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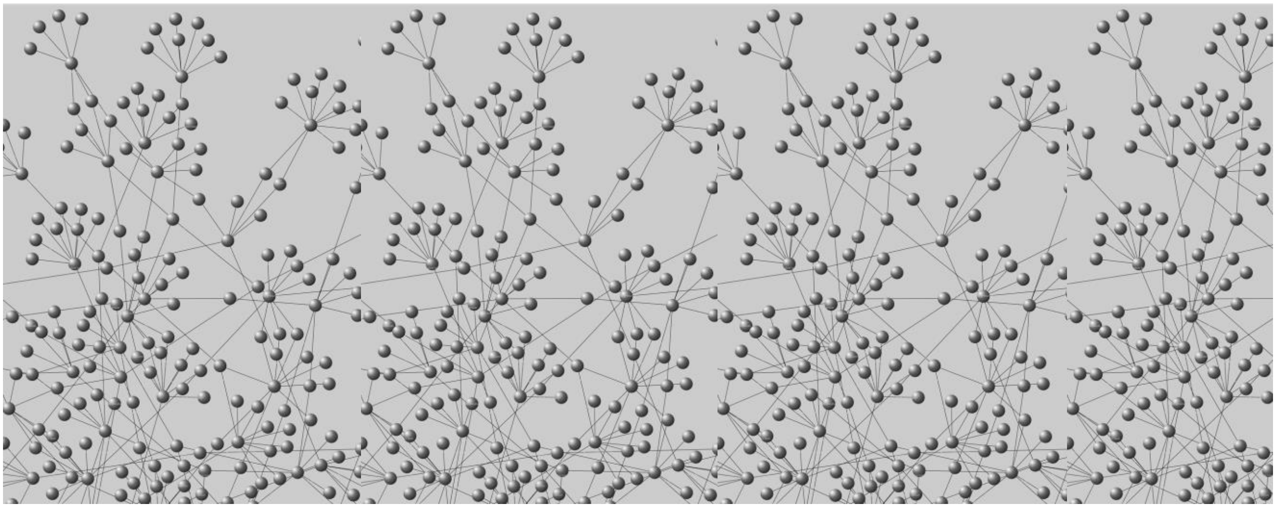
Sydney Southeast Asia Centre

Gender participation and influence in corporate governance networks

Indonesia November 2016



Corporate governance involves efforts to ensure that corporate objectives are met, and that the interests of shareholders and other corporate stakeholders are upheld.

Given the significant accountability of corporate boards for the management and control of capital, studies have explored the implications of board composition and diversity on outcomes such as risk, decision-making, corporate social responsibility practices, and firm performance, among others.

Strong boards are also seen to exert significant influence on corporate culture and organisational management practices. In light of the size and scope of some of the largest corporations in the world, the influence of corporate boards on the domestic and interconnected global economy cannot be underestimated.

Principles of corporate governance

Historically guided by regulatory frameworks, and heavily influenced by cultural norms and social expectations, corporate governance philosophies, policies and practices differ across countries.

Globalisation pressures along with the devastating effects of major economic crises and corporate scandals, however, have prompted efforts to increase the transparency of corporate governance practices, raise the level of accountability of corporate boards, and standardise governance principles around the world.

In spite of these early efforts, cross-country differences remain and there continues to be significant opportunity to further understand the nature and impact of these differences in the areas of theory, policy, and practice.

The task of governance lies with the company's board, composed of both shareholder representatives and independent directors. One important point of difference in governance practices across countries pertains to how boards are structured.

Countries such as Australia and the United States adopt a **sole board structure** (where the responsibilities of both management and control are undertaken by a single corporate board). Others such as Germany and the Netherlands adopt a **dual board structure** (where the control function is undertaken by a supervisory board alongside a separately-constituted management board). A third group of countries (including France and Switzerland) adopt a **mixed board structure,** combining elements of the sole- and dual-structure varieties.

The case of Indonesia

Reflecting its Dutch influences, Indonesian corporate governance structures are characterised by a dual board, composed of a board of commissioners tasked with the control function, and a board of directors tasked with the management function.

The history of corporate governance regulation in Indonesia is fairly short, beginning with the ratification of the Indonesian Company Law in 1995 (subsequently amended in 2007). This law helped raise awareness of the critical role of the private sector in economic development at a time of significant growth in Southeast Asia.

Soon after this first regulatory reform, the country suffered under the shock of the Asian financial crisis, which saw a dramatic collapse of the rupiah and a severe contraction of the Indonesian economy.

In response to the devastating effects of the crisis, the country established a committee for good corporate governance in 1999, leading to the formalisation of a Code of Good Corporate Governance in 2001 (subsequently amended in 2006).

Indonesia has since rapidly established institutions and introduced further regulatory reforms across a range of areas from investment to the eradication of corruption.

Indonesia's top 100 corporate boards

To characterise the typical composition of corporate supervisory boards in the country, data from Indonesia's top 100 companies was analysed.

The companies represent the largest publicly traded corporations ranked according to 2015 market capitalisation. There are 18 industries represented among the top 100 corporations, with the four largest industry groups being financial services (18 companies), real estate investment (15 companies), mining and energy (11 companies), and equipment, engineering and construction (10 companies).

Data shows that a total of 512 commissioners serve on the supervisory boards of the major corporations in the country. A company typically appoints six commissioners to its board, with the smallest board composed of two commissioners and the largest composed of 22 commissioners.

Gender participation in the board of commissioners

Of all the commissioners that serve on the top 100 corporations, only 52 (or around 10%) are women. Women tend to comprise around 10% of the board of commissioners of individual companies. Notably, however, more than half of the companies (a total of 57) have boards that are composed only of men. There remains significant opportunity for companies to increase gender participation and reap the benefits of greater gender balance in supervisory boards in the country.

Industry differences

The data further shows that there are industry differences in gender participation on supervisory boards. On average, women comprise around 5% of commissioners in the mining and energy boards, 6% of commissioners in the equipment, engineering and construction boards, 11% of commissioners on financial services boards, and 19% of commissioners on real estate investment boards.

While the number of women on real estate investment boards is almost double that of the overall average, four of the 15 of real estate investment companies have no board-level participation of women. Half of the financial services companies have all-male boards, and close to 75% of mining and energy companies and 80% of equipment, engineering and construction companies have no women on their corporate boards.

Corporate governance networks

Studies conducted elsewhere have shown that companies tend to share common directors, resulting in interlocking boards. The data shows that in Indonesia, the corporate governance network of the top 100 corporations is relatively fragmented: there are 49 individual companies whose boards are completely disconnected from any other board, while the remaining 51 companies form eight separate clusters of interlocked boards.

Four of the eight clusters are small, each composed of only two companies connected by one common commissioner. Three of the clusters each connect between three and five companies, with companies typically sharing one common commissioner.

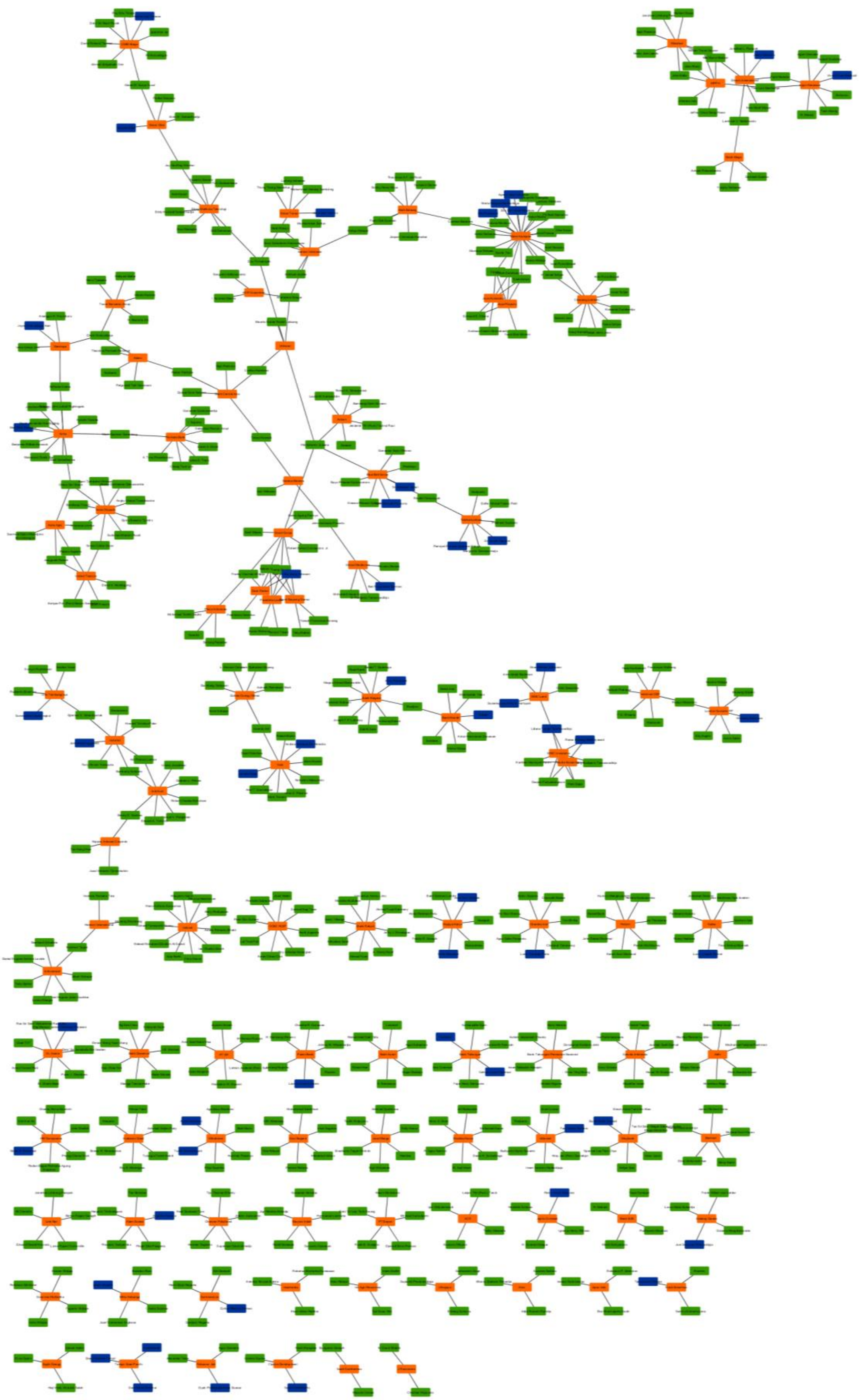


Image: 2015 board interlocks in Indonesia (where blue boxes are women commissioners)

The last of the eight clusters is the largest and most dominant, comprising 158 commissioners of around 30% of the major corporations in the country.

The most represented industries in this dominant cluster are the real estate investment sector (six companies), the financial services sector (four companies), and the telecommunications sector (four companies).

Connectedness and 'betweenness'

The formation of corporate governance networks can be attributed to commissioners who sit on multiple boards. The number of boards on which an individual sits (that is, a commissioner's connectedness) is a key indicator of network position.

From a network perspective, greater connectedness implies greater importance in terms of the role of keeping the network together. Within the specific context of corporate governance, greater connectedness also points to more opportunities to control greater amounts of capital. This signifies importance of a different, but equally crucial kind.

The data shows that in Indonesia, a commissioner typically sits on only one board; therefore, the majority of commissioners tend to have low levels of network connectedness. However, a total of 51 of the 512 commissioners (or around 10%) are members of between two and four corporate boards. Among these most connected (and hence most important) commissioners, only three are women.

An alternate indicator of network importance pertains to the ability of an individual commissioner to connect two or more companies that would not have otherwise had a connection (that is, a commissioner's betweenness). Greater betweenness implies a greater ability to both gain access to and control information flows in the network. Among the 51 most influential commissioners using this indicator, only three are women.

Implications

The fragmented nature of Indonesia's corporate governance structure has important implications on the vulnerability of the corporate sector to crises. This is something that the country has attempted to address since the devastating impact of the Asian financial crisis.

On the one hand, the disadvantages of network fragmentation include a tendency for the sector to experience greater information asymmetry, slow information flows, and thus slower crisis detection and response. On the other hand, the advantages include the possibility of greater board independence and the potentially slower onset of crisis contagion.

An important strategy for sectoral change and reform would be to initiate change at the largest and most connected cluster of companies, specifically eliciting the support of commissioners that have the highest levels of connectedness and betweenness.

The data clearly points to significant opportunities to increase the participation of women in supervisory board membership in the country. Previous studies elsewhere have found higher levels of gender diversity at the board level to have positive effects on stock value and profitability, among others.

This tendency may be attributed to improvements in decision-making processes as a result of the board having a more diverse set of skills, experiences and perspectives to draw upon. Indonesia's corporate sector must proactively put in place measures to increase gender participation in order to reap its benefits, while continuing on its path of corporate governance regulation reform.

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