AN INSIDER'S GUIDE

Indonesian BUSINESS CULTURE

ROB GOODFELLOW
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Preface

Simon Vickers

Cross-cultural understanding... in business as in other aspects of life, can be a fraught process. This book grew out of one kind of cross-cultural meeting; the contacts made between a group of Indonesians and Australians when they were studying at the University of Wollongong. The collective experience the authors bring to this book is an experience of mistakes learned by and insights into each other’s cultures, insights which they wish to share with a wide range of people.
Part Two
Understanding Islamic Banking

Since 1970 more than one hundred financial institutions specialising in the investment of funds according to strict Islamic principles have emerged. Some of these can be found in the Middle East, in countries such as Egypt, the Sudan, Saudi Arabia, Kuwait and Jordan. Some are in non-Middle Eastern countries where Muslims clearly constitute the majority of the population, such as Malaysia and Indonesia.

Significantly, some Western banks are adopting this alternative system. In July 1996 America's CitiBank opened the first Western-owned Islamic bank in Bahrain, committing US$20 million as start-up capital. While together the global Islamic financial network only controls about US$100 billion in assets, or about the same trading volume as a middle-sized Western bank, it is the potential of one billion prospective customers, from Bosnia to the United States (where incidentally there are eight million Muslims), that is attracting a great deal of interest. It must be remembered though that one fifth of this potential customer base is to be found in Indonesia—the world’s largest Muslim country.
In terms of understanding Indonesian business culture, Part Two of this chapter seeks to expand Western businesses' appreciation of Islam and Islamic financial practices through a further understanding of the influence of Islam over all sections of the Indonesian economy. This influence can be seen through the steady growth of Bank Mua'malat Indonesia (BMI), the Islamic Rural Banks or Bank Perkreditan Rakyat Syariah (BPRS) and the outstanding performance of Indonesia's fastest growing non-formal sector bank, the Baitul Maal Tamwil (BMT). Because of the rapid development of Islamic banking in Indonesia, it is useful for the Western businessperson to learn something about the history, development and influence of Islamic banking in Indonesia today, in order to be prepared for tomorrow.

The emergence of Islamic banking as an alternative to the Western model of banking in Indonesia raises a number of questions. What is an Islamic bank? How does it differ from Western convention? How is it managed or operated, and how is it possible to survive in the absence of interest-bearing operations? The answers to these questions are gaining an increasingly relevance for international commerce, as businesses all over the world come into contact with Islam and with Islamic banking practices. Significantly, as previously mentioned, Islamic banking has also captured the imagination of the West, having been established in a number of countries where Muslims are not in the majority, for instance Switzerland, the United Kingdom, Denmark, Cyprus, Luxembourg, India, South Africa, the Bahamas and the Philippines.
A Historical Overview

No one knows when banking as we understand it began. Modern monetary systems were probably a legacy of the Roman Empire, having been introduced by people from the East, either through India or West Africa. There is archaeological evidence to suggest that the Babylonian people applied borrowing systems, had a currency and practised complex credit contract systems sometime before 2500 BC. In turn, the Assyrians, ancient Greeks and later Romans used money to facilitate trade, exchanging different types of currency, accepting deposits for safekeeping and discounting credit notes from innumerable merchants across the provinces and vassal city states of the far-flung Empire. (It is said that the word ‘bank’ comes from the Italian word banco meaning ‘bench’, the place from where the merchants plied their trade.) A dishonest merchant could expect to lose both his customers and his bench—a situation known as bankruptcy.

From this point the history of banking in the West follows the fall of Constantinople and the rise of the Lombard goldsmiths, the creation of ‘goldsmith’s receipts’ or cheques, the advent of fractional reserve banking, the opening of the bank of Sweden in 1556, the Banco di Rialto in Venice in 1584, followed by the banks of Amsterdam and Hamburg in 1609. With the rise of the Bank of England, chartered in 1669, came the growth and expansion of capital, the development of concepts such as borrowed funds, surplus value, long-term lending and the establishment of a stock market. With these developments came the subsequent diversification of banking product into central, investment, mortgage, trading, savings and
commercial banking—basically into function and credit expansion and service rendering, both based on revenue raised by charging fees, or interest. Islamic banking, on the other hand, has its origins in the seventh century with the life and teachings of the Prophet Mohammed. However, in a formal sense the first bank based on Islamic Law or the Shari‘ah was not established until the late 1950s.

At this time, Muslim economists began to formulate a philosophical position against economic liberalism and capitalism—not as an expression of militancy or simply as an angry outburst against the West and international banking convention, but rather as a means of reconstructing the economy by drawing primarily on Islam’s own rich but neglected religio-cultural sources. The focus of this reconstruction was a fundamental re-evaluation of the ‘scientific’ approach to not only economics but life.

Islam specifically rejects the assumption that humankind is a self-sufficient, self-regulatory being. Consequently the social, economic, political and technological questions of what has been called ‘the human experience’ do not, under Islam, exist without reference to God. Hence Islamic economic development is not merely focused on growth models. The values associated with economics or politics are therefore intrinsic expressions of the Islamic faith. For Muslims, all activities can be classified as worship. As explained in Part One of this chapter, Islam is a way of life. Consequently Islam provides a complete guide for living. The founders of the first Islamic bank in Pakistan clearly understood this, as do the boards of BMI, BPRS and BMT in Indonesia.
However, due to their relatively new existence, Islamic banks have not developed the degree of diversification seen in their Western-style counterparts, although this may only be a matter of time. There has, however, developed a distinction in Islamic banking based on ownership and business motive. This includes banks which are fully owned by an Islamic government, owned by the private sector or owned and controlled internationally. So far there is only one Islamic development bank. This was established in Jeddah, Saudi Arabia in 1975. As its name implies, this bank was primarily concerned with assisting a number of other countries with non-commercial projects, such as research and education, as well as infrastructure developments such as irrigation, roads and communication systems. However, in terms of business motive, Islamic banks are distinguished as either commercial or development banks, with a third distinction of a Central Bank in Iran.

What distinguished the first and subsequent Islamic banks from Western convention is not the existence of surplus money arising from deposits, loans or credit, but rather in the way that the price of money is measured either to depositors or to borrowers. In fundamentally rejecting the use of interest as a reward or charge, Islamic banks aim to use a profit-sharing approach to both debtors and creditors. Essentially, then, Western-style banking cannot be separated from any product bearing interest, while Islamic banking cannot accept any product bearing interest. The reason for the prohibition of 'usury' or the charging of interest per se, is because it is believed by Muslims to be unjust in the Eyes of Allah. In the last part of the Koran it is written:
Deal not unjustly by asking more than your capital sums and you shall not be dealt with unjustly by receiving less than your capital sums. (Koran 2:274)

In stating the Islamic prohibition against usury or *riba*, it is interesting to note that the practice was also unacceptable according to the philosophies of Plato and Aristotle as well as the early Christian Church. Aristotle condemned it as an improper use of money and an illegitimate method of becoming wealthy. The early Christian Church also voiced its strong opposition to the practice. The theologian Tertullian (225 AD) recorded his concerns in a canon promulgated by the Council of Nicaea held in 325 AD.

At this point, it should also be explained that in addition to the charging of interest, there is an Islamic prohibition on other economic activities as well. These include hoarding in order to increase the price of certain goods or to satisfy greed, any form of gambling; the sale of *haram* or prohibited goods or alcoholic drinks, and finally, unjust brokerage.

What distinguishes Islamic banking and ensures that these prohibitions are not breached is the existence of Religious Supervisory Boards (RSBs). These have been formed to ensure that a bank's activities are run in conformity with the principles of Islamic Law, or *Shari'ah*. This Board is made up of Islamic scholars or Jurists, and is appointed by a decision of the bank's Annual General Meeting.
Islamic Banking Services

While a vast topic in itself, Islamic banking and accountancy can be better appreciated by briefly explaining some of the products or services offered. These include what are known as wadi’ab, murabahah, musharakah, bai bithaman ajil, bai‘ul-salam, ijarah, wakalah, qardhu ul-hasan, al-rahn, al-kafalah and jo’alab.

Wadi’ah

A wadi’ab is an agreement between a party who owns certain goods, including money, and another party, for example a bank to whom the goods are entrusted. If the wadi’ab is free of other conditions, the bank bears no responsibility for the loss, unless the damage is caused by bank negligence. In the wadi’ab, any benefit raised from the utilisation of entrusted goods or money belongs to the bank. Benefit to the owner of the goods or money can be derived from a non-withdrawal bonus agreement—the fundamental difference between a wadi’ab and interest being that the wadi’ab is a pre-negotiated arrangement which is determined by the viability of the project rather than on the market price of money.

Murabahah

A murabahah is an agreement between an owner of capital—in this instance a bank, though it may also be a private owner of capital or another custodian—and an entrepreneur, where the capital owner has agreed to provide the necessary funds for a particular project. In this case, the entrepreneur is fully responsible for the project's management. Any profit generated from these operations is fully divided into agreed portions. In the case of loss, the capi-
tal owner bears all the loss, while the entrepreneur loses only his or her agreed portion of any profit.

**Musharakah**
A *musharakah* is an agreement between two or more parties in which each group agrees in partnership to co-operate on a certain project within an agreed period. Each party contributes to the capital needed and agrees to divide the net profit or loss in terms of predetermined proportions.

**Bai bithaman ajil**
A *bai bithaman ajil* is a purchase agreement for a specific commodity between buyer and seller, where the seller will deliver a commodity immediately but the buyer will postpone payment until a certain time, or will pay on the basis of instalments. The price of a commodity can be higher than the cash price, but once the price is determined, the seller is committed not to change it. In this instance the bank acts as the capital owner purchasing the commodity and acting as seller.

**Bai’ul-salam**
*Bai’ul-salam* is the opposite of *bai bithaman ajil*. The buyer pays immediately, but the delivery is postponed until a certain period which is agreed in advance by both parties.

**Ijarah**
An *ijarah* is a rental agreement, or rather a form of contractual banking arrangement between an owner of a fixed asset (in this case a bank) with another party or bank. Rent is paid on an agreed amount.

Another kind of *ijarah* is a wage contract, again a form of contractual banking, where one party, or bank, agrees to
pay another party, or customer, for a service rendered.

Wakalah
A wakalah is a contract between two parties where the first is represented by the other in performing a specified task. The asset which is received by the representative in performing the task assigned is assumed as the wakalah.

Qardhu ul-hasan
Qardhu ul-hasan is a credit facility provided especially to those who are in a financially difficult position, particularly those who have incurred unavoidable expenses like the cost of health care, wedding festivities or education. The only obligation to be fulfilled by the borrower is to return the principal. In this instance the money is owned by the bank. Deposits are derived from profit-sharing deposit accounts. In qardhu ul-hasan no interest is charged. The bank does however cover its risk by an administration fee which is pre-negotiated according to the merit of the project and not according to the market value of money at the time.

Al-rahn
An al-rahn is an agreement between two parties where the first party borrows money with an assurance of a certain asset which is lent to a second party. In the case that the borrower cannot return the money, the asset can be sold and the money lender may take the amount of the loan. The excess money on the sold asset, if any, must be returned to the owner of the asset or the borrower.

Al-kafalah
An al-kafalah is a bank guarantee, that is, it is an agreement between two parties, in this case a bank and a client, where
the client performs some task or has to pay some amount to a third party. In this case, if the client fails to perform an agreed specific task, the bank will guarantee its performance. In return the bank pre-negotiates an administration fee.

Jo‘alah
A jo‘alah is a contract on the basis of one party undertaking to pay a specified amount of money to another party, in this case a bank offering a wide range of banking services, that is in accordance with the terms and conditions of the contract.

How Islamic banks generate income
Given the above, as an intermediary institution, an Islamic bank must also attract public deposits within the limits of the Shari‘ah or Islamic Law. The way this is achieved is by the wadi‘ah account, the profit-sharing murabahah savings account, and the murabahah deposit account.

The wadi‘ah account operates on the wadi‘ah principle which can be classified as yad amanah or without guarantee—but it can be used by the bank. As with a Western-style savings account, a client may withdraw funds at any time. In the case of the Bank Mua‘malat Indonesia (BMI), the client is rewarded with a bonus for not withdrawing before an agreed length of time.

The profit-sharing murabahah savings account accepts money on the basis of murabahah—the bank may utilise the money on a certain project. If the project makes a profit, it is distributed according to agreed proportions. One thing
that should be noted with this type of account is that the client can still withdraw funds at any time.

A *murabahah* deposit account acts as an entity which is entrusted to co-ordinated funds with clients acting as capital owners. As stated in the *murabahah* principle, when the particular project generates profit it will be distributed according to agreed proportions. However, if the project fails or incurs a financial loss, the capital owner bears the cost. Like banking in the West, an Islamic term deposit should state a specific period, such as six, 12 or 24 months.

Like any bank, Islamic banks are essentially financial intermediaries which bring lenders and borrowers together, manage risk and provide a range of peripheral services, including the transfer of funds and international exchange. Again, in Islamic banking, a fee is charged. However it must be stressed that this is not interest, because the amount is not connected to the market price of money but to the value of the service provided. It is in this way that Islamic banking products and services are fundamentally different to Western-style ones. In all other respects, however, the definition of banking remains.

Clearly Western organisations and individuals planning to conduct business in predominantly Islamic countries, like Indonesia, would be well served by making every effort to gain an appreciation of the philosophies and principles of Islam and Islamic economic practice, as well as the religious and historical factors which have led to the current development of a distinctive and uniquely Islamic system.
The Case of the Bank Mua’malat Indonesia

Although Muslims constitute the majority of the Indonesian population, an Islamic bank did not exist in Indonesia before the 1990s. Many believe that this situation was a consequence of restrictions raised by the Banking Act No. 14 (1967). However, the issuing of the ‘October Deregulation Package’ of 1988, and more recently the Banking Act No. 7 of 1992, have created the opportunity to operate a bank under Islamic or Shari'ah Law.

The new Banking Act specifies that there should be only two forms of bank in Indonesia: ‘general’ banking (bank umum) and a rural banking system (bank perkreditan rakyat or BPR). All Islamic banks in Indonesia are now categorised in this way. At the time of the most recent Banking Act there were three Islamic banks established: PT BPR Dana Mardhatilla, PT BPR Berkah Amal Sejahtera and PT Amanah Rabbabiah. All three banks are located in the Province of West Java, and take the form of rural banks.

The Bank Mua’malat Indonesia (BMI) was, however, Indonesia’s first and only Islamic commercial bank. BMI would appear to be better prepared than its rural counterparts. It employs experienced bankers, and has a wide customer base which includes non-government organisations, Muslim scholars and intellectuals, academics and state bureaucrats.

Since the legal form of BMI is a limited company, shareholders’ liability is restricted to the amount of capital for which they subscribed. The share capital of the bank is Rupiah 500 million; shares are valued at Rupiah 1000 per share (Rupiah 2454=US$1.00). Paid-up capital on 30
April 1994 was Rupiah 75 billion. After one year this had risen to Rupiah 90 billion, the following year to Rupiah 94 billion, and it continues to grow at the same rate.

As with other Islamic banks, the BMI is managed by three main bodies: the Board of Commissioners, the Shari’ah Supervisory Board (SSB) and the Board of Directors of Management. The Board of Directors and the SSB are responsible to the Shareholders’ Annual General Meeting, while the Board of Directors is responsible to both the Board of Commissioners and the SSB. Significantly, an SSB is compulsory in Indonesia for any bank which operates on a profit-sharing basis.

Here is an example of the way in which the BMI may enter into an Islamic banking transaction. A client wishes to fund a prawn dyke project, and wants *murabahah* financing for a project which requires Rupiah 5 647 000 for an original investment, and Rupiah 4 705 000 for working capital required every six months. The project sale is Rupiah 8 750 000 for each harvest, which would occur at six-monthly intervals. Let’s say the bank wants a revenue-sharing equivalent of 20% of the mark-up, and wants the project to be completed within 36 months. Based on this data, the relative distribution or loss can be calculated.

*Again, murabahah* operates with clients acting as capital owners. As stated in the *murabahah* principle, when the project generates profit, it will be distributed properly on the basis of a pre-agreed proportion. However, if the project fails or incurs a financial loss, the capital owner bears the loss. In reality, however, three possibilities may occur: first, what has been projected may actually happen; sec-
ondly, the revenue may be higher than the projected sale; and finally, the actual revenue may be less than the projected sale. Based on these possibilities, three calculations are made to describe how revenue will be shared between the bank and the debtor. This of course raises questions about accounting methods. One of the main issues that remains, for instance, is how the accounting of financing customers is carried out on the murabahah basis—that is, revenue-sharing as adopted by BMI rather than on ‘real’ profit- or income-sharing.

Since the existence of Islamic banking is a relatively recent phenomenon and accounting still operates in a capitalist environment, Muslim accountants from the Bank Mua‘malat Indonesia accept that current practices, such as accounting ‘revenue-sharing’ as opposed to ‘profit-sharing’, are acceptable in the short term only. In other words, this acceptance can be viewed as a tactic aimed at achieving more strategic objectives, such as reforming not only the banking system but also general methods of accountancy. Learning from Islamic history, we know that the Prophet Mohammed himself required a quarter of a century to impart the fundamentals of Islam to his companions and people. For this reason, the effort to establish a ‘more’ Islamic banking and accounting system in Indonesia is inevitable. Further, many Muslim accountants are strongly influenced by Western thought: they often erroneously believe accounting systems to be ‘value free’.

Given this, it is interesting to know that the Prophet Mohammed himself was the son of a merchant. As a young man the Prophet, who worked as the commercial agent of a wealthy widow, was evidently convinced of the necessity
for keeping accounts in a just and orderly manner. In fact, the Koran contains a clearly prescribed ordinance for maintaining good records:

O you who believe! When you contract a debt for a fixed period, write it down. Let a scribe write it down in justice between you. Let not the scribe refuse to write as Allah has taught him, so let him write. Let the debtor who incurs the liability dictate, and he must fear Allah his Lord and diminish not anything of what he owes. You should not become weary to write your contract whether it shall be small or big, for its fixed term, that is more just in the sight of Allah. (Koran 2:282)

It is interesting to also recognise that credit must be given to Middle Eastern Arabs who became acquainted with the concept of zero in the 13th century, subsequently spreading the use of algebra, mathematics and double-entry bookkeeping throughout the Islamic world, including Indonesia. Clearly the Prophet lived his earthly life in a culture that enjoyed a high level of commercial and accounting sophistication.

Conclusion

An analysis of the comparison between Western and Islamic banking demonstrates many similarities and some fundamental differences. The most important question concerns interest: usury or *riba*. On the one hand, interest remains the cornerstone of Western banking. On the other, in Islam the prohibition on interest is considered to be final. In turn this position has generated a number of alternative Islamic banking products and services which all reflect the profit-sharing remedy. Profit-sharing suggests a different type of relationship between creditor and
debtor, between capital and entrepreneur, and between bank and customer. This leads to an outcome-centred banking system that recognises a moral and religious component to commerce.

Islamic banking, then, seriously considers issues such as fairness, justice and accountability to God. The existence of Shar’iah Supervisory Boards (SSB) is testimony to this. In Islamic banking, economic decision-making is not the only objective. Rather, Islamic banking produces a shared desire to achieve the best possible outcome based on a division of profit that is not determined by fluctuations in the market price of money.

Finally, because Islamic banking is still in the early stages of development, there is a great deal of room for debate and discussion between Muslim scholars, accountants and bankers about the appropriateness of a particular banking product. According to the Prophet, ‘Difference of opinion among my people is a form of blessing.’

The relevance of this information to the Western, non-Islamic businessperson is that to understand Islamic banking is to partly understand Islam. And to understand Islam is to better understand Indonesia.