

Master Thesis in Business Administration

Faculty of Economics and Social Sciences
Agder University College - Spring 2006

Analysis of Good Corporate Governance at Indonesian Telecom Industry after Privatization

Case Study at PT Telkom and PT Indosat

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**ANALYSIS OF GOOD CORPORATE GOVERNANCE
AT INDONESIAN TELECOM INDUSTRY
AFTER PRIVATIZATION:**

CASE STUDY AT PT TELKOM AND PT INDOSAT

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133355

**MASTER THESIS
AGDER UNIVERSITY COLLEGE**

2006

ACKNOWLEDGEMENTS

First, I would like to express my gratefulness to my thesis supervisor, Prof. Trond Randøy who has given me all his valuable motivation, feedback, correction, and suggestion in writing this thesis.

Second, I am greatly thankful to Roes Aryawijaya, Mas Ahmad Daniri, Eva Riyanti Hutapea, Arif Arryman, Strasfiatri Auliana, Jenal Kaludin, Sutopo, Hartono, Rico, Karwiyarso, M Adhi and all political party leaders for their willingness to be interviewed.

Finally, I would like to thank all my colleagues, Supriyadi, Miftah, Nanang, and Dona for making it possible for me to finish this thesis.

Ahmad Amin

DEDICATION

*This thesis is dedicated to my wife, **Trismiati**, and my little daughter, **Meutia Izzah Amin**, whom I owe deep thanks for being patient while I study at Agder University College, Norway..*

*To My mother, **Suparni Musa** and my brothers and sisters, thank you for all prays and supports.*

I love you all.

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ABSTRACT

The objective of this research is to examine whether there are differences of implementation of good corporate governance of company which privatized using different methods. This is relevant with the change of privatization pattern conducted by the government of Indonesia toward its state-owned companies, from Public Offering to Strategic Sale.

One of important decisions taken by the government after the economic crisis is privatization of state-owned companies. It is done because the government finds difficulties to financing its national development programs and economic recovery.

From company side, the change of ownership structure expected to be able to improve financial and operational performance. Furthermore, it is also expected to improve performance of transparency toward public, both obligatory disclosure and voluntary one.

PT Telkom and PT Indosat are major telecommunication companies in Indonesia which, in fact, have been privatized using IPO in 1994/1995. Later, in 2002 PT Indosat was privatized by selling government's shares to PT ICL as a Special Purpose Vehicle of STT Singapore. Privatization method used was Strategic Sale.

This research concludes that privatization methods do not influence implementation of good corporate governance individually. Privatization influence the implementation of good corporate governance if the privatization results ownership structure change significantly, and increases risk which must be borne by new investors. Meanwhile, role of capital market authorities also influence the implementation of good corporate governance if law enforcement is carried out tightly.

Key Words: Privatization Methods, Transparency, Good Corporate Governance, Voluntary Disclosure.

CHAPTER I

INTRODUCTION

A. Research Purpose

This research will examine effectiveness of corporate governance implementation, especially on transparency, as a result of privatization on state-owned enterprises. Privatization is likely influenced by methods chosen by the government to conduct privatization.

B. Problem Statement

Before the political and economic crises happened in Indonesia in 1997, the government of Indonesia had decided to privatize some State-Owned Enterprises. One of the purposes of the privatization, related to the performance of company, is to enhance efficiency and effectiveness of companies' operation. To privatize the state-owned enterprises, the government used public offering mechanism to sell small portions of its shares.

After the political and economic crises had taken place, the government have chosen another method, strategic sale, in order to sell its shares at some companies. Generally, the government's purposes to do privatization process are the same as the purposes mentioned before. The advantage of strategic sale method is the method offers faster process than those of public offering for the government to received additional fund.

Which method is potentially more effective to improve the companies' transparency?

C. Research Question

There are two companies that will be analysed, PT Telkom and PT Indosat. I choose the companies because both of them are the only fully SOE in telecommunication sector before the government of Indonesia privatized them. Also, they are the only Indonesian companies that are listed on international stock exchange.

The privatization methods are chosen as independent variables, whereas transparency is the dependent variable. A question is proposed on this research as follows:

Do the privatization methods chosen by the government influence the implementation of transparency on telecommunication industry in Indonesia?

D. Background

In the period of Indonesian economic crises in the end of 1990s that is depicted by depreciation of Rupiah relative to other currencies, high inflation, unfair business practices – such as monopoly and collusion practices, and wrong management of the country, caused the fiscal and monetary policies become difficult to be developed. During the economic crises, Rupiah was sunk dramatically from Rp2,450/US\$ in June 1997 to Rp14,900/US\$ in June 1998. It affected high inflation happened in Indonesia because of the dependence of Indonesian industry toward raw material imports and foreign loan, and, finally, they caused a destruction of economic fundamental in Indonesia. It was caused by the currency depreciation that affected increasing of final production costs.

To stabilize regional economy, the International Monetary Fund came to help Indonesia and other countries to solve the economic crises by providing fund to safe both fiscal and monetary policies by the agreement that was poured out in letters of intent (LOI), signed at November 13, 1998, July 22, 1999, and, the last LOI, January 20, 2000.

There are some important public decisions for the future economy of Indonesia as mentioned on the Letters of Intent, for example privatization. Privatization could be used as a tool to improve the efficiency and governance of particular state-owned enterprises and preserving budgetary control (Letter of Intent, 1999). On the Letters of Intent, the IMF tried to force the government of Indonesia to reform many sectors, such as the governance of State-Owned Enterprises, banking system, legal and justices, and so on. Regarding to state-owned enterprises and budgetary system, according to IMF, the annual budget of the government of Indonesia was burdened by the existence of State-Owned Enterprises, the condition that should be reversed.

There are two general methods of privatization used in Indonesia, public offering and strategic sale (private placement). The methods indicate different processes and different results. Generally, public offering method will result better impacts than those of strategic sale due to involvement of public monitoring, and management

should direct the companies carefully because they have to satisfy more stakeholders (Prasetyantono, 2003; Sugiharto, 2005).

Comparing both methods of privatization, we could say that the first method is better than the second one, related to the transparency and accountability. In order to improve the quality of transparency and accountability, there are many parties that should cooperate together to create rules or codes of good corporate governance practices in particular countries, for example capital markets, government, accounting profession agency, etc. In many developed countries, for example the US, the UK, Australia, European countries, and Japan, the parties mentioned above issue some rules to be obeyed by listed companies in order to improve their transparency and accountability, because by listing on a capital market, they should realize that capital market work based on information (Abdel-Khalik, 1972).

E. Research Design

This research will be done using qualitative approach. It is fit to the purpose of the research which will be taken to examine the effectiveness of implementation of corporate governance mechanisms, in this case in particular information transparency, in PT Telkom and PT Indosat. Data collection will be done by collecting both secondary data and primary data. Company annual report, personal interview, and other public information are considered as data that have to be collected.

F. The Aroused of Research

This research has some interest points, such as:

a. Theoretical point of view.

Two methods of privatization, public offering and private placement, have a direct relationship with ownership structure. They also influence the principal-agent relationship. Public offering mechanism enables capital market to control the SOE's management, whereas private placement points out the opportunity of institutional investors to manage the company indirectly.

Principal-agent relationship creates a duty of managements to prepare relevant information required by the owner. As the Agency Theory explains, there are some organization assumption between the principal and agent (Eisenhardt, 1989). The first assumption is conflict of interest. It is happened because the principal hires the agent

to manage his money and to create his wealth, and the agent is assumed to manage the assets in order to satisfy his own interests. To reduce the conflict, the principal has to create a contract that covers such conflict. The contract should be able to force the agent provides full information to the principal regarding his/her activities to manage the principal's assets. It also could reduce another organizational assumption provided on the theory, which is information asymmetry.

From the market point of view, the stronger the market efficiency, the higher the willingness of companies to report their actual activities and financial position on a timely basis. Both of the theories, agency theory and capital market hypothesis, will explain which method, public offering or strategic sale, is likely better than another, in term of transparency.

b. Empirical point of view.

PT Telkom and PT Indosat are state-owned enterprises which have responsibility to provide telecommunication facility in Indonesia, that had been privatized before economic crisis was happened in Indonesia in 1997. PT Indosat listed at the Jakarta Stock Exchange and New York Stock Exchange on October 1994, and PT Telkom listed at the Jakarta Stock Exchange, the Surabaya Stock Exchange, the London Stock Exchange, and the New York Stock Exchange at November 14, 1995.

An advanced privatization of PT Indosat was successfully done by the government in 2002 by selling most of remaining shares held by the government to a multinational company, SST Singapore. It means that the government had done two kinds of privatization methods, which are public offering and strategic sale (private placement), in order to enhance efficiency and effectiveness of PT Indosat. It could be questionable, how extent the effectiveness of privatization methods – public offering and private placement – chosen by the government will support objectives of privatization.

G. Presentation of the thesis

The master thesis will be presented on a systematic ways, such as:

Chapter I. This chapter explains the research background, problem statement, research question, and research design briefly. The second part of this chapter is the aroused of research that consists of the theoretical point of view and the empirical point of view.

Chapter II. The first part of chapter II draws the theoretical basis of the analysis: Agency Theory, Risk/return Relationship, Efficient Market Theory, and the relationship between both theories. The second part of this chapter will explain the privatization and corporate governance in theoretical background, and the last part is the empirical basis on privatization and corporate governance. The model of research will be depicted in this chapter too.

Chapter III. The chapter is consisted of research methods employed in this research. The quality of the research will depend on the ability of researcher to understand and to implement the methods, so this chapter is very critical.

Chapter IV. This chapter consists of brief story of Indonesia, privatization, and corporate governance experiences. The privatization and corporate governance are new issues in Indonesia, but in short time, the country has done both concepts in a uniquely manner.

Chapter V. This chapter consists of story of telecommunication industry development in Indonesia and other countries located in South East Asia region, such as Malaysia, Brunei Darussalam, and the Philippines.

Chapter VI. In this chapter, I analyse the facts found by reading some materials and by taking the interview with some key people. The first part will be used as the description of the profile of both companies and telecommunication industries in Indonesia and other data gained from the data collection processes, and the second part will be used to discuss some findings.

Chapter VII. After the analysis of the findings was completed, I find conclusion to explain and answer the research question. Whether the conclusion is to clarify the theories or to find a new perspective will be discussed in the last chapter.

CHAPTER II

BACKGROUND

A. Theoretical Framework

Agency Theory

Management do its efforts to raise funds from investors (Shleifer and Vishny, 1997). The establishment of such relationship can emerge several problems between the parties such as asymmetric information, conflict of interests, bounded rationality, and so on (Eisenhardt, 1989). In order to solve the agency problems, Shleifer and Vishny suggested that investors and management should create an (incentive) contract to protect their interests. According to them, corporate governance is one of mechanisms to protect investor interests, so that they can receive returns from their investments.

In organizational perspectives, incentive drives a conflict of interest (Jensen and Meckling, 1976; Jensen, 1994). Management manages the company in order to expand its market value for example by increasing research and development cost that consequently influences potential return received by investors. On the other hand, management could also utilize the company's assets for its own benefits. In this case, management could decide to "modify" accounting reports by changing their methods and contents (Abdel-Khalik, 1972) that enable them to influence the accounting report users (Gonedes, 1972) such as the Board of Directors and investors, in order to show its performances.

In contrast, investors usually propose a set of contracts to bind management's responsibility to ensure the increase of investors' wealth (Shleifer and Vishny, 1997). Investors can require their companies to distribute a high dividend payout ratio. This decision of dividend distribution could cause new financial problems to the company. The financial problems will disturb the company's ability to improve market share and the following year profits which will also influence management's performance.

Fair relationship between management and investors

The failure of management and stockholders to create good relationship causes a failure in building trust. This could cause them to satisfy their own needs. However, it is not easy to say which party will take advantage because both are dependent of

each other. Stockholders instruct management to manage its capital and management depends on the decision of stockholders whether to stop or renew the appointment. Stockholders delegate special authorities to a board of commissioner to tightly monitor management's daily activities.

The most important theory that could explain thoroughly the phenomena of such relationship is the Agency Theory, sometimes referred to as separation of ownership and control (Shleifer and Vishny). The agency theory explains that there are many problems that will potentially emerge from the relationship between principal (owner) and agent (management), if both parties have different interests (Eisenhardt, 1989; Jensen and Meckling, 1976). Principal appoints the agents certain works which is appropriate with the principal's interests. The agency problems may not happen if both parties create relationship based on full trust (Brennan, 1994 in Jensen, 1994). On the contrary, it is almost impossible to make such relationship (Jensen, 1994).

Therefore, to ensure that the management does its best on behalf of stockholders, they have to provide incentive schemes that force the management to work precisely (Jensen, 1994). As in property rights theory, a contract made between the owners and management should involve the specification of individual rights to determine how costs and rewards will be allocated between the participants in the organization (Jensen and Meckling, 1976; Fama, 1980; and Shleifer and Vishny, 1997). In this matter, a good relationship should be proposed from the beginning of contract followed by actions on what is written on the contract. The contracts are supposed to affect the behaviour of the participants of the organization, so the management interests will be appropriate with the stockholders' concerns. Moreover, Shleifer and Vishny (1997) stated that the objective of providing of contracts is to legally protect both large investors and minority ones from expropriation that may be done by management.

Problems of Principal-Agent relationship.

Eisenhardt (1989) pointed out several problems related to the agency relationship. The first problem is the different interests between principal and agents. The conflict of interest does not create goal congruence which should be achieved by the partnership. The second problem is the difficulty to control what the agents are actually doing. This happened because sometimes the principal could not access all information regarding its agents.

As a risk taker, the principal sets a rule that enable to reduce the differences of interests between the principal and agents. According to Jensen and Meckling (1976), Fama (1980), and Eisenhardt (1989), the principal could limit the differences by providing both monitoring and incentive. Incentive has been explained in the previous paragraph, and monitoring will be explained below.

How to reduce the relationship problems?

Eisenhardt (1989) stated that the focus of the agency theory is to determine the most efficient contract between principal and agents. The efficient contracts should consider all assumptions of people, organization, and information. The understanding on the assumption eases the principal to monitor effectively. The assumptions that serve as basis to develop the agency theory is indicated in table 2.1

An important point in implementing the contract, monitoring should be done by the principal as a mean, rather than an end, to ensure that management acts in line with the principal's interests. However the agency theory noted that it was difficult to verify whether the agent has done what the principal wants.

There are two approaches in monitoring the management's works that could be done by the principal namely structural approach and process approach. In the structural approach, the principal makes a set of rules in order to enforce the agents to provide information to be accessible for the principal's needs. For example, management has the responsibility to issue audited annual financial reports.

In the process approach, principal is involved directly in the process of managing the company. Sometimes, the principal acts as oversight body or a member of the management. In a public company, stockholders delegate such authority to the board of directors.

In other words, the owners have to establish a set of monitoring mechanisms as mentioned in the previous sections, such as contract-based management engagements, tight monitoring, fair incentive schemes, well-designed reporting systems, and so on using both approaches.

Table 2.1.

Agency Theory Overview

Key idea	Principal-agent relationships should reflect efficient organization of information and risk-bearing costs
Unit of analysis	Contract between principal and agent
Human assumption	Self interest, bounded rationality, risk aversion
Organizational assumption	Information asymmetry between principal and agent, efficiency as the effectiveness criterion, and partial goal conflict among participants
Information assumption	Information as a purchasable commodity
Contracting problems	Agency (moral hazard and adverse selection) and risk sharing
Problem domain	Relationships in which the principal and agent have partly differing goals and risk preferences

Source: Eisenhardt (1989)

Agency Theory and Risk/Return Relationship

As stated in the agency theory, one among the characters of a principal or investor is risk taker. This character illustrate that investor is interested to invest an amount of money in uncertain return. For example, the investors are likely to be interested in buying a set of volatile shares in a stock market. The reason of choosing the fluctuate shares instead of stable shares is that the investor could monitor stock trading on time. Moreover, the most important reason is that the investors could gain much more profits from the trading of fluctuate stock than the trading of stable stocks.

Several researchers such as Oviatt and Bauerschmidt (1991) explained that investor expects high return while facing risk on their investment. This could be observed in simultaneous relationship where the relationship is not only influenced by risk and return, but is also influenced by business strategy and industrial condition.

Some researchers stated a different approach called Bowman's risk/return relationship paradox (see Fiegenbaum and Thomas, 1986). It is acknowledged that investors could invest their money to a low risk business environment but they still receive high return. The paradox could be understood that return is the focus of the investors' concern. The best way to obtain high return is when the investors spend their money

on low risk businesses instead of high ones. Modern portfolio theory is based on this paradox.

Another approach, called the high risk – high return relationship, focuses on risk as the starting point of view. If investors choose low risk investment, low return can be expected. In another situation, if the investors choose to spend their money on high risk investment, rational investors shall accept high return only. Figure 2.2. explains the relationship between risk and return, and depicted which conditions are rational to be carried out.

**Figure 2.2.
Risk-Return Relationship**

Return	<p>Low Risk-High Return Rational Ex: Modern Portfolio</p>	<p>High Risk-High Return Rational for risk taker Ex: hi-tech business, fluctuate stock trading, country risk, etc.</p>
	<p>Low Risk-Low Return Rational for risk averse Ex: Stable stock trading</p>	<p>High Risk-Low Return Irrational, even if for risk taker</p>
	Risk	

Relationship between Agency Theory and Efficient Market Theory

As illustrated in table 2.1, principal-agency relationship could create agency problems such as asymmetric information. The asymmetric information is taken place in such condition where principal and agent have different levels of information. It happens because management holds much more information than those of owners. Management directs the company by creating policies which directly involves day-to-day activities. This is different from the experiences of principal which usually monitors indirectly the performance of management and the monitoring process is done annually instead of daily basis.

Along with the development of companies, owners and management usually plan to issue the company’s shares in a capital market. From the organizational per-

spectives, it causes the ownership widely dispersed. It means that effective communication cannot be taken place in the same manner as the company had simpler ownership structure, for example in a limited partnership or a family corporation.

The dispersed ownership forces the capital market authority to compel all listed companies in informing all relevant aspects that influence the companies. Information provided by the companies is a critical device used by stockholders and also potential investors to take further action (Fama, 1970 and FASB, 1992).

Capital Market Roles

In an efficient capital market, stockholders buy shares if the price of the shares reflects all information (Fama, 1970; and Gonedes, 1972). In other words, players at an efficient market will react collectively to a new information in a systematic and an unbiased manner (Abdel-Khalik, 1972).

From the behavioural perspectives, Eisenhardt (1989) suggested that capital market should create mechanisms to control and monitor management behaviour. On behalf of stakeholders, stock market authority should impose management to obey all capital market rules to disclose both obligatory and voluntary information.

As explained in previous paragraphs, we conclude that management is enforced to present full disclosure from internal and external side. The contracts made between management and investors require the management to report both financial and non-financial information. In order to control and monitor what management is really doing, the owners engage reputable people as members of board of directors.

On the other hand, management is compelled to create accurate financial and operational reports in a routine basis, usually quarterly and annually, by the authority of capital market and other stakeholders. To compete on the capital market floor, companies that are listed should adhere to the rules.

Reducing Agency Cost using Accounting Practices

As stated by Eisenhardt (1989), agency problems can be overcome by monitoring, using both process and structure approach. Process approach supports owners to be involved in strategic decision-making processes and monitoring through their board of commissioners, while structure approach supports investors to conduct monitoring through their financial and operational reports requirement.

Transparency related to the disclosures of information is done by management through issuing both non-routine reports and routine reports such as annual report, audited financial statement, and quarterly report.

The influence of transparency toward agency cost could be explained through the objectives of reporting which is written down in SFAC No. 1, Objectives of Financial Reporting by Business Enterprises. This SFAC No. 1 could be applied into other reporting, for example annual reporting, which consists of not only financial statement but also qualitative operational reports. The objective of the financial reporting stated in the SFAC No. 1 is providing information about resources of an enterprise, the claims to the resources, and the effects of transaction, events, and circumstances that change its resources and claims to resources. Another objective of the reporting is helping investors and potential investors to make rational investment, credit, and other decisions.

The quality of reporting presented by management could be measured using several components that form qualitative characteristics of reporting, for example relevant, reliable, and comparable, as stated in SFAC No. 2, Qualitative Characteristics of Accounting Information. Relevant information means that the information has to be disclosed in a timely basis, has predictive value and feedback value. Meanwhile, the characteristics of reliable information among other things are representational faithfulness, verifiability, and neutrality.

Accurate and beneficial information disclosed by management showed its willingness to implement transparency. A positive impact gained from the quality of reporting which is always maintained and enhanced by management is that the owners will believe that management is willing to report its activities in managing fund invested by the investors.

As stated in previous sections, agency problems occurred because there are differences of interests and the nature of the investors and management. Monitoring and controlling could reduce these differences. The commitment of management in presenting full disclosure information can possibly improve the owners' beliefs and directly reduce agency cost that emerges from the effects of agency problems (Hendriksen and Van Breda, 1992).

The improvement of reporting quality is not only conducted by setting reporting standards, but also compiling auditing standard, for example integrated audit of public companies, tight supervising toward accounting firms, and the tightening of auditing

rules (See Sarbanes-Oxley Act 2002). Audit is a tool utilized to reduce agency cost to ensure that management has presented full disclosure of financial and operational information (Aren and Loebbecke, 2000).

Transparency conducted by a company has both positive and negative consequences. It makes that the company always considers cost-benefit in doing full disclosure. There are several positive impacts of full disclosures conducted by the company, among other things:

- A lower average cost of capital
- Enhanced credibility and improved investor relations
- Access to more liquid markets with narrower price changes between transactions
- The likelihood that they will make better investment decision.
- Less danger of litigation alleging inadequate informative disclosure and better defences when such suits are brought (FASB, 2001).

Full disclosure carried on by a company is also caused by its requirement to raise capital periodically. FASB have seen that a company provides full disclosure for competition reason that is the competition to get much more capital.

Cost of capital that should be borne by the company is determined by some factors such as those, which have been stated in Capital Asset Pricing Model (CAPM). To reduce company's cost of capital, the company has to try to decrease the coefficient of systematic risk of the companies' stocks. The disclosure was expected by the company to reduce degree of uncertainty of company's future, and it mean that inherent risks of company's share become lower. Thereby, expected cost of capital of the company could be reduced incrementally.

Full Disclosure also has a positive effect toward information asymmetries. Stockholders can utilize adequate and accurate information in order to observe and analyse relevant and material information of the company. Management could reduce information asymmetry by providing accurate reports. The accurate reports presented enable the stockholders look at performance of the company through "the eyes of management" (Callahan and Smith, 2005). The information especially notify to the expression of non-financial information, which is provided by management on Management Discussion and Analysis (MD&A). Therefore, MD&A presented in an an-

nual report ought to reflect past performance, current performance, and forward-looking projection. The more the company transparent, the more the company is able to access capital, including on international capital markets.

Capital market regulations released after several corporate failures in US and in Europe have reflected that capital market authorities have strong willingness to improve the status of reporting rules in line with the bases laws. For example company which listing in US has to obey Sarbanes-Oxley Act 2002 as it has to obey the bases laws, for example Securities Exchange Act 1934. Issuers and other relevant parties that do not obey SOA can be brought to a court as a collision to the SEA 1934.

In the contrary, there are negative impacts of full disclosure, among other things:

- Competitive disadvantage due to companies' strategies become well known by competitors.
- Bargaining disadvantage from their disclosure to suppliers, customers, and employees.
- Litigation from meritless suits attributable to informative disclosure.
- Cost of reporting and other control systems (Insights into Enhancing Voluntary Disclosure, FASB, 2001).

The negative impacts have forced the company to create its reports by determining several factors, such as types of information, level of detail, and timing of the disclosure. These factors influence whether competitive advantages of company was reduced by full disclosure. For example, a company that is in an R&D projects may not disclose on the projects in detail manner, including on of the possibility that they will postpone their R&D reports one year later or after the R&D results were established.

B. Privatization and Corporate Governance in Theoretical Background

Privatization – Definition and Benefits

Privatization is a program conducted by countries toward its state-owned companies . It has some objectives, such as raising economic efficiency, reducing government debt, achieving consumer benefits, reducing power of special interest groups, etc.

In general, privatization has been defined as reducing government intervention and involvement directly in economic sectors. Basri (2002) said that the government has responsibilities to regulate sectors that are untouchable by private sector, for example national defense and income distribution. Kay and Thompson (1986) defined privatization as a changing of relationship between the government and the private sectors. Unfortunately, according to Kay and Thompson, there is no detailed definition of privatization clarified by scientists and researchers. They stated, "Privatization is a term which is used to cover several distinct..."

Aktan (2003) divided privatisation into two meanings, a narrow meaning and a broader meaning. The narrow meaning clarifies privatization as a sale of a publicly owned enterprise's assets or shares to individuals or private firms. The privatization could be done by issuing shares in a capital market, selling a state-owned enterprise directly to private sectors, etc. Aktan mentioned this kind of privatization as "denationalization." On the other hand, the broader meaning of privatization refers to restrict government's roles and to put forward some policies in order to strengthen free market economy.

According to Parker (2000), there are some arguments and objectives of privatization done by both developed and developing countries, such as:

- Raising economic efficiency;
- Reducing government debt;
- Achieving consumer benefits through more competition;
- Reducing the power of special interest groups;
- Refinancing industries and financing the new investment required by technological change;
- Developing private ownership and private capital markets, including the banking system and stock markets;
- Attracting inward foreign direct investment (FDI); and
- Increasing competition in procurement and therefore supply chains.

Since the objectives mentioned above are tends to satisfy macroeconomic view, several researchers have taken researches to analyse economic efficiency from the microeconomic one. The results document the improvement of companies' performance, such as increasing real sales, achieving high profits, increasing their capital in-

vestment spending, improving operating efficiency, and increasing work force (Megginson et al., 1994, and Boubakri and Cosset, 1998).

Methods of Privatization.

There are several ways that could be taken to privatize a state-owned enterprise; however the main methods are public offering and strategic sales (Ika and Samosir, 2002). Public offering means that the government sells its ownership through capital markets. It could enhance public involvement to control the company. Also, the capital market will be influenced by the public offering, because by selling the stocks of good state-owned enterprises, volume of transactions in the capital market will increase significantly.

The second method is strategic sale, in which the government sells its ownership to other institutions, either domestic organizations or international ones, by selling a block of shares. For example, the government sells 60% of its total shares in a particular state-owned enterprise to a consortium consisted of several companies that operate in the same sector with the state-owned enterprise. Usually, the government does the kind of method by inviting several companies to follow a bid process.

Corporate Governance

The Development of Good Corporate Governance Principles

The modern corporate governance views were started on the US and the UK in order to respond the business crises. In 1980s-1990s, many cases happened in both countries showed that the regulatory and supervision systems were not implemented effectively, caused the corporate failures in both countries (Keasey et al., 2005), for example the Enron and the Xerox cases in the US. In the case of UK, according to Keasey (2005), the establishment of committees to provide codes of corporate governance in the countries was caused by the creative accounting practices, business failures, limitation of the auditor roles, the weak relationship between executive remuneration and corporate performance, and the loose of market controls (p. 21). The problems were responded quickly by creating some committees to asses the effectiveness of corporate regulations in both countries, for example Cadbury Committee, Greenbury Committee, Hampel Committee, Sarbanes-Oxley, etc.

A good example country that actively looks for the best practice principles is the UK. Since 1991, the country has developed many committees in order to find good

corporate governance principles. Cadbury Committee is the first committee that was engaged by London Stock Exchange and accounting profession in order to address the financial aspects of good corporate governance (Davies, 1999 p. 38; and Keasey, 2005). Related to a centralistic power in a company, the committee suggested to decentralized power within the firm. The empowerment of board members was also the emphasis of the report issued by the committee. It suggested that the firm had to increase the role and the independence of non-executive directors.

The Confederation of British Industry was built a committee to review the work of Cadbury Committee, named as Greenbury Committee. The focus of Greenbury Committee is to find the best practices related to the board remunerations. According to Davies (1999), the objective for the Greenbury Report came from the intensive debate in the UK regarding to the increases of the remuneration of newly privatized company boards.

From the case of Cadbury Committee and Greenbury Committee, we could find that the focus of corporate governance is the balance of power among the owner, the board of directors, and the management or executive directors. The important point here is that the increasing power of the board has to be limited, and the use of independent directors as the main actors in many board committees has to be enforced to control both the management and the board of directors. For example, Cadbury Committee supports that the remuneration committee mainly consists of non-executive directors, and the Greenbury Committee is much stronger to suggest the board of directors to create the remuneration committee with entirely consists of the independent directors.

Since the Cadbury report and Greenbury report were not mandatory for companies listed in London Stock Exchange, the Hampel Committee was developed to assess the effectiveness of Cadbury and Greenbury works (Davies, 1999 p. 42). Hampel Committee found that the *box-ticking* employed by Cadbury and Greenbury Committee was not effective to develop good corporate governance in the listed companies. To improve the implementation of good corporate governance principles, the Hampel Committee proposed a narrative approach rather than box-ticking (Davies, 1999; Keasey et al., 2005 p. 32). It seems that the Hampel Committee more emphasizes the company willingness to implement good corporate governance principles rather than just the structure of corporate governance system. Or, refers to Keasey et al. (2005),

Hampel Report was on the need for good corporate governance to be based on principles rather than on prescription.

The Framework of Good Corporate Governance

In order to specify this research, I adopt the definition of corporate governance issued by the OECD as follows:

“Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.”

(The OECD’s Definition)

In term of corporate system, corporate governance concepts are taken by a company in order to ensure that the company had set a mechanism to meet the balance of power between the owners, the board of directors, and the management or executive directors. As explained in the previous section, some problems are happened in the relationship between owners and management, for example information asymmetry and moral hazard. Management has been more powerful than those of owners due to their direct involvement in day-to-day activities in the company.

According to Davies (1999), one of main issues in good corporate governance is how to empower board of directors to improve their ability to control the implementation of corporate strategy carried on by the management. In many countries that employ one-tier board system, some authors offer a rule to separate the position of CEO and chairman of the board of directors in order to reduce CEO power. In one-tier board system, there is one board of directors, including CEO and, sometimes, CFO, and commonly the chair position is held by the CEO. It means that the CEO is the most powerful person in the company.

It is much different from another board system, two-tier board system. In this kind of board system, there are two groups existed on the top level position in a com-

pany. The first group is the executive or management that operates the company on a day-to-day basis. The second group is a supervisory board that controls and keeps the management implements the strategies set by the supervisory board. The real disadvantage of the two-tier board system is the lack of ability of the board of commissioner members to fully understand the company businesses and other practices (Kurniawan and Indriantoro, 2000). Another criticism is that there is often little separation between management and the ownership, even though the company clearly stated the use of two-tier board system (Kurniawan and Indriantoro, 2000). Indonesia chooses the kind of board system in its public companies.

According to Muller (1981), corporate governance involves monitoring and overseeing strategic direction, socioeconomic and cultural context, externalities, and constituencies of the institution. The owners, through board of directors/board of commissioners, improve their power significantly since they realized that the conflict of interests between management and them was existed, and also after they found that corporate failure and bankruptcy was taken place because management did some actions without enough control. Shleifer and Vishny (1997) concluded that one of the important points in corporate governance objectives is to ensure that the owners receive rewards or returns related to risk they had taken in the investment.

Tentative Hypothesis

As mentioned in the first chapter, and strengthened by theoretical framework, I would like to propose a tentative hypothesis as follow:

The privatization methods chosen by the government influence the quality of transparency principle implementation in telecommunication industry in Indonesia.

In order to make it clearer, I made a figure that explains the tentative interrelationship between privatization methods and corporate governance. In this research, I choose PT Telkom and PT Indosat, two companies that are privatized by the government of Indonesia. Both of them used public offering method before the economic crisis was happened at the end of 1990s, and the advanced privatization of PT Indosat was done using private placement (strategic sale) method. The difference between the methods was explained in the previous section.

In this research, I would like to examine the quality of disclosure as a proxy of transparency. The quality of disclosure is a critical point since the companies decided to be listed in both domestic capital markets and international capital markets. They also have to synchronize between Indonesian GAAP and US GAAP. This research will emphasize on voluntary disclosures rather than obligatory disclosure.

C. Empirical Basis on Privatization and Corporate Governance

During 1980s until 2000s, number of researches conducted on privatization areas had increased significantly. Most of them tried to explain the relationship between privatization and the performance of privatized company (See at Megginson et al., 1994; and Boubakri and Cosset, 1998). Other researches focus on comparing the performance between private and public enterprises (See at Borcharding, 1982; Millward, 1982; and Boardman and Vining, 1989).

Megginson et al. (1994) conducted the research on privatization that was done by public offering method. Their reason is companies that be sold by public offering method, rather than strategic sale method, remain independent and continue to generate comparable post-issue financial and accounting data. They researched some accounting data to conclude the company's performance after privatized. They used profitability, operating efficiency, capital investment, output, employment, leverage, and dividend payout as the dimensions of performance, and all of them were significantly different between pre-post privatization. Finally, they concluded that the performance of post-privatized companies were better than those of pre-privatized companies. Boubakri (1998) conducted a more complex research than Megginson et al. did before. Using the same operational dimensions of performance, he found almost the same conclusion as Megginson et al, except on leverage.

Another analysis was conducted by Boardman and Vining (1989) that studied the performance differences between private companies, mixed companies, and fully state-owned companies. The research showed that, generally, there is statistically difference between private companies and state-owned companies, from private companies hold the best performance followed by fully state-owned companies, and the worst performance is held by mixed companies. But, Boardman and Vining did not

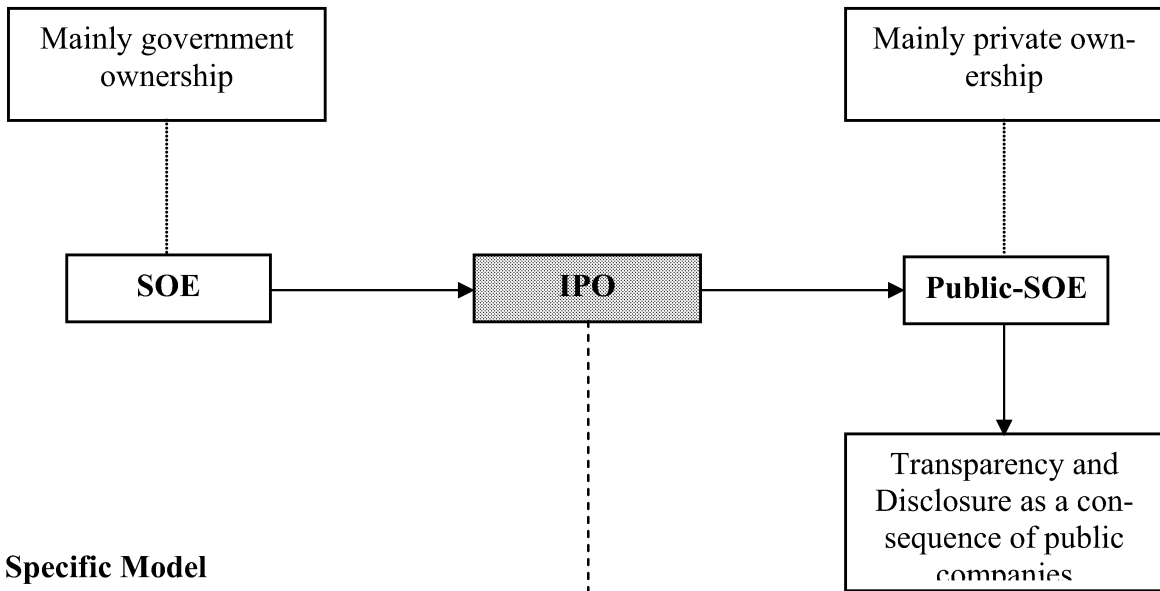
found consistent relationships between mixed companies and state-owned enterprises from the specific measurement, for example profitability, sales per employees, and sales per assets.

We could note that previous researches had rarely informed the relationship between the progresses of privatization and how an intensive corporate governance was implemented. Dharwadkar et al. (2000) have done a research that explains the privatization conducted in emerging economies. They said that weak governance system in emerging countries had created agency problems, and then the effectiveness of privatization processes that were conducted in the emerging countries could be hampered. They examined the ownership structure and capital structure that enhance the meeting of privatization and corporate governance.

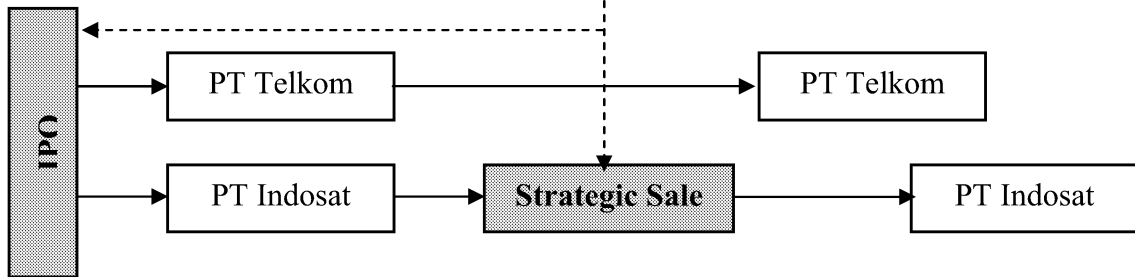
Another research had done by Khanna and Palepu (2001) mentioned the convergence of corporate governance in the world due to globalisation in product and labour market. They concluded that there are some causes that might prevent the convergence of corporate governance in India, for example poor quality firm, weak globalisation effects, and the impracticable US corporate governance in emerging countries. They also concluded that, generally, the adoption of corporate governance should be adjusted to domestic culture.

Figure 2.3.
Model of Research

General Model



Specific Model



CHAPTER III

RESEARCH METHODS

A. The design of research

This research will use qualitative research method as the main way to prepare, to collect and to analyse the data, and to make a report. The qualitative research method is different from the quantitative one in many ways, for example the method focuses on interactive processes rather than variables, authenticity rather than reliability, constrained rather than independent of context, etc. (Neuman, 2000 p. 16). Another explanation of qualitative approach provided by Frankfort-Nachmias and Nachmias (2003) as attempts to understand behaviour and institution by getting to know the persons involved and their values, rituals, symbols, beliefs, and emotions.

Specifically, the research will be focused on case study. Neuman noted in his book that in a case study, researchers examine many features of a few cases over duration of time. Moreover, the researchers may study one or more cases or make a comparison of a limited set of cases and focuses on several factors (Neuman, 2000 p. 32).

B. Unit of Analysis

I choose PT Telkom and PT Indosat as the unit of analysis on the research. Why we decide both companies to be compared is because the companies are two state-owned enterprises that have a relatively the same core business, telecommunication sector. Both companies have been listed in the Jakarta Stock Exchange, Surabaya Stock Exchange, and New York Stock Exchange. There are only two companies come from Indonesia that are listed on the NYSE, PT Telkom and PT Indosat, so I think that both companies are comparable from the transparency process point of view. Another reason is that both companies had been privatized before the economic crises hit the Indonesian economy. But, after the economic crises, based on a letter of intent signed by the government and the IMF, the government of Indonesia was forced to continue the privatization process of PT Indosat, and the government decided to use private placement mechanism rather than public offering.

Based on the unit of analysis, I decide to collect some relevant data that should support the process of analysis of good corporate governance practices in both companies, especially in the term of transparency.

C. Data Collection Methods

Field research will be done to collect the research data. In the field research, a researcher chooses a social group to be a research object, and then he or she observes directly to the object. According to Yin (1981), a case study research may use some data come from field works, verbal reports, observations, archival records, or combination of them. In this kind of data collection methods, the researcher does not have to look at the object physically as it should be done in experimental research, but he or she could observe some documents and information, and make a personal interview.

Secondary data have been collected to satisfy the purpose of research, for example data collected from third party analyses, annual reports of the objects, and any other raw data from some institutions, for example data come from the objects, government, non-government organization, The Jakarta Stock Exchange, BAPEPAM, and so on. However, the interview should be conducted to compare and to cross-check between third party data and the data come from the research objects.

D. Technique of Analysis

As mentioned in previous section, some data will be collected by observing documents and information as secondary data and make a personal interview as primary data. The observation of secondary data results a set of knowledge and of understanding of the company practices. For example the use of annual reports, both regular annual reports and form 20F, issued by the companies will enable us to understand the company facts deeply. In the mean time, other documents issued by the government or other authority bodies will be used to evaluate the compliance of the companies to government regulations.

Then, comparing between the obligatory disclosure and voluntary disclosure done by the companies will be carried out in order to get the facts of the companies' willingness to improve the disclosure quality.

The last data will be procured by performing deep interview. The interview will be taken in order to cross-check the facts related to corporate transparency obtained from the secondary data. The data come from the interviews have to be coded and be grouped in a systematic way. Jauch et al. (1980) give us a good explanation how to analyse data in a case study using content analysis schedule. The content analysis schedule could be used to analyse all secondary data and primary ones at once.

In general, the analysis will be structured as below:

A brief explanation of the implementation of transparency as a dimension of good corporate governance principles that are implemented in both companies.

The explanation will show how the companies implement good corporate governance principles, especially on the transparency and what the companies do in order to ensure the companies operated in a transparent way..

The voluntary disclosures that were done by the companies to improve the transparency principles.

In this section, I will identify the voluntary disclosure items on the companies' annual reports in order to get the information of the companies' awareness that they could use the annual report not only to inform what they had done in the past, but also to show that they have high consciousness to prepare the high quality annual reports. The analysis will be divided into two parts, the first part is a descriptive analysis based on the data from the annual reports. In this part, the research can explore the voluntary disclosures in each information types (strategic, financial, and non-financial information). I will use the potential voluntary disclosure items used by Meek et al. (1995), combined with many governmental body decrees to identify the real voluntary disclosure items in Indonesia.

The second part is the analysis of transparency process that is operated by the companies. For example, how the companies prepare the annual reports on time, how the companies engage an independent auditor, what kind of mechanisms used by the companies to disclose relevant factors that are probable to influence the stock price, etc. It is more difficult and more challenge to explore the companies' process rather than structure. The kinds of processes were hardly disclosed on the annual report and on the other secondary data. I will do this part using deep personal interview, so hopefully I can obtain the relevant, valid, and reliable data.

The Advantages and the Disadvantages of the Methods

The Advantages

According to Neuman (2000), the research method I propose here has several advantages and, in the same time, several disadvantages. I identify several advantages are as follows:

Flexible. Case study, by using some data collection methods, offers the researcher to be more flexible to gain the data. Personal interview planned at the data collection enable the researcher develops good relationship and keep contact with the interviewees. The results are that the researcher can receive more data than those of gained by another method of research. Then, Frankfort-Nachmias and Nachmias (2003) give the example of the interview's flexibility, that is by using good communication with the respondent, the interviewer can determine the fittest wording to avoid misunderstanding between the interviewer and the respondents, to clarify terms that are unclear, to control the order, and to probe for additional information and detail.

High control. The researcher gains high control by using the personal interview that is done in a field study. In this kind of data collections, the researcher can receive the respondents' answer directly. Beside the high relevant answer of respondent, first of all, the researcher will choose the respondents regarding to their position, their academic background, and their special interests. Good communication developed before the interview is done is very critical to get the high control (Zikmund, 2003).

The high control advantage described on the previous paragraph has also described the meaning of *high response rate*. As Zikmund (2003) wrote, the interviewer has to develop intensive communication and high commitment with the respondents in order to control the response rate. Interview schedule should be agreed to ensure that both parties will allocate much time and, the most important from the researcher point of view, the respondents have sufficient time to prepare some data that will be supplied for the researcher's interests.

Fuller information. Combining the personal interview and participant observation enable the researcher to obtain the data as many as possible. The data that are not provided by secondary sources will be completed and obtained from the personal interview, since the personal interview is well prepared. The personal interview and the participant observation will create a self cross-check mechanism to ensure the validity of data come from both methods. The researcher also can receive some data from many respondents that, may be, have different perspectives. For example, the inter-

view can be done in order to obtain some data from the research objects, analysts, government officials, and professionals and academicians.

Deeper information. Using the deep interview conducted on the field study, the researcher will receive deep information, because the question can be developed at the time of interview. Zikmund (2003) wrote that the researcher has to possess the ability not only to analyse the respondents' answers, but also the respondents' attitude, so he/she can avoid a bias on the data analysis.

The Disadvantages.

On the contrary of the previous section, according to Neuman (2000), there are also some disadvantages inherent in the research methods. The disadvantages are as follows:

Information bias. Due to the nature of this kind of research method, sometimes, the respondents keep some data not to be published to the researcher. The problem will be overcome by making interview with some independent people who are not influenced by the research objects.

High cost. Of course, the field study needs much money as operating cost. To do a good research, the researcher has to do field study in Indonesia, the country where the objects are located.

CHAPTER IV BRIEF STORY OF INDONESIA

A. The Economy of Indonesia

Indonesia, as the biggest country and the most populated in Southeast Asia region has adopted the good corporate governance principles since the end of 1990s (LOI, 2000). The adoption was started when the economic crises attacked the economic and political systems in Indonesia. During the economic crises, all people looked at some corporate failures were happened in Indonesia, and they realized that many Indonesian corporations had managed without strong control. The company failures do not only harm the stockholders, but, more generally, also harm the stakeholders.

The description of the development of good corporate governance principles in Indonesia is presented by explaining the national economy and business condition before the economic crises, the condition after the economic crises, and the last description is the development of good corporate governance principles.

Indonesian Economy in Pre-Crisis Period

Southeast Asian countries, including Indonesia, were claimed as the miracle of Asia in the beginning of 1990s (Ponce and Zielenziger, 1997). In this time, it is not so surprise to say that the Indonesian economic was potentially growth as a miracle with the average of the annual growth rate was 5%-7% consistent for two decades since 1980s. But, unfortunately, the country's development was emphasized on the growth rate rather than on the income distribution. While the economic growth rate reached 5%-7% annually, the Gini Index was 0.38, 0.33, and 0.32 for the year of 1978, 1984, and 1990 respectively (Suryana and Erwidodo, 1996). It means that the most circulating money in Indonesia was dominated by few number of people.

During the pre-economic crises, the government had fully intervened many industries in Indonesia and significantly influenced business practices, for example the government performed tight regulation rather than deregulation and also the government decided to involve directly into business practices, almost on all kinds of industries. We could look at the industries covered by some state owned companies that are controlled by the government, such as mining, plantation, forestry, telecommunication, banking, insurance, airlines, etc.

Old Order Nationalization Policy. According to Simanjuntak (2001), the development of state owned companies in Indonesia was started after the Government of Indonesia and the Government of the Netherlands went to war over the Papua sovereignty in 1959. At the time, some companies owned by Dutch were nationalized by the Government of Indonesia, and the government intervention on business practice was consequently started. The nationalization of Dutch companies in 1959 was also a starting point of guided economy implementation.

The Indonesian political and economic policy, in this period, closely related to communism and socialism developed in Soviet Union and China. To establish closer relationship, the government built a special path among countries as Jakarta-Beijing axis. According to Tambunan (2001), the government action was done in order to reflect anti-colonialism, anti-imperialism, and anti-capitalism spirit, because Indonesia had suffered from western imperialism and colonialism during 350 years.

After the regime under President Soekarno, the first president, was succeeded by the new order, called *Orde Baru*, led by General Soeharto, the government continued to manage the state owned companies, but was in different mindset from the socialism to the capitalism.

New Order Economy. In the beginning of 1966, Indonesia entered into new era of governmental system, called as Orde Baru and led by President Suharto. The new government focused on the improvement of social welfare through development of economy and society. It was done by reestablishment of relationship among Indonesia and western countries and also finished the Jakarta-Beijing axis. Communism and socialism were become prohibited ideologies.

In the dictatorship under President Soeharto, after he led the country more than 20 years, common business practices in Indonesia were influenced by special kinds of relationship between the government and business societies, for example there were many people that did their businesses through KKN (Corruption, Collusion, and Nepotism).

Business practices dominated by KKN have reduced the ability of Indonesian companies to participate in a fair competition (Leuz and Gee, 2005). Leuz and Gee wrote in their paper regarding to the opportunities to take advantage from a global financing. They also found that companies closely connected to Soeharto regime had underperformed during the economic crises. Faccio (2002) defined the political con-

nection as a company that one of its large shareholders or its top directors are member of parliament, minister or head of state, or closely related to top official. It is logical since the development of the companies was based on political connection, so they were not ready to solve economic problems fairly.

Monopoly and oligopoly are other issues on the competition environment in Indonesia. Sometimes, the government granted the monopoly rights to some companies, resulted consumer protection was almost impossible to be upheld, and the competition level was very weak (Baird, 2000; Simanjuntak, 2000; and Alijoyo et al. 2004). There are many examples that show how the government created monopolistic or oligopolistic market. PT Astra International was granted as a single automotive player, PT Bogasari Flour Mills was granted as a single wheat production player, PT Telkom and PT Indosat were granted as dominant players in telecommunication industry, etc.

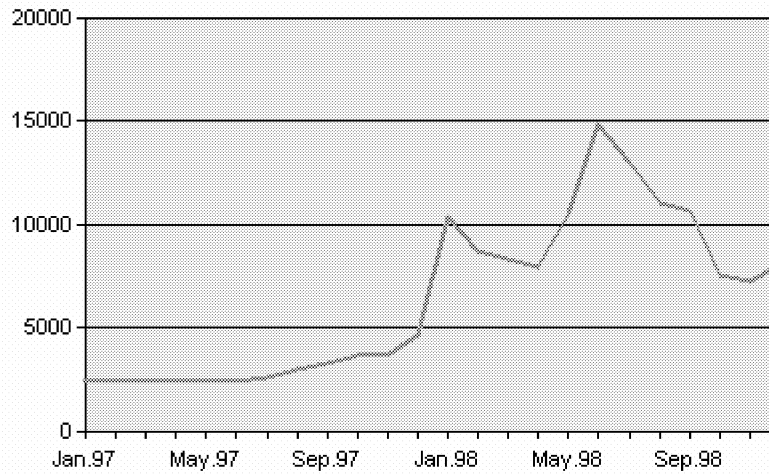
The disturbances of national economy in Indonesia that had been done by Soeharto's family and his cronies significantly influenced the competition level (Leuz and Gee, 2005). In 1996, Tommy Suharto, the youngest son, was awarded by the government to produce national car to produce cars using highly local content parts (Bertrand, 1997 and Hale, 2001), although, in the same year, he did not have a plant to produce the cars.

Small companies that did not have a relationship with the president or his cronies experienced difficulty to involve in the industry. Usually, to gain the business opportunity, finally, the companies paid the lower officials in order to facilitate them, for example to be a winner on a reconstruction projects, the companies that followed the bid process paid much money to the members of committee.

Indonesian Economy in Post-Crises Period

The uncontrollable depreciation of Rupiah from Rp2,450/US\$ on June 1997 to Rp14,900/US\$ on June 1998 (see the figure 3.1) showed that there are wrong policies taken during the Orde Baru. The economic policies based on KKN, family and closely relationship, monopolistic competition, and the inabilities of the government to control the inflation, 78% in 1998, caused the 1998-riot happened in several big cities in Indonesia, such as Jakarta and Surakarta.

Figure 3.1.
Currency fluctuations during the economic crises



Source: Statistics of Bank of Indonesia

On May 1998, President Soeharto decided to retire and handed over the leadership to the vice president, BJ. Habibie. The new president worked hard to appreciate Rupiah at a stable price, from Rp14,900/US\$ on June 1998 to Rp8,025/US\$ on the last of 1998. The new government realized that reformation should be done in a right way. In 1999, the government had conducted the deregulation policies, renewed many acts, and prepared the next democratic election.

According to Baird (2000), the government should improve the business environment in general. It means that the improvement is not only for large companies, but also for small companies. It is relevant with Krisnamurthi (2002), that the small companies and informal sectors had helped the government to minimize the economic crises risk. Moreover, Baird proposed to the government to conduct some actions as below:

- Promote better competition and create the new competition agency provided by the 1999 Law of Competition;
- Reduce the burden of excessive government regulation;
- Strengthen the rule of law and the judicial system; and
- Accelerate banking and corporate restructuring.

Table 3.1.
List of Government Acts issued in 1999 in Economic Policies

Act #	Title
Act No. 5	Prohibition of Monopolistic Practice and Un-fair Competition.
Act No. 8	Consumer Protection
Act No. 23	Bank of Indonesia
Act No. 24	Foreign Exchange and Exchange Rate System.
Act No. 25	Financial Balances between Central and Local Government
Act No. 28	State Management in Clean and Free from Corruption, Collusion, and Nepotism
Act No. 31	Eradications of Corruption
Act No. 36	Telecommunication

Source: Cabinet Secretariat of Republic of Indonesia

According to Keasey (2005), macroeconomic and microeconomic policies influence each other, and they caused economic crises in Indonesia become difficult to be solved in short time. In order to accelerate economic development, Alijoyo et al. (2004) suggested that the government has to improve the competition environment in micro level, and in the same time, the government should reform itself from corruption and bribery practices, because such practices result high cost economy, a problem that exists in macro level.

B. Corporate Governance Practice in Indonesia

In 1995, the Government of Indonesia set the Indonesian Company Law and Indonesian Capital Market Law in order to replace the Indonesian Limited Liabilities Law governed by Commercial Code of 1847 set by the Dutch Government in colonial period. The company law and the capital market law are the basis of corporate governance practices in Indonesia. Under the law, the separation between principals/shareholders and management was existed. In order to supervise management's or board of director's work, shareholders have to form a board of commissioners. Both the board of commissioners and the board of directors are responsible to provide full disclosure of the companies' financial and non-financial position in a General Meeting of Shareholders (GMoS). It indicates that the government chose to adopt two-tier board system, a system that clearly separates the management and the board

of commissioners. In the kind of system, the management is called as the board of directors – in a different meaning from another board system, one-tier board system.

The development of good corporate governance practices in Indonesia after the economic crises was mostly affected by the economic crises and business practices that had been done before. Monopoly, corruption, bribery, collusion, and nepotism are the kinds of practices that had been realized by the government and business societies, and they were the causes of the low level of good corporate governance implementation in Indonesia.

Following the government actions mentioned in the previous section, the Capital Market Supervisory Agency (BAPEPAM) have issued some essential decrees to force the implementation of corporate governance principles. These are examples of financial and non-financial rules issued by the agency:

- II.A.1. Documents available for public.
- VIII.G.2. Annual Report.
- VIII.G.7. Guidelines for financial reporting.
- VIII.G.11. Management responsibilities of financial reporting.
- IX.E.1. Conflict of interest on certain transaction.
- IX.I.1. Planning and conducting the general meeting of shareholders (GMS).
- IX.J.1. The main Articles of Association (AoA) of companies offering their equities to the public and of publicly listed companies.
- X.K.1. Disclosure of information the “Must Immediately be Made Public”.
- X.K.4. Report on the use of funds received from public offering.

Stock Exchange Role

Indonesia Capital Market, as a proxy of degree of competitiveness in the country, had suffered from the unfair business competition created by the government and its cronies. The unfair competition between companies that are listed in the Jakarta Stock Exchange results a bias financial analysis, because the companies show high profit and market shares that actually were not gained by doing the fair competition. For example, PT Indofood has granted as the holder of the biggest market share in food industry in Indonesia, and the company’s shares were sold in the Jakarta Stock Exchange as one of blue-chip shares. The company’s earning per share (EPS) showed Rp90/share and Rp71/share in 2002 and 2003, respectively. After the food and wheat

product market was widely opened, the company just reached Rp44/share in 2004 and Rp5/share in 2005. The company is owned by Salim Group as the largest shareholder. Salim was one of Indonesian-Chinese conglomerates closely connected to Soeharto.

Also, concentration of ownership of companies listed in Jakarta Stock Exchange was not uncommon situation. According to Alijoyo et al. (2004), 64% of all companies listed in Jakarta Stock Exchange has concentration of ownership, so the market players and other shareholders just seized a small part of companies' pie. He defines the ownership concentration as a high proportion of large shareholders from the total ownership. When the condition still exists, there are only small portion of shares traded in a stock market. It is consistent to another research conducted by the Asian Development Bank. In its report issued in 1999, the ADB found some factors that had caused economic crises in some countries in Asia, such as follows:

- High concentration of company ownership;
- Ineffective supervision by the board of directors;
- Inefficiency and lack of transparency on the procedures to acquire a company's control;
- Over reliance on external funding, i.e.: bank loans; and
- Inadequate supervision by creditors.

The concentration of ownership and unfair competition among companies listed in the stock exchange had weakened the regulation enforcement by the authorities, such as BAPEPAM and JSX. It is consistent with the findings of Beird (2000) that concluded the economic crises in Indonesia was caused by poor corporate governance since the corporate governance in Indonesia had some characteristics such as:

- Corporate governance has been seen primarily as a compliance issue rather than a means of enhancing corporate performance;
- Indonesian corporations are dominated by family-owned, even when the corporations were listed in Jakarta Stock Exchange.
- Fraud and insider transactions are common business practices in the stock exchange, so the management, controlled by the majority shareholders, could influence the stock prices easily.
- Disclosure has been weak and the mechanisms created by the authority did not operate effectively.

- Minority shareholders and other stakeholders have had few means to protect themselves.
- State owned companies have been subject to significant intervention by government in business decision.
- The role of the regulators has not been strong enough to control the environment.

National Committee on Corporate Governance Role

In 1999, the government formed the National Committee on Corporate Governance (NCCG). The objectives of the formation of the NCCG, as written down in the report of implementation of the Letter of Intent between the Government of Indonesia and the IMF, are as follows: to rationalize the regulatory framework; to emphasize transparency of business practices; to increase the accountability of corporate management to shareholders and regulators; and to increase the effectiveness of enforcement by regulatory agencies.

Two years after the establishment of the NCCG, in 2001, the agency issued the Indonesian Code for Good Corporate Governance. The objective of the issuance of the codes is to guide the Indonesian companies to implement good corporate governance principles based on international best practices that appropriately adjusted to suit the Indonesian legal and regulatory environment. The purposes of the principles set forth in the guidelines are as follows:

- to maximize corporate and shareholder value by enhancing transparency, accountability, reliability, responsibility, and fairness in order to strengthen the company's competitive position both domestically and internationally, and to create a sound environment to support investment;
- to encourage the management of the company to behave in a professional, transparent, and efficient manner, as well as optimizing the use of and enhancing the independence of the Dewan Komisaris, the Direksi, and the GMOS;
- to encourage shareholders, members of the Dewan Komisaris and the Direksi to make decisions and to act with a strict sense of morality, in compliance with the prevailing regulations having the force of law, and in accordance with their

social responsibility towards the various stakeholders and the environmental protection.

The Indonesian codes of good corporate governance, in general, consistent with the Corporate Governance Principles issued by the OECD (Kurniawan and Indriantoro, 2000). There are many points contained in the codes, such as: shareholders; board of commissioners; board of directors; audit systems; corporate secretary; stakeholders; disclosure; confidentiality; insider information; business ethics and corruption; donations; compliance with health, safety, and environment protection regulation; and equal employment opportunity.

In order to improve the companies' willingness to adopt the guidelines at their article of association and at their practices, the committee had conducted efforts as bellow:

The code of good corporate governance has been submitted to the government as a private sector initiative. It will influence the companies' willingness to directly adopt the guidelines rather than those are issued by the government, because it is influenced by the trust of Indonesian business society to the government.

The code will be implemented like industry standards, such as ISO. As the companies want to be rated by independent institutions on their implementation of quality standards, the NCCG promotes the formation of new independent institutions in order to conduct the corporate governance implementation valuation, as a part of public control mechanisms.

CHAPTER V
TELECOMMUNICATION INDUSTRY DEVELOPMENT IN INDONESIA
AND IN SOUTH EAST ASIAN REGION

A. Development of Telecommunication Industry

Since the end of 1980s, a drastic change at structure of telecommunications industry was happened in the world. The change was begun by telecommunication industry management reform from government, through its state-owned companies, to private sectors. It was done not only through deregulation but also through sales of state-owned companies on the telecommunication sector to private companies. The first privatization in telecommunication industry was conducted in the UK by PM Margaret Thatcher by selling of British Telecom. Then the privatization of telecommunication industry was followed by other countries, both developed countries and developing countries.

Privatization represents one government step to respond trade liberalization, so that the privatized companies are expected be able to do their business function without political interference from their country. According to Poh (1994) and D'Costa (1997), there are some trend that dominate telecommunication industry growth in the world, among other things: advanced technology utilization, globalisation, and liberalisation.

Advanced Technology utilization has consequences that a company competes in telecommunication industry does not merely have to increase its volume of service, but rather, the company has to compete by offering high value added services. Meanwhile, globalization has many impacts that the company has to be able to compete against expansion of foreign companies come from developed countries, what is generally have more financial and operational support and higher level of technology. It is relevant with go-international strategies phenomena imposed by developed countries toward their companies.

Liberalization conducted in telecommunication industry is reflected by deregulation conducted by countries to create fair competition. In this point, the greater the degree of deregulation conducted, it is expected the more foreign investor are ready to do foreign direct investment. Liberalization is also done by reducing government roles in telecommunications industry, from as an operator to a regulator.

B. Brief History of Telecommunication Industry in Indonesia

Telecommunication industry in Indonesia has been started since 1961 when the government of Indonesia nationalized telecommunication company owned by the Dutch in Indonesia. The expropriation was followed by the formation of a telecommunication state-owned company, which finally was named as PT Telekomunikasi Indonesia (PT Telkom).

Meanwhile, acquisition of a foreign company owned by ITT USA by the government of Indonesia results a company that operates in satellite and international direct dialling services, called as PT Indosat.

In order to develop the telecommunication industry, both companies had been granted monopoly rights. PT Telkom had received fixed line licences, consisted of local service and long distance service, and PT Indosat had obtained international direct dialling and satellite services.

In 1994 and 1995, the government of Indonesia conducted privatization to PT Indosat and PT Telkom, respectively. The privatization was done by selling the government's shares at both companies through the Jakarta Stock Exchange, the Surabaya Stock Exchange, the New York Stock Exchange, and the London Stock Exchange. It is a monumental decision that the government and the companies were willing to do dual listing, a practice that had never been done by other companies in Indonesia.

By privatizing both companies, the companies' performance should enhance because the companies have responsibilities to increase shareholders' value. Unfortunately, in Indonesia, the domination of the government toward the companies hampered the companies to grow, because the companies have to satisfy both business and political interests. Until 2002, teledensity rate achieved by the telecommunication companies was 3.7% and 5.5% for fixed line and mobile services, respectively, compared to Singapore 46.4%, Malaysia 19%, Thailand 9.9%, and Vietnam 6.9% (source: Asean Connect).

C. Regulation

Changes towards telecommunication industry activities in Indonesia has been taken place since the government of Indonesia issued Telecommunication Law No. 3/1989 and followed by Telecommunication Law No. 36/1999.

Before the Act No. 3/1989, telecommunication business had been managed using monopoly mechanism by the providing of exclusive rights granted to PT Telkom

and PT Indosat. The Act No. 3/1989 had replaced the monopoly by introducing Public-Private Partnership system. The system required private companies that operate on telecommunication business had to build a special cooperation with public company as a partner. The PPP system offered revenue-sharing, Joint Venture Companies (mobile), and Joint Operation Scheme-KSO (fixed-line).

The ineffectiveness of PPP had caused the government of Indonesia change the competition structure into full competition among developed companies in Indonesia. In order to support the policy, the government required PT Telkom and PT Indosat to stop their cross-ownership at several subsidiaries, such as PT Telkomsel and PT Satelindo. The previous ownership structure at PT Telkomsel and PT Indosat is as follow:

Table 5.1.
Ownership Structure of PT Telkomsel and PT Satelindo

	Launch Date	Ownership Structure
PT Telkomsel	1995	Telkom 51%; Indosat 49%
PT Satelindo	1994	Telkom 30%; Indosat 10%; Bimagraha 60%

Besides, new licences were granted in competitive way by involving more telecommunication operators, especially in mobile services. Now, there are many mobile operators doing business in Indonesia, such as Telkomsel, Indosat, Excelcomindo, mobile-8, Bakrie Telecom, Cyber Access, Lippo Telecom, and Sampurna Tel. Several foreign companies operated in Indonesia through the local companies above as follows:

Table 5.2.

Foreign Players in Mobile Industry

Foreign Players	Local Players
SingTel	Telkomsel
STT-SingTel	Indosat
Telecom Malaysia	Excelcomindo
Hutchinson	Cyber Access
Maxis	Lippo Telecom

(Source: Firmansyah, 2006)

D. Line of Business

Together with the development of telecommunication technology, the government withdrew the exclusive rights bestowed to PT Telkom and PT Indosat and goes into effect competition system. The government granted relatively the same licences toward PT Telkom and PT Indosat. Now, the companies have had lines of business as follow:

- Fixed Line, including wireless devices.
- Mobile
- Data and Internet
- Network and Interconnection

E. Profile of Two Major Companies

This section will discuss company profile of PT Telkom and PT Indosat. Generally, both companies has the relatively same business, that is at telecommunication industry, even in the beginning of the establishment of the industry in Indonesia, both companies were granted by the government of Indonesia two different kinds of monopoly policies.

The discussion will be based on information gathered from the annual reports issued by both companies and the company profiles stated at Real Time Financial Information (RTI).

PT Telkom

History

PT Telkom is a state-owned company associated to public telecommunication provider. In the beginning of economic development of Indonesia, the government offered PT Telkom to develop and to manage fixed line services. Historically, PT Telkom was a private company founded by the Dutch East Indies government in 1884. The first time, the company was named as Post en Telegraafdienst, and had been authorized to develop telecommunication sector for 25 years.

Together with Indonesian fight for freedom, the company was expropriated by the government of Indonesia in 1961, and then the company was named as PN Pos dan Telekomunikasi.

In 1965, PN Pos dan Telekomunikasi was separated into PN Pos dan Giro and PN Telekomunikasi, and then PT Telekomunikasi was separated as Perum Telekomunikasi and PT Industri Telekomunikasi Indonesia. The separation was followed by clearly job distribution. Perum Telekomunikasi had to develop telecommunication network, and PT INTI had to develop telecommunication device manufacturing.

In 1991, the government changed the legal status of Perum Telekomunikasi as “persero”, or state-owned limited liability corporation, with the objective was to strengthen its business practice, to become PT (persero) Telekomunikasi Indonesia.

Because of the width of operational scopes in Indonesia, PT Telkom divided the area in seven regional division and one network division. Additionally, PT Telkom and its several partners from developed country operators formed Joint Operating Scheme (KSO – Kerja Sama Operasi).

KSO Agreement

The KSO Agreement was carried out by PT Telkom and its partners in order to improve society accessible to get telecommunication services widely. The agreement stated that KSO partners had special rights to:

- To manage and operate specified regional division for a fixed term.
- To develop new certain amount fixed-line networks in the period of cooperation.
- To share revenues generated during the agreement.

- To transfer the existing and new facilities to PT Telkom for an agreed amount of compensation.

Nevertheless, the operating of KSO Agreement was hampered by economic crises in Indonesia and the partners suffered difficulties to fulfil the stated target to develop new fixed-line networks in their regional divisions. Finally, PT Telkom decided to take over four KSO partners during 2001-2004 as follow:

- In 2001, PT Telkom acquired more than 90% stocks of Dayamitra, the KSO partner of regional division VI, and on December 2004 PT Telkom exercised its call-option right to buy the remaining shares.
- In 2002, PT Telkom acquired 100% shares of Pramindo, the KSO partner of regional division I gradually.
- In 2003, PT Telkom acquired 100% shares of AriaWest, the KSO partner of regional division III.
- In 2004, Telkom arranged new agreement with Mitra Global Telekomunikasi Indonesia (MGTI) to buy financial control and operating decision of regional division IV for a purchase price of US\$390.7 million. (Form 20-F PT Telkom 2004)

Monopoly Termination

The significant changes of government ownership at PT Telkom was started in 1995 when PT Telkom listed its stocks at the Jakarta Stock Exchange, the Surabaya Stock Exchange, the New York Stock Exchange, and the London Stock Exchange. Since the initial public offering, PT Telkom has changed its legal status as a public company and subject to the enforcement of capital market rules, both national and international.

Although the public offering was carried out successfully, the government decided to dominate the ownership at PT Telkom. In the end of 2005, the ownership structure of PT Telkom was as follow:

The government of Indonesia	51.19%
National Investors	2.61%
Foreign Investors	46.20%

Together with a new order in Indonesia, called “Orde Reformasi”, the government of Indonesia issued a Telecommunication Law No. 36/1999 in order to reform telecommunication industry. The Telecommunication Law provided the basis of the government action to terminate PT Telkom’s exclusive rights of providing fixed-line services. Besides, PT Telkom and PT Indosat had to end their joint ownership at several subsidiaries in order to introduce fair competition in telecommunication industry.

PT Indosat

There are few information gathered by researchers regarding PT Indosat’s history, because PT Indosat did not operate and touch directly in the interest of citizen of Indonesia. PT Indosat was granted to develop international direct dialling (IDD) and satellite services.

History

Historically, PT Indosat was founded in 1967 by America Cable and Radio Corporation, a subsidiary of International Telephone and Telegraph (ITT) in United States. In 1980, the government of Indonesia took over the company from the America Cable and Radio Corporation, and changed the company’s legal status from Foreign Direct Investment company to become State-Owned Company.

During doing the operation as state-owned company, the government ownership at PT Indosat was reduced in 1994 by Initial Public Offering at the Jakarta Stock Exchange, the Surabaya Stock Exchange, the New York Stock Exchange, and the London Stock Exchange. The reduction of the government ownership was taken place in the end of 2002, when the government sold 41.94% of its shares at PT Indosat to foreign investor, Singapore Technologies Telemedia Pte. Ltd through Indonesia Communication Limited as its special purpose vehicle (SPV). It has made the changing of government ownership from 57% to 15%. Entirely, the ownership structure at PT Indosat is 15%, 41.94%, and 43.06% as the ownership of the government, ICL, and public, respectively.

Monopoly Termination

Related to telecommunication business reformation, as of PT Telkom, the business of PT Indosat has been affected by the government policy to liberalize telecommunica-

tion industry. It was started in 1999 after the issuing of the Telecommunication Law No. 36/1999.

The policy has affected PT Indosat, both operational businesses and strategic ones. For example, the merging of PT Satelindo into PT Indosat has changed the PT Indosat's business strategy to become Full Network Service Provider and has forced PT Indosat to focus on cellular business. Besides, PT Indosat has received new license to develop local services and long distance ones together with PT Telkom.

F. South East Asia Countries – A Comparison

In this section, I will inform the description of telecommunication regulations carried out by countries located in South East Asia region, such as Malaysia, Brunei Darussalam, and Philippines, in order to obtain different context of knowledge between countries.

Malaysia. Malaysia has conducted liberalization policy on telecommunication industry since 1991 at the time privatization of Telekom Malaysia (TM) or Syarikat Telekom Berhard before 1987, the largest telecommunication provider in Malaysia. Afterwards, the government gave some licenses to other companies to provide cellular service in order to push fair competition in cellular markets.

Now, Telekom Malaysia still has its own rights to monopolize fixed line services, and meanwhile, cellular services conducted by some companies, among other things: Celcom (100% owned by TM), DiGi Telecommunication, Maxis Telecommunication, and Telekom Cellular. The last company mentioned is a fully state-owned enterprise. One interesting thing is that telecommunication industry in Malaysia has to be dominated by Malaysian natives. For example, only 15% of shareholders in Telekom Malaysia is foreigners, and 4.5% is non-natives (source: Telekom Malaysia's website).

Besides improving operational and financial performance, the government imposes of the company to expand into other countries, among other things to Pakistan, Bangladesh, Indonesia, Thailand, etc. (source: NTP, Malaysia). It means that the government of Malaysia supports Malaysian companies to go-international, from local companies to multinational companies.

Brunei Darussalam. Brunei Darussalam is one of the smallest country and population in South-East Asia. With the number of population of equal to 357,800 people, Brunei has GDP per capita of equal to US\$23,600 (Source: CIA World Facts). Tele-density reaches by 25%, so that with an assumption of per household inhabited by four people, hence Brunei has installed telecommunications services at each household.

The government of Brunei Darussalam decided to grant monopoly rights of its telecommunication industry to Jabatan Telekom Brunei and DST Communication for fixed line services and cellular ones, respectively.

The government has restructured its regulation in 2001 by issuing:

- Telecommunication Successor Company Order.
- Authority for Info-Communication Technology Industry Order (AiTi).
- Telecommunication Order

(Ibrahim, 2005).

Although the country has restructured its regulation of the telecommunication industry, the government still goes into effect dual function systems between operator and regulator. For example, AiTi Order established the AiTi as independent statutory body to regulate the local ICT Industry. Meanwhile, Telecommunication Order confers AiTi the exclusive privilege to provide telecommunication systems and allows the AiTi to grant of licenses for the same to other companies.

The Philippines. The Philippines has uniquely characteristic related to telecommunication regulation with changes of its government regimes, even it could still be seen as progressive policies. The government of Philippines is much powerful to govern telecommunication industry, as of Malaysia case.

When president Ferdinand Marcos led the country, he granted monopoly rights to several private companies. At that moment, the Philippine Long Distance Telephone (PLDT) had monopolized market of both international calls and domestic ones. Two other companies monopolized domestic and international satellite services, and one company monopolized international telex and data communication.

Under the governance of President Corazon Aquino, she started to add some telecommunication services and she gave licenses to other companies, that is in international gateway services, cellular phone services, and cable television. The liberalization continued by President Ramos by publishing the Public Telecommunication Policy Act.

In order to enforce all companies granted the licenses to improve national teledensity, the government released two regulations in 1993 that are intertwined each other, that is interconnection regulation (EO 59) and the regulation that requires each telecommunication operator to install certain number of fixed lines (EO 109), for example a company granted by cellular license has to install 400,000 fixed lines.

To strengthen fair competition, the Philippines invited some investors to enter into its telecommunications markets. Up to 1998, there were some foreign companies invested over there, among other things: Singtel, Deutsche Telekom, First Pacific Hongkong, NTT Japan, and Nynex USA (Source: APEC, 1998). But, the foreign investment was limited as the maximum of 40% ownership held by foreign companies.

But, as in Indonesia, the first mover usually tends to be resistant toward new regulations. For example, although the government issued interconnection regulation, PLDT as the largest operator has limited new comers to get interconnection access to its network or charged prohibitive rates.

The number of companies (14 national network operators) followed by the government regulation, such as EO 109 released in 1993, resulting the dramatic improvement of teledensity from less than 1% in the year 1991 becoming 9% in 1998 (Source: Aseanconnect).

The countries mentioned above, including Indonesia, have different contexts of telecommunication regulation background. Executive/government power, countries' income, and law enforcement strongly influence the performance of telecommunication industry. In Indonesia, PT Telkom as the largest company serves on fixed line services is subject to interference of government and societies, including political parties' interests. For example, the position of CEO and other directorships at Indonesian state-owned companies, including on PT Telkom, is not merely a professional job, but also a political job, a totally difference from other countries' experiences (Jawa Pos, 27 June 2005)

CHAPTER VI
RESEARCH FINDINGS AND DISCUSSION

A. Findings of Research

This section will present finding research obtained from interviews between the researcher and specific targeted people. The interviews had been conducted in Indonesia since March 15, 2006 until April 8, 2006. In order to treat the interviewees anonymously, I will use only unspecified job position. The table below describes the targeted people:

Table 6.1.
List of Respondents

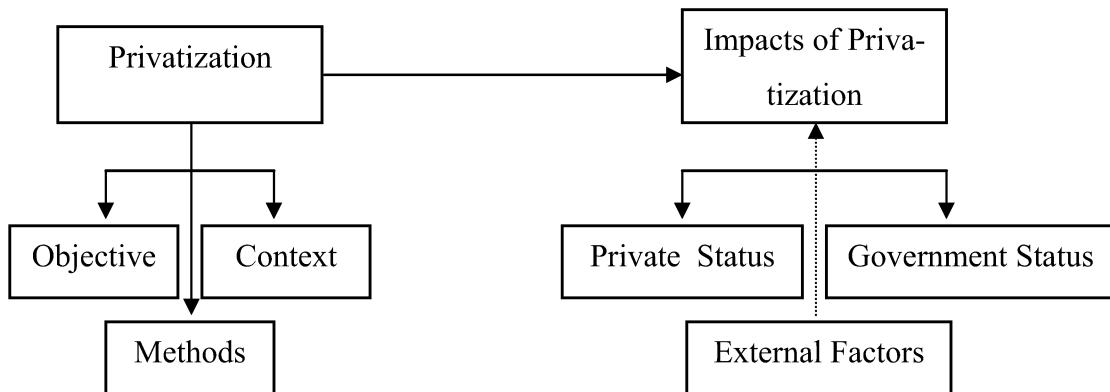
No.	Job Position	Number of people
1.	Deputy Minister of State Owned Company	1 person
2.	Leaders of Political Parties – informal interviews	2 people
3.	Chairman of National Committee on Corporate Governance	1 person
4.	Independent commissioner at PT Telkom	1 person
5.	Independent commissioner at PT Indosat	1 person
6.	Corporate Secretary or Investor Relationship at PT Telkom	2 people
7.	Corporate Secretary or Investor Relationship at PT Indosat	4 people
8.	Practitioners at Mandiri Sekuritas	2 people
9.	Lecturer and Researcher from Gadjah Mada University	1 person

The researcher has obtained much additional knowledge during the interviews conducted. Also, the researcher could verify and clarify some findings found before the interviews to be carried out. The findings are presented as of Figure 6.1.

a. Privatization

This part will discuss about the objective of privatization and methods used on privatization of PT Telkom and PT Indosat. Also, the context underlying the advanced privatization of PT Indosat in 2002 will be described.

Figure 6.1.
Finding Report Structure



The objective of Privatization

In 1994, PT Indosat, followed by PT Telkom in 1995, listed in Jakarta Stock Exchange, the Surabaya Stock Exchange, the New York Stock Exchange, and the London Stock Exchange. It was the first experience of Indonesian companies to do dual listing, in both national capital markets and international ones.

There are two objectives of why the government imposed PT Telkom and PT Indosat to do dual listing; these are to improve business practices in Indonesia and to invite foreign society to participate in telecommunication business. One of Deputy Minister of State Owned Enterprises said as below:

“The main objective of privatization we conducted, either in Indonesian capital market or in international capital market, is to create corporate value.... Why we chose to conduct the IPO in New York Stock Exchange, stock exchange in a state which is more advance than those in Indonesia. After the time of the IPO, we start to improve our reporting systems in order to be more transparent and accountable. In fact we have conducted good corporate governance there. Besides, we wish foreign society assist and participate in telecommunication industry in Indonesia through the share ownership.

And also, why the government so confident of the ability of PT Telkom and PT Indosat was because we looked at telecommunication business characteristics. In the time of IPO, the companies, from both cash flow

and future prospect, was very good, and we were sure that investors will be interested. Afterwards, our projection was proven. A few moment after we were listing, we could sell the shares on PT Telkom and PT Indosat successfully, and after that, the share price has been increasing.”

Another practical objective why the government of Indonesia supports both PT Telkom and PT Indosat conducted dual listing was mentioned by one of researcher from Gadjah Mada University that interested on privatization. The objective is to make PT Telkom and PT Indosat as pioneers. He said as below:

“We know that capital market and law enforcement in Indonesia are still lower than those on other developed countries. Would we still close our eyes and do not see that other countries have been take-off? In my opinion, it is better if we ride in a flying plane than we ride in another one that does not wish to take-off, isn't it? At least, one or two of us follow the flying plane, so they can inform and advise us about how the sky is. Thereby, it is referred as pilot project, that is from a few national corporations which have been listing in international capital market and keep their good performance, and then I am sure other companies will follow them.”

Methods of privatization and underlying context.

Different context was happened when the government conducted the advanced privatization of PT Indosat in 2002. There are many things that influence the privatization process. First, the government had to generate revenue due to lack of state budget. Also, it was the cause of why the government chose strategic sale method rather than public offering one. It was said by the Deputy Minister of State Owned Companies during the interview:

“There is no strange decision on the privatization. It is rational because the government was requiring much money. For example, you have your own program and need much enough fund, but you do not have money. What you will do? Of course, first, you will think to borrow much money. Second, You will try to find something what you can sell, won’t you? That is so realistic, at that time, the state was requiring fund quickly. Then, if we sold our shares through capital market, we could not accept the money quickly.”

An ideal perspective was mentioned by the Minister of State Owned Company, Sugiarto, at a opening lecture in Gadjah Mada University on the beginning of August 2005¹. The privatization methods chosen by the government provides different quality of process accountability. Theoretically, public offering method offers more accountable processes than those of strategic sale one. He said as follow:

“We have some methods of privatization that we can implement. The first is public offering. Second, strategic sale. The last option is Management or Employee Buyout. Of course, the best methods, from accountability point of view, is public offering, because the method will involve capital market authorities, legislative members, press, etc.”

Second, implicitly, he assumed that international institutions had pressured the government of Indonesia to conduct the privatization.

*“If you ask about pressure of international institutions, for example IMF, I thought that they did not insist on. They just gave us choices. If we did not want to do, I think it was still Okay... **Nevertheless, it was related with their aid programs. They required it as one of conditions.** I think it is also taken place around the world. Please do not be spelled out it as a pressure. It is their offer to Indonesia, whether or not, Indonesia wishes to recover the economy quickly. Why we do not spell out as*

¹ The researcher attended on the opening lectures at Gadjah Mada University. Gadjah Mada University is a university that the researcher works as a lecturer.

a pressure is because it will make us become so defensive and also it has negative connotation.”

Third, political parties' involvement. Even though there was strong debate among politician figure on the privatization process, the Deputy Minister of State Owned Enterprises did not mention the influence of political parties at the privatization of PT Indosat. He avoided saying that the political parties were scrambling to take advantage.

“Political party did not fight, but competed. They competed so their candidates can win. It is ordinary situation in business world. And the political parties also are of the same to do this. Then, as long as the winning is based on procedures, in my opinion, it is no problem.”

But, one of Partai Amanat Nasional founders said that his party was involved on the privatization process indirectly. He said that his party carried a multinational company to follow the tender. He said as follow:

“I admit that I and my party had been involved to look for appropriate investor on the privatization of PT Indosat. Then, after my candidate failed, I gathered all regents, mayors, and governors from rich districts to form consortium together to buy PT Indosat. I think this was nationalistic.”

Evidence is told by a member of Indonesia Legislative Assembly that mentioned of political party involvement on the privatization process. Moreover, in this context, he did not only talk about the political party involvement on the privatization process, but also the involvement on state owned companies' strategic decisions. He said as follow:

“It is not a confidential that state-owned companies are become the area of struggling of financial resource for political party, especially to generate financial support in the general election 2004. This problem

frequently present in every privatization failure in Indonesia, including of privatization of PT Indosat.

At least, there are two factors making the privatization of PT Indosat fail to fulfill ideal objectives, such as:

a. The existence of politicization of board of directors at PT Indosat to pursue irrelevant political targets. I believe you know that any members of board of director of PT Indosat at that moment are of political party participants, either directly or indirectly.

b. There was political extortion toward the existence of PT Indosat for the interests of governmental functionary and the political party. In this case, I think you have known if a political party utilized some of privatization results in order to fund the general election in 2004.”

b. The Impacts of Privatization

There were many consequences that would clearly appear after state-owned company was privatized. The first is the changes of ownership structure. Second, the government status. Third, more rules to be obeyed, for example capital market rules.

Ownership

M. Adhi, one of researcher from Gadjah Mada University, is certain that privatization could improve company's performance. Because trend of privatization in the world clearly moves from mainly government ownership to private ownership, he believes that the ownership changes will affect on the performance (see also in Adhi, 2005). He said as follow:

“The government could reduce its ownership by either selling the shares on a stock market or selling the shares directly to strategic investors... In my opinion, the performance of PT Telkom and PT Indosat is different, because the government has done a half-hearted privatization toward PT Telkom. Now, the government keep its shares at PT Telkom 51% of common stock and one sheet of dwi-warna stock. It means that

the government has full control to PT Telkom. In this situation, PT Telkom is still a state owned company and having some special privileges.

Now, the government tries to follow on international trend of privatization that leaves state-owned companies to become mainly private ownership. An example is PT Indosat. We will see the differences between both companies couple years later, after the company stepped back to its status as foreign direct investment.”

Government status

Before companies be privatized, government holds full control, and the government could exercise its control on daily basis. It is different from privatized companies; even though the government still holds most of outstanding shares.

One of independent commissioner of PT Telkom said as:

“By binding ourselves to stock markets, what the government can do? It is not different from other stockholders. But, because the government has more than half portion of outstanding stocks and one sheet dwi-warna stock, the government still controls the company. But, the control should be exercised through a general meeting of shareholders.”

But, at another answer of government intervention, he said that, in fact, the government often intervenes the company’s operation, and not through general meeting of shareholders.

“Often. Very often. And, by law, it violates the law. But, it is common at the businesses of state-owned companies in Indonesia, either explicitly or implicitly. Even, the parliament assumes that it has a right to do that.”

Rules of Capital Market

Public Offering is a way for a company to be better, because, by binding on a stock market, the company has to follow more rules than those of private or family companies. One of Senior Vice President at PT Indosat gave clear statement as follow:

“Since 1994, Indosat has been listing as a public company at the Jakarta Stock Exchange, the Surabaya Stock Exchange, the New York Stock Exchange, and the London Stock Exchange. The experience was followed by PT Telkom in 1995. So, like or dislike, we were bound by rules of capital market, both national capital markets and international ones. Because of that, corporate governance and its aspects have been implemented at PT Indosat as a basis of public company. For example, the company makes annual report and other reports routinely, gives report of all material matters, follows both Indo GAAP and US GAAP, etc.”

It is also agreed by the independent commissioner of PT Telkom I interviewed. He said that US capital market authorities have issued strong rules, and they enforce public companies listing there to do the rules.

“In a process of reporting, there are very detail requirements from the US SEC. The compiling of annual reports also needs high standards, such as accounting standard and reporting standard. Auditors also have different standard when they conduct auditing engagement at PT Telkom, because, after the Enron failure in US, the SEC formed PCAOB and put into effect the Sarbanes Oxley Act 2002. All of requirements of US SEC will reform our organization and will impose the audit of processes and audit of people... This year, we will conduct integrated audit. Not only financial statement audit, but also internal control audits as mentioned on section 404 Sarbanes Oxley Act.”

c. Conclusion of Research Findings

From the research findings mentioned above, I would like to conclude that the government's choice to conduct dual listing is to increase corporate value and to

force companies to implement internationally business practices. It is also in line to the dual listing theory. The theory said that companies listed in dual markets would get advantages from reducing cost of capital.

Also, I find from interviews that there are many factors that affected privatisation performance, especially on transparency and disclosure practices, among other things: capital market role and ownership structure. Capital market enforces the companies that are listing on the institution to improve their transparency using routine report and incidental information. Ownership structure changes, from mainly state ownership to mainly private ownership, also influences corporate performance on transparency.

B. Discussion

a. The Choice of Privatization Methods

There are some methods of privatization which can be conducted by government OF Indonesia as stated in the State Owned Company Law, among other things are Initial Public Offering, Strategic Sale, and Management/Employee Buyout (President Decree No. 122/2001 as of strengthened by SOE Law No. 19/2003 Section 78). Theoretically, each method applied has own advantage/disadvantage that can be explained as follow:

- **IPO.** This method is conducted by selling government's shares to public through capital market institutions. The Public Offering method usually is done by companies that have been well-performed, so the existence of company shares at the capital market could improve corporate value and capital market activity and liquidity.
- **Strategic Sale.** This method often be chosen by the government to privatize less-performed companies. For example, state-owned companies that always burden state budget annually could be offered directly to a strategic investor that has relatively the same business as of the privatized company, so the investor could fully pays attention to improve the company corporate value. Also, the method could be done when the government has to provide much amount of fund to cover its deficit budget.
- **Management/Employee Buyout.** The government could privatize a state owned company by selling the government's shares to management or employees of the company. The advantage of this method is the emerging of sense of belonging of the management and employees toward their company, so they are expected to work harder in order to improve corporate value of the company. Also, this method will enhance operational and financial performance on long term period (Nankani, 1998).

Related to the privatization of PT Telkom and PT Indosat, the government utilized two methods provided by the rule; Initial Public Offering for PT Telkom and PT Indosat and Strategic Sale for PT Indosat. According to a Deputy Minister of State Owned Company, the companies have good prospect, because technology growth of-

ferred, combined with growth of demand on telecommunication services, enable them to generate high revenue in the future.

In 1994, the government privatized PT Indosat and followed by PT Telkom one year later. The method of privatization selected by the government was initial public offering by listing the companies in the Jakarta Stock Exchange, the Surabaya Stock Exchange, the New York Stock Exchange, and the London Stock Exchange. An interesting action had been done by the government and the companies that they listed on national stock markets and international stock markets at once.

The Utilization of Foreign Capital Market

There was no experience had by the government of Indonesia and its state owned companies to carried out the dual listing decision, but they were still optimistic that they would generate more benefits than only conducted single listing in the home country, because they believed that stock markets in the developed countries was more liquid and able to absorb greater number of stocks offered than those in developing countries. This matter was proven by the number of outstanding shares traded in the US compared to those were traded in the home country. Table below describes the structure of ownership of PT Telkom and PT Indosat at the end of 2004:

Table 6.2
Ownership Structure of PT Telkom and PT Indosat

	PT Telkom	PT Indosat
Government	51%	15%
Public Investor – Indonesia	3%	5%
Public investor – US	46%	39%
Strategic investors	-	41% (by ICL)

Source: Company Annual Reports, as of Dec. 2004

We could compare between percentage of the Indonesian public investor ownership and the US public investor ownership at PT Telkom and PT Indosat described by the table above; 3:46 and 5:39 for PT Telkom and PT Indosat, respectively. I do not count on the 41% of strategic investor shares, because the shares are not traded in the stock markets.

Beside the main target of privatization to increase corporate value, in general, the target set by the government to push both companies for listing in international

stock market is so that they would become pilot projects. Thereby, both companies should transfer their knowledge and experiences to other public companies in Indonesia which have not conducted it yet. Also, both companies have to show to other companies that they have better performance. For example the share of the companies are always traded as blue chips on market floor in Indonesia and they are better in the implementation of good corporate governance compared with others. This matter was affirmed by one of independent commissioner of PT Telkom. He said that companies, which listing in international stock markets, have to implement good corporate governance more than simply following its structure, but they have to come into process. He give us an example that to date, national companies are still executing good corporate governance principles only in the level structure, by using check list as assessment tools.

Reducing Cost of Capital

Theoretically, a utilization of foreign capital market gives opportunities to companies reducing cost of capital, that is a combination of cost that should be borne by the companies from equity and debt. Simply, cost of capital could be the obligation of companies to pay dividend out to owners for their capital and pay for the debt interests of the companies to third parties, for example financial institutions. Generally, there are two methods used to determine the cost of capital. The first method is weighted average cost of capital. The weighted average cost of capital is counted by combining the cost of equity and the cost of debt in proportion to the relative weight of them. Another method is Capital Asset Pricing Model.

According to capital asset pricing model, the less coefficient of systematic risk, the less required rate of return that should be borne by the companies, from a certain value to be equal to rate of interest on risk-free bond, for example T-Bills interest rate. Systematic risk is defined as a function of total variability of expected returns of the companies relative to a market index and of the degree to which the variability of expected returns of the companies correlates with expected returns of the market. Or, in a simple way, systematic risk is the risk of the market itself, risk that could not be diversified by the companies (Eiteman et al., 2001). Related to what was said by one of commissioners of PT Telkom, companies that has been listed in developed countries will be forced to have high level of integrity, so that this matter enables the companies

to reduce coefficient of systematic risk of the companies' stock (β). The capital asset pricing model was modelled as follow:

$$K_e = K_{rf} + (K_m - K_{rf}) \beta$$

Where, K_e is expected rate of return on equity, K_{rf} is rate of interest on risk-free bonds, β is coefficient of systematic risk for the company, and K_m is expected rate of return on the market portfolio of stocks. By minimizing β , the expected rate of return of the companies could be closer to rate of interest on risk-free bond, so the responsibility of the companies to provide more rate of return on equity could be reduced.

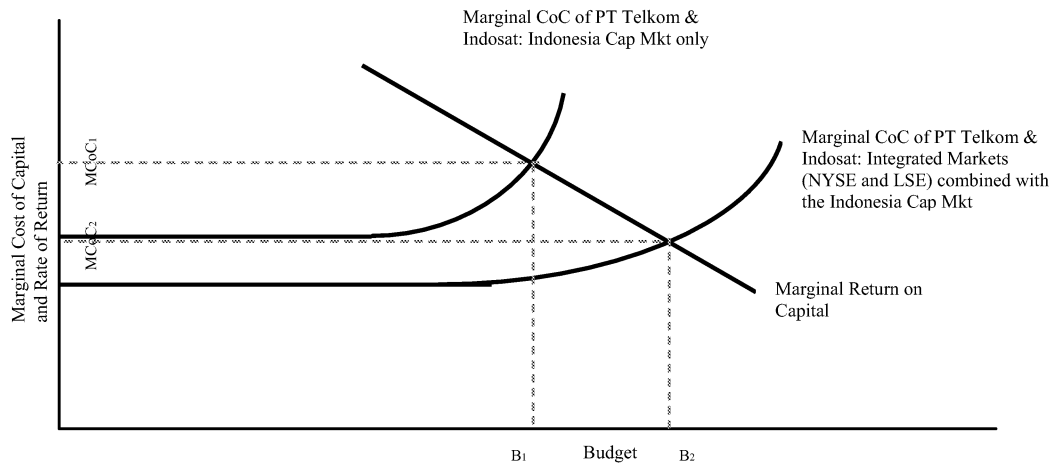
Realizing that capital markets of Indonesia is segmented capital market, hence PT Telkom and PT Indosat conducted dual listing in national stock exchange and in international stock exchange, the New York Stock Exchange and the London Stock Exchange. The NYSE and the London Stock Exchange were recognized to be more liquid and more integrated capital market than those in Indonesia. The advantage PT Telkom and PT Indosat to do dual listing in both national stock exchanges and international stock exchanges, the companies combine effort to obtain financial resources from more liquid and more integrated capital markets at once. Market liquidity could be defined as "degree to which a firm can issue a new security without depressing the existing market price, as well as the degree to which a change in price of its securities elicits a substantial order flow" (Eiteman et al., 2001).

As drawn at the figure below, we could clarify that the advantage of PT Telkom and PT Indosat to do dual listing in more liquid and more integrated stock markets is that the marginal cost of capital shifts to right side and that the initial cost of capital could be reduced as well. Finally, the companies could access to lower cost of capital over the entire budget range.

Given PT Telkom and PT Indosat have their own budget equal to B_1 and marginal Cost of Capital is equal to $MCoC_1$ if the companies had only carried on a single listing in Indonesia. Because the companies have done a dual listing both in emerging markets and in developed markets, then the marginal cost of capital of two companies shifts to the right side, combined with the listing on more integrated markets, so the initial marginal cost of capital also become lower than before. The results are the

moving of marginal cost of capital from $MCoC_1$ to $MCoC_2$ and also more budget can be achieved, from B_1 to B_2 .

Figure 6.2.
Differences of Single Listed and Dual Listed
on Marginal Cost of Capital and Budget



The reduction of cost of capital of companies conducting dual listing also become to be paid attention to by Yagil and Forshner (1991) and Cheung and Shum (1995). Yagil And Forshner conducted a research to find how international dual listing become one of strategies that can reduce the effects of segmented markets. According to Yagil and Forshner, there are three ways of which can be carried on to reduce the effects of segmented markets: foreign portfolio, mergers with foreign firms, and dual listing of domestic firm securities on foreign capital markets. Yagil and Forshner also explain that there is a relationship between risk and return on a security listed on a domestic market only and another security that has identical nature with the security, except that the later is dually listed. They explain that expected return on the dually listed security will be higher and the variance associated with or risk will be lower than those of the single listed one.

Meanwhile, Cheung And Shum have conducted a research toward Hongkong companies' behaviour and concluded that there were some methods that could be used to reduce political risks, that is either to relocate the companies into more stable foreign countries or to conduct dual listing to more liquid and integrated markets.

Why Privatize PT Indosat?

In 2002, the government sold its most of shares at PT Indosat through the mechanism of strategic sale to Indonesia Communication Limited (ICL) as a special purpose vehicle (SPV) of Singapore Technologies Telemmedia Pte. Ltd, a subsidiary company of Temasek Holding Pte. Ltd. The sale was done as a reaction to international pressure and as a method to cover its deficit budget.

International pressure was done by International Monetary Fund (IMF) expressed in Letter of Intent signed at January 20, 2000. In this case, one of Deputy Minister of State Owned Company refused that the opinion aforementioned above as a pressure, but “they offered a program”, because the “pressure” has unfavourable connotation. But, if related to a relief of fund which might not be poured by the IMF if the government did not conduct the programs offered, this matter can be told as a forced offer.

Meanwhile, deficit of state budget become a serious problem for the government of Indonesia. The condition was aggravated by the fluctuation of currency. The deficit of state budget become a very strong reason for the government to select the strategic sale method, because by using this method, the government would generate revenue quickly. In order to describe the Indonesian economy, table below is presented to inform the government financial positions for the year 2001, 2002, and 2003.

Table 6.3.

Indonesia Annual Budget

	2001	2002	2003
Revenue	301,077	305,151	336,155
Expenditure	(341,563)	(345,605)	(370,592)
Surplus (Deficit)	(40,486)	(40,454)	(34,437)
Privatization Target	3,465	4,444	8,000
Currency Rate (Rp/US\$)	10,400	8,940	8,465

What mentioned above also accordance with Ure and Vivorakij (1996). They explain that there is a different characteristic in Asia related to privatization conducted there. They explain that privatization in Asia more relevant to national development rather than in terms of ideologies. Privatization that is based on ideology generally has objectives to liberalize and open the industry in particular countries, so that has an effect on to companies within the industry. With more perfect competition, hence the

companies should take as one of competing actors, and finally the effectiveness and efficiency become the icons to survive that have to be achieved by the companies.

Meanwhile, privatization conducted in Asia is related to national development, that generally influenced by several factors. For example, *first*, contingency factors (ex. financial crisis or government changing), *second*, roles of private business as major telecommunication users that require a better quality and competitive pricing, *third*, international pressures, and *fourth*, issue of development, for example requirement to provide local facility to attract investors.

Beside the two formal reasons mentioned above, international pressure and budget deficit, privatization conducted to PT Indosat was also affected by political factors. Political system that has been changing from single majority system become multi party system have altered political behaviour of dominating parties. The involvement of political Parties on carrying of foreign company in the process of privatization of PT Indosat explained explicitly by the Deputy Minister of State Owned Company, although he assumes that this matter was fair practices in the business world. It was strengthened by one of Partai Amanat Nasional founder who expresses that his party directly carried one of multinational company to follow the process of privatization, but his party's candidate was fail. It gives a picture that political party had follow competition for the successful of their candidates.

Because of the short view and conflict of interests between the government, international pressures, and several political parties, the privatization process of PT Indosat is become debatable and questioned, among other things are:

First, the stock sale using strategic sale method was conducted to a company that has good financial and operational performance.

Second, the company has listed in national capital market and international capital market. If the government had a willingness to sell the stocks in the capital markets, the markets were expected to respond quickly.

Third, the sale of government shares to Indonesian Communication Limited (ICL) as a SPV of Singapore Technologies Telemedia (STT) has indirectly only change the ownership of the government of Indonesia into the ownership of the government of

Singapore, because Singapore Technologies Telemedia is a subsidiary company of Temasek Holdings, one of the biggest state-owned companies in Singapore.

Fourth, the use of SPV should be stated by the bid followers since they submitted the first proposal. But, the ICL as the SPV of STT just emerge at the time of signing the contract. It was pointed out by some observers as a way used by top political party in Indonesia to generate revenues. In addition, ICL is a company which intentionally be formed in Republic Mauritius, the country that permits companies founded without state the owners.

Fifth, according to Batubara (2003) and PT Indosat Annual Report 2004, by the end of 2003 ICL pledged its shares to ICL's creditor. Though, according to the Deputy Minister of SOE, the winner has to lock the ownership up during for the minimum of three years as pursuant to the agreement between the government of Indonesia and the ICL at December 15, 2002. Furthermore, Batubara expresses that ICL pledged its share mentioned above as a guarantee for fund obtained to buy PT Indosat.

Privatization Results

There is difference between strategic sale method and public offering method from the *process accountability* point of view. Generally, interested parties cannot influence the process of privatization conducted using Public Offering method, so that it can limit and minimize vested interests. The independent commissioner of PT Telkom I interviewed explain that the government's role at PT Telkom and PT Indosat become only as stockholder, and does not differ from other stockholders come from the capital markets. The government, even as the majority stockholder at PT Telkom, by laws, cannot exercise its interests except through general meeting of shareholders.

Development of telecommunications industry in the world has changed government roles. The government, including the government of Indonesia, should act as a regulator through Ministry of Communications and Information rather than as a player. Related to privatization ideas, from the government point of view, the government can still obtain advantages from taxes and additional funds obtained from privatization process. Also, the government can allocate its budget to more relevant sectors, such as education, health, etc. From company point of view, privatization will

improve higher level of effectiveness and efficiency compared to the company performances when it was fully held by the government.

Millward (1982) and Boardman and Vining (1989) explain that performance of privatized companies is better than those of state-owned companies. In addition, Boardman and Vining offer additional explanation, that is mixed enterprises (ME) that represent companies which have been partly privatized. They explain that the partial privatization may not be the best strategy, and this matter also can improve conflict between the government and private shareholders. But, if the government realizes its new position as a consequence of its decision that has been made, the government can build better communications with private shareholders.

Moreover, the independent commissioner at PT Telkom also explains that companies which have listing in stock market have to follow various tight capital market rules. It is strengthened by one of Senior Vice President at PT Indosat who affirms that the companies' responsibilities increase by having to obey some conditions required by capital market rules and other laws. The concerns of listing companies also relatively more dispersed, because the companies have to manage good relationship with all investors.

It could be concluded that, both theoretically and practically, public offering offers more accountable process compared to the accountability if the government uses strategic sale, by minimizing of vested interest of various parties and by binding of the companies into capital market regulations. This is also stated explicitly by the Minister of SOE, Sugiharto, in a general lecture at Master of Management GMU on August 2005.²

Related with methods of privatization used by the government and the influences toward the quality of transparency, some parties express that there is no relation between privatization method and quality of transparency. The independent commissioner of PT Telkom, and affirmed also by the SVP of PT Indosat, explain that both companies have listing in both national and international stock markets before the second privatization was done to PT Indosat using the Strategic Sale. The Method only influences the amount of government ownership at the company. Nevertheless, they consider the external factor only, and they do not consider the internal factors potentially influenced by the implementation of the method. The case of PT Indosat

has great influences toward ownership structure, that is the replacement of majority shareholders from the government of Indonesia to foreign private company, though in fact, substantially, STT is not representing a private company because of the full ownership of the government of Singapore.

Adhi explain in moderating way, that privatization will improve performance and quality of implementation of good corporate governance by a company, including on transparency as one of components. This was proved by research which have been done by Megginson et al. (1994) and Boubakri and Cosset (1998). Their researches prove that after state-owned companies were privatized, the companies can improve their profits, capital investment spending, operating efficiency, and change the structure of board of directors significantly. What mentioned above can be taken place at the companies that have been privatized if the companies can alter their employees and management mindset from civil servant to professional.

Related to privatization methods, Adhi explains that the method of privatization has not yet been believed able to influence the quality of transparency, both structure and process, directly. There is one missing link which requires to be explained, that is ownership structure.

² The researcher attended on the general lecture at Gadjah Mada University. The university is the institution that the researcher works on.

B. Ownership Structure Changes

Before the initial public offering in 1994 and 1995 to PT Indosat and PT Telkom, structures of share ownership were 100% held by the government of Indonesia. The government desires to increase performance of both companies have an implication that finally PT Indosat and PT Telkom were privatized by selling amount of shares owned by the government using Initial Public Offering, by registering company's shares in the Jakarta Stock Exchange, the Surabaya Stock Exchange, the New York Stock Exchange, and the London Stock Exchange as mentioned in the first section.

IPO conducted by the government and the companies has automatically altered the structure of ownership of the companies significantly, that is from 100% owned by the government become 65:35 of PT Indosat and 80:20 of PT Telkom, for the government and the public, respectively. The structure of ownership of capital at PT Indosat remain to be maintained equal to 65:35 up to on the middle of 2002 when the government reduced its ownership equal to 8.1% by accelerated global tender, and continued by the end of 2002 by selling most shares to a strategic investor equal to 41.94%. The structure of ownership changes of PT Indosat are described on the following table:

Table 6.4.
Ownership Structure Changes of PT Indosat

Year	Government	Public	ICL
1994	100%		
1995-2001	65%	35%	
17 May 2002	56.9%	43.1%	
20 Dec 2002	15%	43.06%	41.94%
2003-2004	14.69%	44.23%	41.08%

Different from PT Indosat, during listing in capital markets, the government has several times reduced the number of its shares at PT Telkom. This is reflected on the following tables:

Table 6.5.

Ownership Structure Changes of PT Telkom

Year	Action	Government	Public
1995	Pre-IPO	100%	
14 Nov 1995	IPO	80%	20%
11 Dec 1996	Block Sale	75.84%	24.16%
15 May 1997	Incentive Stock from the Government	75.81%	24.19%
7 May 1999	Block Sale	66.19%	33.81%
7 Dec 2001	Block Sale	54.29%	45.71%
16 Jul 2002	Block Sale	51.19%	48.81%

From the tables above, we could infer that there are different changes of ownership structure between PT Telkom and PT Indosat as of following:

- The government ownership at PT Indosat had been maintained until May 17, 2002, and then continued with dramatic changes at December 20, 2002 resulting loss of government control rights at PT Indosat. The changes of ownership at PT Indosat bring consequence that the government had to sign the agreement between the government and ICL. The agreement states that the government has a right to propose only two people of directors and two commissioners, except if the government reduces its portion of ownership. If the government reduces its shares, then the government can promote only one director and one commissioner..
- Meanwhile, the government has experience a stable reduction of its shares at PT Telkom since the government has conducted the IPO up to 2002. The reduction has been conducted by operating the government ownership block sale through capital markets. But, the reduction of government share does not result government's loss of control rights, because the portion of its ownership still maintained more than 50%. In addition, the government still holds one sheet of dwi-warna share that allows the government has special privileges, among other things the veto right to appoint board of commissioners and board of directors through the mechanism of the general meeting of shareholders and a right on articles of association amendments.

According to the Deputy Minister of SOE, one of government objectives to discharge its control rights toward PT Indosat is to introduce fair competition in the tele-

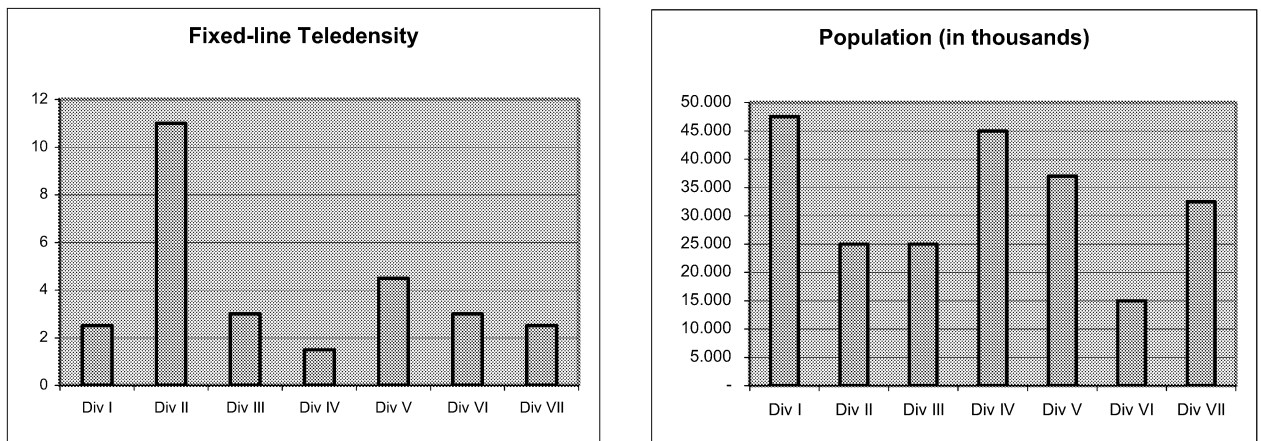
communication industry, so PT Telkom as the biggest telecommunication service provider in Indonesia was expected to be able to improve its competitiveness.

Moreover, the Deputy Minister of SOE worries about the ability of PT Telkom to develop business quickly and to balance out the growth of telecommunication industry, for example telecommunications network and product innovation that always changing. Indicator showing the lack of ability of PT Telkom to develop its business can be seen at data teledensity of Indonesia. The low teledensity can be told as a failure of PT Telkom to fulfill the need of societies to be able to access provided telecommunications network. As stated on previous chapters, PT Telkom had been granted by the government to develop fixed-line telecommunication services, but until the end of 2002, fixed-line teledensity of Indonesia was only 3.7%, less than Singapore 46.4%, Malaysia 19%, Thailand 9.9%, and, in fact, even to Vietnam 6.9% (source: Asean Connect).

Besides, during 30-year of monopoly, PT Telkom has not been successful to provide telecommunication infrastructure which is evenly distributed. PT Telkom has developed the infrastructure that was centered at its Regional Division II in Jakarta. Although Jakarta is the capital of Indonesia, PT Telkom should develop its network in other cities or regions, because the company has to compete with others, especially mobile operators. Figure below describes the comparison between regional teledensity and number of population live in the regional division.

Figure 6.3.

Fixed Line Teledensity Compared with Population in each regional



The Influence of Ownership Changes

Based on the data presented at tables 6.3. above, we could infer that the change of ownership structure of PT Indosat brought consequences the change of status of PT Indosat from a state-owned company become Foreign Direct Investment under STT Singapore. Meanwhile, PT Telkom still holds its status as a state owned company and, according to Sugiharto, the government will maintain the ownership as majority shareholders of PT Telkom.

Of course, the difference of companies' status as state owned company and "private" company brings significant consequences to stockholder. Stockholders of PT Telkom assure that the company still holds special privileges in Indonesia, because as a state owned company, the company still owns its rights to accept subsidy, especially related to its strategic business sector. For example, PT Telkom has been bestowed by the government at the amount of Rp478 billion due to the termination of exclusive rights to monopolize fixed-line services.

The behaviour of the stockholders of PT Telkom could be explained by using a model proposed by Millar et al. (2005) that examined corporate governance and institutional transparency in emerging markets. In their research, Millar et al. use two models to differentiate behaviour of business players in developed countries and those of in emerging countries: market-based institutional transparency and relationship-based institutional transparency, each for developed countries and for emerging countries, respectively. Relationship-based institutional transparency explain that transparency conducted by companies in emerging countries represents the function of relationship developed by the companies, government, and the capital owners, either a bank or stockholders. In the case of PT Telkom, the most dominant capital owner is stockholders.

Stated by Millar et al. (2005), willingness of company and capital owners to conduct transparency is not so strong, if the company assure that the owners will remain to continue the ownership on the company, and the owners have high confidence to company due to the government's guarantee. With the existence of ownership held by the government as the largest shareholder, in turn, other stockholders feel more confident that the interests of PT Telkom will remain to be protected by the government. For Example, the Minister of State-owned company suggested to the Minister of Communication and Information as the regulator of telecommunication frequency, considering to repeat the process of 3G license tender, so that enable state-owned

companies have the same opportunities to develop business in 3G technology. Also, the Minister of state-owned company guarantees to the financial and operational ability of state-owned companies to become players in the newest technology (Tempointeraktif, 17 May 2005).

It is likely so different from the view of stockholders of PT Indosat, especially the majority stockholder, STT Singapore. The winning of STT in the tender of government share sales using strategic sale method means that STT bought not only company's assets, but also prospect, obligation, and risk. Business uncertainty in Indonesia forces, theoretically, management of company to work efficiently and effectively.

As of the high risk high return principle, stockholders will control management performance tightly. In relation with country risk, research conducted by Buttler and Joaquin (1998) explains that business risk from a country that has experiences low politics stability level gives consequence of the increasing of cost of capital which must be borne by foreign company in conducting foreign direct investment. Furthermore, the risk can also mean as risk which must be accepted as the effect of the instable policy making, including on monetary and fiscal policy instability. Therefore, we could conclude that the higher risks that the investors are ready to bear, the stronger they will force the management to provide information disclosure widely, not only mandatory disclosure, but also the voluntary one.

Mixed Enterprise Performance

From the ownership differences of the companies, it could be seen that the government had decided to give different treatment to the companies to increase the competitiveness. First, government waives to control PT Indosat and leaves the company to be managed by private sector. With the status change, PT Indosat is expected to achieve efficient performance. Second, the government remains to hold rights to control PT Telkom, and the company forced to compete with PT Indosat which have become a private company.

According to the research conducted by Boardman and Vining (1989), it could be concluded that the government did a mistake with remain to let PT Telkom becomes a state-owned company that has to compete with private companies, such as PT Indosat, PT Excelcomindo, etc. Boardman and Vining state that mixed enterprises are companies that suffered from the possibility of conflict of interest that could be taken place between government and private shareholders. Moreover, they say that

partial privatization may be worse than complete privatization or, in fact even continued to be state ownership.

C. Capital Market

As mentioned by the independent commissioner of PT Telkom and one of SVP at PT Indosat, external factors has also influenced companies to disclose any material information. For example the company has to fulfil all requirements issued by stock markets. The company's disclosure level would also be influenced by level of stock market efficiency that its shares are traded in.

Level of capital market efficiency is determined by the relationship between behaviour of all market players with the amount of information which available. Capital market was strong efficient if market price fully reflects all publicly available information and market price reacts instantaneously and unbiasedly to new information (Fama, 1970).

Level of economic development of a country influences the level of capital market efficiency. Usually, developed countries have higher level of market efficiency than those on developing countries. It could be understood because in a developed country, capital market is become one of established resource allocation institution beside of banking systems.

It was the basis of the government, PT Telkom, and PT Indosat to conduct the initial public offering in Indonesian capital market, the US capital market, and the UK capital market at once. It was done because they assure that by listing in more efficient capital market, it can improve corporate value. It was affirmed by the Deputy Minister of SOE that explains the reasons of the government and the companies to do dual listing shall be as follows:

- To invite foreign investor to participate in telecommunications business in Indonesia through the ownership of shares.
- To force the companies to conduct business as required by international capital market, for example the implementation of good corporate governance and prudential principle.

The listing conducted by PT Telkom and PT Indosat brought consequences to the companies to fulfil all rules issued by two different institutions. Although there are

a lot of regulations of Indonesian capital market that adopt the US capital market regulation, but there are remain to some differences, for example good corporate governance and reporting practices. In the financial statement reporting, companies are obliged to adjust and to harmonize between Indo GAAP and US GAAP.

Since the US SEC issued the Sarbanes Oxley Act 2002, PT Telkom and PT Indosat have to obey the capital market rules tightly. There are some changes that has been created by the authority of US capital markets among other things:

The addition of Items in Form 20-F. This Form is a routine report form of company that has been listed in US Stock Market, which is submitted every year. The addition of the items, for example the obligation to disclose information about control and procedures, audit committee financial expert, code of ethics, principal accountant fees and services, exemptions from the listing standards for make an audit of committees, and purchases of equity securities by the issuer and affiliated purchasers.

Establishment of Public Company Accounting Oversight Board (PCAOB). The forming of the institute influences level of disclosure of companies that listing in the US capital market, among other things PT Telkom and PT Indosat. According to Sarbanes-Oxley Act 2002, PCAOB has own duty, for example to register public accounting firms which can be engaged by company which are listing there. In Indonesia, from more than 150 public accounting firms, only 8 public accounting firm which has been registered in PCAOB as mentioned on the table 6.6.

The prohibition of services outside the scope of practice of auditors. As mentioned in Section 201 Sarbanes Oxley Act 2002, auditors could not provide the auditee some services outside the auditing services, for example: a) bookkeeping or other services related to the accounting records or financial statements; b) financial information systems design and implementation; c) appraisal or valuation services and fairness opinion; d) actuarial services; e) internal audit outsourcing services; f) management functions or human resources; g) broker or dealer, investment adviser, or investment banking services; h) legal services and expert services unrelated to the audit; and i) any other service that the Board determines, by regulation, is impermissible.

Table 6.6.

List of Indonesian Accounting Firm Registered in the PCAOB

Name	Foreign Associates
Drs. Anwar	
Hendrawinata	Grant Thornton
Haryanto Sahari	PricewaterhouseCoopers
Jimmy Budhi	
Siddharta, Siddharta & Widjaya	KPMG
Tanubrata Yogi Sibarani Hananta	BDO International BV
Prasetio, Sarwoko & Sandjaja	Ernst & Young International
Osman Ramli Satrio & Rekan	Deloitte Touche Tohmatsu

Source: PCAOB

Management Assessment on Internal Controls. Section 404 Sarbanes Oxley Act 2002 about internal control requires annual report states "control report" in it. The report contains statement of the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting and an assessment of the effectiveness of the control structure and procedures of the company for financial reporting, as of the end of the company's fiscal year. According to the audit committee member of PT Telkom, this year, integrated audit will be done into the company. Integrated audit requires the company carried out an alignment toward its internal process, including on its business process, control, and risk management. In integrated audit, there will be three opinion released by the auditors: financial statement opinion, internal control opinion, and management effectiveness opinion.

As mentioned above, in fact, a lot of regulations have adopted by BAPEPAM directly from regulations released by US SEC. However, the government through BAPEPAM does not punish to violation of the regulation conducted by either the issuers or capital market traders. It was mentioned by one of senior officer of National Commission of Corporate Governance of Indonesia. He stated that there are two weaknesses which have been still owned by Indonesian companies and Indonesian capital market authority, that is, *first*, inexistence of ethics and professionalism

awareness from the companies to conduct good corporate governance principles after the companies have been listed in Indonesian stock markets. The implementation of good corporate governance by the companies only represents their efforts to obey the regulations, so that level of implementation of good corporate governance only reaches the structure level rather than the process one. *Second*, BAPEPAM does not create a strong law enforcement to some violation conducted by the issuers or traders. For example, the indication of insider trading, a very prohibited action on capital market in world, that happened at privatization of PT Indosat and PT Semen Gresik have not been followed up by the BAPEPAM (Kompas, 21 July 2002).

From the above paragraphs, we could infer that the government does not carry on law enforcement carefully, though, according to Black (2001), that having strong and effective law is absolute requirements that must be owned to establish strong capital market. One of objectives of having the strong and effective law in capital market is to protect minority shareholders, so that they can access information accurately and also to assure that management and majority shareholders will not deceive them. By the straightening of strong law, hence the companies, like or dislike, will improve their level of transparency, including on the companies' willingness to disclose voluntary information, so that the investors can obtain information completely and accurately (Millar, 2005). Therefore, it could be concluded that the stronger the straightening of law conducted by capital market authority, the higher the quality of transparency provided by the companies listing on stock exchange.

D. Transparency

In this section, I will discuss the analysis of transparency conducted by PT Telkom and PT Indosat. I use two approaches to analyse the dimension of transparency: structure approach and process approach. The structure approach is an approach that analyse phenomena using outputs as the results of the implementation of the phenomena we discussed. For example, Using of annual reports or financial statements to analyse whether a company is transparent or not. Also, using checked boxes to identify whether or not a company has conducted good corporate governance principles.

Another approach, process approach, is an approach that analyse how phenomena be implemented. For example, to analyse whether a company has conducted good corporate governance principles, we discuss with key people in charged on it, so we obtain broader and deeper information. Indonesian Institute on Corporate Governance usually buys some lots of stock in order to get attending and voting rights on companies' general meeting of shareholders. By this way, the institute is able to analyse the implementation of good corporate governance principles, such as fairness, accountability, and transparency. Or, in a simpler way, we can differentiate between structure approach and process approach using "*what*" and "*how*".

Related to the analysis report, I would not like to judge which company is better than another from the process approach point of view, because the researcher has limited information and limited time to conduct deeper research. I will only analyse whether the companies' transparency performance confirmed to the theories I proposed on the theoretical background, such as agency theory, risk-return relationship, and efficient market hypothesis, and then I will compare to the theory of privatization.

How to Build Fair Relationship between Owner and Management? – Process

Approach

As mentioned in agency theory, owner is a risk taker that delivers a number of funds to an agent to manage it in line to the owner interests. To ensure the increasing of corporate value, the owner uses various mechanisms to control management behaviour. Therefore, as mentioned in chapter II, the owner should implements among other things:

Contract-based Appointment. To guarantee management does not misuse toward the owner's fund, generally, the appointment to the management and the commissioners was based on a rigid and specific contract. PT Telkom and PT Indosat have implemented the system of contract that states reward and punishment clearly.

In their Article of Association, both companies stated that the board of directors should be appointed by General Meeting of Shareholders. Normally, the appointment will be closed at the 5th general meeting of shareholders after the first appointment. The difference between PT Telkom and PT Indosat is that the board of directors at PT Telkom should be nominated by Dwi-warna shareholders. In the contrary, the candidates of directors at PT Indosat would be nominated by shareholders, and the Indonesian Government could only nominate for the maximum of two candidates.

The article of associations also states the director's responsibilities and rights to be effective in managing of the companies. Both articles state that the principal functions of the board of directors are to lead and to manage the companies, to continuously improve the efficiency and effectiveness of the companies, and to control, maintain, and manage the assets of the companies.

Moreover, the articles have asserted all rewards that will be received by the board of directors. For example, salary, incentives, insurances, retirement benefits, etc. The board of directors will obtain annual bonus and other incentives if the companies surpass certain financial and operating targets.

Fair incentive scheme. The owner has to give adequate and fair incentives that conform to management responsibilities. Incentives can be given as salary, bonus, perquisite, or stock option policy. Incentive in the form of share ownership is believed to provide more usefulness in the long term. It has been chosen by PT Indosat with the program of Management Share Ownership Policy and Employee Stock Option Pro-

gram. Meanwhile, in order to anticipate the insider trading practice, the company has set a trading window period policy.

Trading window period was started two business days after the quarterly financial report was released and was closed ten days afterwards or until the existence of non public material information. Until the end of 2004, PT Indosat had distributed 51,775,000 series B shares or equivalent with 5% of outstanding shares.

Reporting System. Management has to specify a mechanism of reporting to the owner, both routine and incidental reports. According to Indonesian capital market regulations, the management of PT Telkom and PT Indosat has to submit routine reports among other things are the audited financial statement, annual report, and quarterly report. Besides, the managements have also conducted conference call, public expose, Annual/Extraordinary General Meeting of Shareholders, and disclosure of material matters.

Table below presents the reporting action information of PT Telkom and PT Indosat:

Table 6.7
Disclosure Activities

Information Disclosure Activities	PT Telkom*	PT Indosat	
	2004	2003	2004
Conference Call	4 times	4 times	4 times
Analyst/Investor Meeting	120 times	Once	
Public Expose	Once	Once	Once
AGMS	Once	Once	Once
EGMS	Once	Once	Twice
Bondholder Meeting		Once	
Disclosure of Material Events	18 times	16 times	29 times

Source: PT Indosat and PT Telkom Annual Report

Relationship between Board of Commissioner and Board of Directors

Board of Commissioners – reducing agency problems

Board Of Commissioner is a representative of stockholders, which the aim is to secure the stockholder interests. As explained in the theory section in chapter II, stockholder is a party that does not follow on the company operation on a daily basis. The un-involvement influences the amount of available information that can be used to take further business decision.

The formation of board of commissioner, including on the conditions to appoint some independent commissioners, hence the interests of stockholder can be preserved, because the board of commissioners have gotten the duty professionally to supervise management activities. Now, PT Telkom has five members of board of commissioners with the composition of 3 people of government commissioners and 2 people of independent commissioners. Meanwhile, PT Indosat has 9 members of board of commissioners, that are consisted of 4 people of ICL commissioners, 2 people government commissioners, and 3 people independent commissioners.

Independent Commissioners. According to Daniri, independent commissioners are ought to really independent, by fact and by rule. To increase the independency of independent commissioners, the company can ask executive hiring service that is expert in the area. This has been done by PT Telkom as said by the independent commissioner of PT Telkom.

PT Indosat exploits its internal mechanism to choose independent commissioners, and then they are appointed through the general meeting of shareholders. Nevertheless, one of member of independent commissioners who was interviewed does not explain the mechanism of it. Meanwhile, at another opportunity he/she said that an informal approach had been carried out by the CEO of PT Indosat before accepting formal notification. Furthermore, he/she said, “I think it is no problem. It is only a procedure, because, after all, the general meeting of shareholders will finally decide it.” In the contrary, PT Indosat has never stated that the company has a nomination committee.

Audit Committee. To ascertain the effectiveness of board of commissioner to improve disclosure quality provided by management, as required by BAPEPAM with the decision Number IX.I.5 about the formation and guidance of the audit of Committee and JSX Regulation No. 315/BEJ/06/2000 as of amended by JSX Regulation No. 339/BEJ/07/2004, board of commissioner of PT Telkom formed the Audit Committee that has 7 members, consisted of 2 independent commissioners, 1 commissioner, and 4 independent members. Meanwhile, PT Indosat has the Audit Committee with 5 members, consisted of 2 independent commissioners and 3 independent members.

According to the member of Audit Committee of PT Telkom, the audit committee of PT Telkom has granted authorities, by the board of commissioner and by rules, to involve directly on the financial reporting process. Besides, a member audit committee of PT Indosat discussed about the authority and the involvement of the committee in the financial reports preparation. She told that the committee has involved since the preparation of quarterly financial report. Both Committees also have an authority to choose independent auditor that will be engaged.

These authorities are in accordance with what mentioned on Pricewaterhouse Coopers' White Paper 2002 and the Sarbanes-Oxley Act 2002. The white paper clarifies Sarbanes-Oxley Act that enables audit committee of listed companies to decide both which accounting firms will be appointed and how much the accounting firms will be compensated. Also, the authorities hold by the audit committee will strengthen the independence of external auditor engaged from management interferences. Nature of the audit committee members was stated on Sarbanes-Oxley Act 2002 that the members should be comprised of independent directors and the audit committee also should clearly state that one of its members is a financial expert. In Indonesia, independent directors mentioned on the Sarbanes-Oxley Act have been defined as independent, by definition, commissioners.

According to the interviews, there is no significantly different level of involvement of audit committee to the financial reporting processes and the nature of audit committee activities between PT Telkom and PT Indosat. A little difference is only that there is a commissioner of PT Telkom as a member of the audit committee, but the commissioner does not have voting rights.

Management – Managing the transparency

Management is a party that has responsibility to manage the company on daily basis. In order to reduce agency problems, the management should prepare financial and operational performance timely and accurately. To prepare company's annual reports, board of directors have to be involved directly in order to ensure that the processes are carried out effectively. According to a member of independent commissioner of PT Telkom, both CEO and CFO have to sign the certification of annual reports pursuant to Sarbanes-Oxley Act 2002 Section 302 and Section 906, and BAPEPAM Rule No. 40/PM/2003 in order to state that both CEO and CFO have reviewed the Annual Report.

Also, good relationship has to be built among management, board of commissioner, and shareholders. Related to the duty of management to build such relationship, formally management forms corporate secretary and all its function bodies as a bridge connecting the company and shareholders directly.

PT Indosat has established corporate secretary since 2000 pursuant to BAPEPAM Rule No. 63/PM/1996 on the formation of corporate secretary. The corporate secretary is responsible for the distribution or releases of material information related to the company's performance. He/she should report directly to the CEO and manage some function, such as investor relation (capital market affairs), public relation (public and society affairs), internal communication, and corporate data (preparation of management reports).

Meanwhile, on the beginning of 2006, PT Telkom reorganized its organization structures that replace corporate secretary function into head of corporate communication. The head of corporate communication manage several functions, such as investor relation (capital market affairs), public relation (public and society affairs), and regulatory management (government and regulatory affairs).

To provide information related to company's performance to the investors, PT Telkom and PT Indosat have conducted some activities as mentioned at the table 6.7. above. The information is distributed by the companies through financial reports, annual reports, press conference, analysts briefing, public expose, road show, conference call, and press release. Further, PT Telkom distributes Telkom InfoMemo to the investors routinely on quarterly basis before the conference call has been conducted.

Since corporate secretary is a mandatory functions that has to be established by the companies, PT Telkom and PT Indosat have created more functions voluntarily in order to improve degree of good corporate governance implementation. PT Indosat formed Disclosure Committee that the duty is to ensure the accuracy of all material information disclosed to public and to ensure that any corporate disclosure will not be misleading. It consists of the SVP Corporate Secretary, the SVP Accounting, the SVP Controlling, the SVP Treasury, the SVP Internal Audit, the SVP Legals, the principal risk management officer, and other related SVPs that responsible for each business function (Indosat's Annual Report 2004).

PT Telkom has also formed Disclosure Committee that consists of 14 members led by Chief Financial Officer. The responsibility of the committee is more or less the same with those of PT Indosat's Disclosure Committee.

The companies also provide much information on the Internet at www.telkom.co.id and www.indosat.com.

Facts from Annual Reports – Structural Approach

In this part, I will discuss about items mentioned on annual reports issued by both companies. The companies submit their annual reports to the Indonesia Stock Market Supervisory (BAPEPAM) and to the US Securities Exchange Commission (US SEC). An objective to analyse items mentioned on companies' annual reports is to find whether there is different level of disclosure between PT Telkom and PT Indosat. Also, the researcher has aims to find whether there is a difference between companies' Form 20-F and annual reports. Ideally, there is no significant difference between annual report and Form 20-F, except on the emphasize of reporting. The researcher will find a difference if there is the same item disclosed in different meaning between the reports.

Researcher uses list of potential voluntary disclosures on Meek et al. (1995) combined to the BAPEPAM Decree No. Kep-38/PM/1996 that was issued at January 17,1996. Meek et al. (1995) has divided their list of voluntary disclosures into three parts: strategic information, financial information, and non-financial information. After combined to the BAPEPAM Decree, the researcher found items that likely to be voluntary items in Indonesian companies' annual report.

1. Strategic Information
 - a. Corporate General Information
 - b. Corporate Strategy
 - c. Acquisitions and disposals
 - d. Research and Development
 - e. Future Prospects

2. Nonfinancial Information
 - a. Information about directors and commissioners
 - b. Employee information
 - c. Social policy and value added information

3. Financial Information
 - a. Financial Review
 - b. Foreign currency information
 - c. Stock price information

Annual reports used on the research analysis are the annual reports issued by the companies for fiscal year 2001-2004 and form 20-F 2004. The researcher analysed all parts on the annual reports, because the annual reports were not presented in the same manner to the items listed above. The researcher does the analysis stage in order to obtain more facts about voluntary items disclosed by the companies and then compares them with what the researcher had received during the interviews were conducted.

The tables below present information obtained by the researcher and were used to document the differences of the voluntary disclosures from each annual report.

Strategic Information

As mentioned on the paragraph above, there is much information included on the strategic information, but after I had finished checking all items, I found that the voluntary disclosures on corporate general information, corporate strategy, and future prospects were not so different between PT Telkom and PT Indosat. Both companies presented all data on corporate general information and corporate strategy, but no future prospect was mentioned on the annual reports by them. In order to simplify the presentation, I provide only acquisition and disposals and research and development.

Acquisitions and Disposals

Acquisitions and Disposals	2001	2002	2003	2004	20-F
PT Telkom					
Reason for acquisitions	•	•	•		•
Reason for disposals	•	•			•
PT Indosat					
Reason for acquisitions	•		•		•
Reason for disposals	•		•		•

Both companies presented acquisitions and disposals consistently on their annual reports. During 2001-2004, PT Telkom and PT Indosat had finished their cross ownership at PT Telkomsel and PT Satelindo as of the government instruction to introduce a competition between two “brother” companies. Also, PT Telkom had to solve its problems with some partners on regional divisions called as Joint Operation Scheme (KSO-Kerja Sama Operasi) by acquired most of its partners, such as Dayamitra (2001), Pramindo (2002), AriaWest (2003), and MGTI (2004). Moreover, I did not find the presentation of the transaction carried out by PT Telkom to acquire PT MGTI on the management analysis. I just found the information on the event highlight section in the Annual Report 2004, although the transaction value was US\$390.7 million. It is so different from previous annual reports that mentioned all acquisitions and disposals transaction on Management Discussion and Analysis.

All information were presented on form 20-F submitted to the US SEC. On the report, both companies presented acquisitions and disposals in a historical basis. For example, both companies wrote down all cross ownership transactions that had been finished before 2004.

Research and Development

Research and Development	2001	2002	2003	2004	20-F
PT Telkom					
Research and Development	•	•	•		•
Location of Research and Development					
PT Indosat					
Research and Development		•	•	•	•
Location of Research and Development		•		•	

The researcher assumes that there is no difference between PT Telkom and PT Indosat on Research and Development Policies, because both companies operates in the same business, telecommunication industry, that have to use high technology and search to improve their value added services in order to capture their customers’ loyalty. Both companies have fully competed since the beginning of 2000s, because the government of Indonesia terminated their exclusive rights to monopolize telecommunication sectors. But, the interesting disclosure was found on the Indosat Annual Report 2003 and Form 20-F 2004. In those reports, PT Indosat stated clearly that the company did not conduct significant research and development activities.

There is no information about research and development activities or amount of fund spent on the activities at PT Telkom in 2004 that can be found on the Annual Report. It is different from the Form 20-F that stated the activities and the amount of fund. PT Telkom mentioned on the report that the company had spent at least US\$3 million for video conferencing development, SMS development, CMS System, and CDMA Lab.

Nonfinancial Information

Three tables below indicate nonfinancial information: information about directors and commissioners, information about employees, and social policy and value added information.

Information about Directors and Commissioners

Information about Directors and Commissioners	2001	2002	2003	2004	20-F
PT Telkom					
Age of the directors					•
Educational qualifications	•	•	•	•	•
Commercial experiences of the executive directors	•	•	•	•	•
Other directorships held by executive directors	•	•	•	•	•
PT Indosat					
Age of the directors		•	•	•	•
Educational qualifications		•	•	•	•
Commercial experiences of the executive directors		•	•	•	•
Other directorships held by executive directors		•	•	•	•

Both companies has provided information about directors and commissioners consistently. Almost all items used for the analysis were filled out, except for the age of directors and commissioners of PT Telkom and all items on the Indosat Annual Report 2001. On the annual report 2001, PT Indosat presented only the name and photograph of directors and commissioners, but, after that, PT Indosat has filled all information on the annual reports.

PT Telkom has the same degree of consistency, except on the information of the age of directors, because in the Form 20-F, PT Telkom provided the information fully. But, in my opinion, it is not a significant difference.

Social Policy and Value Added Information

Social Policy and Value Added Information	2001	2002	2003	2004	20-F
PT Telkom					
Environmental protection program					
Charitable donation (amount)			•	•	•
Community programs	•	•	•	•	
Qualitative value added information	•	•	•		•
PT Indosat					
Environmental protection program					
Charitable donation (amount)			•	•	•
Community programs		•	•	•	
Qualitative value added information			•	•	•

Both companies do not state the environmental protection program. Probably, it is caused by nature of business of the companies that does not harm the environment. Also, the companies have the same pattern of social policy reports, both on the annual reports and on the Form 20-F.

Employee Information

Employee Information	2001	2002	2003	2004	20-F
PT Telkom					
Geographical distribution of employees	•				•
Line of Business distribution of employees	•	•			
Categories by gender					
Identification of senior management and their functions	•	•			•
Number of employees for two or more years	•	•	•	•	•
Reason for changes in employee	•	•	•	•	
Amount spent of training		•		•	•
Nature of training	•			•	
Categories of employees trained	•				
Data on accidents					
Cost of safety measures					
Equal opportunity policy	•		•	•	
Recruitment problems and related policy					
PT Indosat					
Geographical distribution of employees		•	•		
Line of Business distribution of employees				•	
Categories by gender					
Identification of senior management and their functions		•	•		•
Number of employees for two or more years		•	•		•

Reason for changes in employee					
Amount spent of training			•	•	
Nature of training		•	•		
Categories of employees trained			•		
Data on accidents					
Cost of safety measures					
Equal opportunity policy				•	
Recruitment problems and related policy					

Items used to calculate the voluntary disclosures on employee information are much more than those of other dimensions. In the table presented above, we could see that PT Telkom and PT Indosat have, more or less, different level of disclosure on the employee information. The sum of item disclosed by PT Telkom is more than the sum of PT Indosat's items. The number of employees is the most consistent to be presented, but the distribution of employees was not presented in a consistent manner, for example geographical distribution and line of business distribution. Moreover, data related to safety and recruitment problems have never been presented by the companies. And, other data have been dispersed, such as training and equal opportunity policy.

Financial Information

There are two measurements of financial information provided by Meek et al. (1995) after I combined to the BAPEPAM Decree: financial review and foreign currency information. Both measurements are presented as follow:

Financial Review

Financial Review	2001	2002	2003	2004	20-F
PT Telkom					
Disclosure of intangible valuations					•
Dividend payout policy		•	•	•	•
Effect of interest rates					•
PT Indosat					
Disclosure of intangible valuations			•	•	•
Dividend payout policy	•	•	•	•	•
Effect of interest rates	•		•	•	•

Both companies have been presented dividend payout policies constantly. May be, it is the best information that companies will take advantage from the information. Research conducted by Pettit (1972) described that the announcement of dividend published by companies is likely to influence companies' stock price.

While presentation of disclosure of intangible valuations and effect of interest rates are found on PT Indosat annual report and Form 20-F, the items are never presented by PT Telkom on its annual report submitted to the BAPEPAM. But, in the contrary, those items were presented on Form 20-F.

Foreign Currency Information

Foreign Currency Information	2001	2002	2003	2004	20-F
PT Telkom					
Effects on foreign currency fluctuations on future opr.					•
Effects on foreign currency fluctuations on current results					•
PT Indosat					
Effects on foreign currency fluctuations on future opr.	•	•	•	•	•
Effects on foreign currency fluctuations on current results	•	•	•	•	•

There is the same condition between financial review and foreign currency information. In the foreign currency information table drawn above, we could look at PT Indosat's presentation at the effect of foreign currency information on future and current results. Different treatment was done by PT Telkom that disclosed the information on Form 20-F, but not on the company annual reports, although the foreign currency fluctuations affect the performance of PT Telkom. For example, on Form 20-F, PT Telkom stated that the company's gain (loss) on foreign exchange-net decreased from the net gain of Rp126.1 billion in 2003 to a net loss of Rp1,220.8 billion in 2004, primarily due to depreciation of Rupiah.

Both companies have presented the information at risk assessment section on the Form 20-F. PT Telkom mentioned clearly that the depreciation of Rupiah towards US Dollar would adversely affect general economic condition in Indonesia. Also, it will increase PT Telkom's capital expenditure, because most of high technology investments at PT Telkom are sourced from foreign countries.

Beside that, PT Indosat have stated the information extensively. It can be found on both PT Indosat annual report and Form 20-F. On its reports, PT Indosat stated clearly the implication of currency value fluctuation on its businesses. Further, the

company explain how to reduce the currency fluctuation risk, such as conducting several foreign currency swap contracts and interest rate swap contracts with several foreign institution.

How Transparency Affects Agency Cost at PT Telkom and PT Indosat?

In the case of PT Telkom and PT Indosat, both positive and negative impacts of full disclosures mentioned on the theoretical framework are likely to influence a company in disclosing all material information in two stock markets, in domestic capital markets and in international capital markets. Unequal treatment was become a critical issue that may be taken place if there is a different substance of reporting material. For example annual reports submitted to BAPEPAM may differ from Form 20-F submitted to US SEC. In the case of PT Telkom, there are several differences on its reporting between two reports.

According to one of commissioner and one of investor relation officer, the difference was happened because of the differences of requirement of US SEC and BAPEPAM. Furthermore, the differences were happened because there is significantly different time frame between the due dates of annual report that should be submitted to the BAPEPAM, 31 March each year, and those of that should be submitted to the US SEC, 30 June each year. According to them, the company does not treat both capital markets unequally, because the company just submitted the Form 20-F in more detail manner than those of the Annual Report. PT Indosat also does the same one.

The researcher has tried to find some significant differences between the disclosure of both companies on their Annual Report 2004 and on their Form 20-F 2004. I find some different substances of information disclosed on the reports of PT Telkom, but I does not find any different substances of information disclosed on the reports of PT Indosat. Sometimes, PT Indosat wrote down information on its reports differently, but the differences were only on the degree of detail. In order to provide clearer information, in the contrary, there are some substantial differences between the MD&A of the annual report 2004 and the Form 20-F 2004 of PT Telkom found by the researcher. The differences are summarized as below:

- Risk Disclosure

Table 6.8 shows that there are different kind of risk mentioned by PT Telkom related to Indonesian economic and political risk and risk related to Telkom and its subsidiaries between the annual report submitted to BAPEPAM and the Form 20-F submitted to the US SEC. It might be taken place because of the company's understanding on the different attitude toward risk between Indonesia and the US.

- Eddy Pianto Accounting Firm Cases

PT Telkom stated on contingency risk section in the Annual Report 2004 that the company and other parties were facing a material litigation from Eddy Pianto, an Accounting Firm that formerly audited PT Telkom in 2002 for the tarnishing of the Eddy Pianto's reputation in public accounting profession. PT Telkom mentioned that until the issuance of the annual report, the South Jakarta District Court had still reviewed all documents and evidences. Moreover, mentioned on the annual report, PT Telkom was not a part of litigation process.

But, a different fact was written down on the Form 20-F (p. 152). In the report, PT Telkom had clearly mentioned all parties involve on the litigation process, such as PT Telkom, Pricewaterhouse Coopers, Deloitte Touche, and BAPEPAM. It is different from the previous paragraph mentioned that PT Telkom is not a part of the litigation. Also, on the Form 20-F, PT Telkom stated that Eddy Pianto withdrew its indictment at March 9, 2005, and at March 14, 2005 the District Court granted its request to withdraw it. It is the opposite of what stated on the Annual Report even though the annual report was issued at the end of April 2005. It means that at the time of annual report issuance, PT Telkom should not put the litigation process into the contingency risk.

Equal Treatment Principles

One of objectives of releasing the SOA is to protect minority shareholders from deceiving that potentially done by management and majority shareholders. It also becomes the attention of good corporate governance principles. There are a lot of type of unequal and unfair treatments, among other things: share dilutions, depriving shareholders' rights on general meetings, and the absence of the disclosure of information, including on the providing of different information to different group of investors.

A company that conducted dual listing has a potency to do unequal treatments; because shareholder dispersion makes the company has difficulties to pay attention to all investor interests. Besides, the imbalances of capital markets liquidity and the different degree of law enforcement enable the company tends to do unequal treatment on the providing of company information, especially if the company has low willingness to conduct voluntary disclosure.

Table 6.8.
Comparison of Risk Analysis on The Annual Report 2004 and the Form 20-F
PT Telkom

Annual Reports	A. Form 20-F
Business Development Risk	Telkom did not file a fully compliant 2002 annual report on form 20-F until February 9, 2004, and may face an SEC enforcement action, or other liability or adverse consequences.
Regulation Risk	Telkom had a number of material weaknesses in its internal control over financial reporting and concluded that as of December 31, 2003 and 2004, its disclosures and controls were ineffective.
Cellular Business Risk	Risk Relating to Indonesia
Contingency Risk	- Current political and social events in Indonesia may adversely impact business activity in Indonesia
Majority Shareholder Interest Risk	- Terrorist activities in Indonesia could destabilize Indonesia, which could adversely affect Telkom's business
Access Code Replacement Risk	- Declines or volatility in Indonesia's currency exchange rates can have a material adverse impact on business activity in Indonesia
Foreign Exchange Rate Risk	- Indonesia ended its extended financing facility with the IMF and the consequences thereof are unpredictable
	- Indonesia no longer has access to the Pris Club but continues to rely on loans from official creditors
	- Indonesia's high level of sovereign debts may result in it being unable to service its debt obligations when they become due
	- Indonesia's sovereign debt rating continues to be reviewed and revised by international rating agencies
	- Indonesia is vulnerable to natural disasters and other events beyond Telkom's control
	Risk Relating to Telkom and its Subsidiaries
	- Telkom's expansion plans may strain key resources and thereby adversely affect its business, financial condition, and prospects
	- Telkom's controlling stockholder's interests may differ from those of Telkom's other stockholders
	- Certain systems failures could, if they occur, adversely affect Telkom's results of operations
	- Regulators and other telecommunications operators may challenge Telkom's ability to apply PSTN tariffs to its new CDMA-based fixed wireless phone service

-	<i>Telkom may need to raise funds required for certain future expenditure requirements and the terms of any debt financing may subject telkom to restrictive covenants</i>
-	<i>Telkom's ability to develop adequate financing arrangements is critical to support its capital expenditures</i>
-	<i>Employee unions may negatively affect Telkom's business</i>
-	<i>New Technologies may adversely affect Telkom's ability to remain competitive</i>
-	<i>Telkom operates in a legal and regulatory environment that is undergoing significant reforms and such reforms may adversely affect Telkom's business</i>
-	<i>Telkom's increasingly important cellular operations face significant constraints and competitive pressures</i>
-	<i>Telkom's satellite have a limited life and substantial risk exists for TELKOM-1, PALAPA B-4, and its to be launched TELKOM-2 to be damaged or interrupted during operation and satellite loss or reduced performance may adversely affect our financial condition.</i>
-	<i>Telkom is subject to Indonesian accounting and corporate disclosure standards that differ in significant respects from those applicable in other countries</i>
-	<i>Telkom is incorporated in Indonesia and it may not be possible for investors to effect service of process or to enforce judgments obtained in the US against Telkom</i>
-	<i>Forward-looking statements reflect current expectations and may not be correct</i>

CHAPTER VII.

CONCLUSION

This Chapter presents conclusion of research analysis done on previous chapters. The conclusion relies on primary data (interview) and secondary data (annual reports, news papers, articles & books, etc). Research findings and analysis have been presented in chapter VI.

A. Empirical Conclusion

The selling of government share using strategic sale method has some consequences that must be burdened by winners of bid, among other things: prospects, obligations, and, of course, risk. It is different from government's selling of share through public offering in capital market, because, generally, the buyers do not have difficult conditions, for example a requirement for locking-up the shares. In the case of PT Indosat, the government's shares sold to ICL had been locked-up during three years after the privatization was taken place. It means that ICL could not sell its shares to public during the locking-up period. Also, PT Indosat could not fire its employees during three years. It affirms that ICL has borne high risk, because its activities during three years represent unpredictable results on economic recovery programs in Indonesia.

Meanwhile, there is significant differences in the structure of ownership of PT Indosat before and after the government conducted the privatization in 2002. At the moment, government only has 15% share compared to ICL and public, 41% and 44%, respectively. This matter also results differences of the government ownership between at PT Telkom and at PT Indosat, which is 51% and 15%, respectively. Also, there is no stockholder of PT Telkom that holds shares more than 5%, except the government. Although the government had sold its shares at PT Telkom by block-sale methods several times through the capital markets (see table 6.5), the position of PT Telkom is maintained as state-owned company, or in other word, the government still holds more than 50% of shares. It results that the stockholders feel confidence that the government remain to hold

its interests at PT Telkom, as both regulator and investor, enabling other stockholders enjoy privileges held by the company.

Data taken from the companies' annual reports and form 20-F indicate that during couple of years, PT Indosat implement transparency in more progressive manner compared to PT Telkom, especially in voluntary disclosure of financial information. Nevertheless, pursuant to results of interview with respondents, we know that PT Telkom has much effort to obey all required rules by capital market authority, which is board of commissioner should be involved actively in transparency process, and has implement best-practice principles in the implementation of good corporate governance.

Moreover, PT Indosat is more consistent in disclosing its annual report in rhythm with its Form 20-F. We know that the US SEC qualify information presented in more detail manner than those of the BAPEPAM, and it has been arranged in the US SEC rules tightly. The consistency indicates that the company wishes to provide information toward all stockholders, including on stockholders who live in less efficient capital market. If companies that have been listing in international stock markets conduct the same, hence this will be expected to improve the quality of transparency in Indonesia.

B. Theoretical Conclusion

Risk-Return Relationship

As stated in chapter II, a rational choice of risk takers at the time of receiving for high risk in their business, they ask the company to provide high return, so a fair relationship between agent and owners are exist. To ensure that they will gain high return on long term period, hence they have to motivate and to impose the company through board of commissioner and general meeting of shareholders, so that the companies always obey to capital market rules in order to implement good corporate governance principles. Good Corporate governance is a mechanism used to increase corporate value and shareholders' value, because the implementation of good corporate governance is believed to be able to improve shares' price significantly.

Moreover, **high risk caused stockholders to force the company to conduct high quality of transparency**. It could be conducted to reduce one of agency problems, that is asymmetric information. Of course, the stockholders do not wish to accept additional risk because of the company's low transparency (see the case of corporate failure of Enron).

Capital Market Involvement.

To impose the establishment of efficient capital market, all companies have to submit all material information to their investors in timely basis, so that the investors have strong bases in order to make a rational decision, which is based on information rather than on rumours. The providing of high quality of information on timely basis can be improved if the companies have set their transparency mechanism.

The involvement of the Audit Committee in the implementation of transparency is not only pushed by internal factors, but also pushed by capital market authorities or external factors. A company, in compiling of its Audit Committee Charter, has to follow rules of capital market related to duties and authorities of the Audit Committee. Level of capital market development – it is common to use capital market efficiency as a proxy of level of the capital market development – influences the level of transparency implementation conducted by companies that listed in the capital market. It is proved by differences of requirement required by the US capital market authorities – the more efficient market – compared to the requirement of Indonesian capital market authorities – the less efficient capital market-, together with the law enforcement. Therefore, **I conclude that the capital market influences the implementation of good corporate governance that has to be carried out by companies that listed in the capital market, if the capital market authorities enforce the law tightly**. Surveys conducted by the Indonesian Institute of Corporate Governance showed that companies that are listed in more efficient markets, than those only in Indonesia, provided higher quality of disclosures (IICG, 2005).

Privatization Methods

Pursuant to the results of this research, **I conclude that privatization methods could influence significantly to the degree of transparency under certain conditions.** Theoretically, it can be stated that IPO offers better transparency compared to those of strategic sale. It can be taken place because of the involvement of public and capital market authorities in observing the companies.

Meanwhile, strategic sale can improve corporate transparency if the privatization follows conditions such as:

- Minimize government ownership.
- Government sets certain conditions to strategic investor, such as locking-up mechanism.

Or, in another word, **strategic sale method offers high quality of transparency if the privatization has an effect on to the ownership structure and risk that must be borne by large investors.**

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