time an event can not be directly observed." To improve internal validity, tactics such as pattern matching, explanation building and time series analysis during the data analysis phase are suggested in the literature.

External validity is about the establishing the domain to which a study's findings can be generalized. The external validity problem has been the main barrier in doing case study research. Critics state that a single case study offers a poor basis for generalization (Yin, 2003, p. 37). Case study research can not be analogized to survey research. Case study relies on analytical generalization rather than statistical generalization for survey research.

The last criterion for evaluating the quality of research design is reliability. This criterion demonstrates that the operations of study such as the data collection procedures can be repeated and result in the same findings. The goal of reliability is to minimise the error and biases in the study. To do that the researcher should make as many steps as operational as possible and to conduct research as if someone were watching over their shoulder (Yin, 2003, 39). The discussion of case study research above reveals that case study research design needs to be planned and conducted in a prudent way.

3.4.7. Data Collection

In doing the current study the researcher used various sources of evidence for data collection. To explore the practise of corporate governance in the subject organisation the researcher used qualitative data which was supported by quantitative data as well. The first contact with the subject organisation was conducted in mid 2002 using electronic mail. The assistant to the corporate secretary of the subject company was the contact person. To gain access to the company he asked for an introductory letter from the institution where researcher came from and reference letters from people in a high position inside as well as outside the company. The researcher managed to submit an introductory letter from the Head of School, complemented by two other letters from officials inside and outside the subject company. From inside the company a reference letter came from the Independent Commissioner and from outside the company a recommendation letter was written by an official of Bapepam (Capital Market Supervisory Board of Indonesia).

After submitting those letters the researcher then contacted the Vice President Director of PT Sari Husada Tbk, Mr Felix P. Mulia. Mr. Felix P. Mulia then confirmed that his organisation could be researched and appointed the assistant to corporate secretary, Mr Anwar Santosa, as the contact person to organize arrangements during the field research. Following the communication with Mr. Anwar Santosa the field research was collected during a four month period at the end of 2002.

The field research was conducted using several methods. These consisted of interviews, observations, archival records, press releases and online information and continued contact through electronic mail. Each of these methods will be discussed as follows.

3.4.7.1. Interview with Staff

The interview is the most important source of evidence in the data collection process for this study. Interviews are used as the main source of evidence about what happened, how it happened and why it happened. The interviews that were conducted involved 21 respondents, 15 from inside the subject company and 6 respondents from outside the company.

The interviewees from inside the company included 7 respondents from top level and management positions (board of commissioners and board of directors), 5 respondents from functional managers, and 3 respondents from non-managerial position. The interviewees from the top level position and managerial positions included the President Commissioner, the Independent Commissioner, the President Director, the Vice President Director (who also holds the position of Finance, Human Resource and Information Technology Director), the Production Director, the Quality Assurance (QA) and Research and Development (R&D) Director, and the Marketing Director. The managerial positions include the Plant Manager, the Finance Controller, the Human Resource Development Manager, the Quality Assurance (QA) and Research and Development (R&D) Manager, and the Chief of Internal Auditor (who also holds the position of Assistant to Corporate Secretary). Interviewees from non-managerial positions include the Chairman of the Labour Union, the Production Supervisor and the Security Guard. These interviewees were expected to give a complete representation of different positions at the subject company, with the focus more on the managerial positions. It was expected that the corporate governance process within the company were well-covered.

Interviewees from outside of the company were expected to give a broader view of how the corporate governance process was viewed from an outside perspective. Those interviewees comprised the Head of the Accounting Standard Bureau of Bapepam, the Interim Head of Investigation Bureau of Bapepam, the Deputy Chairman of National Committee for Corporate Governance of Indonesia (NCCG), the Listing Director of the Jakarta Stock Exchange, a member of NCCG, and a Director of a brokerage firm.

Sixteen interviews were recorded with the consent of the interviewees. Five were not recorded because of the situational condition when the interviews were conducted.

The interview process itself was a semi-structured and open-ended interview. The interview topics covered the background and experience of the interviewee, the job description and its role in the decision making process, the personal, functional and corporate culture, relationship to the Board of Commissioners and Board of Directors, management and owners relationship, the relationship management and other stakeholders, the board meeting process and personal expectations of the company.

The interviews were conducted at the work place where the interviewees conduct their daily activities. The interview approach was to enable the interviewee to speak openly and to give opportunity for them to explain their personal opinions and judgments. All the interviewees were enthusiastic about the research and were answering and explaining the matters which were asked during the interviews. As well some of the respondents were very supportive and willing to continue the interview at another place and also offered to be contacted by electronic mail when further answers were needed.

3.4.7.2. Direct Observation

Direct observation is another important source of data. The researcher visited three separate facilities of the company which were located in three different cities and provinces. The Jakarta office is the office of the Board of Commissioners, the Board of Directors and the Marketing Department. The company's head office and first production facilities are in Yogyakarta. The new plant with more than double the production capacity of the Yogyakarta plant is in Klaten, Central Java.

The first time the researcher visited the new plant, the Plant Manager arranged a tour of the production facility, including the waste water treatment facility. A production supervisor was assigned to accompany the researcher on a tour at the second and bigger production facilities. He was very informative in giving information and answering questions. The tour itself provided the researcher with valuable information related to the production process, the packaging process, material handling and logistic warehousing, maintenance, quality control, the waste treatment process and staff relationships. Also the production supervisor asked the researcher to join shop-floor workers to lunch in the company's canteen when the lunch break came. During the tour of the production facilities and when the production supervisor was explaining about the production process the researcher observed the process thoroughly and took notes.

The researcher also collected some useful information by hanging around and being on the company's premises. Direct observation was also done while researcher was at the company's offices in Yogyakarta and Jakarta, while waiting for the person to be interviewed and during the process of interview. By making such observations the researcher can grasp the very habits of the staff as well as the person interviewed. The corporate culture was also seen in operation in the daily office life.

3.4.7.3. Archival Records

The company's archival records were observed to gain an understanding of its organisational background. These records include the company's history, the annual reports, the organisational structure, the company's statute, the workplace agreement and some publications on baby food industry. These archival records helped the researcher to gather historic data of the company, as well as time series financial data, profitability, baby food industry information and the company's relationship with its staff.

3.4.7.4. Press Releases and Online Information

Additional information of company's news was gathered from the newspapers, company press releases and its website (http://www.sarihusada.co.id). Moreover, information about the macro situation as well as company's news was also gathered from Jakarta Stock Exchange website (http://www.jsx.co.id). The regulatory perspective of listed companies in Indonesia was gathered from Bapepam website (http://www.bapepam.go.id). Related to its parent company, information of Sari Husada as a subsidiary of Royal Numico NV was gathered from the Numico website (http://www.numico.com). The press releases and online information gave insight information about the subject company.

3.4.7.5. Continued Contact with Sari Husada through Electronic Mail

The importance of electronic mail has drastically increased during the last decade. The researcher used electronic mail to gain access to the subject company. The use of e-mail gave the opportunity of an instant and free communication channel to the contact person at the subject company. Even more, electronic mail was used to continue the data collection process when it was no longer feasible to hold continued interviews. The researcher continued asking questions which were raised after the field research through electronic mail.

3.4.8. Analysing Case Study Evidence

The analysis of case study data is the most difficult aspect of doing case study research. To address the propositions of a study, data analysis comprises examining, categorizing, tabulating, testing, or using a combination of both qualitative and quantitative data (Yin, 2003, p. 109). This analysis is difficult because strategies and techniques have not been well developed. The case study research at least should prioritise what to analyse and why (p. 109). There are at least five techniques to analyse the case study research. Those techniques are (1) pattern matching; (2)

explanation building; (3) time-series analysis; (4) logic models; and (5) cross-case synthesis. The last technique can be used in a multiple case design, while the first four are for single or multiple cases.

There are three general strategies in case study. Those strategies rely on theoretical propositions, thinking about rival explanations and developing a case description (Yin, 2003, pp. 111-15). Among these strategies the combination of relying on theoretical proposition and developing a case description strategy seems to fit to enable analyses of the situation at Sari Husada. Using this strategy, researcher developed a descriptive framework for organizing the case study while following the theoretical propositions.

3.5. Conclusion

This chapter describes the methodology used in the current study. In this chapter case study research was chosen to be the most appropriate approach to the study. A qualitative case study approach is suitable for the current study because it enabled the researcher to cover the detailed processes inside the company in answering the research questions.

The purpose of the study was to discover how corporate governance decisions have been made and practised by various level positions in the company. Then the question continues to what was the rationality of those managers in deciding such choices of corporate governance model. The demonstration of theoretical relevance of explanation is the strength of using this single case design (Booth, 1995, p. 99).

The next chapter will discuss the business environment in Indonesia. It will describe general information on Indonesia, the investment environment and business regulation and taxation.

CHAPTER FOUR

BUSINESS ENVIRONMENT IN INDONESIA

4.1. Introduction

This chapter will discuss the business environment in Indonesia. The chapter begins with general information on Indonesia, the investment environment, then business regulations and taxation. The Capital Market Supervisory Agency (Bapepam), the Jakarta Stock Exchange (JSX) and the National Committee on Good Corporate Governance (NCCG) are also discussed to give a regulatory framework for companies listed on the stock exchange.

4.2. General Information on Indonesia

Indonesia is the largest and most populated country in Southeast Asia. The archipelago comprises more than 13,000 islands, which stretch a distance of 5,120 kilometres from east to west. The Indonesian archipelago lies between Asia and Australia, with a land areas of approximately 1.9 million square kilometres. The five largest islands are Sumatra, Java, Kalimantan, Sulawesi and Irian Jaya. Jakarta, the capital of Indonesia and the largest city, is located on Java with a population of around nine million. The climate is tropical and temperatures range between 16 to 35 degrees centigrade. It has only two seasons, the dry season from May to September and the wet season from October to March. Indonesia had a population approximately 203.4 million people in 2000 (BPS, 2000), which means it is the fourth most populous country in the world. Around of 70 percent of the Indonesian population resides on the islands of Java and Sumatra. The people are primarily of Malay descent but the population consists of more than 300 ethnic groups who speak different languages. However, the national official language is Bahasa Indonesia. Around 88 percent of the Indonesian population practises Islam, and the remainder practises Christianity, Buddhism, Hinduism and other religions.

The form of Indonesian government is a republic, with a President as head of the state and chairman of the cabinet. The People's Consultative Assembly (MPR) represents the legislative authority. The MPR is a multi party body that approves legislation and elects the President and Vice President every five years. The Supreme Court's (Mahkamah Agung) judges are appointed by the President. At local government level Indonesia is separated into 32 provinces, two special regions (Aceh and Yogyakarta) and one special capital district (Jakarta).

Indonesia is rich in natural resources with significant reserves of oil, gas, coal and other minerals. Indonesia also has a large forest area with lumber industries. The infrastructure is well developed around the centres of population on the islands of Java, Bali and Sumatra. In these areas roads and rail connections are available for passengers and freight. Sea transport for raw materials and agricultural products is well developed since major islands have multiple ports. A domestic and international airline network is also available and major cities have international airports and others have domestic or pioneered (subsided) airports.

4.3. The Investment Environment

Indonesia has much to offer to foreign investors. The strategic location at the cross road of major world trade routes is one of the reasons. The country also has a large domestic market, an abundant and cost-competitive workforce, rich natural resources, reasonably good infrastructure and an elected government with the commitment to create a conducive investment environment. Although for some years the Indonesian economy has been subjected to unprecedented economic, social and political pressure, the government continues to gain some progress in creating a foundation for a sustainable economic recovery. Along with the International Monetary Fund (IMF) Indonesia targeted a ten point economic acceleration program as mentioned in the IMF Letter of Intent in September 2000. Those points are 1) to create stability in the financial sector, 2) to boost exports, 3) increase the productivity and welfare of farmers, 4) accelerate banking and private restructuring, 5) prioritise on equity-based recovery instead of loan-bank recovery, 6) value creation through privatisation, 7) conduct economic decentralisation, 8) maximise the use of the country's vast natural resources, 9) boost the development of micro, small and medium scale enterprises, and 10) increase people's welfare in the rural areas in order to strengthen socio-political stability. The Indonesian government has also created a blueprint for its economic development program that is to be revised every five years called five-year development program (Propenas). The Propenas which covers the 2001-2005 period has five main objectives, which are: 1) to develop a democratic political system and maintain political unity, 2) to uphold the supremacy of the law and clean government, 3) to accelerate economic recovery while enhancing sustainable and just development, 4) to ensure people's welfare and cultural resilience, and 5) to foster regional development.

To promote a fair business environment the Indonesian government also legislated anti-monopoly and unfair competition laws. The law No. 5 year 1999 forbids an individual company from controlling more than 50 percent of the domestic market and two or three companies from controlling a combined 75 percent of the market. This calculation of market share is determined by sales value rather than volume.

The government realises that exports are the second engine to drive economic recovery after private consumption. It intends to optimise the excess capacity in the manufacturing industry and using excess liquidity in the banking industry to finance international trade in order to boost exports.

4.4. Business Regulation

To attract foreign investors and to make Indonesia more competitive in the global business community, the Indonesian government is still in the process of updating the country's business regulations. There are some important regulations to consider in doing business in this country, such as employment regulations, financial reporting and auditing standards, intellectual property rights and land rights.

4.4.1. Employment Regulations

The basic 40-hour workweek is applied in the country and it is comprised of eight-hour days Monday to Friday, especially for offices in the capital city and the surrounding area, for the rest of the country mostly offices open seven hours per day, Monday to Friday and five hours on Saturday. Labour regulations specify that overtime from Monday to Saturday should be paid at 1.5 times the basic hourly rate for the first hour and two times the basic hourly rate for each additional hour. For Sunday and public holidays overtime pay is two times the basic hourly rate within the considered normal working hours of the company. After this time the pay rate is three times the basic rate for the first hour and four times the basic hourly rate for each additional hour.

For the unskilled workers Indonesia has a competitive wage rate compared to its neighbouring countries. In many cases there are differences in wages between industries and geographical locations. For example, wages in the oil sector are higher than those in the forestry or agricultural sector. Wages in urban Jakarta are also higher than in rural Java and the other islands. The ministry of Manpower regulates the minimum wage for each province or city based on a minimum physical need for a single worker.

Employees in Indonesia are entitled to a maximum of 12 (twelve) working days of paid annual leave. This leave is excluded from 13 (thirteen) paid official public holidays in a year. An employee is also entitled to receive sick leave for a period of up to 12 (twelve) months. A female employee is entitled to a three months paid maternity leave. Paid leave is also given to employees for occasions such as the birth of a child for one day and a death in the family for two days.

The Indonesian workers are generally entitled to fringe benefit from their employers, such as (a) payment of income tax due on salary and wages (the employers pay their employees' income tax so the workers get net take home payments), (b) an annual bonus of at least one month pay (usually paid at the month of Ramadan), (c) daily transport and meal allowances, and (d) in some cases reimbursement of medical expenses.

It is normal for new permanent employees to have a three-month probationary period from their employers. During this period the employers at their discretion can dismiss these new employees. The dismissal after this period requires the permission of the Committee for Settlement of Labour Disputes of the Department of Manpower. The employers are required to provide a dismissal payment, such as a merit or service payment, when the dismissal permission is granted. The amount of this dismissal payment depends on the number of years of employment service, and also depends on the agreement between the employers and employee. Three written warnings are commonly given to an employee prior to termination of service.

Indonesia has a kind of social security system known as Jaminan Sosial Tenaga Kerja or Jamsostek. A company that employs at least ten persons and has a payroll of at least one million rupiah a month must participate in an employee social security program provided by PT Jamsostek (a limited state owned social security company). PT Jamsostek provides benefits to employees for workplace accidents, death, health care and retirement. Both employers and employees contribute to Jamsostek, which is varied by industry and program. This rule is also applicable to expatriates, however it is not mandatory.

According to the Indonesian Law on Labour Unions dated August 2000, workers have a right to establish and develop a labour union. This union is an independent, self reliant, democratic and responsible body. The Law further indicates that a labour union can be established by at least ten workers and grants the union right to enter into collective labour agreements with the employers and represent workers in settling industrial disputes.

4.4.2. Financial Reporting and Auditing Requirements

Like in other countries, Indonesian Law requires business enterprises to maintain books and records in a such manner that their financial position may be determined at anytime. Indonesian Commercial Codes require that books and records be preserved for thirty years, while Tax Law requires that records be kept for ten years.

The Indonesian Generally Accepted Accounting Principles (GAAP) and Generally Accepted Auditing Standards (GAAS), referred to as the Pernyataan Standar Akuntansi Keuangan (PSAK) and Standar Profesi Akuntan Publik (SPAP), are issued by the Indonesia Institute of Accountants. The Indonesian GAAP primarily adopts the International Accounting Standards and some of the US Statements of Financial Accounting Standards, while the Indonesian GAAS adopts most of the

Auditing Standards issued by the American Institute of Certified Public Accountants. For public listed companies there are regulations and rules on the accounting treatment for certain accounts and transactions issued by the Indonesian Capital Market Supervisory Agency (Bapepam) and the stock exchange authorities.

4.4.3. Intellectual Property Rights

The Indonesian government recognises the importance of intellectual property protection. As a member of the World Intellectual Property Organisation and a signatory to the General Agreements on Tariffs and Trade (GATT), the Indonesian government has drawn up a number of bills with the effect of increasing the protection of intellectual property rights. Now Indonesia has laws covering patents, copyrights and trademarks.

The Law No 6/1989 as amended by Law No 13/1997 regulates patents in Indonesia. There are two types of patent in Indonesia. A Regular patent is a special right granted by the government allowing an inventor or other parties to develop a new invention for a certain period of time, while a simple patent is an invention, product or method of production that does not qualify as new invention. A regular patent is granted for a period of twenty years while simple patent is valid for ten years only. The patent holder is allowed to use the patent only in Indonesia except if approved by the Patent Office for outside use.

The Law No 6 /1982 as amended by Law no 12/1997 specifies the items eligible for copyright-protection and the corresponding sanctions for infringements.

These laws will only protect foreign copyright owners if Indonesia has acceded to one of the international copyrights conventions or has signed a bilateral treaty with the country that granted the copyright.

Trademark in Indonesia is governed by Law No 19/1992 as amended by Law No 14/1997. An application for trademark registration using a priority right (regulated by the International Convention on the Protection of Trademarks) is to be filed in Indonesia no later that six months after the initial filing for trademark registration in another country, which is either a signatory to the convention or a World Trade Organisation (WTO) member.

4.4.4. Land Rights

The Indonesian government offers foreign investors land rights that are relevant to the nature of their businesses. According to the Basic Agrarian Law of 1960, as the foundation of land laws in Indonesia, there are eleven land rights. Those laws that are mostly relevant to investors are the right of ownership, the right of exploitation, the right of building, the right of use and the right of lease. The right of ownership (hak milik) of land is an inheritable right reserved for Indonesian citizens only. Although legal entities are theoretically entitled to this right, in practise the right of ownership is no longer issued to them. The right can be sold, exchanged, handed over or transferred to other parties. The right of exploitation (hak guna usaha) is the right to use land for purpose of agriculture, fishing or cattle raising. This right can be held by foreign-owned companies (penanaman modal asing (PMA)) and can be used as collateral or security for financing purposes. The right can be granted for thirty five years with a guaranteed extension of twenty five years if the land is properly used and managed. The right of building (hak guna bangunan) is the right to construct and own buildings on land. This right is that most commonly obtained by PMA companies. Indonesian regulation grants an initial period of thirty years with a guaranteed extension of twenty years. The right is renewable provided the land is used for the same purpose and all regulatory requirements are met. Another right is right of use (hak pakai). This right grants its holder use of the land for a specific purpose, such as the construction of embassy buildings for foreign governments or special purpose buildings for social, cultural and religious organisations. This right has no collateral value to the holders and is not transferable. The right to lease (hak sewa) is similar to leasehold, which is normally granted to tenants of both residential and commercial premises. Foreign residents and foreign companies in Indonesia are entitled to lease property and there is no law or regulation that limits the duration of a lease.

4.5. Taxation

To provide taxpayers with increased fairness and more certainty of their rights and obligations and to offer greater clarity and simplicity in procedural and technical matters the Indonesian government has undertaken various tax reforms. Most Indonesian companies adopt the calendar year as their financial and tax year. For tax purposes corporations are divided into resident and non resident. A resident company is taxed on its worldwide income, while a non-resident corporation is taxed only on income derived from Indonesian sources. Taxable income is defined as any increase in economic value received by a taxpayer from inside or outside of Indonesian territory. It includes remuneration, business profits, dividends, interests, rent, royalties and other income. Some expenses are classified into deductible expenses, such as business expenses, research and development expenses, and training expenses for employees. Progressive corporate tax rates are imposed, those are 10 percent for income up to 50 million rupiah, 15 percent for income between 50 and 100 million rupiah, and 30 percent for income more than 100 million rupiah.

Indonesia has two types of withholding tax which are prepayment and final tax. The withholding tax rates are 6 percent for land and building rental payments to companies and payments for other properties, and also for compensation to management and technical services. Compensation related to professional services is taxed at 7 percent. The withholding tax rate for land and building rental payment to individuals is 10 percent, while dividends payment, interest fees and royalties are taxed at 15 percent.

The value added tax (VAT) is imposed on most goods and services at the rate of 10 percent. Some goods and services may have different value added tax rate between 5 and 15 percent depends on government regulation. The value added tax is collected by the entity which delivers taxable goods and services. The Indonesian government exempts certain industries from value added tax, such as mining and drilling, basic commodities, health and social services, religions services, education services, public transport services, manpower services and governmental services.

4.6. The Condition Prior to Financial Crisis

To give a better picture about the corporate sector in Indonesia prior to the financial crisis the discussion will begin with the historical development of the corporate sector, the capital market, the banking sector, foreign capital, the financial performance and growth of the Indonesian company and the legal and regulatory framework.

4.6.1. Historical Development

Since the nationalisation of Dutch companies after independence, the government started to be involved in Indonesian business and industry. The indigenous and Chinese entrepreneurs were already involved in some areas like trading, textiles and tobacco industries, while medium and large-scale companies were dominated by state owned enterprises. When the New Order government took power in 1967 and introduced the relatively liberal laws that governed foreign and domestic private investment, a substantial volume of private investment began to enter in the industrial sector replacing the public investment. When the Indonesian government got a windfall from oil and gas revenues in the early 1970s, it promoted industrial development via import substitution. The industries that emerged were relatively high import-content and dependent on tariff protection. During this period a discrete group with industrial privileges that had strong links to the political elite of the New Order emerged.

When the government promoted its industrial policy of labour intensive export in the 1980s, export credits with low interest rates were granted to industries that intensively used local labour and materials. This policy began to experience success in 1987 when the shares of export of non-oil products increased rapidly, and in 1992 the value of manufactured exports exceeded the value of oil and gas exports. As a result of the government policy the Indonesian industries were quite varied. While most of the companies were small, they employed most of the industrial labour force and produced mostly consumer goods. There were also large scale companies which grew rapidly. These business groups and conglomerates dominated the share in sectoral outputs and markets.

4.6.2. The Capital Market

Although the government reactivated the stock exchange in 1977 and a number of underwriters and stockbrokers have emerged, the number of firms quoted on the stock market was very limited. The stock market remained unattractive for the companies as a source of finance. There are many reasons why the companies were uninterested in having their shares quoted, such as the founding owners of the companies were reluctant to dilute their ownership. Even though the new shareholders would not threaten company control, the owners felt the listing decision would put the company under greater scrutiny. The stock market was also unattractive to companies to raise funds because the companies could borrow from banks at a very low interest rate. The investors, on the other hand, were also reluctant to buy shares on the stock market because they felt equity instruments had a higher risk but lower return compared to bank deposits. They did not know whom to trust and felt that the protection for minority shareholders' mechanism on the stock exchange was inadequate. The regulation of the stock market at that time also discouraged investors from investing. The capital market executive agency (Bapepam) as the capital market operator issued regulations that granted the agency the right to set prices and to give preference to small orders in initial public offerings. This regulation was targeted to attract small investors to the stock exchange but proved counterproductive, because it limited the prospective investors' ability to get the potential of capital gains.

After the government liberalised the banking sector and allowed it to determine its own lending rates for non-priority loans in 1988, the companies could not benefit from low interest rates any longer. At the same time the government also removed the price setting practise for initial public offerings (IPOs) and eliminated restrictions on price movements in the secondary market. The restriction on foreign investor to buy a significant level of listed shares was also abolished. As a result the number of listed companies on the stock exchange increased significantly, from 24 in 1988 to more than 300 in 1997. During this period the corporate sector started to recognise the stock market as a source for raising capital. The conglomerates benefited from this condition by carrying out 210 out of 257 of the IPOs.

4.6.3. The Banking Sector

Originally the banking sector was the major source of finance for the corporate sector. The Indonesian government reformed the banking sector starting in 1983. Interest rate and credit ceilings regulations were removed. State banks have started to face competition from private banks. Some priority credits still enjoyed subsidized interest from the Central Bank. Another significant reform was continued in 1988 with opening the banking industry to new entrants. There were ten banks which were dominant players. Seven of them were state banks, and the other three were private banks, Bank Central Asia, Bank Danamon and Bank International Indonesia. Although the banking sector was the major supplier of funds for the private sector, it failed to ensure the most effective allocation of capital. The effect was an explosion of credit with a less probability of repayment. The monitoring system of the banking sector failed to exercise its power in ensuring the banking sector performed as it should be.

4.6.4. Foreign Capital

The growing industrial sector in Indonesia has attracted foreign capital and investment. During the 1990s Indonesian corporations borrowed directly from overseas. The Indonesian government, in 1994, allowed foreign investors to have 100 percent interest in almost all Indonesian companies except in strategic sectors. Foreign banks became an important source of finance for Indonesian corporations. Because of the lower interest rates for dollar loans (at 9 percent per annum) and the stable depreciation of domestic currency rupiah (at 4 percent per annum) the corporate sector preferred to borrow in US dollars. This interest rate was more attractive compared to the average domestic interest rate at 18 percent. Under the managed floating system of the Central Bank the depreciation of the rupiah was controlled at fewer than 4 percent per year. The effect was excessive borrowing in foreign currencies by the corporate sector and this borrowing was unhedged. In 1998 the total corporate debt to foreign banks amounted to US $67 billion, this exceeded the debt of domestic banks of US $50 billion. This situation made the corporate sector extremely vulnerable to currency fluctuation.

4.7. The Capital Market Supervisory Agency

After having a difficult time during the economic crisis, the capital market supervisory agency (Bapepam) of Indonesia has set a new vision in facing its future challenge. It has a vision "to develop strong and globally competitive capital markets, as the activator of the national economy" (Bapepam, 2002, p.1). Based on this vision the Bapepam will focus its effort for the next five years on: (1) enhancing commitment to the development of the capital market; (2) enhancing accessibility of small and medium enterprises and cooperatives to the capital market; (3) encouraging regional government to raise funds through the capital market; (4) enhancing participation of domestic investors; and (5) developing the infrastructure of the Indonesian capital market in facing global competition (Bapepam, 2002, pp.2-3).

Bapepam also has to carry out its development strategies for facing global competition (Bapepam, 2002, pp. 17-27). The first strategy is to improve compliance to good corporate governance. This strategy should be supported with improvements in capital market regulation and socialisation and implementation of good corporate governance. The next strategy is harmonisation of rules and institutions. The regulations and institutions within the country should be synchronized, as well as to adapt with foreign regulations and international institutions. This synchronization is not only for capital market institutions but should also include banking and public sector institutions. The third strategy is the integrated development of information technology and human resources. This should assure that the level of knowledge and readiness of institutions related to capital market are acceptable. The next strategy is implementation of safety and service quality conforming to international standards. This strategy is to attract global investors to participate in the capital market. The last strategy is development of market and capital market instruments. Bapepam needs to expand issuers' base, to strengthen domestic investors and to improve the status of the over the counter market (OTC).

The rapid pace of the Indonesian capital market development created distinctive problems specific to the bourse. More complex issues need to be addressed especially in relation to the disputes among market participants. The capital market participants preferred to settle matters at an alternative arrangement different to dispute cases which are brought to court. Therefore, on August 9th, 2002 Indonesian Capital Market Arbitration Council was established. It provides an alternative arrangement to reach a fast, transparent, independent and fair settlement on capital market disputes.

4.8. The Jakarta Stock Exchange

The Jakarta Stock Exchange (JSX) establishment can be traced back to 1912. The first Indonesian stock exchange under the Dutch colonial government was set up in Batavia (later named as Jakarta). The bourse was relatively un-active until 1977 when it was reopened under the Capital Market Executive Agency (or Badan Pelaksana Pasar Modal (Bapepam)), an institution under the control of the Ministry of Finance. The stock exchange activity involved 24 listed companies that traded their shares. The bourse hit its peak in 1990 and on July 13 1992 the Jakarta Stock Exchange became privately owned and operated. Since then the bourse has emerged as one of the most dynamic securities markets in Asia. As the privatisation went on, Bapepam's function has changed to become the Capital Market Supervisory Agency (or Badan Pengawas Pasar Modal (still with the same abbreviation Bapepam)).

Relating to the listed companies on the bourse, the Jakarta Stock Exchange has issued reporting obligations. Those reporting obligations require listed companies to submit to the stock exchange financial statements consisting of: (1) annual statement; audited by a registered accountant and to be submitted within 120 days from the closing of fiscal year; (2) semi annual report; un-audited and to be submitted within 60 days from closing of the first half of fiscal year; and (3) quarterly report; to be submitted 60 days from the closing of each quarter of fiscal year; all important and relevant information which may affect the value of company’s shares or the investment decision of investors; and other information, such as change in articles of association, change in composition of Board of Commissioners or Board of Directors, and change of value of assets and transaction of 10 percent or more from the financial report figures.

4.9. The National Committee on Corporate Governance

The National Committee on Corporate Governance (NCGCG) was established as a non governmental body by the decree of the Coordinating Minister for Economy, Finance and Industry number Kep.-10/M.EKUIN/08/1999 dated August 19th 1999. The main task of this national committee is to formulate and recommend a national policy on good corporate governance. This policy is intended to cover: (1) a code of good corporate governance as a guide to Indonesian companies; (2) improving laws and legislation in line with the implementation of good corporate governance; and (3) institutional structure in the company that supports the application of good corporate governance. As mentioned in its organisational profile the National Committee on Corporate Governance has three aims, which are: (1) to maximise corporate and shareholder value by enhancing transparency, reliability and accountability and establishing a managerial system which promotes entrepreneurship; (2) to assist companies to minimise potential conflict of interests among their stakeholders through rational and fair means; and (3) to encourage shareholders and members of the board to make decisions with morality and applying principles of good corporate citizenship and social responsibility (National Committee on Corporate Governance, 2001).

The National Committee on Corporate Governance has 22 members representing government bodies (such as Bapepam and JSX) and private professional organisations. The economic crisis has been a blessing in disguise for the enforcement of good corporate governance. The Code of Good Corporate Governance was launched on March 8th 2001. This code covers various areas such as: (1) shareholders; rights and equitable treatments; (2) Board of Commissioners; function and composition; (3) Board of Directors; role and composition; (4) audit system; external auditor and audit committee; (5) corporate secretary; function, role and qualification; (6) stakeholders; (7) transparency; timely and accuracy; (8) confidentiality; (9) insider information; (10) business ethics and anti-corruption; (11) donation; (12) adherence to law of occupancy, health and safety and conservation of environment; and (13) equitable job opportunity. Although the target of this code includes all companies established in Indonesia, at the first stage the implementation of the code of corporate governance conducts was instilled to listed companies in JSX and state owned enterprises.

4.10. Conclusion

This chapter describes the business environment that a company faces in Indonesia. Every business entity should cope with business regulations, taxations, banking system, capital market regulations, and other rules issued by Capital Market

Supervisory Agency (Bapepam), the Jakarta Stock Exchange or the National Committee on Corporate Governance.

The purpose of this chapter is to give a brief explanation about business environment, especially regulations, taxations and business institutions which any company operated in Indonesia should meet. The regulatory bodies are also illustrated to give comprehensive insight about doing business in Indonesia, especially listed companies in the stock exchange.

The next chapter will discuss the company's background, its history and the description of baby food industry.

CHAPTER FIVE

THE ORGANISATION OF SARI HUSADA

5.1. Introduction

This chapter will address the reasons behind the choosing of PT Sari Husada Tbk (later be addressed as Sari Husada) as a research site, the history of the company, and the organs and functions within the company which affect the daily operations of the company. It is divided into thirteen subsections, which includes the history of Sari Husada; the transformation of Sari Husada; the production facility; the amulets for success; the leadership of Sari Husada; the management of Sari Husada; the Board of Commissioners; the Board of Directors meeting; the production environment after the crisis; the marketing function; the employee & labour union; the pension fund; and the majority shareholder.

PT Sari Husada Tbk has been chosen as the case study of the research for a number of reasons. First and most important, the company is a public company. Second, Sari Husada outperformed the market average during the Indonesian economic crisis. Most of the Indonesian listed companies booked losses during the crisis while Sari Husada maintained its profit for the same period. Third, Sari Husada is a unique company. This firm has transformed from a joint venture company to a state owned company, and then it became a private company. After building a strong reputation Sari Husada went public, and at last became a multinational company since it was taken over by a European based company. The fourth reason is because Sari Husada is the market leader in its industry, which is nutritious food and beverages for infants, children and adults with a speciality in baby food products. For those reasons Sari Husada is unique and is beneficial to research.

5.2. The History of Sari Husada

PT Sari Husada Tbk was incorporated in Yogyakarta, Indonesia in 1954 under the name of NV Saridele. The company was a cooperative effort between the government of the Republic of Indonesia and the United Nations. The mission of the firm was to assist Indonesia in becoming a self-sufficient producer of protein products by providing cheap and nutritious baby food for lower level income people. The management of this joint venture was given to the Bank Industri Negara (Federal Industry Bank), which was subsequently known as the Bank Pembangunan Indonesia (Indonesian Development Bank). The United Nations through United Nations International Children’s Emergency Funds (UNICEF) provided a loan in the form of machinery for milk processing that had to be repaid by the company in the form of soybean milk. This soybean milk then had to be given to the Ministry of Health of the Republic of Indonesia to be distributed. As a later development, the management of NV Saridele was transferred to Badan Pimpinan Umum (BPU) Farmasi Negara (state pharmaceutical board), which was later known as PT Kimia Farma in April 1961. During this period the name of the company was changed to Perusahaan Negara (state owned company) Sari Husada (Annual Report 2002).

On 8 May 1972 PT Kimia Farma signed a joint venture agreement with PT Tiga Raksa and the company then was called as PT Sari Husada. In 1983 PT Sari Husada was listed on the Jakarta Stock Exchange and as a public company its name became PT Sari Husada Tbk (note: Tbk is abbreviation of: terbuka which means public). When the company went public the shareholding was 20 percent public, 37.5 percent owned by PT TigaRaksa Satria (which was decreased from 45% previously) and the rest of around 42.5 percent remained in PT Kimia Farma's hands (interview with Johnny Widjaja, President Commissioner).

PT Kimia Farma then ended its involvement and sold its stake in PT Sari Husada in 1990 to PT Tiga Raksa Satria, because the Indonesian government as the majority owner decided to focus PT Kimia Farma solely on the pharmaceutical industry. At the end of 1997, because of the national economic crisis that caused PT Tiga Raksa Satria financial difficulties, the firm sold its shares in PT Sari Husada Tbk to Royal Numico NV Holland (also known as Nutricia). Since then PT Sari Husada Tbk has been subsidiary of Royal Numico NV Netherlands. The shareholding composition as at July 2002 was that Nutricia International BV held 80.8466 percent, public shareholders hold 19.1521 percent and Commissioners and Directors hold 0.0013 percent of total outstanding shares (as reported in Sari Husada annual report 2001).

5.3. The Transformation of Sari Husada

At the Annual General Meeting of Shareholders of PT Sari Husada Tbk in May 2002 it was announced that some members of the board of directors had retired. Those directors were Dwiyatno Siswosumarto, President Director, Eddy B. Regar, Marketing Director, and Muhamad Ilham Hidayat, Human Resource Director. Only two Indonesian board members were still in their director's seats, they were Felix P Mulia, Vice President/Finance Director and Setyanto, R&D and Quality Assurance Director (which has moved from the previous position of Production Director). This announcement was very sudden. Even in the annual report of 2001 this change was not mentioned and in the report the list of members of board of commissioners and directors were not mentioned either. Behind this unexpected announcement actually Muhamad Ilham Hidayat the Human Resource Director was the only director who was retired. The other two directors, the president director and marketing director resigned because of undeclared reasons.

Another transformation also took place in the company's vision. As mentioned in its Annual Report Sari Husada has a vision to promote the health and intellectual development of Indonesian children by providing the best nutritious food (Annual Report, 1999). Siswosumarto (known as Pak Dwi), the previous president director, translated the company's vision in his own words as Sari Husada is to 'breastfeed' Indonesian babies. This vision is stuck in the mind of every Sari Husada employee. By working hard in the company the employees contribute to the fulfilment of this vision and this has made every employee of Sari Husada very proud with his/her contribution. When the ownership of the company was changed to the Netherland based company the Sari Husada employees started to question their company's vision. The retirement of most senior board members has added to the employees' confusion. It seems that the staff's pride in contributing to the promotion of the health and intellectual development of Indonesian children has also been questioned.

5.4. The Production Facility

PT Sari Husada Tbk currently has two factories, one in Kusuma Negara Yogyakarta, which is also known as the Yogya office or factory one and one in Kemudo Klaten, Central Java, or factory two. The total production capacity of both Sari Husada factories is 40,000 tons annually. Each factory has its production facilities but only the Kemudo Factory has been equipped with packaging machinery and a storehouse. The Kemudo factory also receives the Yogya factory output to package and store in its facility. The production facilities in both factories operate for 24 hours a day 7 days a week. There are three shifts of operation per day, which are from 7am-3pm, 3-11pm and 11pm-7am.

PT Sari Husada Tbk has a subsidiary that is independently operated. This subsidiary is PT Sugizindo, whose business is to provide a service for the milk powder production process for external parties. Sugizindo was acquired from Tiga Raksa Satria (Sari Husada's previous controlling shareholder) on July 1st, 1995. This acquisition was conducted to increase the production capacity of Sari Husada to meet the growing demand for the company’s products. This decision was made because there were no other choices than the acquisition to increase the production capacity at that time. The Indonesian government has put new investment into the dairy milk industry in the negative investment list (list of prohibited investment into Indonesian regions to protect the existing industries). Sari Husada then, utilised the Sugizindo facility to continue to serve third parties demand for manufacturing their products. Sugizindo clients are Morinaga, Nutricia, MeadJohnson and Wyett.

5.5. The Amulets for Success

The Board of Directors of PT Sari Husada Tbk in the 2002 public expose (an obligatory event arranged by listed company to explain the current development and performance of the company) said that the company has five amulets for its success. Those amulets are a Halal certificate from the Indonesian Council of Ulama or Majelis Ulama Indonesia (MUI), a council where members represent the Islamic community and have power to certify food and beverage that can be consumed by Moslems; the Audit Certificate of occupational safety and health management systems from the Minister of Manpower of the Republic of Indonesia; the food safety system or Hazard Analysis at Control Points (HACCP) certificate; the Certificate of Environmental Management Systems or ISO 14001 certificate and the Certificate of Quality Management systems or ISO 9001 certificate. These last three certificates are issued by SGS International Certification Services Limited. Those amulets guarantee that Sari Husada products are reliable and safe to be consumed by everyone.

5.6. The Leadership of Sari Husada

The changes in the leadership of PT Sari Husada Tbk can be classified into two phases. Those phases are prior to Numico's arrival phase and after Numico's arrival. The first phase was noted with a simple board structure in both the Board of Commissioners (BOC) and the Board of Directors (BOD) (see two-tier tboard structure in chapter two sect 2.6). Prior to the Numico arrival the company had three commissioners sit on the BOC's. Mr Johnny Widjaja and Ir Asikin Suryadhana represented the company's shareholders and Dr. Suad Husnan was an outside commissioner. The Board of Directors was also comprised of three persons, Mr Dwiyatno Siswosumarto as president director, Mr Setyanto as production director and Ms Sri Darumi Irsyad as administrative director (this structure is mentioned in the 1996 Annual Report).

The second phase of leadership change in Sari Husada can be identified after Numico had taken over the firm. At the 1998 Annual General Meeting of Shareholders, after the 1997 takeover, a Sari Husada board was announced. On the Board of Directors old board members were accommodated, although Numico appointed its official to sit as the board's chair. The Board of Directors was comprised of four people, who were Mr Dwiyatno Siswosumarto as President Director, Mr Muhamad Ilham Hidayat as Human Resource Director, Mr Setyanto as Production Director and Mr Felix P. Mulia as Finance Director. The latest name was appointed by the controlling shareholder (Numico) and was brought from another Numico subsidiary PT Nutricia Indonesia Sejahtera (NIS). On the Board of

Commissioners there were two new board members added to the board. Johnny Widjaja, although at that time he represented minority shareholders, was appointed again as President Commissioner. Mr Asikin Suryadhana and Dr Suad Husnan were still serving as commissioners. Numico as majority shareholder assigned two of its officials to join the Board of Commissioners. Peter Kroes, Numico group regional director for Asia, Africa and Latin America was appointed as Vice President Commissioner and J.C.T. van der Wielen was appointed as commissioner. These two boards have basically remained unchanged up to 2002, until the arrival of Mr Eddy Regar as Marketing Director and the resignation of commissioner, Mr Asikin Suryadhana, in 1999.

After this leadership change the executive board continued its policy to produce products at the lowest production costs. The strategic focus was on the volume of sales. Sari Husada products were targeted on middle to low income level people and for most of Indonesian consumers in this category the low price of the product was paramount. In 2001 Numico assigned its Dutch based officials to the Board of Directors. Mr Johannes M (Harry) Klompe was appointed as Business Development Director and Michiel J.A. van der Meer as Project Director (promoted from his previous position as technical advisor). At this stage the previous owner, PT Tiga Raksa Satria, realised that the ownership transfer of Sari Husada had started to affect the company’s culture. Johny Widjaja, PT Tiga Raksa Satria’s owner who sat on the Board of Commissioners of Sari Husada, had tried to restrain drastic changes in the Sari Husada management. The President Commissioner had suggested that the appointment of Dutch officials could be dangerous to Sari Husada's stability because it triggered a rejection from the company's staff.

In response to this reminder Numico considered that the appointment would not affect Sari Husada's stability. As a result of such appointment there were many senior managers of Sari Husada who chose to retire before their term of tenure ended. The retirement of the senior managers was welcomed and Sari Husada appreciated it with a quite generous golden hand shake compensation. This exodus more or less changed Sari Husada's character. The Board of Commissioners and some members of the Board of Directors had been concerned about the leadership changes in the Sari Husada as a result of Numico's expansive policy in Europe and the United States. The board of management was frightened that the new board members would replicate Numico's policy in an expansive way and would change the original core business path of Sari Husada.

The arrival of new Dutch based members on the Board of Directors more or less has made Sari Husada staff a bit confused. Previously the employees only followed a single captain that was Pak Dwi (that's the name Mr Siswosumarto usually uses) the President Director. At that time the orders from the top level management might be in the form of different instructions. The new Numico appointed directors might also request something different from the President Director's desire. This condition made some of the old board members uncomfortable. That was why some board of director members then asked for early retirement. They thought their departure would make it easier for the staff to follow only a single order from the top level executive.

5.7. The Management of Sari Husada

The management team of Sari Husada since it went public, has been in the hands of the production people. The line of business in producing dairy based formula products for infants and toddlers and dairy based food supplements for expecting and nursing mothers fits with the philosophy of the production people. Since the products available in the market were still limited, most of the products offered to consumers were accepted. Mr Dwiyatno Siswosumarto was one example of a production person who's chaired the board of directors. The majority shareholder (PT Tiga Raksa Satria) fully believed and backed the management team's decisions. In one sense the controlling shareholder benefited from the distributing activities of Sari Husada's products, and in another sense it had limited knowledge of producing dairy based formulas.

The challenge arrived when the financial crisis hit the Indonesian companies. Although Sari Husada by the end of 1997 recorded around 75.6 billions rupiah of liabilities (or around 35.3% of total assets), it could affect the company's financial performance since most of the raw material were imported and valued in US dollars. The highly leveraged financial structure of Tiga Raksa Satria, the controlling shareholder, had another influence. To save the holding company Tiga Raksa Satria had to sell its subsidiaries, which were of interest to potential buyers. Sari Husada with its above average financial performance and huge production capacity and market share was one of the subsidiaries. Royal Numico NV, a Dutch dairy milk giant, accepted the offer to come into Sari Husada.

A new management team (board of directors) was appointed at the Sari Husada Annual General Meeting of shareholders in 2002. They were formally introduced to the public at the public expose on 5 September 2002 at the Jakarta Stock Exchange (note: public expose is an event held by a public listed company to present its performance during the current financial year to the public. This event must be held no later than three months after the Annual General Meeting of Shareholders). The new members of the Board of Directors were Soeloeng H. Nasution as President Director, Harry Klompe as Senior Vice President and Marketing Director, Felix P Mulia as Vice President (who also acts as Finance, Human Resource and Information Technology Director), Rahmat Suhappy as Production Director, Setyanto as Research and Development and Quality Assurance Director, Jenny Go as Marketing Director and Michiel J.A. van der Meer as Project Director. All the directors were appointed at the Annual General Meeting except Jenny Go who joined the board two weeks before the public expose. The number of board members had been increased from five to seven. The membership of the Board of Commissioners also changed. Although the number of board members did not change the membership did. The Board of Commissioners members were Johnny Widjaja as President Commissioner, Peter Kroes as Vice President Commissioner, Pim Oomens as Commissioner (substituting for J.C.T. van der Wielen) and Suad

Husnan as Independent Commissioner (previously Commissioner). From the composition of those two boards it can be seen that the Numico headquarters had started to intervene in the decision making process of PT Sari Husada Tbk even deeper than before. The old members of Sari Husada's board, who were originally from inside Sari Husada, included only Setyanto on the Board of Directors and Johnny Widjaja on the Board of Commissioners. There were two independent representatives on those boards who were Soeloeng H Nasution on the Board of Directors and Dr Suad Husnan on Board of Commissioners. The rest of the board members were either Numico people or people with a long time service in the Numico Group or persons recruited by Numico.

5.8. The Board of Commissioners

The Board of Commissioner of Sari Husada has four members. Three members represent the shareholders and there is one independent commissioner. The President Commissioner of the existing board in fact represents minority shareholders. Mr Johny Widjaja is the owner of PT Tiga Raksa Satria the company that owned Sari Husada previously. The majority shareholder, Royal Numico NV, has appointed its officials to the Sari Husada's Board of Commissioners. Mr Peter Kroes, the Vice President Commissioner, is the Numico Group Director for Asia-Africa and Latin America. Another Commissioner is Mr Pim Oomens is a Board member of Numico. The Independent Commissioner, Dr Suad Husnan, comes from an academic background. He is an Associate Professor in Finance at Gadjah Mada

University Yogyakarta. Dr Husnan has already served as a commissioner in Sari Husada since 1992, before being appointed again at the 2002 Annual General Meeting as an Independent Commissioner. This independent status is a result of the Jakarta Stock Exchange's new regulation that requires every public listed company to have independent commissioners equal to at least 30 percent of the total members of its Board of Commissioners. Although Sari Husada did not meet the 30 percent requirement, the company believed that it had already fulfilled the stock exchange regulation, and there was no objection from the stock exchange.

The members of the Board of Commissioners receive reports from the Board of Directors that contain details of operations, finance and other activities. These Board of Directors' reports should be handed to the Board of Commissioners before being reported to Numico's headquarters in Holland. The Board of Commissioners and Board of Directors hold a combined meeting at least every three months. Usually this meeting is held when all Board of Commissioners members are available especially when the Dutch based commissioners are in Indonesia.

5.9. The Board of Directors Meeting

The Board of Directors have a regular monthly meeting and if it is needed it is possible to set up an irregular meeting to discuss the current situation of Sari Husada. There are two forms of Board of Directors meeting, standardised and un-standardised meetings (interview with Rahmat Suhappy, Production Director). The standardised meeting is conducted monthly, which discusses the monthly summary of targeted and actual figures. If the actual figures vary by 10 percent from targeted figures the director responsible for this should explain why the differences have happened. This calculation has been incorporated in a system called EXACT, and it includes performance appraisal for plant and divisional functions. In this system the Board of Directors has set up key performance indicators, which are targeted figures that have been agreed on by all divisions. At the standardised meeting all matters covering all units and functions of the company, persons in charge and actions that have been taken are also evaluated. While in an un-standardised meeting the Board of Directors discusses any other matter that has not been set up in the system or issues related to inter-departments of the firm which need special attention. This kind of meeting can happened any time and the topic discussed in the meeting can cover various matters.

There are indicators of each activity within each unit or function within the company called Key Performance Indicators (KPI).The key performance indicators in practise can be in the form of targeted figures. For example, on the production line there are groups of machinery. Targeted (the management calls them standard) figures for each group of machinery had been set up. Then at the end of the monthly period, the actual numbers can be calculated. Any deviation from the standard figures should be summarised and should be explained and any spare capacity should also be clarified. Any deviation from the targeted figures are expected to have been taken care of by the person in charge and action should also been taken by the manager or lower level staff in charge. From past experience, most of the deviations are caused by the wrong decisions of the manager or the clumsiness of the operators of the machines. If everything is run as expected the director's meeting can decide what action should be taken to handle the spare capacity. The board meeting can anticipate the cyclical demand of company's products and may offer manufacturing services to external parties to produce or package their products to optimise the company's usage of its production facilities.

5.10. The Production Environment after the Crisis

The leadership vision of the company is still focused towards production costs and maintaining quality products, continuous improvements and profitable growth. The business climate began to revive in 1999 despite the slow recovery of the economy, the political stability and the security condition post monetary crisis. The company's decision to invest in new sachet machinery has succeeded to boost the company sales since there is a customer preference for sachet products over canned products (Annual Report 1999). The application of a cost leadership strategy and marketing innovation made the company successful in producing the most affordable infant formula in the country. Combined with the wider and deeper market penetration and maintaining a superior quality of products Sari Husada retained its market dominance.

Sari Husada is highly committed towards the safety aspect of its product and environment since the firm manufactures nutritious food and beverages for infants, children and adults. The implementation of modern management of a product safety system or Hazard Analysis and Critical Control point (HACCP) is one of the firm's efforts. The function of this management system allows for identification, evaluation and control of product safety within the supply chain and production process. This system is to prevent, avoid and eliminate the danger of contamination, microbiology, chemical and other foreign object polluting the product. Furthermore Sari Husada is also committed towards the preservation of the environment by implementing the ISO 14001 system. This environmentally friendly system requires a mandatory work procedure of monitoring and testing potential areas that may impact on the environmental conservation.

In the human resource development area PT Sari Husada focuses and plans to maintain and to enhance the quality of its staff by conducting a number of domestic training programs and providing opportunities for its managers to train abroad. By using the labour market remuneration level as a reference the company was also able to improve the employees' remuneration package. These policies are benefiting PT Sari Husada in improving its excellent industrial relations. Furthermore in the social responsibility area the company provides a number of scholarships to less privileged children and free medication for the community within its neighbourhood. The firm has opened a public health centre called Bethesda Husada to surrounding community and a special health service facility for medical assistance for mothers and children called Panti Husada.

5.11. The Marketing Function

Historically, Sari Husada only conducted production activities. Marketing and distribution activities were done by Tiga Raksa Satria. Since Numico became involved in the management of the company, Sari Husada started to deal with marketing activities, even though it had not been active as a marketing division of other companies. At the beginning of the 70s, when the company was still under Kimia Farma, the distribution function was conducted by Tiga K, a distributor appointed by Kimia Farma. After Tiga Raksa Satria controlled Sari Husada and because its core business was in trading, then Sari Husada ended its relationship with Tiga K. Tiga Raksa Satria developed a subsidiary to become the sole distributor for Sari Husada's products, which was Tiga Husada Ekatama (THE). This Tiga Husada Ekatama that finally became the embryo marketing and distribution division for Sari Husada's products, even though it was still the part of Tiga Raksa Satria. Starting from the first of January 1999, Tiga Husada Ekatama has been excluded from Tiga Raksa Satria and the staff has been recruited by Sari Husada as Marketing and Sales division staff (interview with Anwar Santosa, Internal Auditor).

Based on this historical root, it seems that organisationally the marketing function is separated from the production unit. This separation was continued by Numico, and it also fused its marketing division with Sari Husada's marketing division. These combinations can save marketing cost and Numico also has marketing experts that can be utilised by Sari Husada. Another fact which should be taken into account is the imbalance between production and marketing capabilities.

Sometimes the production division would not produce as much as sales needed, and on the contrary, the production would be in excess of marketing requirements.

5.12. The Employee and Labour Union

Most Sari Husada staff and employees are originally from Yogyakarta, only a few directors and managers are from other cities. Because of this, employees at the production facilities apply the Yogyanese culture in their environment. The Yogyanese tradition, which is rooted from Javanese culture, is evident in the staff behaviour, their loyalty and low profiles (interview with Agung Widyatmoko, Labour Union). Although they practise this tradition they still work professionally.

When Numico took over Sari Husada and expatriates started to be involved in the company new methods have been introduced. Some employees could not adapt to those changes. It is normal that their instinct refused the changes because those changes caused a feeling of discomfort in working conditions. But they finally realised that the new methods were more efficient. They accepted the changes after deciding that the new methods were better than the old ones. They realised that with the new system, they could do their daily activities better and easier.

Sari Husada employees do not mind who owns the company and who is appointed as director. To them what is important is that the owner and manager have objectives to maintain and develop the company to a brighter future. Their attention is more focussed on job security in the company. They believe that key foundation of Sari Husada production facilities is in the middle to bottom level employees' hands.

Those staff have known each other for such long time. They have built honesty and trust among them. Management change would not affect them as long as the company retains plant managers down to bottom staff level.

Sari Husada has one labour union named Perkasa (abbreviation of Persatuan Karyawan Sari Husada or Sari Husada Labour Union). Membership of Perkasa is open to all employees, only the directors are excluded. Most of its members are production people in Yogyakarta and Klaten. All activities in Perkasa are free from the involvement of the company's management and represent all of the employees' needs. Perkasa is to fight for equitable rewards for employees' effort. A career path for the employees is also sought by the labour union. The opportunity for existing employees to be promoted to higher positions is the focus of its effort. For example, as long as a position can be filled by inside people, the company does not need to recruit outsiders.

Staff up to manager level have equal opportunity to sit on the board of Perkasa. The Perkasa Chairman must be held by a person from lower than manager level, where hopefully the person is free from direct management's influence and is closer to lower level employees.

With regard to the industrial relation agreement, Perkasa's duty is to accommodate employees' aspirations. Perkasa also has role as a mediator between employees and the company when conflicts arise. Perkasa and Sari Husada management jointly sat and decided on the renewal of the industrial relation agreement within the company. That agreement is to be used as a reference if any disputes emerged. In the case when the problem is in a grey area, Perkasa will represent employees to make decision together with company's representatives. The industrial relation agreement between employees and the company is to be evaluated every two years.

The Perkasa committee consists of eight people. This committee is responsible for the daily operation of the labour union. Perkasa also has other units, such as a Kebora (kebudayaan dan olah raga, or culture and sports activities) unit, a religious unit, an educational unit, and a cadre and regeneration unit. The Perkasa committee holds its general meeting once in every three years. The committee members are elected at this general meeting. This meeting is run democratically and is free from management's intervention.

5.13. The Pension Fund

Sari Husada has a separate company which manages its pension fund. This pension fund is named Dana Purna Karya (DPK). DPK follows the Pension Fund regulation of Indonesia to provide a pension program with defined benefits to its members. To be included in this pension program a 5 percent contribution is deducted from each member's salary. Sari Husada adds another amount equal to 10 percent of an employee's salary. This total amount of 15 percent of employee's salary is managed by the pension fund.

An employee who retires from the company will receive a benefit of 2.5 percent of the last salary times the length of working period within the company. All employees have been members of pension fund program since 2002, with the exclusion of directors. The pension fund has a limitation on its capacity to pay directors pensions.

The pension fund has its own management, usually appointed from the middle manager levels of Sari Husada. This management is monitored by a controlling board, which is consists of directors and a retired director. The management may manage its fund using any kind of investment activity which is aligned with the Indonesian Pension Fund Investment rules released by the Ministry of Finance. It can invest its funds in time deposits, securities, bonds or shares. DPK is also registered as member of the Indonesian Pension Fund Association and has been since 1998.

The DPK pension fund also has a business unit to sub-contract several working activities in the company. Some jobs which are not directly related to Sari Husada's main activity such as security guards, cleaning service, packing and material transportation are subcontracted to DPK. The idea of establishing this business unit of DPK was actually to give opportunity for employees who were affected by the redundancy program prior to Numico's takeover. That termination of work was imposed on employees who worked at divisions and units which supported the main company activities. Those terminated workers then joined with DPK to continue to work at the same place at Sari Husada. The difference was they are no longer Sari Husada employees. From the financial point of view, those workers were happier. They would receive more or less the same amount of income and got a golden hand-shake compensation accumulated with their pension fund. DPK also does direct selling of Sari Husada products to areas which are not covered by the main distributor (interview with Anwar Santosa, Internal Auditor).

5.14. The Majority Shareholder

This section discusses the condition of Sari Husada when Numico entered into the company, its effect and the development of the Numico strategy as the parent company.

5.14.1. The Entry of Numico

At the end of 1997 when Sari Husada faced financial difficulties a Dutch company was approached. Nutricia International B.V. Holland (later known as Royal Numico N.V. after merging with Milupa – Germany, and Cow and Gate – United Kingdom), one of the world leaders in infant milk formula production, was interested in buying a significant interest in Sari Husada shares. In early 1998 Numico's first involvement in Sari Husada began when it bought 45 percent of the total shares from Tiga Raksa Satria. At that time Sari Husada was unable to move forward because of various burdens. The most substantial hurdles were that the company's profits became consumed by servicing debt and new credit on viable terms was very hard to obtain. Numico injected a substantial amount of funds to abolish Sari Husada's debt as well as taking on 80 percent of Sari Husada capital spending program for the new factory. "(W)ithout this, we would have had to seek new loans, which had very high interest rates.” (interview with Dwiyatno Siswosumarto). The new investment has been to boost Sari Husada, the leading player in its sector with a 60 percent market share in infant milk formula sales, from an entirely domestic-oriented business to an exporter with regional and international orientation. Dwiyatno said, ”(w)e have been making preparation towards the global market but we lacked the experience and expertise to expand globally.” Numico involvement has accelerated the process by providing management expertise, new technology and enhanced financial credibility. By late 1998 Sari Husada had begun to export its infant milk formula to Iran and seriously exploring the Gulf, Middle East and Asian markets. Under Numico’s guidance Sari Husada’s management also kept its eyes on developments in the local market. The firm was to keep its products accessible to Indonesian people during the crisis. Sari Husada took social responsibility seriously by offering cheap products in smaller packages and giving donations to poor people.

5.14.2. The Development of Numico Strategy

Since it expanded Numico has faced financial difficulties. The acquisition of baby formula producers around the world combined with an unsuccessful acquisition of food supplement chains in the US forced Numico to change its strategy. New management has been brought on to the Board of Directors. The appointment of Jan Bennink as President and Chief Executive Officer at the beginning of 2002 has marked a change in Numico’s strategy. The companies acquired by the expansive acquisition which did not perform were to be sold. Numico has defined its new strategy to focus on its strong points.

Numico then defined its-self as “a high-growth, high-margin, specialised nutrition company” (Numico Annual Report 2004). It specialises its products in nutrition for babies, sick and elderly people. It is targeted as the European market leader in baby food for the age range of 0 – 3 years. Numico also aims to be leader in general malnutrition, disease-specific and dietetic nutrition in Europe and internationally. It continues to divest subsidiaries which can not meet the vision. The unsuccessful subsidiaries in South Africa, Brazil and China have been divested. The adoption of corporate governance standard into the firm also has been implemented. Some new strategies have been introduced. Numico wanted to capitalise on the strength of the people, processes and brands. It would put its effort in strong business stewardship, innovation management and continue to streamline its operations (Numico Annual Report 2004, p. 7).

From then Numico has just two core businesses, which are baby food and clinical nutrition. Sari Husada with its core business in infant formula milk products was not affected by the Numico decision in 2003 to go back to their core businesses. Even more, Numico labelled Sari Husada as the centre of its growth to strengthen market share in Indonesia through the SGM brand, while another subsidiary Nutricia Indonesia Sejahtera focuses on premium products (Numico Annual Report 2004, p. 20). Although another Numico strategy is to bring its formula closer to breast milk, it follows the International Code of Marketing as guiding principle marketing effort that “breast is best”.

5.15. Conclusion

This chapter has described the history of Sari Husada as well as its organs and functions. Each ection illustrates the condition within Sari Husada prior to or after Asian economic crisis. What changes happened within the organs is comprehensively illustrated. Those descriptions are to be used as based of analysis for the next chapters.

The next chapters will discuss the analysis of corporate governance practise, the changing of corporate culture and the strategic management of Sari Husada.

CHAPTER SIX

THE CORPORATE GOVERNANCE SYSTEM

OF SARI HUSADA

6.1. Introduction

Corporate governance can be defined as the relationship between shareholders, directors and management, the corporate governance tripod, as Monks and Minow (1995) call it. However, in the development of the corporate governance area, the boundary of corporate governance includes other stakeholders (Tricker, 1994). According to Tricker, corporate governance addresses issues faced by boards of directors in interacting with the management of a company and its relationship with the owners and other parties related to the company's activity, including creditors, fund providers, analysts, auditors and regulators.

The issues relating to corporate governance are mostly derived from two questions; (1) who benefits from corporate decisions, and (2) who should benefit from management actions. Most of the discussions on corporate governance tries to answer those questions. Above all, corporate governance is not an end in itself, but it is a means of achieving corporate objectives and strategy. To include all stakeholders' interests in a company, the discussion should begin with the corporate governance system and variables that affect a company's practise. This chapter will analyse the corporate governance variables that are reflected in the corporate practises in the studied company from the Indonesian business environment's view point.

6.2. The Corporate Governance Model

The studies of corporate governance around the world mostly assume that there are two separate governance models. The first model is the Anglo-Saxon /stockholder/ outside model of corporate governance and the other is Rhineland (Continental)/ stakeholder/insider model. The first model is based on free market operation, where the enterprise is an instrument for achieving shareholder wealth. It is characterised by a greater mobility of capital in the market and widespread shareholding in firms. The other model explains that the role of a company is beyond the maximisation of shareholder wealth and it pays a better attention to other stakeholders. Shareholders in this model are parties who hold their shares for a longer-term than the Anglo-Saxon model. The insider model is based on concentrated shareholding and also in this model, the contribution of institutional investors is relatively limited (see Weimer & Pape (1996); Nederlands Christelijk Werkgeversverbond (1997); Van Hulle (1996) and (1997); Franks & Mayer (1992); and Van den Berghe and De Ridder (1999)).

There are numerous variables that differentiate corporate governance systems around the world. Among the corporate governance studies, the Van den Berghe and De Ridder study gives detailed factors that determine a specific corporate governance system. Van den Berghe and De Ridder (1999) state that there are fourteen (14) relevant factors that determine a specific corporate governance system. In this case study, those factors will be elaborated on a case by case basis. Those relevant factors will be used to analyse the corporate governance system in Indonesia.

6.3. Enterprise

Van den Berghe and De Ridder (1999) try to clarify whether: (1) an enterprise is a means to service the shareholders, where the main goal is to maximise shareholder wealth; or (2) it emphasises more within the enterprise itself with a specific view to balance the contending sub-interests. In between those two poles a company can choose either to satisfy shareholders' interests or to meet the other stakeholders' interests. PT Sari Husada Tbk stands in between both poles. The company, as a subsidiary of Royal Numico N.V. Holland, attempts to satisfy the controlling shareholder, while considering other interests, such as its management, employees, community and the company itself. This process is reflected within the daily operations of the company where the appointment of management, and the accounting and operation system (namely EXACT, the computer accounting system required by Royal Numico) are strongly identified as being a requirement of the major shareholder. The EXACT system itself is used and requires monthly activity reports which are required to be submitted to headquarters in the Netherlands. From another angle, the headquarters provides an opportunity to the company to choose its chairman of the board of commissioners, who represents the minority and former controlling shareholder, and the president director, whose nomination and appointment is based on the minority shareholder’s proposal. These are representations of the balanced accommodation of different interests within the company. However, when the independent director and commissioner, who have no ties to the controlling shareholder, suggested that it would be better for Sari Husada to be managed independently, the headquarters were willing to withdraw its Holland officials from the management team and to replace them with local executives.

6.4. Free Market

Does the market operate freely and does the government take regulatory and market disciplinary actions? The Indonesian stock market operates without intervention from any party, including the government. The stock price fluctuates on the basis of supply and demand for the shares on the market and some external conditions which affect the market, such as economic and political issues. The Capital Market Regulator or Badan Pengawas Pasar Modal (Bapepam), the agency developed by the Indonesian government, issues regulations related to the activity of Indonesian capital markets. Consequently, all market players, including stock market operators, investors, brokers and issuer companies, have to comply with those regulations with no exception.

There is also a National Committee on Corporate Governance (NCCG) in the Indonesian capital market environment. This committee acts as a self-regulatory agency, it issues the Indonesian Code of Conduct, a set of guidelines which should be complied with by companies, especially public listed companies. In this set of circumstances, the market activities are left to the market players, and the Bapepam only makes sanctions against the players which do not comply with the regulations.

The management of Sari Husada feel that the company can choose appropriate actions within the corridor of the regulations of the stock exchange. In the application of the regulation that require companies to have an audit committee, Sari Husada gave a deep consideration to whether it should follow this regulation and bear additional salary expenses or decide to omit the rule since its internal audit team was already independent from executive intervention within the company's structure. In appointing independent commissioners, Sari Husada is of the opinion that it is enough to have one independent commissioner, although that only represents 25 percent of the total commissioners, rather than adding another commissioner to fulfil the minimum regulation requirement of 30 percent independent commissioners out of the total board members. Those governance decisions, according to Mr Anwar Santosa, the assistant corporate secretary, were taken after weighing all costs and benefits. Mr Santosa said: "(t)he Internal auditor's job has already covered the audit committee function… In some cases an outside auditor will be difficult to cover significant findings (because employees are reluctant to give detailed information) … We are not only burden with the additional expenses (of establishing the audit committee), but there will be a duplication of tasks. We also need to spend our time to find persons who are fit to appoint to audit committee positions". Mr Santosa added: "(a)lso the regulation that requires a minimum number of independent commissioners of 30 percent of total commissioners, I suggest (to President Director) that we do not need to add another independent commissioner, so our independent commissioners will be 2 out of 5 commissioners. It will be easier and save (salary) expenses if we only have 3 commissioners in our board" (interview with Mr Anwar Santosa, 2002). Because the Jakarta Stock Exchange and the Capital Market Supervisory Agency had yet to impose a penalty on companies which failed to comply with the regulation on independent commissioners, Sari Husada chose to keep its board of commissioners composition as it had before.

6.5. Governance Structure

The governance structure mostly takes the form of a one tier board or a two tier board. In the one tier countries, i.e. UK and US, companies only have a single board of directors. This board consists of inside (senior management) directors and outside (independent) directors. The chairman of the board can be either Chief Executive Officer or another appointed (outside) director. On the contrary, in the two tier board countries, i.e. Germany and Japan, companies have two separate boards. One is a board of directors that runs the daily operations of the company and the other is a supervisory board that monitors the board of director's functions.

The Indonesian governance structure uses a two tier board, where the management board is called the board of directors and the supervisory board is called the board of commissioners (Company Law No 1, 1995). In this two tier governance structure, the day to day operation of the company is in the hands of management. The supervisory board monitors and gives suggestions when they are needed by the management board. The commissioners only intervene when the decisions of management are related to the bigger interests, such as investment decisions or discontinuation of a line of business. The nomination of a member of the board of directors is usually discussed at the supervisory board level, and the appointment officially starts right after it is decided by the general meeting of shareholders.

The two tier board in Sari Husada represents the most influential party of shareholders. The board of commissioners consists of four members, two members are representatives of the majority shareholder (Numico), one member who is also chairman of the board represents minority shareholders and one of the independent commissioners is appointed by minority shareholders. The board of directors consists of five members. They are the President Director, who is also corporate secretary and is a mature professional executive; the Vice President Director and Production Director who represent the majority shareholder; the Quality Assurance and R&D Director is the reappointed member of the old team; and the Marketing Director is a professional from the same industry. The management team of Sari Husada holds the power to run the business without any intervention from any party. The suggestions from the board of commissioners and the controlling shareholder are taken when these suggestions are considered beneficial to the company's interest.

6.6. Independent Directors

The independent directors, who usually are outsiders and are not actively involved with the daily operation of the company, are represented on the board of commissioners. This supervisory board usually has a representation of major shareholders, minority shareholders, and also professionals or academicians who are invited to sit on the board. The capital market regulations have a rule that public listed companies appoint at least 30 percent of their commissioners from outside commissioners. It means that these independent commissioners should not be related to the management and also the appointment should be free from major shareholder intervention.

Dr Suad Husnan, Sari Husada's independent commissioner, has an academic background and a PhD degree in the finance area. He contributed to the company's decision to acquire Sugizindo in 1994. Sugizindo is a company which has a production facility in the same industry. He also made a contribution through hedging decisions during the imported materials prices fluctuation in 1998. Like other Indonesian supervisory boards, the Sari Husada board of commissioner has no member representing employees.

6.7. Shareholding Structure

The shareholding structure covers several factors such as type of shareholders, level of concentration of shareholding and the extent of involvement of the shareholders in the company's activities. The shareholding of Sari Husada can be broken down into around 84.5 percent of shares held by foreign institution and investors, and about 15.5 percent of shares held by Indonesian institutions and investors (Sari Husada Quarterly Report, September 2003). Among the foreign owners, the Numico group (Nutricia International BV) has an interest of 80.85 percent of Sari Husada shares. Indonesian institutions hold 10.44 percent and Indonesian public shareholders hold 5 percent of the company’s shares. The domination of Numico’s interest as the controlling shareholder is translated into the implementation of Numico headquarter’s policy through the financial and reporting system. Sari Husada as the subsidiary is required to submit monthly reports to the Numico head office and explain every item of actual-targeted budget differences. These conditions, although beneficial to Sari Husada in having such a sophisticated financial and reporting system, can be viewed as a disadvantage by the minority shareholders, became the minority shareholders only get the financial report on an annual basis within the general meeting of shareholders.

6.8. Cross-Shareholding

Cross shareholding often exists in some listed companies in Indonesia, especially within companies that are conglomerates. Although cross-shareholding does not exist in Sari Husada, the controlling shareholder has the privilege to appoint its officials to sit on the board of directors and board of commissioners as well. On the management board, two out of five directors are appointed officials by Numico. Mr Felix Purwadi Mulia (the Vice President Director) and Mr Rachmat Suhappy (the Production Director) have previously served as directors in other Numico’s subsidiaries. On the board of commissioners Numico appointed two of its senior officials to sit as members. Those commissioners are Peter Kroes (the Group Director for Asia, Africa and America) and Wilhelmus Henricus Oomens (former Chief Financial Officer). This strong composition of board members, accompanied with the monthly financial and production reports to the head office, leads to the full monitoring of Sari Husada by Numico.

6.9. Intra-Group Relations

The standard of financial and production reporting imposed by Numico gives a strong indication of the control and monitoring effect of headquarters policies. Similar to Sari Husada, Numico has another direct subsidiary, called Nutricia Indonesia Sejahtera (NIS), and one indirect subsidiary, called Sugizindo, which is wholly owned by Sari Husada. All of these companies are involved in the same industry, i.e. baby food manufacturing. Although it seems that the three Numico subsidiaries might fight for the same market, from the beginning there has been clear differentiation among them. Sari Husada as the Indonesian market leader of baby food products produces its own brands, while Nutricia Indonesia Sejahtera produces licensed brands under Numico's flag and Sugizindo concentrates on delivering the service of production activity to other companies. Sari Husada concentrates its market on low to middle income households, whereas NIS consumers are upper level households. Because of this segmentation, both Sari Husada and NIS have no direct competition against one another. It is also expected that both companies could reduce expenses by joining forces in marketing their products.

6.10. Financial Structure

Sari Husada has a solid financial structure. The company managed to book profits during the year of economic crisis (see appendix). After experiencing the shock of the financial crisis, as a result of moderately high debt in 1997, the company's management developed a strong policy in finance to erase debt from its balance sheet (Sari Husada Annual Report, 1998). With total assets amounting to 1.03 trillion rupiahs, Sari Husada broke the one trillion assets level in 2003 (Sari Husada Quarterly Report, September 2003). As well, the company retained liquidity by holding current assets amounting to more than 760 billion rupiah. The proportion of equity to total assets reached more than 90 percent and indicates that the company has been successful in accumulating its profits into investments. The portions of less significant liabilities are mostly in the form of trade payables, tax payables and accrued expenses. With this strong financial structure, the outstanding shares are in mostly stable hands. The active market for the company's shares seems non existent. Only a small fraction of shares are traded on the stock exchange.

6.11. Pension Funding

The role of institutional shareholders in financing the company is relatively limited. There was a tendency for a decreasing proportion of institutional shareholding in Sari Husada. However, it can be seen from Sari Husada's quarterly report of September 2003 that this proportion had declined by around 1.6 percent of total shareholding from more than 15.7 percent in 2002 to around 14.1 percent in

2003. The Indonesian institutional investors' interests also decreased by 1.9 percent of total shareholding from 12.3 percent in 2002 to 10.4 percent in 2003. Despite this condition, the foreign institutional investors' interest relatively increased from 3.4 percent to 3.7 percent of total outstanding shares. It is not revealed the proportion held by the pension fund in the institutional holding. The company's secretary does not have a record of the type of investors who hold the company's shares. The Security Administration Agency or Biro Administrasi Efek (BAE) does not supply detailed information on shareholder classification to the listed companies on the Jakarta Stock Exchange. It is hard to comment on the accessibility of pension funding as a source of finance to the company.

6.12. Anti-Takeover Mechanisms

Most of the shareholders of Indonesian listed companies are the family/founders of the companies and conglomerates/holding companies. Institutional investors and public (individual) shareholders only hold a relatively small portion of outstanding shares. The majority shareholders mostly appoint the members of the family or group officials to serve as directors or commissioners in those listed companies. Some state owned enterprises (SOEs) and some restructured firms, which the Indonesian government has an interest in as a result of government restructuring programs, are managed by government officials or executives who are appointed by the government. As a result , the controlling shareholders are able to monitor day to day operation of the companies, and most of the companies' executives actions would be under the microscope of the majority shareholders. This situation means that hostile takeovers do not exist on the Indonesian stock exchange. At the same time, the market for corporate control is also in a vacuum since the actively traded shares on the stock exchange only amount to a fraction of the total outstanding shares of the listed companies.

As the controlling shareholder with more than an 80 percent interest and its officials appointed to serve on the board of commissioners and board of directors, Numico has the ability to monitor every Sari Husada action. Numico's interest will not be affected by any transfer of ownership of the company's shares traded in the stock market.

6.13. Transparency

The Capital Market Supervisory Board (Bapepam), as the market regulator, has issued the disclosure regulations for annual reports of listed companies. This regulation actually has already introduced a quite similar level of disclosure, which is required by major stock exchanges in the world. The Jakarta Stock Exchange Committee or Bursa Efek Jakarta (BEJ) with the collaboration of the Asian Development Bank (ADB) has introduced an Annual Report Award program for listed companies which comply with the disclosure regulation. Every year the Jakarta Stock Exchange announces the three best annual reports of listed companies and gives rewards to them consecutively. Unfortunately, this Annual Report Award program is only responded to by a small portion of the listed companies since this program is on a voluntary basis. Most of listed companies on the Jakarta Stock Exchange refuse to enter the program since they think that their annual reports will not meet the requirements and will not compete with ones that have been submitted. Moreover most of the listed companies do not see that such disclosure of their annual reports will be beneficial to them. They think the more their level of disclosure the easier the competitors can see their secrets. The stock market regulator seems to let this unfortunate circumstance happen repeatedly. The market authority does not act to penalise the listed companies that do not comply with disclosure regulations.

Sari Husada knows that its annual report does not satisfy all parties, although the company has tried to comply with the disclosure regulation. Detailed information is only given to shareholders during the general meeting of shareholders or when it is required by the shareholders. The company also refuses to enter the annual report award program, because it thinks that there is no point in entering the program and its report will be eliminated during the contest. As Mr Anwar Santosa says, "(t)he company decided not to enter in the annual report award this year (2002) because we realise that our 2001 Annual Report contains less information and has many disadvantages" (interview with Anwar Santosa). From interviews with Sari Husada management it can be summarised that the firm's decision is to give adequate information for any user of the annual report and to achieve stability and avoid any negative impact from overstating unnecessary information to stakeholders.

6.14. Stakeholders' Influence

Although most of the Indonesian listed companies' shares are held in the hands of the founders' family and conglomerates, the rest of the stakeholders still can play some role in determining companies' futures. Those stakeholders are considered to be minority shareholders, employees, banks and capital providers, government/regulators, non-governmental organisations and customers. Minority shareholders can play their role in the companies by the appointment of independent commissioners that representing those shareholders' interests. These independent commissioners will represent minority interests in the board of commissioners meeting with the executive board. Employees from the lower level up to senior managers are supposed to serve the best interest of the company. If they think that the strategic decision made by board of directors will not be beneficial for the interest of the company, they can resign or protest about the policy through the union channel. The government and capital market regulator can introduce regulations that are favourable for all stakeholders of the company and give penalties for those that do not comply with the regulations. Non-governmental organisations (NGOs) that are concerned with corporate governance issues have emerged in the last few years. These NGOs play roles as pressure groups for regulators and companies to set corporate governance regulations and comply with those regulations respectively. Customers and banks and financial providers, although, they can not participate much in requiring a good corporate governance practise by the company, they actually can still participate by avoiding the company's products and refusing future debt arrangements for companies which do not intend to practise good governance. This condition applies to most of the listed companies on the Jakarta Stock Exchange, including Sari Husada.

6.15. Labour Market

The high level of unemployment in the country directly impacts a company's employee recruitment and selection process. A company can choose widely the employee candidates who are the most beneficial for its interests. There are unemployed skilled workers available in the labour market. The current employees are in a weak position since they can be easily removed from their jobs and replaced with new workers when they make mistakes or if they are not needed by the employer. Although Indonesia has the Ministry of Man Power with the duty to protect and assist employees if they are in conflict with the employers, in fact the enforcement is still weak and the labour forces are in a disadvantaged position. The Labour Relation Law (i.e. Law No 3 year 2003), that regulates social insurance for the labour force already exists, but in practise many Indonesian companies neglect this regulation by not providing insurance for their employees. Because of global competition and the lowering of the manufacturing cost, employers often limit the salary for their employees, even under the regional minimum wages or upah minimum regional (UMR). This minimum wage is the lowest limit which an employer should pay to its employees and is set by regional governments based on the minimum living costs in the region. Many labour unions have struck to protest the current situation, but the employers or even the government officers seem to ignore it. The high unemployment rate is often used as a reason to justify this low payment. Only in a small number of companies do employers serve their duty of care to their employees by paying above the regional minimum wages.

Sari Husada has a policy to raise the employees' salary to above the national average salary level. As Nunung L. Puspitasari (Sari Husada Human Resource Development Manager) said "(w)e always benchmark our salary rate to the national salary level in the same industry, based on research conducted by an independent survey institution. We gave above average salary to our employees." (interview with Nunung L Puspitasari). This is the most important factor in retaining current employees and to attract future employees. Supported by the familiar working atmosphere, the staff feels comfortable and happy to work with the company. Moreover for employees who work in the Yogyakarta factory area, the small city life is really enjoyable and makes life easy. The company even promises a generous bonus and other rewards when the employees succeed in increasing their performance and contribute to the overall performance of the firm.

6.16. Disciplinary Mechanism

A mechanism for disciplining senior managers to pursue the maximum interest of the shareholders seems to be non existent. Most members of the board of directors represent their own stake in the company or they have close relations with the shareholders. The appointment of management in the general meeting of shareholders is like a rubber stamp of the major shareholders' decision. The situation may be different in some companies where the appointment of directors is based on professionalism. In those companies a disciplinary mechanism usually takes place in the form of remuneration linked to the companies' performance. The directors in these companies should be aware that their performance is the key evaluation factor to lengthen or dismiss their professional contract. This situation affects the labour market for professional managers and only exists for modern local companies and multinational firms.

Sari Husada is in the same situation as most of the Indonesian listed companies where most senior managers are appointed by the majority shareholders and shadowed by the controlling shareholders' interests. Together with the coming of more professional managers who have joined the firm in the last few years, the view points of managers and staff have changed. They are not a kind of puppet that follows the shareholders' will anymore. Now they are free to express their intentions, even to move to another company when they feel that the current company can not satisfy their personal needs. There is always a professional labour market for qualified managers and staff.

6.17. Conclusion

The discussion of corporate governance was related to the party/parties that actually are and should be served by a company. Serving the maximisation of shareholder wealth, as Anglo-Saxon/shareholders/outsider model is at one pole, while giving more importance in serving other stakeholders is at the other pole. The practise of corporate governance across the world can differ between those two poles.

In the case of Indonesia, although the corporate governance structure is two-tier boards and the companies' shares are concentrated in the hands of limited parties, in practise most Indonesian companies focus their effort in maximising the shareholders' interests. Sari Husada has moved toward putting its attention more on the stakeholders of the company. Step by step the senior management team has succeeded in directing changes in governance practise toward an ideal condition for Indonesian companies. Although the process is far from finished, at least the major shareholders and other stakeholders are happy to accept the changes.

After analysing the corporate governance system of Sari Husada, the next chapter will discuss the changing corporate culture at the subject company.

CHAPTER SEVEN

THE CHANGING OF THE CORPORATE CULTURE AT SARI HUSADA

7.1. Introduction

A company's real existence lays in the hearts and minds of its employees, because a business is a human institution (Deal and Kennedy, 1982). Bower (1966) provides a loose description of corporate culture as "the way we do things around here." The pattern of employees' behaviour and their work environment will influence the success of a company.

This chapter aims to describe some issues related to the organisational culture at Sari Husada, within the period of pre- and post-Numico's acquisition. To do so, the chapter will describe the definition of culture, organisational culture, changing organisational culture and finally, the changing of corporate culture that has happened at Sari Husada.

7.2. Definition of Culture and Organisational Culture

The concept of culture was introduced in 19th century from the fields of anthropology, sociology and psychology. The first definition of culture, which is commonly quoted, came from Tylor (1871) who said: "(c)ulture, or civilization, … is that complex whole which includes knowledge, belief, art, law, morals, custom, and other capabilities and habits acquired by man as a member of society" (quoted in Kroeber and Kluckhohn, 1952, p. 81). The view of culture in social science borrows a concept from sociology called symbolic interactionism. This concept states that human reality is socially constructed. It means that everything around a human being, like other human beings, institutions, physical objects, events, etc., according to Blumer (1972), "(i)s derived from, or arises out of, the social interaction that one has with one's fellow". Dollard (1939) also states that "(c)ulture is the name given to the abstracted inter-correlated customs of a social group." (quoted in Kroeber and Kluckhohn, 1952, p. 118). The discipline of sociology acknowledges the concept of culture as having a focus on human behaviour, development of learning theory, and the ideas of mutual influence between individuals and their environment. Mead (1937), as quoted in Kroeber and Kluckhohn (1952, p. 90), suggests that "(c)ulture means the whole complex of traditional behaviour which has been developed by the human race and is successively learned by each generation".

The concept of culture has also been applied in the organisational setting. Van Maanen and Brealy (1985, p.31) mention that "(t)he notion that organisations have cultures is an interactive heuristic proposition, especially when explanations derived from individual-based psychology or structural sociology prove limiting." The concept of organisational culture emerged when Schein (1991, p. 9) defined culture as "(a) pattern of basic assumption – invented, discovered, or developed by a given group as it learns to cope with its problems of external adaptation and internal integration – that has worked well enough to be considered valid, and therefore, to be taught to new members as the correct way to perceive, think, and feel in relation to those problems.” Other researchers, Deal and Kennedy (1982), use the term corporate culture when describing various elements that form organisational culture. They believed that values, business environment, heroes, rites and rituals, and organisational communication determine corporate culture. Bower (1966) simplified the definition corporate culture using another words such as: “the way we do things around here”. Dearstone (1989, p. 15) in his research adds that “(t)his definition implies that culture is the observable behaviour of organisational members, reflecting their deeply held values.” Tichy (1983) also sees that value is the essence of culture. Tichy (1983, p. 7) mentions that “(c)ultural systems of values with shared symbols and shared cognitive schemes tie people together and form a common organisational culture.”

Other scholars, like Burke (1982); Baker (1980); French and Bell (1978); Bennis and Nannus (1985), and Siehl (1985) also believe that culture consist of many elements. Burke (1982) gave more emphasis on norms in defining culture. He considered that norms are standards or rules of conduct that every member of organisation should comply with. Baker (1980, p. 8) has another view, that organisational culture is “(t)he underlying set of informal norms and values that govern employee behaviour”. He also mentioned that culture is “(s)ome interrelated set of beliefs, shared by most members, about how people should behave at work and what tasks and goals are important.” (p.8). French and Bell (1978) mention culture, not only in terms of values and norms, but including feelings, informal action and interaction. While, Bennis and Nanus (1985) defined social architecture as norms and values that form behaviour in any organisational setting. They specifically used the term social architecture to replace culture. They also mention that this social architecture has a number of elements, such as: the organisational basic operating principle, the nature of work, decision making, power, influence and status. Siehl (1985), another scholar in the same stand, says that culture is values and beliefs that most of members of an organisation appear to share. This culture is shared through language, organisational stories, rituals, ceremonies, and organisational practises, like recruitment, training and reward systems. Trying to sum up the definition of culture, Boyle (1985, p. 180) in his writing said that culture is “(t)he system of values, beliefs, myths, tools, and practises through which we respond to our environment.” In other words he suggests that what is permitted and what is prohibited to organisation members is culture.

In a comprehensive explanation of culture, Schein (1985) states the definition of organisational culture as: “1) the rules of the game for getting along in the organisation, the “ropes” that a new member must learn in order to become accepted in the organisation, 2) the beliefs and attitudes of employees and/or customers, as reflected in organisational policies, 3) the dominant values held by an organisation, such as product quality or price leadership, 4) the norms that represent the members of a group or of the organisation, 5) behaviours observed when people interact, including the language and rituals used, and 6) the climate that is experienced within an organisation by members which includes such factors as the physical layout and the interactions between organisational members and between members and customers or other outsiders" (quoted in Dearstone, 1989, p. 17).

In a wider view point, some researchers argue that culture is not what an organisation has, but what an organisation is (see Siehl (1985), Weick (1983), and Fombrun (1986)). Siehl suggests that culture is what organisation is, not what it posses. This statement is supported by Weick. He argues that "(o)rganisations don't have cultures, they are cultures, and this is why culture is so difficult to change." (quoted in Siehl, 1985, p.125). Another scholar supports the argument, Fombrun (1986) states that culture is not something that managers manage but something that organisational members create on their own. He does not believe that culture is something to be manipulated by managers, for example, to make employees to work more efficiently and produce more products. An organisation can only change itself if all members of the organisation change. A real culture change can only happen from the bottom-up. Other researchers, Schein (1985) and Dyer (1984) believe that there are layered views of culture, which are artefacts, values and basic assumptions. These layered views of culture are something that are shared by members of an organisation, worked unconsciously and identified as a rule of thumb of an organisation's view about itself and its environment. Dyer (1984, p. 154) specifies another layer of culture that is perspective. He defines perspective as the "(s)ocially shared ideas and actions used by members of an organisation to deal with problematic situations."

To sum up the discussion above, it is commonly said that culture is the values and beliefs held by an organisation. It is reflected in organisational rules of conduct, rites and policies, practises, stories, languages, and behaviour of organisational members.

7.3. Changes in Organisational Culture

Some managers try to change the culture of an organisation to improve their organisational effectiveness and efficiency. They believe that the understanding of organisational culture, which is focusing on the organisational values, norms and beliefs, is one of the important factors in relation to their organisational success. There are some ways that culture can be changed. Some researchers suggest that there are three levels of change that can be applied in the organisation. These three levels are: 1) change directed at a particular unit or subsystem, 2) change directed at a system or set of subsystems removed from the initial target, and 3) change directed at the entire organisational processes (see Siehl (1095), Golembiewski (1979) and Kimberly and Nielsen (1975)).

On the contrary, many researchers believe that culture is impossible or difficult to change. They view culture as what an organisation is. Siehl (1985) and Schein (1985), among those researchers believe that the true culture of an organisation is hard to change. The change can only happen in some of the organisation’s behaviours, values and assumptions. These changes may take place without the real underlying assumptions of the organisation changing.

Although the discussion about the changing of culture is yet to finalise, many researchers argue that the culture itself develops and evolves. Sathe (1985, p. 14) states that "(c)ulture is subject to development and change because of the learning going on in the organisation as it copes with its problems as external adaptation and internal integration." He adds that the change itself is incremental and evolutionary rather than radical and revolutionary. The change in an organisation's culture is needed when the current culture is basically asymmetrical with behaviour needing to change to achieve the required level of organisation efficiency and effectiveness. Goodman and Kurke (1982) believe that the change of culture can be categorised into adaptation and planned changes. Adaptation is a change which occurs when an organisation responds to the changing of external and internal forces, while planned change takes place as a product of organisational planning. Lifson (1984, p. 37) defines that adaptation as "(t)he systematic change of practise as informed by on-going developments in the environment." He argues that adaptation is the key success factor of an organisation that managers should know if they want to perform at their best. Tichy (1983) introduces the term of strategic change to address any change which is "non-routine, non-incremental and discontinuous." Tichy believes that this strategic change is required in the event of a crisis or when an opportunity emerges. This includes "(c)hanges in the environment, diversification, rapid changes in the technology of the organisation, or a change in the people (the skills or knowledge of the people; the expectation of the people; or mix or people)." (quoted in Dearstone, 1989, p. 24). Other researchers, Gilbert and Roberts (1984) support the discussion above with their view that culture is an instrument in which symbols, myths, rituals, heroes, etc can be employed and shape a cultural constitution of an organisation that fit to the executive's desires. At least, most of the researchers believe that in the case of changing a culture the role of a leader is one of the most important factors.

7.4. The Sari Husada Corporate Culture

Although the discussion of whether a culture can or can not be changed is still far from an end, for the purpose of analysing the corporate culture of Sari Husada, this study follows the arguments that culture can be manipulated. Following Gilbert and Roberts (1984) who state that symbols, myths, rituals, heroes, etc are manifestations of culture and not the culture itself, management can use those elements to support executives' decisions.

This section will discuss the corporate culture of Sari Husada before and after the Numico acquisition. The discussion of corporate culture follows the Flamholtz's (2001) Culture Management Process. The Flamholz's process is used because it is able to describe the change of corporate culture before and after the acquisition. It is also able to determine the necessary interventions need to take in the future. This program consists of five steps: (1) describe the current culture; (2) define the desired culture; (3) develop a culture management plan; (4) implement the culture management plan and (5) monitor the culture. The following subsections will describe each step of the process in relation to Sari Husada.

7.4.1. Sari Husada Prior to Numico Arrival

The first step in the culture management process is to describe the current situation. Sari Husada was a market leader in infant milk formula and a Tiga Raksa Satria subsidiary before Numico took it over. The company was a listed company on the Jakarta Stock Exchange, and had already attracted foreign investors because of its huge market share. As one of the managers said, "(i)n fact, many foreign companies had come to Sari Husada to acquire it, but one of the reasons why they retreat was the (big) number of our employees." (interview with Anwar Santosa, Chief of Internal Auditor and Assistant to Corporate Secretary). Sari Husada had around 900 employees. This number impacted the company's productivity in term of sales per employee which was only 204.65 million rupiah per employee per annum in 1995. The Sari Husada executives were aware of its disadvantaged condition. During 1995 to 1997 the board of directors decided to act. Sari Husada made a decision to benchmark its productivity to a reputable foreign company in dairy products, Santosa went on to say "(t)hen, the board of directors decided to benchmark (company productivity) with a foreign company, such as a New Zealand (dairy producer) company." (interview with Anwar Santosa).

Based on the benchmark, the executive directors then decided to reduce the number of staff. "(w)e down-sized our staff from more than 800 staff to around 350 staff, and we still managed to produce our products in an optimal way." (interview with Felix P Mulia, Vice President Director). The company productivity was more than doubled in 1997. The 1997 annual sales per employee increased to 410.54

million rupiah. The downsizing process was done gradually and accompanied with a golden hand-shake policy. The lay-off was applied to all supporting activities, such as drivers, security staff, cleaning service staff, etc. These activities were then contracted to a third party. The core activity departments still held the same number of staff.

Although some of the employees' jobs were terminated, Sari Husada still considered the ex-employees. Through its pension fund, Sari Husada tried to maintain its relationship with them. The pension fund then set up a separate company, named Dharma Purna Karya (DPK), to absorb all terminated staff. The DPK then submitted a working contract to Sari Husada as a third party related to all supporting activities, such as the cleaning service, security guards, drivers, catering, etc. By doing this, the previous staff were still working at the same place but with a different uniform. "(t)he terminated staff were happy to do the same job, to work at the same place in Sari Husada, although they were not Sari Husada's employees anymore. But at least from financial side they were happier. They got a generous golden hand-shake payment, and still continued their jobs with DPK." (Anwar Santosa, Chief Internal Auditor and Assistant to Corporate Secretary).

Most of the Sari Husada staff have pride in working for the company. Their motive is work and being servants of Sari Husada. One of the directors said, "(o)ur staff have pride in themselves from being employees of Sari Husada." (Setyanto, R&D and Quality Assurance Director). Most of the employees are Yogya people, who hold fast the Javanese culture and are famous for their loyalty to their leader figure. Also, a person with a Javanese mentality has difficulty in making decisions and tends to follow orders from the leader. This staff mentality can be seen as an advantage and also a disadvantage at the same time, Suroto said "(I) think Sari Husada has a disadvantage with staff mentality. Our staff have a traditional and a Javanese mentality. Although it can also be considered as an advantage (because in the Javanese culture a subordinate will always do what a supervisor says)…They will not sit on their chair before the ring of the 8 am bell, and will leave their desks when the 4.30 bell rings." (Joko Suroto, Financial Controller Manager). The Javanese background of the staff was clearly demonstrated in such a traditional behaviour, "(w)hen I joined the company, the first time I entered my room in the Yogya office, all of the staff in that room stood up and saluted me at the same time. They honoured a director with a very high respect." (Felix P. Mulia, Vice President Director). One day, when a machine at the plant was broken, and the spare part for the machine was not available in Indonesia the executive director asked a production manager to buy the part in Singapore, but, "(t)he Production Manager was assigned to find the part in Singapore. When he came back, he did not bring any spare part, but only brochures from some suppliers, because he was afraid to decide which spare part he had to buy." (Suad Husnan, Independent Commissioners).

Prior to the Numico take over, most of the executive directorships were occupied by production people, who were close to Sari Husada employees in their hearts. The strong leader figure was seen as Dwiyatno Siswosumarto (called as Pak Dwi), the former President Director. "(P)ak Dwi was a very trusted figure. When he said that we were in trouble our employees heard him." (Erista Adi Setya, Plant Manager of Klaten Factory). Another manager added, "(w)e have a dream proposed by Pak Dwi. Our company is in Yogya (far from the capital city Jakarta) and the market often underestimates a local company like Sari Husada. But, we have a mission to breastfeed Indonesia." (Nunung L. Puspitasari, Human Resources Development Manager). This mission is within the framework of the company vision, "(o)ur vision is to promote the health and intellectual development of Indonesian children by providing the best nutritious food." (Annual Report, 1998).

The company also offers its employees a pension fund program. This program, although it is not an obligation according to Indonesian law and it adds an extra expense to the company, is one way of expressing the view that Sari Husada wants to take good care of its staff. The staff can choose whether to join the program voluntarily. "(T)he pension fund program is managed for employees who voluntarily join the fund. Every staff member has a right to joint. Most of our staff become members of the pension fund program, except a few staff in the marketing department…The pension program is financed by the staff and the company. Every month 5 percent is deducted from staff salaries with a further 10 percent added by the company to this program." (Felix P. Mulia, Vice President Director).

Sari Husada is well-known for its low production cost. For that reason the company is able to sell its products cheaper than its competitors. This statement is supported by one of company's directors, "(i)f we can increase the volume of production, we can optimise the spare capacity, and in the end our production cost can be reduced" (Setyanto, R&D and Quality Assurance Director). Another manager added, "(w)e need to focus our production at low cost for product with a standard quality… We are in the middle-low class market segment…This segment has 80 percent of total market size for infant milk formula." (Agus Budiyanto, R&D and Quality Assurance Manager). Jenny Go, Marketing Director said, "(w)e define ourselves as providing for the middle-low class consumers…This is the biggest slice of the cake (around 80 percent of total market)… The upper class customer will be served by Nutricia (Indonesia Sejahtera)."

7.4.2. The Desired Culture

The second step of the Culture Management Process is defining the desired culture. Of course, the arrival of Numico affected Sari Husada's condition. The corporate culture with a strong Javanese tradition was to be changed to a modern company based on western European principles. This was supported by one of the managers who said, "(i)n my point of view and based on headquarters' demand, as a Numico subsidiary we should have a western mind-set. We need to develop our staff mind-set to adopt the new mentality, especially at manager level and below." (Joko Suroto, Financial Controller Manager). Numico, as parent company, wanted Sari Husada to adopt a system of monitoring and finance which it applies to every subsidiary. This adoption benefited Numico in controlling all of its subsidiaries. "(u)nder Numico's holding, we made several important changes. Our management team implemented a new control and monitoring system. The new system was adopted from Numico's headquarters" (Setyanto, R&D and Quality Assurance Director). Another manager added, "(t)his system is related to the development of a standard costing price… This EXACT accounting system records all activities within the firm. In this integrated system, activities start with issuing purchasing order, then, the arrival of material goods, storage of these materials in the warehouse, then production process, filling and packing process, warehousing of finished good, and sales,…all are recorded." (Joko Suroto, Financial Controller Manager).

Sari Husada was also expected to support Numico's strategy by producing a wider product range, "(N)umico's products are aimed to cover young age to elderly. They serve 'from womb to tomb' customers. Numico asked Sari Husada to help them to launch nutritious products to elderly people as well." (Felix P. Mulia, Vice President Director). In addition to that demand, the management team introduced a new strategy. The new policy is to produce products with a higher profit margin, rather than to increase production volume and to produce low cost products. As one of the director mentioned, "(t)he new management put more attention on value, rather than volume." (Setyanto, R&D and Quality Assurance Director).

7.4.3. The Development and Implementation of Culture Management Plan

The next steps in the Culture Management Process include the development of a culture management plan and its implementation. The development of the plan begins with an assessment of any cultural gaps between the current culture and the desired culture. Then, to fill the gaps, the Sari Husada board of directors took a number of actions.

Numico as the controlling shareholder in Sari Husada planed to increase the capacity of production facilities. Numico predicted that Sari Husada might be a dominant influence in the baby food and milk formula industry and support Numico's grand strategy in the Asian market. The addition of production facilities should be parallel with the adoption of western attitude by Sari Husada employees. The awareness of quality, efficiency and cost cutting was desired by the management to all of the employees. This new attitude would not only benefit Sari Husada in increasing its capability to compete in the global market, but would also make it easier for Numico to control the company. Sari Husada would be more comparable to other Numico subsidiaries.

The executive directors decided to expand capacity by building a new factory in Klaten. This new and bigger facility was completed with new and improved machinery that is able to produce a higher level of products. "(o)ur plant in Klaten lays on a 20 hectares site, including the buffer area (for waste water treatment). It is ten times bigger than the Yogya plant, which is only 2 hectares… The new factory is equipped with a filling and packing facility and its capacity is 30,000 tons per year." (Agung Widyatmoko, Chairman of Perkasa, the Sari Husada Labour Union).

In addition to the new facility, to fill the cultural gap and to speed the development of the culture management plan, the board of directors decided to relocate its executive office from Jakarta to Yogyakarta. This policy differed from the previous executive policy, which decided that only the production director and its related staff needed to be close to the Yogya factory. “(u)nder the previous board of directors, Yogya was only treated as a plant, a production point. The Yogya office supplies data to head office in Jakarta.” (Felix P. Mulia, Vice President Director). With a close contact with its executive management, Sari Husada employees felt that they had better attention from the top management.

The implementation of the culture management plan started with the installation of new systems in all departments in Sari Husada. To make sure those systems worked the managers needed to encourage the staff by introducing a better remuneration package and providing a good example of doing a task. “(w)e preferred to give a better remuneration package for one employee with an outstanding performance rather than pay salary to five persons with a below-average performance.” (Felix P. Mulia, Vice President Director). He added, “(w)hen we installed a new computerised accounting system, I worked in my office until late, around 2 or 3 am in the morning. At 8 am I started my day as usual again. We (directors) have to give them (staff) a good example to motivate them.”

The new monitoring system was installed to make Sari Husada more efficient to compete with its global competitors. “(t)he new system that was adopted from Numico’s headquarters, has what they call key performance indicators (KPIs). These KPIs clarify the plant efficiency, such as how many tons had been produced, unit costing per kg per tonne, the rejection rate, etc. All indicators are controlled and monitored, and their efficiency should be improved from time to time.” (Setyanto, R&D and Quality Assurance Director).

Sari Husada kept its mission as stated previously, although in the next five years it will adapt to market demand and headquarters’ policy. “(o)ur mission has never changed. We (still) want to ‘breast-feed’ and make Indonesian children healthy. But now, we want to widen our (mission’s) scope. Previously we only focussed our product in serving babies and toddlers, in the next 5 years we also serve children until age twelve. We remain focussed on children’s needs by providing milk powder, cereal and vitamin products, because on those products we have our expertise.” (Felix P. Mulia, Vice President Director).

The company was also aware that the loss of a father figure in the company would affect the staff’s performance. To deal with the resignation of Pak Dwi in 2002, Sari Husada employed a novel approach, “(f)or our staff, especially in the production department, we do not want them to lose a father figure. We ask Pak Dwi to come to the plants at least twice a week, on Tuesday and Thursday as a production advisor. We will maintain this policy until Pak Suhappy our production director has an equal reception from our employees. Pak Dwi is also involved in Dharma Purna Karya (DPK), a business unit under our pension fund.” (Felix P. Mulia, Vice President Director).

7.4.4. Monitoring the Culture

After applying such action programs to change the culture, the Sari Husada management needed to monitor the result. One of the feedbacks from the company members was, “(t)here was a cultural change in Sari Husada . The way we work has changed. Since I joined Sari Husada, we had an increase of effectiveness of work. It was how we did our regular jobs with a fewer number of employees.” (Felix P. Mulia, Vice President Director). He also added, ”(w)e succeed in changing our working orientation from time oriented to result oriented. (Previously) our staff had habits to start work at 8 am and finish at 4.30 pm without any motivation. We (management) showed our staff that result oriented work was different to working without motivation. We rewarded them with a good remuneration package. We challenged them to set a target.” Moreover, he concluded that, “(o)ur culture has already changed. We asked our staff to give timely information, our staff to be open-minded, and our staff to be able to work with a challenge. Our career structure is based on personal potential, not based on seniority, and even a new staff member can sit on a manager’s chair if he or she has potential.”

Some of the feedback from the staff suggest that they would reject any changes if this change affected their prosperity. “(o)ur employees need a typically Yogya (father) figure. If they do not trust the figure, it is hard to motivate them… At least, our production staff should be left undisturbed (by any changes).” (Erista Adi Setya, Plant Manager of Klaten Factory). The staff were reluctant to change their behaviour, although their superior has mentioned the importance of the reason for the change, "(o)ur job can not be delayed. A delay will affect the daily figure and can not give true information. At the beginning it was very hard to change this behaviour. Even we, at managerial level, have already given them an example not to leave the office until our job was finished, but our employees were not hesitant to leave the office." (Joko Suroto, Financial Controller Manager).

7.5. Conclusion

Culture is the values and beliefs held by an organisation. It is manifested in every organisation by rules of conduct, management policies, organisational practises, and in the behaviour of organisational members. Although there is a controversy as to whether an organisation has culture or the organisation itself is the culture, some of researchers believe that organisational culture can be manipulated.

The Sari Husada corporate culture has changed since it was taken over by the Numico. This cultural change can be seen in staff's behaviour, management policies and the company's practises. Numico, the controlling shareholder, tried to change the Sari Husada culture to match with the culture owned by the parent company. Some of the changes were adopted successfully, but some others were rejected by Sari Husada members. Sari Husada managed to choose a beneficial new culture which is strengthening its corporate culture.

After analysing the changing of corporate culture, the next chapter will discuss the strategic management process at Sari Husada before and after the Indonesian economic crisis.

CHAPTER EIGHT

STRATEGIC MANAGEMENT IN SARI HUSADA

8.1. Introduction

This chapter will analyse the strategic management process, which was taken by Sari Husada before and after the Indonesian economic crisis. The chapter aims to understand the background of strategy choice and strategy change happened at Sari Husada. The analysis, begins with a discussion of what strategic management is and then goes on to discuss strategic management at Sari Husada.

8.2. History and Definition of Strategy

The concept of strategy has originated from military discipline. The term strategy is derived from a Greek word ‘strategia’, which means generalship (Grant, 2005, p.14). According to Evered (1983), the word ‘strategia’ itself is formed from ‘stratos’, which means army, and ‘–ag’, which means to lead. The concept of strategy in the military sense was discussed by Sun Tzu in his book The Art of War, written about 500 BC (Grant, 2005, p.14). From the field of the military, the idea of strategy became commonly used in business. As mentioned in the Oxford Dictionary, strategy is defined as, “(t)he art of war, especially the planning of movements of troops and ships etc., into favourable positions; plan of action or policy in business or politics etc.”

The term ‘strategy’ then is widely used in business contexts. Grant (2005) defines strategy as a term in explaining, “(t)he overall plan for deploying resources to establish a favourable position.” To elaborate on this definition, he differentiates strategy with tactic. He uses the term ‘tactic’ to explain a plan for a specific action. Grant also gives the example, that tactic is a plan related to win a battle, and strategy is concerned with winning the war. In this sense strategy is used to describe a plan adopted by an organisation to achieve a specific purpose in a longer period of time.

Chandler (1962) also uses the term strategy in a business context and defines it as, “(t)he determination of the long-run goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals.” In the same field, Andrews (1971) says that strategy is, “(t)he pattern of objectives, purposes, or goals and the major policies and plans for achieving these goals, stated in such a way as to define what business the company is in or is to be in and the kind of company it is or is to be.”

Quinn (1980) defines strategy as “(p)attern or plan that integrates an organisation’s major goals, policies and action sequences into a cohesive whole.” He also adds that a good strategy would “(a)llocate organisation’s resources into a unique and viable posture based upon its relative internal competencies and shortcomings, anticipated changes in the environment, and contingent moves by intelligent opponents.”

Grant (2002, p. 17), in a wider context, also adds that a strategic decision involves three characteristics, which are (1) important, (2) involve a significant commitment of resources and (3) not easily reversible. Because of these characteristics, to come to a strategic decision a leader should consider all relevant information and resources in order not to bring its organisation goes to a disastrous situation.

8.3. Strategic Management Concept

Strategic management is a set of managerial decisions and actions that determines the long-run performance of a corporation. Many concepts and techniques in strategic management have been developed and used by successful companies. According to Gluck, Kaufman and Walleck (1982) there are four phases of strategic management that a company evolves through. Those phases are: 1) basic financial planning; 2) forecast-based planning; 3) externally oriented planning (strategic planning); and 4) strategic management (quoted in Hunger and Wheelen, 1998, pp.3-4). The basic financial planning is a phase where managers propose next year's budget. This kind of planning has a time horizon of one year. The planning itself is done on the basis of a little analysis, supported with information coming from within the firm. The second phase, forecast-based planning, is done where managers propose a five year plan. They add to the internal information with available environmental data. The strategic planning, as the third phase, is done when the company seeks to increase its responsiveness to changing markets and competition by thinking strategically. The top managers develop five-year plans, which are supported, with the help of planning staff and consultants, but without any input from lower level. The formal strategy formulation is a result of top-down planning, and leaves the implementation issues to lower management levels. In the last phase of strategic management, top management forms planning groups of managers and key employees at many levels and from various departments. They together develop an integrated strategic plan aimed at achieving the company's objectives. In this phase planning is interactive across all levels of activity and is no longer top down. The strategic plan is completed with implementation, evaluation and control matters.

Wilson (1994), in his survey in various countries and industries, finds that there are three most highly rated benefits of strategic management, these are: 1) clearer sense of strategic vision for the firm, 2) sharper focus on what is strategically important, and 3) improved understanding of a rapidly changing environment. Using strategic management an organisation generally outperforms others that do not use it.

The analysis of strategic management in a company starts from the questions of 'where is the organisation now?' Then the next question is 'what actions should management undertake?' To answer those questions a company needs to know the way modern corporations do business in a changing environment, especially in the era of globalisation where the internationalisation of markets and corporations has happened. The firms need to be more competitive and think of a global market instead of a national market. They need to reach economies of scale to achieve low costs and low prices. A company now needs to become a learning organisation in order to create, acquire and transfer knowledge and modify its behaviour to display new knowledge and ideas. To cope with the changes of environment, a learning organisation avoids stability through continuous examination and experimentation. All members of the organisation need to be involved in the strategic management process.

8.4. Strategic Management Model

As stated in strategic management textbooks, strategic management consist of four basic elements, which are environmental scanning, strategy formulation, strategy implementation and evaluation and control (Hunger and Wheelen, 2000, pp.8-9). Each of these elements is described as follow:

Environmental scanning is differentiated into external and internal scanning. External scanning is concerned with the societal environment and task environment, that is beyond of the control of management. The societal environment consists of economic-, technological-, political-legal- and socio-cultural forces. And the task environment consists of shareholders, employees/labour union, customer, suppliers, government, competitor, creditors, communities, trade association and other special interest groups (Hunger and Wheelen, 2000, pp.9-10).

The second element, strategy formulation, includes corporate mission, objectives, strategies and policies. The organisation's mission is the purpose for the organisation's existence, which tells what the company is providing to society. It identifies the scope of the company's operation in terms of products offered and markets served. The mission tells "who we are and what we do as well as what we'd like to become" (Hunger and Wheelen, 2000, p. 11). The objectives are the end results of planned activity. Hunger and Wheelen (2000, p. 11) state “what is to be accomplished by when and should be quantified if possible.” A firm’s strategy is a comprehensive master plan stating how the company will achieve its mission and objectives. The strategy itself has a hierarchy. The hierarchy of strategy consists of corporate strategy, business strategy and functional strategy. The last sub-element of strategy formulation is policy. A policy of a firm is the broad guideline for decision-making that links the formulation of strategy with its implementation. Policy is used to make sure that the employees of a firm make decisions and take actions to support the company’s mission, objectives and strategies.

The third element of strategic management is strategy implementation. Strategy implementation is a process by which strategies and policies are put into action through the development of programs, budgets and procedures. This strategy implementation is usually to be conducted by middle and lower level managers under top management review. This process involves day-to-day decision on resource allocation. The program is a statement of activities or steps to achieve a single-use plan. To put the programs in term of money a company makes budget. The budget details the cost of each program. To make the budget into practise a company needs to create procedures. The procedures, often to be called standard operating procedures (SOPs), are a system of sequential steps that describe in detail how a particular task is to be done.

The last element of strategic management is evaluation and control. The evaluation and control is a process in which company activities and performance results are monitored. Then the actual performance is compared with desired performance. Managers at all level of company use the result to make a corrective action when they find that the previous strategic plans have weaknesses.

8.5. The Sari Husada Strategic Management Process

This section will discuss the practise of strategic management process in Sari Husada. As stated in strategic management textbooks the process consists on four basic elements, the discussion will follow the logic of those elements.

8.5.1. Company Environment

Environment scanning of a company is answering the question of “where the organisation is now”. It will scan the external and internal environment of Sari Husada. Sari Husada is a company in food and beverage industry with a specialty in producing infant milk formula products. The company occupies the largest market share of infant milk products in Indonesia. Sari Husada has a long history as a milk formula producer. Since it was established in 1954 as a joint venture company, between The World Health Organisation and the government of Indonesia, Sari Husada has produced infant milk formula. It has a specialty of producing cheap milk formula products for the low to middle income class. The company’s previous name, Sari Dele, indicated that the product which the company produced came from soy (dele means soy), which was a substitute for milk formula products that was more expensive and unreachable for most Indonesian families at that time. After evolving into a state owned company and then becoming a private company and listed its shares on the stock market. The company maintains its specialty in producing cheap milk formula products. Together with the previous controlling shareholder, PT Tiga Raksa, Sari Husada is a major player in the production of infant formula products in Indonesia. The company has the advantage of efficient production cost, combined with a strong distribution channel, where Tiga Raksa's main business is in the product distribution.

When the crisis hit Indonesia in 1997, most of the Indonesian companies suffered from its impact. The factor that affected those companies performance was the exchange rate of Indonesian Rupiah. Between mid 1997 – mid 1998 the US dollar soared from 2,400 rupiah per dollar to 16,000 rupiah per dollar. The foreign currency debt of companies jumped overnight. This condition was made worse by un-hedged company funds. Most Indonesia companies were dependant on the Bank Indonesia (the central bank) in maintaining the exchange rate. This condition also affected Tiga Raksa, the controlling shareholder, and also Sari Husada.

Because of the exchange rate fluctuation, Tiga Raksa's liability became unbearable. The company had to sell its subsidiaries to reduce its debt. Tiga Raksa chose Sari Husada as one of its subsidiaries to sell. Although Johny Widjaja (owner of Tiga Raksa and President Commissioner of Sari Husada) refused to admit the situation, in his statement he implicitly offered Sari Husada to a buyer, "(w)hen the size of the company had become larger, we started to seek a new partner and we targeted a multinational company… because we need to prepare to enter global competition, where so far we only compete in the domestic country. I approached Nutricia (Netherlands)." (interview with Johny Widjaja). Sari Husada was an attractive company to buy for foreign investors because of its market leader position in infant milk formula products. Moreover the weak Indonesian rupiah made the selling price even more attractive. The Nutricia group (later became Numico, as the company merged with Milupa and Cow and Gate) then acquired the controlling interest in Sari Husada's shares.

8.5.2. Strategy Formulation in Sari Husada

The formulation of strategy begins with the statement of company mission. Sari Husada has a strong mission statement. This mission statement is rooted to a myth "to promote the health and intellectual development of Indonesian children by providing the best nutritious food" (Annual Report 2002). Because most of the Indonesian people still live in an underprivileged condition, the company needed to produce its products with cheap prices. This is clearly stated in its mission statements, (1) to contribute to the healthy development of babies and children in Indonesia by providing trusted and affordable nutritional products, (2) to generate sustainable growth of the company through high quality management systems and an innovative approach within a culture of high integrity, and (3) to deliver stakeholder's satisfaction (www.sarihusada.co.id).

As the Vice President Director said, "(o)ur mission has never changed. We want to 'breast-feed' and make Indonesian children healthy." (interview with Felix P

Mulia). He added, ”(b)ut now, we want to widen our (mission’s) scope. Previously we only focused our product on serving babies and toddlers (5 years old and under), in the next 5 years we also serve children until age twelve. We remain focused on children’s need by providing milk powder, cereal and vitamin products, because in those products we have our expertise.”

With its strong mission statements Sari Husada does not hesitate to have a vision of “to become the Indonesian market leader in healthy nutritional product for babies and children” (www.sarihusada.co.id). This vision can only be achieved if the company chooses a right strategy. As Porter (1985, p. 11) stated, a company should have a sustainable competitive advantage to outperform other companies in the long run. The firm should choose among three generic strategies for achieving above-average performance in an industry. Those generic strategies are cost leadership, differentiation and focus. A company will never have a competitive advantage at all if it does not make a choice of those bases (Porter, 1985, pp.11-12).

Sari Husada knows its strengths. It can produce a product with lower cost compared to its competitors. It also has to prove to the Indonesian market that it can deliver quality products with affordable prices. Joko Suroto, Financial Controller, said, “Sari Husada strong point is price leadership strategy….we sell baby milk formula at an affordable price (compared to our competitors).” As long as Sari Husada is able to maintain its cost leadership it always attractive to Indonesian buyers who’s more concern on price.

8.5.3. Strategy Implementation

Strategy implementation in a firm should begin with the organising of actions. Corporate strategy formulation will be followed by organisational structure formulation. Chandler (1962) said that “structure follows strategy” (quoted in Hunger and Wheelen, 1998, p.187). The implementation of strategy in Sari Husada can be looked at in the functional structure. There are 5 functions in Sari Husada structure. They are (1) Finance and Accounting (FA), (2) Production, (3) Quality Assurance (QA) and Research and Development (R&D), (4) Human Resource Development and (5) Marketing and Sales.

8.5.3.1. Finance and Accounting

Sari Husada was facing similar problems to these faced by most Indonesian companies during the economic crisis. Sari Husada’s debt and operations suffered from the US dollar fluctuation. From a finance stand point the first step to eliminate this suffering is to repay debt sooner rather than later. Sari Husada had around 60 billion rupiah debt in 1998. At that time the interest rate set by the banking system was around 60 to 70 percent per annum because the central bank liberalised the foreign exchange fluctuations when the rupiah was weakening. Felix P Mulia said, “(i)f we still kept the debt, it meant that we worked hard and the bank had taken the advantage of it” (interview with Felix P Mulia). It was impossible to earn more than 60 percent return on investment and if Sari Husada could, it would not benefit from the result at all. Then in 1998 Felix flew to the Netherlands to ask for more funds from Numico. “I told our Holland-based commissioners that I needed to invest at 150 billion rupiahs and if the headquarters did not support me, the company would find financial difficulties and be bankrupted gradually” (interview with Felix P Mulia). After spending more than a week in Holland and convincing the Sari Husada commissioners finally Felix succeeded in getting the money he wanted. “Finally, they agreed to invest through a rights issue” he said. Because of this fund injection the result was that “(t)he company was dramatically very healthy with its equity financing. All debts, which were amounted to 100 billion rupiah, were terminated” (interview with Felix P Mulia). Sari Husada still kept another 50 billion rupiah and then these funds were invested in working capital and pushed the production process.

Learning from its past experience Sari Husada decided to generate internal sources of finance to expand and invest rather than to borrow from external sources. Felix stated that headquarters told Sari Husada to reinvest its return. “(T)hey (Numico) said that it would be better if we distribute a stock dividend instead of the cash one and the money can be used for the company’s needs” (interview with Felix P Mulia). Felix then proposed through the Annual General Meeting that the money was retained with the intention to be reinvested. This dividend policy was also backed-up with a special treatment to minority shareholders. Sari Husda gave choices to minority shareholders to choose between cash or a stock dividend. The reason behind the Numico decision to omit a cash dividend was that, “(o)ur Dutch shareholder actually does not need a cash dividend. What they need is only the satisfactory performance of Sari Husada, since they need to consolidate it in their financial report. They expect the consolidated report will have a positive effect on the company’s (Numico) share price in the capital market” (interview with Felix P. Mulia).

Besides the above reason to avoid debt financing the Vice President and Finance Director follows a simple finance rule for the company, “(s)imilar to household financial management, I save the money that does not need to be spent (prudential finance) and I will spend the money when we need to invest. Meanwhile, the money can be deposited in foreign banks before it is needed” (interview with Felix P. Mulia).

The strong performance of Sari Husada was reflected by the market price of its shares. For its 500 rupiah nominal value share the market valued it at 14,000 rupiah in 2002. Although many parties, including shareholders (minority), stock brokers and market analysts, suggested that Sari Husada split the nominal value of its shares, the company had reason to reject the suggestions. The Vice President said, “(t)here is no need to do a stock split. If we split our share, the brokers in the capital market are the one that will be happy. There is no benefit for the company or shareholders. It is true that the shares will be more liquid, but for this moment, I think, we do not need this yet. Perhaps later, when we need to change our strategy and need additional funds, we will do a stock split” (interview with Felix P Mulia).

Since 2000 Sari Husada has implemented an accounting system of standard price costing. This system integrated all activities starting from issuing the purchase order (PO), the arrival of material goods, and the storage of these materials in warehouse. Then the activities of production process, filling and packing process, warehousing of finished goods and sales are all recorded with this system. Joko Suroto, the Financial Controller, said, "(w)hen I joined Sari Husada in 2000, the company had just implemented a new system, namely EXACT. This system is related to the development of standard costing price…This EXACT accounting system records all activities within the firm" (interview with Joko Suroto). The Finance and Accounting department is also asked to submit a weekly report to the headquarters in Holland as Joko said, "(w)e (Finance and Accounting department) also make a weekly report that contains inventory, cash in banks and sales to be submitted to the headquarters. All unexpected movement of stocks, cash or sales in that week are needed to be explained to the headquarters" (interview with Joko Suroto). With this prudent financial policy all activities in Sari Husada will be carefully monitored.

8.5.3.2. Production

The Production department has to deliver quality products at an affordable price as mentioned in Sari Husada mission statement. To do that the production staff ensures that the quality of its products are guaranteed. R Suhappy, the Production Director, stated, "(w)e would like to prove that our customers' aim is not only to buy a cheaper product but also a quality product" (interview with R. Suhappy). Parents of babies aged 0 – 1 year, especially the first child from young couple, would also like to follow their doctors suggestion or prescription. In giving their suggestions, the doctors would consider the quality of the product from such parameters as the physical, chemical, or microbiological point of view. There is a certain standard applied by SNI (Indonesian National Standard) and International Standard. Suhappy added, "(w)e convince our customers through the GMP (good manufacturing practise) application. Our production fulfils the International Standard under high quality control, especially from the microbiological aspect, where we employ high quality materials. And the production process is directed to fulfil that specific final target. Customers do not understand exactly about this, but some certifications that we have received could show that we are internationally proven. We have received ISO14000 certificate, HASAP, Halal, etc." (interview with R. Suhappy).

The inputs for its production line were mostly imported from overseas and denominated in US dollars. This was in contrast with its sales revenue, which was in Indonesian rupiahs. Although the production line was not directly affected by the crisis, at least the production department had to seek other suppliers with the same quality but with a cheaper a price. Before the crisis hit, Sari Husada mostly depended on Australian and New Zealand producers of base milk powder. Recently the firm has other suppliers of base milk powder from South America (i.e. Brazil and Argentina) with a cheaper price.

To optimise its production facilities and to gain economies of scale the production department has to schedule its machinery to work optimally. Sari Husada currently operates its machines 24 hours a day and 7 days a week. Every day is divided into three shifts, which are morning, afternoon and night shifts. With its huge production capacity of 40,000 tons per year the production department had to optimise its idle capacity. Setyanto, the Quality Assurance and Research and Development Director, stated, “(e)very new investment results in a spare capacity and this will put more burden on our products’ prices. Our goal in the production department is to fill the spare capacity. If we can increase the volume of production, we can optimise the spare capacity, and at the end our production cost can be reduced” (interview with Setyanto). To do that Sari Husada offer manufacturing services to its sister company Nutricia Indonesia Sejahtera (NIS) and another baby formula producer, Morinaga.

During the period of economic crisis which followed by the chaotic period of political succession, Sari Husada managed to survive within its industry. The unstable situation in 1998 and 1999 started to push baby milk formula customers to panic buying. Suhappy said, “Sari Husada can survive compared to most companies in Indonesia because of its product. The situation in the middle of the crisis and the succession of the national leader had brought chaos to our country and started to push our customers to do panic buying.” He added, “(t)hey (customers) would save their babies and children by buying extra milk for their stock. (In that situation) if we could produce more products, all of the products would be absorbed by the market. (Also) the middle and upper class customers were downgrading the product that they consumed. Above all, basically, the baby food business was not really affected by the economic crisis. Adult people can reduce their food consumption or even fast, but they never decrease or stop feeding their babies or children. In short, this business is categorised as a secured one” (interview with R Suhappy). To deal with this situation

Sari Husada developed the strategy to produce economic size products and smaller packages, even though not all of the baby's food producers, especially high-class product producers, did the same. Sari Husada applied new a strategy when it produced economic size products and smaller packaging. This drove people to buy the company's product, so that Sari Husada apparently was not impacted by the crisis. Suhappy said that, "(w)e also could prove to the customer that our product could compete with under licence products" (interview with R. Suhappy).

8.5.3.3. Quality Assurance and Research and Development

The Quality Assurance (QA) and Research and Development (R&D) department was separated from Production department in 2002. The reason for the separation was Sari Husada needed more new product development, not only current product improvement. The new department would focus in pursuing this demand. To obtain this goal the QA and R&D department should cover the production system and technology, material selection and excellent products. Setyanto, the QA and R&D Director, said, "(Q)A and R&D department activities are very close to production and marketing. Our job is to make improvements to current products so that they meet market trends and technological developments. We also develop new products that the market can absorb. And we do improvements to the production system and technology. Our coverage consists of production, material selection and how the company is able to supply the market with the right products, at the right time, in the right quantity and at the right quality" (interview with Setyanto).

One of the advantages of the Sari Husada formula is its flexibility. Flexibility of formula means that if one or more material ingredients are not available in the market for any reason (for example too expensive), Sari Husada will continue to produce its formula using other ingredients without sacrificing its product nutritional content. This can only be done by a producer of milk formula which has its own brands, but cannot be copied by producers of licensed products. Although Sari Husada has the advantage in its formula, it sometimes also faces a challenge. The change of formula in 2002 demanded a more expensive production cost than the previous formula. The new formula demanded a longer dry-blending process than the old one. At the same time the production capacity of Sari Husada was already at a maximum level. To deal with that situation Sari Husada decided to save its production capacity by buying more base powder from its suppliers, and this action resulted products with more expensive prices. That was an intermediate solution to the problem until the company was able to start its production in the new factory in Klaten, Central Java, in the second semester of 2002.

8.5.3.4. Marketing

The most important issue within the Marketing department of Sari Husada is brand heritage. From generation to generation customers have known SGM as baby milk formula. Even when customers had never hear about Sari Husada, if they were asked about SGM they would recognise it. Suhappy said, “(t)he name of SGM has been identical with baby’s milk. Their parents and even their grandparents also used this product for their children. This brand is also known by the people in the smallest village out in the country, while under license products are only known and available in big cities. Even though they do unceasing marketing, they still cannot enter markets, which are too far from big cities. This fact is the advantage for Sari Husada, so that it still captures most markets around the country" (interview with R. Suhappy). Soeloeng H Nasoetion, the President Director, added, "(N)utricia is involved in Sari Husada truly because it has an advantage, that is what Numico wants to acquire. In Indonesia itself, sometimes we do not recognise what Sari Husada is, but if we hear the SGM name, everybody will recognise it. SGM is a name that is very familiar. Almost all mothers who already have children know SGM." (interview with Soeloeng H Nasoetion).

Sari Husada sales boomed in 2000 and 2001. The reason behind this sales boom was that it was the year of golden dragon. Indonesian families, especially those of Chinese origin felt it was good to have new babies in this year. Setyanto explained, "(t)he sales boom in 2000 was affected by the year of golden dragon of the Chinese calendar. The high growth rate of Indonesian population also contributed to this booming." (interview with Setyanto). Moreover, he pointed out the new trend of working mothers also pushed the sales of baby milk formula, he said, "(a)nother reason was there was a starting new life-style in our society. More women want to be in the workforce. This new life-style made breast-feeding activities decline. More mothers gave formula milk to their babies".

Another key success secret of Sari Husada's marketing strategy is marketing through midwives. "(M)arketing can not only be delivered by media advertisement. Moreover, the Sari Husada's marketing strength is through midwives. Through the midwives, the promotion of Sari Husada products has reached optimality. For our products, promotion through midwives has bigger correlation than through doctors. That is equivalent to our market target which is middle and low income people." (interview with Johny Widjaja, President Commissioner). This reason for success is because traditional Indonesian families will go to a midwife rather than to a doctor, especially those who live in small cities and villages.

8.5.3.5. Human Resource Development

Human Resources are one of the most important elements of a company. An employee will only be loyal to the company if he or she is treated well. One reason to make sure an employee stays loyal to the employer is a clear career path. That is why Sari Husada has a clear policy regarding career path. Sari Husada has a policy which is prioritising the internal sourcing to fill vacant positions. This policy is able to encourage the staff to work hard and get a chance to be promoted to the next level. Erista, the Plant Manager Kemudo, said, "(t)he policy also maintains the employees' productivity at a high level. They know that they compete with their colleagues to be promoted. The internal sourcing policy gives an expectation to the staff to path their career, and also the process of forming cadres goes naturally. For the supervisors, they can only be promoted to the higher level if they have cadres who are ready to fill the position they leave" (interview with Erista). To ensure this policy will be secure in the long run, Sari Husada uses a program called Management Trainees. The staff recruited through this program are expected to fill managerial position in the future. "Sari Husada has a Management Trainee program, which a trainee is to be trained for a 12 months period. My policy is all trainees start their work from the lowest level as operator. They have to master the machine in deep detail. I rotate them to different places and departments so that they get to know every side of their working environment. The probation will be evaluated in 3 months and those who do not perform will be terminated" (interview with Erista).

Sari Husada always does the recruitment process for new staff seriously. The company only accepts qualified applicants with strong selection results. "(W)e are very careful in recruiting our staff. I do not want an unqualified person to be selected who will harm the rest of our 500 staff in the company. Although a candidate has a very strong reference letter, he or she should meet the critical requirements during the recruitment process" (interview with Erista).

When opening its new production facility in Kemudo, Klaten (known as Sari Husada 2), Sari Husada had to transfer some employees from Kusuma Negara, Yogyakarta. The chosen employees were happy to transfer to new plant because of they knew that only staff with special skill and ability were offered this chance. "(F)or staffing the new plant in Klaten, we needed additional employees. Those new staff members were allocated to positions in the Yogya plant, while experienced staff from Yogya were transferred to Klaten. We challenged our existing staff to handle new machines, and they answered it with honour. They were proud of being chosen to handle new machines within a new environment. For the new staff, we transferred them to the new plant after they had finished their apprentice program in the Yogya factory" (interview with Setyanto). With this arrangement Sari Husada maintained the production process running smoothly, while the new plant production was started in 2002.

Sari Husada has an evaluation procedure for its employees. With this current performance appraisal an employee can have feedback on their performance. Joko Suroto said, "(w)e have an annual performance appraisal for our staff, which is usually held on October. This is an appraisal where not only a supervisor evaluates his/her subordinates' performance, but the subordinates have opportunities to assess themselves. It is a kind of cross check and at the same time it gives feedback to both sides to increase their mutual understanding. The appraisal stresses personal performance, which is to be met with expected performance. The next point is attitude, because personal attitude can influence other people's performance" (interview with Joko Suroto). Using this evaluation procedure Sari Husada employees' expectation to path their careers is transparent.

For the manager and director positions Sari Husada also retains its policy of internal sourcing. Numico also supports this policy. Felix said, "(N)utricia has its fundamental policy that as long as local people can handle the job why should it put a headquarter's person in here" (interview with Felix P Mulia). This statement was also backed by Suhappy, "(N)umico has policy that as long as it (the subsidiary) has an internal candidate, it would have priority to assign them in any position in its subsidiary" (interview with R Suhappy). An opposing view on directorial positions was stated by Suad Husnan. He said that the controlling shareholder may have its own agenda. Headquarters may appoint its manager to sit as a director of its subsidiary. "(T)he chauvinism always stays alive. Since Nutricia is a Dutch company, they will be keen to choose a Dutchman to be a director… Harry Klompe (Senior Vice President) becomes one of the CEOs, where the president director is only a symbol. The acting executives are Harry and Felix. I think this strategy is used to adjust the Indonesian condition and culture. If the president director is (seen) a Dutchman, it is agonised that more foreigners will be employed" (interview with Suad Husnan, Independent Commissioner). The director appointment in Sari Husada was depended on the headquarters' proposition. Numico would allow a local manager to be elected as a director when it had a candidate from a local subsidiary. But when there was no candidate from an internal source, Numico appointed its headquarters' official to be a director at its subsidiary.

8.5.3.6. Overall Function

Sari Husada has a unique advantages compared to other Indonesian companies. This uniqueness consists of skilled people, a flexible formula for its product and brand heritage. "(T)he tremendous development of Sari Husada at recent years was because Sari Husada people did that, not the Dutch. Nutricia was willing to come into the business, not because Sari Husada needed them, but they chased something in here that they had not had before, i.e. the Sari Husada people's ability and skill to generate a new formula with a competitive price, which can capture the wider community" (interview with Soeloeng H. Nasoetion). During the crisis, Sari Husada's direct competitor, Nestle, has increased its baby milk formula (Dancow) price, because of the increased raw materials' price. At Sari Husada, this condition has brought it to be more creative, since the increase in raw materials' price, Sari Husada has changed the formula which results in the same quality and fulfils certain nutrition requirements with an affordable price.

The company's existence is benefiting local people and the government. It creates mutual dependency between the company and the surrounding society. "(W)e want to show that the existence of a company is not a burden for the surrounding society. Our existence in Klaten will benefit the local government, through tax income, and benefit the surrounding society, through employment creation and the increase of land prices in the area. When the society gains benefit from the existence of the factory, this society will have a feeling of ownership and it will protect the factory from any trouble that may come in the future" (interview with Setyanto).

The relationship between Sari Husada and its parent company, Numico, is doing well. Each side has something to offer and to take. Sari Husada benefits from knowledge transfer from Numico. "(A)lmost in all aspects, starting from sales and marketing, there are science and knowledge exchanges. We assign some employees to study over there. That has also occurred and runs well in finance, and more over in production activity… Every year, at least for 2 to 3 weeks, some of our R&D staff are assigned to the Netherlands to study the new trends that are employed by Nutricia" (interview with Felix P. Mulia). Setyanto agrees with this view, "(u)nder strategic alliances with Numico, Sari Husada gains some advantages. Those advantages are (manufacturing) technology mastering, access to the international market and access to sources of materials. Numico also has research centres where laboratory results have gained international appreciation. On the other hand, as a subsidiary, Sari Husada gives fees to headquarters for the cost sharing of the headquarters' laboratory. Numico takes advantages of Sari Husada's position as a leader in its local market. Our products have been known and our relationship with our customers has been done well for a long period of time. In the production line, Sari Husada is able to produce products with low cost leadership." (interview with Setyanto).

Sari Husada also offers its advantage to its parent company. Its flexible and affordable baby formula is offered to other Numico subsidiaries. "SGM formula which is inexpensive and has variations is sold to Africa and China. The brand name of SGM becomes Infant Care in South Africa and Qing-Qing Babe in China. In Iran, it becomes Nini, which means baby. Above those, the milk itself is the concept of SGM. We do mutual symbioses. We give to the head office and we also take from there. The SGM formula is significantly different now. The nutrition content is much better with the cheaper product. We got many inputs about that formula which matches with the Nutricia standard at an affordable price." (interview with Felix P. Mulia). With the SGM formula transferred to the other subsidiaries, Numico benefited from the increase of sales potential. Its consolidated sales from all subsidiaries would boost Numico's financial performance.

8.5.4. Evaluation and Control

The last element in the Strategic Management Process is to monitor the result of the performance of a company. This element can pinpoint the weaknesses of previous process and take corrective action if needed. To evaluate and control effectively managers should obtain true information from people within an organisation.

Sari Husada has an evaluation and control mechanism in it to monitor its performance. Every department is to report all of its expenses and to clarify any variance from its budget. "(E)very department has its own cost centre code. And at department level, the cost centre is broken-down into director level, manager level, etc. to the lowest level. Every cost centre is responsible for all expenses they spent. The Finance and Accounting department issues a monthly cost centre report, to be distributed to the Board of Directors and all cost centres within the company. Each cost centre is required to give clarification about variances of all expenses from the budgeted figures. Headquarters demands an explanation of every 10 percent variance of spending from the targeted figure. The Finance and Accounting department role is to be the watchdog, we just ask them to make explanation if any variance unexpectedly happens." (interview with Joko Suroto).

The Finance and Accounting department should provide data for management to make decisions. To do that staff need to monitor daily transactions at all department levels. “(T)he Finance and Accounting department has a goal to supply reliable data to management within the allocated timeframe. To supply this reliable data we need to control and make adjustment on a daily basis. If an unusual transaction and balance happens during the day, we inform the related department. The department will check whether that movement is fine and in accordance with that department’s planning or not. At least a responsible manager is always aware of the department on that specific day. Our staff in the Finance and Accounting department already know their job in monitoring the daily transactions of all departments within the company” (interview with Joko Suroto). With this evaluation and control mechanism Sari Husada’s spending can be closely monitored. The Finance and Accounting department does this as part of the comprehensive monitoring systems. The executive management is able to make a right decision because of the information supplied by the Finance and Accounting department.

8.6. Conclusion

Strategic Management is a process within a company to optimise usage of its resources to gain an advantaged position amongst its competitor. Most of scholars agree that the strategic management process consists of environmental scanning, strategy formulation, strategy implementation and evaluation and control. This process is a never-ending procedure in which a company should tackle to succeed.

Sari Husada has followed a good practise of strategic management. It can be seen at the department and overall level that each of them tries to optimise the usage of resources it has within its situation. Sari Husada has succeeded to benefit from it relationship with parent company Numico.

After analysing the strategic management process in Sari Husada, the next chapter will provide an analysis of the development of Sari Husada.

CHAPTER NINE

ANALYSING THE DEVELOPMENT OF SARI HUSADA

9.1. Introduction

The development of Sari Husada as a company has continued since it was established as the state owned company (perusahaan negara) Sari Husada in April 1961 (Indonesian Government Regulation PP 83/1961). The establishment of Sari Husada was a result of merger between NV Saridele and another state owned company. According to the Indonesian Government Regulation PP 83/1961 the new company formation aimed to participate in developing the national economy within the pharmaceutical and medical equipment industry with a focus on fulfilling the needs of society.

This chapter aims to critically analyse the development of Sari Husada as a company. To do so this chapter will describe the evolution and corner stones of Sari Husada, the spin-off of Sari Husada, Sari Husada under the Numico era, the changes of management, the crucial decisions made by the management, the whistleblower, later Numico intervention within the company and the meeting of a Sari Husada Director with the Indonesian House of Representative.

9.2. Sari Husada as a Private Company

Since the formation of Sari Husada as a joint venture company between PT Kimia Farma (a state owned company) and PT Tiga Raksa Satria in 1972, operationally Sari Husada was transformed into a private company. Combining the advantages of a producer of baby milk formula with a trading company, PT Tiga Raksa Satria had set up Sari Husada to make a start to grab the Indonesian baby formula market.

Moreover since the listing of its shares on the Jakarta Stock Exchange in 1983 Sari Husada became a more advanced form of company. Only twenty four companies were listed on the bourse at that time. With the public holding twenty percent of the company's shares Sari Husada was not only able to gain fresh funds, but it also was able as a consequence to open itself to the market. The money gained from the public offering was used to modernize the production facilities in its Yogyakarta factory. Kimia Farma had a limited concern in developing Sari Husada because of its limited experience as a state owned company. No other state owned company did business in the baby formula industry. Tiga Raksa eyed this opportunity and waited until Kimia Farma wanted to sell its stake in Sari Husada. Kimia Farma then, decided to focus its business solely on pharmaceutical production.

Although Sari Husada was fully owned by a private company, the management was retained using a company system that was the same as that used by a state owned company. The Yogyakarta factory was treated as just a production point which had the duty to produce as much product as possible. The marketing activity was conducted in Jakarta which had no direct relation to the production line. Tiga Raksa Satria as a trader company only had knowledge of distribution matters but had no experience in creating new formulas or products. Fortunately the management of Sari Husada was in the hands of production people. Although it got no instruction from the marketing division, which was conducted by the parent company (Tiga Raksa Satria), Sari Husada's management was able to show its performance by booking profits over the years. The experience in the production line was the key success factor in doing this. The traditional production approach used by the management was a consequence of the unguided policy of its board of commissioners.

9.3. The Spin-off of Sari Husada

Sari Husada was jewel in the crown for Tiga Raksa Satria. It was a very hard decision to sellSari Husada. In the situation of a high debt burden with rocketed interest rates in 1998, there was no other choice for Tiga Raksa Satria to save its business conglomerate. Tiga Raksa Satria had to spin-off the most attractive subsidiary to Royal Numico N.V. The majority share-holding of Sari Husada was transferred to Numico's hands. Sari Husada's Board of Commissioners as representing the majority of shareholders agreed to sell Sari Husada to Numico, while the Board of Directors had to agree to what Board of Commissioners wanted.

Johny Widjaja as the principal owner of Tiga Raksa Satria had unwritten promises with Numico management. When Sari Husada grew Numico would make it the principal subsidiary for the Asia Pacific region in the future (Interview with Johny Widjaja). In return Numico would benefit from all the formulas of Sari Husada's products and might pass these formulas to other Numico's subsidiaries.

9.4. The Reasons for Numico Acquisition

During the time of the economic crisis in 1998 Sari Husada faced the fact that its profit had become consumed by servicing debt and new credit on viable terms was hard to obtain. It was not only unable to move forward but also was expending all of its energy even to stand still (Metro-Press, 2003). The arrival of Royal Numico N.V. Holland, which took over 45 percent of Sari Husada's shares from Tiga Raksa Satria, had provided new blood for Sari Husada. Numico also took on 80 percent of Sari Husada's capital spending program in new investment projects by dominating a rights issue to buy newly issued shares for existing shareholders. With a high value of foreign currency to Indonesian domestic currency the takeover was very cheap in US dollar terms. Numico's involvement has accelerated the production capacity and has provided management expertise to Sari Husada's management. New technology was introduced while financial credibility was enhanced. Sari Husada also had started to export its products to Iran to accommodate the excess production which was created by the drop in the domestic market demand in 1998 (Metro-Press, 2003).

The take-over has not only benefited Sari Husada but it has also benefited Numico. With a relatively low consumption of baby milk formula by Indonesian babies, many global baby milk formula producers were being encouraged to enter

Indonesian market (Hellen Keller Worldwide, 2003). Unfortunately new investment in milk formula manufacture was classified as a negative investment by the Indonesian government. The only way to enter the Indonesian market was by a take-over of the shares of an existing manufacturer. The acquisition of Sari Husada not only opened the way for Numico to enter the Indonesian baby formula market as a dominant player, but also provided a back-up for its existing subsidiary, PT Nutricia Indonesia Sejahtera. When there was an increase in demand for Nutricia products, Sari Husada might allow Nutricia Indonesia Sejahtera to manufacture its products using Sari Husada's production facility. For Sari Husada this situation was also a benefit because it could optimise its production efficiency. The joint forces of these two subsidiaries alowed Numico to grab all of the market segments for baby milk formula. Sari Husada filled the low to middle income customer and Nutricia Indonesia Sejahtera served the upper income level customer.

9.5. The Management of Sari Husada after the Acquisition

The management of Sari Husada as Numico's subsidiary was made public at the 1998 Annual General Meeting of Shareholders. The AGM kept Dwiyatno Siswosumarto as the President Director and Setyanto as Production Director. The AGM also appointed Muhammad Ilham Hidayat as Human Resource Director (Annual Report 1998). As Finance Director, Numico, the majority shareholder, appointed Felix P. Mulia. Felix previously had worked for Nutricia Indonesia Sejahtera, another Numico subsidiary in Indonesia (Interview with Felix P. Mulia).

By appointing its official to the Board of Directors Numico had the expectation that every finance decision would be under its surveillance.

The appointment of Felix as Finance Director was seen as a means to speed up the integration of Sari Husada with Numico headquarters. The Board of Directors felt that it had weaknesses in the finance area, especially in finding channels for sources of funds. Numico's appointment of Felix was appreciated by the members of Board of Directors who saw the appointment of an Indonesian official, rather than a Hollander, as smoothing the transition after acquisition. An Indonesian born official might know an Indonesian company better than a foreigner. Felix was accompanied by other Numico officials on the Board of Commissioners, they were Peter Kroes and J.C.T. van der Wielen. With three other Sari Husada commissioners chaired by Johnny Widjaja, the Board of Commissioners was expected to guide and monitor management decisions (Annual Report 1998).

Under this management Sari Husada continued previous management policy in doing its business. The company continued to focus its business on production. The sales and marketing department was still not considered to be as important, because Sari Husada had sold most of its products to Tiga Raksa Satria. By the end of 1998 Sari Husada proposed Eddy B. Regar as Marketing Director. He, then, was appointed at the 1999 Annual General Meeting of Shareholders (Annual Report 2000). This appointment signaled that Sari Husada had started to explore other areas of development and expansion for the company.

Numico has continued to integrate Sari Husada to its system by appointing two other Holland based officials to serve on the Board of Directors. At the 2001 Annual General Meeting of Shareholders of Sari Husada, Numico appointed Johannes (Harry) M. Klompe as Business Development Director and Michiel J.A. van der Meer as Project Director (Annual Report 2001). The Klompe appointment has strengthened Sari Husada's marketing strategy, especially the launching of new products and advertising campaigns. While the van der Meer appointment was made to oversee the development of new manufacturing and storage facilities in Klaten. Numico realized that the future of Sari Husada was based on the capacity to produce more products and to sell them.

9.6. The Resignation of the Sari Husada CEO and Appointment of New CEO

The management of Sari Husada changed again in 2002. Three members of the Board of Directors were replaced. Dwiyatno Siswosumarto resigned as President Director. Eddy B. Regar also resigned as Marketing Director, while Muhamad Ilham Hidayat retired as Human Resource Director. The resignation of so many board members indicated that there was a problem within the management team. The reason has emerged that Dwiyatno's resignation was triggered by incompatible policies within the Sari Husada board, especially the aggressive intervention of the Holand based directors. As a captain of Sari Husada Dwiyatno realized that it was impossible to have a ship led by two commanders. It was better for the company if he gave the new commander an opportunity to lead the company. Dwiyatno mentioned that the formal reason for his resignation was because he wanted to spend his time with his family and donate his efforts to religious activities (Interview with Felix P. Mulia).

The Sari Husada Annual General Meeting of Shareholders, 2002, then appointed Soeloeng Hamonangan Nasoetion as President Director. The AGM also elevated Johannes M. Klompe to Senior Vice President Director and Michiel J.A. van der Meer to Operation Director. The board also received Rachmat Suhappy as Production Director, while Setyanto got a new position as Research and Development and Quality Assurance Director. A few months after the AGM, the majority shareholder also nominated Jenny Go as Marketing Director.

The new President Director has had various experiences in conducting business in Indonesia and overseas. Nasoetion was educated at a Western university. He is half Indonesian and half Dutch. The greatest advantage he had was that he had a background in accounting and was one of the founders of a big Indonesian accounting firm (Interview with Nasoetion). The appointment itself was unexpected by Nasoetion. He was contacted by Johnny Widjaja (President Commissioner) and was offered the Sari Husada CEO position. Then Johnny proposed his nomination to Peter Kroes (Vice President Commissioner). Peter also knew Nasoetion before and agreed to nominate him to the AGM. This appointment was considered to heal the wound suffered by the Sari Husada employees from the loss of Dwiyatno, who was a father figure for all of the employees at Sari Husada (Interview with Felix P. Mulia).

The other two new directors were recruited differently. Rachmat Suhappy originated from Sugizindo, a Sari Husada subsidiary that provided manufacturing services for producing and packaging infant formulas. Before he served as a director in Sugizindo, he had experience in working as a manager in Nutricia Indonesia Sejahtera (another Numico subsidiary in Indonesia). From his background, the appointment of Suhappy was considered to be an internal promotion within a Numico subsidiary. His position on the Sari Husada Board of Directors was expected to bring Sari Husada's decision making process in line with Numico's policies. Another director, Jenny Go, had experience in the food and beverage industry. She had served as the Marketing Director of an indirect competitor of Sari Husada (Interview with Jenny Go). Although her educational background was far from the marketing area, her experience in the marketing activities made an advantage for her.

9.7. The Withdrawal of Numico's Officials from the Board

In 2003 Board of Directors was readjusted again. After only serving for one year Klompe and van der Meer were called back to Holland for another appointment. The positions they left were not filled by other persons. The Sari Husada Board of Directors then consisted of five members and the Board of Commissioners operated with four members. Although the number of directors was reduced by two, the withdrawal of the Holland based directors did not affect the business activities of Sari Husada.

Numico decided to withdraw its Hollland based officials from the Sari Husada Board of Directors in 2003 because of a number of reasons. As the Numico strategy was to focus on high growth and high margin products, it felt that Sari Husada's strategy did not totally fit with it. After a visit by the Numico CEO, Jan Bennink, to Sari Husada in October 2002 Numico saw that Sari Husada's products were targeted to low-middle income families. These products could be high growth products, but might not be high margin products. Sari Husada had a thin margin on its products. The only possibility for profit growth was to produce those products in the most efficient way and sell as much as possible. In Sari Husada's management terms the key success point of Sari Husada was volume not value (Interview with Agus Budiyanto). For this reason the Numico management saw the appointment of Dutch officials to Sari Husada was no longer needed. Numico believed that the management of Sari Husada would take care of the business in an appropriate way as was needed.

A year after the withdrawal of the Holland based directors the General Meeting of Shareholders in 2004 appointed a new Independent Commissioner, Marzuki Usman. It was thought that Marzuki, who was a former chairman of Bapepam, a former Indonesian Minister and currently serves as Senior Advisor to the Jakarta Stock Exchange, would attract special treatment from the government agencies. This appointment was suggested by Johnny Widjaja.

9.8. The Crucial Decision Made by the Board

During Sari Husada's development the Board of Directors has made some important decisions. Those decisions were an Employee Stock Option Program (ESOP), a share buyback, a stock split and the implementation of SAP. Each of these decisions will be discussed below.

9.8.1. Employee Stock Option Program

An Employee Stock Option Program (ESOP) is a scheme to grant a company's employees an ability to participate in owning the company shares. The program aims to relate compensation for employees to the financial and market performance of a company. An ESOP itself can be classified into two proposals which are an All-employee Share Plan and an Enterprise Management Incentive (EMI) (Casson, 2000, p.viii).

The ESOP proposal was discussed at an Extra-ordinary Meeting of Shareholders of Sari Husada in October 2003. The General Meeting of Shareholders agreed to grant an ESOP to its commissioners, directors and managers of five percent of total outstanding shares or equal to 94 million shares. According to Casson (2000) this ESOP is an Enterprise Management Incentive (EMI) which was specially targeted to tie management incentives to the financial and market performance of the company. The proportion of shares disbursed in the ESOP program was 44.8 percent for the members of Board of Commissioners, 42.5 percent for the members of the Board of Directors and 12.7 percent for managers. Johny Widjaja as President

Commissioner received 19.67 million shares which were 20.88 percent of total ESOP distribution, Peter Kroes as Vice President Commissioner was given 12.5 million shares and Suad Husnan as Independent Commissioner earned 10 million shares from the ESOP program. The members of Board of Directors each received an equal amount 8 million shares regardless of their tenure in serving the company. The managers were given a lesser amount of shares since their total rights amounted to 12 million shares and these were divided among more than 30 people (Koran Tempo, Friday 8 July 2005).

From the distribution of shares in this ESOP program it can not be denied that the most beneficial recipients were the members of the Board of Commissioners, especially Johny Widjaja who received 20.88 percent of the total ESOP share distribution. The initiation of the ESOP program was from a Board of Commissioners' proposal rather than from the Board of Directors' initiative as Nasoetion (President Director) mentioned (Koran Tempo, 2005). When the Board of Directors asked for a distribution for employees Widjaja said that the shares should be taken from the Board of Directors portion (Toarik, 2005a). The question was why the Board of Directors passed the ESOP proposal to the Extra-ordinary Meeting of Shareholders in 2003. The management might have thought that this initiative had been discussed with the Numico headquarters. Numico should have known of the proposal because its representative Peter Kroes (Head of Region of Numico for Asia, Africa, and South America) sat on the Board of Commissioners.

9.8.2. Share Buyback

Share buyback is a finance decision of a company to buy some of its outstanding shares from the market. Dobbs and Rehm (2005) state that a share buyback will send signals about the company situation to the market. The signals may be a positive signal that the company's shares are undervalued or that the management was confident with its cash policy to cover future commitments. But a share buyback may be translated into a negative signal when the market suspects that management has few investment opportunities ahead and is advising investors to put their money elsewhere. Technically a share buyback will increase earning per share (EPS) because the earnings will be divided between a smaller amount of shares. This finance decision will also affect a company's capital structure when available cash is absorbed to finance the action. Dobbs and Rehm (2005) suggest that a share buyback does not increase underlying performance or value of a company. They add that if the program allows management compensation to be linked to earning per share it will harm the long term health of the company.

The Sari Husada General Meeting of Shareholders at its Extra-ordinary Meeting in October 2003 came up with several decisions. One of these decisions was a share buyback program which started immediately after the meeting for the following 18 months. The buyback program was to buy 10 percent of its outstanding shares which amounted to 188.35 million shares. Sari Husada prepared 200 billion rupiah from its account to finance this program. The strange fact, which was seen by market analysts, was that the share buyback program was in parallel with the ESOP.

At the time these decisions were announced the Sari Husada shares which actively traded in the market amounted to only 5 percent of shares issued. The buyback program of 10 percent of outstanding shares was easily interpreted as being designed to absorb the newly outstanding shares issued by the ESOP program.

9.8.3. Stock Split

The stock split decision was a result of the Sari Husada Annual General Meeting in 2003. The decision was made to improve the liquidity of shares traded on the Jakarta Stock Exchange. Sari Husada shares with a nominal value of 500 rupiah were traded above 21,000 rupiah in the market in 2003, while average share prices traded on the bourse was thousands rupiah rather than tens of thousands. For a quite long period stock analysts and brokers suggested that Sari Husada management should split the nominal value of its shares to boost the activity of share trading. The high price of the share meant investors were reluctant to buy because they needed a large amount of funds and they also might think that the high share price was hard to move up. They were better off in investing their funds by targeting the average priced shares in the market, which were actively traded.

The 2003Annual General Meeting finally agreed to a decision on the stock split to make Sari Husada share trading more active. This decision was sound from a finance point of view but the real reason behind this decision should be suspected because for a long period Sari Husada management rejected such a proposal. The policy to split the nominal share price was granted when the company was conducting two other important policies, the ESOP and a share buyback. The market could easily read that this decision was targeted to activate Sari Husada's share trading and to gain price increase of the market price of the company's shares. The parties that would benefit most would be the recipients of the ESOP program.

9.8.4. Implementation of SAP

The SAP (Systems, Application and Products in Data Processing) program is a part of Enterprise Resource Planning (ERP) and Supply Chain Management (SCM) which aims to improve the efficiency of all lines of a company. Sari Husada invested US$ 2 millions for a SAP Business Suite application program. This SAP Business Suite program consists of modules which cover the areas of finance, human resource management, sales and distribution, plant management, quality management, sales order and production planning (Deriz, 2004). Sari Husada needed this SAP program to integrate its business processes and supplier and marketing channels, and to handle various alternative formulas of its milk based products.

Felix (Vice President Director and CFO) mentioned that this information technology development was in line with Sari Husada's vision to provide an affordable price for its dairy based products without sacrificing the quality (Deriz, 2004). The implementation of the SAP program was in June 2004 and went operational in February 2005. Using this SAP program Sari Husada was able to perform product tracking in less than 4 hours, a substantial improvement from 2-3 days previously (Annual Report 2005). This product tracking method provided Sari

Husada with a significantly improved quality assurance system. The company was not only able to improve operational efficiency, but also was able to increase product quality and post lower rejection rate and consumer complaints. With this information technology investment, including the development of infrastructure and refurbishment of all personal computers, the Sari Husada management was preparing to face global competition in the future with more confidence.

9.8.5. Corporate Social Responsibility and Award Received

Sari Husada believes that programs on Corporate Social Responsibility (CSR) should not be implemented on the basis of compliance. It should be come from a sincere dedication to build harmonious relationships with communities to create prosperous coexistence (Annual Report 2005). Sari Husada translated CSR into some community development programs addressing education, social welfare and empowerment of small-scale economy. In 2005 the company spent more than 1.5 billion rupiah to finance its CSR programs. In the education area, Sari Husada provided scholarship programs for around 2000 students. Around 1,600 patients received free medical treatment sponsored by the company. It also provided packages of stapled food for under-privileged families and gave monthly donations to nursing homes for the elderly and orphanages. Sari Husada trained individuals and small-scale enterprises with basic business knowledge, such as costing and pricing calculations. It also supported a working capital for qualified participants to accelerate the development of their businesses.

Sari Husada received some awards for its products and brands in 2005. It was chosen by SWA magazine and MarkPlus Consulting as the Best Public Company based on Economic Value Added (EVA) Concept. The backbone brand, SGM, also received the most valuable brand in formula milk category from SWA magazine and MARS. The other packaging and consumer branding awards received by Sari Husada were SGM in the baby porridge category, SGM 2 in the baby powder milk under 1 year, SGM 3 in the kids powdered milk category and Lactamil in the pregnancy milk category. Those awards strengthened the existence of the company's products.

9.9. The Whistleblower

The whistle-blowing phenomenon happens when a person in an organisation knows something is wrong in the organisation. A whistleblower can be a hero who fights corruption (Julie, 1987) or a company traitor who reveals secrets for his/her own personal glorification (Petersen & Farrell, 1986). For a whistleblower there are reasons for blowing the whistle. The important consideration is that this phenomenon will have personal consequences for the blower and for the organisation in the short and long term.

Felix P. Mulia according to one of the finance magazines in Indonesia can be categorized as a whistleblower. As the Vice President Director and Finance Director (CFO) of Sari Husada he had already tried to prevent two significant decisions which may have affected the company's financial health. He has also enthusiastically reported the decisions made by the Board of Commissioners to Numico headquarters in Holland but received no equal reply (Toarik, 2005a). The decisions to give the Employee Stock Option Program (ESOP) to members of the Board of Commissioners, the Board of Directors and company managers and to do a share buyback at the same period alarmed Felix. Especially the idea that the ESOP was only granted to members of the Board of Commissioners and the Board of Directors and would not give any benefit to the other employees of Sari Husada upset him. Then the ESOP program was adjusted to include all managers of the company in order to hush possible rejection from employees. The ESOP program finally has been granted with a big proportion of the ESOP rights directed to the members of the Board of Commissioners, a fair sum amount for members of the Board of Directors, and a small portion for the managers. The inequality of ESOP distribution was not only in the proportion of distribution but among the member of the Board of Directors the distribution was seemed unfair. Every member of the Board of Directors was granted the same amount of shares regardless of their tenure in serving the board.

The whistle-blower phenomenon should consider the cost and benefit of the action. A whistleblower may experience retaliation or may be ignored by the organisation (Miceli & Near, 1992). He or she has to prepare for any consequence affected by the action.

9.10. Meeting with the House of Representative

The Board of Director of Sari Husada was summoned to the Indonesian House of Representatives (DPR) on 22 June 2004 to give an explanation at a public hearing by Commission VII. Lapoe Moekoe, a member of the House of Representatives, accused Sari Husada of misleading its Indonesian customers by giving a statement that SGM, one of its baby milk formula products, had the same nutrition as mother's breast milk. Lapoe also found a contract between a mid-wife in Singaraja Bali with Sari Husada which stated that the mid-wife would recommend SGM to all mothers who gave birth at her clinic. As a reward the mid-wife received 6 million rupiah (Dewan Perwakilan Rakyat, 2004a and 2004b). This practise violated the International Code of Marketing of Breast Milk Substitute which banned samples and gifts to mothers and health workers and banned sales incentives for breast milk substitutes (IBFAN, 2004). Although Indonesia had implemented parts of the Code since 1985, all milk formula producers used to conduct these practises to gain larger market shares.

Nasoetion, the President Director of Sari Husada, answered the House questions with a statement that none of the milk formula products had an equal nutrition content to mother's breast milk. Sari Husada denied the accusation that its product could be consumed as a substitution for mother's breast milk. Although giving free samples to birth clinics and hospitals and providing gifts to health workers and mothers were commonly practised by all milk formula producers, Nasoetion promised to the House of Representatives to reevaluate Sari Husada policies and marketing activities with regard to the implementation of International Code of Marketing of Breast Milk Substitutes.

9.11. The Later Numico Intervention

Numico intervened to change the board formation of Sari Husada again in 2005. There were two reasons for this action. First, the Board of Directors should be reformed again after the retirement of President Director Nasoetion. Nasoetion's appointment in 2002 was only for three years. The second reason was the scandal of insider trading which emerged after the ESOP program and share buyback policy was instituted. The Indonesian Capital Market Supervisory Agency (Bapepam) conducted an investigation to uncover the insider trading accusation.

At the Annual General Meeting of Shareholders in 2005, Numico as controlling shareholder nominated a new President Director for Sari Husada. Budi Satria Isman, who had previously served as a Director at Coca Cola Amatil Indonesia, was appointed as CEO at the AGM. The AGM also agreed not to appoint Felix P. Mulia as Vice President Director. This decision was related to the insider trading accusation which involved him. The AGM also made the decision to switch a position on the Board of Commissioners. Johnny Widjaja and Peter Kroes changed positions. Kroes then was serving as President Commissioner and Johnny as Vice President Commissioner.

Soon after the 2005 AGM there were some events which happened in Sari Husada. First, Suad Husnan, the long serving Independent Director, resigned due to an unexplained reason. His successor, Mardjono Reksodiputro, was appointed at the Extra-ordinary Meeting of Shareholders in 2005. Presently Mardjono is the chairman of the Indonesian Crime Prevention Fund Foundation (ICPFF) and is a prominent figure in the Indonesian and ASEAN Law Community. Second, Bapepam investigated the Sari Husada management to find out the truth about the insider dealing charge. During the inspection the Board of Commissioners assigned the Independent Commissioner and former Chairman of Bapepam Marzuki to represent Sari Husada before the Bapepam committee (Toarik, 2005b). The accusation that the Marzuki appointment was to gain a better protection against government bodies was proven. Another event was the resignation of the President Commissioner and the Vice President Commissioner. Kroes and Johnny resigned from Board of Commissioners. Budi Satria Isman, the new President Director, announced Gerrit Kayaertes as the new President Commissioner.

The final event was that Johnny Widjaja and his family sold all of their Sari Husada shares to Numico. Numico believed that although the insider dealing charge was still undecided yet, it had implications for Sari Husada shares market price. Numico bought the remaining shares from the Widjaja family for several reasons. Numico wanted to honor the Widjaja family for its dedication in forming and developing Sari Husada for more than 32 years. The Widjaja family gained a significant premium over the market price when selling its shares. Numico bought Sari Husada shares at 3,500 rupiah per share from the Widjaja family and announced that it would buy at the same price from public shareholders. This announcement was responded to positively by the market. When the insider dealing charge was under investigation by Bapepam, the market responded to the decision by elevating Sari Husada's price to nearly 3,500 rupiah from around 2,000 rupiah previously.

Bapepam on 20 September 2005 concluded that insider trading was not found in the Sari Husada case (Detik, 2005). Sari Husada shares were traded fairly and the share buyback was based on fair market transactions. The increase of the Sari Husada share price was gradual within the bourse regulation and was a result of market transactions. Bapepam only found violations of the share buyback transactions done by Johnny Widjaja and Felix P. Mulia. Both of them were doing transactions on buying and selling of Sari Husada shares on the same day as the company did the share buyback from the market. Johnny and Felix were penalized by a fine of 1.3 billion rupiah and 981 million rupiah respectively. Other members of the Board of Commissioners and the Board of Directors were also fined because of the late submission of a report for the changing ownership of the company's shares.

9.12. Conclusion

Sari Husada has developed as a reputable baby food producer company over a four decades. It has evolved from a state owned company to a joint venture company, and then it became a private company. Then after listing its shares on the Jakarta Stock Exchange Sari Husada became a public company. The financial crisis of 1998 caused financial difficulties for Sari Husada and its parent company Tiga Raksa

Satria. Then Numico, a giant multinational company based in the Netherlands took over Sari Husada.

Under the Numico umbrella, Sari Husada managed to grow and became a modern company. The information system application supported Sari Husada's development as a subsidiary of a multinational company. Despite its development Sari Husada experienced a number of events that influenced its situation. The proposals of the ESOP program, a share buy back and a stock split were agreed at the 2003 General Meeting of Shareholder with the intention to encourage Sari Husada's managers to perform better and to activate Sari Husada share trading on the bourse. Unfortunately these policies were used as a means to gain a personal benefit by a member of the board. The majority shareholder realised that this situation resulted from the failing of the monitoring system of the Board of Commissioners. That was why the company appointed Marzuki Usman and Mardjono Reksodiputro to be the Independent Commissioners. Their experience and reputations were expected to increase the ability of the Board of Commissioners to monitor the executives and to help the company when it has problem with the authority.

Above all Sari Husada's management still managed to book profit for the shareholders. The current development of Sari Husada showed that the company was not only recovering from the Indonesian economic crisis, but moreover it was able to evolve into a new modern company. The implementation of sophisticated IT systems, and the management making hard efforts in implementing the corporate governance codes has made Sari Husada able to build a prosperous future.

Although as Davis (2005) mentions profit is not an end in itself but it is signal from all customers and society that a company is providing things that people want. So a company should not only consider its own interests but should also have a wider responsibility to wider stakeholders and society. This corporate social responsibility signals that a company should have a legal obligation to its stakeholders and society as a whole. When a company ignores the public interest it makes itself vulnerable in defending its market share from any fluctuation in the market.

After analyzing the development of Sari Husada as a company, the next chapter will conclude the study. The conclusion chapter will wrap up all the aspects which are discussed in the previous chapters.

CHAPTER TEN

CONCLUSION OF THE STUDY

10.1. Introduction

The purpose of this study has been to gain an understanding of the pattern of corporate governance practised at PT Sari Husada Tbk. The study has addressed several questions of how the company governed itself, what elements of corporate governance existed within the company and why the company practised it like that. Those questions should reveal a comprehensive understanding of the corporate governance system which was adopted by a profit oriented public listed company.

In Chapter One, it was noted that the availability of published research on corporate governance practise in Asian countries during and after the Asian economic crisis is very limited. Even more it was revealed that the knowledge of corporate governance practise in the Indonesian company context is also limited. The past studies on corporate governance in Indonesia were only conducted in the banking sector (Tabalujan, 2001, 2002a and 2002b). In Chapter one, it was argued that a study of real world experience of corporate governance practise could contribute to the body of knowledge of corporate governance over the years. Good corporate governance practise was suspected to be the driver of survival of companies during a crisis. Accordingly the current study has focused on the practise of corporate governance of a private sector organisation in Indonesia which survived and booked profits during a crisis.

In Chapter Two, the notion of corporate governance from different aspects was discussed. The term corporate governance came from Berle and Means (1932) writing about the separation of ownership and management. The owners of a corporation have difficulties in monitoring and disciplining managers who run the company on daily basis. Jensen and Meckling (1976) state that the separation of ownership and management creates an opportunity for managers to pursue their own interests, because of the inability of the owners in monitoring them.

In Chapter two the various definitions of corporate governance were discussed. The definition emphasizes three important parties within a company, owners (shareholders), directors and managers (executives). In maximizing the firm profit and long term value the managers should take into account the interest of other stakeholders (Stone et al., 1998). The different models of governance were also discussed with special focus on the specific countries of the US, Germany and Japan. Each governance system claims an advantage above other systems but none of the systems can be implemented in every condition.

During the Asian economic crisis some factors were pointed to as the cause of corporate failures. The high concentration of ownership, ineffective mechanisms of board supervision, inefficiency and non-transparency of control procedures, high dependence on external source of funds and a lack of creditor supervision were among of the causes of the company crisis (ADB, 1999). Good corporate governance practise is believed to be the main factor leading to better financial performance (see Perry (1999); Desai (1998); Darazsdi (1996); Daily (1991); Forjan (1993); Rubach (1997); Kochhar (1995); Gedajlovic (1993); Mulick (1993); Rechner (1996); Wang (1991); Molinary (1990); and Ikenberry (1990)).

In Chapter Two, it was shown that there was a challenge to build better corporate governance systems in Asia after the economic crisis. Each country differs in governance practise because of different legal and cultural systems. In this study models and elements of corporate governance were observed to gain understanding of different perspectives of corporate governance practise which happened in the Indonesian company context.

In Chapter Three, the research method was discussed to provide guidelines and a framework for doing the research. Case study research was chosen as the approach to study the phenomena of corporate governance practise in an Indonesian company. Using the case study method of research all data relevant to the case were gathered and organized and used to intensively analyse specific details. In this chapter, the research design was developed to link the research question to the data and allow a conclusion to be drawn.

Chapter Four described the business environment in Indonesia. In this chapter the general information about Indonesia was described and the business regulations, with a description of employment regulations, intellectual property rights, land rights and taxation. The development of the capital market, banking sector and foreign capital as the source of finance for a company, was also discussed. The development of Jakarta Stock Exchange, the capital market regulatory vision and strategy and the National Committee on corporate governance establishment were also discussed.

Chapter Five described the organisation of the subject company. The reason for choosing Sari Husada as the case study for the research was revealed. The company evolved from a state owned company, then became a join venture company, and then became a private company. After listing its shares on the Jakarta Stock Exchange Sari Husada was then acquired by a multinational company, and became a subsidiary of Royal Numico of the Netherlands. Under Numico ownership many changes were made. The leadership changes in Sari Husada affected the expansion of the production facility. It was also revealed in the chapter that Sari Husada has five amulets for its success which guarantees its products are safe and reliable to be consumed by everyone.

In Chapter Six, the corporate governance model employed by Sari Husada was discussed. The two-tier board structure of Indonesian companies has influenced the practise of corporate governance systems which differ from Anglo-Saxon models in maximizing shareholder wealth. Sari Husada has managed to move toward putting attention more on the stakeholders' interests. The step by step changes of governance practises made by the executive board has succeeded in directing the practise toward an ideal condition for an Indonesian company.

Chapter Seven discussed the corporate culture. The pattern of employees' behavior and their work environment will influence the success of a company, because the real existence of a company lays in the heart and mind of its employees.

Bower (1966) describes corporate culture as "the way we do things around here". Schein (1991, p.9) provides a definition of culture as "a pattern of basic assumption - invented, discovered, or developed by a given group as it learns to cope with its problems of external adaptation and internal integration - that has worked well enough to be considered valid, and therefore, to be taught to new members as the correct way to perceive, think, and feel in relation to those problems."

In this chapter the cultural change in the form of staff' behavior, management policies and the company's practises were discussed. Some changes which were introduced by Royal Numico were adopted successfully. Sari Husada managed to choose a beneficial new culture which is strengthening its corporate culture.

Chapter Eight discussed what strategic management is and the implementation of strategic management at Sari Husada. The term strategy which originated from military discipline then was brought into the business context. The term strategic management means a process within a company to optimise usage of its resources to gain an advantaged position amongst its competitors. This is a never-ending procedure which a company should face to gain success. In this chapter it was shown that Sari Husada has followed a good practise of the strategic management process. All departments within Sari Husada have tried to optimise the usage of resources in dealing with the changes in the external environment.

In Chapter Nine, the development of Sari Husada as a private company was described. The adjustment of board members to accommodate the interests of all parties happened. Directors have come and gone during the process. This chapter noted the crucial decisions made by the board. The sophisticated SAP (Systems, Application and Products in Data Processing) information technology program has been adopted. As part of the Enterprise Resource Planning (ERP) and Supply Chain Management (SCM) the implementation of the SAP Business Suite application program aimed to improve the efficiency of all lines of the company. There were also two other important decisions made by the board, the Employee Stock Option Program (ESOP) and the share buyback. Both decisions later were found to be wrong decisions and caused some members of the Board of Director to leave their positions. Stock market analysts suggested that the problem emerged because of the lack of trust by Royal Numico headquarters of its official serving in a director position who blew the whistle.

10.2. Major Findings

The major findings of the current study are discussed in the following subsections.

10.2.1. The Evolution of Sari Husada

The evidence found at Sari Husada shows that the organisational structure of the company evolved from a simple structure to a modern and complex structure. At the beginning of the development of Sari Husada, it had an organisational structure which was dominated by the production function. The company, at that time, focused its operation on the production of baby milk formula products. The marketing activities were conducted by an external party. Then, after it listed its shares on the stock market and operated a bigger production facility, Sari Husada added an additional function to its organisation structure. The company realised that it faced competition from other manufacturers and started to involve itself in marketing activities to push up its sales. The later development of Sari Husada under Numico's holding, led to a more complex organisational structure. In its organisational structure, Sari Husada divided its operation into several functions, including production, marketing, finance and accounting, human resource, information technology (IT) and research and development (R&D) and quality assurance (QA).

The enlarged and enriched organisational structure was backed up by IT systems. During the late 90s and the beginning of 2000, Sari Husada used the EXACT accounting and reporting system. This accounting and reporting system was able to relate activities done by separate divisions. The management was well informed about the fulfillment of targeted figures in each division. Any deviation by the real figure from the targeted figure needed to be clarified by a responsible manager or staff. The system was perfected by using the SAP (Systems, Application and Products in Data Processing) program. This Enterprise Resource Planning (ERP) and Supply Chain Management (SCM) application program was able to improve the efficiency of all lines of the company. Sari Husada was not only able to integrate all of its business processes with supplier and marketing channels, but also was capable of handling various alternative formulas of its milk based products. Using the SAP program Sari Husada had an ability to track its raw materials and products along the supplier and marketing channels within hours. This ability allowed Sari Husada to ensure its production processes and the quality assurance of its products operated efficiently.

10.2.2. Role of the Change Agent

There are some milestones in the development of Sari Husada with regard to the role of change agent within the company. Prior to the Numino acquisition and a while after that Dwiyatno Siswosumarto as the President Director had been able to play an important role in the production area. He transformed Sari Husada from a local minded company to a more modern and forward looking company. He conducted the benchmarking of the company's production to the performer companies within the same industry in the Asia-Pacific region. Dwiyatno then streamlined the company's organisational structure to focus only on its core activities. The number of employees was cut from around 750 people to around 500 people. Sari Husada then gave a golden hand-shake reward to the outgoing employees. The company also provided a safety net for these employees by setting-up a new company within its pension fund. This new company allowed the outgoing employees to continue working at Sari Husada but with different uniform and a different employer.

Felix P Mulia joined Sari Husada just after the Numico acquisition. His role was to introduce a new culture to Sari Husada. The result oriented culture was introduced to replaced a time oriented one. He started to do this not only by words but also by action. Felix also introduced information technology application into the company’s accounting and finance system. Felix’s decision to apply the SAP Business Suite program was an important cornerstone to Sari Husada success. Felix played another role as a liaison officer of Sari Husada to its headquarters in the Netherlands when the company needed an injection of funds to curb the impact of the Asian economic crisis in 1998. He succeeded in convincing Numico to give fresh funds to Sari Husada in order to enable the company to survive and grow during the economic crisis.

Soeloeng H Nasoetion was elected by the Annual General Meeting of Shareholders in 2002 to be the President Director after Dwiyatno’s departure. As a new CEO Nasoetion was able to play a role in bridging the interests of Sari Husada and the interests of Numico as the majority shareholder. He knew the boundaries of Sari Husada staff in receiving new directions from the Holland based Directors. Nasoetion was able to reduce tension within the Board of Directors and deliver more acceptable policies to Sari Husada employees.

10.2.3. The Dominant Role of the Controlling Shareholder

Royal Numico, N.V. has played a dominant role in deciding what Sari Husada should do since the company took it over from Tiga Raksa Satria. As a parent company, Numico imposed a same policy on all of its subsidiaries. The policy should be in line with the 2003 new vision and mission of Numico which was to be a high growth, high margin, specialised nutrition company. Numico required all of its subsidiaries to submit monthly performance figures, complete with an explanation of variance when the performance varied from the targeted figures. Numico appointed its Holland based officials to serve on the Board of Directors and the Board of Commissioners. By doing this, Numico had an ability to monitor all decision making processes at Sari Husada. Even though, in practise the appointment of Holland based Directors and Commissioners did not guarantee that every important decision will be scrutinized thoroughly by the headquarters. The insider trading of Sari Husada's shares which was investigated by Bapepam was evidence of this.

10.2.4. The Tyranny of the Minority

The tyranny of the minority is a unique phenomenon in the Indonesian stock market. This phenomenon is related to the conflict of interest transaction. The conflict of interest transaction happens when the majority shareholder or a director or a commissioner is involved in a company transaction. When this event happens in a company, the authority to resolve the matter is in the hands of an independent party. This independent party is not a shareholder with a substantial shareholding, but the minority shareholders (see interview with Noor Rachman). With this power the minority shareholders have an influence to direct the management policy through a member of the Board of Commissioners. A member of Board of Commissioners, whether he/she is an ordinary commissioner or an independent commissioner, represents the interest of the minority shareholders.

The tyranny of minority phenomenon happened at Sari Husada when a member of Board of Commissioners proposed some proposals, which mostly benefited the interest of the member himself, to the General Meeting of Shareholders. The Employee Stock Option Program (ESOP), a share buyback and a stock split were some of those proposals which were proposed by the member of the Board of Commissioners who represented the minority shareholders.

10.2.5. The Change of Corporate Culture

Sari Husada managed to smooth the change of corporate culture within the company. Previously, Sari Husada had a culture which was oriented to time. Staff did not start their job before 8 AM, and rushed out from their office at 4 PM. Sari Husada management succeed to transform its company culture into result oriented culture. At the beginning of the introduction of the new culture, a manager gave an example of starting work before 8 AM and often staying in the office until late at night to finish his work. The management was able to find the motivation driver of the employees. Sari Husada introduced generous salary packages added to by bonuses which were tied to the company performance. The staff was highly motivated to work hard in fulfilling and exceeding the targeted performance given to them. This performance driven culture is based on the company’s values of trust, transparency and teamwork.

10.2.6. The Focus of Strategic Management

To respond to the market dynamic Sari Husada has set its competitive strategy. This competitive strategy is aimed to increase market acceptance, to expand coverage of products and market, and to improve the efficiency of the distribution channel (Annual Report 2005). The strategy covered some key priority areas. The first priority is affordable price. With a decline of household spending capacity, consumers targeted their budget to buy affordable products. Sari Husada implemented a competitive pricing strategy while maintaining its level of profitability. Innovative product developments were targeted to different market segments with more health-conscious demand. The company continued to release new products to fulfil customers' needs. The continuous development of the distribution channel was an attempt to improve the effectiveness and efficiency of product delivery to customers. The SAP program ensured the monitoring system of product delivery worked as it was planned. Marketing communication was a strategy to promote products' benefits and to gain a better understanding of consumers' requirements and expectations.

Sari Husada on the other side also had a disadvantage under Numico's holding. Because of the different mission of its parent company Sari Husada lost the potential to expand to the global market. With a focus on the affordability of its products, which is different to the high margin products of Numico's mission statement, Sari Husada would grow and expand into global market if it could sell its secret formulas of products to the same industry in other developing countries. This opportunity was restricted by Numico because it would trouble Numico's value which produces high margin products only.

10.3. Strengths and Weaknesses of the Study

A number of academics and theorist in the field of corporate governance have presented ideas and suggestions regarding the context and the use of corporate governance in practise and its impact on organisational effectiveness. As pointed out in the introduction to the study, few published case studies exist to demonstrate the practise of theories in corporate governance in order to gain more understanding of the real world experiences of corporate governance. This case study has a major strength in showing the fact that it uses the concept of corporate governance as a means of developing a model of a real organisational experience. The framework of the current study is built upon the work of researchers and describes how the researched organisation uses a particular corporate governance model in realizing its objectives. The study contributes to the corporate governance discipline because the studied company was able to create its own path in delivering its vision and mission.

Another strength of the current study is the use of the case study method. A case based study is more likely to play an important role because it can include observations of a wide range of practises of corporate governance. The current study has not been confined to a limited number of hypotheses and it shows a wide range of aspects in corporate governance practises, including the corporate culture and strategic management. This study provides a detailed and descriptive analysis of a real organisation that seeks organisational efficiency and effectiveness through the practise of its corporate governance system.

The current study also contributes to the field of corporate governance by observing the efforts of some members of the Board of Directors in practicing their role as agents of change. A routine reporting to headquarters and the appointment of the parent company's officials did not guarantee that the monitoring system was totally effective. When conflicting signals emerged from different positions at the subsidiary regarding the decision making process and there was a whistle-blowing phenomenon, headquarters should investigate. Good and bad managers can be affected by the bad judgment of the majority shareholder. But whatever the policy is taken by the parent company regarding its subsidiary, this policy should not influence the existing good corporate culture and employees' perception.

At the same time, several limitations of the current study are acknowledged. The major limitation of the current study is the fact that it is a single case study. The conclusion drawn from this case study can not be generalized by other similar organisations. However, the research findings can be transferred to other similar organisations in an analytical sense. The inductive reasoning can be employed to provide significant understanding in an attempt to comprehend the pattern of corporate governance practise in those organisations.

The empirical research has been based on data gathered from many sources, mainly from interviews with members of the organisations and related parties outside the organisation. Within the organisation, the interviews were conducted with the interviewees who were the members of the Board of Commissioners, the members of the Board of Directors, managers at different divisions and the chairman of the labour union. All of these interviewees were Sari Husada's employees and none of them represented the controlling shareholder. Holland based directors rejected the interview and asked the researcher to interview Indonesian officials only. This might affect the analysis of the research because it is based on the story of Indonesian officials alone. The researcher has asked the Numico's headquarters to correspond by electronic-mail but this request was not agreed to. Numico's headquarters data was gathered only from its website and published media. During the interview some important data, such as key performance indicators, were kept secret by the interviewees. Those facts might be the weaknesses of the current research.

This research represents the situation for the period between 1997 and 2005. More specifically, the interviews (as a major source of research data) were conducted at the end of 2002, and followed up with the electronic-mail correspondence. The Asian economic crisis hit Indonesian companies at the end of 1997 and the impact of the crisis was experienced in 1998. At the same time in 1998, Royal Numico, N.V. took over the company from PT Tiga Raksa Satria. The company continued to live and change in many aspects. This report includes only a portion of the changes and interventions in the company's corporate governance for several short periods of time. The current event of the company, such as the impact of Yogyakarta earth quake in May 2006 on the company's production facility in the Yogyakarta region, might be missed from the observation. Therefore the time period of the research can be considered another weakness of this study.

10.4. Future Research Directions

Several suggestions are offered for future research to extend the current study and overcome its limitations. While this case study provides an example of the practise of corporate governance in an Indonesian public listed company, other example from different companies and industries are still needed. Future research has an opportunity to study other public listed companies, the Indonesian conglomerates and their subsidiaries, the state owned enterprises, and the small and medium enterprises to gain a complete picture of the Indonesian corporate governance system.

Further research on PT Sari Husada, Tbk would also be helpful in understanding the full potential of corporate governance practise. The current study has been based only on some Indonesian officials' interviews. Hence, it is recommended that future research on the subject organisation includes wider range of managerial positions and a greater number of interviewees, especially officials who represent the majority shareholder. By doing this future research could gain comprehensive insights of the subject company.

This study suggests that the practise of corporate governance at the subject company is related to corporate culture and the strategic management. Future research should explore more details of manager-employee relationship, the relationship between majority shareholders, the Board of Commissioners and the

Board of Directors, and the access to minutes of meeting of company's boards. By doing this the future research might be able to make a better contribution to the Indonesian corporate governance area.

10.5. Conclusion

This study has been concerned with the corporate governance practise at PT Sari Husada Tbk. The study explores some transformation of governance practise within the main divisions at Sari Husada. Although Tabalujan (2001, 2002a and 2002b) has found why Indonesian corporate governance had failed during the economic crisis at 1998, the current research found that the corporate governance practise at the studied company has enabled Sari Husada to survive and book profits during the years of economic crisis. The scope of the study has been wide across different levels of the company and it has been possible to cover a wide range of aspects of corporate governance practises that exist within the studied organisation.

The research adopted a variety of data collection methods using a single case study approach in conducting the empirical study. This approach has enabled an in depth observation of governance practise in the studied company. The research has found that Sari Husada's governance practise is partly adopted from the literature, the international standard and the national corporate governance codes with some adjustments being made. The adjustments were needed to include local cultures and national interests. Over past decades the company has been able not only to transform from a simple and traditional producer of milk formulas for babies, but also get over the Indonesian economic crisis. The company survived the crisis of 1997 for a number of reasons. The Numico's ownership with an adoption of a multinational company's working systems into the Sari Husada's system is one of the reasons. The cultural change within the company toward the attitude of productivity, efficiency and cost cutting is another reason. The line of company's products with an affordable price and quality nutrition content also contribute to the survival of Sari Husada. Above all, the long and enduring efforts of Sari Husada's managers and employees contribute the most. Because of those reasons the company has been able to transform into a new modern company which produces various related food products for babies. This makes Sari Husada able to build a prosperous future, while it is also able to fulfil its vision and mission.

The study has explored an integrated corporate governance practise at an Indonesian public listed company. It discusses the strength and weaknesses of the current study and provides direction for future research. Moreover, the current research reveals how the corporate governance has been practised by commissioners, directors and managers in their daily activities.

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