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The Regulatory Framework of Village-Owned Enterprise in Indonesia: Does It Conform with Good Corporate Governance Principles?

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ABSTRACT
The establishment of Village-Owned Enterprises ("BUM Desa") in Indonesia is expected to improve the village economy. Business entities like BUM Desa receiving capital from the public budget must apply Good Corporate Governance (GCG) principles, which include transparency, accountability, responsibility, independence and fairness. BUM Desa need to be managed based on these principles to reach their maximum potential and fulfil public accountability. A few studies have shown that many public organizations have not been able to ensure public accountability. Laws and regulations on BUM Desa do not specify and regulate GCG principles explicitly. Previous regulations actually contain clearer management principles in line with GCG principles. However, these have been revoked. This paper aims to examine and discuss the accommodation of GCG principles in the laws and regulations related to BUM Desa and the extent to which they intersect with GCG principles. It is part of a research project that examine the implementation of GCG principles in BUM Desa in North Sumatera region. Based on normative legal research, this paper concludes that the current legal framework on BUM Desa contains provisions which mirror the aspects of the GCG, in essence, aim to implement parts of the GCG. Unfortunately, it is still not adequately comprehensive. The legal framework should explicitly contain and adopt the principles of GCG, which consist of transparency, accountability, responsibility, independence and fairness. These principles must then be translated and formulated in such a way that it can be implemented in accordance with the capacity of BUM Desa to provide a comprehensive management and accountability standard for BUM Desa.
Keywords: *village owned-enterprise, BUM Desa, corporate governance*

1. INTRODUCTION

Before the Industrial Revolution, almost 90 percent of the world's population lived in rural areas. Today, rural areas still dominate various parts of the world, especially in Asia and Africa [1]. More than 45 percent of the Indonesian population reside in rural regions [2]. Rural areas play an important role in the development and efforts to create national stability.

One of the main objectives of village autonomy is to encourage development at the village level. Village governments have the authority to manage their economy independently by establishing Village-Owned Enterprises (otherwise known as *Badan Usaha Milik Desa* and hereinafter referred to as "BUM Desa") to improve the economy in rural areas. BUM Desa has both commercial and social orientation, to gain profits as a source of village income, as well as providing public service and improving the welfare of the village community as a whole. The establishment of BUM Desa is part of village-scale authority based on the principles of recognition and subsidiarity as embedded in the Law No.6 of 2014 (hereinafter referred to as "Village Law").

BUM Desa is considered to be an appropriate approach to develop entrepreneurship in the village. Entrepreneurship in rural development is beneficial as it provides villagers access to goods and services, promotes economic growth, reduces urbanization, promotes social security and welfare, as well as encouraging the creation of new business and jobs [3]. The concept of BUM Desa can also be seen in other countries. In China, for example, Township-Village Enterprises (TVEs), which have similar concepts to BUM Desa, became the main engines of rural industrialization. TVEs play an important role in developing entrepreneurship and have become engines of China's rapid economic growth [4].

Sound and professional management of BUM Desa is particularly important because it relates to the Indonesian Government's Village Fund program. In the 2019 State Budget Plan, the allocation of Village Funds reaches IDR 70 trillion, approximately three percent of the total budget

[5]. A major portion of this is allocated for the establishment of BUM Desa as one of the four priority uses of funds.

A number of studies have reported that when government organizations at the local level are provided with the authority to manage budgets, this has been accompanied by less than adequate financial accountability. In the paradigm of rural economic empowerment through the establishment of BUM Desa, this is alarming. A recent finding of the Indonesian State Audit Board (*Badan Pemeriksa Keuangan* or "BPK") showed that BUM Desa has not been able to make a significant contribution to the village economy. Based on a study conducted on 85 districts/cities in Indonesia, BPK found a considerable number of BUM Desa that were established without proper business feasibility study, did not have competent managers, were underperforming in administration and reporting, did not submit reports and were operating without having yet delivered benefits [6]. Various corruption cases of BUM Desa have also emerged [7].

Given the scale of budget allocations the government is contributing towards BUM Desa and some of the issues identified above, it is incumbent for the government to put in place mechanisms to make sure that this financial allocation is being managed effectively.

Other beneficiaries of public resources, such as State-Owned Enterprises (*Badan Usaha Milik Negara* or "BUMN") and Regional-Owned Enterprises (*Badan Usaha Milik Daerah* or "BUMD") are subject to rigorous transparency and accountability mechanisms. This paper argues that the effectiveness of BUM Desa would benefit from similar Good Corporate Governance (GCG) principles being applied at this level, which include transparency, accountability, responsibility, independence and fairness. The current legal framework does not provide sufficient clarity concerning the application of GCG for BUM Desa.

2. METHOD

This paper aims to examine and discuss the accommodation of GCG principles in the laws and regulations relating to BUM Desa and the extent to which they intersect with GCG principles. It is based on the normative legal research method using secondary data. Data were obtained through library research by analyzing relevant laws, documents, journal articles, and literature. The data was then analyzed qualitatively, and then conclusions were drawn.

3. DISCUSSION

A. Good Corporate Governance Revisited

1) General Concept of Good Corporate Governance

Corporate governance can be defined as the process and structure of the management of the business and other company affairs to improve corporate prosperity and corporate accountability with the main goal of realizing optimal shareholder value in the long term and by taking into account the interests of other stakeholders [8].

There is no single definition of corporate governance, and there is no theory of corporate governance that is universally accepted. The Cadbury Report identifies three general principles: openness, integrity and accountability. These are commonly viewed as the starting point for corporate governance laws and principles developed by national governments and international organizations, including the Organization for Economic Cooperation and Development (OECD).

However, beyond this, many variables must be taken into account. These variables differ in each country, depending on prevailing social, economic and political conditions [9]. Besides, corporate governance rules continue to evolve, at a different pace and in different directions across countries, to meet the demands of various domestic and international forces such as technological innovation, financial liberalization and globalization to achieve the ideal corporate governance [10].

The concept of corporate governance first emerged at the international level due to cases of financial fraud in developed countries like the USA, UK and Italy. This resulted in national governments and various bodies, making an effort to initiate changes by revising and toughening the laws on corporate governance. This includes introducing sanctions for companies that do not adopt ethical and transparent policies. These are then translated into corporate governance codes [11]. These days, most developed and developing countries, including Indonesia, have a Corporate Governance Code.

According to Claessens and Yurtoglu, the application of GCG by business entities brings several benefits, namely:

a. Better access to external financing, which in turn will increase investment, higher growth and create more jobs.
b. Lower costs and higher value from business entities, which can also attract investment and job creation
c. Better decision-making strategies and operational performance through better allocation of resources and more efficient management, which in turn will increase assets.
d. Lower risk of crisis and scandal.
e. Better relations with various stakeholders, which in turn can reduce poverty and injustice (inequality) [12].

In Indonesia, the GCG concept began to emerge when the 1997 economic crisis hit the country. Poor corporate governance exercised by Indonesian companies and banks were to blame [13]. In response to this, the national government started to take GCG more seriously, in part due to commitments under the bail-out programs with international institutions. These commitments included the establishment of an institution, known today as the National Committee on Governance Policy (*Komite Nasional Kebijakan Governance* or "KNKG"), which subsequently formulated the Indonesian Guidelines of Good Corporate Governance (Indonesian GCG Code).

The KNKG has identified five principles of GCG in Indonesia: transparency, accountability, responsibility, independence and fairness. Transparency refers to disclosure and providing adequate and easily accessible information to stakeholders. Accountability refers to the clarity of functions within the company and how to account for them. The company, therefore, should be managed properly following the interests of all stakeholders. Responsibility requires companies to comply with laws and regulations and act in good faith to ensure businesses maintain a sustainable relationship with communities and the environment in which they operate. In other words, they prioritize good corporate citizenship over the longer-term. Independence means that the company must be managed independently so that each organ of the company will not dominate each other and cannot be intervened by any party. Fairness requires that companies treat stakeholders equally, including through providing equality of opportunity. Companies should apply principles of fairness both to shareholders and stakeholders [14].

The principles outlined in this Code have become embedded in related laws, including the Company Law, Banking Law, Capital Market Law and Investment Law. Moreover, laws relating to BUMN and BUMD has also been strengthened to conform to the GCG principles.

2) Good Corporate Governance in the Public Sector

Good governance in the public sector is as crucial as for the private sector. This is even more so because the public sector deals with the use of public money in relation to providing public service and achieving public welfare. The applicable principles of corporate governance in the public sector are similar to those for companies in the private sector. Just like managers acting as agents for the best interest of shareholders, officials in the public sector (including the managers of state-owned ventures) act as the agent of taxpayers to serve the best interest of the general public [15].

The governance issue in the public sector is even more challenging. Systems of governance need to be structured to balance sufficient accountability that provides assurance to the multiple stakeholders while avoiding the negative effects of overly bureaucratic control [16]. In a corporate governance perspective, state-owned companies, for example, faces a different and more complicated agency issues compared to private companies.

In principle, every business entity whose capital is sourced from public finance must implement GCG. The implementation of GCG is an implication of the corporatization approach in managing public economic institutions to insert corporate culture in delivering public service. Valkama further explains that the process of corporatization implies:

> "a set of administrative actions that convert a non-independent public sector entity into a legal person in the nature of an enterprise with a corporate style capacity to have the competence that is separated from the owners of the company" [17].

The corporate form then becomes the vehicle for the government's business, together with work contracts and trade relations, resulting in a combination of continuity and flexibility in running a business [18]. Corporatization of economic institutions whose capital is sourced from public finance, such as state-owned companies, is also in line with the concept of the New Public Management (NPM) [19].

In the context of the Indonesian public sector, this is in line with the concept of "*kekayaan yang dipisahkan*". *Kekayaan yang dipisahkan* (separated asset) refers to a phrase stipulated in the law referring to assets from the public budget placed in a different economic entity in a corporate form to be managed for commercial objectives.

B. Good Corporate Governance in BUM DESA

1) BUM Desa v. BUMN and BUMD

The existence of BUM Desa as an economic institution in Indonesia has been recognized since 2004. However, with the issuance of the Village Law, BUM Desa has entered a new dynamic. The issuance of the law has resulted in a shift in the concept of the village, which was originally a local state government, into a community government, a mixture of a self-governing community and local self-government. This shift has influenced the BUM Desa concept.

In theory, the position of BUM Desa is similar to BUMN at the national level and BUMD at the local government level. In BUMN, government ownership is represented by the Minister, who is appointed and authorized to represent the government as a shareholder. In BUMD, regional government ownership is represented by the regional head (i.e. Governor). Taxpayers and the public as the ultimate owners have no power to exercise rights as shareholders. Such rights in factual terms can only be exercised by the government/local government.

In BUM Desa, however, the village community plays a more direct role in its management. BUM Desa is established based on community initiatives and is based on the potential that can be developed using village resources. The establishment of BUM Desa must be agreed in the village conference ("*musyawarah desa*"), involving all components of the community. The role of the central and local government, in this case, is to motivate villages to establish BUM Desa and provide the necessary education, training and other means to do so. The operational mechanism is, thus, left to the village community.

Despite the distinguishing aspect, the three entities share one common characteristic. The assets or funds placed in BUMN, BUMD and BUM Desa are all treated as *kekayaan yang dipisahkan* (separated assets) that are managed autonomously and professionally. This separation draws a line of management and financial accountability of the funds.

2) Legal Framework for Good Corporate Governance in BUM Desa

The philosophy behind the establishment of BUM Desa is similar to that of a company, which is to accumulate capital. Capital accumulation in a company is for the benefit of investors (shareholders). For BUM Desa shareholders are villagers and, as a result, the benefit is for the community. Therefore, applying GCG principles in

BUM Desa is as important as applying them to companies in general.

According to the current legal framework, BUM Desa can form business units that can be incorporated as limited liability companies (*perseroan terbatas* or "PT") and control them in a holding structure. BUM Desa is responsible for the loss of business units they control. Poor management and the complexity of the activities of business units can affect village finance.

The law also stipulates that BUM Desa can form business units in the field of microfinance (*Lembaga Keuangan Mikro* or "LKM"). As a form of financial services, this also requires the application of GCG because it introduces more complex potential risks which can ultimately affect BUM Desa and village finance in general.

Moreover, the development of information technology will enable BUM Desa to utilize technology in running BUM Desa business. With adequate resources and capital, the BUM Desa business network can cross village boundaries. Cross boundaries activities are also in line with the concept of a joint BUM Desa ("BUM Desa *Bersama*") formulated in the law. BUM Desa *Bersama* is a BUM Desa established and owned by two or more villages. The complexity of the risk becomes higher and therefore needs to be controlled with a good system. Good governance can be a solution.

As explained by Mulgan (2013), accountability deficit is one of the negative effects of decentralization. Professional management of BUM Desa is important because it relates to the Indonesian Government's Village Fund program. Accountability can be upheld through professionalism and the application of GCG principles, which include transparency, accountability, responsibility, independence and fairness.

In addition to the creation of professionalism, the essential impact of implementing GCG is to clarify the position and distribute the roles and responsibilities of each organ of BUM Desa. Moreover, it is also important to minimize various financial accountability issues like corruption. However, inserting professionalism in managing BUM Desa does face a challenge of its own because it can be analogous to introducing a 'white-collar' work style to village communities, which are generally more identical to blue-collar or manual work. One of the biggest challenges to date is the competence level of management in running business.

For BUMN, Law No.19 of 2003 stipulates that BUMN needs to foster corporate culture and professionalism, among others, through improving management and supervision. Beyond the village level, management and supervision of SOEs must be based on the GCG principles. This is regulated in the SOE Ministerial Regulation No.PER-01/MBU/2011 that requires BUMN to adhere to the five key principles of GCG. Government Regulation No.54 of 2007 also set the same regulatory standard for BUMD.

The current legal framework of BUM Desa, however, does not make any explicit reference to the principles. The legal framework includes the Village Law, Government Regulation No.43 of 2014 ("PP 43/2014"), which is further regulated in The Minister of Village, Disadvantaged Regions and Transmigration Regulation No.4 of 2015 ("Permendesa 4/2015").

BUM Desa are further regulated in local laws. Most regencies issued local laws on the establishment and management of BUM Desa. Most local laws on BUM Desa contain the same general provisions as the provisions in PP 43/2014 and Permendesa 4/2015. These local laws then become the basis for village regulation ("*Perdes*") on the establishment of a BUM Desa in a village.

The previous technical regulation, the Minister of Internal Affairs Regulation No.10 of 2010 (revoked and replaced), stipulated that the management of BUM Desa shall adhere to the principles of transparency, accountable, trustworthy and rational, which intersect with the GCG principles. However, these principles were not included or even supplemented and clarified in the subsequent regulation.

The Minister of Home Affairs Regulation No. 20 of 2018 concerning Village Financial Management requires that village finances are managed based on the principles of transparency, accountability, participation and are carried out in an orderly and budgetary discipline. Do these principles of village finance apply to the management of BUM Desa? Some people would argue, yes. However, it should be reemphasized that assets in BUM Desa are assets separated from the village budget to be managed autonomously. The administrators of BUM Desa are fully responsible for the management of BUM Desa. In the realm of corporate law, this separation is important to provide autonomy for administrators to manage BUM Desa professionally and clarify the lines of accountability between the village and BUM Desa as a separate economic entity. In principle, therefore, BUM Desa should be regulated and subject to a separate and more specific set of standards. Due to the shared characteristic, BUM Desa should also naturally be subject to the same GCG principles applied to BUMN and BUMD.

Permendesa 4/2015 as the most technical legal reference contains eight related articles concerning corporate governance of BUM Desa, as the implementation of the provisions of PP 43/2014 and the Village Law. Although there is no explicit reference to the five GCG principles, the legal framework of BUM Desa contains provisions that, in essence, maybe in line with the principles. For some instances, they can be interpreted to be consistent with some of these principles; they reflect the principles; they overlap with the principals but remain ambiguous. In other instances, the principles are not represented.

a) Accountability

In essence, the distribution of role and duties between organs is in line with the principle of accountability. For the distribution of roles and responsibilities, Article 10 of Permendesa 4/2105 stipulates that BUM Desa organs consist of *penasihat* (advisor), *pelaksana operasional* (administrator) and *pengawas* (supervisor). Each organ can be addressed with a local term of each village.

However, PP 43/2014 as a higher law stipulates that the organs of BUM Desa must at least comprise advisor and administrators. The phrase “at least” in the article allows the technical regulation to regulate other organs. This may result in two approaches in BUM Desa management, one with supervisor based on PP 43/2014 and the other without supervisor based on Permendesa 4/2015. Subsequently, this means that BUM Desa supervisory organ as regulated in the Permendesa 4/2015 is lacking a regulatory basis in a higher law that underlies the provision. PP 43/2014 would not be able to clarify potential legal issues related to the position of supervisors. Legal issues include potential conflict of interest that can occur regarding who can fill the supervisor positions because the regulations do not provide clear guidelines and restrictions on the criteria to uphold GCG practices.

The BUM Desa advisor is ex officio held by the village head. The advisor’s main task is to provide advice and opinions to administrators in managing the company.

The administrators must manage the company in accordance with the charters and bylaws. They must ensure that the BUM Desa serves the economic needs or provide public services to the villagers, explore and utilize the economic potential of the village and create income and cooperate with other village economic institutions. PP 43/2014 stipulates that the management of BUM Desa becomes the responsibility of the administrators. In other words, all business risk of BUM Desa becomes the personal risk of the administrators.

The supervisors are acting for the interest of the village community. It must hold a General Meeting to discuss the performance of BUM Desa at least once a year. In these general meetings, supervisors are required to discuss business development policies of the company, monitor and evaluate the manager’s performance, and, at relevant times, administer the election and appointment of the board of supervisors.

The Permendesa 4/2015 regulates further that the administrators can appoint other management members, especially for accounting, administration and operational functions of the company, and also employ employees as needed with a clear description of responsibilities and division of work.

It can be seen that in general, the existing legal framework has regulated the duties and authorities of each BUM Desa organ. However, there is no clearly defined stipulation on work relations, ethical relations and legal relations between the organs in BUM Desa management. These are left to the governance mechanisms set out in the charters and bylaws.

b) Independence

PP 43/2014 set out the general rule that village officials and officials of village community institutions (*lembaga kemasyarakatan* desa) are not allowed to take part in BUM Desa management as administrators. This provision may reflect the principle of independence out of the five GCG principles. It is unclear, however, whether the prohibition also extends to BUM Desa supervisors. It is also unclear whether BUM Desa administrators can do other jobs, including government job outside the village structure. Furthermore, it is unclear whether the member of the Village Consultative Body (*Badan Permusyawaratan Desa* or “BPD”—similar to village parliament) is allowed to become administrators. Permendesa 4/2015 does not regulate these matters.

In practice, many administrators do have two or more jobs. Some BUM Desa do not provide a salary for the administrators. They only get a percentage from the company’s profit at the end of each financial year. Many BPD members also serve as administrators of BUM Desa. Such practices do not fully reflect the principles of GCG, specifically the aspect of independence, because they open up possibilities for various conflicts of interest.

Permendesa 4/2015 also requires the advisor to control the management of BUM Desa. Hence, it is not clear to what extent BUM Desa managers can exercise managerial autonomy.

Furthermore, PP 43/2014 also stipulates that the management (administrators and supervisors) are appointed and dismissed by the village head. Nevertheless, this provision is in conflict with Permendesa 4/2015 which regulates that the village community selects the organizational structure of BUM Desa through a village conference based on the procedure set in the related ministerial regulation.

c) Transparency

PP 43/2014 prescribes that the administrators must submit reports on BUM Desa management regularly. The Permendesa 4/2015 further regulates that the administrators are authorized to make monthly financial reports and activity progress reports of the company’s business units and provide the business units progress report to the village community through the village conference at least twice a year.

The submission of the report to the village head and village conference is in principle in accordance with the principle of transparency. However, the phrase "authorized" (*berwenang*) in the said regulation gives the impression that this is more a right rather than an obligation or duty. Furthermore, the laws provide no further details on the standard and the mechanism of reporting. This matter, along with the competency of management mentioned above, might explain the current accountability problems of BUM Desa.

The laws and regulations provide no specific provision that may reflect the principles of responsibility and fairness in BUM Desa management

The current legal framework on BUM Desa leaves more detailed governance measures of BUM Desa to charters and bylaws set by Perdes. The minimum content of charters and bylaws set by PP 43/2014, however, is insufficient to reflect the application of GCG principles.

The application of GCG principles in BUM Desa requires further regulation in a number of other bylaws documents, such as code of GCG, Code of Conduct, governance manual, internal supervision system, key performance indicators, risk management guidelines and procurement guidelines. As these important points are not regulated in the existing BUM Desa regulations, they should, at a minimum, be accommodated in the charters or bylaws documents that are produced internally by the BUM Desa. Assuming that the level of experience and education of the village community is still lacking, external interventions may be required to emphasize the existence of a minimum standard of charters containing the norms of BUM Desa management.

In principle, BUM Desa is not as complex as other companies that are subject to GCG principles standards (like BUMN, BUMD, publicly listed companies and direct investment companies). Therefore, the application of GCG in BUM Desa should not be fully equated with the application of GCG principles in these companies. The implementation model of GCG principles should be formulated in such a way that it can be implemented based on the capacity of BUM Desa (in particular the ability of human resource and the character of the business unit being run).

4. CONCLUSION

The legal framework of BUMN and BUMD explicitly adopt the five GCG principles, the BUM Desa legal framework does not. The legal framework contains provisions which mirror aspects of the GCG, in essence, aim to implement parts of the GCG. Unfortunately, it is still not adequately comprehensive.

BUM Desa have great economic potential and, therefore, needs to be managed professionally to be able to reach their full potential and fulfil the accountability. BUM Desa management must be supported with a stronger legal framework to ensure more detailed and clear management standards.

The legal framework of the BUM Desa should explicitly contain and adopt the principles of GCG consisting of transparency, accountability, responsibility, independence and fairness. These principles must then be translated and formulated in such a way that it can be implemented based on the capacity of BUM Desa to provide a comprehensive management and accountability standard for BUM Desa.

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