

DOING BUSINESS IN INDONESIA

KEY POINTS

- The Government's reform program, including measures addressing corporate governance and the legal system, is changing the business culture.
- The Indonesian market rewards Australian businesses that take time to develop strong personal relationships and community ties.
- Managing a business in Indonesia requires a sound understanding of the culture's influence on hiring, training and managing staff.
- Navigating Indonesia's legal and regulatory system is best done with the aid of a notary; consulting a notary when setting up a company, obtaining approval for foreign investment and drafting a contract is strongly advised.

Operating successfully in Indonesia requires patience and an understanding of influences affecting business culture, and legal and regulatory environments. Many promising changes underway in the Indonesian business environment eventually should help Indonesia emerge as an attractive investment destination and profitable market for Australian companies.

This chapter analyses cultural influences on business and identifies ways to use these to commercial advantage. It assesses the possible impact on the commercial environment of reforms introduced since the financial crisis. Finally, the chapter analyses significant aspects of the changing regulatory and legal environment relevant to undertaking business.

INDONESIAN BUSINESS CULTURE

Businesses understanding and capitalising on cultural influences are more likely to succeed than those simply 'coping' with them. This section identifies how foreign firms can use local approaches to their advantage.

Importance of Building Relationships

Investing in relationships is critical to succeeding in Indonesia. Establishing a relationship requires time, preferably with face-to-face contact with a person of similar age and status. Demonstrating loyalty and trustworthiness is critical to maintaining a relationship. The longer term returns of investing in relationships can be significant and include:

- expediting bureaucratic processes where the relationship is with a government official
- accessing information and distribution networks
- opening joint venture opportunities, especially in manufacturing.

Relationships can determine many facets of commercial life, including granting credit, placing orders and awarding contracts. A longstanding obligation between two people can affect commercial outcomes. Showing patience and flexibility in commercial dealings builds trust and improves the chances of a successful outcome; contrasting expectations can have adverse consequences. Australian business people should not 'force' a relationship, or overestimate its depth.

Variables including age, gender, educational and marital status, also affect how easily personal and commercial relationships are formed. Western firms may find it more productive to send older, more mature executives rather than young personnel to negotiate or work in Indonesia. Men especially are not considered mature until they are 40 years old, and younger people can be excluded from decision making processes. In all spheres, younger people defer in language and attitude to older people, even if the age difference is negligible.

Business as Part of a Community

The group's welfare predominates in Indonesian culture, so the local community is very important. Foreign businesses fulfilling their obligations to those living and working in their immediate neighbourhood stand to gain significant advantages.

The local community centres around the neighbourhood council, comprising a group of five to 40 houses (a RT or *Rukun Tetangga*), that together form a larger unit (a RW or *Rukun Warga*). Informal meetings of RT and RW are held monthly, and businesses are expected to notify each of these bodies of their arrival in the local community.¹

The neighbourhood council can assist local firms, including:

- expediting bureaucratic processes, such as obtaining permits
- resolving disputes through the *musyawarah*, an important process of conflict resolution involving all concerned parties. A policeman convenes the *musyawarah*, and the results are based on community consensus. Its concluding communique outlines the consensus decision. Its decisions have a very strong legitimacy in the community, as all parties have been consulted and involved in the process. An official *materai* (tax stamp) is often affixed, increasing this legitimacy
- forming the first line of defence against acts of crime through surveillance and information sharing.

Businesses in Indonesia are well advised to develop a genuine awareness of their surrounding community. Demonstrating a business contributes to community welfare helps ensure the community has an interest in protecting the business. Unless a venture seeks local community involvement, providing employment and investment will not ensure good relations or security.

The concept of traditional land ownership remains strong across Indonesia, and irrespective of contractual rights the Government may award, local communities will act to protect their environment. Hence, mining companies adopting consensus based approaches to secure their rights are more likely to receive local community support than those relying on legal solutions.²

IMPACT OF RECENT REFORMS ON THE BUSINESS ENVIRONMENT

Government and broader society are responding to the financial crisis and the ending of the New Order regime, and gradually changing business practices. Indonesians are increasingly proactive in championing social justice and transparency.

New government reforms and laws passed since 1997 governing corporations are changing the business environment. For example, new corporate financial reporting and shareholder accountability laws increase business transparency and information, especially for those seeking to invest in existing

¹ These meetings commonly are held on the seventeenth of each month.

² Under the Soeharto regime, local communities often were by-passed in the consultation process for projects, or were pressured to accept very unfavourable terms. Foreign mining companies often were unaware of this, and many are shocked by recent developments at their mines.

ventures (*Jakarta Post*, 28 April 2000). New bankruptcy and capital market laws conform with international best practice, clarifying firms' obligations to creditors and shareholders. Newly introduced laws covering anti-competitive behaviour also protect new entrants from predatory behaviour by existing market players. Recent audits of government institutions and investigation of state officials and bureaucrats eventually should improve the quality of the public service. Indonesian Bank Restructuring Agency, IBRA, sales of Indonesian corporations and banks may dilute the concentration of asset ownership in the economy over coming years, especially through increasing foreign ownership and competition between companies and industrial groups. (See Chapter 8 - *Corporate Restructuring*.) Nevertheless, implementing these new laws will take time and resources, so gains will not be immediate; the Government recognises this is the case with legal system reforms.

MANAGING A BUSINESS IN INDONESIA

The gradual change in business culture since the crisis generates both opportunities and uncertainties for foreign managers. Basic features of society are likely to adapt to, rather than be replaced by new approaches to doing business. Corporations investing in training and language skills are best placed to take advantage of these opportunities.

Approaches to Management

Firms should devise management systems to interface as far as possible with local approaches, accommodating hierarchy and encouraging social interaction in the workplace. While these may appear less efficient from an Australian perspective, they usually suit the Indonesian environment.

Firms need to recruit carefully at all levels, as unsatisfactory performance is not sufficient reason to dismiss a worker. Dismissal for misconduct can occur only after issuing three warnings, spaced three months apart. More culturally acceptable ways of dismissing a worker include negotiating, facilitating a face-saving exit or paying a lump sum. As a preventative step, firms can engage employees on pre-agreed one to three month contracts.³

Remuneration packages usually have several components, a basic wage (*gaji pokok*) and allowances for transport, meals, attendance, and occasionally, productivity. Sometimes, married men with children receive an additional sum. Annual bonuses equal to one month's wages are paid either just before *Lebaran* (the annual Islamic celebration) or Christmas, depending on the worker's religion. Foreign owned companies generally pay higher wages.⁴

³ The Department of Manpower, *Depnaker*, regulates employment practices in Indonesia, including conditions of employment and labour-employer relations. Work contracts for groups and individual workers are common in Indonesia; the *Depnaker* approves them, and typically they operate for one to three years.

⁴ Worker insurance is very underdeveloped; *Jamsostek*, the government backed insurance scheme, only nominally protects workers for accidents, health and old age pensions. Premiums add 7 to 11 per cent to total wage bills. As *Jamsostek's* compensation rarely covers medical or living expenses, the employer supplements the payment if an accident occurs (*Depnaker*, 1997).

PT OKUSI MARBLE IN EAST JAVA

Okusi Marble, a small Australian owned enterprise, successfully accesses local East Javanese artisans by carefully managing cultural issues. The firm manufactures highly ornate marble fireplaces for export to the US market. The workshop in a small village in rural East Java is strongly traditional, with social structures centred around village leaders.

The workshop employs more than 40 people, nearly all from the village or neighbouring areas, including artisans, carvers, saw and lathe operators, and polishers. By employing people who live locally, the firm reduces the incidence of absenteeism that can disrupt operations in Indonesia.

Okusi Marble's managers always seek to balance their commercial needs with worker and local community priorities. Its methods for dealing with conflict complement local approaches, and are largely successful. By ensuring the local community benefits from the firm's prosperity, Okusi Marble ensures its managers are well positioned when negotiating with the local community. To retain local community support, at times, the firm has accepted practices that, in the west, may seem inefficient.

Its managers are well educated Yogyakarta graduates, and its less educated workforce is comfortable taking directions from them, minimising the chances of conflict. Because the managers speak Indonesian and labourers speak 'low' Javanese, the foremen act as intermediaries, communicating with both groups.

Source: Dean, 2000.

Training and Staff Morale

Whilst low labour costs induce businesses to locate in Indonesia, often workers need training to optimise productivity. To train successfully, firms need to be culturally sensitive and willing to adapt. Companies that train bright new graduates in basic skills, including computing and report writing, usually are rewarded with loyal and productive employees. Across Indonesia, the ability to speak English increases a person's status; consequently, this training engenders loyalty and productivity in employees.

A failure to provide an appropriate social environment in the workplace may lead to absenteeism. A more clinical business style with separate business and social activities usually is inappropriate in the Indonesian setting.

The Bureaucracy

Developing relationships with government officials is particularly useful in streamlining the application process for obtaining licences, permits and information. Bureaucrats or 'national officials' (*pegawai negeri*) traditionally are treated with respect and deference. Government initiatives have brought real and significant improvements in recent years to the way the bureaucracy works, making it easier for firms wanting to conduct business in Indonesia (Dean, 2000). Nevertheless, pay levels remain low and transparency is still a major issue.

THE REGULATORY ENVIRONMENT

Recent government initiatives have streamlined the regulatory environment for western firms, through relaxing laws governing foreign company structures and simplifying the processes for forming a company. Despite these initiatives, traditional notaries are vital in legal and regulatory matters, especially in drafting contracts. Business contracts should be seen in their broader cultural significance, and are more likely to be adhered to where key relationships are maintained.

Legal System

Indonesia's new bankruptcy, capital market and company laws now are based on international best practice, but the Government is aware implementation needs to be improved. In several instances, courts failed to prosecute prominent figures of the New Order regime, often on technical grounds. (*Straits Times*, 6 April 2000; and *Straits Times*, 12 April 2000). Hence the Government's new initiatives include appointing ad hoc judges to commercial courts to improve the operation of the legal system. (See Chapter 8 - *Corporate Restructuring*.) Together, these initiatives aim to provide greater certainty to creditors and investors across the Indonesian corporate sector.

Role of Notaries

Hiring a notary, or local legal expert, is the most efficient way of navigating the Indonesian legal and regulatory system. These government registered legal officers play an important role in commercial dealings in Indonesia; companies should invest in building a relationship with a reputable notary. Apart from understanding the law, notaries have extensive networks of contacts and high social standing; they can expedite many bureaucratic processes. Notaries can obtain investment approvals, incorporate a company, and secure licences and permits to operate a company. While most of this paperwork does not legally require a notary, often one person can more conveniently handle all these matters. A contract drawn up and co-signed by a notary carries more legitimacy than one drawn up by a non-notary. Elaborate signing ceremonies have important symbolic value and increase the contract's prestige and legitimacy.

However, many notaries are unfamiliar with processes relevant to foreign investors, and their knowledge and fee structures vary considerably. Provincial offices of the Investment Coordinating Board, BKPM, can suggest notaries experienced in foreign investment, although their rates often are higher than those of other notaries. Indonesian based business consultants normally use their own experienced notaries.

Role of Contracts

Contracts have a very important place in Indonesian business, although their role may differ from western practice. Individuals are unlikely to breach contracts reached through consensus with a group of distinguished peers. Compared with their foreign counterparts, many Indonesian contracts

are less detailed and the negotiations are more likely to influence their meaning. While contracts often outline specific details, including obligations and dates, Indonesians commonly assume contracts will be subject to ongoing negotiation and interpretation, if circumstances change.

To honour contractual obligations, firms cannot simply rely on a signed document. They also must maintain relationships at many different layers of business, government and the community. To secure binding business agreements, social pressure is more important than legal documents.

Contracts generally are in Indonesian, except where large Indonesian corporations are involved; here English often is used. Firms should obtain more than one English translation.

Foreign Business Structures

Recent legislation allows 100 per cent foreign owned companies to operate in most sectors. In many cases, however, foreign investors may seek joint venture partners to complement their skills and resources. (See Chapter 3 - *Foreign Investment*.) The foreigner's depth of knowledge of the local business environment should influence the level of local cooperation sought. Local partners generally have knowledge of the Indonesian economy and society. However, those already familiar with the local business environment often choose outright foreign ownership. The need to access local distribution channels, and business and bureaucratic contacts also will influence a decision to enter a joint venture.

In some instances, businesses opt for long term, performance based contractual arrangements with Indonesian companies rather than joint ventures. Fully owned structures allow complete control by the foreign entity, and remove the potential for disagreement inherent in joint ventures and partnerships.

In many joint ventures, Indonesian partners with local expertise exercise on-the-ground control, although the Australian partner maintains an important presence. Joint ventures require careful research, as mistakes can be costly and withdrawal difficult. However, well chosen joint venture partners should provide access to local expertise and cultural knowledge, distribution networks and links to the corporate sector and bureaucracy. When seeking a joint venture partner, Australian companies should seek Indonesian partners with a similar company structure and culture, although these may not be common. Major differences in perceptions and expectations amongst foreign and local partners are common, with disagreement over the organisation and management of the joint venture most problematic (Dean, 1999).

Setting up a Company

Recent reforms streamline procedures for foreign firms establishing operations.⁵ Investors must submit a brief business plan and outline the proposed structure of the company to the provincial office of the BKPM; approval takes at least ten working days.⁶ However, a good relationship between the investor and the relevant bureaucrat helps reduce processing time. Local officers undertaking the preliminary

⁵ See Presidential Decrees KP 96/1998 and KP 99/1998.

⁶ The firm then receives a letter of agreement (*surat persetujuan*).

work may request a very small processing fee. Once the company structure is approved, the investor must apply for licences from local authorities, a process often fraught with bureaucratic chicken and egg situations. For example, before obtaining company articles of association with the central office of the Law Department in Jakarta, a firm must provide documentary evidence that it has deposited share capital in its bank account. However, to open a company bank account, a firm must produce registered articles of association. Depending on the quality of the relationship between the investor and BKPM officials, the latter can assist in these processes.

IMPLICATIONS

Understanding Indonesian culture and applying it to management and negotiating situations can generate substantial commercial and personal benefits for foreign businesses operating in Indonesia. Given the time required to establish relationships and networks, business people should plan for longer horizons to achieve returns. Also, with the rapid economic and political change currently underway, firms must remain responsive to the evolving business culture.

REFERENCES

Dean, G., 2000, 'Report to the East Asia Analytical Unit on the Indonesian Business Environment', July, Jakarta.

___ 1999, 'Joint Venture or 100 per cent Foreign-Owned?', *OzIndo*, Vol. 5, No. 1, www.okusi.net/garydean/works/jv.html, accessed on 16 May 2000.

Depnaker, 1997, Government Publication on Business Environment, Jakarta.

KP 96/1998 (Presidential Decree 96/1998), 1998, concerning Business Sectors Closed for Investment, 2 July, Jakarta.

KP 99/1998 (Presidential Decree 99/1998), 1998, concerning Business Sectors Reserved for Small Business and Sectors Open for Medium or Large Businesses on Condition of Partnership, 14 July, Jakarta.

