CORPORATE ELIGIBILITY TO CONDUCT INITIAL PUBLIC OFFERINGS IN INDONESIA: AN EXAMINATION OF THE DISCLOSURE PRINCIPLE

Dewi Kurnia WIDYASTUTI

Bachelor of Laws (*Universitas Diponegoro)*, Master of Laws (*Universitas Diponegoro*)

This thesis is a partial fulfilment of the requirements for the degree of Master of Research (MRes)

Macquarie Law School

Faculty of Arts

Macquarie University

29 June 2016

Declaration

The work presented in this thesis is, to the best of my knowledge and belief, original except as acknowledged in the text. I hereby declare that I have not submitted this material, either in full or in part, for a higher degree to any other university or institution.

……

Dewi Kurnia WIDYASTUTI

Macquarie University

Sydney, June 2016

Acknowledgements

Sincere thanks to my supervisor, Professor M. Rafiqul Islam, who gave me valuable feedback on the thesis. My appreciation to Dr. David Mullan for his constructive suggestions on conceptualising my thesis. Thanks also for the academic and technical support from Macquarie Law School and Higher Degree Research staff.

I acknowledge the Australian Awards Scholarship and the Indonesian Financial Services Authority, without whose financial support I could not have undertaken my studies.

Finally, my gratitude to my loving family; my father, mother, and my two lovely daughters; Mabel and Alea.

List of Legislation

Law No. 8 of 1995 on Capital Market.

Rule No. IX.A.1 of Bapepam-LK Concerning General Requirements Regarding Submission of a Registration Statement.

Rule No. IX.A.2 of Bapepam-LK Concerning Registration Procedures for a Public Offering.

Rule No. IX.A.3 of Bapepam-LK Concerning Procedures for Requesting Amendments and or Additional Information to a Registration Statement.

Rule No. IX.A.4 of Bapepam-LK Concerning Procedures for Suspending of a Public Offering.

Rule No. IX.A.5 of Bapepam-LK Concerning Offering That Are Not Considered To Be Public Offerings.

Rule No. IX.A.6 of Bapepam-LK Concerning Restrictions on Shares Issued Prior to Public Offering.

Rule No.IX.A.7 of Bapepam-LK Concerning Responsibilities of Underwriters with Respect to Subscriptions and Allotments of Securities in a Public Offering.

Rule No. IX.A.8 of Bapepam-LK Concerning Preliminary Prospectus and Information Memorandum.

Rule No. IX.C.1 of Bapepam-LK Concerning the Form and Content of a Registration Statement for a Public Offering.

Rule No. IX.C.2 of Bapepam-LK Concerning Guidelines Concerning the Form and Content of a Prospectus for a Public Offering.

Rule No. IX.C.3 of Bapepam-LK Concerning the Form and Content of a Summary Prospectus for a Public Offering.

Rule No. IX.I.6 of Bapepam-LK Concerning Director and Commissioner of Issuers and Public Companies.

Rule No. IX.E.2 of Bapepam-LK Concerning Material Transaction and Changing in Core Business.

List of Cases

Indonesia

Abdul Malik Jan v. PT Media Nusantara Citra Tbk., et a.l, District of Central Jakarta Court Decision No 29/PDT.G/2011/PN.JKT.PST (21 June 2011).

Siti Hardiyanti Rukmana et al. v. PT Berkah Karya Bersama et al., The Supreme Court Decision No. 862K/Pdt/2013 (2 October 2013).

PT Berkah Karya Bersama et al. v. Siti Hardiyanti Rukmana et al., The Supreme Court Decision No. 238 PK/Pdt/2014 (29 October 2014).

United States

Grayned v. City of Rockford, 408 U.S. 104, 108 (1972).

TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 450 (1976).

List of Abbreviations

Bapepam-LK	(Badan Pengawas Pasar Modal dan Lembaga Keuangan, Indonesian Capital Market and Financial Institutions Supervisory Agency)
BB	(PT Blue Bird, Tbk)
BBR	(PT Bina Buana Raya, Tbk)
BKPM	(Badan Koordinasi Penanaman Modal, Investment Coordinating Board)
EGMS	(Extraordinary General Meeting of Shareholders)
FGD	(Focus Group Discussion)
GLP	(PT Graha Layar Prima, Tbk)
IDX	(Indonesia Stock Exchange)
IPO	(Initial Public Offering)
MNC	(PT Media Nusantara Citra, Tbk)
OJK	(Otoritas Jasa Keuangan, Financial Services Authority)
TPI	(PT Televisi Pendidikan Indonesia)

Table of Contents

Abstract

In capital markets, disclosure is the main source of information for investors. One of the most important types of information in disclosure is information about a company's legal non-compliance. Information about a company's legal non-compliance is not only socially significant but also financially important as it may lead to hefty penalties, loss of contract and other economic effects. However, in contrast to financial information which is quantitatively measured, the consequences of non-compliance often involve a qualitative aspect making it difficult to articulate its materiality.

This study is doctrinal legal research and it sets out to evaluate whether the enforcement by the Indonesian Financial Services Authority (OJK) of its disclosure policy on legal non-compliance is sufficient to protect the investing public. The study aims to mitigate the impact of information asymmetry due to incomplete disclosure of corporate legal non-compliance as well as to enhance corporate accountability to shareholders for company illegality. It argues that factors such as materiality, regulatory capture, and the roles of securities lawyers have been creating inconsistencies in OJK's implementation of its legal non-compliance disclosure policy. The outcome of this study would be useful to articulate lessons for other developing capital markets, particularly those with conditions of legal uncertainty similar to those in Indonesia, in advancing the goal of disclosure.

Chapter I

Introduction

Background of the study

Every year, there is an increase in the total number of companies raising capital by issuing their shares to public investors. This enthusiasm demonstrates the significant level of interest from entrepreneurs in viewing Initial Public Offerings (IPOs) as fulfilling 'a need for expansion capital, a desire to obtain greater public visibility for the company, the ability to use stock in place of cash for future mergers and acquisition, tax and estate planning, and the insiders' desire to receive cash compensation for their early entrepreneurial efforts'.[1] Despite the complexity of the IPO process, especially for established businesses, selling shares to public investors is a beneficial strategy in acquiring fresh funds compared to loan-based financing due to the latter's repayment requirements.[2]

In order to generate desirable investment growth from stock trading activities, a strong securities market is required.[3] Furthermore, a robust securities market does not exist without tenacious efforts from a range of actors, including the capital market regulator, stock exchange, securities lawyers, underwriters, market analysts, etc. These efforts inherently depend on market-supporting institutions that effectively carry out their respective roles, with the support of sufficient infrastructure and efficacious regulations with the main aims of protecting the investing public from the risk of information asymmetry and also from fraudulent acts by corporations.[4]

In capital markets, disclosure is the underlying source of information for investors. Disclosure aims to protect investors' interests by alleviating information asymmetry and

---

[1] Michael L. McBain and David S. Krause, 'Going Public: The Impact of Insiders' Holdings on the Price of Initial Public Offerings' (1985) 4(6) *Journal of Business Venturing* 420.

[2] Neil Kokemuller, *What Are the Advantages & Disadvantages of Selling Stock to Raise Funds for a Small Business*, Chron <http://smallbusiness.chron.com/advantages-disadvantages-selling-stock-raise-funds-small-business-46585.html>.

[3] See Bernard S. Black, 'The Legal and Institutional Preconditions for Strong Securities Markets' (2001) 48(4) *UCLA Law Review* noting that in weak capital market, the companies rely on internal financing or debt as the source of financing.

[4] Ibid 783.

preventing fraud. Accordingly, it is important to ensure the reliability and adequacy of disclosure for the protection of the investors. However, reducing information asymmetry, if it cannot be eliminated altogether, is a complicated and challenging task. Especially in the case of IPOs, potential investors may find it difficult to assess the veracity of the information provided by the issuing company because they have no previous encounters by which to indicate the company's quality.[5]

One of the most important types of information in disclosure is information about a company's legal non-compliance. Legal non-compliance includes violation of laws or legal deficiencies whether generally or specifically applicable for the type of industry, expiring agreements, breaches of contract, and legal disputes (litigation or non-litigation). Information about legal non-compliance is significantly important for the investors as it bears economic consequences to business continuity.[6] However, in contrast to financial information which is quantitatively measured, the consequences of non-compliance often involve a qualitative aspect making it difficult to articulate its materiality. The question of materiality becomes a source of potential embroilment amongst regulators, securities lawyers, companies, as well as investors. Further, the company's legal non-compliance often causes delay in obtaining the effectiveness to the registration statement from the Indonesian Financial Services Authority (OJK).

This study is doctrinal legal research and it sets out to evaluate whether OJK's enforcement of its disclosure policy on legal non-compliance is sufficient to protect the investing public. This evaluation will be achieved by conducting analysis on the factors, challenges, and enforcements that would influence the extent of OJK's policy-making process in regard to disclosure and materiality of a company's legal non-compliance. The study aims to mitigate the impact of information asymmetry due to incomplete disclosure of company legal non-compliance as well as to enhance corporate accountability to shareholders for company illegality.

[5] Ibid 786.

[6] Cynthia A. Williams, 'The Securities and Exchange Commissions and Company Social Transparency' (1999) 112 (6) *Harvard Law Review* 1278.

Study justification

The reason for emphasising this study on disclosure derives from the recognition of disclosure in the Indonesian securities market regulatory framework as the sole mechanism to assess corporate liability in conducting an IPO. Particularly when OJK does not obtain any legal basis to issue a stop-order or dismiss a Registration statement, it becomes more important for disclosure to be improved in standard and quality. As significant as it is for the protection of the investors, formulating an effective disclosure policy is not a simple task. Serving as the epitome of investor protection, disclosure works by reducing information asymmetry to prevent fraud by the issuing corporation. Nevertheless, the extent of disclosure's effectiveness in its ability to achieve its goals varies, substantially depending on how stringent the authority enforces its discretion to yield concrete benefits in protecting the investors, despite external and internal influences.

The extent of enforcement has important consequences on promoting market support to bolster investment growth. Yet this enforcement of disclosure has been questioned in several cases where disclosure has failed to achieve its goal of protecting shareholders.[7] To date, there are two different cases on disclosure matters which involve OJK as defendant; a report to the Ombudsman, as well as law suits, over OJK's decision to allow the Registration statement of PT Blue Bird, Tbk (BB) and PT Media Nusantara Citra, Tbk (MNC) to become effective when these companies had been facing intellectual rights and ownership disputes at the time of their IPO. Taking those cases into account, this study attempts to propose possible ways to improve the current procedure of OJK in enforcing disclosure as a policy matter, particularly in dealing with disclosing legal non-compliance with the possibility of financially-material impacts.

Significance of the study

This study is crucial for three main reasons. First, it will contribute to the advancement of knowledge on the role of disclosure in disciplining corporate conduct and protecting the investing public in relation to IPOs proceeding or otherwise. Second, the findings of

[7] Joseph A. Franco, 'Why Antifraud Prohibitions are not enough: The Significance of Opportunism, Candor and Signaling in the Economic Case for Mandatory Securities Disclosure' (2002) 2002(2) *Columbia Business Law Review* 245.

this study will help to promote wider understanding among the OJK officials, legislators, and policy makers about the importance of disclosure in preserving capital market integrity. It is hoped that the capital market regulator will be better able to change its actions and attitudes to provide greater protection for the investors. And finally, this study attempts to articulate lessons that other countries' disclosure regimes with a situation similar to Indonesia can learn on how to discipline corporate conduct.

Research methodology

This study in particular discusses the enforcement of disclosure to mitigate the problem of information asymmetry in legal non-compliance, in regards to the issuance of new shares, without ignoring the monitoring aspect of disclosure. Due to the lack of empirical study and published data or articles relating to the disclosure policy in Indonesia, this study will mainly use foreign secondary sources relatable to Indonesian capital market regulations.

This study will employ doctrinal and library-based research through primary and secondary sources of law that are relevant to answer the research question. Primary sources such as legal documents, court proceedings, prospectus, statistical data, and news, are beneficial in exposing this research to the first-hand materials as a basis for in-depth analysis about OJK's disclosure policy on financially-material information and its implementation. Further, this study also critically examines books, articles, and internet sources as sources for interpretation and analysis, in regards to understanding the benefits, drawbacks, and challenges of disclosure to propose the best possible approach to ensure corporate compliance with an extended disclosure policy and therefore to maximise the intended impact of disclosure to protect the investing public.

Rationale for methodology

The selection of the methodology used in the study is guided by the research question (which seek to evaluate whether OJK's enforcement of its disclosure policy on legal non-compliance is sufficient to protect the investing public), the contributions expected from

the research, and the approach utilised in the research.[8] In regards to the normative character of the research question, this study is conducted using doctrinal legal methodology[9] which allows this study to analyse the concept of disclosure and examine the efficacy of the disclosure principle in the Indonesian capital market by investigating the factors, challenges, and enforcements that would influence the decision-making process of OJK in regard to disclosure and materiality of a company's legal non-compliance.

Doctrinal legal methodology is appropriate to investigate the legal framework that become the basis of OJK in conducting examination process towards a corporate's Registration statement in the IPO process. The legal framework includes the duties and functions of OJK and the regulations that underlie the scope of work and the authority of the OJK to pursue greater disclosure on corporate legal non-compliance. Further, doctrinal analysis is needed to critically examine the strength and weakness of OJK's disclosure and materiality policy, and to evaluate the corporate's accountability to its shareholders in case of legal non-compliance.

Synopsis of the study

Chapter one provides background information on the study, study justification, significance, as well as the research methodology that will be employed in this study.

Chapter two begins with the discussion on Berle and Means work as the theoretical framework for the thesis. It then addresses the need of securities market regulations to control information asymmetry. This chapter also addresses the arguments to support mandatory disclosure as a better mechanism compared to voluntary disclosure because this mechanism is most suitable to inculcate legal certainty and trust in the Indonesian capital market as well as to compel corporations to provide complete and reliable disclosure. Chapter two concludes that the mandatory disclosure regulatory system provides OJK with the authority to exercise discretion on disclosure policy and request for further information on company's legal non-compliance.

[8] David E. Gray, *Doing Research in the Real World* (Sage Publications, London, 2004) 25.

[9] Paul Chynoweth, 'Legal Research' in Andrew Knight and Les Ruddock (eds), *Advanced Research Methods in the Built Environment* (Blackwell Publishing, 2008) 30.

Chapter three provides an overview of the capital market regulation in Indonesia, particularly IPO proceedings. It highlights three major aspects that influence OJK disclosure policy, namely materiality screening, regulatory capture, and the role of the securities lawyers. Chapter three then demonstrates how these factors are able to hinder and also enhance OJK's decision-making process in legal non-compliance disclosure policy. Further, this chapter discusses mitigation strategies implemented by OJK to address those factors. Chapter three concludes that OJK should acknowledge these aspects to be able to improve its role in preserving capital market integrity and protecting investors.

Chapter four discusses the two main categories of legal non-compliance disclosure and their values in protecting the investors. It also assesses how investors respond to the legal non-compliance disclosure which is provided by the offering company. Chapter four evaluates the criticism addressed to OJK in regards to its disclosure policy and decision making process on corporate eligibility to conduct an IPO. Chapter four concludes that OJK could benefit from legal non-compliance disclosure, not only to protect the investors but also the paramount interest of the public benefit by compelling the company to comply with the regulation.

Chapter five presents a conclusion that OJK has the power to compel the company to provide full disclosure about the company's affairs. However, OJK has been inconsistent in applying its disclosure policy, which affects the efficacy of disclosure in protecting the investors. It offers a suggestion for OJK to apply its disclosure policy consistently, effectively and fairly, to maximise the legitimate interests of all stakeholders in the capital market of Indonesia.

Chapter II

Regulating Publicly Listed Companies through Mandatory Disclosure

Introduction

The first step in answering the research question as to whether OJK's enforcement of its disclosure policy on legal non-compliance is sufficient to protect the investing public leads one to discuss the work of Adolf A. Berle and Gardiner C. Means entitled "The Modern Corporation and Private Property" (1932) as the theoretical framework that will be used to shape the thesis. This thesis gives a nod to Berle and Means' contention that it is important to control the large companies by ensuring the conduct of their business with integrity and responsibility to their shareholders and to expose these companies to greater public accountability.

This chapter then explains the importance of alleviating information asymmetry for the protection of the shareholders. Putting Berle and Means into the context of publicly listed companies which hold a "wide diversity of economic interest", this chapter argues that mandatory disclosure is the most suitable approach to restrain these corporations from abusing their power to the expropriation of the shareholders by closing the information gap between the shareholders and the controlling party of the companies.

The Separation of Ownership and Control Theory

Modern corporations, according to Berle and Means, have become more dispersed in their share ownership, which bring about fundamental change in the relation between the share owner and the wealth derived from share ownership.[10] Corporate ownership no longer holds the conservative idea of wealth as owning a property because in these modern corporations, ownership and control are attached to different individuals.[11] This means that shareholders surrender the control over their companies to the hands of the managers who secure the legal rights and duties to obtain domination over the company's business and assets.[12] Consequently,

[10] Adolf A. Berle and Gariner C. Means, *The Modern Corporation and Private Property* (Harcourt, Brace and World, New York, 1968) 47.

[11] Ibid 305.

[12] Ibid 196.

while this ownership represents certain rights and expectations, it has little control over the enterprise and bears no responsibility to it.[13] The value of the ownership entirely depends on the actions of the individuals who control the corporation.[14] Owning corporate wealth then becomes merely a symbol when the actual power, responsibility and substance that used to be attached to the ownership have been shifted to managers.[15]

Without proper regulation, share ownership is merely a representation of ill-protected rights and expectations,[16] and in contrast, individual(s) who have the power to control a company have almost no enforceable duties under this power.[17] Laws provide the standard of conduct applicable to the management with the aim to compel management to pay decent attention to the company, have fidelity to the company's interest, and have reasonable prudence towards the company.[18]

Furthermore, Berle and Means discuss the concept of modern corporations not only in terms of business enterprise but also in terms of social organisation.[19] This concept recognises the impact of concentration of economic power combined with a "wide diversity of economic interest – those of the "owners" who supply capital, those of the workers who "create", those of the consumers who give value to the products of enterprise, and above all those of the control who wield power".[20] In this sense, regulating modern corporations is not a matter of "choice between strengthening the rights of passive property owners and leaving a set of uncurbed powers in the hands of control"[21] but it should be aimed at the paramount interests of the public.[22] This is so especially in a situation where a considerable proportion of industrial wealth

[13] Ibid 64.

[14] Ibid 65.

[15] Ibid 65.

[16] Ibid 305.

[17] Ibid 305.

[18] Ibid 197.

[19] Ibid 309.

[20] Ibid 309-10.

[21] Ibid 311.

[22] Ibid 312.

is controlled by relatively few large corporations and these large companies possess extensive influence far beyond their directly controlled assets.[23] This influence is described as "a tremendous force which can harm or benefit a multitude of individuals, affect the whole district, shift the current of trade, bring ruin to one community and prosperity to another".[24]

The need to control information asymmetry

One way to increase the shareholders' active participation is by providing equal access to reliable information about the company's activities and operations.[25] However, providing equal access of information to market stakeholders is not an easy task. Especially since much of this information is firm-specific information that only insiders possess. Information asymmetry relates to the knowledge disparity of the market participants in analysing and evaluating a company's economic potential.[26] Cohen and Dean attribute this to the combination of (1) the complex nature of the company as an organisation; which encompass interdependent aspects of leadership, culture, technology, output, and strategy, and (2) the incentive from the management to manipulate company's profile.[27] Consequently, certain parties with an information advantage will benefit more compared to less-informed investors.[28] This issue raises concerns which range from the inability to distinguish a good company from bad ones to the fear of investors' funds being abused by the company insider.

Disparity of information in the context of IPOs, however, is unavoidable.[29] Where a company offers its shares to the public for the first time, potential investors hold substantially limited knowledge compared to current security owners.[30] This happens because potential investors do

[23] Ibid 33-4.

[24] Ibid 46.

[25] Robert Hessen, 'The Modern Corporation and Private Property: A Reappraisal' (1983) 26(2) *The Journal of Law and Economics* 278-9.

[26] Stephen J. Choi, 'Selective Disclosure in the Public Capital Markets' (2001) *Boalt Working Papers in Public Law* UC Berkeley: Boalt Hall 2-3.

[27] Boyd D. Cohen and Thomas J. Dean, 'Information Asymmetry and Investor Valuation of IPOs: Top Management Team Legitimacy as a Capital Market Signal' (2005) 26(7) *Strategic Management Journal* 684.

[28] Choi, above n 26, 2-3.

[29] Cohen and Dean, above n 27, 684.

[30] Cohen and Dean, above n 27, 683-4.

not possess any knowledge of the company's past performance, current projects, industrial benefits or prospects, as a comparison to judge the signals of quality.[31] The absence of previous encounters as indicators of the company's credibility imposes a risk of difficulties in observing the truthfulness of the information.[32] To make matters worse, for the benefit of acquiring fresh funds, management would likely have the incentive to overstate their company's prospects.[33] Further, information asymmetry not only happens between the issuing company and the investors, but also exists between institutional and unsophisticated investors, and even between the issuing company and the capital market authority as the regulator.[34]

As full and credible information is everything to guide investors in valuation judgment of the price share and associated risks,[35] the prospectus becomes a beneficial source of observable information (signals) to make investment choices. According to Downes and Heinkel, signals are "observable firm characteristics which are directly controllable by the firm at the time of the equity issue and convey information about the distribution of future cash flows".[36] Signals theory suggests that observation of the company's signals reduces the likelihood of investors being manipulated by the company's insiders due to their lack of knowledge.[37] Understanding how to interpret these signals is crucial for the investors to be able to examine the claim made by the company.[38] Failure in understanding signals when the level of information asymmetry is high may prove fatal for the investor's ability to accurately judge investment value. However, signals are not easily observed. Therefore, investors rely on the willingness and the ability of

[31] Hayne E. Leland and David H. Pyle, 'Information Asymmetries, Financial Structure, and Financial Intermediation' (1977) 32(2) *The Journal of Finance* 371.

[32] Black, above n 3, 786.

[33] Leland and Pyle, above n 31, 371.

[34] Zhijian Xu and Zhiyou Xie, 'Impact of Insiders and outsiders of entrepreneurial firms on Valuation in Initial Public Offering' (2014) 1(1) *Journal of Chinese Management* 1.

[35] Susanna Kim Ripken, 'The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation' (2006) 58 *Baylor Law Review* 153.

[36] David H. Downes and Robert Heinkel, 'Signaling and the Valuation of Unseasoned New Issue' (1982) 37(1) *The Journal of Finance* 3.

[37] Xu and Xie, above n 34, 2.

[38] Downes and Heinkel, above n 36, 1-2.

the company's policy maker - either management or controlling shareholders - to credibly commit to providing complete disclosure.[39]

Recognising the importance of equal access to accurate information among management, current security owners, and potential investors, capital market regulations mainly aim to mitigate the problem of information asymmetry. These rules are designed to make the company's activity observable for potential investors. [40] Disclosure requirements bridge this information gap by promoting transparency, which levels the playing ground for all market participants.[41] Most theories of disclosure aim to discover the best approach for the authority to alleviate information asymmetry and fraud by management.

The next section provides justification for why mandatory disclosure is more compelling than voluntary disclosure in deterring the problem of informational asymmetry, signalling, and fraudulent behaviour.

Mandatory disclosure as a core mechanism to control information asymmetry

James D. Cox states that disclosure is "a bundle of social, political and economic choices that nations make".[42] This definition illustrates that the rationale behind disclosure regime involves a vast aspects of society. Armitage and Marston define disclosure as "the provision of information of all types by a company, both to the public at large and to restricted groups of information users".[43] From this definition, it can be inferred that disclosure is basically a means of communication between a company and its stakeholders to inform the company's performance and governance.[44] In capital markets, disclosure is communicated by a publicly traded company at the time of: (1) initial public offering; (2) on periodic occasions for the life

[39] Allen Ferrell, 'The Case for Mandatory Disclosure in Securities Regulation around the World' (2007) 81(2) *Brook. J. Corp. Fin. & Com. L.* 86.

[40] Leland and Pyle, above n 31, 371.

[41] Ripken, above n 35, 153.

[42] James D. Cox, 'Regulatory Duopoly in U.S. Securities Market' (1999) 99 (5) *Columbia Law Review* 1200.

[43] Seth Armitage and Claire Marston, 'Company Disclosure, Cost of Capital and Reputation: Evidence from Finance Directors' (2008) 40(4) *British Accounting Review* 315.

[44] Paul M. Healy and Krishna G. Palepu, 'Information Asymmetry, Company Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literature' (2001) 31(1) *Journal of Accounting and Economics* 405.

of the publicly traded company such as quarterly and annual reports, as well as annual shareholders' meeting; and (3) at any extraordinary company actions.[45]

A prominent US Supreme Court Judge who profoundly influences the disclosure approach in the US,[46] Louis D. Brandeis, identifies two major purposes of disclosure. The first is to assist the investor to accurately value the share worthiness at the time of investment and second, to control the behaviour of the company controlling party at the deterioration of the investors.[47] To achieve these goals, disclosure should not only provide information of the current company state of affairs, but also other relevant forecast and intention that would affect significantly on the company's business and prospects.[48] Additionally, to be meaningful, disclosure should be exhaustive, not merely about financial data alone, but also incorporate qualitative aspects.[49] It should include, but not limited to, legal compliance, company governance, and other social disclosure, which are deemed significant for any reasonable investor to consider.[50] Nevertheless, disclosure requires a powerful mechanism of enforcement, by reason of issuer will be very cautious about the cost and incentive of such substantial exposure.

Two Views on Disclosure Enforcement

As most scholars agree that disclosure must be effectively implemented, there are two distinct views how disclosure should be enforced on the issuer. These views are explained below:

---

[45] Williams, above n 6, 1207.

[46] Ibid 1212.

[47] Louis D. Brandeis, *Other People's Money and How the Bankers Use It* (Frederick A. Stokes, New York, 1932) 98-104.

[48] Donald C. Langevoort, 'Managing the "Expectations Gap" in Investor Protection: The SEC and the Post-Enron Reform Agenda. (Symposium: Lessons from Enron, How Did Company and Securities Law Fail?)' (2003) 48(4) *Villanova Law Review* 1152, 1154.

[49] Klaus J. Hopt, 'Modern Company and Capital Market Problems: Improving European Company Governance after Enron' (2003) 3(2) *Journal of Company Law Studies* 242.

[50] For more discussion about social disclosure, see Williams, above n 6, ch V.

A. Disclosure should be voluntary and based on issuers' discretion

Capital market demands flexibility to be able to work efficiently in global situation and over-regulation impede entrepreneurship and rights to economic success.[51] These contexts put forward the contention that the regulator shall facilitate the capital market by providing a platform, without meddling in private contracting between a company and its shareholders. This platform is associated with voluntary disclosure which regards the willingness of the company to disseminate information beyond the original requirements. Supporters of voluntarily disclosure render the argument that without government intervention, effective disclosure could be achieved by the following practices.

1. Reputational interest

The reputational interest is based on the notion that a company will gain commercial benefits by developing good recognition for being transparent.[52] Openness and frankness indicate the reliability of the company.[53] Accordingly, a company will not sacrifice its reputation by giving false nor misleading information for its shareholders and other stakeholders. A company will have a bigger opportunity to attract new capital based on its reputation for being honest. Therefore, it will voluntarily provide a proficient disclosure beyond legal requirements.[54] In addition, this reputational perspective describes that even without government intervention, any kind of wrongdoing by company management will be penalised by the market.[55] This punishment is reflected in declined stock price.[56]

The primary drawback of the reputational argument is that there is evidence showing how greed and opportunistic behaviour would not prevent company managers to sacrifice their reputation by short term profit seeking.[57] They do not hesitate to

[51] Langevoort, above n 48, 1141.

[52] Armitage and Marston, above n 43, 334.

[53] Ibid.

[54] Ibid.

[55] Robert A. Prentice, 'The Inevitability of A Strong SEC' (2006) 91(4) *Cornell Law Review* 780.

[56] Edward S. Adams, 'Company Governance after Enron and Global Crossing: Comparative Lessons for Cross-National Improvement' (2003) 78(2) *Indiana Law Journal* 726.

[57] Prentice, above n 55, 799 (noting several researches on how factors such as enormous incentives from a self-dealing transaction, delayed gratification, and judgement bias influence the decision to pursue short-term reward over building a reputation).

conduct wrongdoing so long as it is deemed profitable for them.[58] For these reasons, there is a concern of managerial abuse at the shareholders' cost.[59] This behaviour is worsened in a heavily concentrated ownership structure where the owner commonly holds a top managerial position and consequently it is a difficult task to ensure the independence of the directors from the interest of the controlling owner.[60]

A company controller holds complete authority to control the company and accordingly, minority shareholders have no power in the decision-making process.[61] The correlation between greed and the lack of accountability of the controlling party is recognised by Berle and Means as they state: 'In the operation of the corporation, the controlling group even if they own a large block of stock, can serve their own pockets better by profiting at the expense of the company than by making profits for it'.[62] These would result in the lack of trust for potential investors and they will not be convinced to participate in the capital market, and prefer to invest their money elsewhere.[63] In turn, the company will lose its chance to acquire low price capital for further economic growth.[64]

2. Gatekeeper involvement

Prentice categorises auditors, attorneys, stockbrokers, securities analysts, investment banks, mutual funds, rating agencies, and stock exchange as capital market gatekeepers.[65] These gatekeepers engage as a form of company control for any

---

[58] Lee Drutman and Charlie Cray, *The People's Business: Controlling Corporations and Restoring Democracy* (Berrett-Koehler Publisher, San Francisco, 2004) 135.

[59] Langevoort, above n 48, 1153.

[60] Erik Berglof and Anete Pajuste, 'What Do Firms Disclose and Why? Enforcing Company Governance and Transparency in Central and Eastern Europe' (2005) 21(2) *Oxford Review of Economic Policy* 180.

[61] Berle and Means, above n 10, 128-131 (noting that legal permission to vote by proxy and the inability to remove directors during his tenure have gradually weakened the control by the shareholders over the management).

[62] Ibid 114.

[63] Ripken, above n 35, 154-5.

[64] Ripken, above n 35, 154-5.

[65] Prentice, above n 55, 785-97.

misconduct to ensure the soundness of capital market.[66] Each of them has its independent role and function, yet they are mutually interrelated. This relationship implies that every act of misdeed undertaken by one of them would cause adverse effect on the others. Thus, they will each oversee and preserve the market order from company malfeasance.

Nonetheless, it has proved to be challenging to expect a commitment from the market participants that they would rationally behave in the expected manner.[67] Potential bias on decision-making mechanism has led to habitual inconsistency with the expected manner.[68] This bias emerges due to the conflict of interest associated to the nature of consultant-client relationship.[69] The expectation that market participants would pay more careful attention for their role as gatekeepers is proved to be merely rhetoric, when mandatory disclosure requirements is obscure.[70] Therefore, the promotion of market participants' involvement as gatekeepers still requires continuous control from the market regulator.[71]

To conclude, regardless of reputational constraint and participative style of gatekeepers, government intervention is aimed to protect the market operation by providing mechanism where the market actors shall have their fully informed decision.[72] It has never been easy to formulate a policy and regulation to protect shareholders' interests. The effort could be

[66] Healy and Palepu, above n 44, 410.

[67] Prentice, above n 55, 798.

[68] Ripken, above n 35, 176.

[69] See Hopt, above n 49, 247 (noting the evidence of auditors' failure to acknowledge prior to the occurrence of a financial breakdown. He further suggests that the auditors of a publicly traded company should be appointed by the capital market authority in order to have the salient control function; Healy and Pauly, above n 44, 415-7 (noting the additional service of certain audit firms that cater an additional consulting service to their auditing operation raise question of independency and credibility to their financial qualification and further noting that financial analyst has given incentive by their brokerage affiliation for positive recommendation); Lisa H. Nicholson, 'A Hobson's Choice for Securities Lawyers in the Post-Enron Environment: Striking a Balance between the Obligation of Client Loyalty and Market Gatekeeper' (2002) 16(1) *Georgetown Journal of Legal Ethics* 138 (discussing a lawyer's competing interests of professional liability and protecting the capital market from fraudulent act by its clients); and John C. Coffee, Jr., 'Privatization and Company Governance: The Lessons of Securities Market Failure' (1999) 25(1) *The Journal of Corporation Law* 32 (noting that exchanges have more incentive on trading volume and from the competition to other exchanges).

[70] Langevoort, above n 48, 1154.

[71] Hopt, above n 49, 248.

[72] Williams, above n 6, 1296-7.

judged as the lack of power, too many restrictions, or not empowering enough.[73] Khademian once stated that the government endures tremendous political pressure.[74] It militates against any effort of the regulator to enforce a mandatory disclosure regulation. This situation is worsened by the fact that often regulations deal with authoritative business entities with vast wealth and hold the power to influence legislatives, capital market executives, and the press.[75] Mandatory disclosure, if enforced, would avert the abusive behaviour of powerful entity on its minority shareholders.

B. Disclosure should be regulated through mandatory disclosure regulations

Whilst the proponents of self-tailored disclosure regimes opt out of government intervention, the supporters of mandatory disclosure regulation assert that to achieve an efficient and effective capital market, it is necessary to have government intervention in form of mandatory disclosure regime. As mentioned earlier, to alleviate information asymmetry and provide observable signals for investors are the reasons for disclosure. However, what is the rationale behind the use of mandatory disclosure? Why is mandatory disclosure more compelling to facilitate a strong capital market compared to voluntary disclosure?

Mandatory disclosure addresses information asymmetry issues by compelling the company to provide more firm-specific disclosure.[76] This means mandatory disclosure constrains the company from strategically withholding information and therefore allows investors to have more access to information possessed by the company.[77] Companies should not be left to their own discretion when it comes to disclosure due to two sources of impediments. First, for their own interest, controlling shareholders would ignore the harm they cause to minority shareholders.[78] The latter would be concerned that the managers or the controlling shareholders could abuse the minority shareholders' capital. Mandatory disclosure requirements prevent the controlling shareholders from

[73] Anne M. Khademian, 'Reinventing a Government Corporation: Professional Priorities and a Clear Bottom Line' (1995) 55(1) *Public Administration Review* 23.

[74] Ibid.

[75] Prentice, above n 55, 800; Berglof and Pajuste, above n 60, 182.

[76] Franco, above n 7, 289.

[77] Ibid 289-90.

[78] Ferrell, above n 39, 87.

manipulating company resources at the expense of the minority shareholders[79] by standardising the content, format, and timing of disclosure.[80] Further, the presence of these requirements enhances the efficacy of antifraud regulations, thus promoting trust in the integrity of the capital market.

Second, even though disclosure is beneficial for the economic interest of the issuer, it rarely goes beyond the minimum legal requirement[81] because of the assumption that disclosure would expose the company to an unnecessary intervention or supervision.[82] Managers have a bias towards the view that disclosure is a burdensome existence.[83] Accordingly, without mandatory disclosure requirements, the company will generally disclose only good news.[84]

This above-mentioned standardisation facilitates investors in making a fair judgment of the company's share value. By verifying a company's business conduct such as the appointment of company managers, acquired projects, stock options, agreements, and legal non-compliance, investors would be able to assess the company's prospect to generate profit compared to others.[85] Hence, the accuracy of that information is a paramount matter, as a basis for investors' to determine their portfolio.[86]

Mandatory disclosure requirements compel a company to map its advantages and disadvantages and therefore help to design its strategy. Taking into account the fact that company strengths and weaknesses are exposed to all investors and stakeholders, such transparency will encourage a company to deliver its services and generate profit by operating in the most efficient manner to achieve its goals[87] and to attract new capital.[88]

---

[79] Ferrel, above n 39, 86.

[80] Franco, above n 7, 295.

[81] Armitage and Marston, above n 43, 315.

[82] Prentice, above n 55, 816.

[83] Prentice, above n 55, 816.

[84] Russel Lundholm and Matt Van Winkle, 'Motives for Disclosure and Non-disclosure: A Framework and Review of the Evidence' (2006) 36(1) *Accounting and Business Research* 45.

[85] Frank H. Easterbrook and Daniel R. Fischel, 'Mandatory Disclosure and the Protection of Investors' (1984) 70(4) *Virginia Law Review,* 673-6.

[86] Ibid 673.

[87] Khademian, above n 73, 17.

Otherwise, if it fails to construct an effective and efficient strategy, other companies will quickly replace its position in the market and the inefficiency will lead to profit loss and dividend restraint.[89] This condition will not motivate any logical investor to invest in a company with detrimental governance. Disclosure allows the investors to evaluate the company's governance and determine their investment accordingly.

Moreover, mandatory disclosure enables investors to monitor the duty of care and duty of loyalty of the managers. This ability is beneficial for the investors and other stakeholders to monitor how managers conduct their duties and work on the shareholders' behalf to the shareholders' best interests.[90] Particularly in a concentrated ownership situation where block shareholders typically dominate the top managerial positions, minority shareholders or public shareholders do not acquire an active role in the company decision as their share amounts are too few to have significant voice in shareholder meetings.[91] This situation raises a potential agency problem between the managements and the minority shareholders, as well as a concern as to funds expropriation for self-interested arrangements at the expense of the shareholders.[92]

On the other hand, it should be noted that fraud occurs only when there is an opportunity to deceive.[93] Compromises to accounting standards to manipulate liability, deficiencies in anti-fraud enforcement and private litigation, and lack of political will are among the factors that encourage fraudulent acts.[94] Rather than punish it, disclosure regulation tends to restrain fraud before it occurs and results in cost damages[95] by forcing the company controller to behave according to their fiduciary obligations.[96]

---

[88] Lucian Arye Bebchuk and Mark J. Roe, 'A Theory of Path Dependence in Company Ownership and Governance' (1999) 52(1) *Stanford Law Review* 134.

[89] Kadhemian, above n 73, 17.

[90] Adams, above n 56, 416.

[91] Adams, above n 56, 731 (noting that the issue of collectivist constraint has impede the ability of minority shareholders to involve in monitoring and controlling roles).

[92] Simon S.M. Ho and Kar Shun Wong, 'A Study of the Relationship between Company Governance Structures and the Extent of Voluntary Disclosure' (2001) 10(2) *Journal of International Accounting, Auditing and Taxation* 145; Healy and Palepu, above n 7, 409.

[93] Langevoort, above n 48, 1149.

[94] Langevoort, above n 48, 1149-50.

[95] Langevoort, above n 48, 1152.

Conclusion

Berle and Means analyse the impact of the modern economy's great concentration of power in large corporations, which have a diversity of interests surrounding this powerful entities. These economic powers obtain great capability to influence the whole society of a nation, whether to bring prosperity or downfall. For this reason, Berle and Means emphasise the importance of regulating the power of large corporations to increase its desired impact for the welfare of their shareholders and the public. Further, Berle and Means assert that managers of large corporations should be regulated so that they will not taking advantage of their fiduciary's duties at the expense of the shareholders as the real owner of the companies and the public.

The changing nature of modern corporations and private property raises a problem of how to increase the shareholders control over the managements and impose the public accountability to those who hold the power. Two rationales are put forward why disclosure is the best way to mitigate this problem. First, disclosure exposes the corporate business activities and conduct and therefore it bridges the information gap not only between the company and the shareholders, but also to the regulator. Second, disclosure restrains the management's behaviour by subjecting their behaviour to public exposure.

There is substantial evidence of the appreciation for and utility of mandatory disclosure to regulate publicly listed companies. Particularly in the emerging markets, mandatory disclosure regulation is best practice to ensure company's accountability to its shareholders and public. As a prerequisite to a strong capital market, government intervention is highly necessary in diminishing corporate fraud and establishing a fair market for all its participants. Despite the assumption that reputational constraint and market participation will preserve the effectiveness of voluntary disclosure regimes, evidence shows the opposite. Various studies consistently agree with the importance of mandatory disclosure. However, successfully achieving an effective and efficient disclosure requires a complex array of support mechanisms, such as the active participation of gatekeepers, effective anti-fraud regulation, strong checks and balance mechanisms, litigation avenues, as well as political will from the capital market regulator.

[96] Williams, above n 6, 1211-1212.

Chapter III

Implementing Mandatory Disclosure Requirements in Indonesia

Introduction

Having argued in the previous chapter that the great influence of large companies on the economy deserves a well-regulated corporate system to ensure that this power is utilised for maximum benefit to the welfare of shareholders and society. With this goal in mind, an effort of the implementation of mandatory disclosure has been establish to regulate public companies.

This chapter begins with some background information about capital market regulations in Indonesia, particularly in regards to mandatory disclosure requirements in the IPO process. It proceed to examines the factors which dominantly influence the policy making process of OJK in enforcing its mandatory disclosure power to ensure company provides reliable and sufficient disclosure. Factors that will be analysed are the materiality of information need to be disclose, regulatory capture, and the role of securities lawyers in the offering process.

The importance of this evaluation is to provide greater understanding of how these factors may limit the ability of OJK as the capital market regulator to enforce disclosure as a means to protect the public shareholders. Given the circumstance in which OJK does not have any legal authority to refuse or dismiss a registration statement, the capital market relies solely on the reliability of disclosure as mean to preserve its integrity. Further, result of this analysis is useful to provide recommendations on how to improve the efficacy of mandatory disclosure to achieve its goals.

Indonesian capital market law: an overview

Before 31 December 2012, the capital market in Indonesia was supervised by the Capital Market Supervisory Agency and Financial Institution (Bapepam-LK) established under the Ministry of Finance. Due to the financial crisis in 2008, the government and the House of Representatives agreed that Indonesia is urgently needed to have a single institution that would supervise the banking sector, capital market, and financial institutions as part of essential financial reform.[97] Based on Law No. 21 Year 2011, the Indonesian Financial Services

[97] Maikel Jefriando, *Kelahiran OJK, Sejarah Baru Perekonomian Indonesia* [The Birth of OJK, New History of the Indonesian Economy] (27 December 2012) Sindo News

Authority (OJK) was incorporated on 31 December 2012. The establishment of OJK, however, was not without controversy both from Indonesia and from foreign institutions.[98] Their first concern was the example of the failed abolishment of the Financial Services Authority (FSA) in United Kingdom. Lead Financial Sector Specialist of World Bank, PS Srinivas, voiced his concern that Indonesia was facing immense challenges in the transition of the regulatory responsibilities that had been split transferred from the Indonesian Bank and Bapepam-LK to OJK.[99] This transition not only involves migrating the employees of Bapepam-LK and the Indonesian Bank to OJK, but also establishing new regulations under the OJK regulatory system. A smooth transition was necessary to ensure OJK, as a new institution, worked properly to implement the financial reform in Indonesia. The second concern was related to the recognition of OJK as a new independent agency which regulated the whole financial system of Indonesia possibly being subject to corruption which could create further financial turmoil.[100]

In 31 December 2012, OJK began to take over the functions and authority to supervise the capital market and the financial institutions from Bapepam-LK. Then, at the end of 2013, the functions and authority to supervise the banking sector began to transition from the Indonesian Bank to OJK. To date, transition effort of migrating the capital market regulations of Bapepam-LK to the regulations of OJK is still underway. During the transition period, Bapepam-LK regulations, as long as there are no new regulations from OJK, remain valid.

Regulations to conduct Initial Public Offerings

Law No. 8 Year 1995 Concerning Capital Market (Capital Market Law) serves as the legal umbrella for the capital market regulations in Indonesia. It consists of eighteen chapters and 116 articles, and regulates the main features of capital market activities, such as Indonesia stock exchange, mutual funds, capital market supporting institutions and professionals, issuer and

<http://ekbis.sindonews.com/read/700589/90/kelahiran-ojk-sejarah-baru-perekonomian-indonesia-1356414181>.

[98] Ibid.

[99] Extracted from Herdaru Purnomo, *Bank Dunia: Transisi Pembentukan OJK Berisiko Besar* [World Bank: OJK is facing Great Risks during Transition Time] (1 December 2011) Detik <http://finance.detik.com/read/2011/12/01/110200/1779870/5/bank-dunia-transisi-pembentukan-ojk-berisiko-besar>; Nur Farida Ahniar, *Bank Dunia: Waspadai Transisi OJK saat Krisis* [World Bank: Be Wary to the OJK's Transition Time of Crisis] (1 December 2011) <http://bisnis.news.viva.co.id/news/read/268823-bank-dunia-ingatkan-transisi-ojk-saat-krisis>; <https://en.wikipedia.org/wiki/Financial_Services_Authority>.

[100] Jefriando, above n 97.

public company, market manipulations, as well as the sanctions. This law also provides definitions of the commonly used term in the capital market activities.

The current regulatory arrangement to conduct IPO is under the Bapepam-LK regulatory classification of "Issuer and Public Company" which encompass thirty one rules. These rules regulate, among others, the content of a registration statement and public offering, public company registrations, guidelines of the form and content of prospectus for public offering, and other rules regarding the requirements for issuers and public companies.

OJK does not specifically regulate the eligibility of a company to issue an IPO. However, the Indonesian Stock Exchange (IDX) has certain requirements to determine a company's eligibility to issue an IPO and list its public shares;

> Overall, every corporation that has been operating for at least 12 months, having at least Rp 5,000,000,000 (five billions rupiah) of net tangible asset, has received an Authentic Without Exception opinion from a public accountant registered in the OJK for its latest audited annual financial report, has sold at least 50,000,000 (fifty millions) shares or 35 (thirty five) percent of its total issued shares (depends on which one is the smallest number) and having at least 500 (five hundreds) shareholders, can become a public company that shares are traded in the Bourse.[101]

To be able to issue an IPO, a company must prepare and submit a registration statement and supporting documents to OJK in a certain format as required in Rule No. IX.A.1 of Bapepam-LK concerning General Requirements for Submitting a Registration Statement. To ensure that the issuer fulfils its responsibility of disclosing material information, OJK may request changes and or additional information to the issuer. Furthermore, according to this rule, it is the issuer's responsibility to ensure the adequacy, accuracy, and truthfulness of the information and opinions contained in the registration statement.

According to Rule No. IX.C.1 of Bapepam-LK concerning Form and Content of a Registration Statement for a Public Offering, documents that form part of the registration statement consist of at least a cover letter, a prospectus, a legal audit report and opinion, an audited financial statement, a comfort letter, and other documents.

OJK's Division of Corporate Finance is the division which is responsible for conducting the review of the registration statement for public offering and gives comment to the registration statement. The review, made in oral and written comments by OJK officers, is basically a

[101] Indonesia Stock Exchange, *How to be a Listed Company* (2010) <http://www.idx.co.id/en-us/home/information/forcompany/howtobealistedcompany.aspx>.

negotiation process between OJK officers and the lawyers, issuer, and underwriter which produces the final prospectus as the outcome.[102] These comments are mainly, but not limited to the request for clarification, disclosure, legal opinion, and company's compliance to the applicable rules.

The review process starts as soon as the registration statement filed to OJK.[103] The first stage of the review is a technical review, which involves document verification.[104] Failure in submitting the right form or main documents will result in resubmission of the registration statement.[105] The next step is disclosure review,[106] which encompasses three aspects, namely disclosure, accounting, and legal aspects. In carrying the review, OJK also introduces the merit review. This means OJK uses its authority to compel the company, not only to disclose, but also to comply with the regulations.

The issuers and their consultant team (the underwriter, securities lawyers, and auditors) will respond to the comments and requests until OJK is satisfied with the disclosure and the completeness of the registration statement documents. However, despite Indonesian securities regulatory system referring to US securities regulation, unlike the US regulation, Indonesian capital market laws do not support OJK with the authority to institute "refusal order or stop-order proceedings".[107] According to the Capital Market Law, OJK has the power to declare, delay, or cancel the effectiveness of a registration statement.[108] Base on Rule No. IX.A.2 of Bapepam-LK Concerning Registration Procedures for a Public Offering, a registration statement becomes effective under the following circumstances:

---

[102] Mark A. Sargent, 'State Disclosure Regulation and the Allocation of Regulatory Responsibilities' (1987) 46(4) *Maryland Law Review* 1028.

[103] The Ad Hoc Subcommittee on Merit Regulation of the State Regulation of Securities Committee, 'Report on State Merit of Regulation of Securities Offering' (1986) 41(3) *The Business Lawyer* 801.

[104] Ibid.

[105] Ibid.

[106] Ibid.

[107] Richard W. Jennings, 'The Role of the States in Corporate Regulation and Investor Protection' (1958) 23(2) *Law and Contemporary Problems* 210-1, noting that the Securities and Exchange Commission possess the power to issue refusal order or stop-order proceedings to compel issuers to provide full disclosure.

[108] Law No. 8 Year 1995 Concerning Capital Market. According to the explanation of this article, ""effectiveness" refers to having completed or fulfilled all procedures and legal requirements with respect to a registration statement".

A. On the basis of elapsed time;

1. 45 (forty five) days from the date since a complete Registration statement has been received by OJK, which include all the stated criteria on the Registration statement form; or
2. 45 (forty five) days from the date since the latest amendments proposed by the issuer or requested by OJK have been submitted; or

B. On the basis of a declaration of effectiveness by OJK that no further disclosures are required.

In the case where the information disclosed by the company does not fulfil the standards set by OJK, the public issuance will be delayed or enjoined.[109] In the absence of legal authority to institute "refusal order or stop-order proceedings", OJK should employ the highest standard in the review process to ensure sufficiency and adequacy of disclosure for the protection of investors.

The influences to the implementation of mandatory disclosure requirements

The Capital Market Law gives the mandate to OJK to act in accordance with protecting the minority shareholders and public under the disclosure principle. This mandate provides OJK with powerful authority to deter information asymmetry and punish companies for non-conformity to achieve more desirable outcomes of disclosure. Especially in situations of corruption and red tape, mandatory disclosure policy is an ideal option to allow securities markets to operate efficiently where gatekeepers are trustworthy and no fraud goes unpunished.[110] Moreover, mandatory disclosure works by controlling corporate speech, by time, place, or manner.[111]

OJK will enhance its reputation for quality and effectiveness as a capital market regulator if it consistently applies a stringent approach to all of its registration statement reviews. Issuers (as well as those who are involved in the securities offering process, such as underwriters, auditors, and securities lawyers) will learn that OJK consists of "dedicated and well-qualified" officials

[109] Chenggang Xu and Katharina Pistor, 'Law Enforcement under Incomplete Law: Theory and Evidence from Financial Market Regulation' (2002) *Suntory and Toyota International Centres for Economics and Related Disciplines, London School of Economics and Political Science* 31.

[110] Prentice, above n 55, 828.

[111] Easterbrook and Fischel, above n 85, 680.

that will not overlook any wrongdoing. However, there are several factors which influence the policy making process of OJK in implementing the mandatory disclosure requirements.

A. Materiality

Rule No. IX.A.1 of Bapepam-LK Concerning General Requirements Regarding Submission of a Registration statement states that the registration statement must also include other material information to ensure the adequacy of disclosure that the investors require to make investment decision and the issuer should also ensure that the disclosure is accurate.[112] With regard to the materiality, Law number 8 year 1995 on Capital Market defines material information as "any significant/important or relevant fact concerning events, incidents, or data that may affect the price of a security on an exchange and/or may influence the decisions of investors, prospective investors or others that have an interest in such information".[113] However, this rule is considered too broad and vague. What is considered materially important will differ from one person to another. For instance, one investor might regard information about the legal proceeding against management or the illegal payments to the government officials is an important aspect in making the investment decision while other investors may not. Consequently, with the definition of materiality promulgated by Capital Market Law, company may have difficulties to decide which information should be disclosed in prospectus.

The following two opinions show why materiality is often about personal discretion which is not only rooted in economic significance.[114] Judgement of materiality is "a mixed question of law and fact; involving [the] application of a legal standard to a particular set of facts".[115] Another opinion asserts that "the contours of materiality are in an increasing state of flux and that in many situations there is a genuine difference of opinion as to whether a fact is material".[116]

---

[112] Rule No. IX.A.1 of Bapepam-LK Concerning General Requirements Regarding Submission of a Registration Statement art 4.

[113] See Law No. 8 Year 1995 concerning Capital Market art 1(7).

[114] Bevis Longstreth, 'SEC Disclosure Policy Regarding Management Integrity' (1983) 38(4) *The Business Lawyer* 1414.

[115] TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 450 (1976).

[116] Allan Horwich, 'The Neglected Relationship of Materiality and Recklessness in Actions Under Rule b-5' (2000) 55(3) *The Business Lawyer* 1023.

Materiality encompasses two types of materiality, namely quantitative and qualitative materiality. Quantitative materiality is based on a benchmark of assets, earnings and liabilities, and employs amount, number, or percentage as the determination factors.[117] When the effect of the fact equals or exceeds this benchmark, materiality is triggered and therefore this fact needs to be disclosed.[118] This type of materiality is characterised by the economic impact of certain information to the company's financial performance which ultimately affect the share price.[119] Judgment of these factors may be easy to reach objectively because quantitative materiality has clear requirements.[120]

On the other hand, there is qualitative materiality which encompasses illegal or unethical conduct by a company such that even though this conduct may not have any significant financial impact, it should be disclosed.[121] This study emphasizes in the qualitative aspect of disclosure which has a particular bearing on the management's integrity and which may or may not have economically significant impacts on the investors. Qualitative materiality aims to provide a more holistic picture of the corporate circumstances than a partial quantitative approach, and therefore disclosure would better reflect the company's overall management and financial integrity.[122] In contrast to quantitative materiality, qualitative materiality utilises an imprecise benchmark.[123] It is almost impossible to provide standardised requirements for qualitative materiality which are able to anticipate what kind of information to disclose in every circumstance.[124] This type of materiality is inherent in

---

[117] John M. Fedders, 'Qualitative Materiality: The Birth, Struggles, and Demise of an Unworkable Standard' (1998) 48(1) *Catholic University Law Review* 41.

[118] Kenneth C. Fang, 'Clarifying and Protecting Materiality Standards in Financial Statements: A Review of SEC Staff Accounting Bulletin 99' (2000) 55(3) *The Business Lawyer* 1042.

[119] Fedders, above n 117, 46.

[120] Ibid.

[121] Ibid, 41.

[122] Nicholas Kappas, 'A question of Materiality: Why the Securities and Exchange Commission's Regulation Fair Disclosure is Unconstitutionally Vague' (2001-2001) 45(3-4) *New York Law School Law Review* 661.

[123] Fedders, above n 117, 41.

[124] Longstreth, above n 114, 1416.

individual circumstances and depends on the specific case in interpreting what deemed to be materially relevant.[125]

In the absence of standardised requirements, it can be argued that the law regulating qualitative materiality is incomplete because the rule is open-ended and fails to establish workable standards as a boundary. [126] What is deemed qualitative information is material may not be agreed amongst the market actors since each of them will interpret differently according to their respective interests.[127] Consequently, disclosing qualitative materiality becomes a matter of discretion as well as consensus between OJK officials as the reviewer and the company as the disclosing counterpart.

When the regulator is unclear about the scope of the qualitative materiality, one of the possibilities is that the company may not disclose the information especially when it is concerned that the information could affect the company's capital-raising efforts. The company may prefer to pay fines which are considerably lower amounts of money compared to the greater risks of losing the opportunity to acquire capital from disclosing negative information.

In a democratic market, a legal entity (whether it is a person or a corporation) has the freedom to navigate its conduct between the lawful and unlawful.[128] However, this freedom is restricted by the principle where the "laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited so that he may act accordingly".[129] However, the term "reasonable" is too broad as well as subjective;[130] therefore, often this principle is hard to implement. On the other hand, under the principle of freedom of contract, a company will be free to do whatever they want to do until the law says otherwise. For this reason, the regulation under the qualitative materiality standard should be explicit; otherwise the company will choose a favourable interpretation for its own benefit.

[125] Richard C. Sauer, 'The Erosion of Materiality Standard in the Enforcement of the Federal Securities Laws' (2007) 62(2) *The Business Lawyer* 319.

[126] Xu and Pistor, above n 109, 4-5.

[127] Xu and Pistor, above n 109, 5.

[128] Grayned v. City of Rockford, 408 U.S. 104, 108 (1972).

[129] Ibid.

[130] Fedders, above n 117, 46.

But how can the capital market authority possibly expect the company to voluntarily disclose their dishonest conduct? For instance, a company would not accuse itself of un-adjudicated illegalities.[131] When a company fails to disclose its illegalities, the company argues that it would not yet know or be aware of whether any of its behaviour could be classified as unlawful. Therefore, it would have no reason to disclose a prediction that it would face a legal suit for its unlawful conduct. However, it may be useful to question the managers' integrity to be involved in such grey areas.

This study supports the contention that OJK, in order to ensure informed decisions by the investors, must be allowed to compel the company to disclose qualitative information that is deemed to be material to avoid misleading the public as to the company's managerial and financial integrity.[132] OJK considers qualitative information to be as important as quantitative information for the investors to make a fully-informed investment decision.[133] Fedders, however, disagrees that qualitative information should be incorporated into disclosure if the regulator is unable to provide a workable standard to be followed by the offering company.[134] Further, the generalities and the element of subjectivity in qualitative materiality raise a question about the appropriateness of the regulator to become the sole party in interpreting the matter of materiality.[135]

In accordance with this contention, this study disagrees with Fedders' claim that the investors disregard qualitative information and they only consider quantitative information that provides significant economic figures.[136] He argues that rather than employing qualitative informative, investors prefer to utilise the other information that would directly impact financial growth.[137] The reason for the disagreement is that unethical or illegal conduct often gets adjudicated and receives hefty fines which inflict financial injuries to the company and further, as a result, the share price is dropped.

---

[131] Ibid, 61.

[132] Kappas, above n 122, 661.

[133] Ibid.

[134] Fedders, above n 117, 42.

[135] Kappas, above n 122, 662.

[136] Fedders, above n 117, 42.

[137] Fedders, above n 117, 42.

B. Regulatory capture

To date, there are mounting debates on what constitutes "best" policy. Levine and Forrence describe it as policy that its dominant character is to provide maximum benefits for the public interest "that goes beyond individual self-interest".[138] For instance, the economic regulation acts as the government regulatory instrument to protect the public from the manipulative behaviour of the large company.[139] In contrary to the public interest theory, is where the officials act selfishly to gain personal benefits (often pecuniary) from abusing its power; known as the capture theory.[140] In this theory, rather than aiming the regulation for the public benefits, agencies became "captured" by the narrow interest of the regulated institution.[141]

In its effort to establish an effective set of regulations, OJK holds Focus Group Discussions (FGD) by inviting capital market representatives such as securities lawyers, underwriters, representatives of the banking industry, auditors, other/related government institutions or ministries, and publicly listed companies. The FGD aims to gather inputs from the market actors in certain issues or to draft of regulation before it is ratified. This mechanism allows OJK to gain an overview of market support and objections over a draft of the regulation as well as the benefits and drawbacks of the particular draft.

However, this mechanism may have caused OJK's policy and decision to become influenced by the interest of the community which OJK intends to regulate, and the mechanism may generate a propensity for regulatory capture. Those market actors are often more interested in influencing the regulator to create regulations with the least burden possible for them.[142] As the consequence, OJK is susceptible by the interest of its regulated

[138] Michael E. Levine and Jennifer L. Forrence, 'Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis' (1990) *Journal of Law, Economics, & Organization* 6(SPEISS) 168.

[139] Ibid.

[140] Ibid 169.

[141] Michael R. Potter, Amanda M. Olejarski, and Stefanie M. Pfister, 'Capture Theory and the Public Interest: Balancing Competing Values to Ensure Regulatory Effectiveness' (2014) 37(10) *International Journal of Public Administration* 638.

[142] Ibid 638.

community rather than act for the greater public interest.[143] Ideally, OJK should be able to maintain a close partnership to capital market actors without losing its authority as the main capital market law-maker.[144]

In exercising discretion in disclosure policy during the Registration statement review, OJK officers as the street-level regulators should understand their role as a public representative. When interpretation of law is necessary, the interpretation should be done with great respect to public benefit, and not be based on the interest of narrow clientele groups that OJK is intended to regulate.[145] Nonetheless, it has proved to be challenging to resist the power of the capital-intensive interest groups to influence the decision-making mechanism.[146] In order to counteract this challenge, OJK must be cognizant of its public representative status in the policy making process.[147]

As per the aforementioned arguments, the effective regime of mandatory disclosure creates a more efficient securities market compared to disclosure deregulation.[148] Nevertheless, mandatory disclosure regulations would be merely lip-service, where the authority does not have the understanding and expertise to translate the regime into applicable laws. However, this concern should not keep OJK from maintaining close interaction with the industry to ensure that OJK has input from the industry during the rule-making process in the form of "notice and comment process" and other support during the implementation.[149] This process will help to guarantee that the rules receive all due consideration[150] to avoid regulatory error or overreaching.

---

[143] Christopher Jewell and Lisa Bero, 'Public Participation and Claims Making: Evidence Utilization and Divergent Policy Frames in California's Ergonomics Rulemaking' (2007) 17(4) *Journal of Public Administration Research and Theory* 625–650.

[144] Ibid 642.

[145] Potter, Olejarski, and Pfister, above n 141, 642.

[146] Ibid.

[147] Ibid.

[148] Prentice, above n 55, 804.

[149] Eric J. Pan, 'Harmonization of U.S.-EU Securities Regulation: the Case for a Single European Securities Regulator' (2003) 34(2) *Law and Policy in International Business* 530 discuss how the SEC maintain close communication with the industry it seeks to regulate by "notice and comment" procedures in the rule-making process and close interaction during the implementation which is OJK similarly adopt.

[150] Prentice, above n 55, 802.

C. The role of securities lawyers

Lawyers play a substantial role in the securities market. Along with other members of the consultancy team – underwriters and auditors – this team helps the issuer to polish its company's profile. The first main role of the securities lawyers is to provide legal advice on the company's capital-raising plans by actively structuring the securities transactions.[151] This role, together with the issuer and the underwriter, involves drafting disclosure documents, filing them with the OJK, and responding to the comments of OJK.[152] The process starts several months or sometimes more than a year prior to the submission of the documents, by conducting legal due diligence on the issuer about the overall state of the corporate affairs. Legal due diligence includes but is not limited to the investigations on company's legality of establishment, articles of association, managements, business activities, licenses and permits, labour policy, changes of ownerships, wealth, insurance, contracts/agreements, and any pending or un-adjudicated legal dispute. Legal due diligence is based on the investigation of all the documentation which should be made available by the company and the lawyers present all the findings about the company's business and activities in the form of a legal opinion.

The length of time taken to conduct legal due diligence is varied, depending on the scope of the investigation which may be determined by the life span of the company, the number of its subsidiaries, the complexity of the changes of ownership, the availability of relevant documentation, the level of cooperation between the securities lawyers and the company's in-house counsel, and the location of its property. The result of legal due diligence is disclosure of documents which include legal opinions[153] that will be relied upon by investors in making investment decisions.[154]

In the examination of disclosure documents, OJK administrators conduct a full review of the legal due diligence to ensure that the lawyer's legal opinion truly reflects the legal due

[151] Nicholson, above n 69, 100.

[152] Ibid.

[153] Rule No. IX.C.2 of Bapepam-LK concerning Guidelines Concerning the Form and Content of a Prospectus for a Public Offering stated that legal opinion also encompass "other material information concerning legal status of the company and the securities offering".

[154] Nicholson, above n 69, 100.

diligence and that the information contain in the prospectus is accurate. OJK administrators must also ensure that the lawyers provide straightforward language in their legal opinions. Often, lawyers use pleonastic language which not only obscures the opinion, but also avoids their professional liability. The use of words "based on company's statement" in the legal opinion is also restricted to ensure lawyers provide an independent opinion.

Security market regulations also provide OJK with the authority to request further disclosure, investigate when there is any indication of infringement, and carry out necessary punishment for misconduct.[155] By this given authority, OJK is able to introduce a merit system in its review process which means OJK may compel the company's conformity with the regulations.

In regard to the lawyers' role in providing legal advice, there is a conflict of interest between protecting the public interest and assisting their client in securities transaction. It may be argued, that due to reputational constraint, lawyers would be more circumspect to not engage in securities transaction scam.[156] However, some clients may prefer lawyers who could help in pulling shenanigan arrangements,[157] dedicated to averting the rules.[158] The improper conduct particularly exists in a loose legal environment where the incompleteness of law creates loopholes. For the sake of capital-raising, the issuer, underwriter, and lawyers, saddled with their conflict of interests, have an incentive to find a way to avoid disclosing incriminating information. Unregulated markets encourage this misbehaviour.[159] Discrimination of one particular registration will undoubtedly incur moral hazard and degrade trust in OJK as the capital market regulator.

The second role of the securities lawyers is as the gatekeeper who has the responsibility not only to their client, but also to the investing public.[160] This role is achieved by ensuring the company's legal compliance with the regulations.[161] The securities lawyers assist their

[155] Xu and Pistor, above n 109, 31.

[156] Donald C. Langevoort, 'Where Were the Lawyers? A Behavioural Inquiry into Lawyers' Responsibility for Clients' Fraud '(1993) 46(1) *Vanderbilt Law Review* 112.

[157] Ibid.

[158] Bebchuk and Roe, above n 88, 161-2.

[159] Prentice, above n 55, 790.

[160] Nicholson, above n 69, 100.

[161] Nicholson, above n 69, 100.

clients in obtaining all documents and permits as required by the laws. Even though this process is often prolonged because obtaining documents and permits involves different government agencies, it is beneficial in deterring company misconduct.

Securities lawyers have been involved closely with OJK in preparing the securities offering.[162] It is a common practice for them (along with the issuer and underwriter) to have a preliminary meeting to explain their securities transaction as well as to seek advice regarding the transaction from OJK. Particularly in the case of complicated securities transaction schemes, this practice is often necessary to ensure that the transaction would not constitute a violation of the securities regulations.

However, in some instances, lawyers fail to advise their client against misconduct.[163] Driven by the concern of exposing themselves to the professional liability, these lawyers often consult with OJK about this failure and alert OJK about the company's involvement in misconduct so OJK could comment on the activity. This well-maintained cooperation between OJK and lawyers is beneficial in upholding investors' trust to the integrity of the capital market. Nonetheless, this cooperation require lawyers to be honest and honouring their ethical obligations in preventing the company from misconduct and protecting the investing public.[164]

OJK, given its limited staff and resources, relies on the integrity and the competence of securities lawyers in exercising their duty as gatekeeper.[165] On the other hand, the staff and resources shortage may have contributed to impeding OJK's ability to carefully review the registration statement documents. The growing organisation structure of OJK and the growing interests from the company to raise capital in securities market has not been matched by the adequate staffing of OJK.

Moreover, the expertise and knowledge amongst OJK administrators are diverse which result in substantial variety to the intensity of the review.[166] The first reason for this variety

---

[162] Pan, above n 149, 530.

[163] Nicholson, above n 69, 93.

[164] Ibid, 94-5.

[165] Ibid, 100-1.

[166] Sargent, above n 102, 1034.

is that every registration statement filed to OJK has its own dynamic and complexity. For instance, one company may have an undocumented takeover or acquisition, while another company may have a legally questionable securities transaction. The next reason is each of business sectors or industries in Indonesia has their own business specific regulations. These cases require different levels of scrutiny in the review process.

From the aforementioned contention, it can be inferred that disclosure is often a matter of policy to make substantive and procedural judgement within the limits of the authority's power.[167] However, the negotiation during the review process proves to be helpful for lawyers to understand how OJK implements its disclosure policy because it often goes beyond the promulgated regulations. The negotiation also reduces the possibility of future liabilities for failing to disclose and increase the understanding of OJK administrators about the securities transaction so that OJK can ensure the company's adherence to the regulations.

Conclusion

OJK is responsible for conducting the review process to determine the company's eligibility to conduct a securities offering. This review aims to ensure the company's compliance with securities regulations which include disclosure requirements, because investors rely on this information to make their investment decisions. Subsequent to a satisfactory disclosure, OJK will issue an "effective statement" as permission to conduct the IPO. The disclosure regime implies that as long as disclosure is satisfactory, OJK has no legal basis to refuse or dismiss the registration statement. Consequently, for the investors' protection, OJK must assure that the offering company provides accurate, sufficient, and reliable information in its disclosure.

Nonetheless, in enforcing disclosure, there are several factors that influence OJK's disclosure policy. The first one is materiality, in particular qualitative materiality. Unlike quantitative materiality which has clear benchmark, to decide whether qualitative information is material thus requires disclosing is far from trivial. However, discretion mandated by the Capital Market Act enables OJK to decide that even though the information has no significant financial impact, if it is deemed to be important to provide

[167] Kenneth C. Davis, *Discretionary Justice: A Preliminary Inquiry*, (Lousiana State University, Baton Rouge, 1969) 2.

comprehensive details on the company's business conduct and integrity, then the information needs to be disclosed.

The second one is regulatory capture. OJK has been developing a close interaction with capital market actors which enables OJK to receive valuable inputs in the policy making process and provide support to the implemented securities regulations.[168] On the other hand, the close interaction often creates a situation of regulatory capture, with lenient disclosure enforcement by OJK. Finally, the role of securities lawyers which influences OJK disclosure policy. Securities lawyers hold a substantial role in assisting the issuer in share offerings and throughout the registration statement filing process. Especially for reputable securities lawyers, their negotiation skills have significantly influenced OJK's disclosure policy in the review process. Acknowledging these factors could assist OJK to map their advantages and weaknesses in implementing disclosure policy to achieve the goal of investor protection.

[168] Pan, above n 149, 530.

Chapter IV

Legal Non-compliance Disclosure

Introduction

The previous chapters demonstrate that mandatory disclosure is beneficial in mitigating the problem of information asymmetry. It allows OJK to pursue greater disclosure from the company to reveal important information that may be significant for investors making their investment decisions. However, the enforcement of mandatory disclosure requirements is substantially influenced by the screen of materiality, regulatory capture, and the negotiation skills of the lawyers assisting IPOs.

This chapter takes the last step in answering the research question: whether OJK's enforcement of its disclosure policy on legal non-compliance is sufficient to protect the investing public. This chapter begins by discussing two main categories of legal non-compliance and proceeds to address the value of legal non-compliance disclosure. Although this information is beneficial for investors, not all of them appreciate its importance. This chapter evaluates investor responses to the incorporation of legal non-compliance information in prospectuses in order to improve the effectiveness of legal non-compliance disclosure.

Finally, this chapter demonstrates how OJK can advance the goal of mandatory disclosure by compelling issuing companies to provide information about their legal non-compliance. Furthermore, it presents the argument that legal non-compliance often has a significant economic impact either to the issuer or the investors and that legal non-compliance disclosure significantly improves the effectiveness of disclosure to protect the investor's interest.

Legal Non-compliance

Legal non-compliance disclosure is one of the valuable elements that the investors should have full knowledge of before allocating their portfolio in a company issuing a new share. Compliance with the law reflects how the managers run their business. First of all, their

honesty determines their trustworthiness in managing investors' funds.[169] Second, managers who intelligently manage potential risks including risks of legal non-compliance are more likely to manage other company's aspects intelligently as well.[170] Legal non-compliance disclosure is not only socially significant information, but also material from an economic standpoint, as non-compliance with the law may trigger liabilities, penalties, loss of contract, and other contingencies of economic effect.[171] This information is taken into account as one of the underlying facts in evaluating the potential risks, rewards and price of the investment.[172] Further, it is quite common for the company's legal non-compliance to cause delay in the issuance of an effective statement from OJK. Such delay prompts the rescheduling of the public offerings which is costly for the issuing company. Such delay also indicates that OJK values legal non-compliance information as an important source for the investors to make their investment decision.

Categories of Legal Non-compliance Disclosure

There is a particular section in a company prospectus which is dedicated to incorporating legal opinion and information about a company's legal non-compliance. Based on the writer's experience in reviewing prospectuses and the legal opinions, this study identifies two categories of legal non-compliance that OJK requires to be disclosed in prospectus.

1. Breach of law

This measure could establish a pattern on how a company conducts their business. A fair and honest company will employ maximum efforts to comply with the applicable regulations and conform to its contractual agreements.

A. Violations of law

There are numerous regulations on business practices such as minimum wage, taxation, employee health insurance, and negative investment lists which regulate the limitation of foreign direct ownership in a particular business sector. Before lawyers can provide their legal opinion, they are required to perform legal due diligence to examine the

[169] Williams, above n 6, 1283.

[170] Williams, above n 6, 1285.

[171] Williams, above n 6, 1252-3.

[172] Williams, above n 6, 1273.

company's compliance with these regulations and to submit their legal due diligence (whether in working sheets or as a summary) to OJK. Based on the legal due diligence, OJK could determine which regulation the company does not comply with and request conformity as part of their assessment.

However, there are several cases where the regulation is uncertain and therefore lawyers' opinions might differ. The most common issue, difficult to resolve, is the issue of negative investment lists, which contain restrictions on foreign direct investment in Indonesian companies. However, this regulation on negative investment lists does not apply to portfolio investments conducted through the capital market. This exception creates uncertainty among lawyers and regulators on how the restrictions will apply to publicly listed companies. Consequently, lawyers have developed their own measures to help their clients avoid the barrier of a negative investment list by using a capital market scheme.

Two examples of legal opinions highlight this point. The first one is the legal opinion of PT Bina Buana Raya Tbk (BBR), an Indonesian ship-chartering company, and the second is PT Graha Layar Prima Tbk (GLP), an Indonesian movie theatre chain. Both of these companies fall under the foreign direct investment restriction. However, while BBR as a shipping company is allowed to have up to 49% of foreign ownership, GLP is restricted from any foreign ownership. These companies employed almost identical methods of using the convertible bonds issuance mechanism to avoid the restriction.

The lawyers of GLP and BBR, understanding the loophole in regulations of foreign direct investment restrictions to publicly listed companies, have a major contribution in giving legal advice in arranging the scheme to avoid the restriction. Extracted from BBR and GLP prospectus, these lawyers use the issuance of convertible bonds before the IPO and convert the bonds into shares on the listing day. Further, the lawyers hold the opinion that such transactions ought to be considered a portfolio investment because the conversion is carried out after the newly issued shares (including the new shares catered for the conversion) have been listed as public shares.

These schemes, although not necessarily violating the law, as the law itself is unclear, imposes risk to the companies. For instance, BBR is facing legal proceedings; it is being sued by the Ministry of Transport because of the cabotage principle which requires ships that sail in Indonesia territory to have Indonesian ownership. Such

ownership is difficult to prove as BBR is a publicly listed company and at the time of IPO, 49% of its shares were owned by a Singaporean ship-chartering company, Marco Polo Marine Ltd, apart from 25.1% of publicly owned shares.

B. Expired agreements

Often, during the assessment of legal due diligence, OJK officials discover expired agreements. One possible implication of overdue agreements is a penalty. The severity of this penalty ranges according to the nature of the agreement. Expired office rent agreements will probably generate lower penalties compared to expired million dollar "automatic roll over debt" agreements, for instance. When there is a case of expired agreement, OJK officials will request clarification and the opinion of the lawyer as to whether there is any extension to the agreement, whether the agreement is still in effect, and whether any penalty applies which is going to be economically significant to the company.

2. Legal disputes

This study identifies legal disputes under two different categories as follows.

A. Pending legal proceedings

The case of PT Blue Bird Tbk (BB), being one of Indonesia largest taxi companies with fifteen subsidiaries,[173] provides an interesting example of how pending legal proceedings have created long delays in receiving OJK's approval - causing BB to cut the size of its offering target from $307 million to $200 million.[174] The IPO of BB raised a concern for OJK because of the outstanding lawsuit over share ownership and trademarks from a family member of the company's founder (Mintarsih Latief).[175] Prior to the IPO, OJK had received a legal notice from Latief's attorney about the legal issues faced by BB and when BB finally submitted its registration statement, OJK treated it

[173] Indonesia Stock Exchange <http://www.idx.co.id/en-us/home/information/forcompany/howtobealistedcompany.aspx>.

[174] Neraca, *Tersandung Hukum, OJK Kaji Ulang IPO Blue Bird* [Involved in Legal Issue, OJK Re-evaluates the IPO of Blue Bird] (23 October 2014), par 4 <http://www.neraca.co.id/article/46795/tersandung-hukum-ojk-kaji-ulang-ipo-blue-bird>.

[175] Fathiyah Dahrul and Eveline Danubrata, *Indonesian Taxi Operator Blue Bird to Revive IPO Plan: sources* (16 July 2014) Reuters <http://www.reuters.com/article/us-indonesia-ipo-blue-bird-idUSKBN0FL0YH20140716>.

with a careful evaluation process particularly with regard to documentation completeness and disclosure.

As a result, the prospectus of BB comprised nearly a thousand pages to ensure the completeness and accuracy of the information especially with respect to legal proceedings. The cover of the prospectus also clearly disclosed that the company had, continues to have, and will likely have further lawsuits from parties closely related to the management and shareholders, concerning the company, intellectual property rights, and particular assets that had been used by the company. The prospectus cover further mentioned that the company does not own the trademark it had relied on in its business activities, and that failure in protecting other intellectual property rights would result in potentially material impacts to the company's reputation, branding, and operations.

B. Un-adjudicated violations of law

The case of PT Media Nusantara Citra Tbk (MNC) demonstrates how un-adjudicated violations of law can have economic significance. MNC received approval from OJK (Bapepam-LK at that moment) to launch its IPO on 13 July 2007 and it was the second largest IPO in the Indonesian capital market in 2007, generating fresh funds of $416 million.[176] This IPO attracted both domestic and international investors due to its corporate growth potential[177] and because MNC is part of the Harry Tanoesudibjo conglomerate with vast developing business from property, infrastructure, financial services, to media.

In 2011, the IPO process of MNC was sued by one of its public shareholders, Abdul Malik Jan, based on the allegation of misleading information in MNC IPO prospectus due to the failure of MNC in providing information about a dispute in PT Televisi Pendidikan Indonesia (TPI; one of MNC subsidiaries).[178] The plaintiff argued that a

[176] Anette Jonsson, *Indonesian Media Corporate Prices IPO* (8 June 2007) Finance Asia <http://www.financeasia.com/News/83223,indonesian-media-corporat-prices-ipo.aspx.>

[177] Ibid.

[178] Bisnis Indonesia <http://ftp.unpad.ac.id/koran/bisnis/2011-03-17/bisnis_2011-03-17_010.pdf>.

dispute over TPI ownership should have been disclosed in the prospectus as it was a material fact due to its 21.9% contribution to MNC consolidated revenue.[179]

In 2013, following the decision of Supreme Court No. 862K/Pdt/2013 which granted the demand of Siti Hardiyanti Rukmana (one of TPI's share owners) to retake the ownership of TPI, the share price of MNC dropped 10.34% leading to IDX's suspension of stock trading.[180] Nevertheless, the MNC boss, Harry Tanoesoedibjo insisted that "from a legal standpoint, this case has nothing to do with MNC".[181] Further, in 2014, decision on reconsideration by the Supreme Court Number 238 PK/Pdt/2014 held that PT Berkah Karya Bersama had illegally acquired share ownership of TPI and also illegally prevented the registration of extraordinary general meeting of shareholders (EGMS) decisions of TPI held by Rukmana as TPI shareholders to Legal Entity Administration System of Ministry of Law & Human Rights.[182]

By the time of the IPO, this dispute had not yet been filed in court, although OJK had received several letters warning about the dispute. Further, MNC argued that the dispute was between Rukmana and PT Berkah Karya Bersama (a subsidiary of PT MNC Asset Management as part of MNC group conglomerate and one of the previous TPI share owners which transferred its ownership to MNC) therefore MNC is not a party and had no obligation to disclose this information. Attorneys gave the opinion that based on the company's documentations and government registration, MNC ownership in TPI was legitimate.

OJK did not pursue any further disclosure. In its prospectus, MNC only disclosed that TPI received a legal notice from Crown Capital Global Limited and Maestro Venture Limited which demanded TPI pay to each party $53,000,000 and $4,460,000. It further said "These claims came from TPI's past debt obligations which were taken over by another party before TPI was acquired by MNC. TPI contended that those claims were lacking in legal basis and TPI also had sent a reply requesting that Crown Capital Global Limited and Maestro Venture Limited file claims to related parties. However, as TPI

[179] *Abdul Malik Jan v PT Media Nusantara Citra Tbk., dkk*, District of Central Jakarta Court Decision, No 29/PDT.G/2011/PN.JKT.PST (21 June 2011).

[180] Suryo Wibowo, *IDX Suspends MNC Stocks* (14 October 2013) Tempo, < http://en.tempo.co/read/news/2013/10/14/056521622/IDX-Suspends-MNC-Stocks>.

[181] Ibid.

[182] CNN (20 January 2015) <http://ireport.cnn.com/docs/DOC-1208163>.

understood, to date, there has been no legal action taken either by TPI or the claimant to bring the case to court." This information might be significant for investors, as they would be curious about the actual issue and whether there were any contingencies of future liabilities regarding this matter. Nevertheless, this information is too vague, partial, elusive, and insubstantial.

An evaluation of the prospectus also revealed that other than the above mentioned opinion, there was no opinion about MNC subsidiaries, while it is mandatory for the appointed lawyer to provide a complete opinion on the subsidiary company to the same extent as the opinion about the issuer itself. There is also no opinion from the lawyer as to whether TPI has any legal dispute or un-adjudicated legal dispute.

The difficulties are, although the Supreme Court Reconsideration decided that PT Berkah Karya Bersama illegally acquired its ownership over TPI and PT Berkah Karya Bersama is part of MNC group, OJK may not have enough reason to directly sue MNC for misleading information by not revealing this un-adjudicated case by the time of IPO. This case of un-adjudicated violations of law and its aftermath, support the contention that "violations will be discovered sooner or later, and whoever owns the issuers' stock at the time will pay the price".[183]

Since then, OJK officials have taken further steps to ensure cases such as MNC's lack of disclosure can no longer occur. Lawyers must now provide a full legal opinion on subsidiary companies to the same level as the company offering the shares. Lawyer should also provide opinions on whether those companies faced any pending or contemplated legal disputes (litigation or non-litigation) and any un-adjudicated illegal acts. The same opinion should be provided to respective directors and commissioners.

Interpretation of legal non-compliance disclosure value

There are a number of remarks to make about the legal non-compliance disclosure in publicly listed companies. First, legal non-compliance disclosure has become an important factor which allows the potential investors make better and more-informed investment decisions. As contended above, legal non-compliance could have economic consequences and often this is price-sensitive information. Empirical studies show that information on

[183] Williams, above n 6, 1279.

legal compliance is indeed material, as evidenced by the decline in share prices by the time companies announce illegality.[184] Accordingly, such information should be provided in a timely manner, and OJK will examine this information with care to ensure its reliability, truthfulness, and completeness.

Second, the opinion on legal non-compliance demonstrates the lack of legal certainty that riddles Indonesia's business environment. A statute that should have a uniform meaning may be construed differently by the authority through exception, exemption, and privilege.[185] Stringent regulation is a toothless tiger when enforcement is inconsistent. Inconsistency hinders the ability of investors to make investment judgments in light of such unpredictability.[186] It creates costs for market actors in collecting information, costs of legal disputes, and the costs of "beneficial charges" in the attempt to push through legal claims (this includes pay-offs to speed up the approval of legal procedures).[187] Legal practitioners in Indonesia have long voiced their concerns about how corruption, red tape and legal uncertainty have reached unsettling levels which, without question, have contributed to the economy's sluggish performance.

In the spirit of establishing market integrity and enacting legal certainty, the demand for a more comprehensive harmonisation of law[188] has increased. Legal certainty is a minimum requirement to allow optimum economic growth. Regulators and authorities should gradually close legal loopholes, clarify ambiguity, and provide clear guidance to market participants.[189] In the case of legal loopholes requiring a policy-making decision, OJK requests clarification from the business sector, related ministries and the Indonesia

[184] Williams, above n 6, 1279.

[185] Anthony D'Amato, 'Legal Uncertainty' (1983) 71(1) *California Law Review* 4.

[186] Ibid, 3.

[187] Helmut Wagner, 'The Cost of Legal Uncertainty: Is Harmonization of Law a Good Solution?' (2007) *Modern Law for Global Commerce, Congress to celebrate the fortieth annual session of UNCITRAL* 2.

[188] Ibid 1 (in this context, harmonisation of law referred to is harmonisation between specific regulations enacted by the ministries for business sectors, foreign and domestic investment regulation enacted by BKPM, and capital market regulations. As many ministries regulations and BKPM regulations are difficult to implement to publicly listed companies, this has been creating uncertainty for publicly listed companies and OJK as the policy maker of capital market).

[189] D'Amato, above n 185, 3 (note that these tasks are far from easy tasks, especially these impediments have been the dominating factors that hinder the investment growth in Indonesia for tens of years. For this reason, the word "gradually" is proposed).

Investment Coordinating Board. The explanation, however, is often unsatisfactory. The letter of clarification does not provide a clear answer and merely reiterates the statute.

Third, OJK should be more proactive in controlling the interaction between the company and its shareholders and therefore its mandatory regulatory mechanism must be able to enforce restrictions on company behaviour.[190] Investment risk associated with legal uncertainty could be reduced by having disclosure requirements demanding additional information on a company's legal non-compliance. Proactive also means introducing merit review for legal non-compliance as the securities law is "an integral part of a broad scheme for correcting some of the inequities and defects which may otherwise arise in the practices of corporation finance"[191]. Merit review may not be able to be used to maintain control of corporate conduct but surely it helps as a corrective means at the time of the offering.

Fourth, legal non-compliance disclosure is a valuable opportunity to change business conduct. A company offering its shares to the public would have incentives to improve its value in front of potential investors. By improving its value, the company can be confident in selling its shares at an optimum price, thus achieving its funds acquisition targets. If this fails, the company needs to adjust its use of proceeds accordingly as it may not be able to fund particular projects because of its inability to acquire the necessary capital.

The principle by which legal non-compliance can be translated into investment risk is straightforward.[192] Accordingly, before the company files a registration statement, a company will take the required step to resolve any non-compliance by completing all documentations and obtaining required legal approvals. However, it is possible that during the time frame for the registration, there are documents which are not obtained yet. The reason for this is predominantly because of delays in gaining legal approvals to obtain documentation (licenses and permits).

To conclude, legal non-compliance disclosure transparency remains the best antidote for corporate malfeasance. Transparency helps to prevent misconduct from happening by exposing the company's operations and activities to the public. The enforcement of mandatory disclosure should be based on the contention that anyone who sponsors the

[190] Wagner, above n 191, 1.

[191] Jennings, above n 107, 213.

[192] International Energy Agency, 'Climate Policy Uncertainty and Investment Risk' (2007) 13.

investment of other people's money bears a high standard of moral responsibility not only to shareholders but also to the public.[193]

Investor responses to legal non-compliance disclosure

Deciding whether information about non-compliance with the law is worth disclosing is often challenging. Due to their own bias, companies probably will argue that excessive disclosure of such information increases the cost of marketing in share offerings. For the purpose of selling shares at the best possible price, companies often avoid disclosing certain information, to their benefit. Investment risks generating price volatility and risk due to non-compliance is one of the investment risks that the investors take into account. For those reasons, the company's hesitation to disclose increases.

Moreover, since there is no legally binding court ruling, lawyers are often not confident to provide opinions on whether the company's act of illegality will have a material economic impact.[194] Most lawyers also provide the "legal qualification" in their legal opinion that they do not provide financial judgement. OJK on the other hand, argues that lawyers should be able to provide opinions on materiality based on the claim amounts of the lawsuits.[195] Therefore, a lawyer's opinion will say "The issuer is involved in a lawsuit as plaintiff/defendant with X (name of other parties) at X court (name of the court). This lawsuit is about X with the claim amounts of X. To date, the lawsuit does not (or does) have a legally binding court ruling. On the circumstances where the court decides issuer is lost, it will materially impact the issuer." Moreover, their opinion on the materiality of case is often accompanied by the issuer statement about the economic impact to the issuer.

In circumstances where legal uncertainty is entrenched and enforcement is lax, there is another aspect worthy of discussion: how the investors respond to information about the issuer's illegal conduct. First, investors are more observant in making investment decisions as they aware of the risks of such investment. The risk is due to the unpredictability of the lawsuit outcome. The famously corrupt legal system in Indonesia is causing investors to

[193] Williams, above n 6, 1228 noting the use of Louis D. Brandeis's language in The House Committee Report.

[194] See Nicholson, above n 69, 94-5; Selene E. Mize, 'Should the Lawyer's Duty to Keep Confidences Override the Duty to Disclose Material Information to a Client?' (2009) 12(2) *Legal Ethics* 172-8; Langevoort, above n 158, 81.

[195] Rule No. IX.E.2 of Bapepam-LK Concerning Material Transaction and Changing in Core Business.

have scepticism about the fairness of the legal outcome. The fairness of legal outcome might be affected by pecuniary and political power. While it cannot be generalised that the legal system in Indonesia is entirely corrupt, this has become one of the main impediments to investment growth.

Investors pay more attention to disclosure and legal opinion in prospectuses and conduct further research to find more information about the company's legal problem. Observant investors use disclosure of legal non-compliance to evaluate the overall pattern of legal compliance because it bears on the integrity and honesty of a company and ultimately reflects the quality of management.[196] Not only legal compliance/non-compliance exposure of the issuer, its subsidiaries, and respective directors and commissioner; legal opinion also encompasses compliance to Rule No. IX.I.6 Concerning Director and Commissioner of Issuers and Public Companies. This rule in particular prohibits those directors and commissioners from falsely stating or failing to disclose material information so that statements are misleading. Further, this rule also explains the sanctions attending to such actions. The matter of truthful information has been raised consistently by OJK to ensure investors have access to material information including company's compliance with applicable regulations.

Even though small or unsophisticated investors might have difficulty in obtaining and verifying firm-specific information, they could benefit from information provided by capital market intermediaries such as financial analysts. Financial analysts are resourceful and they evaluate company's performance, forecast its prospects, and provide recommendations on valuable shares.[197] Furthermore, with competition among public issuers to attract capital, investors could choose a company with lower legal risks to suit their preferences.

There are particular cases where the issuing company is a large corporation that owns media. MNC for instance, operates three television media with 34.9% audience share, and it operates the third biggest nationwide circulation newspaper.[198] With such power to influence the press, it is difficult for investors to verify the truthfulness of news and to

[196] Williams, above n 6, 1282.

[197] Healy and Palepu, above n 44, 416.

[198] PT Media Nusantara Citra Tbk, IPO prospectus, 14 June 2007.

search for unbiased information. Control of media means these companies are able to shape public opinion as on which companies provide better investment returns. There is no law regulating indirect publicity in the privately owned mass media and directing opinion should be properly supervised by the regulator to avoid dissemination of misleading and inaccurate information.

To promote investors' awareness of securities investment risks and benefits, OJK regularly organises public training to educate investors. These training seminars are held in small cities, universities, and public/private offices and target wide ranges of audiences. Investments promoted include not only equity investment, but also Islamic stocks, conventional bonds, and Islamic bonds. However, despite wide promotion to encourage securities investment, many people still believe that this investment is high risk, compared to deposits for instance. Additionally, lack of confidence in Indonesian legal certainty is causing the capital market to remain underdeveloped.

Second, investors ignore information on the company's legal non-compliance. To assume that all investors read and understand prospectuses oversimplifies these matters. Prospectuses become "so elaborate that many investors are unable to detect even blatant fraud solely by reading"[199]. It encompasses multiple aspects (financial information, legal, marketing, taxation, dividend policy, etc.). In contrast, it is often impossible to describe the structure and operations of a company in simple terms.[200] The breadth and complexity of a prospectus makes it difficult for the investors to identify what the information means.[201] This also applies to the information on legal non-compliance. Many investors fail to incorporate this information into their investment decision. If it is true that the prospectus is impenetrable and therefore investors ignore this information, it means the prospectus has failed its communicative purpose.[202]

The ability to analyse a prospectus and incorporate its information into their decision making process differs from one investor to another investor. The disparity stems from

[199] Alison Grey Anderson, 'The Disclosure Process in Federal Securities Regulation: A Brief Review' (1974) 25 *Hastings Law Journal* 325.

[200] Ripken, above n 35, 185.

[201] Ibid.

[202] Ibid.

factors such as experience, time and resources to conduct market research.[203] Skilled and resourceful investors such as institutional investors may not think that the complexity of prospectus is a barrier. They understand the importance of each piece of information, analyse it, and are able to judge accurately the intrinsic value of a share based on this information. On the other hand, ordinary investors face the risks of being disadvantaged as compared with their more-informed counterparts in share trading, including risk of future loss due to miss-judgement as to the worthiness of a business venture.

To make this matter worse, disclosure nowadays is "written by corporate lawyers in formalized language to protect the corporation from liability rather than to provide the investor with meaningful information".[204] As OJK administrators could attest, straightforward opinion is rarely given by lawyers. Legal qualification is also used by lawyers to limit their liabilities towards their opinion. One of the tasks of OJK officials is to ensure lawyers give opinions; complete according to the mandatory requirements, straightforward, and not merely using descriptive language; the use of plain language is encouraged. Legal qualifications should be clear and not limit the responsibility of the lawyer to the legal aspect of disclosure. The above are the attempts to improve the readability of disclosure that have been undertaken.

Another factor that contributes to investors' ignorance as to legal non-compliance disclosure is weak enforcement and the compromising of punishment for non-compliance. Enforcement consists of two different approaches, namely a compliance approach which educates potential offenders to comply with the law, and a deterrence approach which utilise penalties and prosecutions to deter breaches of the rules.[205] Ineffective enforcement has undermined the regulatory intention to control persons or institutions.[206]

Legal mechanisms in Indonesia are full of uncertainty.[207] There is a saying that law enforcement in Indonesia is like a knife; "sharp at the bottom and blunt at the top". This

[203] Choi, above n 26, 2.

[204] Ripken, above n 35, 186.

[205] Robert Baldwin and Martin Cave, *Understanding Regulation: Theory, Strategy, and Practice* (1999) 96.

[206] Entcho Raykovski, 'Continuous Disclosure: Has Regulation Enhanced the Australian Securities Market?' (2004) 30(2) *Monash University Law Review* 288.

[207] See, eg, Simon Butt, 'Regional Autonomy and Legal Disorder: the Proliferation of Local Laws in Indonesia' (2010) 32(2) *Sydney Law Review* 177-97; Shawn Donnan, 'Foreign investors Still Wary of Jakarta: Legal Claims against Multinationals Create Uncertainty and are Likely to Deter the Cash Inflows Indonesia Needs,

means that law enforcement is only harsh and stringent for those who cannot afford legal advocacy. In contrast, the rich and powerful seem untouched by the legal system. Even when they are, prosecutions of these people are often mild and lenient, consisting of relatively small penalties and only short-term imprisonment. It is no secret that in the case of imprisonment, they would have relatively lavish or comfortable facilities such as rooms with air condition, pleasant bathrooms, refrigerators, and unlimited visits.[208]

Poor enforcement also applies to securities market violations. Compliance and deterrence approaches should be implemented comprehensively to improve the standard of behaviour of the publicly listed companies.[209] Capital market regulations should "ensure that an appropriate action is available for every type of breach and an escalation is always available to the next level".[210] Mandatory disclosure mechanisms allow OJK as the capital market regulator to enact tougher rules in regulating securities market especially given the uncertain environment. Law No. 8 Year 2005 concerning Capital Market also gives a mandate to OJK to act in order to protect minority shareholders. This mandate provides OJK with authority to punish companies for non-conformity to the securities law to achieve more desirable outcomes of disclosure. In this way, legal non-compliance disclosure will be more effective in protecting the investors.

Conclusion

Having full knowledge about the issuing company is beneficial to investors who can thereby make better judgements as to the investment. Information about a company's legal non-compliance is not only socially significant but also financially important as it may lead to hefty penalties, loss of contract and other economic effects. This importance is evidenced by dropped share prices in times where a company announces illegal conduct. With the wide scale of legal uncertainty that has riddled Indonesia for years, it is reasonable

writes Shawn Donnan (COMPANIES ASIA-PACIFIC)', *The Financial Times*, (London), 9 February 2005, 27; Amahl S. Azwar, 'Legal Uncertainty Remains Big Problem in RI Mining Sector', *The Jakarta Post*, (Jakarta), 17 June 2013, 14.

[208] Extracted from *Indonesia Inmates Buy Jail Luxury* (16 January 2010) <http://www.aljazeera.com/news/asia-pacific/2010/01/201011655325437391.html>; Ross, *Artalyta Suryani & Prison Luxury* Indonesia Matters (12 January 2010) <http://www.indonesiamatters.com/8002/sel-mewah-artalyta-suryani/>.

[209] Baldwin and Cave, above n 205, 98.

[210] Raykovski, above n 206, 290.

to consider legal non-compliance equally important to financial information. Disclosure in non-compliance to law has several benefits whether to the investors and the issuer itself. First, compliance to the law reflects the integrity and trustworthiness of the company. Second, it demonstrates the capability of the company to manage its potential risks, including risk of legal non-compliance as well as other aspects.

There are a number of noteworthy aspects of legal non-compliance disclosure in publicly listed companies. First, it improves the ability of investors to evaluate share value. Therefore, capital market regulator should treat this information carefully to ensure equal and complete dissemination. Second, it shows that Indonesia is still full of legal uncertainty, requiring a comprehensive solution. Regulators must ensure that the interaction between issuer and investors is healthy and that the current mechanism is sufficient to prevent *mala fide* behaviour of a company.

Regardless of the power of OJK to apply its discretion on implementation of its legal non-compliance disclosure policy, this chapter demonstrates that OJK is inconsistent in applying the power. In some of the offerings companies fully disclose their legal non-compliance; therefore the investors' right to access to full and equal information is fulfilled. On the hand, other companies get away with avoiding disclosing such incriminating information, and in those cases the investors are the ones who will suffer the consequences.

Chapter V

Conclusion

Introduction

The focus of this study is to examine the sufficiency of OJK's disclosure policy on legal non-compliance to protect the investing public. To be able to do so, this study has critically examined the regulatory framework for OJK's mandatory disclosure policy. This examination is needed to establish the argument that OJK has the legal grounds to compel the issuing company to provide the legal non-compliance information in its disclosure.

The study addressed the importance of mitigating information asymmetry in the capital market and identified mandatory disclosure as the better mechanism to promote greater transparency compared to a voluntary disclosure mechanism. Further, this study also examined the factors that influence OJK's implementation of mandatory disclosure policy, and OJK's policy on the company's legal non-compliance disclosure.

The literature points to the importance of disclosure in preserving the capital market integrity. However, only a small proportion of the literature analyses the necessity of the qualitative information disclosure to provide a comprehensive picture of the company's business conducts and activities. In fact, several scholars argue that qualitative information should not need to be incorporated in disclosure because this information has no financial impact. This study demonstrates that the company's legal non-compliance indeed has significant economic impact either to the issuing company or to the investors and revisited the cases of the company's legal non-compliance disclosure in order to understand the impact of such disclosure on its share price.

This concluding chapter explicates the connections amongst the discussion chapters in answering the research question and proceeds to summarise the findings of those chapters.

Interrelation between chapters and summary of the findings

Chapter two discusses Adolf A. Berle and Gardiner C. Means book entitled "The Modern Corporation and Private Property" (1932) which contended that there is a need to control the large companies to prevent abuse their powers at the expense of shareholders and the public. Berle and Means also address the possibility of imposing greater public

accountability on those powers as they have great influence on the economic system of the nation. In order to strengthen the participation of the shareholders in supervising the company's conduct, equal access to company-specific information is necessary. Disclosure ensures the potential subscribers receive an appropriate level of information before making their investment decision. Chapter two argues that in order to achieve an effective and efficient capital market, mandatory disclosure is the better mechanism to regulate the publicly listed companies. This chapter concludes that the efficacy of mandatory disclosure requires strong support from the government in the form of clear regulations that are able to encourage the active participation of the capital market actors.

Chapter three provides background information on the Indonesian capital market regulatory system to help the reader to understand the statutory context behind the Indonesian disclosure regime. This chapter then addresses the statutory authority which allows OJK to exercise discretion on its disclosure policy (in particular, qualitative information disclosure) as long as it is necessary for the prosperity and the well-being of the public. Nonetheless, discretion as a policy is often influenced by factors such as materiality screening, regulatory capture, and the role of securities lawyers. Chapter three demonstrates that those factors may hinder the efficacy of mandatory disclosure in the Indonesian capital market. The purpose of this chapter is to describe the appropriate action that OJK should take in order to enforce disclosure requirements.

Chapter four evaluates the OJK's policy in pursuant to the company legal non-compliance disclosure. Several scholars argue that it is unnecessary to require companies to provide qualitative information as this rarely has an economic impact to the investors, however this chapter attests that information about a company's legal non-compliance is clearly significant to capital market stakeholders. It concludes that OJK should advance the goal of disclosure, not only for the protection of the investors' interest, but also as an opportunity to change corporate conduct, promote legal certainty, and enhance public accountability.

In addition, this study also established several constraints to enforcement of an obligation to provide the company's legal non-compliance information. These constraints are due to the difficulties of establishing a workable materiality standard for qualitative information disclosure as it is difficult to assign precise benchmarks to the requirements and because of resistance from companies to providing incriminating details.

Recommendations based on the study

This study offers several recommendations based on its findings. First, the thorough legal due diligence submitted by the lawyers as part of the registration statement documents allows OJK to review the overall "company's finances, managements, operations, and other business activities"[211] from a legal aspect. This is a valuable opportunity for the government to conduct an audit of company legal compliance. This study recommends the establishment of an integrated platform that allows OJK to have closer cooperation with other related government institutions, such as BKPM and other ministries which regulate specific industries so that these institutions could have joint supervision of company legal compliance.

Second, this study found that many unsophisticated investors (such as non-institutional investors) have difficulties in understanding prospectuses and incorporating the information contained in them into their investment decision processes. A prospectus aims to mitigate the investment risks derived from the problem of information asymmetry in capital markets. For this reason, this study recommends OJK intensify training in understanding prospectuses so the risks of investing in the capital market could be better understood by the broader investing public.

And finally, OJK must demonstrate its consistency in its effort of enforcing capital market regulations to preserve market integrity. Investors rely on OJK to protect the interests of the investing public. From the findings of the study, OJK has not been consistent in enforcing its discretion on company legal non-compliance. Several companies have escaped from disclosing the necessary information about their legal non-compliance.

Suggestions for future research

This study has identified the problem of legal uncertainty as a major impediment to investment growth in Indonesia. The current president of Indonesia, Joko Widodo, has been vigorously promoting Indonesia as an investment-friendly country and inviting neighbouring countries and large multi-national companies to invest in Indonesia. However, without the proper enforcement of law, investors are reluctant to invest in

[211] The explanation of Law No. 8 Year 1995 concerning Capital Market.

Indonesia. A further consequence of the legal uncertainty is that Indonesia will remain only a market for foreign products, with its local industries unprotected against those large economic powers.

Further empirical research should be conducted to analyse the role of capital market regulations in improving legal certainty regarding investment in Indonesia, particularly in relation to the regulation of foreign investment in Indonesian public companies.

Conclusion

One of the main roles of OJK as the capital market regulator is to improve the transparency of capital markets. Market transparency is beneficial for preventing market manipulation and insider trading, increasing control over managers' business conduct, and promoting legal certainty in the market, and also for the investors by helping them to make better judgments on share values. Transparency in legal non-compliance is also regarded as valuable information for investors to evaluate the manager integrity in business. It provides a holistic portrayal of the company's affairs rather than quantitative information alone.

The findings of the study will contribute to the enrichment of the literature of disclosure in capital markets regarding the importance of incorporating information about legal non-compliance. OJK as the capital market policy maker is expected to have a better understanding of the challenges of ensuring market transparency for the protection of the public interest. This study hopes to encourage OJK to improve its strategy in pursuing greater transparency amongst publicly listed companies. It also offers lessons for other developing capital markets, particularly those with conditions of legal uncertainty similar to Indonesia, in advancing the goal of disclosure.

BIBLIOGRAPHY

A *Books*

Baldwin, Robert and Martin Cave, *Understanding Regulation: Theory, Strategy, and Practice* (Oxford University, 1999)

Berle, Adolf A. and Gariner C. Means, *The Modern Corporation and Private Property* (Harcourt, Brace and World, 1968)

Brandeis, Louis D., *Other People's Money and How the Bankers Use It* (Frederick A. Stokes, 1932)

Davis, Kenneth C., *Discretionary Justice: A Preliminary Inquiry*, (Lousiana State University, 1969)

Drutman, Lee and Charlie Cray, *The People's Business: Controlling Corporations and Restoring Democracy* (Berrett-Koehler Publisher, 2004)

Gray, David E., *Doing Research in the Real World* (Sage Publications, 2004)

B *Edited Books*

Chynoweth, Paul, 'Legal Research' in Andrew Knight and Les Ruddock (eds), *Advanced Research Methods in the Built Environment* (Wiley-Blackwell Publishing, Oxford, 2008) ch 3, 28-38

C *Journal Articles*

Adams, Edward S., 'Corporate Governance after Enron and Global Crossing: Comparative Lessons for Cross-National Improvement' (2003) 78(2) *Indiana Law Journal* 723-781

Anderson, Alison Grey, 'The Disclosure Process in Federal Securities Regulation: A Brief Review' (1974) 25 *Hastings Law Journal* 311-354

Armitage, Seth and Claire Marston, 'Corporate Disclosure, Cost of Capital and Reputation: Evidence from Finance Directors' (2008) 40(4) *British Accounting Review* 314-336

Bebchuk, Lucian Arye and Mark J. Roe, 'A Theory of Path Dependence in Corporate Ownership and Governance' (1999) 52(1) *Stanford Law Review* 127-170

Berglof, Erik and Anete Pajuste, 'What Do Firms Disclose and Why? Enforcing Corporate Governance and Transparency in Central and Eastern Europe' (2005) 21(2) *Oxford Review of Economic Policy* 178-197

Black, Bernard S., 'The Legal and Institutional Preconditions for Strong Securities Markets' (2001) 48(4) *UCLA Law Review* 781-855

Butt, Simon, 'Regional Autonomy and Legal Disorder: the Proliferation of Local Laws in Indonesia' (2010) 32(2) *Sydney Law Review* 177-97

Choi, Stephen J., 'Selective Disclosure in the Public Capital Markets' (2001) *Boalt Working Papers in Public Law* UC Berkeley: Boalt Hall 2-57

Cohen, Boyd D. and Thomas J. Dean, 'Information Asymmetry and Investor Valuation of IPOs: Top Management Team Legitimacy as a Capital Market Signal' (2005) 26(7) *Strategic Management Journal* 683-90

Coffee, Jr, John C., 'Privatization and Corporate Governance: The Lessons of Securities Market Failure' (1999) 25(1) *Journal of Corporation Law* 1-39

Cox, James D., 'Regulatory Duopoly in U.S. Securities Market' (1999) 99(5) *Columbia Law Review* 1200-1252

Downes, David H. and Robert Heinkel, 'Signaling and the Valuation of Unseasoned New Issue' (1982) 37(1) *Journal of Finance* 1-10

D'amato, Anthony, 'Legal Uncertainty' (1983) 71(1) *California Law Review* 1-55

Easterbrook, Frank H. and Daniel R. Fischel, 'Mandatory Disclosure and the Protection of Investors' (1984) 70(4) *Virginia Law Review* 669-715

Fang, Kenneth C., 'Clarifying and Protecting Materiality Standards in Financial Statements: A Review of SEC Staff Accounting Bulletin 99' (2000) 55(3) *The Business Lawyer* 1039-1064

Fedders, John M., 'Qualitative Materiality: The Birth, Struggles, and Demise of an Unworkable Standard' (1998) 48(1) *Catholic University Law Review* 41-92

Ferrell, Allen, 'The Case for Mandatory Disclosure in Securities Regulation around the World' (2007) 81(2) *Brook. J. Corp. Fin. & Com. L*. 81-131

Franco, Joseph A., 'Why Antifraud Prohibitions are not enough: The Significance of opportunism, Candor and Signaling in the Economic Case for Mandatory Securities Disclosure' (2002) 2002(2) *Columbia Business Law Review* 223-362

Healy, Paul M. and Krishna G. Palepu, 'Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literature' (2001) 31(1) *Journal of Accounting and Economics* 405-440

Hessen, Robert, 'The Modern Corporation and Private Property: A Reappraisal' (1983) 26(2) *The Journal of Law and Economics* 273-289

Ho, Simon S.M. and Kar Shun Wong, 'A Study of the Relationship between Corporate Governance Structures and the Extent of Voluntary Disclosure' (2001) 10(2) *Journal of International Accounting, Auditing and Taxation* 139-156

Hopt, Klaus J., 'Modern Company and Capital Market Problems: Improving European Corporate Governance after Enron' (2003) 3(2) *Journal of Corporate Law Studies* 221-268

Horwich, Allan, 'The Neglected Relationship of Materiality and Recklessness in Actions under Rule b-5' (2000) 55(3) *The Business Lawyer* 1023-1038

International Energy Agency, 'Climate Policy Uncertainty and Investment Risk' (2007)

Jennings, Richard W., 'The Role of the States in Corporate Regulation and Investor Protection' (1958) 23(2) *Law and Contemporary Problems* 193-230

Jewell, Christopher and Lisa Bero, 'Public Participation and Claims Making: Evidence Utilization and Divergent Policy Frames in California's Ergonomics Rulemaking' (2007) 17(4) *Journal of Public Administration Research and Theory* 625-650

Kappas, Nicholas, 'A question of Materiality: Why the Securities and Exchange Commission's Regulation Fair Disclosure is Unconstitutionally Vague' (2001-2001) 45(3-4) *New York Law School Law Review* 651-675

Khademian, Anne M., 'Reinventing a Government Corporation: Professional Priorities and a Clear Bottom Line' (1995) 55(1) *Public Administration Review* 17-28

Langevoort, Donald C., 'Managing the "Expectations Gap" in Investor Protection: The SEC and the Post-Enron Reform Agenda. (Symposium: Lessons from Enron, How Did Corporate and Securities Law Fail?)' (2003) 48(4) *Villanova Law Review* 1139-1165

Langevoort, Donald C., 'Where Were the Lawyers? A Behavioral Inquiry into Lawyers' Responsibility for Clients' Fraud' (1993) 46(1) *Vanderbilt Law Review* 75-119

Leland, Hayne E. and David H. Pyle, 'Information Asymmetries, Financial Structure, and Financial Intermediation' (1977) 32(2) *The Journal of Finance* 371-387

Levine, Michael E. and Jennifer L. Forrence, 'Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis' (1990) *Journal of Law, Economics, & Organization* 6(SPEISS) 167-198

Longstreth, Bevis, 'SEC Disclosure Policy Regarding Management Integrity' (1983) 38(4) *The Business Lawyer* 1413-1428

Lundholm, Russel and Matt Van Winkle, 'Motives for Disclosure and Non-disclosure: A Framework and Review of the Evidence' (2006) 36(1) *Accounting and Business Research* 43-48

McBain, Michael L. and David S. Krause, 'Going Public: The Impact of Insiders' Holdings on the Price of Initial Public Offerings' (1985) 4(6) *Journal of Business Venturing* 419-428

Mize, Selene E., 'Should the Lawyer's Duty to Keep Confidences Override the Duty to Disclose Material Information to a Client?' (2009) 12(2) *Legal Ethics* 171-205.

Nicholson, Lisa H., 'A Hobson's Choice for Securities Lawyers in the Post-Enron Environment: Striking a Balance between the Obligation of Client Loyalty and Market Gatekeeper' (2002) 16(1) *Georgetown Journal of Legal Ethics* 91-154

Pan, Eric J., 'Harmonization of U.S.-EU Securities Regulation: the Case for a Single European Securities Regulator' (2003) 34(2) *Law and Policy in International Business* 499-537

Potter, Michael R., Amanda M. Olejarski, and Stefanie M. Pfister, 'Capture Theory and the Public Interest: Balancing Competing Values to Ensure Regulatory Effectiveness' (2014) 37(10) *International Journal of Public Administration* 638-645

Prentice, Robert A., 'The Inevitability of A Strong SEC' (2006) 91(4) *Cornell Law Review* 775-839

Raykovski, Entcho, 'Continuous Disclosure: Has Regulation Enhanced the Australian Securities Market?' (2004) 30(2) *Monash University Law Review* 269-302

Ripken, Susanna Kim, 'The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation' (2006) 58(1) *Baylor Law Review* 139-204

Sargent, Mark A., 'State Disclosure Regulation and the Allocation of Regulatory Responsibilities' (1987) 46(4) *Maryland Law Review* 1027-1070

Sauer, Richard C., 'The Erosion of Materiality Standard in the Enforcement of the Federal Securities Laws' (2007) 62(2) *The Business Lawyer* 317-357

The Ad Hoc Subcommittee on Merit Regulation of the State Regulation of Securities Committee, 'Report on State Merit of Regulation of Securities Offering' (1986) 41(3) *The Business Lawyer* 785-852

Wagner, Helmut, 'The Cost of Legal Uncertainty: Is Harmonization of Law a Good Solution?' (2007) *Modern Law for Global Commerce, Congress to celebrate the fortieth annual session of UNCITRAL* 1-10

Williams, Cynthia A., 'The Securities and Exchange Commissions and Corporate Social Transparency' (1999) 112 (6) *Harvard Law Review* 1197-1311

Xu, Chenggang and Katharina Pistor, 'Law Enforcement under Incomplete Law: Theory and Evidence from Financial Market Regulation' (2002) *Suntory and Toyota International Centres for Economics and Related Disciplines, London School of Economics and Political Science* 1-44

Xu, Zhijian and Zhiyou Xie, 'Impact of Insiders and outsiders of entrepreneurial firms on Valuation in Initial Public Offering' (2014) 1(1) *Journal of Chinese Management* 1-12

D *Newspaper Articles*

Azwar, Amahl S., 'Legal Uncertainty Remains Big Problem in RI Mining Sector', *The Jakarta Post*, (Jakarta), 17 June 2013, 14

Donnan, Shawn, 'Foreign investors Still Wary of Jakarta: Legal Claims against Multinationals Create Uncertainty and are Likely to Deter the Cash Inflows Indonesia Needs, writes Shawn Donnan (COMPANIES ASIA-PACIFIC)', *The Financial Times*, (London), 9 February 2005, 27

E *Webpage/sources*

Ahniar, Nur Farida, *Bank Dunia: Waspadai Transisi OJK saat Krisis* [World Bank: Be Wary to the OJK's Transition Time of Crisis] (1 December 2011)

<http://bisnis.news.viva.co.id/news/read/268823-bank-dunia-ingatkan-transisi-ojk-saat-krisis>

Bisnis Indonesia <http://ftp.unpad.ac.id/koran/bisnis/2011-03-17/bisnis_2011-03-17_010.pdf>

CNN (20 January 2015) <http://ireport.cnn.com/docs/DOC-1208163>

Dahrul, Fathiyah and Danubrata, Eveline, *Indonesian Taxi Operator Blue Bird to Revive IPO Plan: sources* (16 July 2014) Reuters <http://www.reuters.com/article/us-indonesia-ipo-blue-bird-idUSKBN0FL0YH20140716>

Indonesia Inmates Buy Jail Luxury (16 January 2010) <http://www.aljazeera.com/news/asia-pacific/2010/01/201011655325437391.html>

Indonesia Stock Exchange, *How to be a Listed Company* (2010) <http://www.idx.co.id/en-us/home/information/forcompany/howtobealistedcompany.aspx>

Indonesia Stock Exchange < http://www.idx.co.id/en-us/home/listedcompanies/companyprofile.aspx >

Jefriando, Maikel, *Kelahiran OJK, Sejarah Baru Perekonomian Indonesia* [The Birth of OJK, New History of the Indonesian Economy] (27 December 2012) Sindo News <http://ekbis.sindonews.com/read/700589/90/kelahiran-ojk-sejarah-baru-perekonomian-indonesia-1356414181>

Jonsson, Anette, *Indonesian Media Corporate Prices IPO* (8 June 2007) Finance Asia <http://www.financeasia.com/News/83223,indonesian-media-corporate-prices-ipo.aspx>

Kokemuller, Neil, *What Are the Advantages & Disadvantages of Selling Stock to Raise Funds for a Small Business*, Chron <http://smallbusiness.chron.com/advantages-disadvantages-selling-stock-raise-funds-small-business-46585.html>

Neraca, *Tersandung Hukum, OJK Kaji Ulang IPO Blue Bird* [Involved in Legal Issue, OJK Re-evaluates the IPO of Blue Bird] (23 October 2014), par 4 <http://www.neraca.co.id/article/46795/tersandung-hukum-ojk-kaji-ulang-ipo-blue-bird>

Purnomo, Herdaru, *Bank Dunia: Transisi Pembentukan OJK Berisiko Besar* [World Bank: OJK is facing Great Risks during Transition Time] (1 December 2011) Detik <http://finance.detik.com/read/2011/12/01/110200/1779870/5/bank-dunia-transisi-pembentukan-ojk-berisiko-besar>

Ross, *Artalyta Suryani & Prison Luxury* Indonesia Matters (12 January 2010) <http://www.indonesiamatters.com/8002/sel-mewah-artalyta-suryani/>

Wibowo, Suryo, *IDX Suspends MNC Stocks* (14 October 2013) Tempo, < http://en.tempo.co/read/news/2013/10/14/056521622/IDX-Suspends-MNC-Stocks>

<https://en.wikipedia.org/wiki/Financial_Services_Authority>

F *Prospectus*

PT Bina Buana Raya, Tbk, Rights Issue prospectus, 14 October 2014

PT Blue Bird, Tbk, IPO prospectus, 30 October 2014

PT Graha Layar Prima, Tbk, IPO prospectus, 14 March 2014

PT Media Nusantara Citra Tbk, IPO prospectus, 14 June 2007