

GOVERNANCE PROCESS IN PT. PUPUK KALIMANTAN TIMUR: A SEARCHING MEANING OF GOOD CORPORATE GOVERNANCE

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This research is a case study conducted on a private company in Indonesia which is predicated as a company with the best good corporate governance in 2007, 2008, 2009, 2010, and 2011 respectively. In the number of cases of failure to implement the good corporate governance, on the contrary, PT. Pupuk Kalimantan Timur has shown their successful in implementing their good corporate governance. It certainly attracted the public attention, especially for the author of this research to know directly how the governance process in PT. Pupuk Kalimantan Timur encountered certain excellences and constraints. This research also tries to interpret the meaning of good corporate governance in their governance process to discover the uniqueness of PT. Pupuk Kalimantan Timur which believed as one of success key of PT. Pupuk Kalimantan Timur in implement their good corporate governance. The results of this research shows if PT. Pupuk Kalimantan Timur certainly has almost implemented all good corporate governance principles well, has some excellence and constraints, and also has a uniqueness in translating or interpreting the meaning of good corporate governance.

Keyword: governance process, excellences, constraints, the meaning of good corporate governance, uniqueness

INTRODUCTION

The problem still faced by the developing countries is the weaknesses of corporate governance structure. This is because a number of developing countries face numerous problems that include unstable political regimes, low per capita incomes and diseases (Wong, 2011). Indonesia, as one of developing countries has also suffered from the poor corporate governance. The numbers of cases to failure implement the good corporate governance in Indonesia are emerges. Good corporate governance in Indonesia is considered the worst compared to the other ASEAN countries (Suratman, 2005). Survey from Booz-Allen in East Asia (1998) showed that Indonesia has the lowest index of good corporate governance scoring 2,88 far below Singapore (8,93), Japan (9,17), Malaysia (7,72), and Thailand (4,81) (Bisnis Indonesia, 2003).

Good corporate governance is a key for company success to grow and to give long term benefits, at once winning the global business competition (Daniri, 2005). Good corporate governance is believed as a tool for company management control which creates a healthy company. In appreciating the importance of good corporate governance, therefore, it requires companies especially in Indonesia to well implement the good corporate governance.

Although the implementation of good corporate governance has been still rated low, but the spirit to improve the implementation of good corporate governance is continuously developed. Besides the worst governance cases, there are so many successful stories of good corporate governance implementation. Among others is the successful story from PT. Pupuk Kalimantan Timur.

Good corporate governance implementation also happened in PT. Pupuk Kalimantan Timur, as a winner in the Annual

Report Award (ARA) 2011 achieving an excellent score of good corporate governance: 85,39. PT. Pupuk Kalimantan Timur dominated 62 other contestants for the category of private listed non-finance companies (IDX newsletter, 2012). PT. Pupuk Kalimantan Timur also was a champion for the same category in 2007, 2008, 2010, and 2011 respectively (PT. Pupuk Kalimantan Timur press release, 2011).

In the number of cases of failure to implement the good corporate governance, on the contrary, PT. Pupuk Kalimantan Timur has shown their success in implementing their good corporate governance. It certainly attracted the public attention, especially for the author of this research to know directly how the governance process encountered certain uniqueness as well as the constraints in its governance process. This research can also be used as a good example for the other companies, especially for the new companies as well as growing companies regarding on how good corporate governance should be implemented.

Moreover, this research discusses the meaning of good corporate governance from all governance processes in PT. Pupuk Kalimantan Timur in order to know the meaning behind the governance process and then discover the uniqueness of PT. Pupuk Kalimantan Timur in implementing the good corporate governance. The uniqueness might happen if during the governance process maybe PT. Pupuk Kalimantan Timur actually implements its good corporate governance not only based on five principles of good corporate governance but also less or more than those five principles.

LITERATURE REVIEW

Definitions of Good Corporate Governance

Based on Organization for Economic Cooperation and Development (OECD) (2004), corporate governance is the structure through which shareholders, directors, and managers set of the board objective of the company, the means of attaining objectives and monitoring performances. Jill and Solomon (2004) consider if corporate governance may be treated in a narrow or broader manner. In a narrow view, corporate governance is restricted to the relationship between a company and its shareholders. This is the traditional finance paradigm, expressed in 'agency theory'. In broader point of view, corporate governance may be seen as a web of relationships, not only between a company and its owners (shareholders) but also between a company and a broad range of other 'stakeholders': employees, customers, suppliers, bondholders, to name but a few. Such a view tends to be expressed in 'stakeholder theory'.

Theories of Good Corporate Governance

There are a number of various theoretical frameworks which have evolved to explain and analyze corporate governance, such as agency theory, stakeholder theory, stewardship theory, transaction cost theory, and so on. Each of these frameworks approaches corporate governance in a slightly different way, using different terminology, and views corporate governance from a different perspective, arising from a different discipline (e.g., the agency theory paradigm arises from the fields of finance and economics, whereas transaction cost theory arises from economics and organizational theory). Other frameworks, such as stakeholder theory, arise from a more social-orientated perspective on corporate governance. Although there are marked differences between the various theoretical

frameworks, as they each attempt to analyze the same problems but from different perspectives, they do share significant commonalities (Jill and Solomon, 2004). In this research, researcher use agency theory and stakeholder theory because those theories are the most commonly used theoretical frameworks in accounting and finance related disciplines.

Agency Theory

The agency problem was first introduced in Ross research (1973) entitled *The Economic Theory of Agency: The Principal's Problem*, with the first detailed theoretical exposition of agency theory presented in Jensen and Meckling research entitled *Theory of the Firm: Managerial Behavior Agency Costs, and Ownership Structures* (1976). In the agency theory view of the firm, governance is about aligning managerial incentives and providing monitoring of management behavior (Kim, Nofsinger, and Mohr, 2010).

In finance theory, a basic assumption is that the primary objective for companies is the shareholder's wealth maximization. In practice, this is not necessarily the case. It is likely that company managers prefer to pursue their own personal objectives, such as aiming to gain the highest bonuses possible. Managers are likely to display a tendency towards egoism. This can result in a tendency to focus on project and company investments that provide high short run profits, rather than the maximization of long term shareholder wealth through investment, in projects that are long term in nature (Jill and Solomon, 2004).

Agency problem leads to agency cost because the agency problem presents shareholders with a need to control company management. Jensen and Meckling (1976) concluded agency costs as the sum of:

1. The monitoring expenditures by the principal,
2. The bonding expenditures by the agent,
3. The residual loss.

Another important and basic assumption of agency theory is that it is expensive and difficult for the principal to verify what agent is doing (Eisenhardt, 1989). There are a number of ways in which shareholders and managers' interests may be aligned, but there are costly.

Stakeholder Theory

Stakeholder theory has developed gradually since the 1970s. Stakeholder theory was first expositioned by Freeman (1984) in the management discipline. Through his book entitled *Strategic Management: A Stakeholder Approach*, he combined corporate accountability to a broad range of stakeholders. Since then, there has been much research presented based on stakeholder theory, across a wide array of disciplines, for the example in journal entitled *Corporate Governance: A International Review* by Donaldson and Preston, 1995.

There are various definitions of stakeholder theory and stakeholders. Based on Pearce, 1982; Freeman, 1984, Hill and Jones, 1992 in Jill and Solomon, 2004, one commonality characterizing all definitions of stakeholders is to acknowledge their involvement in an 'exchange' relationship. Stakeholders are not only affected by companies but also they affect the companies in some ways. They hold a 'stake' rather than simply a 'share' in companies (Jill and Solomon, 2004). Stakeholder includes shareholders, management of company, costumers, employees, suppliers, government, and society. Furthermore, in the extreme point of view stakeholder theory suggest if the environment, animal species, and future generations should be included as stakeholders.

However, the problem arising from stakeholder theory is from the lack of consensus on how to measure and to report on changes in stakeholder welfare. Although to date, there are some ideas to solve those problems, namely balance scorecard approach and triple bottom line. The other criticism

about stakeholder theory is stakeholder theory doesn't provide the chance to accept or reject the validity of the stakeholder view. Since stakeholder view is not a well-defined theory, it is difficult to assess. Furthermore, critics argue that company deviated too far from the profit, maximizing role of companies. It would be harmful to society. Consequently, when managers have to take into account a wider range of goals and to involve themselves in stakeholder engagement activities, higher costs and impaired business performance are likely to follow. When managers of company try to serve the stakeholder too much, managers often become ineffective in achieving any of more regulations. Indeed, more exacting environmental and social standards will bring more regulation. Overregulation brings enormous cost on society in the form of limiting competition, narrowing opportunities, and worsening economic performance. History shows that when the economy is intentionally focused on social goals, such as employment, production, and so on, society becomes worse off (Kim, Nofsinger, and Mohr, 2010).

The Principles of Good Corporate Governance

Based on *Pedoman Umum Good Corporate Governance Indonesia* conducted by *Komite Nasional Kebijakan Governance*, the principles of good corporate governance consist of:

1. Transparency

In a basic principle, to maintain the objectivity in running a business, the company must provide material and relevant information in a way that is easily accessible and understandable by the stakeholders. The company should take the initiative to express not only the problems matter required by legislation, but also it is important for decision-making by the shareholders, creditors, and other stakeholders.

2. Accountability

In a basic principle, companies must be accountable for their performance transparently and reasonably. Thus, a company must be properly managed, scalable and in accordance with the company's interests while taking into account the interests of the shareholders and other stakeholders. Accountability is a necessary prerequisite to achieve continuous performance.

3. Responsibility

In a basic principle, companies must comply the legislation and implement the responsibility to society and the environment so that in its long term, businesses could be maintained and they are acknowledged as good corporate citizens.

4. Independence

In a basic principle, to smoothen the implementation of the principles of good corporate governance, the company should be managed independently so that each company organ does not dominate the other organs and there is no intervention from the other parties.

5. Fairness

In a basic principle, in conducting its activities, a company should always consider the interests of the shareholders and other stakeholders based on the principles of fairness and equality.

RESEARCH METHOD

This research is included in qualitative research because of: (a) this research needs to explore a central phenomenon (good corporate governance), requires both exploration (the need to better know the governance process in PT. Pupuk Kalimantan Timur) and an understanding (because of its complexity) in interpreting the meaning of good corporate governance based on PT. Pupuk Kalimantan Timur governance process, (b) this research needs a deep data which can best be learnt from the participants, (c) this research contains extensive data collection to convey the complexity of the phenomenon or process, (d) unlike in the quantitative research, the literature review in this research plays a less substantial role at the beginning of the research because this research relies more on the views of participants and less on the direction identified in the literature by the researcher. The participants in here are the employees of PT. Pupuk Kalimantan Timur, and (e) the reason behind choosing the qualitative research is because of the pure desire from the researcher. According to Lincoln and Guba (1994) they argued if the personal choice is a right legitimate and reason in choosing the approach of the research.

Moreover, this research uses an interpretive paradigm because: (a) the understanding emerges through the interaction, (b) understanding the context, (c) how to understand the informant experience, (d) how the informant make and share their understanding. Moreover, interpretive paradigm allows the researcher to get involved subjectively with the participants in research. Interpretive researcher believe on the reality is formed through interpretation and social interaction (Hines, 1998; Miller, 1994; Morgan, 1998; Munro, 1998).

Furthermore, this research use case study because case study is suitable for this

research. According to the understanding of the researcher, the ‘thing’, which differentiates the case study from other research methods, is the case study cannot be over generalized. Usually, case study just concentrates on one case, discusses and peels it completely. This research uses a case study because case study is considered the most suitable method in in-depth discussion regarding the governance process in PT. Pupuk Kalimantan Timur with expectancy that other parties gain some beneficial reflections through this research.

FINDINGS AND DISCUSSION

PT. Pupuk Kalimantan Timur, as the winner in the Annual Report Award with a category of the best good corporate governance in 2007, 2008, 2010, and 2011, has almost implemented the good corporate governance well in its governance process. The researcher who has observed and looked the governance process directly, argue if PT. Pupuk Kalimantan Timur has almost implemented well the five principles of good corporate governance in its governance process. Among others are shown from the openness of the company information toward their stakeholders (transparency), a good and clear job description which describe the accountability, the equal treatment which is giving to minority shareholder (fairness), and many others.

During observing the governance process in PT. Pupuk Kalimantan Timur, the researcher found some excellence of PT. Pupuk Kalimantan Timur related with the good corporate governance implementation; among others are (a) lies on the accountability of the Board of Directors. The Board of Directors in PT. Pupuk Kalimantan Timur are usually come from the senior employees who started his career as an employees (from down) until become a director (to the top). Therefore, company knows his track record and his background and also the Board of Directors who be appointed from the senior employees has a good affinity and internalization to the company. Its cause the fraud cases such as conflict of interest, intervention, and so on are rarely happen. Different with the others companies, usually almost of their Board of Directors are a person who come from the outside company, (b) lies on the job description of PT. Pupuk Kalimantan Timur which is represented the accountability of the company. PT. Pupuk Kalimantan Timur has certified from Hay-

Group; therefore, they can make their job description professionally, (c) lies on the number of the professional internal auditor in PT. Pupuk Kalimantan Timur is included in the others excellences in that company because it rarely happens in the other similar companies. The existence of professional auditors is believed as one of success key in actualizes the independence of the internal auditors in PT. Pupuk Kalimantan Timur, (d) and last is lies on the excellence of PT. Pupuk Kalimantan Timur on their e-learning and knowledge management program which is applied as one of the best practice in good corporate governance implementation. PT. Pupuk Kalimantan Timur has achieved the appreciation of state owned enterprise with the best human resource innovation award at Anugerah BUMN 2011.

Besides the excellences of PT. Pupuk Kalimantan Timur in its governance process, however, according to researcher, PT. Pupuk Kalimantan Timur still has several recommendation which should be follow up as soon as possible, among others are: (a) PT. Pupuk Kalimantan Timur should determine at least 20% independent commissioners, (b) PT. Pupuk Kalimantan Timur should complete their board manual as soon as possible, (c) Board of Commissioners of PT. Pupuk Kalimantan Timur should realize the meetings, both internal meetings as well as joint meetings with shareholders in accordance with the schedule (12 times a year), (d) Board of Commissioners of PT. Pupuk Kalimantan timur should apply the self assessment system, (e) Internal Audit Unit should complete the ratification process of Quality Assurance Guidance as soon as possible, (f) the corporate secretary of PT. Pupuk Kalimantan Timur should be more orderly in its administration process, (g) code of conduct in PT. Pupuk Kalimantan Timur should describe the indicators of conflict of interest and

intervention more detail and if needed, also given along with the examples of complaints.

And last, the interesting part of this research is lies on the interpretation of the meaning of good corporate governance based on the governance process in PT. Pupuk Kalimantan Timur. Researcher tries to construe the implied meaning of good corporate implementation in PT. Pupuk Kalimantan Timur and the results are: (a) researcher catches if PT. Pupuk Kalimantan Timur understanding the meaning of independence of the Board of Commissioners is based on their performance, their way or work, their judgment, and their way of solving the problems. Therefore, researcher concludes if PT. Pupuk Kalimantan Timur translates the meaning of independence of the Board of Commissioners with the reliability, (b) researcher interprets PT. Pupuk Kalimantan Timur believe the professionalism of the internal auditor as one of the form of the independence of the PT. Pupuk Kalimantan Timur internal auditor, (c) researcher also catch if there are another principles emerge in the PT. Pupuk Kalimantan Timur governance process, namely: equilibrium principle, (d) and last researcher interprets PT. Pupuk Kalimantan Timur believe if the transparency is one of form of the company's credibility.

SUMMARY

This study is aimed to know the governance process in PT. Pupuk Kalimantan Timur encountered its excellence and constraint. This research is also tries to interpret the meaning of good corporate governance based on the governance process in PT. Pupuk Kalimantan Timur to discover the uniqueness of PT. Pupuk Kalimantan Timur in implement the good corporate governance.

The results of this study are PT. Pupuk Kalimantan Timur has almost implemented well the five principles of good corporate governance in their governance process, PT. Pupuk Kalimantan Timur also has some excellence and constraint during the ongoing governance process, and PT. Pupuk Kalimantan Timur has their uniqueness in construe or interpret the meaning of good corporate governance that researcher believe it as a uniqueness as well as one of successful key of PT. Pupuk Kalimantan Timur in their good corporate governance.

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