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Small enterprises and company law in Indonesia; A study of the limited company in Indonesian commercial practice

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SMALL ENTERPRISES AND COMPANY LAW IN INDONESIA: A STUDY OF THE LIMITED COMPANY IN INDONESIAN COMMERCIAL PRACTICE[1]

A. Introduction

A recent World Bank report (1990) on Indonesia expresses great faith in the possibilities of building up the Indonesian economy with the help of legislation. Legislative reform is one of the main courses recommended in this report, which suggests that this is the way of solving problems of development. This represents a line of reasoning which is well-established among development-oriented politicians and administrators, both in the Western and the non-Western world. Nevertheless, social scientists have for a long time expressed doubts about the effectiveness of legislation in bringing about social reform in developing countries. They have taken the view that change cannot be imposed, but that the legislator must rather sit

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back patiently and wait for it to happen.[2] In this perspective, legislation has little effect on society at large, which has its own momentum, as it were. Legislation will only be obeyed if it reflects this momentum; otherwise it will not and will remain up in the air. Legislation hence is the result of social forces in society, rather than being their guide.

The above is a highly simplified representation of these two lines of thinking, but I believe that in essence they are correctly represented this way. Nevertheless, I do feel on the one hand that there is more to legislation than the simple confirmation of prevailing notions in society. On the other hand I agree that reform does not come easy to existing social structures.

In this essay I propose to consider the effect of a specific piece of economic legislation in a particular society. For this purpose I have selected legislation pertaining to the limited company and its use by small-scale entrepreneurs in Indonesia. In order to illustrate how members of Indonesian society avail themselves of this specific legal construction, I have conducted a case-study in a small Surabaya-based company. From the results of this case-study it will become apparent that the option for and use of the company is primarily determined by an assessment of the benefits and the costs which it entails, rather than by cultural or legal factors.

B. The limited company and liability

There is general consensus among lawyers about the basic characteristics of the limited company which flow from the idea that it is a separate legal person. These may be listed as follows: liability limited by division of the capital into shares, attraction of capital through the issue of shares, and separate taxability.

Apparently, these characteristics which the law attributes to the limited company seldom constitute relevant considerations in Indonesian commercial practice. Thus, as I have demonstrated earlier (Pompe 1991), a limited company may be a separately taxable object, but then so are other forms of commercial venture which are much more easily established, such as the *usaha dagang*. Furthermore, as is indicated by Kaehlig (1986),

[2] F. von Benda-Beckmann (1983) has said in so many words that the lesser evil is for the legislator to do nothing rather than push through reforming legislation (see also Allott 1980 and Allott and Woodman 1985). This is by no means a uniquely academic approach. Spear (1978:151) suggests that after the Indian Mutiny the colonial legislator in India was infected with a similar scepticism about the rate at which change could be effected in the sub-continent. 'All interference was therefore eschewed from this time on; it was fortunate that suttee had been suppressed thirty years before. Such measures as Dalhousie's Widows Remarriage Act and the allowing of converts to inherit property were no longer thought of. After the promulgation of the Indian Penal Code in 1861, which involved little practical change, there was no social legislation until the Age of Consent (Sarda) Act of 1929, which, however, the government did not seriously attempt to enforce.'

limited companies in Indonesia do not appear to meet their basic aim of building up capital through the issue of shares. In practically all Indonesian companies, shares are held only by the director and his close relatives.[3]

A recent development has shown up the weakness of Indonesian limited companies in Indonesian commercial practice as far as their most basic characteristic is concerned, namely limited liability. This entails that shareholders cannot be held liable for company debts in excess of the sum of the stated value of their shares and that ownership and management are legally separate (even though the director may be the owner).

According to the law, limited liability is established as follows. Art. 38 of the Indonesian Commercial Code requires the publication of the articles of incorporation in the State Gazette (*Berita Negara*). Whilst a company is deemed to have come into existence after it has received government approval as stipulated in art. 36 of the Commercial Code, its directors remain personally and severally liable until the publication of the articles.[4] Thus, registration is essential to limit the liability of directors. Publication is technically speaking a simple administrative matter following government approval.

In the course of time a considerable discrepancy has arisen in Indonesia between the number of companies receiving government approval and the number publishing their articles of incorporation in the State Gazette. Now the Indonesian government has reacted to this development by decreeing that no government approval as indicated in art. 36 of the Commercial Code will be given unless an advance payment is made to the government printing office for publication of the articles in the State Gazette.[5] This measure can be explained by a desire on the part of the Indonesian government to increase the effectiveness of the Commercial Code. This must be taken to be directed at encouraging the use of the limited company form and thus promoting limited liability in Indonesian commercial prac-

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[3] This should not be overstated as a 'typically' Indonesian feature. It may be that in this respect there is little difference between private limited companies in the West and limited companies in Indonesia. See Pompe and Winter 1988.

[4] In the past, there have been some doubts about the precise moment of incorporation of companies in Indonesia. The matter is now settled. For a brief review see Pompe and De Vries 1986.

[5] Surat Edaran Direktur Jenderal Hukum dan Perundang-undangan Departemen Kehakiman no. C.HT.01.01.1 tentang Pengumuman Anggaran Dasar Perseroan Terbatas Dalam Tambahan Berita Negara R.I. tgl. 6 Desember 1988, *Media Notariat* January 1989 no. 10 thn. 4. The registration fees are announced in the Pengumuman Percetakan Negara R.I. no. 001/Peng/I/1/1989, *Media Notariat* no. 11 thn. 4. An interview with the responsible government official was published in the same journal. The latter states that the main reason for this regulation is that so few companies have their articles of incorporation published in the State Gazette.

tice.[6] One may question whether these aims will be realized through this measure, however.

C. The costs and the benefits of limited liability[7]

In order to be able to assess these costs and benefits, one must examine the causes of the above-mentioned discrepancy in the first place. The reason which is generally advanced in the (sparse) literature on the subject is that in Indonesia no practical benefit is derived from the publication of articles of incorporation. Thus, Kaehlig (1986) has argued that the limitation of liability does not work in Indonesian commercial practice. This means that, even if liability is limited by following the proper procedure, in the Indonesian social and cultural context it is generally considered to be reprehensible to hide behind the fiction of a company to evade the claims of creditors.[8]

This idea is corrobated by other data as well. There are strong indications that in many Indonesian companies private and company funds mix freely.[9] This suggests that company creditors are paid out of private funds

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[6] Interestingly enough, it is not clear why the Indonesian government is so bent on promoting the limited company. Kaehlig (1986) claims that it is an effective instrument of government control. This may be so, but then such control on the individual citizen is no more and no less effective. Furthermore, this interpretation does not fully explain why commercial ventures of types other than the company are allowed their slice of the cake as well (Pompe 1991). It has been suggested that the limited company is promoted by the government in line with the cooperative movement as a vehicle for economic development in a capital-poor society. Nevertheless, the limited company has so far failed to bring labour and capital together.

[7] I have found strong arguments in favour of the cost-benefit approach in a recent publication on the Peruvian informal sector by De Soto (1989). De Soto's work is so commendable among other things because it quantifies the obstacles to access to state law in Peru in terms of effort, time and money. As De Soto points out in his book, concrete data of this sort are expensive and extremely difficult to get hold of.

[8] Kaehlig bases his argument precisely on the existence of the above-mentioned discrepancy. It should be added here that it still remains to be seen whether these findings, which derive from research into small and medium-scale companies, also hold for large companies. It may be relevant in this connection that usually the owner and the manager are one and the same person, or are closely related. It may be that the situation in cases in which the two are completely distinct, or in which there are a large number of small shareholders, is totally different. It remains to be established whether Indonesia and the West are fundamentally different in this respect. See generally S. Pompe and J.W. Winter 1988.

[9] My own enquiries at the *Balai Harta Peninggalan*, within whose jurisdiction bankruptcies come, indicate that at least in South Jakarta the number of bankruptcies is incredibly low by Western standards (3 bankruptcies in a period of five years).

as the need arises. There is furthermore evidence that creditors are not as a general rule prepared to pursue their claims to the bitter corporate or personal end (Burns 1980). This facilitates a settlement involving both company and private funds.[10]

What all this boils down to in practice is that, if a company cannot pay its debts, its director will not have it declared bankrupt but will pay the creditors out of his own pocket. The above-mentioned measure will not make any difference to this commercial practice.

Where the practical benefits of publication of the articles of incorporation are negligible, therefore, the costs, on the other hand, are considerable. These costs include not only the formal administration fees payable to the government printing office, but other charges as well. The reason is that, whilst normally publication should take only a few months, allegedly it may take anything up to five years if one does not help the administrative machinery along. Such a long period effectively vitiates articles 38 and 39 of the Commercial Code.[11]

The logical conclusion appears to be that, if it is so costly to have articles of incorporation published and if the effect of publication in practice is so limited, it is a waste of time and money to publish them.

D. The costs and the benefits of a limited company

If the basic characteristics of the limited company are irrelevant in Indonesian commercial practice, the question arises why beginning entrepreneurs in that country opt for this type of commercial venture at all. This, I would submit, also essentially goes back to a cost-benefit analysis.

The costs of setting up a limited company can be defined in terms of finance, effort and, alongside these two, time. An additional cost factor is the uncertainty of the law.

Regarding *finance* the following remarks can be made. To begin with, it is necessary to furnish starting capital for the company.[12] This capital may come from several sources, but according to the law at least 10% must

[10] Burns' findings could also be interpreted as indicating that precisely because the articles of incorporation are not published, the directors can be held severally liable at law for the company's debts, which in turn explains why private and company funds mix freely and why the need for bankruptcy proceedings does not arise. It is my view that this approach will not stand up to critical examination in the field. To mention just one reason: it does not explain why private and company funds apparently mix freely even where there is no threat of bankruptcy, as I will demonstrate below.

[11] It would appear that the government has designed the above-mentioned measures to combat this through announcement of the official administration fees as well as the fixing of a time-span for publication.

[12] Art. 50 of the Commercial Code stipulates that the first directors must hold at least 1/5 of the stated company capital.

be the director's own.[13] To this must be added all the regular costs: the fees of the notary public for drafting the articles of association, of the government for approval pursuant to art. 36 of the Commercial Code, of the Court of Justice for registration in accordance with art. 38 of the Commercial Code, of the government printing office for publication in the State Gazette as required by articles 38 and 39 of the Commercial Code, and of the Department of Trade for the various necessary trading licences – to name just a few of the obligatory costs.

As regards *effort*, one may refer to the considerable administrative hassle of establishing a company: the articles of incorporation must be drafted, licences must be obtained, the tax office must be informed and a tax number secured, membership of the official association of entrepreneurs must be applied for, and so on. All these steps require quite a lot of administrative work, besides effort and time.

The additional cost factor is the *uncertainty* of the law. This becomes manifest in various ways, which each stands on its own. One example which has already been cited is that of the additional financial injections needed to get the government machinery moving, as in the case of getting the articles of incorporation published within a reasonable period of time. The law evidently is not as certain as it seems, and this may push up the price of enjoyment of its benefits.

The benefits of the limited company are on the whole financial, but also concern legal security and, perhaps to a lesser extent, social status.[14] This can be illustrated as follows.

Indonesia is a capital-poor country where the government constitutes the principal source of revenue for entrepreneurs. One of the chief ways of tapping this source is through government contracts. A description of the legal framework for government contracts and tender procedures as governed by Presidential Decision no. 29/1984 is beyond the scope of this paper; in any case this has already been considered in another context (Verrier 1988, Pompe 1989). The important thing to note here, however,

[13] Decision of the Bank Indonesia of 30 May 1984, art. 2; Circular Letter of the Bank Indonesia no. 17/1/UKK dated 30 May 1984, chapter IV; Decision of the Board of the Bank Indonesia no. 21/13/Kop/Dir of 14 June 1988; Letter of Instruction no. 21/4/Ukk, chapter V.2.1., of 14 June 1988. There is a consistent rumour that banks in fact exceed the 10% limit and in some cases even have provided all the starting capital. Nevertheless, even before 1988, banks on the whole were only prepared to fully finance the setting up of a new company if collateral was provided. Furthermore, the latest measure seems to be aimed particularly at excluding the possibility of setting up a company with entirely external funding.

[14] Even though tax benefits constitute an important incentive in establishing companies in Western countries, it is not certain that this applies to the Indonesian types of small-scale and medium-scale enterprises under review here, particularly if one considers the comparative advantage of the limited company over against the *usaha dagang*. Since both these forms of commercial venture are apparently taxed separately, taxation does not provide an explanation for why entrepreneurs choose one form or the other.

is that the law stipulates that only limited companies qualify for such contracts, with the exception of contracts for projects of the smallest category. This means that as a rule beginning entrepreneurs can only tap government funds if they establish a limited company.

As far as the *financial* benefits are concerned, the law contains the following provisions. First, payment is made in instalments in step with the progress of the work and includes advance credit to an amount of 20% of the total value of the contract (see Presidential Decision 29/1984 art. 20(5) and (6)). As a result, the entrepreneur's own advance investment is limited, which is of crucial importance in a capital-poor society. Second, legislation is aimed at spreading the benefits of government contracts over as large a group of Indonesian entrepreneurs as possible.[15] Contracts are therefore not necessarily awarded on the basis of high quality at the lowest cost. As a result, the benefits may be considerable once one has joined the bandwagon.[16]

As regards *security* as well, the law indicates two benefits. First, the quota system ensures that once one has entered the system, and if one does one's work properly, there is relative security of income. Second, the state is a reliable debtor and does not welsh on its debts.[17]

So far I have examined the reasons people may have for establishing companies or for not doing so by reference to the law and the literature. In the next section I propose to examine how all this works out in practice, towards which end I have conducted a case-study.

E. An illustration

The main features of the case to be discussed here have been described in an earlier publication, to which the reader is referred for details (Pompe 1991). It will be recalled that the case concerns a Minangkabau couple

[15] Pursuant to this legislation, only the 'weak economic category' may take advantage of these provisions. This group is defined on the basis of the ethnicity of the entrepreneur, who must be Indonesian (as opposed notably to Chinese), and the size of the capital of the limited company, which may not exceed 100 million rupiah. See Presidential Decree no. 29/1984, art. 19(1) jo. (5), and the Official Explanation of art. 19(5), Surat Edaran Bank Indonesia no. SE 17/3/UKK (1984), Tentang pengertian golongan ekonomi lemah (Concerning the meaning of weak economic category), and Pompe (1989).

[16] The system is such that every registered company is awarded a certain quota of contracts, namely the number which it is assumed to be able to carry out in one year. This quota is determined on the basis of size of capital, past experience, quality of the work, and so on. Once a company has been awarded its specific quota, no further contracts will be forthcoming, even if the company is out of work or puts in a tender at the best price.

[17] A further advantage may be the satisfaction some people derive from the knowledge that they are operating inside the law rather than outside it, or the possible rise in social status. This, however, is difficult to quantify.

living in Surabaya, of whom the husband is called Zafrullah and the wife Laila.

The main protagonist, Zafrullah, did not like being referred to as an entrepreneur. He had not been able to complete his degree in construction engineering in Bandung, but nevertheless perceived engineering as his calling. After abandoning his studies, he took a job with the civil service as the best alternative. His wife Laila took noticeable pleasure in telling me that, but for her, he would never have thought of becoming an entrepreneur, or rather a salesman, as he called it. According to her story, he regarded the activity of selling goods across the counter as a demeaning one. It was she who had eventually induced him to open two clothes shops and a grocery store, with evident success - all three were *usaha dagang*.[18]

Yet Zafrullah would assert himself if in his eyes the occasion called for it; starting a construction business obviously was one of those occasions. By the late 1970s and early 1980s the clothes shops and grocery store had yielded considerable profit, as was evident from the nice house the couple had built in Surabaya in 1977. This had made Zafrullah think about his old calling again and toy with the idea of doing something in construction engineering.[19]

It is important to point out in this context that it is a firm business principle with both Zafrullah and Laila, as explicitly stated to me on frequent occasions, not to borrow money from the bank. In any case, the chances of getting credit from a bank for starting up a new business are low. For a bank, there are considerable risks attached to giving credit to someone whose assets are so few that they cannot serve as security in the case of default.[20] The couple also told me repeatedly that they would not enter into any large transactions with private businessmen. In their view these could not be trusted. This meant that the sum of the initial outlay required to gain a foothold in the construction sector had to be paid by the family, at least in the first instance. It also resulted in Zafrullah's not

[18] Indeed, whilst Laila would only rarely challenge her husband overtly in public (though delaying tactics on her part were the order of the day), it was obvious that she lived up entirely to the idea of the emancipated Minangkabau woman. The business acumen that had brought prosperity to the family was at least as much hers as Zafrullah's. 'A husband is to be ruled via the bedroom', she once told me, leaving me, suddenly overcome by the strong impression that I had been imbued with all the wrong notions about Muslim propriety, quite tongue-tied.

[19] Laila told me that she had not thought it at all a good idea: she felt that the initial outlay was too high and the returns too uncertain - an assessment that eventually proved all too right. She proposed instead converting the grocery store into a supermarket and perhaps renting a section of it to one of those popular *Kentucky Fried Chicken* restaurants. But on this point Zafrullah was not to be budged, either outside or inside the bedroom.

[20] It must be noted that in 1990 the KIK/KMKP credit programme for small-scale entrepreneurs was replaced by the obligation for every commercial bank to spend 20% of its lending portfolio on loans not exceeding 200 million rupiah to small-scale borrowers/entrepreneurs. This has not in any way alleviated the problem of collateral for beginning entrepreneurs with little or no capital.

contracting to work for just anyone, but concentrating all his energies on securing contracts from the government in the framework of the SD-Inpres school building programme.

And so, in 1982, Zafrullah established two limited companies *(perseroan terbatas)*.[21] They can be briefly described as follows.[22]

Of the first company Zafrullah is the director. The nominal share capital is 100 million rupiah, divided into 200 shares of 500,000 rupiah each. A total of 40 shares, to a total value of 20 million rupiah, have actually been issued, 22 shares being owned by Zafrullah himself. The other shareholders are all close relatives. Indonesian law, like Dutch law, provides for a board of supervisors *(commissarissen)*. The board of supervisors of Zafrullah's company has two members, who are both relatives.

Of the second company Zafrullah's wife Laila is the director, the other shareholders being her cousin and her son. The nominal share capital here is 25 million rupiah, divided into 250 shares of 100,000 rupiah each. A total of fifty shares, to an amount of 5 million rupiah, have been issued, 35 shares being owned by Laila and 10 by her son. The board of supervisors has her son as sole member.

In line with the family's business principles, all issued shares have been paid for directly out of Zafrullah's pocket. The other shareholders have paid nothing. In order to establish these companies, therefore, Zafrullah would have had to bring together 25 million rupiah (1982), not including administrative expenses such as the fees for the various licences and the notary deed.

The establishment of the companies proved rather an ill-fated affair for Zafrullah. After the procedure had been completed (and all the connected costs paid), it transpired that a company with precisely the same name as one of Zafrullah's companies had been set up in Medan at some earlier date. One of the government's duties before it gives its approval is precisely to avoid such duplications, but the system had evidently malfunctioned. The government therefore informed Zafrullah that he would have to change the name of the company concerned. So Zafrullah had to go through the entire procedure again, from the amendment (by notary deed) of the original notary deed of establishment and the application for a business licence to the publication of the revised articles of incorporation in the State Gazette.

The venture into the construction world was Zafrullah's idea, and he managed everything in this connection. Laila distanced herself from the

[21] It is interesting to note that he initially started out with an *usaha dagang*, which type of commercial venture can apply for the smallest government contracts. He evidently planned for his business to grow.

[22] Copies of the articles of incorporation of both these limited companies are in my possession.

project from the very start, concentrating her attention on the clothes shop and the grocery store.[23] As a result, Laila's role as a company director was wholly that of a stooge. The same went for her son. When asked about this, the son said that he signed whatever papers his father put in front of him - even though his father had no formal function in his son's company. Once, in 1985, I summoned up enough courage to tell the family at the dinner table that, according to the Indonesian Commercial Code, the son as a *commissaris* could veto decisions of his mother as a director. This comment could easily have been considered subversive within the family context, albeit on a microcosmic level. The relation between the son and the father was strained, and my comment might have been interpreted as giving the son ideas. Fortunately, however, the family took the remark in good humour, judging from the general merriment which it generated. 'You still have a lot to learn about Indonesian law', Zafrullah exclaimed, patting me on the back.

The change of focus of Zafrullah's activities away from the clothes shop and grocery store to the construction business soon became very manifest. In the late 1970s I would usually find him behind the counter of the clothes shop bargaining or behind the till of the grocery store, but during my visits in the early 1980s he hardly ever visited these places any more.[24]

Keeping his head above water in the construction world proved a precarious exercise. Zafrullah's companies were marked by an almost total lack of capital: they were of the 'middleman' type described by Sannen (1986). The office was a wooden shed. Hardly anyone was employed in it on a regular basis. There was no construction equipment or material, with the exception of a fair quantity of timber. Labour was hired - through a foreman[25] - and materials purchased whenever a contract was landed. Building materials had to be secured separately and did not include the

[23] Typically also, she went quietly ahead with her plans to have the grocery store converted into a supermarket. In 1985 her daughter entered university to study, of all subjects, engineering. For one of her 1989 exams she drew up the construction plans for a supermarket precisely adapted to the site of the present grocery store.

[24] Whereas before, the role played by Laila had been less obvious to an outsider, and probably was more subtle, by the early 1980s she was obviously the one running the clothes shop and to some extent the grocery store.

[25] I was informed that this was normal practice, even though the law requires the conclusion of individual contracts. See Decision of the Minister of Manpower re the protection of casual/day workers, no. PER.06/MEN/1985, dated 12 September 1985. Instructions and money are given only to the foreman. In his turn, the foreman is responsible for work discipline among the labourers and for the safety of the building materials and the site. In my experience, foremen actually moved with their family into a shed on the building site and operated as *jaga* at night.

trucks for transport or the labour to load or unload them.[26]

Nevertheless, in view of the system of advance as well as step-by-step payments envisaged in the case of government contracts, Zafrullah felt his future looked pretty rosy in 1982.

By 1989, however, Zafrullah's venture in the construction world had effectively collapsed. The shed had become a dormitory. The timber was burnt for cooking rice. Zafrullah was evidently not giving any attention to his companies, and there was no trace left of the hustle and bustle of some years before. What had happened?

Laila told me that initially the project had looked pretty promising. She said that Zafrullah had secured some large contracts - a remarkable compliment from her, who had criticized the undertaking from the start. But he had no skill in chatting up persons who mattered, according to her. He had kept running around from one to the other, but with limited results. He would come home exhausted, and one day on his return home he had collapsed, bleeding from the nose. The problem was essentially twofold.

Firstly, in spite of the advance payments made in the case of government contracts, Zafrullah's companies were too thinly stretched financially. The system of staggered advance payments envisaged by the law did not run parallel with the flow of expenditures. The expenses are usually very high in the initial stages and lower in the final stages, and the law does not take this into account. Moreover, the law provides for advance payments on the basis of the contract value, but does not consider the various unofficial payments that have to be made to secure a contract in the first place. Secondly, as the government budget decreased in the later 1980s, the competition for government contracts grew increasingly stiffer and the slice of the cake ever smaller. All sorts of obscure wheelings and dealings took place. In one case Zafrullah obtained a contract but was compelled by the powers that be to transfer it to another company.

And so Zafrullah was slowly squeezed out of the market. Instead of engaging in building himself, he began to lend the name of his company to fellow-entrepreneurs who stayed on in the construction business. Zafrullah's companies were still listed in the register on the basis of which government contracts were awarded, and had become a front for the operations of other, politically more powerful entrepreneurs. When these entrepreneurs have received their full quota of government contracts as

[26] The driver functioned much in the same way as the foreman on the building site. I witnessed a deal as follows. A truck contracted to convey a load of sand was driving at walking speed along an alley where workers were waiting in the shade with their shovels. As the van passed, they walked up to it and dropped their shovel on top of it to indicate their preparedness to work. They then looked in the rear-view mirror for a sign from the driver that they had been taken on. Once the driver felt he had enough for the job (four to six men, as far as I was able to count), the van picked up speed and the remaining workers waited for a new opportunity.

stipulated by the law, they look around for other, dormant companies which may qualify for such contracts. They then 'borrow' such companies against 5% of the value of the contract. Formally speaking, everything is in order, as Zafrullah on paper is the holder of the contract - as indeed he is allowed by law to be. Yet, in fact, someone else does the work and reaps the main benefits.

F. Assessment

The above-described case represents an illustration of the cost-benefit analysis approach of the limited company in Indonesian commercial practice.

Why a limited company?
Whilst Zafrullah had been doing well with the clothes shops and the grocery store, there were limits to his growth here. But he wanted to grow further, and his natural inclination was towards the construction business. The principle that he would not work for private clients made him turn to the government for contracts. The advance payments provided for in the legislation governing government contracts constituted a relevant consideration as well, since he did not want to borrow money from the bank. Against this background it is natural that Zafrullah should have decided to establish a limited company.

Why two limited companies?
The nature of the legislation also helps explain why Zafrullah established two companies, as well as their respective sizes in terms of statutory capital. To begin with, it must be noted that none of his companies exceeded the prescribed capital ceiling of 100 million rupiah for a company to qualify as a member of the 'weak economic group'. Furthermore, in connection with the different size of their capital, these companies may compete for contracts of different sizes as envisaged by the legislation. This enhances the chances of securing a contract in two ways. First, each company may compete for a contract within its own category. Second, sub-contracting is an important consideration for the government in awarding contracts. The present set-up allows Zafrullah to sub-contract to his own company, thus increasing his chances of landing a contract, whilst benefiting himself just the same.

It is evident, then, that the companies have been set up with a view to optimizing the chances of securing government contracts.

What about assets?
The companies' assets were financial. They did not have any other assets, nor did they acquire these in the period they were in operation.

Both Zafrullah and Laila told me that the whole of the share capital for the two companies had been provided by the family. This appears to be in line with their principle not to borrow money from a bank. It is interesting to note three things in this context.[27] First, in both cases the companies have only issued the absolute minimum amount of shares prescribed by the law. The law requires that at least 1/5 of the statutory shares be actually issued, and Zafrullah's companies have not exceeded that minimum by a single share. Second, even as the difficulties began to mount in the course of the 1980s, no new shares were issued to raise extra capital. Third, although I could not get any information on the extent to which the issued shares had actually been paid up, this actually seems to be an irrelevant question. There are strong indications that company and private funds mixed freely, and if this is in fact correct, it is of no practical consequence whether shares have been paid for or not. Indeed, I believe that I was not able to obtain any concrete data on this subject from the family precisely because it was considered irrelevant. The strongest indication that private and company funds mixed freely is provided by Laila's protests that the profits from the clothes shops and the grocery store were being used to buttress the two limited companies. It was for this reason that Laila could not go ahead with her plans for building a supermarket with a *Kentucky Fried Chicken* restaurant on the site of the grocery store and that, ultimately, she condemned her husband's venture into the construction world.[28]

And so the picture presents itself of formal capital input being restricted to the absolute minimum required, with this not changing even when difficulties present themselves. There are strong indications that no distinction is made between private and company funds, and that private funds are injected when required.

How did the legislation function?

There can be no denying that in certain respects the legislation functioned as intended. Zafrullah's limited companies were duly established, contracts were concluded, construction materials and labour were acquired. Moreover, it can be deduced from Laila's reports concerning the first few years that advance finance was provided and profits were made.

Nevertheless, the legislation turned out to have some weaknesses as well. Some minor ones are the opportunity it afforded Zafrullah to control

[27] The Commercial Code makes a distinction between the shares listed in the articles of incorporation of a company (statutory shares), issued shares (i.e., those made available for sale), and issued shares that have been paid for - since there is no obligation for the full share value to be paid up. This obligation only arises when the company so requires.

[28] Interestingly enough, there was never any talk of money moving in the opposite direction, i.e., from the companies to the family. Nevertheless, the companies did yield profits at times, as Laila acknowledged, and with three children at university, these profits may have been siphoned off for private purposes.

companies in which he exercised no formal function, or to contract labour in contravention of the existing law in that field. Errors on the part of the government in connection with the administration of companies may also be mentioned in this context. The most fundamental weakness, however, concerns the administration of the legislation with respect to government contracts. This legislation is administered in such a way as to frustrate its fundamental aim, which is to spread the benefits of state funds over as wide a category of entrepreneurs in the weak economic sector as possible. This is manifest in a number of ways.

To start with, the system of patronage ensures that patron-less entrepreneurs have no access to contracts, legal guarantees notwithstanding. Thus, Zafrullah had to abandon his projects in spite of the fact that the system guaranteed him his quota of contracts. According to Laila, this was because he was no good at chatting up people. But there are other signs of the pervasiveness of patronage. For instance, how was it that Zafrullah was forced to abandon his projects while other entrepreneurs were able to secure contracts using his companies? Furthermore, the legislation has sufficient loopholes for someone else to be able to use Zafrullah's companies to benefit from government contracts. This is contrary to the aim of the legislation to spread the benefits over as large a group as possible. Instead, contracts and the profits therefrom are concentrated in the hands of a few.

Finally, the case of Zafrullah shows that, even after a contract has been awarded, the law offers insufficient guarantee that the contractor will be able to hold out against overwhelming pressure to transfer the contract to someone else. This is a further indication that patronage outweighs contractual rights.

G. Conclusion

When all is said and done, the above case suggests that, while legislation plays a guiding role in economic development, this role is different from what was intended by the legislator. The concept of cost-benefit analysis helps to explain why this is so.

As regards the limited company, this case supports Kaehlig's (1986) contention that companies are primarily established in order to attract credit, rather than to accumulate capital. Limited companies in Indonesia lack many of the important legal characteristics which should mark that type of venture according to the law. There seems to be no clear demarcation between company and private funds. Shares are irrelevant as a means of acquiring capital. Limited liability is of no practical consequence.

Nevertheless, limited companies do exist in this country. As regards the reason for this, I have indicated in this paper that the legislation concerning government contracts plays an important role here. Although in some cases this legislation operates as it should, in other instances it appears to

be misapplied, mainly under the influence of patronage. The main aim of this legislation, being the spreading of benefits amongst the group of beginning entrepreneurs in the weak economic category, is frustrated in a number of ways. Its present effect seems to be the concentration of the benefits in the hands of a few well-connected entrepreneurs.

There is nothing to suggest that Zafrullah, in establishing his limited companies, was guided by considerations which can be traced back to his Minangkabau background.

With regard specifically to the new regulation stipulating advance payment to the Goverment Printing Office in enforcement of the rule on publication of the articles of association in the State Gazette, the following can be stated. This regulation only increases the costs without providing additional benefit. It thus makes limited companies less attractive and more inaccessible for beginning entrepreneurs. If it is the Indonesian government's aim to stimulate the use of the limited company, it should offset this extra cost with some additional benefit.

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