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**The Effects of Public Voluntary Regulation in Developing Country
Contexts: Comparing Regulatory Performance Across Sectors and
Firms in Indonesia**

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Abstract

In recent decades, governments worldwide have embraced public voluntary regulation as a non-mandatory regulatory strategy with the aim of improving socio-environmental performance in business. While such non-mandatory approaches to government regulation originated in North America and Europe, they have also been employed by a range of developing country governments, raising questions about the capacity of public voluntary regulation to function in developing country contexts. Existing regulatory scholarship has not yet developed a systematic framework for understanding how and why the effects of public voluntary regulation vary across different countries, sectors and firms, and if and how public voluntary regulators can adapt regulatory strategies to accommodate variation in such multiple dimensions of institutional context.

This thesis aims to answer these questions by investigating how the capacity of public voluntary regulation to improve socio-environmental performance in regulated companies is mediated by varied institutional contexts. Analysis draws on a qualitative study of a prominent public voluntary regulatory program in Indonesia—PROPER (Industrial Environmental Rating Program). Drawing on empirical findings from extensive in-country field research together with theoretical insights on public voluntary regulation, political economy, environmental governance and CSR; the thesis presents a comparative analysis of how the PROPER program operated across two contrasting sectors (oil and gas and palm oil), and across state-owned and private firms.

Findings indicate there is significant potential for public voluntary regulation to improve socio-environmental performance within the distinctive context of a developing country. However, specific regulatory strategies and their effects are shown to be highly sensitive to country, sectoral and firm contexts. Analysis identifies three key contextual factors that played a key role in the extent to which PROPER was able to improve socio-environmental performance: (1) the degree of pressure from third-party firm stakeholders (such as NGOs, communities, investors or consumers); (2) the sensitivity of firm management to government pressure, which depended in turn on the degree of discretionary power that government could exercise over firm managers through corporate governance arrangements and/or political patronage networks; and (3) the capacity and incentives of government to provide technical assistance to firms. These factors are shown to vary significantly between industrial sectors, and between private and state-owned firms, which in turn influenced the Indonesian regulatory environment. Findings also highlight the distinctive ways in which Indonesian regulators adapted public voluntary regulatory strategies to the Indonesian context—relying much more on informal, discretionary sources of state authority, than ‘background threats’ of formal regulation, on which much prior regulatory scholarship has focused. These findings are shown to have significant implications for both the theory and practice of public voluntary regulation in developing countries.

Declaration

This is to certify that:

- (i) the thesis comprises only my original work towards the PhD except where otherwise indicated.
- (ii) due acknowledgement has been made in the text to all other material used.
- (iii) the thesis is fewer than 100,000 words in length, exclusive of tables, maps, bibliography and appendices.

Signature:

A handwritten signature in blue ink, consisting of a large, stylized initial 'J' followed by a series of connected loops and a final horizontal stroke.

Date: May 8, 2020

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Doing a PhD is the unforgettable moment in my academic journey. It taught me how to cope with a limited source of living and unexpected conditions, notably the Covid-19 virus, which significantly changed not only educational processes but also human interactions. However, this journey provided the opportunity for me to be richer in thoughts, patience, and courage.

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Acronyms and Abbreviations

AAHTP	Agreement on Transboundary Haze Pollution
AMDAL	<i>Analisis Dampak Lingkungan</i> (Environmental Impact Assessment)
ASEAN	Association of Southeast Asian Nations
BAT	Best Available Technology
BNI	Bank National Indonesia
BOD	Bio-Oxygen Demand
BPS	<i>Badan Pusat Statistik</i> (Statistics Indonesia)
CCD	Corporate Community Development
CEO	Chief Executive Officer
COD	Chemical Oxygen Demand
CPO	Crude Palm Oil
CSOs	Civil Society Organisations
CSR	Corporate Social Responsibility
DITJEN PPKL	<i>Direktorat Jenderal Pengendalian Pencemaran dan Kerusakan Lingkungan</i> (Directorate General of Pollution and Environmental Damage Control).
EMAS	Environmental Management and Audit Scheme
EOF	Eyes on the Forest
EPA	Environmental Protecting Agency
FFB	Fresh Fruit Bunches
FGD	Focus Group Discussion
FoEI	Friends of the Earth International
FPIC	Free Prior Inform Consent
GAP	Good Agriculture Practice
GDP	Gross Domestic Product
GRP	Green Ratings Project
HCV	High Conservation Value
HGU	<i>Hak Guna Usaha</i> (Land Cultivated Right)
HSSE	Health Safety Security and Environment

IDR	Indonesian Dollar Rupiah
IFC	International Financial Corporation
IFC	International Financial Corporation
IMF	International Monetary Fund
IP	Identity Preserved
IPPAL	<i>Ikatan Petani Pecinta Alam Lestari</i> (Association of Sustainable Nature Farmers)
ISO	International Organisation for Standardisation
ISPO	Indonesian Sustainable Palm Oil
KPA	<i>Konsorsium Pembaharuan Agraria</i> (Consortium for Agrarian Reform)
KPI	Key Performance Indicators
KPK	<i>Komisi Pemberantasan Korupsi</i> (Indonesian Corruption Eradication Commission)
KW	Kilowatts
MB	Megabytes
MBTU	Million British Thermal Units
MJ	Megajoules
MOEF	Ministry of Environment and Forestry
MPOA	Malaysia Palm Oil Association
MT	Metric Ton
NGOs	Non-Government Organisations
NMVS	National Violence Monitoring System
NSMD	Non-State Market-Driven
OECD	Organisation for Economic Cooperation and Development
OJK	<i>Otoritas Jasa Keuangan</i> (Financial Service Authority)
P&C	Principles and Criteria
PBI	Peraturan Bank Indonesia (Bank Indonesia Regulation)
PEM	Pertambangan Energi dan Mineral (Mining Energy and Minerals)
PKS	<i>Pabrik Kelapa Sawit</i> (Palm Oil Mill)
PPM	Parts per million

PROPER	<i>Program Penilaian Peringkat Kinerja Perusahaan dalam Pengelolaan Lingkungan Hidup</i> (Industrial Environmental Rating Program)
PT	<i>Perseroan Terbatas</i> (Limited Company)
RPJMN	<i>Rencana Pembangunan Jangka Menengah Nasional</i> (Five-year National Medium-term Development Plan)
RSPO	Roundtable on Sustainable Palm Oil
SHE	Safety Health and Environment
SKK MIGAS	<i>Satuan Kerja Khusus Pelaksana Kegiatan Usaha Hulu Minyak dan Gas Bumi</i> (Special Task Force for Upstream Oil and Gas Business)
SOC	State Oil Company
SOEs	State-Owned Enterprises
SOPs	Standards Operational Prosedures
SRI	<i>Sistem Rice Intensification</i> (Rice System Intensification)
Subdit PPKL	<i>Sub bagian Pengendalian Pencemaran dan Kerusakan Lingkungan</i> (Pollution and Environmental Damage Control Subdivision)
UD	<i>Unit Dagang</i> (Trading organisation)
UNEP	United Nations Environment Programme
USD	United States Dollar
UUD 1945	<i>Undang-Undang Dasar 1945</i> (The 1945 Constitution of the Republic of Indonesia)
VP	Vice President
WTC	Waste Treatment Centre
WWF	World Wide Fund for Nature

Chapter 1

Introduction

1.1. Background

After decades of economic expansion, largely at the expense of environmental quality, new trends in environmental governance are taking shape in Asian countries, including Indonesia (Quitow et al., 2013). Pollution associated with expanding production processes has systematically diminished not only environmental quality but also key elements of social welfare (Bikorimana & Sun, 2020; Duraipah, 1998).

Indonesian industrialisation processes have been associated with several catastrophic episodes of environmental damage which have produced extensive social problems. One prominent environmental disaster involved a mudflow in the oil and gas sector in East Java which forced thousands of people in twelve villages to abandon their homes and their sources of income permanently (McMichael, 2009; Muhtada, 2008; Novianto, 2010; Schiller et al., 2008). Despite the magnitude of the social and environmental impacts of this event, the Indonesian government faced critical challenges in regulating the company because the majority owner of the company was a business conglomerate controlled by the Bakrie Family, a family dynasty closely linked to Indonesia's influential Golkar party. Another prominent episode that illustrates the socio-environmental governance challenges faced by the Indonesian government are the forest fires which burned about 5.3 million hectares between 2015-2020 (MOEF, 2020). These forest fires produced noxious haze that blanketed parts of Indonesia and the region, disrupting transport, trade, and tourism, forcing school closures and negatively affecting public health (World Bank, 2016, p. 1). Like the case of the mudflow disaster, the Indonesian government faced significant challenges in enforcing regulation of relevant companies, because of the influence and reach of companies' political networks (Purnomo et al., 2017; Varkkey, 2013).

Such examples illustrate the serious challenges facing social and environmental regulators in countries such as Indonesia, in which the state's

capacity to regulate business is limited by both political and institutional constraints. In such environments, the state needs to collaborate with third-party actors such as investors, banks, buyers, NGOs, and communities, to increase their capacity to pressure business to improve their environmental and social performance. It is to this end that agendas of public voluntary regulation have attempted to make new inroads.

Since the 1990s, an increasing number of state environmental regulators have added public voluntary regulation to the regulatory repertoires through which they seek to influence the social and environmental impacts of business (Koehler, 2007). Public voluntary regulation involves a collaborative and non-mandatory approach. Governments play a central role in developing regulatory standards, while promoting regulatory compliance through disseminating information about corporate socio-environmental performance to a range of key company stakeholders (Koehler, 2007; Leveque, 1996; Lyon & Maxwell, 1999; OECD, 2003).

The origins of public voluntary regulation can be traced back to a prominent regulatory initiative developed in 1991 by the United States Environmental Protection Agency (EPA) titled the “33/50 Program”, in reference to the program’s objectives to progressively cut—by 33% and then 50%—emissions by US companies of high-priority toxic chemicals (Arora & Carson, 1995). The core innovation of this program was to incentivise progressive reductions in these emissions by publicising information about individual firm emissions. This was followed by the European Commission’s creation of a public voluntary regulatory program in 1993—the Environmental Management and Audit Scheme (EMAS)—which seeks to regulate environmental management systems adopted by European companies through a system of setting environmental management standards and compliance audits that are government run but non-mandatory, together with a public certification process through which compliance can be communicated to a range of firm stakeholders. A key objective of such schemes is to improve regulated firms’ environmental performance with regard to legal

or regulatory compliance, but also implemented programs that go beyond the requirements of the law.

Following widespread interest in these pioneering non-mandatory regulatory approaches, various governments other than industrialised countries in which these initiatives originated have subsequently adopted public voluntary regulatory programs. For example, Mexico (Blackman et al., 2010), and several countries in Asia, such as Indonesia, the Philippines, India and China (Afsah et al., 1996; Blackman, 2008; Kathuria, 2009; Wang et al., 2004). In a number of cases—such as Indonesia and the Philippines—these public voluntary regulatory initiatives were promoted and provided with financial and technical assistance by the World Bank (Asfah et al., 1996). Such support was underpinned by the view that voluntary regulatory approaches could offer distinct value in developing country contexts in which institutional capacities to support mandatory regulatory approaches were lacking. In this sense, voluntary regulatory approaches were viewed as a way to side-step institutional constraints by drawing on pressure from market or civil society stakeholders of regulated firms to strengthen firm incentives to comply with social and environmental regulation (Blackman, 2010; Prakash & Potoski, 2012).

However, notwithstanding the enthusiastic embrace of such public voluntary regulatory experiments across a range of developing countries; numerous commentators have questioned the potential of such approaches to work as intended in political and institutional contexts that differ markedly from those in North America and Europe, where public voluntary regulatory approaches were first developed (Blackman, 2008). Political structures differ significantly between different developed and developing countries, as do a range of other factors with potential significance for regulatory functioning. These factors include: patterns of state control and regulation of the private sector; levels of resourcing and capacity of public sector institutions; distribution of regulatory authority between different agencies or levels of government; and the orientation and capacity of a range of markets and civil society institutions (Blackman, 2008, 2010; Prakash & Potoski, 2012). Some

commentators have suggested that in many developing country contexts, pressure on environmental issues from markets and civil society is weak, while the capacity of public regulators to consistently apply voluntary regulatory approaches is undermined by high levels of influence over state actors by powerful business interests (Decker, 2011; Russell & Vaughan, 2003). As a result, they have argued that incentives to sponsor and participate in voluntary regulation vary significantly across countries, weakening the potential of voluntary public regulatory approaches in many contexts (Prakash & Potoski, 2012, p. 123).

Despite such issues, public voluntary regulation has continued to be widely practiced across a range of developed as well as developing country contexts. Yet existing regulatory scholarship has thus far not developed a systematic framework for understanding how and why the effects of public voluntary regulation can be expected to operate differently across these varied institutional contexts. One challenge has been that the body of regulatory scholarship that directly addresses such questions of contextual variation in the operation of public voluntary approaches has remained relatively limited in scope. Notable exceptions are Blackman (2008, 2010) and Asfah (1996). Such scholarship has also developed largely in parallel to bodies of work relating to environmental governance and comparative Corporate Social Responsibility (CSR). These offer useful yet under-utilised insights into how variations in firm ownership and the industry sector can influence the operation of regulatory processes, for example, as a result of varying configurations of community or market stakeholders across sectors, or in response to differences in the ownership and corporate governance arrangements of private and state-owned companies (Gunningham & Sinclair, 2002; Tan, 2002; Wang & Jin, 2002).

Significant questions therefore remain unanswered regarding how companies' responses to public voluntary regulation are likely to vary across countries, sectors and firms, and if and how public voluntary regulators can adapt regulatory strategies to accommodate variation in such varied institutional contexts.

In response to these gaps in existing scholarship on public voluntary regulation, this thesis aims to build new understanding of how the capacity of public voluntary regulation to achieve their objectives of improving CSR performance is influenced by distinctive features of institutional context—where institutional context is understood to vary across countries, sectors and types of firm. This overarching aim can be addressed in two central research questions:

1. How and to what extent do public regulators adapt voluntary regulatory strategies to accommodate the distinctive institutional contexts in which they operate?
2. How do variations in institutional context enable and constrain the ability of these voluntary regulatory strategies to induce improvements in socio-environmental performance of regulated firms, both within and beyond the requirements of the law?

The thesis examines these questions through a detailed study of a prominent public voluntary regulatory program in Indonesia, titled PROPER (Indonesian Industrial Environmental Rating Program). Focusing on Indonesia offers the opportunity to unpack how the performance of public voluntary regulation operates in a developing country characterised by distinctive institutional contexts, such as weak environmental enforcement, poor state regulatory capacity, weak civil society pressure, and extensive political patronage (Blackman, 2008; Eskeland & Jimenez, 1992; Russel & Vaughan, 2003).

1.2. ‘Public voluntary regulation’: Definitions and key features

Before presenting further discussion of the theoretical and methodological approach, it is useful to provide a more detailed introduction to concepts and practices of public voluntary regulation. This preliminary conceptual analysis helps to make sense of how public voluntary regulation fits within wider debates about global social and environmental regulation, and broader conceptual understandings of regulation.

The literature on environmental governance provides an insightful framework through which to analyse public voluntary regulation. While public

voluntary regulation was initially developed and advocated as a means of regulating environmental pollution, public voluntary regulatory practices have expanded in scope to encompass not only environmental but also social aspects of business regulation. As such, integrating literature on Corporate Social Responsibility (CSR) with insights from environmental governance scholarship provides a strong critical basis for analysis of public voluntary regulation. CSR is frequently understood to encompass a range of social as well as environmental concerns (Dahlsrud, 2008). Accordingly, the concept of socio-environmental governance is used throughout the thesis to reflect decision making processes related to environmental and social governance norms situated at various scales from local to global, and interacting across scales (Bennett & Terre, 2018).

Conceptual understandings of socio-environmental governance have evolved significantly over recent decades. The field of environmental regulation—of particular salience to this thesis—has been at the forefront of such shifts (Gunningham, 2009). In the early 1970s, 'regulation' was conceptually associated with those government activities that sought to establish rules to control the way both individuals and organisations behaved in relation to environmental issues. In this period, regulation was monopolised by the state and often expressed through specific state-based laws; little emphasis was placed on the role of non-state actors within regulatory processes. The ascendance of neo-liberal ideologies from the late 1970s left a powerful mark on debates about the environmental regulation of business, as advocates of minimal state intervention critiqued heavy-handed forms of state environmental regulation. Such critics argued that governments' environmental regulations were inherently inefficient, involving unnecessarily cumbersome efforts to control environmental pollution (Gunningham et al., 1998, p. 6). Moreover, such proponents of minimal state intervention increasingly argued that environmental regulations were better developed by market actors instead of government (Khanna & Anton, 2002; Lyon & Maxwell, 1999).

In the early 1990s scholars and policymakers (particularly in the United States) were dissatisfied with the highly dichotomised character of debates between state and market led regulation (or deregulation) and sought to reconceptualise environmental regulation in ways that could bridge such divides (Gunningham, 2009, p. 181). Such scholars argued that just as the state was incapable of acting alone to solve environmental problems, companies were limited in their capacity to be the sole actors responsible for addressing an increasing array of environmental problems (Gunningham et al., 1998). Therefore, collaboration between state and market actors was needed to handle environmental problems. In addition, stakeholders or third parties, both commercial (investors, buyers and consumers) and non-commercial (Civil Society Organisations-CSOs and communities), could arguably offer important sources of 'regulatory pressure' to motivate companies to improve their environmental performance (Campbell, 2006; Grabosky, 1995). Thus, regulation was conceptualised more broadly, to encompass flexible, imaginative and innovative forms of social control that could seek to harness not only governments but also business, markets and other third parties (Gunningham, 2009, p. 181). The concept of smart regulation has often been used to capture this central insight regarding the potential value of harnessing multiple sources of regulatory pressure—including state, business and third-party actors—in support of regulatory aims (Gunningham et al., 1998).

In this thesis, public voluntary regulation is understood to build on this third conceptual view of regulation, which highlights the interaction between state, corporate and other third-party actors. Theories of public voluntary regulation have been developed by scholars and policymakers in response to the conviction that neither state, corporate nor other third-party actors alone can act to solve complex social and environmental problems to which business frequently contributes (Lyon & Maxwell, 1999), and that collaboration from these actors is therefore necessary for better environmental regulation (Gunningham et al., 1998). Public voluntary regulation thus embodies the pursuit of forms of regulation that harness the capabilities of state, corporate and other stakeholders to meet regulatory objectives.

Public voluntary regulation is commonly used by governments to regulate social and environmental aspects of business activity (Leveque, 1996; Lyon & Maxwell, 1999; OECD, 2003). The concept of public voluntary regulation refers to non-mandatory rules developed by a government body (Leveque, 1996). Public voluntary regulation involves establishing voluntary programs in which participating firms agree to comply with regulatory standards developed by government (Lyon & Maxwell, 1999). At the same time, public voluntary regulators draw on a number of regulatory tools in order to harness pressure from a range of stakeholders in support of regulatory aims. In this sense, public voluntary regulation can be understood at its core as a regulatory approach in which government takes a central role in developing regulatory standards, while regulatory compliance is promoted through disseminating information to companies and the public.

As illustrated in Figure 1.1. below, a range of hybrid regulatory approaches to socio-environmental governance are widely used, all of which are based on the shared recognition that no single agent is capable of addressing the multiple facets, interdependencies and scales of social and environmental issues (Delmas & Young, 2009, p. 79; Lemos & Agrawal, 2006, p. 311). These include approaches based on unilateral commitments or negotiated agreements¹ involving: regulated companies; eco-labels, which consist of the formation of a coalition among the three categories of state, private and social actors; Non-State Market-Driven (NSMD) governance, which emerges through collaboration between business and civil society (Bernstein & Cashore, 2007; Cashore, 2002); and “Resources co-management”, understood as a form of hybrid governance involving collaboration between state and civil society actors (Borrini, 2000; Borrini et al., 2007).

¹ Unilateral commitments involve voluntary programs set by business entities without any participation from public agencies (OECD, 1998), while “negotiated agreements” occur when governments communicate with companies to set agreed environmental targets (Lyon & Maxwell, 1999; OECD, 1998).

Amongst this broader family of hybrid regulatory approaches, public voluntary regulation can be distinguished from other hybrid regulatory approaches by its particular mix of government-led standard-setting, and collaboration with both private companies and other third parties as part of overarching efforts to induce behavioural change in targeted companies.

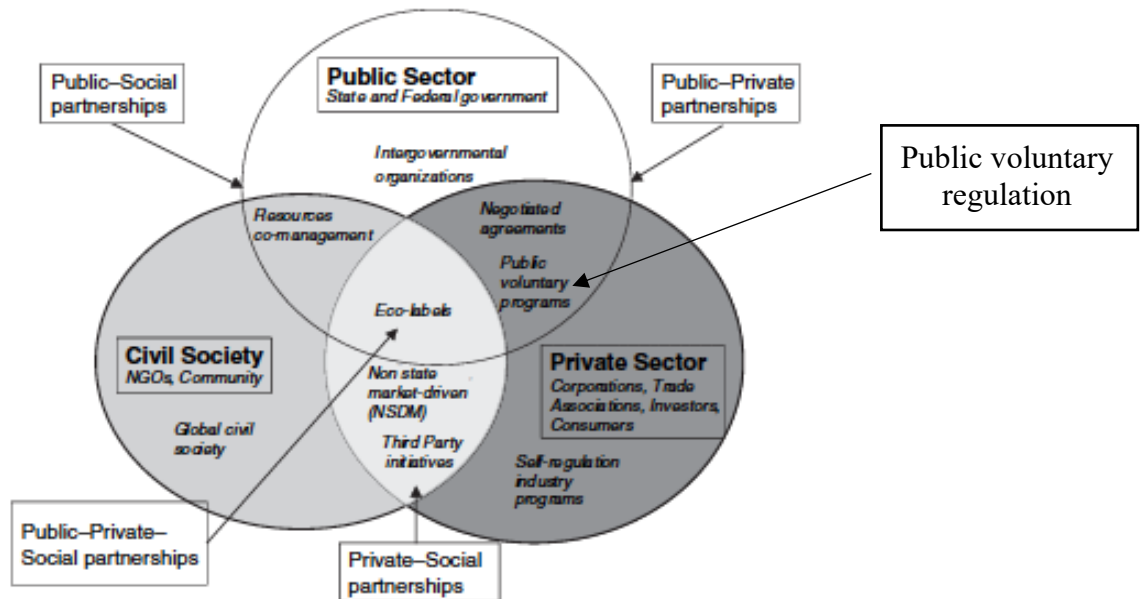


Figure 1.1. Public voluntary program and its siblings

Source: Delmas & Young, 2009, p. 8

As illustrated in the diagram, public voluntary regulation is only one of several prominent regulatory approaches to socio-environmental governance. Situating public voluntary regulation in this broader regulatory context offers the potential to build new insights into a distinctive and relatively understudied form of hybrid regulation, while contributing to broader literature on evolving forms of regulation and governance through enriched understanding of the resilience or vulnerability of voluntary regulatory approaches to the varied institutional contexts in which they operate. Contextualising public voluntary regulation in the broader regulatory context offers the potential to build new insights into a distinctive and relatively understudied form of hybrid regulation, while contributing to broader literature on evolving forms of regulation and governance through enriched

understanding of the resilience or vulnerability of voluntary regulatory approaches to varied institutional contexts in which they operate.

1.3. Contribution to scholarship on public voluntary regulation: Theoretical approach

Building on the concept of socio-environmental governance, the central aspiration is to contribute to existing literature on public voluntary regulation by systematically examining how the capacity of public voluntary regulation, to induce improved socio-environmental performance in regulated companies, is mediated by varied institutional contexts.

A central focus of existing literature on public voluntary regulation has been outlining the strategies through which public voluntary regulation is designed and carried out, and through which regulators aim to produce causal effects on the behaviour of regulatory targets—thus inducing improvements in firms' socio-environmental performance. Although there exists only a small body of research that specifically focuses on public voluntary regulation in developing countries, the research published on this topic suggests three main groups of regulatory strategies to be prevalent, namely: (1) promotion of environmental leadership within companies; (2) provision to companies of technical assistance to support regulatory aims; and (3) public disclosure by companies of specified information on socio-environmental performance (Afsah et al., 1996; Alberini & Segerson, 2002; Blackman, 2008, 2010; Garcia et al., 2009; Kathuria, 2009; Pargal et al., 1997; Wang et al., 2004).

Although the abovementioned body of work does not directly address the central interest here in the potential of public voluntary regulation to operate effectively across varied institutional contexts; engagement with this work nonetheless makes an important contribution to building a strong theoretical and empirical basis for understanding the causal mechanisms through which public voluntary regulation seeks to influence firm behaviour.

This analysis of regulatory strategies thus lays a crucial foundation for subsequent development of a systematic theoretical framework from which to analyse how the mechanism and regulatory strategies of public voluntary

regulation can be expected to work differently across different contexts. This framework is developed by drawing on scholarship on public voluntary regulation together with key insights from comparative theoretical traditions for the study of corporate social responsibility (Campbell, 2006; Dong et al., 2014; Kang & Moon, 2011), environmental governance (Larson & Soto, 2008; Raik et al., 2008; Ribot, 2002), and political economy (Vithiatharan & Gomez, 2014). On this basis, the thesis develops a framework which hypothesises three broad categories of institutional variables to be particularly significant in shaping the capacity of public voluntary regulation to work, as intended, across varied institutional contexts. These are: (1) the relationship between business and the state; (2) state regulatory capacity; and (3) the environmental commitment and action capacity of third-party actors such as investors, banks, buyers, consumers, CSOs and local communities.

In order to analyse how public voluntary regulation can be expected to operate differently across multiple dimensions of contextual variation—at country, sector and firm levels—analysis builds on a multi-layered institutional framework developed by Matten and Moon (2008) for the purpose of comparative analysis of CSR. This provides a helpful means of operationalising the theoretical framework within a comparative research design for this study, designed to explore the distinctive role of country, sectoral and firm-level conditions in shaping the functioning of public voluntary regulation.

1.4. Methodological approach

The research design for this thesis is built around a qualitative comparative case study approach, the central aim of which is to explore how the capacity of public voluntary regulation to improve firm' socio-environmental performance is enabled and constrained by contextual conditions at country, sectoral and firm levels.

The central analysis focuses on a prominent public voluntary regulatory initiative in Indonesia: The Industrial Environmental Rating Program (PROPER). PROPER is a major, cross-sectoral public voluntary

regulatory program which has been in operation since 1995, and which is currently operated by Indonesia's Ministry of Environment and Forestry. In-depth within-case analysis of the case of PROPER, drawing on extensive in-country field research within Indonesia, and utilising a process-tracing approach to within-case analysis (Beach & Pedersen, 2019), enables detailed exploration of the complex and dynamic processes through which country-level contextual factors influence the operation of public voluntary regulatory processes.

The thesis also develops a comparative analysis of how the PROPER program operates across two different sectors (oil and gas and palm oil), characterised by contrasting regulatory arrangements and production processes, and across state-owned and private firms—ownership structure also being suggested by the existing literature to be a potentially important factor driving varied responses to regulatory pressure for improved CSR performance (Wang & Jin, 2002). Combining detailed within-case analysis with cross-case comparative analysis enables systematic empirical exploration of the multiple axes of contextual variation identified within the theoretical framework.

1.5. Overview of this thesis

Building on theoretical and methodological foundations, the thesis finds that there is significant potential for public voluntary regulation to improve firm CSR performance within the distinctive context of a developing country, and across differing sectoral and firm contexts. However, in the cases examined in this thesis, both specific regulatory strategies shown to be effective, and the extent to which these strategies succeeded in improving socio-environmental performance, varied significantly across both sectors and public versus private firms.

By drawing on both theoretical insights from existing scholarship on comparative CSR and environmental governance, and empirical evidence regarding the experiences of multiple firms engaging with Indonesia's PROPER program of public voluntary regulation; the thesis identifies three key

contextual variables shown to play a vital role in explaining the extent to which PROPER was able to induce varied degrees of improved CSR across the cases.

First, the degree of pressure from third-party firm stakeholders (such as CSOs, communities, investors or consumers) was a crucial factor in mediating the capacity of regulatory strategies to influence firm behaviour—both because of their crucial role in incentivising change in response to public disclosure by regulators of information about firm's socio-environmental performance, and the sensitivity of regulators to civil society or market pressure in determining the intensity of direct pressure for change imposed by regulators on top-level firm management.

Second, the capacity of regulators to improve socio-environmental performance depended on the sensitivity of firm management to government pressure. And this in turn depended both on the degree of discretionary power that government could exercise over firm managers as a result of corporate governance arrangements, and the capacity of political elites to exercise more informal influence over firm management through political patronage networks linking state and business elites.

Third, effects of regulatory interventions on improved socio-environmental performance depended on the capacity and incentives of government to provide technical assistance to firms. Such capacities and incentives were shown to be highly variable across national and sub-national levels of the Indonesian government.

Each of these conditions in turn was shown to vary significantly between industrial sectors, and between private and state-owned firm types, reflecting different configurations of firm stakeholders, corporate governance arrangements, state-business patronage networks, and patterns of regulatory decentralisation across sector and firm type. Such variation provides a strong basis for explaining significant variation in the effectiveness of Indonesia's public voluntary regulatory scheme (PROPER) across sectors, and across public and private firms.

At the same time, analysis revealed distinctive features of the Indonesian regulatory environment, which recurred across sectors and firm

types, associated with distinctive approaches by Indonesian regulators to adapting regulatory strategies to the Indonesian context. In particular, although Indonesian regulators used the same broad categories of regulatory strategies documented in other country contexts, these strategies tended to rely much more strongly on informal, discretionary sources of state authority than 'background threats' of a formal regulatory nature, on which much existing regulatory scholarship has focused.

Following the current introductory chapter, **Chapter Two** presents the theoretical framework of this thesis. First, this chapter draws on insights from existing literature to inform identification of key regulatory strategies used by public voluntary regulators, and analysis of how such strategies can harness multiple sources of social, market or institutional pressure in support of regulatory aims. A framework through which to understand how and why these regulatory strategies can be expected to operate differently across varied institutional contexts is developed. Drawing on literature on public voluntary regulation together with insights from broader bodies of comparative scholarship on CSR, environmental governance and political economy, this chapter develops three key categories of institutional conditions which might explain public voluntary regulation across contexts. These factors are hypothesised to generate variation across multiple axes of contextual variation at country, sectoral and firm levels.

Chapter Three outlines the design that underpins the research, explaining the qualitative comparative case study approach adopted in the thesis. This approach involves a central focus on a major public voluntary regulatory initiative in Indonesia: The Industrial Environmental Rating Program (PROPER). Within-case analysis of this case enables exploration of how country-level contextual factors influence the operation of public voluntary regulatory processes, while comparative analysis of how the PROPER program operated across two different sectors (oil and gas and palm oil) and across state-owned and private firms, enables exploration of the multiple axes of contextual variation identified within the theoretical framework outlined in the previous chapter.

Chapter Four presents a more detailed exploration of the institutional conditions that underpin regulatory processes within these case studies. The chapter first explores key institutional conditions at the country level, highlighting key features of Indonesia's economic dependency on natural-resources extraction, the history of close links between business and political and military elites, and the recent history of democratic transition and political and administrative decentralisation. Analysis then examines how these institutional conditions play out differently across different sectors and types of firm, as a result of variations in relationships between business and the state, state regulatory capacity and third-party actors' environmental commitment and capacity to exert pressure on companies to improve environmental and social performance.

Chapter Five presents the case of PROPER's relatively successful efforts to improve socio-environmental performance of a state-owned oil company, which led to sustained improvement in the company's socio-environmental performance—the company ultimately achieving the highest level of beyond-compliance performance recognised by PROPER. The chapter demonstrates that the key factors explaining this relatively successful regulatory intervention were sustained national government pressure on top-level management, together with national government provision of technical assistance to support beyond-compliance performance. The regulatory intervention was further supported by strong recognition of the legitimacy of the PROPER program by key company investors—thus bolstering market as well as political incentives in support of improved beyond-compliance socio-environmental performance. These enabling conditions in turn were facilitated by centralised regulatory arrangements in the oil and gas industry, together with high levels of political leverage over firm management associated with corporate governance arrangements involving the political appointment of corporate leaders.

Chapter Six presents a similarly successful case of public voluntary regulation, involving a private oil company, which like the state-owned company examined in Chapter 5 improved its socio-environmental

performance to achieve the highest possible rating offered by PROPER. As in the case of the state-owned oil company, sustained national government pressure on top-level management played a central role in explaining the effectiveness of public voluntary regulation, though the mechanism through which this pressure was exerted differed: in the private company, such pressure was exercised not through formal corporate governance structures but rather through the involvement of the company's founder in informal patronage networks involving political elites and high-level bureaucrats. As with the state-owned oil company, the provision of technical assistance was a key enabling factor, though in this case the company relied more heavily on assistance from private consultants. The regulatory process was further supported by strong recognition of the PROPER program by international investors—the Gold rating provided by PROPER enabling the company to demonstrate its adherence to international sustainability standards demanded by key company investors.

Chapter Seven examines the challenges faced by Indonesian regulators operating the PROPER program as they sought to influence the socio-environmental performance of a state-owned palm oil company in the palm oil sector. In contrast to the relatively successful cases examined in the oil and gas sector, socio-environmental performance of this state plantation company in fact declined from a beyond-compliance to basic compliance rating under the PROPER scheme. However, despite relatively weak performance against PROPER standards, this company did strengthen some elements of its socio-environmental performance, as captured by compliance with Roundtable on Sustainable Palm Oil (RSPO) standards. The chapter identifies several key factors explaining this decline in performance. First, there was a lack of recognition of PROPER by both commercial and non-commercial firm stakeholders, in the face of competition from a major international sustainability certification program in the palm oil sector. Second, government capacity to provide technical assistance in support of improved socio-environmental performance was undermined by weak subnational government capacity, in the context of regulatory decentralisation in the palm

oil sector. Third, the decline over time from beyond to basic compliance ratings was driven by a shift in the national government's motivation and capacity to pressure top-level company management to improve their PROPER rating, amidst a change in the state-owned company's corporate governance arrangements, and government concerns about PROPER's lack of recognition amongst international market stakeholders.

Chapter Eight explores the challenges faced by the PROPER program in its efforts to improve the socio-environmental performance of a private palm oil company. Like the state-owned palm oil company, PROPER was generally less effective at improving socio-environmental performance in this case than in the oil and gas sector cases. However, this company's socio-environmental performance fluctuated over time in a different pattern to the state-owned palm oil company—moving from a basic to beyond compliance PROPER rating, before returning to a basic compliance rating. This performance contrasts to the firm's socio-environmental performance as judged against RSPO standards, which improved from year to year. As in the case of the state palm oil company, key factors explaining relatively weak performance within the PROPER program involved lack of recognition of PROPER by key firm stakeholders, and weak subnational government capacity to provide technical assistance in support of improved socio-environmental performance. Like the case of the state-owned palm oil company, the fluctuation over time between basic and beyond compliance performance resulted from changes in direct government pressure exerted on top-level company management; however, the drivers of such change differed between public and private firms. In the case of the private firm, the temporary movement to beyond-compliance performance coincided with political pressure to strengthen environmental performance in response to national and international concerns about forest fires, to which private palm oil companies were perceived to be disproportionately contributing through their expansion into forested land.

Chapter Nine presents a synthesis of the overall findings from the thesis—comparing findings across case studies and reflecting on implications for the central questions relating to the impact of multi-level contextual

variables on the capacity of public voluntary regulation to drive improvements in corporate socio-environmental performance. The chapter demonstrates that while there is significant potential for public voluntary regulation to improve firm socio-environmental performance within the context of a developing country such as Indonesia, the specific regulatory strategies shown to be effective, and the extent to which these strategies succeeded in improving socio-environmental performance, varied significantly across both sectors and public versus private firms. Three specific contextual variables are identified across case studies that play a key role in explaining the extent to which PROPER improved socio-environmental performance amongst regulated companies.

Chapter Ten offers concluding remarks. This thesis contributes to the global discussion on public voluntary regulation by presenting a systematic account of how varied institutional conditions at country, sectoral and firm levels both enable and constrain the capacity of public voluntary regulators to influence socio-environmental performance of companies operating in developing country contexts. The thesis also contributes new understanding in relation to how public regulators adapt their regulatory strategies to accommodate the distinctive regulatory conditions they encounter in a given jurisdictional, sectoral and firm-level regulatory context. Analysis draws particular attention to the distinctive ways in which regulatory strategies tended to rely much more strongly on informal, discretionary sources of state authority, than on 'background threats' of a formal regulatory nature, on which much existing regulatory scholarship has focused.

Chapter 2

Public voluntary regulation in varied institutional contexts:

A theoretical framework

2.1. Introduction

This chapter explores concepts and theories of public voluntary regulation and develops a framework for analysing how associated regulatory strategies operate differently across varied institutional contexts. Drawing on insights from several influential theoretical perspectives on public voluntary regulation, analysis identifies several regulatory strategies that have consistently been identified as core elements of public voluntary regulation, aiming to improve socio-environmental performance in business.² Of these, three regulatory strategies have been used with particular frequency by developing country governments and examined here in detail. These strategies are: (1) promotion of environmental leadership within companies; (2) provision to companies of technical assistance to support regulatory aims; and (3) public disclosure by companies of specified information on socio-environmental performance. These regulatory strategies have been used by a number of developing country regulators, including in India (Blackman, 2008), Indonesia (Afsah et al., 1996; Blackman, 2008, 2010; Garcia et al., 2007;2009; Pargal et al., 1997), The Philippines (Kathuria, 2009), Mexico (Blackman et al., 2010, Blackman & Kildegaard, 2010) and China (Wang et al., 2004).

² This thesis does not draw extensively on responsive regulation theory by Braithwaite and Ayres (1992). Under a responsive regulation approach, most regulatory action occurs at the base of the pyramid, where regulators coax compliance through persuasion. The next phase of enforcement escalation involves a warning letter; if this fails to secure compliance, this is followed by imposition of civil monetary penalties; if this fails, criminal prosecution; if this fails, permanent revocation of the business license (Aryes & Braithwaite, 1992:35-36). While such "responsive regulation" strategies continue to rely centrally on state authority as the basis for securing regulatory leverage over business, public voluntary regulation is more centrally focused on harnessing sources of leverage from a range of third-party actors.

Despite the widespread practice of public voluntary regulation across a range of very different regulatory contexts, existing theories have not yet developed a systematic framework to understand how and why regulatory strategies deployed by public voluntary regulators can be expected to operate differently across varied institutional contexts. This chapter takes initial steps towards developing such a framework.

To this end, the first theoretical task is to synthesise insights from various theories of public voluntary regulation to use as a basis for explicitly specifying theoretical expectations regarding how each major strategy harnesses social, market or institutional pressure in support of regulatory aims.

Second, analysis draws together insights from comparative literature on political economy, environmental governance, and Corporate Social Responsibility (CSR). These insights serve as a basis for identifying key categories of institutional conditions that play either an enabling or constraining role in mediating the capacity of public voluntary regulatory strategies to operate as intended in a given regulatory context. Although the specialist literature on public voluntary regulation has not yet developed an explicit comparative focus, these intersecting bodies of comparative scholarship offer rich insights into how varied economic, political and social conditions can influence socio-environmental company performance, and the capacity of political actors to influence firm behaviour in line with regulatory aims.

By drawing on a synthesis of insights from related bodies of existing scholarship, this chapter develops a preliminary framework for identifying salient categories of enabling and constraining conditions. This framework hypothesises three broad categories of institutional variables of particular significance in shaping the capacity of public voluntary regulators to harness social and institutional pressure in accordance with regulatory aims. These categories are: (1) the relationship between business and state; (2) state regulatory capacity; and (3) the environmental commitment and capacity of

third-party actors such as investors, banks, buyers, consumers, CSOs and local communities.

Crucially, prior comparative research suggests that these institutional conditions can vary across multiple units or scales of analysis—sometimes varying in accordance with a given national or sub-national jurisdiction, and sometimes varying at the sectoral or firm level. In accordance with this important insight, the framework for theorising how public voluntary regulation is expected to operate differently across varied contexts is operationalised across multiple units of analysis, reflecting country level, sector level and firm level variation. To this end, analysis builds on the multi-layered institutional framework developed by Matten and Moon (2008) as a tool for comparative analysis of CSR, to support analysis of the varied functioning of public voluntary regulatory strategies across these multiple dimensions of regulatory context.

The structure of the chapter that follows reflects these key steps in developing a theoretical framework. The following section presents an overview of existing theories of public voluntary regulation, which elicits an explicit account of both regulatory strategies, and assumptions regarding the causal processes through which they are understood to bring about behavioural change amongst regulated companies. Analysis then draws on insights from intersecting bodies of comparative literature to identify hypothesised institutional conditions that are expected to shape the performance of public voluntary regulation across contexts, and explains how these can be analysed across multiple axes of contextual variation, at level of country, sectoral and firm.

2.2. Existing regulatory strategies of public voluntary regulation and their theoretical explanation

Public voluntary regulation has been theorised by scholars from various disciplinary fields (Afsah et al., 1996; Blackman, 2008, 2010; Garcia et al., 2009; Kathuria, , 2009; Pargal et al., 1997; and Wang et al., 2004). Of particular influence are theoretical lenses drawn from organisational theory, stakeholder

theory, and rational choice traditions of regulatory analysis. Each tradition has drawn on distinctive assumptions and orientations as a basis for theorising regulatory processes through which public voluntary regulation is understood to operate. Broadly speaking, organisational theorists have stressed the role of management norms, culture and organisation in shaping firm behaviour; stakeholder theorists have stressed both economic and non-economic sources of pressure derived from the firm's external operating environment; and rational choice theorists have stressed both internal and external economic incentives as core drivers of firm responses to regulation. Despite significant differences in emphasis between these theoretical perspectives, each offers distinctive insights that can be synthesised in pursuit of a broader framework for theorising how public voluntary regulatory strategies can be understood to work—articulating what forms of social pressure any given regulatory strategy draws on as a basis for promoting firm behavioural change in accordance with regulatory objectives.

Existing scholarship on public voluntary regulation has identified a broad range of strategies commonly used across a range of regulatory contexts. Table 2.1 presents a brief synthesis of this empirical body of scholarship, summarising the range of strategies shown to be in widespread use across developing countries.

Table 2.1. Public voluntary regulation in varied institutional contexts

Program	Country	Introduced	Regulatory strategies	References
Clean Industry	Mexico	1992	• Public disclosure • Technical assistance	Blackman et al., 2010
Industrial Environmental Rating Program (PROPER)	Indonesia	1995	• Public disclosure • Technical assistance • Promoting environmental leadership	Afsah et al., 1996; Blackman, 2008; 2010 Garcia et al., 2009; Pargal et al., 1997
Green Ratings Project (GRP)	India	Mid 1990s	• Public disclosure	Blackman, 2008

EcoWatch	Philippines	1996	• Public disclosure • Promoting environmental leadership	Kathuria, 2009
GreenWatch	China	2000	• Public disclosure • Technical assistance • Promoting environmental leadership	Wang et al., 2004

This analysis reveals that while some widely analysed regulatory strategies such as tax incentives and subsidies appear to have been used primarily in industrialised countries (Lyon & Maxwell, 2007), other strategies have been commonly deployed in developing as well as industrialised country settings. In particular, this synthesis of prior research shows three broad categories of regulatory strategy to be particularly salient in developing country contexts: (1) promoting environmental leadership within companies; (2) provision to companies of technical assistance; and (3) public disclosure by companies of specified information on socio-environmental performance (Afsah et al., 1996; Blackman, 2008, 2010; Garcia et al., 2009; Pargal et al., 1997, Kathuria, 2009; Wang et al., 2004).

While these three strategies are not mutually exclusive and often used together, each can nonetheless be understood as based on a distinctive set of assumptions about how the regulatory strategy can operate to induce behavioural change on the part of regulated companies. Drawing on insights across theoretical perspectives on public voluntary regulation, the following discussion examines each strategy in turn.

2.2.1. Promoting environmental leadership within companies

Discussion begins by examining the regulatory strategy of promoting environmental leadership within companies. The concept of ‘environmental leadership’ has been analysed in a variety of ways by scholars from varied disciplinary and theoretical perspectives, such as organisational theory

(Aragon-Correa et al., 2004; Portugal & Yukl, 1994), environmental governance (Evan et al., 2015), and Corporate Social Responsibility (CSR) (Malik et al., 2018).³ For the purposes of this thesis, promoting environmental leadership is understood as activities undertaken by state regulators with the aim of promoting environmental governance principles amongst corporate leaders, particularly firm owners or other top-level management (Afsah et al., 1996).

In practice, promoting environmental leadership typically entails two strategies. First, governments conduct direct communication with owners and top-level management, seeking to raise their awareness about both the general value of environmental management issues, and specific performance failings within their firms. Such communication aims in part to address an absence of advanced knowledge of environmental issues amongst many firm owners and top-level managers (April & Greiner, 2000). Many firm leaders have an educational background in fields such as petroleum engineering (in oil and gas companies) or agriculture (in palm oil companies). Firms are thus often slow to adopt improved environmental practices such as clean or energy-efficient technologies, even where these are profitable, simply because managers lack relevant knowledge (Blackman & Kildegaard, 2010; DeCanio, 1994).

Moreover, staff responsible for monitoring and managing environmental performance within firms are often positioned relatively low-down in the firm's managerial hierarchy, and frequently meet resistance from top-level management when they seek to highlight failings in the firm's environmental management systems, or to advocate new practices or technologies to improve environmental performance.

To address this challenge, government regulators can communicate directly with owners and top-level management, using their political leverage to: draw the attention of firm leaders to shortcomings in company

³ Although these different perspectives share the broad aim of understanding the role of leadership of top-level management in shaping companies' environmental and social performance, each perspective develops a distinctive conceptual definition of environmental leadership, and a distinctive explanation of how sources of regulatory pressure operate to induce behavioural change within companies.

environmental performance; improve knowledge of 'best practice' with regard to environmental performance; and raise awareness about ways in which firm efficiency or competitiveness can be strengthened through improved environmental performance.

Second, government regulators seek to intensify pressure on top-level management to take environmental performance seriously by comparing their performance with competitor firms, thereby seeking to create peer group pressure amongst competitor firms in a given sector. Peer pressure is designed to generate not only moral pressure, but also to stimulate managerial concerns about losing competitive advantage to peer companies who are shown to have superior environmental performance (Gunningham, 1995, p. 77).

The strategy of promoting environmental leadership can be understood as grounded in underlying assumptions about the dependence of corporate decision-making regarding socio-environmental behaviour on the knowledge and beliefs of firm owners and top-level management. According to such a view, top-level management's beliefs about the costs or benefits of improved environmental performance play a decisive role in shaping a firm's environmental practices, as a result of managerial authority to control internal firm processes of strategy and policy formulation, distribution of resources and power, socialisation of staff, and internal reward systems that can mainstream environmental values within organisational processes (Logsdon & Yuthas, 1997, p. 1219). The rationale for this strategy is grounded in a broad body of research in the field of organisational theory, particularly studies of firm leadership, which have often highlighted the significance of top-level management knowledge and expectations as key determinants of firm environmental performance (Moffat & Auer, 2006; Swanson, 2008).

2.2.2. Technical regulatory assistance

In addition to promoting environmental leadership, public voluntary regulators have often provided firms with technical assistance to support improved corporate socio-environmental performance. Technical regulatory assistance is understood here to involve efforts by government regulators to

improve the regulatory knowledge and skills of key staff within regulated companies, supporting firms to meet minimum legal requirements with regard to environmental performance, as well as to adopt beyond compliance standards and practices. This involves efforts by government regulators to increase capacity amongst firm employees to recognise the existence of shortcomings in firm environmental performance, and to educate staff about what can be done to address environmental problems within the parameters of existing government regulations (May, 2005, p. 32). This also involves efforts by government to raise awareness amongst firm staff about the potential economic benefits of improved environmental performance, and a corresponding 'business case' for investments that improve environmental performance (Segerson & Miceli, 1998).

A key underlying assumption of technical regulatory assistance is that improving environmental performance needs not only a commitment from top-level management, but also knowledge and skills of employees at operational level (Asfah et al., 1996). Because plant level employees have day-to-day control over environmental practices, environmental performance importantly depends on their capacity to design and implement environmentally friendly programs. Even where companies are willing to make efforts to strengthen their environmental performance, they may fail to do so because of a lack of knowledge about complex environmental regulations or technologies (Kagan & Scholz, 1980). Thus, while strategies of promoting environmental leadership focus on firm owners and top-level managers, technical regulatory assistance focuses on strengthening environmental knowledge, skills and attitudes of employees at operational or plant levels (Gunningham et al., 1998, p. 60).

The rationale for provision of technical regulatory assistance to firms also draws on assumptions about the potential for knowledge of the 'business case' for strengthened environmental performance to generate economic incentives for behavioural change—resonating with the emphasis rational choice theorists of regulation place on economic incentives as drivers of firm behaviour (Ehrlich, 1972; Koehler, 2007; Segerson & Miceli, 1998; Winter &

May, 2001). Such scholars have often recognised not only the potential value of direct economic incentives (i.e. tax incentives) as means of incentivising strengthened environmental performance (Yap, 2000, p. 68), but also the potential of altered *knowledge and beliefs* about the costs and benefits of environmental regulatory compliance to generate incentives for behavioural change.

Such assumptions about the potential of regulatory assistance to stimulate strengthened firm environmental performance in turn depend on assumptions about the knowledge and capacities possessed by state regulators. Because this strategy relies on government regulators providing new forms of knowledge or information to companies (Asfah et al., 1996), these regulators themselves require relevant forms of knowledge about not only the requirements of environmental regulations, but also technical dimensions of production processes, as these relate to calculation of production costs associated with varied environmental practices or technologies. In order to provide technical assistance of this kind, government regulators therefore require comprehensive and accurate knowledge of the technical requirements and capacities of a given regulated industry. This task is complicated by sector specificity of production processes, and associated environmental risks and management strategies (Gunningham et al., 1998, p. 44).

2.2.3. Public disclosure

A further strategy through which government regulators can seek to influence corporate behaviour is often referred to as 'public disclosure'. Understood in this context as a regulatory strategy, public disclosure involves the government's active mobilisation and publicisation of information concerning regulated companies' environmental and social performance, with the aim of disseminating this information amongst key public constituencies of concern to regulated companies. These typically include investors, buyers, consumers, communities and Civil Society Organisations (CSOs) at both domestic and international levels (Gunningham et al., 1998).

In this process, government regulators play a role in both specifying what information concerning socio-environmental performance companies are required to disclose and making this information available to public audiences. For example, a common strategy is for regulators to prepare annual reports in which they present a summary of information about social and environment performance of individual companies in a standardised format, and publish this information on an official government website. Governments sometimes also convene conferences, exhibitions or other events in which companies are encouraged to present more detailed information about key elements of their socio-environmental practices and initiatives. Journalists and civil society organisations are often invited to such events, alongside broader business and investor stakeholders, as a means of exposing such information to a broader public audience (Kathuria, 2009; Lyon & Maxwell, 2007).

The central underlying rationale of public disclosure strategies used by regulators is based on the expectation that exposure of information about corporate socio-environmental practices will give rise to diverse sources of pressure from external company stakeholders for behavioural change. While government regulators act as facilitators to expose information about a company's behaviour to its stakeholders, incentives for companies to change their behaviour are the direct result of pressure exerted by consumer, investor and/or broader social stakeholders. Disclosing information about company performance can thereby operate as a regulatory tool by empowering corporate stakeholders to demand behavioural change (Asfah et al., 1996). While such pressure may emerge in part in response to voluntary reporting by companies about their socio-environmental performance, the distinctive value of a government mandated reporting framework is grounded in evidence revealing reluctance on the part of many companies engaged in voluntary reporting to disclose information that reflects unfavourably on company performance (Cowan & Gadenne, 2005, p. 176).

Various assumptions about how public disclosure mechanisms can generate company pressure have been explored, including organisational and

sociological, stakeholder, and rational choice theorists regarding such regulation.

Organisational theorists, for example, have often articulated the logic of this regulatory approach in broad terms, with reference to the concepts of corporate reputation or organisational legitimacy, understood as a “generalised perception or assumption that actions of an entity are desirable, proper, or appropriate within some constructed system of norms, values, beliefs, and definitions” (Deephouse & Suchman, 2008, p. 52). Thus, the sociological legitimacy of a business rests on subjective judgements of key stakeholders with regard to the firm’s ability to comply with stakeholder expectations; these judgements in turn draw on information about (perceived) past performance (Fombrun & Van Riel, 1997; Van-Erp, 2011, p. 324). This view has also gained support from a range of sociologically oriented stakeholder theorists, who have emphasised the tendency of firms to conform to external influences within the organisational environment (Darnall, 2003, p. 5; Hoffman, 2000; Klassen & McLaughlin, 1996; Konar & Cohen, 1997; Oliver, 1997).

Corporate reputation or legitimacy is further viewed as playing a key role in underpinning competitiveness of a given company, generating economic incentives for businesses to respond to subjective perceptions of stakeholders (Solomon & Lewis, 2002). Such economic incentives have received particular emphasis from rational choice theorists, who have focused on ways in which stakeholders respond to information about corporate performance and this in turn generates economic incentives to respond to stakeholder demands (Arora & Cason, 1996; Hoffman, 2000).

In analysing how these distinct sources of market and social pressure are mobilised to incentivise change in company behaviour, scholars from across these theoretical perspectives have often distinguished between different categories of corporate stakeholders (Harrison et al., 2019) or ‘third parties’ (Gunningham et al., 1998). These include both commercial stakeholders, such as company investors and customers (Darnall, 2003, p. 4),

and non-commercial actors such as local communities or CSOs (Gunningham et al., 1998).

Investors

Investors often constitute a key source of stakeholder pressure through their capital market connections to companies, in which they interact with companies in the provision of loans (Tietenberg, 1998). In circumstances where investors have good reason to be concerned about environmental performance, such investors can use information provided through public disclosure mechanisms as a basis for evaluating corporate performance and pressuring companies to improve key areas of social or environmental performance, in relation to risk or returns on investment. Although investors do not always prioritise such concerns, evidence suggests that in many countries banks have increasingly incorporated environmental considerations pertaining to corporate lending decisions (Thompson & Cowton, 2004). Scholars have pointed to a range of factors driving such investor behaviour, including increased global awareness about environmental issues, and the framing of such concerns within a risk management lens. Poor environmental performance may likely generate concerns about investment risk where a company is embroiled in environmental disputes (Tietenberg, 1998). In the presence of such pressure from investors, a company will need to increase its internal investment in socio-environmental performance, being more likely to view such expenditure as a valuable form of investment towards improving its reputation (Porter & Linde, 1995).

Buyers and consumers

Commercial pressure can also be exerted on companies through product markets, in which companies interact with consumers or other business-to-business customers within more complex supply chains, in selling their goods or services (Tietenberg, 1998). Such buyers or consumers are thus sometimes key actors who have the capacity to induce behavioural change at companies in the direction of strengthened social or environmental performance.

A range of literature has highlighted the potential significance of end consumers as key users of information produced through mechanisms of

public disclosure (Delmas & Toffel, 2004, p. 213; Henriques & Sadorsky, 1996; Tietenberg, 1998). Consumers who are actively engaged with social or environmental agendas may sometimes access information about corporate performance from regulators' websites, though more commonly CSOs or other civil society organisations play a key role in disseminating information generated through public disclosure processes to a wider consumer audience (Tietenberg, 1998). The motivation of consumers to pressure companies to improve socio-environmental performance is often linked to increasing public awareness of major consumer markets concerning environmental issues. For example, analysts have often emphasised the salience of such concerns for companies that export consumer products to European markets, due to a broad-based "green culture" amongst many European consumers (Lyon & Maxwell, 2004).

While much emphasis has been placed on the role of consumers in driving pressure for improved strengthened socio-environmental performance, such pressure is often exercised more directly by large retail, manufacturing or trading firms that occupy intermediary positions within global supply chains, and directly purchase large volumes of primary commodities, the production of which is the subject of government regulation (Stranieri et al., 2019; Zhang et al., 2019).

Civil society: Communities and CSOs

Significant sources of pressure for corporate behavioural change can also come from non-commercial stakeholders such as CSOs, other civil society organisations and grassroots communities located near sites of business activity. The notion that wider sources of social pressure play a significant role in influencing corporate behaviour has its roots in debates concerning the social costs or 'externalities' of business activity (Coase, 1960; Konar & Cohen, 1997). The potential for business activity to impact directly and/or indirectly on wider social constituencies generates the core underlying motivation for such non-commercial actors to use information accessed through public disclosure mechanisms to pressure companies to improve relevant aspects of their socio-environmental performance (Tietenberg, 1998).

Such pressure can be particularly effective where levels of awareness and concern about environmental issues are high in civil society organisations, and where such actors have the capacity themselves to harness wider sources of social, political or legal pressure in support of demands for corporate behavioural change (Gunningham et al., 1998, p. 96). For example, in cases where civil society actors have strong links to and support from international or government actors, their capacity to effectively pressure companies via catalysing wider reputational or regulatory threats is often enhanced (Hamilton, 1999, p. 110). Such non-commercial stakeholders can also impose direct costs on companies through mechanisms such as political or legal demands for financial compensation. For example, Tietenberg (1998) has documented cases in which communities have made use of information gained through public disclosure processes to support legal claims for pollution-related damages.

The capacity of civil society organisations to generate forms of pressure that incentivise corporate behavioural change is of particular significance when such organisations have the capacity to mobilise grassroots communities or wider publics in support of their concerns. Forms of mobilisation such as public protests threaten to directly harm corporate reputation or the 'social licence to operate', and in some circumstances, can also impose direct economic costs through obstructing production. Unplanned shutdowns in production caused by community protests or other forms of social mobilisation can generate significant economic costs for companies, particularly in a sector such as oil and gas, which relies on an extraction process that demands continuity of crude oil flows from wells (Lim et al., 2019)

In sum, the above analysis of three key regulatory strategies commonly used by public voluntary regulators demonstrates complex sources of pressure that regulators can draw on as a means of inducing behavioural change in companies. While these strategies are often used together, the above analysis has shown how each can usefully be understood based on a distinctive set of assumptions about how the regulatory strategy can operate to induce

behavioural change on the part of regulated companies. However, while existing scholarship provides a useful foundation for understanding how regulators can use these strategies to improve socio-environmental practices within companies, this literature has not yet developed a systematic or explicit account of how the capacity of regulators to effectively deploy such strategies is uneven and thus varies across different regulatory or institutional contexts. It is to this task that we turn in the following section.

2.3. Significance of varied institutional contexts: Towards a theoretical framework

As noted earlier, a significant body of existing research has documented the use of public voluntary regulation approaches across a range of regulatory contexts—encompassing both country contexts and targeted economic sectors (see Table 2.1 on page 20). Public voluntary regulation has thus travelled from the United States—a key industrial origin for the development and promotion of public voluntary regulation—to several major developing countries characterised by distinctive regulatory contexts.

The rich experience of implementing public voluntary regulation across varied institutional contexts highlights the significance of questions about how such contexts influence public voluntary regulation operations in shaping company environmental and social practices. Indeed, the likely significance of contextual factors in shaping the impact of regulatory strategies on corporate behaviour has been explicitly recognised by a number of regulatory scholars.

In developing the influential theory of ‘smart regulation’—a regulatory approach focused on generating productive interaction between multiple regulatory actors and instruments, of which public voluntary regulation is one possible variant, Gunningham and colleagues (Gunningham et al., 1998, 2017; Gunningham & Holley, 2016) have explicitly acknowledged the potential significance of contextual variation in shaping the effects of regulatory intervention. In discussing the importance of combining regulatory instruments within hybrid regulatory approaches, these authors highlighted

that outcomes of a mix of certain regulatory instruments “may be largely determined by the specific contexts in which they are applied”, while noting: “Unfortunately, the task of answering the question of which particular combinations are complementary, which are counterproductive, and which are context-specific is complex” (Gunningham & Sinclair, 2017, p. 139). In such analyses, both country and sectoral contexts have been highlighted as particularly significant.

However, despite widespread practice of public voluntary regulation across a very different range of regulatory contexts, and explicit recognition of the potential importance of varied institutional contexts for the capacity of regulatory strategies to work as intended to induce corporate behavioural change; existing theories have not yet developed a systematic framework through which to understand how and why regulatory strategies, deployed by public voluntary regulators, can be expected to operate differently across varied institutional contexts.

In response to this challenge, the analyses that follow combines insights from comparative literature on political economy (Kang & Moon, 2011; Vithiatharan & Gomez, 2014), environmental governance (Assetto et al., 2003), and Corporate Social Responsibility (CSR) (Campbell, 2006) to identify key institutional conditions that play either an enabling or constraining role in mediating the capacity of public voluntary regulators to harness multiple sources of pressure from state, corporate and third-party actors in support of regulatory aims.

Although the specialist literature on public voluntary regulation has not yet developed an explicit comparative focus, these intersecting bodies of comparative scholarship offer rich insights as to how varied economic, political and social conditions can influence socio-environmental company performance, and the capacity of political actors to influence firm behaviour in line with regulatory aims.

By drawing on these related bodies of existing scholarship, this chapter develops a preliminary framework for identifying salient categories of enabling and constraining conditions. This framework hypothesises three

broad categories of institutional variables significant in shaping the capacity of public voluntary regulators to harness social and institutional pressure in accordance with regulatory aims. These institutional conditions are: (1) the relationship between business and the state; (2) state regulatory capacity; and (3) the environmental commitment and capacity of third-party actors such as investors, banks, buyers, consumers, CSOs and local communities.

For the purpose of this analysis, the concept of 'institutional context' is used to refer to the configurations of actors (at global, national and subnational levels), norms and rules that influence the response of state, business and third-party actors toward public regulatory strategies (Baldwin, 2019; Campbell, 2006). This understanding is broadly aligned with concepts of institutional context or institutional environment developed within new institutionalist theoretical traditions (Peters, 2019).

2.3.1. Relationship between business and state

A significant factor in shaping the capacity of public voluntary regulators to harness multiple forms of social pressure in support of regulatory aims is the relationship between business and state in a country and/or sectoral context.

Here, the relationship between business and state is understood to refer to the way a given economic and political system organises relationships between state and business actors, particularly between top-level management and top-level bureaucrats and politicians (Yakovlev, 2006). While scholarship on comparative political economy and management has theorised many different dimensions of business-state relationships, analysis here focuses on how these relationships structure political influence over firm decision making, and associated orientation of firm management towards responding to formal or informal sources of state pressure both at national and subnational levels. Covering both national and subnational levels is critical because each sector may have different patterns of state-business relationships.

An important source in such relationships, which has received significant emphasis from many comparative political economists and

comparative theorists of CSR, is the organisation of a country's capitalist system at the macro level, and its articulation with the wider political regime. In general, in countries where the state wields greater control over rules and resources of particular salience to business operations, the more strongly oriented corporate management is likely to respond to formal and informal state pressure (Schrempf-Stirling, 2018; Tang, & Li, 2009).

One way in which such macro-level features of a country's political economy influence firm sensitivity and responsiveness to state pressure is via the dependence of firms on financial, technological or political resources over which states have privileged access. For example, comparing CSR practices in state-led market economies and liberal market economies, Kang and Moon (2011) demonstrated that companies operating within state-led market economies rely more heavily on state-controlled banks for corporate financing (Zysman, 1983), and on centralised collective bargaining arrangements to coordinate their labour force (Kang & Moon, 2011, pp. 93-94). Other examples similarly show how managers in Chinese firms prioritise state and other political actors in their decision-making processes (Dong et al., 2014), reflecting the critical role of the Chinese state in facilitating business competitiveness (Athukorala, 2009). Such relationships make firms operating in such environments more reliant on state support to achieve their economic objectives, in turn rendering them sensitive to political pressure from state actors (see also Apriliyanti & Kristiansen, 2019; Chang 2000; Kang, 2002; Vithiatharan & Gomez, 2014).

However, other research has also shown that state-business relations can also be shaped by the underlying structural conditions of the resource sector, including global demand for resources during resource booms, and the relative contributions of global and domestic capital to extraction in particular sectors. While this thesis explores this further in terms of the pressure from third party actors on the state and firms (in this case the influence of international investors and other international actors), it is important to emphasise here that international markets, via investors and consumers can influence domestic institutions particularly when countries are reliant on

export revenues. Equally, when resources are in high demand and industries are less reliant on foreign capital (for example in maturing extractive industries that have already benefitted from foreign capital investments), domestic institutions and resource nationalist policy agendas can have greater leverage (on Indonesia see Ross, 2001; Winters, 1996, and Smith, 2007).

While these forms of resource dependence are grounded in formal state provision of key resources, other scholars have focused on more informal features of varied political economies, which likewise create significant variation in the dependence and associated responsiveness of firm managers to pressure from political actors at national and subnational levels. For example, such relationships have been extensively analysed by scholars of so-called 'crony capitalism', a term that has been used to describe close relationships between state actors and top-level management in private companies, in which: "personal connections and political patronage, rather than entrepreneurial ability, determine who gets access to government-generated rents, bank credit and other economic resources, usually on very lucrative terms" (Chang, 2000, p. 775). Within systems characterised by crony capitalist state-business relationships, a business class is generated which is highly dependent on state resources for access to benefits such as licences, participation in lucrative infrastructure projects, or other privatised rents (Vithiatharan & Gomez, 2014, p. 602). Once again, this dependence tends to be associated with increased sensitivity on the part of firm leaders to formal and informal political pressure (Kang & Moon, 2011).

The nature of such relationships has been shown to vary not only between countries, but also between sectors and between public and privately-owned companies (Campbell, 2006). Sectoral variation in state-business relations has been shown, for example, to depend on the role of the state in controlling key assets or resources required for the production process (Baer, 2016; Schienstock, 2007). Meanwhile, state-business relations have also been shown to depend crucially on corporate ownership structure (state-owned versus private), both as a result of contrasting executive appointments and corporate governance processes, and the differing role of

firm economic performance in shaping the incentives of top-level corporate executives (Goldeng et al., 2008; Graves & Waddock, 1994; Johnson & Greening, 1999; Li & Zang, 2010; OECD, 2016, p. 4).

Specific to Indonesia, Warburton (2017) has also shown that there are different patterns in the corporate ownership structure of private firms by sector, in terms of the size of ownership share of foreign vis-à-vis domestic capital and the degree to which transnational and domestic capital is interdependent or differentiated. Such distribution, Warburton (2017) argues, shapes the underlying incentive structures for domestic tycoons to favour particular political interests (e.g. economic nationalism or liberalism) and their preferences to support either domestic or global institutional arrangements. She has shown that influential domestic tycoons in the mining sector (in which foreign and domestic capital ownership structures are highly differentiated) were highly supportive of the growing resource nationalism agenda in Indonesia, whereas those in the palm oil sector (in which foreign and domestic capital is highly interdependent) supported liberalisation and a more open foreign direct investment regime.

The role of informal political pressure in influencing firm behaviour has potentially significant implications for understanding contextual variation in regulatory processes, since such informal relationships contrast with the 'background threats' of formal, mandatory regulations highlighted by many scholars of public voluntary regulation, focused on regulatory processes in industrialised countries (Blackman, 2010; Khanna, 2001; Lyon & Maxwell, 1999; Winter & May, 2001). Such close relations between business and state actors can be expected to enable the capacity of regulators to effect change in firm behaviour in line with social and environmental regulatory agendas, where state actors who control key resources are supportive of regulatory agendas. In contrast, close relationships between business and state actors can be expected to constrain the capacity of public voluntary regulators to influence firm behaviour where key state actors, to whom firms are responding, promote different objectives.

2.3.2. State regulatory capacity

Another factor that has often been highlighted as a key enabling or constraining condition for the effective operation of public regulatory or environmental governance processes is state regulatory capacity both at national and subnational levels. The concept of state regulatory capacity is used here to refer to material and non-material resources available to state agencies to support their performance of a broad range of regulatory functions through which they seek to influence the behaviour of targeted actors engaging in certain forms of social and economic behaviour (Brown & Scott, 2010, pp. 3-4). State regulatory capacity has been widely recognised as a key enabling condition for the effective operation of public regulatory processes, reflecting the central role of the state (Blackman, 2008; Leveque, 1996; Lyon & Maxwell, 1999).

Alongside recognition of the significance of state regulatory capacity has been acknowledgement of the broad contextual variation of state capacity. Relevant capacities vary not only between countries, but between levels of government. Comparative literature on environmental governance has often highlighted significant variation in state regulatory capacity across countries and levels of government (Duek & Rusli, 2010), while studies carried out by major international organisations such as the World Bank have documented variation in state capacity across countries.⁴

A growing body of literature on environmental governance has similarly documented broad variations in state regulatory capacity across levels of government within decentralised governance systems. While some studies (see for example Larson & Soto, 2008; Raik et al., 2008; Ribot, 2002) have suggested in general terms that national government tends to have stronger environmental governance capacities than local governments, others

⁴ <https://datacatalog.worldbank.org/dataset/worldwide-governance-indicators>. Accessed on November 6, 2019. These indexes focused on criteria such as quality of public services, quality of the civil service and its degree of independence from political pressure, quality of policy formulation and implementation, and the credibility of government's commitment to such policies.

have highlighted the specific capacity gaps that arise when local governments are assigned authority for performing key environmental regulation functions, while lacking the requisite capacities to discharge these responsibilities (Baland et al., 2010; McCarthy, 2002; Thun, 2004).

By combining insights from analyses of regulatory capacity with the above analysis of regulatory strategies drawn from scholarship on public voluntary regulation, it is possible to articulate how state capacity might be expected to shape the effectiveness of particular regulatory strategies.

Arguably, the first strategy in promoting environmental leadership is to demand specific state capacities to collect and analyse data concerning companies' environmental performance. When persuading top-level management to engage with regulatory agendas, government regulators benefit from reliable data concerning companies' environmental performance, enabling them to identify potential corporate responses which both contribute to environmental conservation and reduce production costs (Asfah et al., 1996).

Second, distinctive state regulatory capacities are likely to be required to support provision of technical regulatory assistance by state regulators to regulated companies. Provision of such assistance is likely to require comprehensive and accurate knowledge of specific industries being regulated, in order to identify potential ways to comply with minimum legal requirements while also utilising opportunities to reduce the cost of production (Afsah et al., 2013; Dasgupta, 1999). Broader institutional and financial resources are also likely to be required in order to communicate such knowledge in appropriate formats to business actors (Gunningham et al., 1998).

Third, regulatory strategies based on public disclosure are likely to depend on a range of state capacities, including knowledge on environmental impacts of business, collecting and analysing the data on company performance, and using comprehensive and high-quality information to trigger peer group pressure among companies (Tietenberg, 1998, pp. 590-591). More intangible state capacities such as credibility are also likely to play

an important role in enabling or constraining public disclosure strategies used by public regulators, since the response of public stakeholders to disclosed information is likely to depend in part on the credibility of government actors who have collected and compiled the information used in public rating systems (Wang et al., 2004, p. 130).

2.3.3. Third-party actors environmental commitment and capacity to pressure companies

Another factor frequently highlighted as a key enabling or constraining condition for the effective operation of public regulatory processes is the degree to which 'third party' (commercial and non-commercial) corporate stakeholders, both domestic and international, prioritise environmental commitments, and have the capacity to pressure companies to incentivise stronger socio-environmental practices. The potentially influential role of third-party actors in shaping corporate socio-environmental performance has been elaborated by scholars in various disciplines, including regulatory studies (Gunningham et al., 1998), comparative CSR (Campbell, 2006), and comparative environmental governance (Cashore, 2002). Such orientations and capacities of corporate stakeholders are of particular relevance to public regulatory strategies based on public disclosure, since the capacity of public disclosure to incentivise corporate behavioural change rests on the willingness of commercial and non-commercial third-party actors to respond to information about corporate environmental performance as a basis for punishing or rewarding companies.

In the case of commercial stakeholders (i.e. investors, buyers or consumers), such capacities take the form of economic or market leverage as a means of pressuring companies to improve environmental performance. In the case of non-commercial actors (i.e. local communities and CSOs), such capacities centre on the ability to access information about corporate environmental performance, and mobilise social pressure as a means of sanctioning poor behaviour and incentivising behavioural change (Campbell, 2006; Gunningham et al., 2004; Van-Erp, 2011).

Such motivations and capacities of firm stakeholders have been widely recognised to vary significantly across different regulatory contexts—in relation to different countries or jurisdictions, different economic sectors, and different regulatory issues. Configurations of stakeholders can also vary significantly between state-owned and private companies. For example, the influence of private investors over state-owned companies is sometimes limited by extensive access on the part of state-owned firms to capital flow from government budgets (Shirley & Nellis, 1991), though such arrangements vary widely depending on the governance of SOEs. Moreover, SOEs operating as monopolies in particular markets are less responsive to consumer demands than private companies operating in competitive market environments (Shirley, 1983).

Variation in the motivations and capacities of firm stakeholders thus reflects quite different profiles of investors, consumers and CSOs active in different contexts (Campbell, 2006; Chapple & Moon, 2005;; Williams & Aguilera, 2008). These stakeholders are likely to have varied environmental commitments, and varied capacities to access and mobilise information provided through public disclosure systems. The following minor sections will explore the variation of environmental commitments and capacities to pressure companies across different categories of stakeholder, namely; investors, buyers and consumers, and local communities and CSOs.

Variation of environmental commitment amongst investors

A range of studies on environmentally responsible banking have demonstrated evidence of significant variation in environmental commitments amongst banks based in different countries. For example, studies of so-called ‘green banking’—involving investment in low-emission energy suppliers, energy-efficient sectors, and carbon capture and sequestration—have highlighted the concentration of such practices amongst banks based in a small number of industrialised countries (Inderst et al., 2012, p. 11). Similarly, studies of the uptake of global standards on socially and environmentally responsible lending, such as the Equator Principles, have highlighted significant variation in the uptake of such lending safeguards

amongst banks from different countries (Conley & Williams, 2011). Furthermore, a study by Scholtens and Dam (2007) also have suggested that CSR policies (of the financial institution that adopted the Equator Principles) are rated significantly higher than those of financial institutions that did not sign up. Such variation means that the extent to which Indonesian companies are likely to be pressured by banks or other investors to improve their environmental performance—in response to publicly disclosed information about their environmental performance—is likely to depend importantly on sources of investment in a given firm or sector.

Variation of environmental commitment amongst buyers and consumers

The effectiveness of public disclosure strategies as means of environmental regulation also significantly depends on the motivation and capacity of buyers and consumers to pressure companies for strong environmental performance (Delmas & Toffel, 2004; Tietenberg, 1998). Such commitments and capacities have also been shown to vary significantly across contexts. For example, studies of green consumption—understood as a willingness amongst consumers to purchase products and services perceived to have a positive (or less negative) impact on the environment—have shown significant differences across countries in consumers' perceptions of and willingness to purchase 'green' products and services (Chekima et al., 2016; D'Souza et al., 2007; National Geographic & GlobeScan, 2008; Roberts, 1996, p. 222).

In addition to consumers, the role of direct supply chain buyers is also often critical in shaping socio-environmental performance. Buyer preferences have been shown to vary significantly across countries. For example, a publication by World Wide Fund for Nature (2020) (thereafter referred to WWF) entitled "*Palm oil buyers scorecard*" demonstrates the varied commitments of major supply chain buyers of sustainable palm oil.

Such variations in consumer and buyer behaviour mean that variation between firms and sectors in the geographical location of product markets is likely to have significant implications for how public disclosure of information about corporate environmental performance translates into pressure on

companies to improve their environmental management practices (Delmas & Toffel, 2004, p. 213; Henriques & Sadosky, 1996).

Variation of civil societies' environmental commitment and action capacities

As explored previously, public voluntary regulation approaches based on public disclosure also benefit significantly from the engagement of non-commercial actors such as communities and CSOs. Public disclosure works best to induce behavioural change in companies in situations where such civil society actors have the motivation and capacity to pressure companies to improve key dimensions of their environmental policies and practices (Gunningham et al., 1998; Tietenberg, 1998). Such motivations and capacities of non-commercial stakeholders have also been shown to vary significantly across contexts.

One important influence on the capacities of civil society actors to mobilise and pressure companies to change their environmental behaviour is the extent to which the broad political environment in the country is conducive to political rights and civil liberties. A range of literature on comparative politics and social movements has highlighted the challenges faced by civil societies (in non-democratic countries) when they attempt to mobilise and advocate for environmental change (Steel et al., 2007; Van Der Heijden, 1999; Yang, 2005). Furthermore, scholars also have identified some variables that influence the capacity of civil societies to mobilise the grassroots to advocate their interests in front of companies, namely links to national and international networks (Lewis, 1998), and the economic stake of communities in the production process (which influences their motivation to put pressure on companies to improve their environmental performance) (Pargal et al., 1997). Significant cross-country variations in the character of the democratic environment in which civil societies seek to mobilise have been widely documented (see for example the work of Freedom House, 2019).

Together, these diverse bodies of work form the basis for a broad expectation that public regulators are more likely to be able to draw on pressure from third-party stakeholders in support of regulatory aims, to the extent that these stakeholders are motivated to prioritise environmental

issues in their engagement with companies, and further possess requisite capacities to access information about corporate environmental performance, responding by sanctioning or rewarding companies accordingly.

2.4. Multi-layered institutional conditions of public voluntary regulation

As we have seen from the above discussion, a range of prior comparative research has shown how the institutional environment in which public regulators seek to influence firm behaviour varies across multiple units or scales of analysis—sometimes varying in accordance with a given national or sub-national jurisdiction, and sometimes varying at the sectoral or firm level. This central insight is neatly captured by the multi-layered institutional framework developed by Matten and Moon (2008) as a tool for comparative analysis of CSR. According to this framework, institutional conditions can be conceptualised as organised around several layers, namely: the national institutional environment; the organisational field of an industrial sector⁵; and the organisational space of an individual firm (Matten & Moon, 2008, p. 413).

To support the application of the abovementioned theoretical framework to the selection and analysis of case studies, this thesis adapts Matten and Moon's framework as a basis for exploring how public voluntary regulation can be expected to operate differently across varied contexts—exploring such variation across these three central units of analysis, reflecting country-, sector- and firm-level variation. In this way, the thesis aims to conduct a systematic exploration of the varied functioning of public voluntary regulation strategies across multiple dimensions of varied regulatory context.

2.5. Conclusion

This chapter has explored concepts and theories of public voluntary regulation and developed a framework for analysing how these distinctive regulatory strategies can operate differently across varied institutional contexts.

⁵ Scholars in the tradition of institutional theory, such as DiMaggio and Powell (1983), have developed the concept of an organisational field to refer to a collectively recognised area of institutional life (DiMaggio & Powell, 1983:148).

First, drawing on insights from several influential theoretical perspectives on public voluntary regulation, three core regulatory strategies were identified: (1) promotion of environmental leadership within companies; (2) provision to companies of technical assistance to support regulatory aims; and (3) public disclosure by companies of specified information on socio-environmental performance.

Analysis then demonstrated how, despite the widespread practice of public voluntary regulation across a range of contrasting regulatory contexts, existing regulatory theories have not yet developed a systematic framework through which to understand how and why public voluntary regulation operates differently across varied institutional contexts. In response to this gap in the research, this chapter has woven together insights from a range of comparative literature on political economy, socio-environmental governance, as a basis for identifying systemic theoretical expectations regarding the ways in which public voluntary regulation can operate differently across varied institutional conditions. This analysis enabled the identification of three broad categories of institutional variables that existing theory and literature indicates may be significant in shaping the capacity of public voluntary regulators to harness social and institutional pressure in accordance with regulatory aims. These institutional conditions are: (1) the relationship between business and the state; (2) state regulatory capacity; and (3) the environmental commitment and capacity of third-party actors to pressure companies, such as investors, banks, buyers, consumers, CSOs and local communities.

Finally, analysis drew on the multi-layered institutional framework developed by Matten and Moon (2008) as a basis for operationalising public voluntary regulatory strategies across national, sectoral and firm-level dimensions. The following chapter will build on this framework as a foundation for elaborating an empirical research design through which the impact of varied institutional contexts in the operation of public voluntary regulation are subject to systematic empirical investigation.

Chapter 3

Methodology and methods

3.1. Introduction

This chapter introduces and explains the research methods used in this thesis, explaining the qualitative comparative case study approach that underpins the project's research design. The overarching research design is shaped by the central aim: to examine how the capacity of public voluntary regulators to achieve their objectives of improving firm Corporate Social Responsibility (CSR) performance is influenced by distinctive features of institutional context, which vary at multiple levels—countries, sectors and types of firm.

To support analysis of how the capacity of public voluntary regulation varies across different institutional conditions, this thesis adopts a qualitative comparative case study approach. Analysis focuses on a major public voluntary regulatory initiative in Indonesia: The Industrial Environmental Rating Program (PROPER). Within-case analysis enables exploration of how country-level contextual factors influence the operation of public voluntary regulatory processes, while comparative analysis of how the PROPER program operated across two different sectors (oil and gas, and palm oil) and across state-owned and private firms, enables exploration of the multiple axes of contextual variation identified within the theoretical framework for this thesis.

This chapter is structured in the following way. The next section explains the qualitative case study approach, outlining how this explains processes and mechanisms of regulatory influence. Discussion then examines the comparative dimension of the research design, justifying my selection of case studies at country, sectoral and firm levels, and the approach taken to within-case and cross-case analysis. The central case study, that is, PROPER, is then introduced in more detail. Next, the chapter outlines data collection methods during each of the three research phases, namely pre-fieldwork, research phase 1, and research phase 2. The approach to data analysis is then introduced, with a focus on the use of process tracing analysis to support

within-case analysis. Finally, the approach to managing research ethics is outlined.

3.2. Qualitative case study

To support the examination of how varied institutional conditions affect the regulatory capacity of public voluntary regulation to shape socio-environmental performance, this thesis adopts a qualitative case study approach. Such an approach incorporates multiple sources of data—interviews, observations and documents—to investigate how regulatory strategies interact with varied institutional contexts in shaping socio-environmental performance.

The definition of what precisely constitutes a qualitative case study remains a contested issue among scholars (Gustafsson, 2017; Thomas, 2011; Yin, 2003). For the purpose of this thesis, a case study is conceptualised in line with Creswell's definition of case study as "a real-life, contemporary bounded system" (Creswell, 2013, cited in Gustafsson, 2017, p. 2). This broad conceptualisation is well suited to the analysing case studies at multiple levels of analysis (i.e. country, sectoral and firm). As Creswell notes, qualitative analysis of a case study involves "detailed, in-depth data collection involving multiple sources of information" followed by reporting of a case description and case themes (Creswell, 2013, cited in Gustafsson, 2017, p. 2).

The justification for adopting such a qualitative case study approach has multiple dimensions. First, by drawing together multiple sources of data (i.e. interviews, observations, documents and other secondary data) to construct a picture of a complex case (cf. Creswell, 2013); such a method offers a promising framework through which analysis in this thesis is able to trace and analyse the complex relationships between public voluntary regulatory strategies, sources of pressure exerted on businesses to improve environmental performance, and multiple institutional conditions that may shape the effects of regulatory intervention on socio-environmental performance.

Second (and relatedly), a case study approach can capture the complexity of dynamics through which regulatory interventions induce

behavioural change in companies. In view of the multi-level theoretical and methodological stance taken here, an approach that is capable of capturing the dynamism and complexity of interactions between different contextual elements is required. A distinctive, useful feature of a qualitative case study approach, from the perspective of this thesis, is that it offers tools through which social and institutional contexts comprise an explicit focus of analysis—not only presenting findings, but also elucidating the institutional conditions within which the findings must be understood (Baxter & Jack, 2008; Gustafsson, 2017). This is particularly well suited to this thesis in relation to analysing complex variations in institutional contexts in which public voluntary regulation operates. Such an approach to analyse complex case study dynamics is further enhanced by its capacity to provide rich “narrative detail” (Flyvbjerg, 2006, p. 237), which assists analysis of both complex cases and the multi-dimensional contexts in which they can be understood.

3.3. Comparative case study

Building on this qualitative case study approach, the thesis also adopts a qualitative approach to comparative analysis. For the purpose of this thesis, the comparative case study approach is adopted as a means of comparing cases across multiple units of analysis and across varied contexts. This involves the study of a public voluntary regulatory program in a single country, involving efforts to regulate company’s socio-environmental performance across different sectors and types of firm. This comparative research design aims to support analysis of how the institutional conditions in a single country (Indonesia) interact with varied institutional conditions across sectors and types of firm.

As Yin (2003) explains, such a comparative case study approach enables data analyses both within and across cases and contexts. Unlike research focused on a single case study, research involving comparative case study analysis provides an opportunity for the researcher to understand similarities and differences between cases (Baxter & Jack, 2008). Such an approach is

helpful for identifying causal mechanisms that explain variation in outcomes across case studies (Yin, 2003).

This multi-level approach to case study analysis required choices to be made about case selection at multiple levels. Table 3.1 illustrates the comparative case framework of this thesis.

Table 3.1. Comparative case framework: Four cases of PROPER implementation⁶

Types of firm \ Sector	Oil and gas (under national government authority)	Palm oil (under both national and subnational government authority)
State-owned company	Subang company	Tebing company
Privately-owned company	Tarakan company	Ketapang company

Considering analysis at the country level, a decision was made to focus on a single country case study within which to compare four cases of the implementation of PROPER. This enabled in-depth analysis of context, and the interaction between country context with sectoral and firm-level variables. The case of Indonesia was chosen for several reasons. First, this case enabled the study of a prominent and longstanding public voluntary regulatory program—PROPER—which has operated in Indonesia since 1995. Second, the focus on Indonesia supported the thesis aim to explore the operation of public voluntary regulation within the context of a developing country. In this context, key contextual variables relating to the political system, economic structure, state-business relations, state capacity, and dynamics of market and civil society pressure, contrast in important ways from industrialised country

⁶ This thesis is using pseudonyms due to the confidential agreement between companies and the author of this thesis.

contexts on which much prior scholarship on public voluntary regulation has focused.

Second, the process of case selection required identification of two contrasting sectors within which firm-level case studies could in turn be selected. A decision was taken to focus on the oil and gas, and palm oil sectors, both within the overarching country context of Indonesia. The choice of these two sectors reflected contrasting regulatory arrangements and production processes that characterised each. One potentially significant difference between the regulatory contexts of these two sectors in Indonesia is the fact that oil and gas production is regulated by the national government, while palm oil is largely regulated by subnational governments. Such variation is expected to have significant implications for regulatory dynamics across these sectors, given evidence from existing studies of environmental governance (see for example Larson & Soto, 2008; Raik et al., 2008; Ribot, 2002) which suggest that national governments tend to have stronger regulatory capacity for socio-environmental governance than subnational governments. Moreover, the kinds of social and environmental impacts generated by firms operating in these contrasting sectors differ in important ways, with potential implications for the kinds of regulatory strategies and capacities required to influence firm CSR performance (Gunningham et al., 1998). Such contrasting sectoral characteristics enable analysis of the effects of varied sectoral contexts on the capacity of public voluntary regulation to shape firm 's socio-environmental performance.

The third level at which case selection was required was individual firms. Here, the aim was to examine the impact of varied ownership structure on the capacity of public voluntary regulation to influence firm's socio-environmental performance between state-owned and private companies. Analysing ownership structure makes sense of the potential impact of variations in corporate governance arrangements and associated state-business relationships in shaping the effects of public voluntary regulation on different types of firm. As discussed in Chapter 2, comparative literature on CSR has shown ownership structure to play an important role in shaping how

companies respond to stakeholders' demands, thereby generating potentially significant implications for regulatory strategies and influence (Li & Zhang, 2010). The Indonesian government has only one State Oil Company (SOC) and one state plantation company (holding), making selection of state-owned firms in each sector straightforward. To facilitate comparative analytical focus on differences between publicly- and privately-owned companies, the largest privately-owned company in each sector was selected, supporting comparability with large state-owned firms.

In general, the structure of a company can be decided on two levels, namely corporate (or headquarter) and plant. Corporate has responsibility to manage the business (i.e. investment, marketing and human resources). However, plant focuses on production processes and manages environmental and social impacts. As such, PROPER assessment focuses on plant rather than corporate level.

In analysing firm-level case studies, a decision was taken to focus analysis of socio-environmental performance at the level of one specific plant (production unit) within each firm. Four plants (or production units) were selected as subjects of primary empirical data collection—one plant per firm. In each firm, the research focused on the plant with the longest period of time participating in PROPER, thereby enabling a clearer picture of how the effects of PROPER's regulatory interventions had evolved over time. This decision to focus analysis of changes in socio-environmental performance on a specific production unit within each selected firm reflects the regulatory design of PROPER, which assesses companies' environmental and social performance at plant level, instead of firm level as a whole.⁷ In explaining processes of regulatory influence over this plant-level performance, however, analysis encompasses a broader view of the firm, in recognition of the central role of decision-making processes at higher levels of firm management, as well as the role of external firm stakeholders, in shaping plant-level socio-environmental performance (Boyd, 2012).

⁷ This approach is specified in the Minister of Environment Decree No. 3/2014.

3.4. Case study of Industrial Environmental Rating Program (PROPER) in Indonesia

Before elaborating how the qualitative case study method was operationalised in this thesis, it is instructive to present an overview of the aims and regulatory design of the Industrial Environmental Rating Program (PROPER), on which this thesis focuses. PROPER is one of the largest public voluntary regulatory programs implemented in a developing country. It is one of the earliest programs of its kind to be implemented outside of the industrialised world (Asfah et al., 2013). PROPER is designed and operated by Indonesia's national government and is implemented across a range of sectors and types of firm (state-owned and privately-owned companies). Therefore, examining PROPER offers the opportunity to understand how its regulatory capacity varies across sectors and types of firm.

PROPER was established by the Indonesian government in 1995 during the final years of President Suharto's authoritarian regime, which was known as the New Order. As a public voluntary regulatory program, PROPER was designed by the government to provide an alternative approach to strengthening corporate compliance with environmental legal regulations, while also inducing improvements in firm environmental performance beyond the minimal forms of compliance required by law (Afsah et al., 1996, 2000, 2013; Blackman, 2008, 2010; Garcia et al., 2009; Pargal et al., 1997).

At the time PROPER was introduced, the New Order regime was renowned for protecting business interests—both individual state actors and the regime benefitted financially and in other ways from business patronage (see later in discussion in this chapter and in Chapter 5). However, during the mid-1990s, the regime came under scrutiny for the massive environmental degradation occurring in Indonesia, especially the pollution of its waterways resulting from its rapid and expansive industrial development program (Afsah et al., 1996; Garcia et al., 2009). Suharto was under pressure from international institutions, particularly from the World Bank—that often acted on behalf of other international institutions and investors—to introduce measures to address these issues of environmental pollution (Afsah & Vincent, 1997). At

the same time, Indonesia was also seeking access to foreign capital to fund its industrial development program as insufficient funds were available domestically. To demonstrate his commitment to the environment, Suharto supported the introduction of PROPER as a part of his politico-economic strategy to attract foreign investors.

He created the National Pollution Control Agency (BAPEDAL) as a special agency directly responsible to the President to oversee PROPER and related efforts to reduce environmental degradation in Indonesia from business activities (Afsah et al., 1995). BAPEDAL had equal powers to ministries and the authority to revoke business licences. However, it was a public secret at the time that very few state agencies would take actions in practice to threaten the business interests of Suharto's family and friends through exercising such authority (Simanjuntak, 2010). To circumvent this issue, BAPEDAL designed a new strategy to engage the market in oversight of environmental management, in particular to encourage foreign investors to pressure the regime and domestic firms to improve their environmental performance (Afsah et al., 2000). It did so by introducing public disclosure mechanisms through PROPER, in which it made detailed information on companies' environmental performance publicly available. Afsah et al. (1996, 2000, 2013) Blackman (2008, 2010) and Garcia et al. (2009) argue that this strategy proved effective, marking a paradigm shift in Indonesia. Although in its 1995 iteration, PROPER was narrow in scope in its aim of addressing issues of water pollution (Afsah et al., 1996; Garcia et al., 2009).

As demands for greater freedoms and democratic reforms grew in 1996 and intensified alongside the onset of the Asian Financial Crisis in 1997, the regime made further concessions to address concerns of environmental degradation beyond water pollution through the ratification of the Law on Environmental Management (Law No. 23/1997). This law contained more stringent mandatory regulations with which business had to comply, not only on water pollution but also in relation to air emissions and toxic and hazardous waste management.

As the financial crisis took hold, PROPER was temporarily suspended from 1997–2001. The collapse of the Suharto authoritarian regime in 1998 then changed the political landscape in Indonesia. The country set about creating an enormous set of political and economic reforms, which introduced all manner of political freedoms not possible under the military regime. As democratisation strengthened, civil society groups were increasingly able to voice concerns about environmental degradation, land grabs, and other violations by companies. International agencies supporting the reforms and the response to the financial crisis through loans and aid also became increasingly influential in Indonesia. Overall, third-party actors (investors, banks, consumers, buyers, NGOs and communities) both nationally and internationally were able to pressure the Indonesian state to give greater attention to social-environmental governance.

When PROPER was reintroduced in 2002, the Ministry of Environment sought to respond to these concerns and strengthen the credibility of PROPER by involving different stakeholder groups in the PROPER oversight Board, including potential critics (MOEF, 2011). They also collaborated with universities for undertaking assessments of firm performance (MOEF, 2011), and continued to use the public disclosure mechanism to publicise the environmental performance of firms. This created an accountability mechanism by which observers could use assessment results to verify performance against realities on the ground. Given the greater press freedoms of the day, it also created a disincentive for state actors to distort ratings of firm performance—mismatches between ratings and on-the-ground realities would be publicised and reduce the credibility of the program, which continued to be important for attracting investment.

It is important to also note here that although the country had decentralised much political and fiscal authority with the legislative reforms introduced at the onset of democratisation, PROPER nonetheless remained within the regulatory authority of the national government as many of the firms that it had historically assessed were in the oil and gas sector for which the national government retained regulatory authority. As later analysis will

show, decentralisation interacted with PROPER in other ways and was more relevant as PROPER expanded to cover other sectors such as palm oil, for which the authority to issue business licences and land concessions for operations (at particular scales) was decentralised.

The specific aims of PROPER were also expanded when the program was reintroduced to also encompass broader issues of environmental pollution, such as air pollution, land pollution, toxic and hazardous waste management and peatland conservation, much of which had already been outlined in the 1997 Law on Environmental Management.⁸

The number of participants in PROPER has increased significantly since the program was introduced. In 1995 only 146 companies participated (Asfah et al., 2000, p. 12). Table 3.2 shows that for the assessment period 2014-2015, the number of participants reached more than 2000 companies (2137). However, the number of participants decreased slightly to 1906 companies by the 2017-2018 assessment period (MOEF, 2019, p. 2). This decrease was due to budget cuts that occurred during this period, limiting the capacity of MOEF to inspect the environmental performance of PROPER participants, which in turn led PROPER to limit the number of participants.

Table 3.2. Number of participants in PROPER, 2012-2018

Assessment period	Number of participants (companies)
2011-2012	1317
2012-2013	1812
2013-2014	1981
2014-2015	2137
2015-2016	1930
2016-2017	1819
2017-2018	1906

Source: Ministry of Environment and Forestry, PROPER's results 2012-2018

⁸ <http://pskl.menlhk.go.id/peraturan.html>. Accessed February 28, 2020.

Despite these fluctuations in numbers of participants over time, the long-term trend has reflected a gradual increase in the scale of the program. The increasing number of participants in PROPER has changed the program's regulatory design. When the number of participants was under 1000 (prior to 2010) the national government had exclusive responsibility for PROPER, with the program's implementation managed by the Directorate General of Pollution and Environmental Damage Control (hereafter DITJEN PPKL). However, after the number of participants in the program exceeded 1000, DITJEN PPKL delegated some responsibilities for evaluation of firm environmental performance to subnational governments (at the provincial level).

The performance of participating companies is evaluated based on both demonstrated compliance with existing government environmental legal regulations, and indicators of beyond-compliance performance developed by PROPER. These indicators focus on three dimensions of firm performance. The first relates to environmental management systems. The second relates to environmental conservation programs, relating to issues such as energy efficiency, water efficiency, renewable energy and biodiversity. The third dimension, PROPER's evaluation, examines the firm's Corporate Community Development (CCD) programs, such as provision of public infrastructure, income-generating activities, or contributions to charities or religious organisations (Chambers et al., 2003).

On this basis, PROPER makes an overall assessment of firm's socio-environmental performance, communicated via a colour coded rating. The five colour codes are Black, Red, Blue, Green and Gold. Each colour demonstrates the level of environmental and social performance achieved by the assessed company (see Table 3.3).

Table 3.3. Five colour codes and their meanings in PROPER
Source: Regulation of the Minister of Environment No.3/2014 regarding

Grade	Colours	Meanings
Beyond compliance level	Gold	A company has been assessed as ranked in the top quartile of companies in their sector overall, and they can demonstrate that they have made significant contributions to improving local community welfare through empowerment programs.
	Green	A company has complied with all legally mandated environmental regulations, complied with PROPER's reporting requirements, and has made proactive efforts to reduce environmental pollution through beyond-compliance programs. They must also be ranked above the bottom quartile of companies in their sector overall.
Compliance level	Blue	A company has complied with all legally mandated environmental regulations, and has complied with PROPER's reporting requirements.
	Red	A company has made some efforts to control environmental pollution but has not complied with all legally mandated environmental regulations and/or has failed to comply with PROPER's reporting requirements.
	Black	A company has failed to comply with legally mandated legal regulations and has made virtually no efforts to comply.

PROPER.

In assessing compliance level ratings (Blue, Red and Black), PROPER does not differentiate participants according to the sector. However, for assessments of beyond-compliance ratings (Gold and Green), firms are

organised into sectoral groups to facilitate the ranking of performance within each sector.⁹

3.5. Data collection across research phases

Data collection methods

In order to address the central question regarding how the regulatory capacity of PROPER varied across sectors and types of firms, several data collection methods were used, including document analysis, semi-structured interviews and non-participant observation. These methods not only provided a wide range of information but also enabled triangulation across different sources of data (Yin, 2003).

Document analysis drew on a range of sources, including government inspection reports, company data on self-reported performance against PROPER indicators, company annual reports and company sustainability reports. Analysing these documents facilitated insights into relevant dimensions of organisational policies and processes within both PROPER and regulated companies.

This document analysis was supplemented by data generated through semi-structured interviews at national and subnational levels. Formal interviews were conducted with 95 respondents, drawn from a range of stakeholder categories; government officials at both national and subnational levels of government, companies, CSOs, smallholder farmers and other local community stakeholders.

Table. 3.4. Categories and number of interviewees

Categories	Number of interviewees
Employees of companies	35

⁹ There are eleven sectoral groups. They are (1) palm oil, (2) upstream oil and gas, (3) mining, (4) sugar and rubber factories, (5) cement, refinery, pulp and paper, and fertilizer, (6) food and beverages, (7) power plant, (8) chemical, shoes, pharmacy and paper, (9) industrial estates, (10) automotive factory, and (11) petroleum and gas distribution.

Government officers at national government level	6
Government officers at subnational government level	19
CSOs	15
Local communities	20
Total	95

Individual participants were selected through a purposive sampling method (Mills et al., 2009, p. 496), based on their professional jobs in regulatory agencies, companies or other third-party organisations. Data drawn from these semi-structured interviews played an important role in enabling the researcher to gain both depth and breadth of insight into the regulatory processes being studied (Mills et al., 2009, p. 496). For example, the interviews enabled the researcher to explore the personal experiences of interviewees regarding compliance processes in particular companies, and associated perceptions of PROPER's activities.

Finally, in addition to the extensive interviews conducted nationally and subnationally, direct observation of firm operations was used in the thesis to gain additional insights into firm responses to regulatory processes at the level of individual companies. The researcher spent two weeks physically based in the office of each of the four firms being examined as case studies in the thesis, directly observing how individual employees and broader organisational processes responded to regulatory interventions from PROPER. Such observations not only provided new data sources in their own right, but they also provided an important means of contextualising data obtained both from documents and from interviews.

Research phases

The data collection is divided into three phases, namely pre-fieldwork, fieldwork phase 1 and phase 2. Pre-fieldwork focused on analysing documents relating to PROPER's regulatory processes provided both by government and

firms, and CSOs publications that provided relevant contextual information about PROPER's regulatory activities. Phase 1 encompassed both interviews and direct observations of how bureaucrats within subnational levels of government and employees at specific companies organised and responded to PROPER's activities. Finally, phase 2 collected additional data by interviewing bureaucrats at the national level, top-level management in individual companies, and national environmental CSOs about their experiences of PROPER.

Pre-fieldwork

As illustrated in Table 3.5 below, the pre-fieldwork phase focused on exploring documents from government, companies and other third-party stakeholders. The government, particularly the Ministry of Environment and Forestry (MOEF), provided both published and unpublished documents about PROPER for this thesis. The published documents cover annual reports of PROPER between 2010 and 2017. Unpublished documents include government inspection reports on the four companies in this thesis. These reports provide data that evaluate these companies' current performance relative to minimum legal requirements (*baku mutu*).

Analysis also drew on corporate self-assessment documents, including both annual reports and sustainability reports. Each company provided multiple years for these published reports on their websites. In general, the annual reports cover information about each company's profile, organisational structure, and financial performance. Meanwhile, the sustainability reports focus on informing company stakeholders about environmental policies and financial investment in environmental and societal programs.

In addition to exploring government and company documents, the pre-fieldwork research phase also involved analysing a range of CSO publications, which provided numerous research reports and background information about civil society advocacy campaigns, alongside background information about CSO engagements with corporate CSR programs and private regulatory systems in both sectors.

Phase 1

After conducting pre-fieldwork activities, interviews were conducted with local government officers at both provincial and district levels, employees at plant level, and members of local communities and local CSOs. The research phase 1 was carried out in four provinces: Aceh, North Sumatra, South Sumatra and West Kalimantan.



Notes:

- State -owned oil company (SOC) in Aceh Province
- State-owned palm oil company in North Sumatra Province
- Privately-owned oil company in South Sumatra Province
- Privately-owned palm oil company in West Kalimantan Province

Figure 3.1. Map of case studies

Source : <https://aseanup.com/free-maps-indonesia/>

Visiting environmental regulators' offices at the provincial level was an important first step in conducting fieldwork. This is because environmental regulators served as principal inspectors to verify environmental performance of palm oil companies in response to PROPER's regulatory interventions, in light of decentralised governance arrangements prevailing in this sector.

Environmental regulators at the district level were also interviewed at this stage. Even though they are not principal inspectors for the PROPER program, they play an important role in providing day-to-day monitoring of companies' environmental performance. Building relationships with local environmental regulators also served to facilitate company access. Some companies required local government approval before accepting the researcher's proposals to visit at the plant level.

Data from environmental regulators at both provincial and district levels were analysed to explore several issues: local governments' regulatory strategies to implement PROPER; exploring a public voluntary regulation program (i.e. PROPER) across multiple levels of government demanded interviews at each of these levels, to examine how the design and implementation of PROPER played out across these different scales; and exploring the extent to which local government exercised discretion over how PROPER's regulatory strategies were implemented at the local level.

After visiting government offices both at provincial and district levels, data were collected from company plants in four Indonesian provinces. Several methods were used, including semi-structured interviews, Focus Group Discussions (FGD), non-participant observations and document analysis. Semi-structured interviews were used to interview management and employees at the plant level, with a particular focus on plant managers and field managers, both of whom have responsibilities for ensuring plant-level compliance with social and environmental regulations. In addition, staff in environmental and social departments were interviewed, reflecting their central contributions to socio-environmental performance on the front line, implementing social and environmental programs.

When interviewing management representatives and other staff, data were gathered regarding how individual employees at the plant level perceived and responded to PROPER. This enabled the role of individual beliefs and interests in shaping company responses towards PROPER to be explored (Gabel & Sinclair, 1993; Segerson & Tietenberg, 1992).

In addition to collecting data within companies, members of local communities and CSOs located around the plants were also interviewed. Local community interviews focused on those that live in business-affected areas, for example, plant neighbours. From these interviews, data were collected on community responses toward business activities, particularly on the social license to operate. Scholars define social license to operate as the condition in which a company's behaviour meets society's expectations and avoids any activities that societies (or influential elements within them) deem unacceptable (Gunningham et al., 2004, p. 308). Local communities may withdraw their social license to operate if companies do not meet their expectations. Losing such a license limits how companies can secure their production processes. And ultimately, this affects economic performance.

Finally, CSOs based near plant-level operations were also interviewed. Similar to local communities, local CSOs were interviewed to explore their activities (i.e. demonstrations and campaigns) to pressure a company for better environmental and social performance. CSOs can play a role as "key starter" or leaders to organise activities to pressure companies.

Phase 2

After collecting data at plant level, the focus shifted to exploring how PROPER shapes socio-environmental performance at corporate headquarters level. During research phase 2, interviews were conducted with government agencies, companies and environmental CSOs at the national level. Semi-structured interviews were utilised to explore the experiences of these stakeholders regarding ways in which PROPER shapes company's socio-environmental performance. The Ministry of Environment and Forestry (MOEF), and Ministry of State Secretary were key information sources from the national government. At the Ministry of Environment and Forestry, the Director General and Secretary of Directorate General of Pollution and Environmental Damage Control (DITJEN PPKL) were interviewed. This directorate exercises central responsibility for designing, implementing and evaluating PROPER. Data from this directorate also contributes to

documenting national government's regulatory approach towards the PROPER program.

At the national level, the Minister of State Secretariat was also interviewed, with the central objective of understanding relevant elements of government policy. Interviews were also conducted with companies at the corporate headquarters level. Three of the companies in this thesis were based in Jakarta Province, and one company was based in the North Sumatra Province. At corporate headquarters level, I interviewed the most senior managers in the Environmental Department and Corporate Social Responsibility Department (or equivalent, i.e. Community Engagement Department).

The purpose of these interviews was to explore internal dynamics in response to PROPER's regulatory interventions. Corporate headquarter level is responsible for designing and allocating budgets and human resources to translate top-level management commitment to PROPER into real programs which are implemented by plants. These interviews therefore yielded important insights regarding shifting CEO perceptions toward public voluntary regulation.

Finally, during this phase of the fieldwork two types of CSOs were interviewed: CSOs with an organisational relationship with international CSOs; and national CSOs originally established in Indonesia. The data from these interviews were designed to generate insights into the role of CSOs in shaping companies' environmental strategies. Moreover, they informed how transnational actors' strategies worked to shape Indonesian companies' environmental behaviour.

Table 3.5. Research phases

Research phase	Method used	Key data sources	Analysis
Pre-fieldwork	Document review	Government - Annual report of PROPER by the Ministry of Environment and Forestry (published) - Inspection reports (unpublished)	- Regulatory design of PROPER - Government's regulatory strategies - Companies' compliance performance
	Document review	Companies - Annual reports (published) - Environmental reports (unpublished) - Sustainability reports (published)	- Business characteristics - Organisational structure - Companies' environmental policies - Stakeholders' pressure (the audience of company's annual report and sustainability report)
	Document review	Stakeholders - CSO publications (published) - Roundtable Sustainable Palm Oil (RSPO) compliance reports and company profiles (published) - Buyers' website	- Transnational regime on the industrial sector - Global movements for the sustainable palm oil industry
Phase 1 Plant level	Semi-structured interview	Governments Subnational governments at the provincial and district level	- Government regulatory approach/style - Bureaucrats' interest in PROPER
	Semi-structured interview, Focus Group Discussion (FGD), and non-participant observation on the plant	Companies - Management and employees at plant level - State-owned Oil Company (SOC)'s plant in Aceh Province - Privately-owned oil and gas plant in South Sumatra Province - State-owned palm oil in North Sumatra Province - Privately-owned palm oil plant in West Kalimantan Province	- Business characteristics - Organisational structure - Companies' environmental policies - Top-level management interest in PROPER - Employees' interest and agenda

	Document review	- Companies' self-assessment document for PROPER (unpublished) - State-owned Oil Company (SOC) = 893 MB, 148 files - Privately-owned oil company = 1.6 GB, 679 files - State-owned palm oil company = 912 MB, 649 files - Privately-owned palm oil company = 255 MB, 370 files.	- Business characteristics - Organisational structure - Companies' environmental policies - Environmental and societal friendly programs
	Semi-structured interview	Stakeholders - Local communities located around companies' plants - CSOs located around companies' plants	- Stakeholders' pressure - Transitional actor's network in local contexts
Phase 2 Corporate level, political elites, and high-level bureaucrats at national level.	Semi-structured interview	Governments Environmental regulator at the Ministry of Environment and Forestry	- National environmental regulators' regulatory style - Regulatory design of PROPER
	Semi-structured interview	Minister of State Secretariat	- President Joko Widodo's approach to palm oil companies - State's policy in the palm oil industry
	Semi-structured interview	Companies - Management and employees at the corporate level - SOC, private oil company and private palm oil company in Jakarta Province - State plantation company in North Sumatra Province	- Top-level management behaviour - Economic motivation - Business characteristics - Organisational structure - Companies' environmental policies - Investors' pressures
	Semi-structured interview	Stakeholders Environmental CSOs at national level	- CSOs' responses toward PROPER - Role of CSOs to pressure companies' environmental and social policies - Characteristics of the industrial sector - Transnational regime's influences

3.6. Data analysis

This research adopts process tracing to explain outcomes (see for example Beach & Pedersen, 2013, pp. 18-21) to analyse the various data collection at various levels within each case study. Process tracing is a data analysis method for identifying, validating, and testing the causal mechanism within case studies in a specific, theoretically informed way (Mills et al., 2009).

Why would this research adopt process tracing in explaining compliance? Process tracing is more frequently used within research that investigates the decision-making process as its central question (Mills et al., 2009). Company compliance or non-compliance with regulation is the result of a decision-making process. Process tracing is, therefore, the most appropriate data analysis to determine whether the company does or does not comply with social and environmental regulation in Indonesia linked to the activities of PROPER. Process tracing analysis within cases helps us to understand the contribution of institutional contexts (as an intervening variable) in the relationship between regulatory capacity of public voluntary regulation and CSR company performance (see for example Bennett & Checkel, 2015; Bennett & George, 1997; Ford et al., 1989).

In this thesis, socio-environmental performance in PROPER is seen as the dependent variables which is influenced by regulatory strategies as independent variables. The relationship between socio-environmental performance and regulatory strategies is mediated by institutional conditions of public voluntary regulation, namely the relationship between state and business, state regulatory capacity, and third-party actors' environmental commitment and capacity to pressure companies.

3.7. Research ethics

A long-term commitment to respecting and protecting the privacy of research participants is a fundamental ethical value of a qualitative researcher. The results of qualitative research not only create knowledge but foster a long-term relationship between a researcher and the subject of research. To comply with this research ethic, this research was conducted with approval from the

University of Melbourne Human Research Ethics Committee. The University of Melbourne Human Research Ethics Committee approved this research project within the minimum risk category on March 2, 2017, with the reference number 1648374. As an Australian university, the University of Melbourne adopts the Australian National Statement on Ethical Conduct in Human Research (updated May 2018).

Both the University of Melbourne's research ethics policy and the Australian National Statement on Ethical Conduct in Human Research required the researcher to submit the research proposal, plain language statement, and informed consent documentation for research participants. These documents were sent to the companies targeted as research participants for this thesis. Based on the documents above, approval for all companies to participate in the research project was granted.

The companies that accepted the proposal to participate required the researcher to sign a confidentiality agreement to access internal company documents and to protect any confidential information. Furthermore, research ethics and confidentiality agreements required anonymity for research participants—protecting the research participant's or site's identity. To do so, the researcher has applied pseudonyms as a means of referring to research participants, both organisational and individual.

Table 3.6. Pseudonyms used to comply with research ethics and confidentiality agreements with companies

Oil and gas industry	Pseudonym
State Oil Company	Subang company
Private oil company	Tarakan company
Palm oil industry	
State plantation company	Tebing company
Private palm oil company	Ketapang company

3.8. Conclusion

This thesis adopted a qualitative comparative case study approach, as a means of supporting analysis of how the capacity of public voluntary regulation varies across different institutional conditions. A qualitative case study approach facilitates the use of multiple data collection methods, including interviews, direct observation and data analysis.

Analysis focuses on a major public voluntary regulatory initiative in a single country: Indonesia. Indonesia has been selected on a purposive basis, because it is a developing country that has been implementing a prominent and pioneering public voluntary regulation program entitled “Industrial Environmental Rating Program” (PROPER). Within-case analysis enables in-depth exploration of how country-level contextual factors influence the operation of public voluntary regulatory processes, while comparative analysis of how the PROPER program operated across two different sectors (oil and gas and palm oil) and across state-owned and private firms, enables exploration of the multiple axes of contextual variation identified within the theoretical framework.

The next chapter will elaborate how the Indonesian institutional context shapes three key contextual variables hypothesised to be central to shaping the varied dynamics of public voluntary regulation, namely the relationship between business and state, state regulatory capacity, and third-party actors' environmental commitment and capacity to pressure companies.

Chapter 4

Overview of Indonesian institutional contexts

4.1. Introduction

As explained in preceding chapters, by examining PROPER strategies, this thesis explores the mechanisms or pathways by which public voluntary regulation shapes environmental performance of firms in varied institutional contexts in Indonesia. The theoretical framework (outlined in Chapter 2) draws on insights from the literature on regulatory studies (see for example Gunningham et al., 1998) and combines this with literature on comparative Corporate Social Responsibility (CSR) (e.g. Campbell, 2006), political economy (e.g. Kang & Moon, 2011; Vithiatharan & Gomez, 2014), and comparative environmental governance (Assetto et al., 2003) to hypothesise how institutional conditions may shape how regulatory strategies influence behavioural change in firms.

Using a multi-layered institutional framework (Matten & Moon, 2008), this chapter provides an overview of three hypothesised institutional conditions that can shape the enabling environment for the operation of PROPER in the Indonesian context: (1) state-business relationships (including the different relationships between businesses and both national and subnational political elites), (2) state regulatory capacity, and (3) third-party actors' environmental commitments and capacity to pressure companies. Key features of these institutional conditions at national, subnational and sectoral (or firm) levels are outlined to better understand how they enable or constrain the ways in which regulatory strategies harness multiple sources of pressure to incentivise behavioural change in companies' environmental performance. This thesis demonstrates that the three aforementioned institutional conditions are key variables informing how regulatory strategies operate differently across sectors (oil and gas, and palm oil) and types of firm (state-owned and privately-owned), to be explored in subsequent chapters.

The following section overviews key aspects of the Indonesian political economy with particular focus on institutional conditions at the country level,

including discussion about the importance of Indonesia's highly-prized natural resource base for Indonesia's economic development over time, and the history of strong ties between Indonesian businesses and the military. An outline of changes in power and political and fiscal authority, as Indonesia has decentralised and shifted from highly-centralised authoritarian rule to democratic rule is also included.

The third section explores the relationship between business and state across sectors and types of firm, while the fourth section explores state regulatory capacity across oil and gas and palm oil sectors. Here, I seek to illustrate that the national government (at the national level), as the actor with regulatory authority for the oil and gas sector, tends to have a higher regulatory capacity when compared with subnational governments, which on the whole have responsibility for regulating the palm oil sector, particularly new licenses. The fifth section discusses the environmental commitment and action capacity of investors, banks, civil society organisations (CSOs) and local community (third-party actors) in Indonesia. This chapter demonstrates that global demands for sustainable finance and processes of democratisation have shaped third-party actors' environmental commitment and action capacity to improve socio-environmental performance in companies.

4.2. Overview of distinctive Indonesian institutional conditions

Before exploring the mechanisms by which public voluntary regulation shapes socio-environmental performance, it is essential to understand key features in the Indonesian context that shape institutional conditions. These include historical and contemporary reliance on natural resource extraction revenues to drive economic development and the history of strong relationships between corporate interests and the military, which together with the shift to democratisation and decentralisation, shape contemporary structures of power and authority in Indonesia. Understanding these distinctive features in the Indonesian context shape key institutional conditions—the relationship between business and state, state regulatory capacity and third-party actors' environmental commitments—helps explain the variation in how public

voluntary regulation implemented through PROPER may affect environmental performance.

Natural resource exploitation, economic development and crony capitalism under Suharto

Natural resource exploitation has long been a core source of revenue for economic development in Indonesia, particularly during the 1960s-1980s (Winanti and Diprose, 2020). Under both Dutch colonialism and Indonesia's first President, Soekarno (1945-1967¹⁰), the exploitation of oil and gas, timber, and other natural resources expanded and were important sources of state revenue, particularly oil (Arndt, 1983). Political elites have long sought to control these sectors, which continued after the collapse of the Soekarno regime. In 1965, amidst the faltering economy, widespread poverty and growing political turmoil, General Suharto supported by several factions of the military seized power following an alleged military coup by military officers deemed to be close to the Indonesian Communist Party (Anderson & McVey, 2009; Crouch, 1975). Robinson (2018) estimates that half a million members of the Indonesian Communist Party (Partai Komunis Indonesia, or PKI) and those labelled as associated with communism were killed by the Indonesian military and paramilitary groups such as the Pemuda Pancasila (Pancasila youth) and youth wings of organisations such as the mass Muslim organisation Nahdlatul Ulama (Fealy & McGregor, 2010; Ryter, 1998). Others were imprisoned. Suharto used the 'instability' that characterised 1965-1966 and the decade prior under Soekarno to promote an agenda of increasing stability through military rule (Hooker & Dick, 1995). To support Indonesian development, he also used the events of 1965-1966 to build closer military and financial ties with the United States of America (which was staunchly anti-communist), and to shift Indonesia's orientation away from bilateral ties with the rival of the US, the communist Soviet Union (Yazid, 2014).

¹⁰ While Soekarno was officially in power until 1967, Soeharto seized control in 1965 with the backing of several factions of the military and was the de facto president until 1967,

The shift to authoritarianism under Suharto's New Order (1967-1998) also marked a major turning point in Indonesia's political economy of resource extraction, in which an increasingly narrow circle of Suharto's family and close business associates, as well as military officials, benefited from the rapid extraction of resources (Smith, 2007). Under the regime, bolstering economic development was at the forefront of political discourse and policy development, alongside maintaining 'stability' through a dual role (*dwi fungsi*) for the military in both civilian politics and defence (Hooker & Dick, 1995; Schwartz, 2007). Military generals were not only appointed as governors and to other political positions throughout the country, but also to the top-level management positions of the State-Owned Enterprises (SOEs), especially in the resources sectors. Smith (2007) argues that together, revenues from natural resources extraction (especially oil) and military power provided the foundation for the New Order's firm grip on the country. Oil revenues were used by Suharto to fund and maintain the support of various institutions, coalitions and the military for his regime. Moreover, the military was also able to access other forms of illicit rents from "black market" opportunities from resource extraction in Indonesia's subnational regions, in particular through smuggling oil-related products, and from protecting or directly engaging in illegal mining and logging (McCulloch 2000: 26). Not surprisingly, with so much of Indonesia's wealth located in the commodity-rich provinces, the military also has close associations with key income-producing businesses (Kingsbury, 2003:195)".

One of the other key strategies of the Suharto regime was to exploit natural resources for Indonesian economic development and personal gain for Suharto's family and his inner circle (Hapsari, 2011). This resulted in the domination of conglomerates—often owned by Sino-Indonesians—commonly referred to as "crony capitalists" (Chalmers & Hadiz, 2005, p. 167). Under crony capitalism, personal connections and political patronage, rather than entrepreneurial ability, determined which actors could access government-generated rents, bank credit and other economic resources, usually on very lucrative terms (Chang, 2000, p. 775).

These crony capitalists collaborated with influential military leaders and bureaucrats at a national level who all gained significant rents from Suharto's development agenda, including natural resource extraction (Brown, 2006). Together, these actors worked assiduously to create the image of political stability and communal harmony that earned the country a reputation as a safe haven for foreign capital and foreign direct investment grew (Schwartz, 2007, p. 76), particularly in the extractive sectors (Lindblad, 2015).

Indonesian economic growth was impressive for most of Suharto's rule. For example, in 1968, Indonesian Gross Domestic Product (GDP) grew by 12 per cent from the previous year (Basri, 2016). Impressive economic growth continued until the financial crisis destabilised the economies of most Asian countries in 1997. Under Suharto, Indonesia's oil and gas sector was one of the highest contributors to the Indonesian economy (Harvie & Thaha, 1994). The oil boom bolstered the Indonesian economy and state revenues, particularly in the 1970s and 1980s, with the state-owned oil company conferring many personal benefits on Suharto's friends and family (Glassburner, 1976). In the 1970s, in particular, the oil boom improved the government's financial capacity to introduce state-led industrial development strategies, resulting in substantive government investments in heavy industry (Aswichayono et al., 2007, p. 351). By the end of the 1980s, the contribution of oil and gas to the Indonesian economy had continuously declined although this remained significant (Harvie & Thaha, 1994) (see discussion below).

The Asian Financial Crisis that began in 1997, together with other factors, was one of the key triggers for the political crisis in Indonesia that contributed to the collapse of the Suharto regime (Bunnell & Miller, 2011). Indonesian GDP dropped to -13.1 per cent in 1998 and poverty escalated (Basri, 2016). Large-scale student demonstrations pressured Suharto and the military to withdraw from "day-to-day" politics (Crouch, 2010, p. 135). Finally, after three decades, Suharto's authoritarian regime came to an end with his resignation on 21 May 1998 (Emmerson., 2015, p. ix).

Democratic transition and decentralisation: changing structures of power and authority

Davidson (2018) divides the post-Suharto periods of political leadership into three distinct periods—innovation (1998-2004), which was characterised by significant political (and economic) reforms, stagnation (2004-2014), which was characterised by stagnation of these reforms and worsening corruption, and the polarization of interests under Joko Widodo's leadership (2014-present). I explore each in turn.

During the period of innovation (1998-2004), Indonesia undertook significant political and economic reforms. It introduced a multi-party electoral system in which the Indonesian people could freely vote in elections (Tomsa, 2008), and one which acknowledged broader political rights and civil liberties (including CSOs' freedom) (Freedom House, 2019). The role of the military in politics was wound back until it was eliminated in 2000 and large-scale military businesses were abolished. However, military actors stationed in many resource-rich regions continued to gain resource rents through more informal and illicit practices or personally-owned businesses (Mietzner, 2006).

Alongside democratisation, Indonesia introduced new Laws to give greater autonomy to Indonesia's regions. This included Law No. 22/1999 (updated through No. 32/2004 and 23/2014), which significantly changed the relationship between national and subnational governments and decentralised significant political and fiscal powers to subnational governments, especially districts. Indonesia's regions, particularly in the islands outside Java, had long demanded greater authority to govern their own regions, which not only manifested in regional rebellions in the 1950s, but in centre-periphery tensions thereafter particularly as Indonesia's regions were tightly controlled by the military (Diprose, 2009; Harvey 1977). At the onset of democratisation, significant communal and separatist violence had also escalated in a number of Indonesia's regions.

The onset of democratisation provided the opportunity for factions of national political elites as well as many subnational leaders to push the

decentralisation agenda forward to address centre-periphery and other tensions. Many argued that decentralisation would bring government closer to citizens and more effectively meet the demands of communities (Fitriani et al., 2005). Such arguments were also backed by the World Bank and others in Consultative Group on Indonesia as a policy solution to some of Indonesia's governance challenges that had resulted from 32 years of authoritarian rule (Larson & Ribot, 2004). With its introduction, the goal of decentralisation was to foster regional development from below by giving subnational governments greater discretion in determining programmes that are more aspirational to the interests of the community and local and regional development objectives (Talitha et al., 2019). Decentralisation also granted subnational governments more authority for generating their own revenues and running more tailored, decentralised public services (Duek & Rusli, 2010). However, the Minister of Home Affairs admitted that while decentralisation and the creation of new regions in many cases should have helped 'improve public services, increase democratisation, and speed up economic development', in reality, 'political considerations had been very dominant in past approvals of [new] regions', with decentralisation also introducing perverse fiscal and bureaucratic rent-seeking incentives (Fitriani et al., 2005:58).

Others such as Fox et al. (2005) contend that one of the key underlying drivers in the push for decentralisation on the part of subnational leaders was gaining the power and authority subnationally to manage the extraction of natural resources. Revenues from extraction had long benefited big business, the central government and those closely tied to the Suharto regime, rather than subnational governments and communities (Diprose and Azca, 2020). Changing the structures of power and authority in natural resources governance also had implications for environmental management, particularly in the forestry, palm oil, fisheries and coal mining sectors for which many powers were decentralised, while sectors such as gold mining and oil and gas remained within the authority of the central government.

During what Davidson (2018) describes as the stagnation period (2004-2014), decentralisation in Indonesia continued to be contested between

national and subnational governments, with each struggling for power and authority (Hadiz, 2004). In the early years of decentralisation, thousands of licenses for resource extraction were issued subnationally (Cramb & McCarthy, 2016), which had implications for environmental degradation and triggered the push for recentralised control, particularly in the resources sector (Diprose, et al. 2020; Junaenah et al., 2015). Indeed, the decentralisation laws were revised in multiple iterations (in 2004 and 2014), with provincial governments having more significant authority for extractive sectors (with the exception of oil and gas) since 2014 than was previously the case, but authority has not been completely recentralised (Diprose et al., 2020).

Democratisation in Indonesia, together with growing environmental problems that accompanied an increase in businesses licenses, provided political opportunity structures for communities and CSOs to both grow in number and develop their capacity to make demands for improved environmental performance on the part of government as well as companies (Hadiwinata, 2003). The growing number of CSOs arising from democratisation and the ways they have pressured companies are discussed in section 4.5. in relation to third-party actors' environmental commitment.

During this time too, particularly under the Yudhoyono administration, debates were raging between economic nationalists and liberalists (Davidson, 2018), particularly in relation to control of Indonesia's natural resource base (Warburton 2017; Winanti and Diprose, 2020). Yudhoyono introduced a number of changes to wind back liberalisation and limit foreign investment in key sectors, in particular in mining as a part of an agenda to promote resource nationalism (Warburton 2017; Winanti and Diprose, 2020). Late in his administration, after a controversial Constitutional Court ruling, economic nationalists in alliance with Islamic nationalists were also successful in their agenda to dismantle one of Indonesia's key regulatory agencies in the upstream oil and gas sector (BP MIGAS), which significantly changed the regulatory arrangements and oversight of the sector (Davidson, 2018).

Economic nationalists used the strategy of problematising the legality of the BP MIGAS several times, in 2003, 2007 and 2012, with the case reaching

the Constitutional Court. According to economic nationalists, the organisational structure of BP MIGAS, as the Independent Regulatory Agency (IRA), sought to liberalise the oil and gas industry, in ways that did not comply with the 1945 Constitution of the Republic Indonesia (Davidson, 2015). In the first two judicial reviews (2003 and 2007), the pressure from economic nationalists failed as at the time the majority political elites supported the agency, especially Yudhoyono and his ruling Democratic party.

However, by 2012, things had changed. Economic nationalists collaborated with Islamic organisations (Muhammadiyah and Lajnah Siyasyiah Hizbut Tahrir Indonesia) to increase political pressure on the state to dismantle BP MIGAS (Jakarta Post, May 19, 2012). As a result, the regulatory agency suddenly lost its independence, and some of its role was transferred to a new agency, the Special Task Force for Upstream Oil and Gas Businesses (SKK MIGAS), now under the authority of the Ministry of Energy and Mineral Resources).

During what Davidson (2018) describes as the period of polarisation (2014-present) under President Joko Widodo, Indonesia has become deeply polarised around the role that religious norms should play in public life (Klinken, 2019), which has increasingly threatened democratisation in Indonesia (Hadiz, 2017). Davidson describes the emergence of a cynical and destructive anti-democracy alliance linking wealthy oligarchs, the military and Islamic nationalists (Davidson, 2018). Further, in the resources sector, Widodo continued Yudhoyono's resource nationalist agenda (Winanti and Diprose, 2020).

The importance of resource extraction for contemporary economic development

Since the Asian Financial Crisis and subsequent major political, economic and other reforms, Indonesia's economic situation has markedly improved (World Bank, 2020). After the crisis, the country's annual GDP per capita has steadily increased from USD 823 in 2000 to USD 3,932 in 2018. By 2018, this economic performance placed Indonesia in the group of countries with lower-middle-income status. In 2018, the Indonesian economy was also the largest among

Southeast Asian countries based on GDP, with a value of USD 1.042 trillion (World Bank, 2020). However, when Indonesian GDP per capita in 2019 reached USD 4,193 in 2019, it marginally surpassed the threshold for upper-middle-income country status set at USD 4,036 (World Bank, 2020).

According to Statistics Indonesia (2020)—the central bureau of statistics—since democratisation and more recently, revenues from natural resource extractive industries remain an important contributor to Indonesian GDP. Agriculture and agribusiness (including palm oil) has contributed 12.65 per cent of GDP in 2019 (BPS, 2020). The contribution from the oil and gas sector was 7.77 per cent of GDP in 2019 (BPS, 2020). Both sectors together contribute significantly to state revenue; although the contribution of oil and gas has declined over time (see Table 4.1).

Table 4.1. The Economic contribution of oil and gas, and palm oil sectors to total revenue

Year	Oil and gas (%)	Palm oil (%)
2012	22.54	14.33
2013	21.22	12.41
2014	20.62	14.29
2015	8.96	14.68
2016	5.44	15.90
2017	8.29	16.97

Source: Ministry of Finance, 2018

Indeed, since 2015, the structure of state revenue has changed significantly. Traditionally, the oil and gas sector contributed more to the economy when compared with the palm oil sector. However, in 2015, the contribution of the palm oil sector to the Indonesian economy at 14.68 per cent was almost double that of the oil and gas sector (see Table 4.1). The palm oil sector is considered one of the most important and fundamental contributors to the national economy (Indonesian Palm Oil Association, 2016).

Changes to Indonesia's political economy over time, including new structures of power and authority introduced with democratisation and

decentralisation (and contestation over these), have historically informed the institutional conditions that influence power relations among actors, and between national and subnational governments. This is particularly the case for natural resources governance and business regulation. Discussion in the following sections will explore the impact of these changes in the Indonesian political economy on the three abovementioned institutional conditions (i.e. the relationship between business and state, state regulatory capacity and third-party actors' environmental commitment), proposed here as important for understanding how PROPER may (differentially) induce behavioural change in socio-environmental performance across sectors (oil and gas, and palm oil) and types of firm (public and privately-owned).

4.3. Relationship between business and the state across sectors and type of firm

This section discusses the relationship between business and state across sectors and types of firm in the Indonesian institutional context. Here I argue that decentralisation which has influenced the relationship between business and state varies across sectors—historically, top-level management of firms in the oil and gas sector have preferred to build relations with political elites at the national level, while in the palm oil sector, firm management has been more sensitive to the preferences of political elites at the subnational level. Moreover, this section also discusses the various motivations of top-level management across types of firm in their responses to political elites. Arguably top-level management of state-owned companies tends to build political support networks to secure individual interests such as senior appointments in these firms. Meanwhile, in the private sector, top-level management has tended to engage with political elites to support company access to business opportunities and organisational performance.

4.3.1. The relationship between business and state across sectors

As previously discussed, one of the distinctive features of the Indonesian governance system is its degree of decentralised authority, which varies

across sectors. As such, the level at which authority is concentrated for regulation of a particular sector influences the orientation of top-level management's efforts to build political networks with influential authorities to support their business interests. The oil and gas sector is regulated by national government, while much authority for governing the palm oil sector sits at the subnational level of government. Arguably, each sector is thus more sensitive to the demands of political elites who have the predominant fiscal and decision-making authority to influence firms.

The oil and gas sector

Since Indonesian independence in 1945, the national government has regulated the oil and gas sector. This authority, at the broadest level, has its base in Article 33 (Clause 3) of the Constitution of the Republic of Indonesia of 1945 (hereafter referred to as the 1945 Constitution), which states that:

The land, the waters and the natural resources [of Indonesia] shall be under the control of the state and shall be used to the greatest benefit of the people.

More recently, Law No. 22 (2001) confirmed that the national government had authority over the sector, with Article 3 stating that the purpose of the law is to:

- (a) Assure effective implementation and control of Exploration and Exploitation business activities in a useful, efficient, and highly competitive and sustainable manner of strategic and non-renewable Oil and Gas that belong to the State [national government] through open and transparent mechanisms;*
- (b) ...*
- (c)*
- (d) Support and promote the growth of national capacity to be more competitive at the national, regional, and international levels.*

Law No. 22 (2001) also grants legal authority to the national government to regulate fiscal management of the oil and gas sector, and to issue business permits and environmental licenses. Further, subnational governments must follow national government decisions in this sector.

The centralisation of formal state authority over the oil and gas sector has implications for formal interactions between the state and firms under existing regulatory arrangements (or formal rules), corporate governance arrangements within firms in Indonesia, and the nature of informal relationships between the leadership of oil and gas companies and national-level state agencies (Ascher, 1998). Formal interaction occurs between the regulator (or responsible state agency/ies) and regulatory target (companies) through implementation of and adherence to existing rules outlined in laws, regulations and technical policy instruments. Informal interaction occurs between influential state actors in the oil and gas sector and top-level management of firms through building close relationships and networks, so as to influence the preferences of both.

The Special Task Force for Upstream Oil and Gas Businesses (SKK MIGAS) mentioned above, is the sole national government agency responsible for managing the extraction and exploitation of oil and gas resources in Indonesia (but not the regulation of environment impacts of industry activities). Until 2013, SKK MIGAS (as BP MIGAS) was an agency directly under the authority of the President, after which it came under the authority of the Ministry of Energy and Mineral Resources.

Oil and gas companies need to submit proposals to SKK MIGAS to be designated work areas (*wilayah kerja*-WK) for oil and gas industry activities, as well as to gain business licenses and environmental permits. Because Indonesia adopts what is known as Production Sharing Contract (PSC) arrangements (Pongsiri, 2004), the operational costs of oil and gas companies must be also approved by the Indonesian government as government shares some of the costs of production. Approvals are needed for work plans and budgets (WPNB) for oil and gas production—often several times a year from authorities—which if slowed has implications for production. Hence, companies endeavour to make this process as smooth as possible.¹¹ Environmental permits are also issued by the national government through

¹¹ Multiple confidential interviews with senior company management in the oil and gas sector on 18 April 2017, 20 April 2017 and 26 April 2017 respectively.

SKK MIGAS under Government Regulation No. 101/2004. Upstream oil and gas activities involve many toxic and hazardous materials and conditions need to be met for managing the waste from such industry activities.

Regardless of where oil and gas industries are located in Indonesia, top-level management of oil and gas companies tends to focus on building allegiances with national-level political elites, so as to ensure they gain support for licenses and permits, and to make processes for meeting regulatory requirements less bureaucratic. In Indonesia, both state-owned companies and private companies in the oil and gas industry (and for that matter palm oil) need the support of political elites because they operate within the broader structures of a patrimonial state that has its historical roots in Suharto's crony capitalism, as discussed above. Many scholars have identified Indonesia as an example of a patrimonial state (Choi, 2009; Crouch, 1979; Yudo, 2019), in which the operation of political institutions is dominated by patron-client networks and the pervasiveness of personal ties, rather than universal connections (Choi, 2009, p. 132). Patrimonial states create a culture of securing access to the state and the opportunities it provides (i.e. permits and resources) via informal relationships between non-state actors and authoritative state actors, in particular those in the bureaucracy.

It is unsurprising then that top-level management of oil and gas companies are commonly known to develop close personal ties with political elites who have authority in the oil and gas sector through extracurricular activities. For example, according to an investigation by *Tempo Magazine*, many oil and gas projects are discussed by companies and political elites when playing golf (*Tempo Magazine*, 18 August 2013). According to confidential interviews conducted for this thesis, for companies, approaching influential political elites through informal activities is important for developing relationships and gaining their support, to ensure lower-level bureaucrats within their agencies quickly grant permits and deal with administrative matters.¹² This is particularly important from the perspective of companies, as

¹²Multiple confidential interviews with senior company management in the oil and gas sector on 18 April 2017, 20 April 2017 and 26 April 2017 respectively.

government agencies are known to be organised around patronage structures and have their basis in patrimonial governance arrangements (see for example McLeod, 2008).

Moreover, as mentioned in Chapter 2, a study by Warburton (2017) has shown how patterns in the ownership structure of firms in different resource sectors (mining and palm oil) shape interests and the ways that domestic tycoons might support or constrain the political agendas and ultimately the influence of national institutions, which would also have implications for the support for and influence of PROPER on the environmental performance of firms in each sector analysed in later chapters. According to this study, the ownership structures of private sector firms in the mining and oil and gas sectors are highly differentiated between domestic and foreign capital. It is unsurprising then that in the political struggle between economic nationalists and liberalists, there was little resistance from wealthy Indonesian tycoons in the oil and gas sector to growing economic and resource nationalist sentiment, as it did not fundamentally threaten their economic interests (Habir, 2013). These underlying conditions of the sector in terms of how capital and ownership is structured will also be an important consideration in later analysis for understanding how PROPER might be resisted or supported by oil and gas firms.

The palm oil sector

The nature of the relationship between business and state in the palm oil sector is different from that of the oil and gas sector. Law No. 39/2014 on Plantations gives authority to subnational governments to issue business permits for palm oil companies. Article 48, for example, states:

- a. *Plantation Business Licenses referred to in Article 47 are granted by:*
 - a. *The Governor for areas that cross districts (kabupaten)/municipalities (kota); and*
 - b. *The District Head (Bupati)/Mayor (Walikota) for areas within a district/municipalities.*
- b. *In the case that land with The Plantation is located in more than one province, permission [is] granted by the Minister.*

By law, the national government has the authority to grant business licenses to establish new plantations in areas that cross provincial boundaries. Interviewees revealed that most palm oil companies try to avoid the national government due to the complexity of national bureaucratic processes for regulating the sector.¹³ A study by McCarthy et al. (2012) also supports this finding, explaining it is a common strategy of both subnational elites and companies to avoid national government intervention in issuing business licenses. They demonstrate that after decentralisation, palm oil companies have tended to collaborate with subnational elites, particularly in the bureaucracy, to create intermediate-size (5-10 hectares and extending up to 200 hectares) oil palm plantations (McCarthy et al., 2012, p. 559). For intermediate-size plantations, companies only need to submit requests for business licenses to the district or municipality governments and the process is therefore simpler.

Under decentralisation, top-level management of palm oil companies is thus more sensitive to the demands and preferences of political elites at subnational rather than national level. Understanding the political situation at subnational level is critical for palm oil companies to secure support for both licenses and for day-to-day business practices in their plants. Thus, confidential interviews revealed that top-level management in the palm oil sector prefers to build informal relationships with subnational political elites to smooth these processes.¹⁴ Such relationships are formed at the critical stage of establishing plantation areas, as this paves the way for future interaction. This renders palm oil companies indebted to political elites at the subnational level that secured their licenses and permits, which meant intervention by national government was avoided. This creates relationships between companies and subnational government actors based on reciprocity.

¹³ Confidential interviews with senior company management in the palm oil sector, on 8 April 2017 and 18 May 2017.

¹⁴ Ibid.

However, in Indonesia's patrimonial state, just like in the oil and gas sector, many land concessions and licences in the palm oil sector were granted before decentralisation was introduced, and large inter-provincial concessions are still under national authority. Thus, in the palm oil sector, there are additional complexities in the ways that national and subnational political interests interact (and are sometimes in contradiction). Large firms in particular need the support of both levels of government for significant expansions of their operations.

Indeed, the strong relationships between large palm oil conglomerates and national political elites have historical roots—most of the dominant companies today were founded with the support of the Suharto regime. At the time, access to forest areas was not only controlled by the military, but military officers also directly benefitted from logging (McCulloch, 2003). The military tended to collaborate with wealthy tycoons (often Sino-Indonesians) for large scale timber extraction (Mackie, 1991). As many logged areas became deforested and converted to areas for agribusiness, in particular oil palm production, land concessions were sold to these tycoons by the military. For example, Liem—the founder of the Salim Group with one of the large portfolio of companies in palm oil sector—historically had strong connections with the Suharto regime and such relationships have continued subsequent governments. He sustained his close relationship with Suharto through regular weekly meetings (Dieleman & Sachs, 2008, p. 1288). Continued engagement by these firms with the state has been necessary to build close relationships and to secure the support of political elites for access to business opportunities and to create certainty for investments over the longer term (Masuhara, 2015).

There is a further point of differentiation between the structures of the oil and gas and palm oil sectors. In the palm oil sector, Warburton (2017) shows that the structure of investments in privately-owned palm oil firms are highly integrated. This, she argues, has seen wealthy tycoons in this sector resist the resource nationalist agenda and support those political elites seeking a more open foreign investment regime (Warburton, 2017, p. 287). Such structures of ownership in the sector and preferences of its conglomerates

might also have implications for the ways firms support domestic institutions and respond to domestic programs such as PROPER.

4.3.2. The relationship between business and state across types of firm

Scholars have indicated that the ownership structure of companies may shape the nature of the relationship between business and state or political elites (Li & Zhang, 2010). The state has greater influence over appointments and day-to-day operations of state-owned companies, compared with those of private sector companies. In the next section, I discuss how these different ownership structures drive the interests of top-level management in companies, identifying ways that shape obligation and reciprocity.

State-owned companies

According to the Organisation for Economic Cooperation and Development (OECD), the term 'State-owned Enterprise (SOE)' refers to any corporate entity recognised by national law as an enterprise, and in which the state exercises ownership (2015, p. 14). As such, state actors, including political elites, not only regulate SOEs but also act as owners of SOEs. In Indonesia, they have the legal authority to manage SOEs, including making senior appointments at top-level management, such as President Director and Director. Given the significance of patrimonialism in the Indonesian state; top-level managers in SOEs need political support to secure their positions, which creates an environment of patronage politics in corporate governance structure.

In Indonesia such patronage politics often begins during general elections. Political actors need financial and other resources to be able to compete. Mietzner (2014) has identified how many existing political parties are funded by wealthy oligarchs. Bakrie (a tycoon with a wealth of \$2.45 billion) has supported Golkar and other parties; Hashim Djojohadikusumo, worth an estimated \$700 million is a Gerindra party patron who supported his brother, Prabowo in running in different elections and for the Presidency; and, among others, Hatta Radjasa, the chairman of the National Mandate Party (PAN), has a declared fortune of only \$3 million, but was widely believed to

have been backed by the wealthy oil trader, Muhammad Riza Chalid (Mietzner, 2014:119).

Confidential interviews for this thesis also revealed that political and financial support for politicians who successfully gain office is commonly rewarded with SOE appointments, as either commissioners on the board of directors of SOEs, or as directors of portfolios in the operation of SOEs.¹⁵ For example, 23 supporters or volunteers of President Joko Widodo in the 2014 elections have since been appointed as commissioners at several SOEs (*Detiknews*, 20 October 2017).

Commissioners appointed by the Minister of SOEs (often with input from the Indonesian President) to the Board of Commissioners (hereafter Board Commissioners) are also entry points for political actors to influence corporate governance. Board Commissioners, who make SOE senior management appointments and set corporate priorities and policy directions, have the power to influence decisions of the SOE President Director and members of the Board of Directors (each member of which heads a division in the company), and corporate planning and governance. According to Law No. 19/2003 on SOEs, corporate planning and annual reports must be approved by the Board of Commissioners.

As such, political interests of Commissioners permeate corporate planning and the type and nature of programs introduced by SOEs and those sub-contractors prioritised for specific projects.¹⁶ Confidential interviews explained that financial benefits, political support and other benefits then accrue to these Commissioners from sub-contractors and senior management who gained preferential treatment.¹⁷ However, the process of making senior management appointments and selecting companies for contracted services is contested among Commissioners on the Board, some of whom support selection based on merit and proficiency, and some of whom have other

¹⁵ Confidential interviews with senior company management in the oil and gas sector on 26 April 2017.

¹⁶ Ibid.

¹⁷ Ibid.

reasons for preferred appointees and contractors.¹⁸ It has often been the case that independent commissioners (from outside of politics) have resigned from the Board of Commissioners in multiple SOEs in frustration, regarding the ways politico-economic interests of other Commissioners have dominated management decision making (*CNN Indonesia*, July 2019).

The most powerful political actor that can influence SOEs and intervene in corporate governance is the Minister of SOEs. The Minister is a political appointment by the Indonesian President. Historically, most Ministers of SOEs tend have been drawn from members of parliament rather than from professional circles.¹⁹ For example, the Minister of SOEs (2014-2019) is politically affiliated with the Indonesian Democratic Party of Struggle (*Partai Demokrasi Indonesia – Perjuangan*, PDIP), which is the party with the largest number of seats in the national parliament and supported the Widodo Presidency (Kompas, October 26, 2014). Under the former Yudhoyono Presidency, the Minister for SOEs (2004-2007), Soegiharto, was a politician from the Unity Development Party (*Partai Persatuan Pembangunan*).

The Minister of SOEs has a critical role in selecting members of the Board of Commissioners and approving appointments to the Board of Directors at the SOEs by the Commissioners. Such selections are often underpinned by the politico-economic interests of the Minister in terms of gaining political patronage. One Deputy Director in the Ministry of SOEs highlighted the highly political nature of appointments of Directors and Commissioners in SOEs who often come from the senior membership of political parties or elected candidates (*Detik-Finance*, February 5, 2015). According to Minister of SOEs Decree No. 2 and 3/2015, selecting political actors as Directors of SOEs is not a regulatory violation.

The appointment of political actors at multiple levels to the management of SOEs as Commissioners and Directors, has led to a high degree of political capture of these firms and poor corporate governance. Wicaksono

¹⁸ Ibid.

¹⁹ In Indonesia, some ministerial appointments are made from professional circles rather than parliamentarians.

(2008) has argued that SOEs are long been known for being inefficient, mismanaged, and cash cows for political groups and individuals. Corruption is also common in SOEs (Wicaksono, 2008). For example, in 2019, eight directors from multiple SOEs across sectors were identified as being involved in corruption activities (*Bisnis tempo*, October 4, 2019). Most were caught in the act by the Indonesian Corruption Eradication Commission (KPK) when accepting bribes from company suppliers.

Privately-owned companies

The intimate relationship between political elites at a national level and top-level management of firms shapes corporate governance not only in state-owned companies, but also in privately-owned firms. This is especially the case in oil companies that, as mentioned above, pursue strong relationships with the state at the national level. But it also occurs in the palm oil sector when companies are pursuing large-scale oil palm plantation licenses issued by the national government. However, the nature of these relationships is qualitatively different for private sector companies in terms of how corporate governance is politicised compared with SOEs. In the latter, political actors and top-level management pursue reciprocal relationships based on individual interests. However, in private-sector companies such relationships are important for top-level management so the firm can access sustainable business opportunities (discussed in the section on sectoral differences mentioned above), especially given that senior positions are not appointed by the state and such companies often compete with SOEs for favourable business opportunities and licenses.

Most of the largest private companies in Indonesia today, both in the oil and gas and palm oil sectors, have been supported by political elites during the Suharto regime and thereafter, so as to access permits and licenses. For example, in the oil and gas sector, Arifin Panigoro (the owner of Medco Energy), Prayogo Pangestu (the owner of Barito Pacific Group), Abu Rizal Bakrie (the owner of Mega Persada Energy) are all examples of influential private-sector players with large companies that have had historically strong connections with the Suharto regime and subsequent governments. They were

initially supported and given preferential treatment by Suharto to build private-sector businesses that provided services to the state-owned oil company in the oil and gas sector. Further, they were protected and privileged under government policy vis-à-vis foreign competitors (Aden in McVey, 1992, pp. 89-102). Thus over time, these companies were in a strong position to conduct their own exploration activities when the sector was opened up to competition in 2001.²⁰ Engagement with state actors by these firms to secure the support of political elites was necessary for access to business opportunities and to create certainty for their investments over the longer term.

In the palm oil sector too, the Salim Group (mentioned earlier) that owns Golden Agri Resources, the biggest palm oil company in Indonesia that manages more than 499,000 hectares of oil palm plantations, gained privileges and support under and following the Suharto regime.²¹ Liem, the founder of the Salim Group, was a key supporter of the New Order government (Dieleman & Sachs, 2008). A combination of his connections to Suharto, serendipity and personal charm propelled Liem to become the wealthiest tycoons in Southeast Asia (Borsuk, 2014; Davidson, 2016; Robinson, 2016; Nathan, 2015; Winters, 2013). Currently, the Salim Group remains one of Indonesia's most influential companies in agriculture development as well as other natural resource extraction industries.

However, close relationships between private sector companies and the state create problems for regulatory governance in both the palm oil, and oil and gas sectors. Regulatory processes and programs in developing countries are often heavily influenced by industrial interests, a phenomenon often referred to as “regulatory capture” (Blackman, 2010, p. 121; Russell & Vaughan, 2003). Indeed, regulatory capture of environmental regulations and standards is not a new phenomenon in Indonesia—political actors have long protected companies they have had close relations with through the way they

²⁰ Confidential interviews with senior company management in the oil and gas sector on 18 April 2017.

²¹ <https://goldenagri.com.sg/about-gar/>. Accessed on October 17, 2019.

apply and legally enforce regulations both during the Suharto regime and today.

Consider several examples. PT²² Indorayon Pulp and Paper, an agribusiness company in the forestry sector had the political support of the Suharto regime (Simanjuntak, 2010). The company, which operates in North Sumatra was able to build its plant without the necessary permit from the Ministry of Environment that estimated the environmental impact of its activities, which is a necessary step for new extractive companies under Indonesian Law. However, the company coordinated their actions with President Suharto to pass environmental assessment without it ever being conducted. And in 1989, Suharto attended the opening ceremony of the parent holding company of PT Indorayon Pulp and Paper. Suharto supported the company because members of his family were notable shareholders in the three main conglomerates which invested in PT Indorayon Pulp and Paper: the Salim Group, the Tirtamas Group and the Marisan Nusantara Group (Simanjuntak, 2010).

In the post-Suharto years, political support to both oil and gas and palm oil companies with poor environmental performance or those that do not comply with regulations has also been provided by political elites under President Susilo Bambang Yudhoyono and President Widodo's administrations. Under Yudhoyono, the case of PT Lapindo Brantas provides a significant example of how political power protected the oil and gas company from the impact of their violations of environmental regulations. On 29 May, 2006, hot mud began spurting from the ground near a PT Lapindo Brantas oil and gas well in East Java. This led to an environmental and social disaster—the mudflow continued to erupt for months, flooding 19 villages in three subdistricts, and 90,000 people were displaced (*Kompas*, 2016). The mudflow disaster also polluted the marine and coastal environment in the nearby Java Sea. Thousands of people who depended on marine and coastal resources (fish, shrimp) lost their livelihoods due to the disaster (McMichael, 2009;

²² PT (*Perseroan Terbatas*) are limited companies in Indonesia.

Muhtada, 2008). Top-level management of PT Lapindo Brantas did not want to take responsibility for the disaster and the environmental rehabilitation needed, because of the impact on its business and profits (Novenanto, 2010).

PT Lapindo is part of the business conglomerate controlled by the Bakrie family. It is one of the richest corporations in Indonesia, with assets worth US\$5.4 billion in 2007 (Schiller et al., 2008, p. 55). Bakrie himself was also the head of the ruling Golkar party (also long associated with the Suharto regime) at the time, and held the appointment of Coordinating Minister for People's Welfare in the Yudhoyono government. Bakrie used his political connections and power to stop the criminal prosecution of PT Lapindo by the Indonesian police and the Ministry of Environment (Novenanto, 2010). Bakrie also rejected bearing the financial burden for the necessary environmental rehabilitation and the social costs incurred from the disaster (Novenanto, 2010). President Decree No. 14/2007 on the Establishment of the Sidoharjo Mudflow Mitigation Agency outlined that the cost of social and environmental rehabilitation would instead be borne by the Indonesian government.

Similarly, under President Widodo, public protests took place in 2015 as the government provided protection for those companies responsible for out-of-control forest fires by refusing to publish their names. The fires often began with the illicit use of burning for land clearing – in many cases to clear the way for oil palm plantations. Law No. 32/2009, Article 69, Clause (H) on Environmental Management prohibits land conversion through the use of fire. Nonetheless, forest fires sparked by land clearing burned 2.6 million hectares between June and October 2015 (World Bank, 2016, p. 1). The Coordinating Ministry for Political, Legal and Security Affairs would not publish the names of the companies that had burned their plantation areas (*CNN Indonesia*, October 27, 2015), although Joko Widodo did threaten to prosecute companies responsible for burning (*BBC Indonesia*, September 16, 2015).

It was suspected that the Minister's policy not to release the names of companies responsible was due to the interests of political elites close to President Widodo, who had ties to these companies or were stakeholders in the companies allegedly responsible, such as Luhut Binsar Pandjaitan.

Pandjaitan is a retired military general and influential businessperson who owned mining companies, power plants, and palm oil companies under the PT Toba Sejahtera empire suspected of involvement in forest fires (*The Jakarta Post*, February 27, 2019). Pandjaitan supported Widodo's campaign and has been a member of his inner circle since 2014. President Widodo appointed him first as his chief of staff, responsible for balancing the interests of army generals and the business elite, as well as political actors in Indonesia (Syailendra, 2016). This role was important for Widodo because, prior to becoming President, he did not have strong networks with the military or strong political party support to enable him to push through his policies. Since late 2015, Pandjaitan has held several Ministerial positions.

These examples illustrate regulatory capture by businesses and how it constrains companies in developing corporate governance practice that respects environmental values and the rights of civil society. The intimate relationship between political elites and business has meant that if companies commit violations of environmental regulations, there may be little consequence when they are protected by influential state actors. Political influence in the extractives sectors has also diminished the means by which environmental regulators, such as staff in the Ministry of Environment and Forestry, could legally enforce environmental standards if these state actors have the interest to do so.

That said, there is little evidence to suggest that across each of the successive periods of post-Suharto leadership identified by Davidson (2018) described earlier in the chapter, that there was direct interference in PROPER in terms of its structure, staffing or resourcing. In fact, even when the Widodo administration merged the Ministry of Environment and Forestry, the only Directorate to remain unchanged was the one responsible for PROPER.

Thus, in exploring the ways that public voluntary regulation through programs such as PROPER might influence environmental behavioural change in firms in Indonesia; it is critical to understand how the intimate relationship between business and political elites influences the ways top-level management might respond to regulatory strategies across sectors and types

of firm. I have demonstrated above, that historically, top-level management of firms in the oil and gas sector have preferred to build relationships with political elites at the national level, given the centralised control and regulation of this industry. Meanwhile, top-level management of firms in the palm oil sector has tended to engage with and be more sensitive to the preferences of political elites at the subnational level due to the decentralised control of and authority over this industry.

I have also highlighted the implications of patrimonial state structures for corporate governance generally and across types of firm. In patrimonial states like Indonesia, both state-owned and privately-owned companies need to build strong political networks to support their interests either individually or at the organisational level. These relationships are based on patronage and reciprocity in both sectors, but also on obligation, particularly in the oil and gas sector where the state sets policy, business direction and makes leadership appointments. Such protection not only provides opportunities for individuals in appointments (in SOEs) and business opportunities (in the private sector) but can protect companies from incurring serious sanctions from environmental violations.

4.4. State regulatory capacity in two industries or sectors

This thesis also examines the ways state regulatory capacity might shape the pathways of PROPER to improve socio-environmental performance in companies. However, this was not intended to imply that interactions between the state and other regulatory actors and scales are not important. Here, state regulatory capacity is defined as material and non-material resources available to state agencies to support their performance across a broad range of regulatory functions. Through these functions they seek to influence the behaviour of targeted actors engaged in certain forms of social and economic behaviour (Brown & Scott, 2010, pp. 3-4).

State regulatory capacity has been widely recognised as a key enabling condition for the effective operation of public regulatory processes, reflecting the central role of the state within such processes (Blackman, 2008; Leveque,

1996; Lyon & Maxwell, 1999). This section argues that the state regulatory capacity in Indonesia varies across levels of government. Specifically, I argue that national government tends to have a higher state regulatory capacity compared with subnational governments, especially given the three decades of highly centralised authoritarian control of the archipelago in which national agencies were the main regulator across sectors, prior to the recent implementation of decentralisation in 1999.

4.4.1. State regulatory capacity in the oil and gas sector

As explored previously, the oil and gas sector is regulated by central authorities in the national government. In this discussion of state regulatory capacity in the sector, I refer to the Ministry of Environment and Forestry (MOEF) and its agencies, as this Ministry now regulates the sector and is also responsible for PROPER. As the designer of PROPER, initially the Ministry of Environment, before it merged with the Ministry of Forestry, had long-term experience in implementing PROPER in the oil and gas sector, since its establishment of the program in 1995. As such, the Ministry of Environment accumulated substantial knowledge over 25 years so as to provide technical assistance to oil and gas companies to improve socio-environmental performance under PROPER.

Centralisation of the oil and gas sector has also provided the Ministry with the opportunity to interact closely with oil and gas companies so as to support their efforts to meet the requirements of PROPER. The national government's environmental inspectors have had extensive experience in developing ways to respond to the environmental pollution produced by oil and gas firms and to find ways to minimise such pollution. Consequently, the civil servants long employed in the Ministry of Environment garnered significant knowledge to develop appropriate and applicable regulations to manage environmental pollution. This has been bolstered by their frequent interaction and assistance to companies to manage pollution. Together, these aspects have underpinned strong state regulatory capacity for managing

environmental impacts from the oil and gas sector, which creates opportunities for influencing behavioural change in firms.

However, capacity to regulate environmental practice in business more broadly has changed in some ways over time. For example, President Widodo took the critical decision during his first period in office (2014-2019) to merge the Ministry of Environment with the Ministry of Forestry to become the Ministry of Environment and Forestry (MOEF). In general, this merger has had some implications for decreasing state capacity to regulate the environmental impact of the extractive sectors in Indonesia, although the capacity to implement the specific program PROPER remains. Before merging, the Ministry of Environment had eight directorates (known as Directorate Generals), led by director generals, employed as Echelon 1 staff; that being staff employed at one level under—and directly responsible to—the Minister. After the merger, only one directorate remained from the Ministry of Environment, four were completely abolished, and three were merged with directorates from the Ministry of Forestry (MOEF, 2020b).

The merger, to a degree, decreased the authority and capacity of environmental regulators across directorates to influence environmental behaviour in Indonesia. However, the directorate responsible for implementing PROPER remained in the new organisational structure of the MOEF as the Directorate General of Pollution and Environmental Damage Control (herein DITJEN PPKL). The DITJEN PPKL was the only directorate general not completely affected by the merger between the two ministries.

As the designer of and implementing agency for PROPER, staff in the DITJEN PPKL have a long history of interacting with the oil and gas industry. Their expertise has covered three specialists areas, namely the environmental impact of the manufacturing industry, such as car assemblage, textiles and fertilizer production; the environmental impacts of mining, energy and minerals production, including oil and gas production, power plants, and coal and gold mining; and the DITJEN PPKL, which has dedicated staff that focus on managing the environmental impacts of the agriculture and forestry industries,

including pulp and paper production, and tea, coffee, palm oil and rubber plantations.

The DITJEN PPKL also allocates a budget to support PROPER both for programs at the national level and those implemented by subnational governments, the latter of which includes support for subnational governments to undertake PROPER assessments of companies whose licence was issued subnationally (this includes activities in palm oil and other sectors within the jurisdiction of subnational governments).²³ In Indonesia, the funds to support these subnational governments are allocated through what is known as the "deconcentrated budget". For deconcentrated budgets, the national government has budget authority, but spending this allocation is undertaken by subnational governments, which must comply with standards set by the national government.

In summary, the management of the oil and gas sector is centralised in Indonesia, as is the regulation of environmental impacts from oil and gas activities through PROPER under the national DITJEN PPKL. The knowledge and experience of the state in monitoring, assessment, and providing technical support to companies also exists nationally. Thus, there is a high degree of alignment between how the sector is both run, regulated and technically supported by the state to improve socio-environmental performance.

Despite restructure of the Ministry responsible for PROPER, the MOEF; staff in the DITJEN PPKL have accumulated extensive knowledge and experience in regulating the oil and gas sector, with budgets allocated to support the implementation of PROPER and to provide technical assistance to companies. For the oil and gas sector, these factors indicate a strong regulatory capacity in terms of the everyday functions of state for implementing PROPER, although as discussed in the section above, this can be subject to the overriding influence of political elites and their relationship with business through

²³ For companies that have nationally issued licenses, even when their activities take place in specific localities, the national government environmental regulators undertake the assessments.

patronage networks, when it is in the interests of both to avoid regulatory compliance.

4.4.2. State regulatory capacity in the palm oil sector

The regulatory arrangements in the palm oil sector demonstrate how the decentralisation of political and fiscal authority for regulating this sector has affected the environmental regulation of firms. This subsection argues that subnational governments responsible for regulating the palm oil sector have a limited capacity to provide technical assistance to companies to implement PROPER, and particularly given they have less accumulated knowledge compared with the oil and gas sector, and because of the lack of political will of influential subnational actors such as District Heads and Mayors to implement PROPER.

As discussed above, under decentralisation, subnational governments have the authority to issue business permits to establish oil palm plantations, with the exception of those plantation areas that cross-cut provincial jurisdictions. In the latter case, business permits are issued by the national government. Subnational governments are also responsible for monitoring and evaluating the environmental impacts of activities conducted by firms under these subnationally issued business permits. However, subnational governments tend to have limited knowledge on how to ensure businesses meet the conditions necessary to gain environmental permits, and how to monitor business activities and implement environmental regulations.²⁴

When Indonesia was decentralised in 1999, subnational governments gained many new powers to regulate their jurisdictions. However, the transition from centralisation to decentralisation saw a greater focus on the transfer of authority and fiscal responsibility from national government to subnational governments (Devas, 1997; Hadiz, 2004) rather than significant attention to building the capacity of subnational governments to carry out their functions (Bedner, 2010). This includes the organisational capacity for

²⁴ Multiple confidential interviews with senior civil servant subnational governments on 10 April 2017, 12 April 2017, 19 April 2017 and 5 May 2017 respectively.

regulating industry. While of course this is changing over time, this gap between authority and capacity has been a critical problem of decentralisation in Indonesia (Bedner, 2010; Setiawan & Hadi, 2007).

Under decentralisation, subnational governments have the authority to develop their organisational structures. As such, these structures vary across Indonesia. For environmental regulators, there are various examples of local environmental agencies across the country, such as environment and forestry²⁵, environment and sanitary services²⁶, environment, sanitary services and management of public parks, and environment and land procurement.²⁷ Each has varied commitment to environmental regulation, as demonstrated by their nomenclature—multiple functions are often merged in single agencies, and rarely are specific organisations established to focus on environmental regulation. Subnational governments prefer to combine the function of environmental regulator with other functions, such as sanitary services, gardening and land procurement.

Moreover, local environmental agencies have also been established at various levels of subnational governments, with differing authority, as expressed through appointments made at each level and the degree of seniority of staff in these agencies. A study by Setiawan and Hadi (2007) of several subnational governments in Sulawesi island, analysed the degree of organisational authority given to different subnational environmental agencies across a variety of subnational governments. In districts and municipalities, the most senior position in the organisational structure of the bureaucracy are Mayors of municipalities and District Heads of districts, both of which are popularly elected positions along with their deputies. These leaders are supported by senior bureaucrats appointed, often by the Mayors and District Heads, with various degrees of authority and seniority. The highest subnational levels under these political leaders are Echelon (or Level) 2 under the Mayor/District Head, and then decreasing in seniority and authority to

²⁵ <https://dlhk.jogjaprov.go.id>. Accessed on February 19, 2020.

²⁶ <https://lh.denpasarkota.go.id>. Accessed on February 19, 2020.

²⁷ <http://dlhp.sumselprov.go.id/>. Accessed on February 19, 2020.

Echelon 3a, 3b, and Echelon 4. The Indonesian Civil Service regulations designate the degree of authority and budgetary control that each level can exercise. Mayors and District Heads can set the organisational structure and upgrade or downgrade the authority in each agency.

Table 4.2. Organisational level of environmental regulator in subnational governments' organisational structure in Sulawesi Island.

Type of office	Highest level of authority in the organisational structure	Number
Dinas (Agency)	Echelon 2	5
Kantor (Office)	Echelon 3	8
Division	Echelon 3b	3
Sub-division	Echelon 4a	2

Source: Modification from Setiawan and Hadi, 2007, p. 80

Table 4.2 illustrates that in Sulawesi Island the level of authority of the environmental regulator varies across subnational governments. Some subnational governments are committed to establishing a full office or agency responsible for environmental regulation, known as *Dinas*. In other cases, subnational governments have only established environmental regulatory authorities at the sub-division level, which indicates very limited regulatory capacity in terms of authority, budget control and influence.

In part, the problem of environmental regulation under decentralisation results from variation in the commitment and political will of Mayor or District Heads and other political elites to prioritise environmental issues. Even when the leadership establishes full Regional Environmental Agencies (*Dinas Lingkungan Hidup Daerah*) with the highest (Echelon 2) authority for the head of the agency, it is often treated as a marginal organisation with a limited budget and mixed functions (e.g. environment and sanitation) in the organisational structure of subnational governments. This is

explored in some case studies (see Chapters 7 and 8) with reference to the palm oil sector.

A lack of financial support for these subnational environmental agencies limits the regulatory capacity of the environmental regulator. Many studies have found that subnational governments do not allocate sufficient budgets for local environmental regulators to carry out their responsibilities, such as monitoring and evaluating company environmental performance. A study by Marsuyetno and Harahap (2013), for example, has shown that the North Sumatra Province Environment Agency was not able to monitor and evaluate company environmental performance due to a limited budget. Similar findings were evident in the study of environmental regulators in Sulawesi by Setiawan and Hadi (2007). Learning from these studies, we see here that the leadership in each district can indirectly influence PROPER in terms of the power and resources available to the subnational regulator, although according to confidential interviewees, the leadership is less likely to interfere in the technical regulations and processes of the subnational regulator as they do not understand these processes.

At the subnational level, the story of regulatory enforcement to prevent or institute sanctions on firms for forest fires, is more complicated, given the rent-seeking interests of local political actors for support from firms, particularly during elections. A study by Purnomo et al. (2017) shows that the number of fires is significantly correlated with timing of district and provincial elections, indicating that regulatory enforcement is weak as political elites provide protections for businesses.

In summary, when there is a lack of political commitment to environmental conservation from subnational governments, this limits state regulatory capacity of the environmental regulator in the palm oil sector. This is particularly acute under decentralisation in which there is less accumulated knowledge subnationally of how to regulate environmental performance in the palm oil sector when compared with decades of experience in the oil and gas sector. There is also subnational variation in organisational authority and financial support for subnational environmental regulators to regulate,

monitor, and evaluate company environmental performance, which also contributes to this limited capacity. Weak state regulatory capacity has implications for institutional conditions in the way that public voluntary regulation strategies, such as PROPER, can influence environmental behavioural change in the palm oil sector, particularly because this sector is regulated by subnational governments.

Overall, variation in state regulatory capacity across industry sectors and levels of government helps us to understand what might constrain and enable environmental regulators to implement strategies of public voluntary regulation in Indonesia, such as PROPER. These institutional conditions, together with the context-specific sources of pressure they draw on in support of regulatory aims (discussed below), may help explain the different outcomes of public voluntary regulation in environmental performance across sectors and types of firm.

4.5. Third-party actors' environmental commitment and capacity to pressure companies

This section focuses on the environmental commitment of third-party actors such as investors, consumers, and CSOs or civil society organisations and their capacity to pressure companies for better environmental and social performance in Indonesia. At the international level, the Indonesian palm oil sector also faces significant pressure from third-party actors due to the European Union Ban in 2019. The European Union adopted a revised Renewable Energy Directive (RED) which effectively banned palm oil from the EU's renewables programmes (Purnomo et al., 2020). This regulation gives more justification for third-party actors to exert pressure for sustainable production in the Indonesian palm oil sector.

Exploring the environmental commitment and action capacity of third-party actors to pressure companies is critical to understand how the mechanisms of regulatory strategies of public voluntary regulation operate to improve socio-environmental performance in companies. Programs such as PROPER encourage public disclosure of information about the company to

provide third-party actors with critical information about company performance, which includes information on environmental performance. They can then use this information to pressure behavioural change in companies.

However, how well these third-party actors can pressure companies is important for the effectiveness of this public voluntary regulation strategy. Here, I argue that environmental commitment and capacity of third-party actors (investors, consumers, CSOs) varies by type of actor. Democratisation and economic reform, including financial governance, has helped improve both the commitment and capacity of investors and CSOs to pressure companies for better environmental performance. However, the capacity of 'green consumers' to influence environmental behavioural change in firms in Indonesia is weak.

Civil society

The resignation of Suharto in 1998 was a critical turning point for the development of civil society in Indonesia. After three decades of authoritarian rule, civil society had been severely weakened by laws and policies that curtailed the development of Civil Society Organisations (CSOs), and limited their actions and capacity to express their collective voice (Diprose et al., 2019). This was further curtailed by the heavy hand of the military in responding to demonstrations and public criticism of government or companies and other actors closely associated with the regime (Lee, 2010).

However, with the onset of democratisation, opportunities opened up for civil society in Indonesia to exercise political voice and to improve their capacity to pressure companies for better environment and social performance. Democratisation and decentralisation meant that civil society could vote out politicians that approved licenses or supported companies they deemed unacceptable. Democratisation and associated institutional and legislative reforms have also improved the bargaining position of civil society organisations vis-à-vis companies by giving local communities increased rights, including land rights, which can influence the processes for gaining legal licenses to operate (Zelli & Asselt, 2013). But there are also opportunities

for CSOs and communities to influence companies through enabling or constraining their social license to operate.

Social license to operate refers to the condition in which a company's behaviour meets societal expectations and avoids any activities that societies (or influential elements within them) deem unacceptable (Gunningham et al., 2004, p. 308). Losing the social license to operate limits the ways companies can secure their production processes in which, in the end, will also affect their economic performance.

Democratisation in Indonesia opened up the opportunity for civil society to pressure companies through many different actions, including public protests or demonstrations, and through making land and other claims in areas companies consider under their control.²⁸ Since the resignation of Suharto in 1998, diverse indigenous communities and ethnic groups across Indonesia have publicly, vocally, and sometimes violently, demanded the right to implement elements of *adat* (custom and tradition) in their home territories (David & Henley, 2007: 1). The political and legal reforms that accompanied the democratic transition gave greater recognition of *adat* rights and customary law, creating an institutional environment of legal pluralism, particularly in relation to land claims and environmental management (Hamilton-Hart, 2016). As such, firms need to not only to comply with state regulations on land access and use, but also *adat* or customary land laws.

In some cases in Indonesia, public protests have been able to shut down company production processes (Wulan et al., 2004). The number of public protests by communities challenging company actions increased significantly during the democratic transition in Indonesia in 1999 (Mongabay, 2019). Data from the National Violence Monitoring System shows that one of the most frequent forms of contestation, since the onset of democratisation to 2015 in Indonesia, has been over resourcing which often

²⁸ In 2013, the Constitutional Court ruled that customary rights to land ownership is equal rather than subordinate to state ownership of land. This has opened up the opportunity for customary communities to make land claims in areas once deemed state-owned land, often allocated under concession licence arrangements to business.

involves tensions, conflicts and sometimes violence involving companies and communities or communities and the state (NMVS, 2018). Data from the Consortium for Agrarian Reform (KPA, 2019) shows that many of these conflicts surround land grabs and dispossession for various agribusiness and plantations (KPA, 2019).

In addition to growing grassroots movements, democratisation also resulted in a significant increase in the number of civil society organisations (CSOs) established. Time-series data compiled and analysed by the SMERU Research Institute shows there were 1600 registered CSOs in Indonesia in 2000 (SMERU, 2000). This number had doubled, reaching 3000 CSOs by 2018 (SMERU, 2019). Furthermore, data from the SMERU Research Institute also shows that CSO types are wide and varied, with their work traversing 26 clusters of focus areas, such as the environment, women and gender, and education.²⁹ Among these clusters, the environment is the sector most CSOs in Indonesia focus on in their work. In contrast, technology is the least common focus issue among CSOs in Indonesia.

On the one hand, under the democratic system, CSOs act as a critical source of pressure on companies for better environment and social performance. They have also sought to promote environmental values among communities in Indonesia. However, on the other hand, direct community demands for environmentally friendly sustainable development remain weak. A study by Mangunjaya et al. (2013) found a gap between community knowledge of 'sustainable development' (which includes how to sustainably use environmental resources for development and to manage waste), and attitudes and daily practices of communities to manage the environment sustainably. In this study, 90.3 per cent of respondents knew about concepts of sustainable development, but less than 50 per cent implemented actions corresponding to knowledge of sustainable development. A more recent survey of environmental behaviour by the BPS (2019b) established an index

²⁹ <http://www.smeru.or.id/en/content/ngo-database>. Accessed on October 18, 2019.

to measure environmentally friendly behaviours in Indonesia.³⁰ In 2017, the index (measured between 0 and 1) was 0.51, indicating that Indonesians only meet 50 per cent of the indicators of environmentally friendly behaviour. It is unsurprising then that widespread 'green consumerism', in which consumers demand changes in company practice, is yet to take root in Indonesia.

From the discussion above, it is evident that while CSOs and communities have made some demands on companies (as evidenced by the most common form of conflict in Indonesia), particularly in relation to land access, they face significant challenges in realising these claims in the face of powerful state-business relations discussed earlier. Further, as discussed in subsequent chapters regarding the four case studies, this has not always corresponded with consumer pressure for 'greener' company behaviours in domestic markets.

Commercial actors

In addition to CSOs and communities, third-party commercial actors also act as sources of pressure on companies to meet regulatory goals of public voluntary regulation strategies. This section focuses on how investors and banks in Indonesia adopt environmental principles in their investment policies. Here, I argue that regulations for banking and investment in Indonesia, which include compliance with environmental regulations, encourage investors and banks to pressure firms to improve their environmental performance. Important in this process are the sustainable finance policies and principles used by both the Indonesian Central Bank and Indonesian Financial Services Authority (*Otoritas Jasa Keuangan-OJK*) to regulate the Indonesian financial system.

Based on regulations of the Indonesian Central Bank and the OJK, investors and banks must ensure their debtors meet the legal requirements of environmental regulations in their sector (OJK, 2014; UNEP, 2017). The

³⁰ The index of environmentally friendly covers several indicators, namely using public transportation, waste management, electricity efficiency, water management and eco-product consuming behaviour.

Indonesian Central Bank and the OJK mandate that all financial services, companies or banks must include environmental assessments in their investment policies and financial approval processes. Financial services, companies or banks may use either company documents that demonstrate legal compliance, or government documents, such as a Blue rating in PROPER, to evaluate company compliance with legal regulations (OJK, 2014).

Debtor compliance with environmental legal regulations is the basic indicator of sustainable finance policy in Indonesia. The Indonesian government defines sustainable finance as the comprehensive support from the financial services industry to achieve sustainable development and which balances economic, social and environmental interests (OJK, 2014, p. 16). To encourage investors and banks to not only meet minimum legal requirements but also adhere to wider beyond-compliance environmental principles in business investment, Indonesia has introduced the sustainable finance policy (OJK, 2014, p. 16). First, the sustainable finance policy seeks to achieve industry, social and economic superiority in addressing the threats of global warming, and to mitigate other environmental and social challenges. Second, this policy aims to shift industry activities towards supporting a competitive low carbon economy. Third, Indonesian financial markets must strategically promote environmentally friendly investment in various businesses and economic sectors. Fourth, Indonesian financial market actors must support the principles of development in Indonesian, namely pro-growth, pro-jobs, pro-poor and pro-environment.

The existing environmental commitment of investors and banks is shaped by regulations and policies issued by the Indonesian Central Bank and the Indonesian Financial Services Authority. The Indonesian Central Bank has issued the Bank Indonesia Regulation (PBI) No.7/2/PBI/2005 on Asset Quality Ratings for Commercial Banks. This regulation mandates that commercial banks must ensure that the debtor undertake efforts to protect the environment. When applying for credit, companies must provide documentation that an environmental impact assessment (AMDAL) has been

undertaken for their firm's activities, or they can show documentation that they have achieved a minimum a Blue rating in PROPER.

In summary, the mandatory regulations issued by Indonesian financial regulators support public voluntary regulation strategies to improve the environmental performance of firms by harnessing investor and bank pressure on companies. The role of investors and banks to meet the objectives of public voluntary regulation is critical because they directly impact companies through investment policy, and firms are reliant on banks and investors for credit to build or expand their businesses.

4.6. Conclusion

This chapter has discussed the ways Indonesian institutional conditions—business–state relationship, state regulatory capacity and third-party commitment and action capacity—may either enable or constrain how public voluntary regulation strategies meet the objectives of public voluntary regulation. The distinctive characteristics of the Indonesian context, such as the scale of natural resource extraction and the contribution of these industries to the economy, as well as the strong, historically embedded relationships between business, state and military inform these institutional conditions. Democratic transition and decentralisation have also shaped the way the authority of the state operates at national and subnational levels and the opportunities for different stakeholders to pressure companies.

In this chapter, I have argued that there is variation in the ways these institutional conditions could shape the outcomes of public voluntary regulations by sector, types of firm and third-party actors. First, the relationship between business and state varies across sectors, depending on the degree to which authority is decentralised and also patterns in corporate ownership structures. The oil and gas industry is more sensitive to the interests of political elites at a national level, because authority for this sector is also centralised, and there is a long history of close relations between national political actors and the oil and gas industry. In contrast, the palm oil sector is more sensitive to the interests of political elites at a subnational level,

as authority for regulating this sector and issuing permits and licenses is decentralised, although for large concessions, palm oil firms must maintain close relationships with state actors at both levels, creating a more complex picture of state-business relations in this sector.

Furthermore, the relationship between business and state also varies across types of firm. Top-level management of state-owned companies tends to build strong relationships with influential national state actors, due to patrimonial state structures in which they operate, based on practices of obligation and reciprocity to secure their own senior positions in SOEs. This condition sets the direction of company objectives and corporate governance, which are strongly influenced by state-nominated Board Directors. While private sector firms also operate within a similar political economy, top-level management positions are not appointed by the state. They nonetheless require strong political connections to ensure they have sustainable business opportunities and access to licenses and permits for their business activities. Such connections also have implications for these businesses in avoiding serious sanctions for environmental violation.

Second, state regulatory capacity varies across sectors because of the degree to which the authority for each sector is decentralised, and the extent of accumulated knowledge and supporting resources to regulate the sector. The oil and gas industry is regulated by national government which has accumulated knowledge and experience in the sector, and appropriate authority and resources that together provide sufficient regulatory capacity to provide technical assistance to companies to meet environmental performance goals. The palm oil sector is regulated by subnational governments which face organisational challenges in terms of the designated authority of regulators, sufficient knowledge and experience, and in some place budget constraints. These features are in part shaped by the political will of subnational political leaders to hold firms to account for violations of environmental regulations, and together they create a high degree of variability across Indonesia in the capacity of the state to regulate firms' environmental performance. Thus, I

contend there is more limited state regulatory capacity in the palm oil sector to encourage environmental behavioural change in firms.

Third, this chapter demonstrates that the effectiveness of the public voluntary regulation strategy of PROPER discussed in later chapters—which includes public disclosure of various aspects of company performance for third-party actors to apply pressure—is likely to depend on the commitment and capacity of civil society organisations, communities, investors and other stakeholders to pressure companies. As such, understanding third-party actors' capacity to exercise this pressure is important. This chapter has demonstrated that third-party actors' environmental commitment and capacity to pressure companies varies by type of actor.

This chapter has also argued that such variation is shaped by both the opportunities afforded by Indonesian democratisation: CSOs and communities have more political opportunities to pressure companies and a stronger bargaining position, but it is unclear as to whether there is also domestic consumer pressure on firms. This will be discussed in the case studies in subsequent chapters. Further, this chapter has shown that regulatory frameworks in the Indonesian financial system encourage environmental sustainability in business practice by mandating that investors and banks must promote 'sustainable finance' and disclose their performance through various forms of documentation.

Overall, this chapter demonstrates that the three institutional conditions, discussed in this chapter, may shape the pathways by which the strategies of public voluntary regulation used by PROPER are able to influence socio-environmental performance. This has implications for variation in outcomes across sectors and types of firm. To explore the interaction between these institutional conditions and the effectiveness of public voluntary regulation, the next four Chapters (5, 6, 7, 8) thus investigate how the strategies used by PROPER influence behavioural change in different sectors – oil and gas, and palm oil – and different types of firms (state-owned and privately-owned companies) in these industries. Combining analysis across sectors and ownership structures offers the opportunity to better understand

the distinctive ways that regulatory strategies are able to harness the intended sources of pressure (or not) to induce behavioural change under different institutional conditions associated with each sector and type of firm.

Chapter 5

The case of a state-owned oil company

5.1. Introduction

This chapter examines the ways public voluntary regulation achieves its objectives of improving socio-environmental performance at the state-owned oil company, herein the Subang company.³¹ I seek to analyse what strategies PROPER regulators use to induce improvements in socio-environmental performance of regulated firms—in this case the Subang company—both within and beyond the requirements of the law. This chapter also seek to identify how and to what extent public voluntary regulatory strategies to accommodate distinctive features of the institutional contexts in which they operate.

I first examine Subang's socio-environmental performance through its achievements in PROPER between 2009 and 2017. Over time, Subang's performance improved from meeting PROPER's standards to achieving basic legal compliance level (Blue rating) to the highest level of beyond compliance performance (Gold rating). It is important to note here that indicators used by PROPER only refer to two aspects of CSR, namely environmental management and Corporate Community Development (CCD). As such, the analysis focuses on how PROPER seeks to influence these two aspects in its business practice. This thesis does not analyse performance in terms of, for example, upholding human rights, transparency and accountability, which are indicators of socio-environmental performance sometimes used in other beyond compliance certification programs, because PROPER does not target these performance dimensions.

This chapter demonstrates that public regulators, via PROPER, were able to harness multiple sources of pressure to elicit improvements in socio-environmental performance over time at the Subang company. In particular, I demonstrate that improvements in performance were the result of three

³¹ I refer in this thesis to the Subang company because my arrangements with the company for this research required that I maintain the confidentiality of the company and its staff.

public voluntary regulation strategies to influence the company: promoting environmental leadership in Subang's top-level management; providing technical assistance to improve the knowledge and capacity of company employees to implement PROPER; and publicly disclosing company performance through the PROPER rating system to apply pressure on the company from third parties, such as investors.

This chapter argues that the way these strategies operated took advantage of Indonesia's distinctive institutional conditions. This includes close state-business relations and the structure of state-owned companies—in which senior management positions are appointed by political actors—and investment policies that require certain social and environmental standards are met by creditors. I seek to show that these strategies were able to elicit direct pressure from both political elites at the national level and from top-level management investors to commit to and implement PROPER's beyond compliance performance standards. The knowledge, skills and resources (capacity) of national PROPER regulators, I further contend, were critical to the operation of PROPER's technical regulatory assistance strategy that improved the knowledge of company employees so they could meet PROPER's public voluntary regulation standards.

To investigate how public regulators of PROPER improved socio-environmental performance at the Subang company this chapter proceeds as follows. The next section provides an overview of shifting Subang ratings in PROPER over time. The third section explores how national regulators sought to promote environmental leadership at the Subang company and use pressure from national political elites to encourage the company to improve its performance. This chapter argues that Subang's top-level management responded to these demands because managers perceived that obtaining a beyond compliance Gold rating in PROPER would help them secure their positions and promotions. The fourth section presents the adoption of the technical regulatory assistance strategy. This chapter argues that the national PROPER regulator in the oil and gas sector had the interest and capacity to improve the employees' knowledge of PROPER and associated skills, who

were then able to design and implement beyond compliance programs. The final section presents the discussion of the interaction between PROPER and global investors, particularly global bondholders, followed by the chapter conclusion.

5.2. Subang's performance in PROPER (2009-2017)

Prior to understanding how the public regulators achieved their objectives of improving socio-environmental performance at the Subang company through PROPER, it is necessary first to provide a snapshot of the Subang company's ownership structure and then changing PROPER ratings over time (2009-2017).

The Subang company is 100 per cent owned by the Indonesian government. As explored in Chapter 3 on methodology, given the way PROPER operates and assesses a company's production units at plant level, this thesis focuses on environmental and social performance of one of Subang's plants—Rantau. As a holding company, the Subang company has several plants or production units that each may obtain different ratings in PROPER. Rantau was selected because, among Subang's plants, Rantau had been participating in PROPER for the longest period of time, thereby enabling a clearer picture of how the effects of PROPER's regulatory interventions have evolved over time. However, some of PROPER's strategies also seek to influence corporate priorities and company commitments. Thus, this thesis also examines these dimensions of PROPER, where relevant.

The Rantau plant, located in Aceh Province, participated in PROPER between 2009 and 2017. During that time, Rantau's socio-environmental performance changed significantly and improved according to the assessment from PROPER regulators. As demonstrated in Table 5.1, in the early years, the Rantau plant only managed to meet minimum legal requirements for environmental management, achieving the relevant basic compliance (Blue rating) in PROPER. Its beyond compliance performance improved, however, for the 2011-2014 assessment periods, for which the Rantau plant achieved a Green rating. A green rating indicates that the plant not only met minimum

legal requirements but also implemented a policy to reduce environmental pollution.

Table 5.1. Performance of the Rantau plant in PROPER, 2009-2017

Period of assessment in PROPER	Socio-environmental performance
2008-2009; 2009-2010	Blue (compliance)
2010-2011; 2011-2012; 2012-2013; 2013-2014	Green (basic level of beyond compliance)
2014-2015, 2015-2016, 2016-2017	Gold (the best level of beyond compliance)

Source: MOEF, PROPER's ratings, 2009-2017.

Thereafter, the Rantau plant performed at the optimum beyond compliance level, achieving a Gold rating in the last three years (2015-2017) investigated for this thesis. During this time the company not only reduced environmental impacts from its production activities, but also created community development programs to improve local community welfare. The organic fishery program introduced and funded by the company, for instance, significantly enhanced local community income levels by up to 50 per cent (Subang Company Environmental Report, 2015, p. 25). Other community development programs introduced by the plant included a program to improve education, health and livelihoods in one of the disadvantaged villages in Aceh Province.

"Sieukula Anak Nangroe" (School for Children) is one of CSR programs introduced by the Subang company that supports the future life of children from some disadvantage villages in Aceh Province (*Media Indonesia*, May 02, 2008).

However, one challenge encountered by the PROPER program is the way it rates community development initiatives. The rating system cannot easily account for the scale of impact from its initiatives—companies can introduce small initiatives that only target a few beneficiaries and still gain a Gold rating. For example, at the Rantau plant only 24 people benefited from the organic

fisheries program, whereas the population of the village where the program was implemented was 3173 in 2013 (BPS³² Aceh Tamiang, 2014).

The following sections discuss how the public regulators at national government level adopted regulatory strategies—promoting environmental leadership, technical assistance and public disclosure—to improve socio-environmental performance at the Subang company in the Indonesian institutional context. Moreover, the discussion also analyses how aspects of Indonesia’s institutional context enabled and constrained PROPER in shaping socio-environmental performance at the Subang company.

5.3. Promoting environmental leadership in the state-owned oil company

This section elaborates how national government, particularly the Directorate General of Pollution and Environmental Damage Control (DITJEN PPKL – *Pengendalian Pencemaran dan Kerusakan Lingkungan*), adopted the strategy of promoting environmental leadership to improve socio-environmental performance at Subang. It discusses how the national government used the strategy of promoting environmental leadership to top-level management through organising events, such as the Environmental Awards Night (mentioned in an earlier chapter). At this event, the DITJEN PPKL employed political elites in shaping company’s socio-environmental performance in the Indonesian political context. This strategy was not only a means of showcasing best performers in PROPER to motivate others, but also to facilitate informal relationships building between political elites, top-level management and regulator to get companies such as Subang to support PROPER. I also examine how structures of political patronage—particularly the reciprocal benefits of close relationships between state actors and the state-owned oil company, and how political elites select top-level managers—enabled this strategy to influence senior Subang managers to support PROPER’s beyond compliance programs.

³² *Badan Pusat Statistik* -BPS (Statistics Indonesia).

5.3.1. Promoting environmental leadership among the Subang company's top-level management

As explored in Chapter 2, the strategy of promoting environmental leadership is defined as government activities that encourage the leaders of companies to adopt environmental values in their business practice. Each year, the DITJEN PPKL invites company CEOs (in the private sector), President Directors of State-owned Enterprises (SOEs), other directors in both private companies and SOEs, Provincial Governors, District Heads (*Bupati*), Mayors (*Walikota*), and Heads of Sub-national Environment Agencies to attend the Environmental Awards Night.³³ Other meetings are also organised around this event, or at other times of the year between these actors.

At this event, the national regulator works with political elites (such as the Indonesian Vice President, the Minister for the Environment and Forestry and other politicians that attend) at national level to encourage and persuade top-level management to participate in PROPER's beyond compliance programs.³⁴ This includes pressuring the Subang company to participate and take action to meet beyond compliance standards. At the Environmental Awards Night, the DITJEN PPKL also publishes the rank of a company's performance to create peer group pressure among top-level management to obtain the highest attainable performance in PROPER.

The Indonesian Vice President and the Minister of Environment and Forestry are keynote speakers at the event to indicate political support for better environmental management. The participation of the Vice President and other political leaders in such events, and their support for the program over successive periods of political leadership is not merely ceremonial. It has become an important part of their political-economic strategy to show they support efforts at better environmental management, so as to garner foreign investment, aid and loan support for their wider development agenda, particularly given that investment support was withdrawn at various points

³³ Confidential interview with a bureaucrat at the Ministry of Environment and Forestry on April 27, 2017.

³⁴ Ibid.

following the series of environmental disasters, such as the East Java mudflow volcano, forest fires, and publicly available satellite imaging of deforestation.. The Yudhoyono administration, for example, made improving environmental management a cornerstone of his Five-year National Medium-term Development Plan (RPJMN), and also introduced various policies to support trials in reducing deforestation and forest degradation in an effort to mitigate climate change. As we shall later see, under pressure Widodo undertook significant efforts to tackle forest fires, as global criticism and pressure from neighbouring Singapore and Malaysia (that shut down schools and businesses due to health concerns from fire haze) grew to tackle the environmental impacts of business activities. Indonesia sought to demonstrate such commitment to improved environmental management not only through the PROPER program, but also through participation in and commitment to global agendas—the Sustainable Development Goals (SDGs), the Paris Agreement on climate change mitigation, and UN Global Climate Summit. Further, as part of their investment policies, most international financial agencies and investors require evidence of debtor CSR commitment.

As such, the Indonesian Vice President supported PROPER to encourage companies to perform at best (Gold rating) in PROPER. At the 2014 Environmental Awards Night, the Indonesian Vice President presented a Gold rating to the best performer. That year, only one Gold rating was awarded to the private sector oil and gas company's Rimau plant, discussed in the next chapter. As he presented the award, he remarked:

Only one? [just for a private oil and gas company], I think more than one [Gold rating is achievable] because we [Indonesia] have so many oil and gas upstream companies! (MoEF, 2014a)³⁵

Even though the Indonesian Vice President joked, his comment effectively put pressure on company leaders present, including the President Director of the state-owned Subang company, to obtain a Gold rating in PROPER. After the 2014 Environmental Awards Night, Subang's President Director and other

³⁵ Audio visual documentation of Environmental Awards Night 2014 by the MOEF.

directors created policy to make the necessary changes to achieve a gold rating in PROPER. An employee at the Subang company highlighted:

At our company, our only motivation is to be the same or exceed [the performance of] Medco Rimau in PROPER (Interview with Mr B, April 26, 2017, Jakarta).

This demonstrates that meeting the expectations of high-level political actors, such as the Indonesian Vice President, motivated Subang top-level managers to achieve a Gold rating in PROPER, the reasons for which are discussed further in the next section.

Top-level management at the Subang company translated the commitment of the company into beyond compliance performance (Gold rating) programs. This included not only introducing a number of new environmental and socially friendly programs but also integrating aspects of PROPER's principles into employees' key performance indicators (KPIs). First, it introduced "Re-engineering Compressors" to reduce the amount of energy used in the Rantau plant by 42.9 MBTU (Subang Company Environmental Report, 2016, p. 2). Subang invested IDR 2.1 billion or USD 160,414, exchange rate at IDR 13,518 (Subang Company Environmental Report, 2016, p. 8). Second, it introduced the "Using Cutting Dryer Approach" in oil and gas drilling processes. This program reduced toxic and hazardous waste produced by the plant in 2016 by 200 tons (Subang Company Environmental Report, 2016, p. 2). The cost of this program was IDR 2.2 billion or USD 167,110, exchange rate at IDR 13,518 (Subang Company Environmental Report, 2016, p. 15). For social programs, the Subang company focused on the "*Sieukula Anak Nangroe*" (School for Children) mentioned in the prior section. This program aimed to improve children's access to education in disadvantaged villages in Aceh Province (Subang Company Environmental Reports, 2016, p. 2). This program was financed by the Subang company for amount IDR 13.4 billion or USD 997,262, exchange rate at IDR 13,518 (Subang Company Environmental Report, 2016, p. 25).

In addition to real programs implemented at the plant and in local communities, Subang's corporate managers changed their corporate

management structures to incorporate indicators of PROPER into the internal management system, particularly its KPIs. The Subang company also included achievements in PROPER as one of the KPIs for the President Director (i.e. the performance contract agreement). Similar to the President Director's performance indicator for meeting targets for oil and gas production volumes at holding level, PROPER also contributed 4% to total President Directors' KPIs in his performance contract agreement with the Minister of SOEs. This indicates that PROPER (as an indicator of socio-environmental performance) was equally as important to the company as its core business of oil and gas production.

Table 5.2. President Director's job contract with the Minister of SOEs in 2016

No	Aspects	Contribution
1	Finance and market	24%
2	Consumers' satisfaction	18%
3	Production process • Production of oil and gas (4%)	26%
4	Environment and human resources (labour)	15%
	HSSE Excellent (9%) • Number of Major Accidents (NoA) 5% • PROPER 4%	
	Human resources Excellent (6%)	
5	Leadership, governance and social responsibility	15%

Source: Subang Company Environmental Report, 2017, pp. 4-5.

The Subang company began integrating PROPER indicators into its internal management system in 2008. An employee at the Subang company said:

We adopted PROPER in KPIs in 2008. At that time, the President Director was Mr Ari Soemarno (2006-2009). However, [adopting PROPER in KPIs] was still just in its infant phase then [the company was focused on first meeting the basic compliance requirements];

it still needed to be improved [by separating the evaluation of departments by function, from individual performance] (Interview with an employee, Mrs Y, April 26, 2017, Jakarta).

Adopting PROPER as an environmental certification standard was a new policy introduced at the Subang company in 2008. In the first year of assessment (2008), only 69 percent of Subang's plants met minimum legal requirements.³⁶ Based on this result, the company implemented a system that applied sanctions to head of plants and their employees that obtained either a Black or Red rating in PROPER, which meant it had not met minimum legal environmental requirements:

Top-level management cut the yearly bonuses of employees as a sanction for [when a plant] received either [a] Black or Red rating in PROPER. This policy worked to pressure plants to meet the minimum legal requirements and obtain a Blue rating in PROPER (Interview with an employee, Mrs Y, April 26, 2017, Jakarta).

Furthermore, top-level management at the Subang company issued Memorandum No. 008/000000/2014-SO on The Road Map to Health, Safety, Security and Environment (HSSE) Excellence (Subang Company Environmental Report, 2016). This memorandum mandates that all departmental directors (e.g. Upstream Production, Gas, Refinery, and Marketing and Distribution) must prioritise PROPER in their directorates. Directors must ensure that beyond compliance programs are fully financed to meet beyond compliance standards to achieve a Green or Gold rating. As such, each director at Subang is also involved directly in plants (sub-national production units at the Subang company) to introduce, operationalise, or improve programs to obtain a Gold rating. Previously, this had not been standard practice to visit and work closely with plants. An employee responsible for the community development program expressed:

The director's involvement in the [Rantau] plant's planning [for the community development programs that organised the School

³⁶ Confidential interview with an employee at the Subang company on April 26, 2017.

for Children located in the Tampur Paloh village³⁷] was such a surprise. As far as I know, it was the first time that Mr John H Simamora [the director] came to the plant to prepare us for the Gold PROPER assessment (Interview with Mr D, March 22, 2017, Aceh).

In the boardroom at Subang, there is an informal rule among company directors, underpinned by competition among peers.³⁸ At the holding level, the number of Gold ratings achieved across plants or production units that directors manage influences the speaker and seating sequence at the Health Safety Security and Environment (HSSE) excellence meeting. An employee at the Subang company remarked:

The director with the lowest number of Gold ratings [across the plants they manage] is expected to speak last and sit at the back. Although it is informal, it effectively influences the directors' efforts to support production units in obtaining a Gold rating in PROPER (Mrs Y, April 26, 2017, Jakarta).

The directors who have production units that participate in PROPER in the four directorates of the company (Upstream Production, Gas, Refinery, and Marketing and Distribution) adopted a Gold rating as one of their “proud of leadership” initiatives.³⁹ Internal “peer group pressure” among directors bolsters the regulatory influence of PROPER on the Subang company, particularly for meeting beyond compliance standards to obtain a Gold rating. An employee at Subang said that:

PROPER is prestigious in the Subang company among our directors. For example, if one director gets two Gold ratings and another gets one. The question is why I [Director of Gas] have not got a Gold [rating], yet? (Mrs Y, April 26, 2017, Jakarta)

³⁷ This the location of community development programs at the state-owned oil company. It is one of the poorest villages in Aceh Province. Tampur Paloh is located in the East Aceh District about 5 hours from the plant (3 hours by car and then 2 hours by boat).

³⁸ Confidential agreement with an employee at the Subang company on April 26, 2017.

³⁹ Ibid.

The findings above demonstrate that PROPER's strategy of promoting environmental leadership was able to effectively harness pressure on top-level management in the oil and gas sector to meet PROPER's beyond compliance performance standards. The President Director of the Subang company translated his commitment to PROPER by integrating indicators of commitment to and performance in PROPER into the company's KPIs. This directly incentivised company directors and employees to endeavour to ensure that Subang's plants met the expected level of beyond compliance performance in PROPER. Top-level management are committed to providing budgets and human resources to meet the Gold standard in PROPER, but they are also directly involved in the field to ensure programs are running well. As a result, Subang's socio-environmental performance in PROPER improved, with the Rantau plant shifting from meeting compliance level standards (Blue rating) to the best level of beyond compliance (Gold rating) over time.

5.3.2. Political patronage between the state and SOE management; enabling institutional conditions for promoting environmental leadership

This thesis aims not only to understand how the regulator of PROPER adopted regulatory strategies, but also institutional conditions under which strategies operate to improve socio-environmental company performance. This subsection argues that the strategy of promoting environmental leadership operated through existing structures of political patronage and corporate governance to influence the commitment of top-level managers to PROPER's beyond compliance standards. I seek to show that the appointments of these managers, including the President Director and directors at Subang, are underpinned by close, beneficial relationships that are reciprocal between political elites and the leadership of state-owned companies. The evidence presented below suggests that there can be benefits from understanding and harnessing the underlying of the structures of the patronage state for improved social-environmental governance, which is in contrast to the findings of other political scholars who have often detailed the negative

consequences of patronage systems, in work on elections and money politics (Aspinall, 2013) and on forest fires (Varkkey, 2013).

To understand these dynamics, it is important to first gain an overview of the way the relationship between state political actors (with designated authority or influence in the sector) and SOE management is formally structured in Indonesia. While I present the structure of the Subang oil and gas company, this structure is also similar to other SOEs. Figure 5.1 shows that senior political elites in Indonesia, such as the Minister of SOEs (who is influenced by the President and Vice President of Indonesia) and Board Commissioners (discussed in Chapter 4) have the legal authority to make SOE management appointments to the SOE Board of Directors (Figure 5.1) and therefore to direct SOE business priorities. Such authority is also outlined in Law No. 19/2003 regarding state-owned enterprises (SOEs).

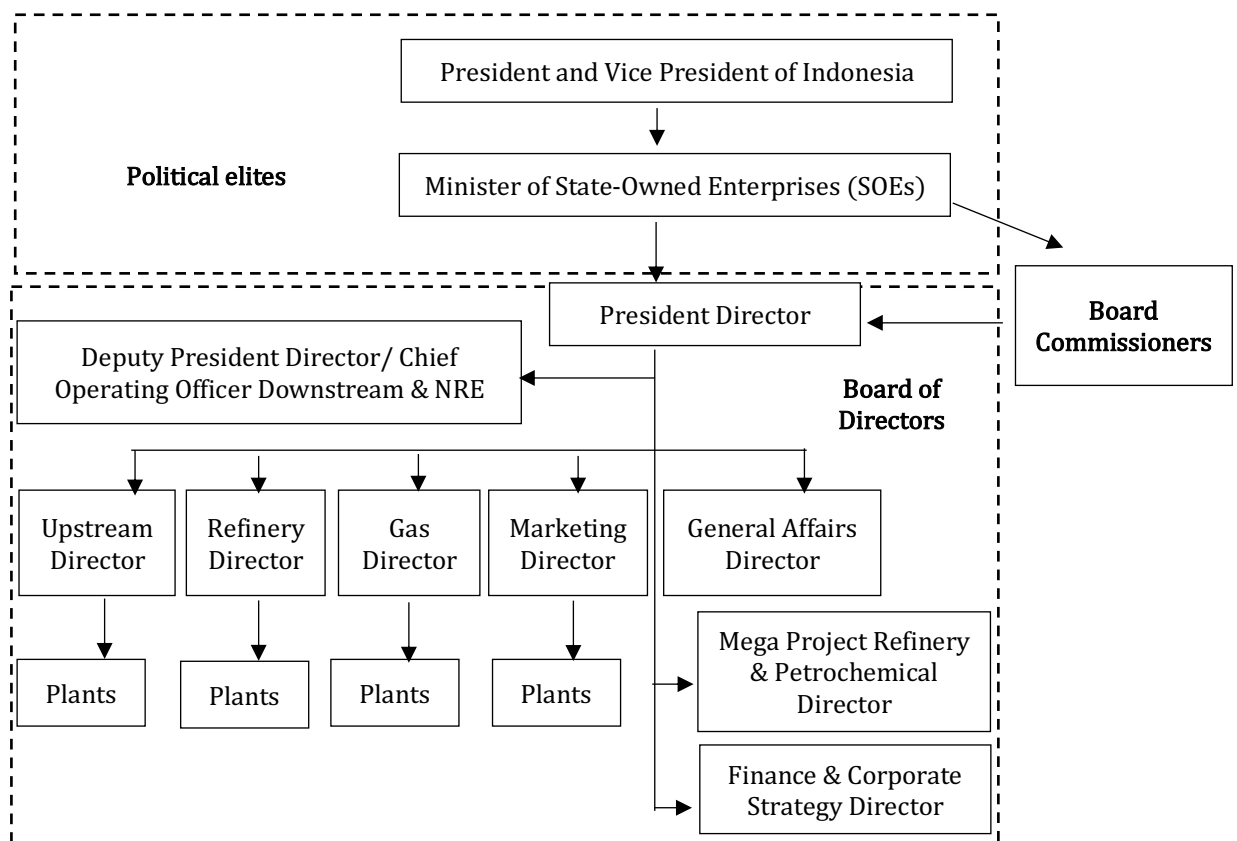


Figure 5.1 Relationship between Board of Directors at the Subang company and political elites at national level.

Source: modified from the Subang company's Annual Report, 2017, pp. 108-109.

As the regulator of PROPER, the DITJEN PPKL has attempted to design PROPER strategies to leverage the traditions of patrimonial state to achieve its regulatory objectives,⁴⁰ using a strategy of engaging high-level political actors to support public voluntary regulation matters in Indonesia. The patrimonial state in Indonesia, in which close relationships based on patronage between business and the state shaped corporate strategies and appointments, has a long history. Many researchers have identified that the Subang company provided financial resources to advance President Suharto's own interests (Crouch, 1975; Kobonbaev, 2006; McCawley, 1978). In return, Suharto protected the Subang company from sanctions for violating environmental and societal regulations (Mietzner & Misol, 2013). Thus, a strong corporate culture of SOEs developed in which directors sought to satisfy political actors who controlled them rather than maximising profit (Boycko et al., 1996).

Political actors continue to be critical sources for pressuring Subang's top-level management in the post-Suharto regime, particularly given that political intervention is deeply rooted at the Subang company and specific political actors still have authority over SOE direction and appointments. Aprillanti and Kristiansen (2019) have shown that appointments to high-level positions at SOEs continue based on political relationships rather than solely on merit. Senior political actors are the most salient stakeholders for top-level management at Subang, and who frequently seek to demonstrate their leadership capacity and performance, as well as their allegiance to political elites that can influence their career paths.⁴¹

Thus, involving political actors in the Environmental Awards Night described earlier, is one such example of how PROPER has sought to leverage such features of Indonesia's broader institutional context, that being historically-embedded close relationships between political actors and SOEs. It also helps us understand the response of Subang's top-level management to

⁴⁰ Confidential interview with high-level bureaucrat at the MOEF on April 26, 2017.

⁴¹ Confidential interview with top-level manager at the Subang company on April 26, 2017.

the Indonesian Vice President's speech at the PROPER Environmental Awards Night. One senior manager explained that building a connection with political elites is essential for top-level management at the Subang company.⁴² Subang's top-level managers perceived that performing to a Gold standard in PROPER was one way to demonstrate they had responded to the demands of political actors in terms of their professional performance in environmental and social aspects of the business.⁴³

Political "winds" [pressures] significantly influence high-level appointments in the State-Owned Enterprise (SOE). They [the directors] must be ready to be replaced by the government [political actors] at any time (Interview with an employee at the SOC, Mrs Y, April 26, 2017, Jakarta).

In 2018, a Subang director was rewarded for the improved environmental performance of Subang and promoted by the Minister of SOEs to President Director at another SOE (*The Jakarta post*, September 10, 2018). These findings are in line with the work of McLeod (2005) and *McLeod and McIntyre* (2007) that show the close ties between the state and businesses, and the individualised nature of business-government interactions and patronage, particularly in SOEs. Lobbying, and informal and firm-specific deal making has continued to characterise to a significant degree the nature of relationships between state and private business actors.

Top-level managers at the Subang company also perceived that the Environmental Awards Night is a strategic event that provided them with an opportunity to build connections with political elites, particularly the Indonesian Vice President.⁴⁴ For Gold performers, senior managers not only receive the award from the Indonesian Vice President, but they are also invited by DITJEN PPKL to dinner with political elites, including the Vice President, the Minister of MOEF and Head of District or Mayor where companies operate. These engagements improve interpersonal relationships between senior

⁴² Ibid.

⁴³ Ibid.

⁴⁴ Confidential interview with top-level manager at the Subang company on April 28, 2017.

management and politicians to facilitate smoother business processes, but also so that senior managers have personal relationships with influential political elites who make appointments and promotions within and across companies as opportunities arise.⁴⁵

This relationship also has reciprocal benefits for political elites. Senior SOE managers give preferential treatment to project subcontractors affiliated with political elites. One interviewee described how this was also the trend at the Subang company.⁴⁶ Top-level management pressured subcontractors to sponsor the political party's anniversary event, if they wanted to win new projects from the Subang company. Top-level management took this approach because sponsoring a political party is not allowed, by regulation, as well as good corporate governance. In some cases, the distribution of projects does not comply with the procurement system, which was one of the allegations against some of the eight SOEs directors involved in corruption cases between 2014 and 2019, as described in the previous chapter (*CNBC Indonesia*, October 3, 2019).

From the discussion above, it is evident that PROPER's strategy of promoting environmental leadership among Subang's top-level management was able to leverage the features of Indonesia's context—that being the institutional conditions of close, reciprocally beneficial relationships between political elites and the leadership of state-owned companies—to influence the commitment of top-level managers to PROPER's beyond compliance standards. By gaining the support of national political elites for PROPER who then pressured Subang's senior managers, the company then undertook significant steps to improve its beyond compliance performance rating in PROPER.

⁴⁵ Ibid.

⁴⁶ Ibid.

5.4. PROPER strategy: Technical regulatory assistance and state regulatory capacity

In addition to promoting environmental leadership, PROPER also adapts the strategy of technical regulatory assistance to bolster socio-environmental performance at the Subang company. Such assistance aims to improve the company's capacity to meet minimum legal requirements (Blue rating) as well as encourage the company to meet beyond compliance standards (either a Green or Gold rating). Below, I contend that this strategy was able to improve employees' knowledge and skills on PROPER to meet both compliance and beyond compliance standards. I also argue that the function of technical assistance was not only to improve employee knowledge and skills, but also a means of developing and strengthening informal relationships between the PROPER regulator and regulatory target. Such a close relationship is the reason why the regulator of PROPER took an informal discretionary policy (unwritten) to the Subang company, because of its regulatory violation on toxic and hazardous waste management.

Further, this subsection argues that PROPER's strategy of technical regulatory assistance was enabled by the strong capacity of the national regulator, the DITJEN PPKL, to provide such assistance. I seek to demonstrate this was due to knowledge accumulated over time by the national regulator, who also had the authority to adopt discretionary policies. Arguably, PROPER has been able to support sectors regulated nationally, such as the oil and gas sector, as the design of PROPER and the authority of the DITJEN PPKL is structured to be well aligned with centralised sectors regulated by national authorities. As we shall see in Chapters 7 and 8, in other sectors for which regulatory authority is decentralised, this is not necessarily the case. The configuration between direct political pressure on top-level management, and the ability and authority of national government to provide technical assistance is crucial to improve Subang's socio-environmental performance.

5.4.1. Technical regulatory assistance in PROPER

The DITJEN PPKL provided technical regulatory assistance to improve the knowledge and skills of Subang company employees regarding PROPER standards. Technical assistance is developed and provided by the DITJEN PPKL to companies based on the Minister of Environment and Forestry Decree No. 3/2014 on PROPER. The DITJEN PPKL collaborated with the Health, Safety, Security and Environment (HSSE) Department of the Subang company to deliver in-house training in PROPER. In 2017, such in-house training was carried out by the DITJEN PPKL in sessions facilitated by the HSSE Department in several provinces, such as in North Sumatra, South Sumatra, Jakarta, Yogyakarta, East Java, East Kalimantan and South Sulawesi (Subang Company Environmental Report, 2018). Rantau plant staff travelled to North Sumatra for the training sessions. For each in-house training session, the HSSE Department also invited national and subnational government staff, as well as experts affiliated with PROPER to deliver sessions.

The DITJEN PPKL developed and delivered a curriculum of in-house training based on the Ministerial Decree mentioned above, covering both compliance and beyond compliance standards in PROPER.⁴⁷ The compliance standards related to environmental legal regulations such as water pollution, air pollution, land pollution, toxic and hazardous waste management, and conducting an Environmental Impact Assessment (EIA) as well as producing appropriate EIA documentation. Beyond compliance training covered policies on the management of natural resources such as efficient energy and water usage, reducing released emissions, reducing toxic and non-toxic hazardous waste, conservation of biodiversity, as well as community development programs.

According to Subang company data, 396 employees participated in in-house training sessions up to December 2016. Five types of in-house training were delivered (see Table 5.3 below).

⁴⁷ Confidential interview with senior bureaucrat at the MOEF on April 27, 2017.

Table 5.3. Types of training conducted at the Subang company

Types of training	Number of participants
Water pollution control	58
Air pollution control	54
Hazardous and toxic waste management	141
Indicators of PROPER (environmental legal compliance) and beyond compliance standards	127
Software for environmental management	16

Source: Subang company Environmental Report, 2018

Technical regulatory assistance influenced how employees at the Subang company perceived and understood PROPER. An employee at the Rantau plant highlighted that training in PROPER influenced employees' responses to improving environmental and social performance at the plant. He remarked:

So PROPER is a kind of motivation for employees competing to improve themselves because they would be embarrassed [by a poor rating]....Participating means complying with the regulation. If not, we [at the plant] are humiliated because PROPER publishes the results. Thus, I understand PROPER as: (P) **P**reparation, (R) **R**egulatory compliance, (O) **B**eyond compliance, (P) **P**eculiarity (uniqueness), (E) **E**ngagement with stakeholders, and (R) **R**oad trips to the field [to gain a Gold rating] (Interview with Mr I, March 22, 2017, Aceh Province).

For the Subang company, PROPER increased employee awareness of the importance of and how to undertake environmental regulatory compliance. The employees must ensure that production processes in the field meet minimum legal requirements, and if not the result (obtaining either a Black or Red rating) will be published and the company and employees humiliated.

In-house training also provided Subang company employees with the opportunity to build on prior interactions with the PROPER regulator. Prior to 2002, the DITJEN PPKL was structured so that each Directorate within it

focused on regulating a particular aspect of the environment (e.g. the Directorate for Water and the Directorate for Air Pollution, among others). Under this structure, companies would have to deal with multiple Directorates for permits and to meet minimum legal requirements. In 2002, the DITJEN PPKL restructured to focus its Directorates on regulating specific sectors. For example, it abolished Directorates such as Water, and introduced the Directorate of Mining, Energy and Minerals (hereafter referred to as the PEM Directorate) among others, so that companies would only have to engage with one Directorate, making it easier to regulate their environmental management processes.

After the restructure, most members of PROPER secretariat came from the PEM Directorate, which was responsible for developing environmental regulations for the oil and gas industry. Thus, the staff responsible for PROPER, in particular its design, were PEM Directorate staff. They often consulted with oil and gas companies and sought their input while developing environmental regulations for the oil and gas industry, including those of PROPER.⁴⁸ Thus, the basic design of PROPER was well aligned with the structure of the oil and gas industry and how it operated—given so much consultation had already taken place with oil and gas companies at the outset—although companies in many other sectors participate in PROPER. A senior environmental regulator at the MOEF stated that:

In 2002, the organisational structure of the DITJEN PPKL changed to have a sectoral basis: Mining, Energy and Minerals (PEM); Manufacturing, Infrastructure and Services (MPJ); and Agro-Industries.⁴⁹ This change introduced a much more strategic organisational structure [at the DITJEN PPKL in the MOEF] to develop environmental regulations based on the

⁴⁸ Ibid.

⁴⁹ The change in organisational structure at the Directorate General of Pollution and Environmental Damage Control (as the host of PROPER) was due in turn to the changing function of the Ministry of Environment (MOE) from coordinating ministry to implementing ministry. As the implementing ministry, the MOE must develop regulations and strategies to improve environmental quality at the plant, such as business entities.

context specific to each industrial sector. It was a most productive time to establish the regulations [for the oil and gas sector], which later became key indicators used in PROPER. The sectoral based organisational structure explains why we [the regulator] have a close relationship with oil and gas companies. Thus, we [staff in the PPKL] are comfortable in working with the state-owned oil company in PROPER (Interview with Mr S, April 27, 2017, Jakarta).

Many of the PROPER secretariat staff (now located in the overarching office for the DITJEN PPKL) previously worked in the PEM Directorate when the PROPER secretariat came under its authority. Thus, those staff had already developed close relationships with the Subang company and others in the oil and gas sector.⁵⁰ Company staff responsible for environmental management communicated frequently with the Directorate of PEM to prepare and submit applications for environmental permits, and for monitoring and reporting on company levels of water pollution, air pollution and land pollution.

The strategy of technical regulatory assistance under PROPER offered the opportunity for DITJEN PPKL's staff and the Subang company to build on this previous interaction. As such, the regulator and company perceived that technical regulatory assistance is not only the way to improve employees' knowledge and skills on PROPER, but also to solve regulatory problems more broadly.⁵¹ For example, the Rantau plant was struggling to comply with Government Regulation No. 101/2014 on The Management of Toxic and Waste Materials. This regulation requires that a company must use a licensed vehicle to transport this kind of waste and issue a manifest when transporting any toxic and hazardous waste via public roads, even if only crossing them.

According to the company, this regulation, in particular Article 47 on Transporting Waste, was not compatible with the Rantau plant's workflow.⁵²

⁵⁰ Confidential interview with senior bureaucrat at the MOEF on April 27, 2017.

⁵¹ Confidential interviews with senior bureaucrat on April 27, 2017 and an employee at the Subang company on March 22, 2017.

⁵² Confidential interview with an employee at the Subang company on March 22, 2017.

Most oil wells are located far from the central processing plant, and environmental officers must use public roads for transporting toxic and hazardous waste such as used oil, used batteries, and contaminated rugs from wells to the central plant.⁵³ The company uses its daily operations vehicles (rather than specially licensed vehicles) to transport toxic and hazardous waste from wells to the central plant. According to the Government Regulation No.101/2014, using this type of vehicle to transport toxic and hazardous waste constituted a regulatory violation, meaning it could not meet minimum legal requirements and ultimately, PROPER's basic compliance standards. An employee at the Rantau plant explained that:

We know that our way does not comply with the regulation, but following the regulation [is] so irrational. The regulation was developed by the state based on the idea of plant based, where the source of waste is located in one area [near the plant]. Fences are a sign used to differentiate the company's area and public areas. In oil and gas, all [the oil wells and sources of waste] are spread out over hundreds of kilometres (Interview with Mr H, March 22, 2017, Aceh).

Given the strong relationship and regular interaction between PROPER regulators and the company, PROPER regulators were not only made aware of this problem, specific to the oil and gas sector, but had the cumulative long-term knowledge of working with the sector (discussed further in the next section) to develop a discretionary policy to address the Subang company's regulatory problem. Responding to the aforementioned regulatory problem at the Rantau plant, PROPER regulators made an informal discretionary policy (unwritten) to interpret Government Regulation No. 101/2014 to only apply the regulation when toxic materials were transported from the central processing plant to the treatment facility. Discretionary policies are policies based on ad hoc judgements of policymakers as opposed to policy set by

⁵³ Ibid.

predetermined rules (Cukierman & Meltzer, 1986). According to an environmental regulator:

The company must obey the regulation [Government Regulation No. 101/2014, particularly the Article No. 47] to transport the toxic and hazardous from the central processing unit to the hazardous and toxic waste treatment plant, but not from oil wells to the central processing unit (Interview with regulator, Mr W, March 23, 2017, Aceh).

Permitting the company to use a non-licensed vehicle to transport toxic and hazardous waste from oil wells to the central processing unit was such a discretionary policy that different from the legal regulation. The regulator, in this instance, judged that Subang's actions in the way they transported materials from oil wells to the central processing plant did not constitute a regulatory violation on toxic and hazardous management.

For the company, participating in PROPER is one of Subang's strategies to build a good relationship with the DITJEN PPKL and Aceh Provincial Government Environment Agency, so as to be able to, among others, ensure regulations were aligned with business processes.⁵⁴ Meanwhile, the DITJEN PPKL perceived that companies participating in PROPER that actively sought to learn about PROPER through training and other activities organised, demonstrated a commitment to improving their socio-environmental performance. One of PROPER's staff highlighted that:

We [the regulator] often offer some discretionary policies [not written] to participants in PROPER. The discretionary policy [action] is developed after conducting a series of discussions with the company usually during PROPER training sessions. [The question is] does the regulatory problem potentially cause catastrophic environmental pollution or not? If not, we make discretionary policies to encourage the company to do more for environmental conservation. If we don't provide a discretionary

⁵⁴ Confidential interview with an employee at plant level on March 22, 2017.

policy [solutions] to the company, the company would not invest [go beyond basic compliance] to obtain a Green or Gold Rating. Thus, we rule out the small things [that are not critical regulatory violations] to encourage better environmental and societal commitment, which is also one of the regulatory objectives of PROPER (Interview with regulator, Mr W, March 23, 2017, Aceh).

In the discussion above, we can see that the technical regulatory assistance provided by PROPER helped Subang company employees to improve their knowledge, but also generated closer working relationships with the Subang company more broadly, building on previous and present frequent interactions. This helped the regulator understand and respond to key compliance issues encountered by the company based on a mismatch between broad aspects of regulations and practicalities in the field, through the introduction of informal discretionary policies (unwritten). Technical assistance that facilitated regular interaction with and support from the regulator contributed to improvements in socio-environmental performance of the Rantau plant (and the Subang company more generally) under PROPER. The findings reflect that socio-environmental performance of this state-owned oil and gas company reflect not only the company's commitment to improve socio-environmental, but also support from the government, often with the use of informal discretionary policies (unwritten).

5.4.2. Centralisation oil and gas sector ; the enabling institutional condition of the strategy of technical regulatory assistance

This subsection explores underlying institutional conditions which supported how the technical regulatory assistance strategy was able to influence the Subang company. This subsection argues that strong state capacity, particularly from the DITJEN PPKL, bolstered the influence from the technical assistance strategy. As such, employees at the Subang company can design, implement and evaluate environmental and social programs required by PROPER. I contend that such capacity was based not just on the allocation of financial resources, but the strong knowledge and skills held by the regulator

based on years of experience in regulating the oil and gas sector at the national level. Further this subsection argues that while most regulatory authority in Indonesia is decentralised, including some extractive sectors such as palm oil, regulatory arrangements of the oil and gas sector remain with the national government. This aligns with the authority of the DITJEN PPKL's authority for environmental management oversight and the way PROPER was designed with inputs from the oil and gas sector at the outset, providing strong, enabling conditions for achieving regulatory goals. Such aligned authority applies informal pressure and active background threats to induce behavioural change in companies.

The operational mechanisms of providing technical regulatory assistance depend on DITJEN PPKL's knowledge of the oil and gas industry, as well as their authority as the PROPER regulator. Having comprehensive and accurate knowledge of how the oil and gas industry operates in practice, facilitates the ways DITJEN PPKL can offer, through technical assistance, applicable and contextual solutions to solve regulatory problems and encourage beyond compliance performance, as we saw, for example, in the discretionary policy discussed above.

As explored in Chapter 4, DITJEN PPKL is the only Directorate General that remains, after merging between the Ministry of Environment and the Ministry of Forestry to become the Ministry of Environment and Forestry (MOEF). DITJEN PPKL is led by a Director General, employed as Echelon 1 (one level under the Minister and directly responsible to the Minister). DITJEN PPKL employed 233 staff (MOEF, 2018, p. 6) and managed a budget of IDR 110,732,685,000 or USD 8,325,765, exchange rate at IDR 13,300 (MOEF, 2018, p. 201). With this number of staff and budget, DITJEN PPKL prioritised PROPER as the program to improve environmental quality in Indonesia, particularly business activities.

Regarding knowledge and skills, bureaucrats at the DITJEN PPKL have long-term experience in regulating environmental aspects in business since

the centralisation policy under the Suharto regime.⁵⁵ A bureaucrat at MOEF explained that:

Not only [do] the senior bureaucrats have advanced knowledge and skills for regulation [of] environmental aspects in business but also young staff of DITJEN PPKL. For example, Mr R and Mr F [have not reached echelon 4] were able to teach the bureaucrats at subnational government; even though they were older and [had a] higher level of position [either echelon 3 or 4] (Interview with a bureaucrat at the MOEF, April 27, 2017, Jakarta).

As mentioned previously, staff now in the PROPER secretariat had a long history of working closely with oil and gas companies who they consulted on the design of PROPER.⁵⁶ Some of these staff have been in the DITJEN PPKL for more than a decade, and have strong technical knowledge of the oil and gas industry. Given that the sector is not decentralised (see further discussion below), they do not need to transfer such knowledge to sub-national regulators across Indonesia's 36 provinces—they can instead transfer knowledge with new DITJEN PPKL staff over time within their own office and also retain knowledge, as an agency, over time. Further, they are able to tailor technical assistance to the needs of oil and gas companies, possibly to a greater extent than in other sectors with which they are less familiar.

The average performance of [the] oil and gas sector is higher than other sectors. It reflects how our staff [DITJEN PPKL] were able to assist companies to improve their environment and social performance (Interview with a bureaucrat at the MOEF, April 27, 2017).

Compared with palm oil and other sectors, the significant investment required in developing oil and gas extraction infrastructure and processing plants is significant. Thus, there are fewer players with which the DITJEN PPKL needs to interact and provide technical assistance. DITJEN PPKL states that it has a sufficient budget to deliver training and support to oil and gas

⁵⁵ Confidential interview with bureaucrat at MOEF on April 27, 2017.

⁵⁶ Ibid.

companies, supporting the argument that the regulator has strong capacity to provide technical assistance.

PROPER is the priority program of DITJEN PPKL. As such, [the] Director General commits to allocating a sufficient budget to support regulatory strategies of PROPER, such as technical assistance and public disclosure (Interview with a bureaucrat at the MOEF, April 27, 2017).

Notwithstanding crucial benefits of technical aspects in providing assistance, findings on the Subang company discussed below also suggest that this regulatory strategy worked because of the "informal pressures" on companies to participate in both the program and its technical assistance initiatives, so as to be better able to smooth environmental permit processes. A study by Berenschot and Klinken (2018), for example, has found that informal relationships and processes occur across government levels and multiple sectors and that bureaucrats in Indonesia use their authority to reward or punish companies in ways that fall outside formal rules and procedures regarding permits. (I discuss this further in Chapter 7.)

With this in mind, the ways in which DITJEN PPKL was able to activate the informal background threat through its technical regulatory assistance strategy was not only due to its strong regulatory capacity in terms of knowledge, skills and resources. Such capacity was underpinned by the broader centralised authority of the national government to regulate the sector. As mentioned in Chapter 4, national government agencies are responsible for regulation and oversee the oil and gas industry under Law No.22/2001. Oil and gas companies must apply for business licenses from the national (central) government, particularly from the Special Task Force for Oil and Gas Business Activities (SKK MIGAS). The national Ministry of Environment and Forestry (MOEF) has the legal authority to issue, monitor and evaluate environmental permits for oil and gas companies. Thus, the MOEF is an influential actor for oil and gas companies as it controls environmental permits.

It also has the discretionary power to help companies meet standards through the ways it provides technical assistance, not only in terms of discretionary policies, as mentioned in the previous section, but also in providing time and support to introduce systems that bolster compliance. A senior regulator at the MOEF said that:

They [the MOEF] need us for environmental permits. Participating in PROPER [through accessing technical assistance] can help them get the environmental permits. For example, the Subang company does not have a system to measure the amount of emissions released into the air [which is mandatory]. I give them extra time to develop the system to meet the minimum legal requirements. Then, the Subang company hired an expert from Gadjah Mada University to develop the software system [to measure the amount of emissions released into the air], which is now used in all production units owned by the company (Interview with Mr S, April 17, 2017, Jakarta).

Having the extra time to meet minimum legal requirements is one of the informal benefits of participating in the program and drawing on technical regulatory assistance provided by PROPER.

The introduction in 2001 of the law on oil and gas also presented a critical juncture at which to reform the state-owned Subang oil and gas company and further bolster its commitment to improve its environmental performance, for example, meeting PROPER beyond compliance standards.⁵⁷ This law replaced Law No. 8/1971 on the State Oil and Gas Company which was highly resource nationalist in orientation. The 1971 Law gave the company immense regulatory power and created opportunities for domestic entrepreneurs to partner with and contract to foreign multinational oil

⁵⁷ Law No.22/2001 about oil and gas article 2 states that a commitment to environmental conservation is one of the basic principles and objectives of the Indonesian oil and gas industry.

companies (Warburton, 2018, pp. 132-133). Under Law 22/2001, the State Oil and Gas Company no longer had this regulatory power.

The change in the Law, again during Indonesia's early reform years when international agencies wielded significant influence (see Chapter 4). Reforming the State Oil Company (SOC) was one of the requirements of the Structural Adjustment Program (SAP) under the International Monetary Fund (IMF) (and the World Bank), when it provided loans to the Indonesian government during the financial crisis in 1997. The IMF demanded the liberalization of the Indonesian oil and gas industry and the IMF and the World Bank used the SAP as an impetus to reform the Indonesian regulatory framework for the oil and gas sector. In November 1998, just several months after the Suharto regime collapsed, the World Bank began research on the oil and gas sector in Indonesia that continued until December 1999 (World Bank, 2000). Based on this research, it assisted the Ministry of Energy and Mineral Resources draft the new Oil and Gas Law, which was then presented to parliament in 1999. This draft sought to make the industry more competitive and market oriented, reduce government interference and to be consistent with international industry best practice (World Bank, 2000: v). Much of this agenda of liberalisation was retained in the ratified Law.

Under the new law, the management at the Subang company must reform its organisational culture to become a world-class oil and gas company. In order to reach world-class status, the company must not only comply with minimum legal requirements (such as environmental permits) but also implement beyond compliance standards or what is known as 'corporate environmentalism'.⁵⁸ Having valid environmental permits from DITJEN PPKL is foundational to be able to achieve the company's vision to be a world-class oil and gas company.

Both improving its regulatory knowledge of PROPER's compliance and beyond compliance standards and building state-business relationships, so as to access permits and smooth business processes motivated the Subang

⁵⁸ Confidential interviews with top-level management at the Subang company on March 22, 2017 and April 26, 2017.

company to participate in PROPER's beyond compliance programs and technical assistance initiatives. The Subang company must submit the required documents to obtain environmental permits, but without networks and connections with regulators, they may not be appropriately or efficiently processed, which can affect production processes.⁵⁹

Regulators always inspect the plant before approving environmental licenses. During the inspection, regulators will look for regulatory violations, even if these are not related to the proposed permit. For example, if the aim of an inspection is air emissions, the regulators might also inspect water treatment facilities to find the regulatory violation by the company. However, the regulators' behaviour when inspecting the company facilities will be different if we have a good relationship with regulator. When we have good relationships, the regulator concentrates only on the issues specific to the permit and trust me [manager] to ensure we meet other aspects of regulatory compliance (Interview with a Rantau plant staff member, Mr I, March 22, 2017, Aceh).

Due to the uncertainty over permits and processing times, Subang has sought to build good relationships with state actors and the regulator that issues permits. Companies use technical assistance training, not only to gain regulatory knowledge and share with regulators the challenges they face, but most importantly develop relationships with government regulators. Indeed, as one company staff member explained, they support all government events:

We always support government programs. We provide the regulators with what is necessary for running their programs, such as a hat, t-shirt, bin (Interview with a staff member at the SOC, Mr I, March 22, 2017, Aceh).

Thus, securing access to environmental permits, from the government, acted as a background threat to motivate the company to participate in PROPER and

⁵⁹ Ibid.

augmented the ways technical assistance helped induce behavioural change in socio-environmental performance at the Subang company. This kind of background threat is different from the experience of industrialised countries, which use the threat of introducing stringent mandatory regulations in future to motivate companies to comply with present beyond compliance performance standards (Lyon & Maxwell, 2004).

In summary, institutional conditions of strong, national government capacity to provide technical assistance and the importance of developing close state-business relations (through participating in training and other events) were essential institutional conditions which supported the Subang company to obtain a Gold rating in PROPER. As the regulator that has had long interaction with and cumulative knowledge of the oil and gas sector—which also strongly informed PROPER’s design that is well aligned with how the sector operates—the DITJEN PPKL also has the skills and authority to adopt discretionary policies tailored to the needs of the sector. This proved attractive to the Subang company and its Rantau subsidiary to participate in PROPER to meet its beyond compliance standards. In the Indonesian context, providing technical assistance is not only about improving employees’ knowledge and skills on beyond compliance standards, but also provides the opportunity to build a good relationship between regulators and regulatory targets.

5.5. PROPER’s public disclosure: Eliciting pressure from third-party actors to improve Subang’s performance

This section elaborates how regulators adapt the strategy of public disclosure that shares information on the environmental and social performance of companies with third-party actors (investors, CSOs and local communities) through PROPER’s rating system. The five colour codes used by PROPER (discussed in Chapter 3) provide a simple way to communicate a company’s non-compliance with legal standards (Red or Black), compliance with minimum environmental legal standards (Blue) or beyond compliance performance (Green or Gold) with the public, both nationally and internationally. These colour codes help third parties, from investors to CSOs,

to understand the complex system of environmental assessment. This section argues that this strategy was effective in eliciting investor pressure on the Subang company to approve its socio-environmental performance. The effectiveness of this strategy, I contend, has been supported by the global commitment of 'green' investors in the oil and gas sector to provide 'sustainable finance' to companies, that being credit based on policies that take into account the environmental (and sometime social) impacts of investments.

It is important to note here that in this case I do not explore the influence of other third-party actors, particularly local communities. This is because in the fieldwork there was little evidence that such third parties had sought to or been a strong influence on social and environmental behaviours at the Rantau plant. When exploring why this was the case⁶⁰, interviewees explained that Subang's advanced oil and gas facilities at the Rantau production unit were established long ago under the Dutch colonial administration, which strongly controlled state-owned land in and around lucrative oil wells.⁶¹ The company had long held this iron-clad land concession, the control of which was only further consolidated under the later authoritarian government. The few communities who live in the concession area thus do so with the permission of the company, rendering their bargaining position weak vis-à-vis that of the company.⁶²

5.5.1. Pressure from investors through global bonds

The Subang company accesses much of its finance through the international financial market by issuing global bonds, which act as loans to the company in return for interest payments. This subsection explores PROPER in the broader socio-environmental governance context, with particular reference to the role of investors augmenting the regulatory impacts of PROPER through due diligence processes prior to purchasing the Subang company's global bonds.

⁶⁰ See also the discussion in Chapter 4 on the history of the development of the oil and gas sector under colonial and subsequent authoritarian administrations.

⁶¹ Confidential interviews with employees at the Subang company on March 22, 2017.

⁶² Ibid.

This subsection argues PROPER's public disclosure strategy was able to elicit pressure from these investors to encourage the Subang company to improve its performance against PROPER's beyond compliance standards to achieve a Gold rating.

International investors interested in purchasing Subang's global bonds used PROPER ratings in their due diligence processes to evaluate the company's environment and social management. Due diligence is defined as investor activities (such as audits or investigations) that are conducted to evaluate a company's performance against a range of indicators—which can include financial, environmental and social aspects—before entering into a loan agreement (Seiler,1988). In early 2014, international investors interested in purchasing global bonds sent several emails to the Subang company's Directorate of Finance about Red ratings it had received in PROPER for the 2012-2013 assessment period. One of these emails is reproduced below.

From: [REDACTED]
To: [REDACTED]
Cc: HSSE Department
Subject: PROPER RATING
Date: Monday, February 03, 2014 4:03:34 PM
Dear HSSE Department,
Here are the questions from lenders [financial services companies] which are related to the production units that obtained a Red rating in PROPER in for 2012-2013;
Production unit [REDACTED] in Jakarta Province
Production unit [REDACTED] in Southeast Sulawesi Province
Production unit [REDACTED] in North Sulawesi Province
Please provide information to explain why these production units obtained a **Red rating in PROPER**, and the corrective actions that will be undertaken.

Regards
Analyst Trade & Working Capital

Figure 5.2. Email from investors responding to the Subang company's Red PROPER rating

Source: Compiled from the Subang Company Environmental Report, 2014. This is a translation of the email originally sent in Bahasa Indonesia.

The email above conveyed that investors were not happy with Subang's environmental performance as three production units (each assessed separately by PROPER and given its own rating) had obtained a Red rating in PROPER, as these units had not met minimum environmental legal requirements. Two of these production units did not submit a hazardous and waste management report in 2013.⁶³ The third unit had a level of air pollution over and above the maximum level allowed by government.⁶⁴

Furthermore, the email above also indicates that investors examined the Subang company's legal compliance at the corporate level (i.e. the level of the holding company that has many subsidiaries), instead of at the level of specific production units, each of which is often constituted as a separate subsidiary company. Even though the Rantau production unit (and others) had met basic legal compliance standards, investors drew on PROPER's publicly disclosed ratings of all production units and perceived that if just one production unit at the Subang company had not met minimum legal requirements (achieving at least a Blue rating), then the Subang holding company overall was not in compliance with legal regulations. Thus, PROPER's disclosure system played a pivotal role in informing investors of regulatory violations, which in turn put pressure on the company.

The Subang company responded promptly to concerns from investors regarding the three production units that violated environmental regulations and thus obtained a Red rating. Interviewees explained that Subang had limited time to ensure it had resolved all regulatory violations, identified in the 2012-2013 assessment period, before issuing its global bonds in 2014.⁶⁵ The Subang company was only given five months (February to May 2014) to report to investors that its Red-rated production units had taken steps to comply with legal environmental regulations. Subang's Directorate of Finance and HSSE Department worked together to address these regulatory violations.

⁶³ Confidential interview with an employee of the Subang Company on April 26, 2017.

⁶⁴ Ibid.

⁶⁵ Ibid.

According to an employee in the HSSE Department, top-level management at the Subang company made the concerns from investors about their PROPER rating a priority issue.⁶⁶ After receiving emails from investors, Subang's Vice President (VP) of the Directorate of Finance sent Memorandum No.034/H20100/2014-S4 to the Vice President (VP) of the HSSE Department on February 6, 2014, requiring the HSSE VP to provide updated information on environmental performance of all Subang's production units and ensure that all production units complied with legal environmental regulations.

Responding to this memorandum, the HSSE Department undertook corrective actions to resolve the problems identified by PROPER assessors in those production units that had received the Red rating (Subang Company Environmental Report, 2014). First, for the two production units that had not met reporting requirements, the HSSE Department collaborated with environmental regulator staff in the relevant plants to re-submit documentation, including the hazardous and toxic waste reports. Second, the Subang company fixed the incinerator at the production unit which had violated regulations on maximum levels of air pollution, so that legal requirements were met.

The chronology outlined in Figure 5.3 below summarises the sequence of events outlined above and below, to illustrate the way PROPER's public disclosure strategy elicited, first a response from investors that pressured the company, and second, a response from the company to improve its performance. By April 2014, the HSSE Department reported to the Board of Directors that remedial actions had been undertaken to resolve regulatory violations at the three production units (Subang Company Environmental Report, 2014). To support this claim, the HSSE Department provided documentation of the steps the company had undertaken to meet legal requirements, which was published by the MOEF, specifically the PROPER

⁶⁶ Ibid.

Secretariat.⁶⁷ After addressing these violations the Subang company issued global bonds to interested investors on May 30, 2014.

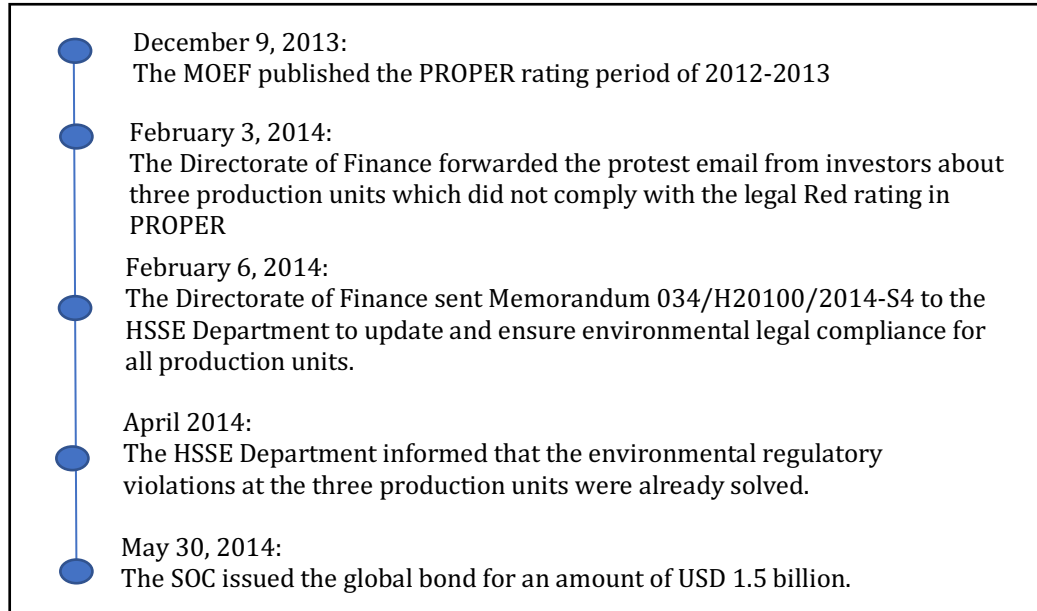


Figure 5.3. Chronological explanation of the relationship among PROPER, investors and the global bond.

Source: Compiled from the Subang Company Environmental Report, 2014, pp. 4-10. This is a translation into English of the original report.

From the discussion above it is evident that investors used the information disclosed by the PROPER regulator for their investment decision-making processes. PROPER regulators expect public disclosure will harness pressure from third-party actors (investors) and that public disclosure through PROPER will be more effective than direct efforts at legal enforcement in Indonesia. An environmental regulator at the MOEF explained that:

Companies care less about the law than they do about PROPER.

PROPER influences the banks. Companies are afraid of the banks because of their loans. They are not afraid of the law,

⁶⁷ The document that informs companies that have improved their compliance level with regulations in the period 2012-2013 can be accessed via <http://proper.menlh.go.id/portal/?view=x&desc=0&collps=102>. Accessed on May 8, 2019.

because they believe that they can win in the courts by paying bribes to court (Interview with Mr S, April 27, 2017, Jakarta).

Such PROPER public disclosure mechanisms are also supported by the mass media in Indonesia, such as the English-language *The Jakarta Post* which is available online and can be accessed by audiences worldwide (*The Jakarta Post*, December 11, 2013). Media such as the *Jakarta Post* improves the reach of PROPER's public disclosure strategy to international audiences, which is important because the DITJEN PPKL only publishes the results for PROPER in the Indonesian language. Tietentberg (1998) has suggested that using non-international languages for public disclosure mechanisms often present critical problems in ensuring this strategy exercises maximum influence on third parties.

Overall, the findings above demonstrate PROPER's public disclosure strategy, which deliberately targets third parties, such as investors, induced behavioural change in Subang's socio-environmental performance, at least initially to obtain the minimum legal compliance level (Blue rating – see further discussion below) as well as to encourage the company to go beyond compliance level. Investors used PROPER ratings in their due diligence processes for approving loans through global bonds. As the users of information published by PROPER, 'green' international investors amplified the influence of PROPER on the company. Given that the state tends not to use more coercive measures to ensure legal compliance, the ways in which public disclosure mechanisms can elicit pressures from third parties on companies is critical for improving their socio-environmental performance.

5.5.2. International investors commitment and action capacity: Global commitment to sustainable investment

The case of the Subang company demonstrates that the national regulator's public disclosure strategy can utilise international investors as a source of regulatory pressure to improve company's socio-environmental performance. Thus the critical question is, under what conditions does this strategy operate to influence international investors to use PROPER ratings for their

investment policy? This subsection argues that the global trend among investors was to increase their ‘green’ commitment to provide ‘sustainable finance’. I also contend that investors have strong action capacity to pressure the company to meet PROPER standards based on this commitment, particularly given the significant degree of capital required by oil and gas companies for production.

As a sector with a high degree of capital investment, oil and gas companies depend on international investors for business expansion. In 2014, the Subang company collaborated with seven international financial organisations by distributing its global bonds to the value of USD 1.5 billion.

Table 5.4. Subang company partners for distributing global bonds in 2014

Name of bank/Financial service company	Country
Barclays	United Kingdom
Citigroup	United States
The Royal Bank of Scotland	United Kingdom
Deutsche Bank	Germany
Bank HSBC	United Kingdom
Mitsubishi UFJ Securities	Japan
Mizuho Securities	Japan

Source: Subang Company Environmental Report, 2015

As detailed in Table 5.4, investors in Subang’s global bonds in 2014 are banks from countries with high ethical standards in investment policy or “green banks”. As “green banks”, the banks listed above have implemented policies to support environmental and social values in business practice. Consider Mitsubishi Bank, one of the investors in the Subang company, that uses sustainable finance goals to guide its investors. In its investment policy, Mitsubishi Bank defines sustainable finance as the

provision of finance for the businesses (including loans, equity investment in funds, an arrangement of project finance and syndicated loans, underwriting of equities and bonds, and

financial advisory services) with reference to the relevant external standards (e.g. Green Loan Principles, Green Bond Principles, and Social Bond Principles) (MUFG, 2019).

Based on the definition above, Mitsubishi Bank categorises sustainable financial goals in managing environmental and social impacts from business. For example, Mitsubishi Bank focuses on the adaptation and modernisation of technology to respond to climate change impacts from business. Some programs seek to address climate change, such as renewable energy programs, energy efficiency improvements, and green buildings (e.g. arrangement of loans and project finance for renewable energy projects, and underwriting and distribution of green bonds). In the social programs, Mitsubishi Bank commits to contribute to poverty alleviation, providing energy to local communities, supporting basic service provision, including public transport, waterworks and airports, and essential services such as hospitals, schools and police (MUFG, 2019).

The sustainable financial policy outlined above pressured Subang to meet not only minimum legal compliance standards but also to obtain a Gold rating. As a debtor under pressure from international investors, the Subang company must implement business practices with reference to global financial standards on environmental and social dimensions in business. In the first instance, meeting minimum legal requirements (Blue rating) in PROPER was one of management's priority programs to access international financial markets so as to have sufficient capital to implement its Long-term Corporate Plan (2012-2016).⁶⁸ Based on this Plan, it needed to increase its access to oil reserves and increase production in the upstream sector. For this to occur, it needed to undertake exploration activities to find and then build new oil well drilling facilities at the Rantau plant as well as other plants across Indonesia. However, such activities are costly. In an interview with a journalist, the Director of Exploration and Production Development at the Subang company highlighted that:

⁶⁸ Confidential interview with top-level management at the Subang company on April 25, 2017.

The cost of exploration (finding and drilling oil/gas wells) averaged between USD 8.06 million-USD 12.09 million per oil well (at an exchange rate at IDR 12,400). In 2014, the State-owned Oil Company's Exploration and Production Unit allocated a USD 400 million (exchange rate at IDR 12,400) budget for drilling oil wells (*Detik finance*, March 9, 2014).

According to the budget for drilling above, the capital required to improve the reserves and production in the upstream sector accounted for 26.7 per cent from total global bonds issued to raise capital in 2014, which reached USD 1.5 billion (Subang company website, 2019). Thus, the Subang company prioritised meeting the demands of investors in global bonds to finance activities in the upstream sector.

Without a good performance in PROPER (minimum Blue rating), the Directorate of Upstream Production could not raise enough funds to finance its oil well drilling plan.⁶⁹ This is one of the reasons why Subang committed so heavily to supporting PROPER. For the company, performing at the highest level in PROPER (and achieving a Gold rating) addressed multiple demands of political actors, environmental regulators and international investors. Investors interested in Subang's global bonds monitored the company's performance in PROPER. They encouraged the company to have more and more plants which obtained beyond compliance ratings (either a Green or Gold rating)

We can see from the discussion above that investors had strong environmental commitment and action capacity. Such conditions bolstered the influence of PROPER's public disclosure strategy on Subang's environmental performance, at least to the level meeting minimum legal compliance standards and often to beyond compliance standards.

⁶⁹ Confidential interview with an employee at the Subang company on April 26, 2017.

5.6. Conclusion

This chapter has described how the national regulator adapted the regulatory strategies of PROPER—promoting environmental performance, providing technical assistance and public disclosure—and the condition under which these regulatory strategies were able to harness multiple sources of pressure to improve socio-environmental performance at the Subang company. As a public voluntary regulation program, PROPER was relatively successful in improving socio-environmental performance at Subang, particularly the Rantau plant from the compliance level (Blue rating) to the highest level of beyond compliance (Gold rating). It was able to elicit broader changes across other Subang subsidiaries over time to reach at least a Blue level, with other subsidiaries (production units) also meeting PROPER's beyond compliance standards.

The discussion in this chapter has shown that the pathways by which PROPER was able to elicit such behavioural change from the state-owned oil and gas company were contingent on the distinct configuration of strategies used and conditions in Indonesia's context. Most importantly, the commitment of Subang's top-level management to beyond compliance standards was the result of the ways PROPER was able to harness direct pressure from political elites and third-party international investors on top-level management. Given the long history in Indonesia of close, reciprocal, beneficial relationships between the oil and gas business and the state that historically shaped the way business was done, PROPER's strategy of promoting environmental leadership by drawing in political elites to pressure companies proved successful. High levels of political leverage over firm management—associated with corporate governance arrangements in which corporate leaders are appointed by influential political elites—enabled the strategy of promoting environmental leadership to influence top-level management to improve socio-environmental performance. Company directors needed the support of influential elites for promotions and appointments at Subang and possibly other SOEs across their careers. The Subang company, including its Rantau plant, also needed strong connections to influential bureaucrats in order to

gain business and environmental permits and to ensure business processes ran smoothly. Influential political actors in turn required political and financial support from the company.

The company's influential international investors were both committed to 'green' sustainable investment policies and had strong action capacity to influence Subang's commitment to environmental standards. These actors recognised PROPER as legitimate and used PROPER's publicly disclosed ratings of both compliance and beyond compliance performance to pressure the company to improve its performance—first to the level of blue across all subsidiaries and then to beyond compliance with either a Green or Gold rating. Such investor commitment was underpinned by sustainable investment policies that require certain social and environmental standards are met by creditors. PROPER's management saw achieving a beyond compliance rating (Gold) in PROPER as the way to meet the demands of multiple actors, both domestically and internationally.

PROPER's technical regulatory assistance strategy, I further contend, was critical to improving company employees' knowledge, who were then able to design and implement beyond compliance programs required by PROPER. This regulatory strategy (as well as the strategy of promoting environmental leadership) succeeded in improving socio-environmental performance at the Subang company due to several enabling institutional conditions. First, the strong capacity (knowledge, skills and budget) of national regulators to provide technical assistance helped the company meet its compliance and beyond compliance standards. However, the process of providing technical assistance also indirectly strengthened relationships between company employees and bureaucrats, which were crucial to smooth business practice.

Second, the centralised authority of the national state government aligned well with the way the oil and gas sector had long operated and the way PROPER was designed, with significant input from oil and gas companies at the outset. While many of the powers to regulate the natural resources sector (at particular scales of licence) are decentralised in Indonesia, regulatory arrangements in the oil and gas sector remain centralised, rendering it easier

for the national regulator to use national-level technical regulations, long acquired sectoral knowledge, and political levers to influence the firm and to introduce discretionary policies to tackle challenges specific to the sector.

The question remains as to whether PROPER can elicit similar kinds of pressures through its public voluntary regulation strategies in private sector oil and gas firms. The next chapter will examine how the national government adopted regulatory strategies and the conditions under which these strategies shaped socio-environmental performance at the biggest Indonesian privately-owned oil company.

Chapter 6

The case of a private oil company

6.1. Introduction

The previous chapter highlighted that in the implementation of PROPER, direct pressure from national political elites at top-level management of the state-owned oil and gas company, together with strong state capacity to support the company with technical assistance, were key institutional conditions that shaped environmental performance. It also highlighted that top-level management was sensitive to the interests of national political elites who both set the direction of the company and make top-level management appointments. Environmental performance was also influenced by pressure from third-party actors, particularly investors in the oil and gas sector and international Civil Society Organisations (CSOs).

This chapter examines how PROPER has been able to influence socio-environmental performance at the privately-owned Tarakan oil and gas company.⁷⁰ Tarakan's performance in PROPER improved from meeting the standards for basic compliance (Blue rating) to meeting the conditions for the highest level of 'beyond compliance' performance (Gold rating) during its participation in PROPER. This chapter argues that pathways by which PROPER induced improvements in socio-environmental performance at the privately-owned oil company is similar to the state-owned oil company case. Improved performance through the implementation of PROPER was enhanced by direct pressure of national political elites on company managers, and company response to pressure from investors in the oil and gas sector who received information about company performance from PROPER's public disclosure strategy. I also argue that the technical capacity of the firm to implement PROPER was crucial to performance by improving employees' knowledge of PROPER, and skills in environmental management and support for community

⁷⁰ I use "Tarakan oil and gas company" due to the confidential agreement with the company. As the researcher, I am not permitted to use the name of the company in this thesis.

development, although such technical capacity was provided by company resources and not by support from the state.

However, I also contend that the motivation of top-level management at the privately-owned oil company to commit to PROPER differs somewhat from the state-owned oil company case. At Tarakan, making the necessary changes to organisational and incentive company structure so as to achieve a Gold rating was driven externally by the nature of business-state relations in the oil and gas sector based on patronage and reciprocity, but also internally by a sense of obligation on the part of the company founder to the state. Top-level management at Tarakan perceived that supporting environmental and social programs in PROPER was a way to 'pay back to the nation', given the advantages the company had experienced in the past.

To investigate the pathways by which PROPER shapes environmental performance at the privately-owned oil company, this chapter proceeds as follows. The next section provides an overview of Tarakan company's performance in PROPER over the last fourteen years (2004-2017). The third section investigates how national political elites influenced the response of the founder of the company – who had a long history of strong political networks with state actors – towards PROPER. The fourth section discusses the ways that PROPER was able to induce behavioural change in environmental performance, partly through its regulatory approach of 'naming and praising' strong performers in PROPER through promotion events, which created competitive pressures on the firm. As the designer of PROPER, Ministry of Environment and Forestry also has an interest in publicly promoting the program by highlighting successful cases so as to garner continued political and budget support from influential state actors, as well as public acknowledgement that PROPER is successful at improving socio-environmental performance in Indonesia. The final section presents analysis of how market actors in oil and gas sector recognise PROPER and use the information provided through public disclosure. International investors and CSOs both use PROPER's rating to monitor Tarakan's environmental and social performance.

6.2. Tarakan's performance in PROPER, 2004-2017

This section overviews the Tarakan oil and gas company's ownership structure and its socio-environmental performance through participation in PROPER over a period of fourteen years (2004-2017). Tarakan is 71.74 per cent controlled by two domestic companies that are owned by one of Indonesia's wealthiest tycoons. The remainder of the share is controlled by public investors that purchase through the international stock market, listed on Indonesian stock exchange. As such, its ownership structure is highly differentiated between domestic and foreign capital.

As with the case of the Subang oil and gas company, PROPER assesses socio-environmental performance at the plant level for the Tarakan company with several production units that may each achieve different ratings in PROPER. However, some sources of regulatory pressure shape the regulatory impact of PROPER at the corporate level. In this discussion, I explore PROPER's rating of the Rimau plant, one of Tarakan's production units.

The Rimau plant, located in South Sumatra Province, participated in PROPER between 2004 and 2017 (The period beyond 2017 is not covered by this thesis.). Similar to the state-owned Subang oil and gas company, the Rimau plant improved its socio-environmental performance rating significantly during this period. As demonstrated in Table 6.1, in the early years of its participation, the Rimau plant met minimum legal requirements in environmental performance, obtaining a Blue rating. Performance improved between 2008 and 2009 and 2009 and 2010 resulting in a Green rating (Green was the highest level achievable in 2009-2010). After that, the Rimau plant performed optimally to achieve achieving the Gold rating over seven years to 2017. Achieving a Gold rating indicates that the Rimau plant implemented not only environmental conservation programs but also contributed to improving the welfare of local communities.

Table 6.1. Performance of the Rimau Plant in PROPER, 2004-2017

Annual assessment	Environmental performance
2003-2004, 2004-2005, 2005-2006, 2006-2007, 2007-2008	Blue (compliance)
2008-2009 2009-2010	Green** (the best level of 'beyond compliance' available in the rating system at the time)
2010-2011, 2011-2012, 2012-2013, 2013-2014, 2014-2015, 2015-2016, 2016-2017	Gold (the best level of 'beyond compliance')

**Green was the highest level attainable prior to the period 2010-2011. The Ministry of Environment and Forestry added the Gold level commencing in the 2010-2011 evaluation period.

Source: PROPER's rating, 2004-2017.

The following sections discuss how institutional conditions intersected with PROPER strategies to induce improvements in environmental performance over time at the Tarakan company. This chapter argues that institutional conditions strengthened the ways in which two of PROPER's regulatory strategies—promoting environmental leadership and public disclosure—were able to harness multiple sources of pressure to improve Tarakan's socio-environmental performance. I also argue that technical capacity to improve performance was important. However, as illustrated below, the regulator of PROPER, DITJEN PPKL (Directorate General of Pollution and Environmental Damage Control), did not provide technical regulatory assistance to Tarakan as it did at the state-owned Subang oil and gas company, because the Tarakan company sought to improve its technical capacity by collaborating with business consultants who conducted in-house training to increase regulatory knowledge.

6.3. Promoting environmental leadership in the private-sector oil and gas company

Promoting environmental leadership through pressure from influential state actors on firms is the first regulatory strategy explored in this chapter. I seek to show that national political elites were able to persuade top-level management at Tarakan to support beyond-compliance levels through competitive pressures introduced at the Environment Awards Night held each year. At the Environment Awards Night, the regulator of PROPER employed political elites in shaping the company's socio-environmental performance in the Indonesian political context. I also seek to show how institutional conditions, in particular the relationship between business and state, enabled this strategy to be effective in motivating top-level management to improve Tarakan's socio-environmental performance.

6.3.1. Promoting environmental leadership to top-level management at Tarakan

Every year, the DITJEN PPKL invites top-level management at Tarakan to attend the Environment Award Night. This is just one of a number of strategies employed by the Ministry to facilitate direct communication between the national government—in particular the Minister of Environment and Forestry (MOEF)—the Director General, and DITJEN PPKL staff and top-level management at Tarakan.

At the Environment Award Night, these influential national state actors as well as subnational influential state representatives, such as Mayors and District Heads, get together with top-level management to discuss informally the role of business for environmental conservation and social welfare. This event is often used by the Minister of MOEF to encourage top-level management to support PROPER. In the case of Tarakan, the Minister of MOEF and Director General of PPKL directly appealed to the founder of Tarakan to support PROPER by aiming to achieve the highest rating, Gold. Gaining support of the private-sector oil and gas company was an important way for the state

to respond to third-party pressure to improve environmental performance. An employee at the Tarakan company explained that:

Mr K [a senior bureaucrat at the MOEF] directly asked Mr AP [founder of the Tarakan company] to support PROPER. This program [PROPER] needs a good company to perform to the highest standard [Gold rating] to show to public that PROPER works as a way of improving socio-environmental performance in Indonesia (Mr I. April 28, 2017, Jakarta).

This direct pressure from the regulator on the founder of Tarakan to seriously commit to corporate environmentalism or beyond compliance values business proved successful, the reasons for which will be explored in the next section. The founder used his commitment to encourage Tarakan senior management to incorporate beyond compliance environmental values into firm structure and incentives. In the company's 2007 annual report the then top-level member of management repeatedly referred to how he was inspired by the founder to organise business priorities and activities based on the principle of "doing more than others" (Tarakan Company Annual Report, 2007). As a family business, the founder still had critical influence on the company's decision making even though he had formally resigned from his position as President Director in 1998. Confidential interviews for this thesis revealed that whenever he attended company meetings, the founder always reiterated that if other companies were satisfied with only meeting the government's basic requirements (Blue rating in PROPER), the Tarakan company must nonetheless aim to meet beyond compliance standards (either Green or Gold rating) to differentiate itself from other companies, so as to gain international market reputation (Mr I. April 28, 2017, Jakarta).

The leadership commitment of the company founder to aim for and support a high standard of environmental and social performance was also echoed by his brother, who joined the Tarakan company as Vice President in 1997 (Tarakan company, 2020). Similarly, all subsequent President Directors (equivalent of CEOs) of the Tarakan company have given the same commitment to "do more than others" in reducing environmental and social

harm that may occur from the company's extractive activities. Such commitment was helpful for the company in obtaining outstanding performance in PROPER.

The commitment of the subsequent President Directors to "do more than others" was then translated by senior management into the internal corporate governance structures of the company, which include the company's internal integrity mechanisms (core values governing business activities and employee behaviour), and standards, real programs and funding allocations. For the Tarakan company, this commitment to environment and social performance not only focussed on PROPER standards, but also sought to make even broader commitments to environmental conservation and stronger contributions to social welfare in the local communities where plants were situated. Thus, the way the Tarakan company internalised its commitment was different to that of the state-owned oil company (SOC) that predominantly used the indicators and parameters of PROPER to structure the organisation and assess staff.

To implement the company's changed internal corporate governance structures and integrity mechanisms, the President Directors of Tarakan introduced 'beyond compliance' projects for assets and production units in 2008. A senior employee stated that:

The management leadership style [of each President Director] is different. Mr Budi [the President Director from 2008 to 2011] supported PROPER [in meeting beyond compliance standards in PROPER]... PROPER provides three benefits: improved public image [given the image of the company was previously tarnished due to the mudflow disaster discussed in Chapter 4 and further below], clean production facilities and accommodation for employees, and minimising the impact of pollution on communities. (Interview with a company employee, April 18, 2017. South Sumatra)

The commitment of Tarakan President Directors to improve environmental and social performance was translated into real company

programs. They supported the Department of Safety, Health and Environment (SHE) of the company to design and implement programs that contributed to reducing environmental pollution from industry processes. They seem not to have undertaken what is known as decoupling, when a company may pretend to do well by communicating its policies to gain legitimacy, but these policies might not result in the implementation of CSR in practice (Bromley & Powell, 2012; Graafland & Smid, 2019, p. 233). Scholars have identified decoupling as a critical problem in relation to how top-level management respond to stakeholders' CSR demands (Crilly et al., 2012; Sauerwald & Su, 2019).

Indeed, consistency between commitment and action of CEOs at Tarakan indicates decoupling did not take place. There were several environmental conservation programs in the Rimau plant's green project. First, the company established a Waste Treatment Centre (WTC) in 2008. This program aimed to reduce the environmental impacts of hazardous chemicals and toxic waste. The WTC is an example of how the Tarakan company went beyond compliance, which is not required by law. The company invested USD 1.5 million in building the WTC (Tarakan Company Environmental Report, 2016b, p. 8).

Second, the company adopted "demulsifiers", a chemical to separate oil and water in the processing of crude oil. Demulsifiers reduced the amount of heating needed to separate oil and water, thus decreasing the company's electricity consumption. Top-level management allocated a budget of approximately IDR 20 billion or USD 153,000 for this program (Tarakan Company Environmental Report, 2016bi, p. 8). These two environmental conservation programs improved the Rimau plant's score in PROPER. The WTC program contributed to improving the score for the indicator of hazardous chemicals and toxic waste management in PROPER. Meanwhile, adopting demulsifiers increased the company's score for the indicators of energy efficiency in PROPER.

To improve the social impacts of such activities, Tarakan's headquarters spent USD 733,523 to finance community empowerment programs in 2016. One program, the Rice Intensification System (System Rice

Intensification - SRI) helped support communities by introducing organic fertiliser for local farmers. The company claims that this program improved rice harvests from 3.5 tons per hectare to 10 tons per hectare (MOEF, 2013, p. 139). The company also established the Association of Sustainable Nature Farmers (*Ikatan Petani Pecinta Alam Lestari* - IPPAL) which has 1000 members from 12 different villages. Through these programs and support from IPPAL, local farmers located near the plant have received organic rice certification (Tarakan Company Sustainability Report, 2017a, p. 48)

The three programs that helped meet beyond compliance standards discussed above demonstrate the support of Tarakan top-level management for improving environmental and social performance under PROPER. The first two programs demonstrate leadership commitment to environmental conservation. Meanwhile, the SRI Organic Rice program included initiatives to improve environmental and social performance. These programs worked well, bolstering the company's performance and shifting its rating in PROPER from Green to Gold.

To reward employees for their efforts in obtaining a Gold rating in PROPER early on, top-level management gave employees special gifts, such as wrist watches and holiday tickets. However, after many years of maintaining its Gold rating in PROPER, such gifts were no longer provided as in management's view "the corporate culture had already shifted to prioritise high achievements in upholding environmental and social standards" (Interview with an employee, Mr H, April 18, 2017, South Sumatra). What we can see from the discussion above is that the commitment of top-level management was key to shifting company culture so as to prioritise and implement environmental and social friendly programs with significant resourcing. Such commitment was externally driven by initial pressure applied by influential state actors responsible for PROPER at top-level management, and internally driven by the values prioritised by the company's founder, which were then translated by top-level management into practical programs implemented by Tarakan's Department of Safety, Health and Environment (SHE).

6.3.2. Historical politico-economic relations of reciprocity and obligation; enabling institutional conditions for promoting environmental leadership

This research was developed to understand why regulatory strategies may be more (or less) effective at harnessing (multiple) sources of pressure in some contexts and not others. Thus, understanding why direct pressure from state actors on Tarakan's founder proved effective in achieving beyond compliance commitment is critical for understanding the outstanding performance of Tarakan company in PROPER. This subsection argues that the strategy of promoting environmental leadership was effective in harnessing the commitment of top-level management at Tarakan, because it activated the strong, long-established political networks of the founder with the state based on reciprocal benefits and mutual obligations. The founder had previously benefited from state patronage and preferential treatment for his companies, especially in the oil and gas industry; and the Tarakan company had also previously been protected from incurring the costs of other environmental disasters committed by its subsidiaries, such as PT Lapindo Brantas (see Chapter 4). Together, these underlying conditions in state-business relationships bolstered the philanthropic commitment of Tarakan to invest in environmental and social programs to solve environmental and social problems in Indonesia under the rubric of a discursive nationalist agenda of 'pay back to the nation'. This was also in line with the broader resource nationalist push at the time, in which politically, economic nationalists were at loggerheads with liberalists (see Chapter 4). The founder of the Tarakan company was a strong supporter of economic nationalists pushing the resource nationalism agenda forward.

The founder of the Tarakan company had long engaged in close relationships with highly influential political actors who had provided many business opportunities and protection, particularly during the Suharto regime. As was discussed in Chapter 4, in the 1980s, Suharto implemented a protectionist policy of preferential treatment for Indonesian companies in the Indonesian oil and gas service industry (Aden cited in McVey, 1992, pp. 89-

102). This policy arose because the government saw that the economic benefits of oil and gas production were often afforded to foreign contractors rather than local (*pribumi*) businessmen in the 1970s and earlier. The new policy aimed to support Indonesian businesses to gain benefits in the oil and gas industry (in addition to those received by the State-owned oil and gas company) from oil and gas commodities and industry services. The founder of Tarakan was one of those *pribumi* businessmen who was a beneficiary of this policy. Without this policy and the finance that followed, the Tarakan company would not have been able to buy the drilling equipment necessary for oil and gas extraction. Support was only provided for “selected” *pribumi* who had close relationships with the regime. Tarakan’s founder set up the Meta Epsi Pribumi Drilling Company in 1980, with financial assistance from Eddy Kowara Adiwinata – the father in law of Suharto’s daughter, Siti Hardijanti ‘Tutut’ Indra Rukmana (Aditjondro 2006, 136)

In the book *Bangkitnya Entrepreneur Nasionalis (The Rise of Nationalist Entrepreneurs)*, the founder of Tarakan explains how Rachmat Saleh (the former Governor of Bank Indonesia, Indonesia’s central bank) helped establish Tarakan (Dahlan, 2017, pp. 230-232) by approving a loan of approximately USD 4 million, based on this policy of privileging young, up-and-coming young Indonesian entrepreneurs. Masuhara (2015) also explores the close relationship between the founder of the Tarakan company and the Suharto regime in her book *The End of Personal Rule in Indonesia: Golkar and Transformation of the Suharto Regime*. Masuhara outlines how this relationship was reciprocal. She identifies the ways the “Ginandjar Boys” (Masuhara, 2015, p. 116), those businesspeople associated with Golkar politicians and businessmen, organised business patrons to provide political and financial support to Sudharmono, a senior member of the Golkar party during the Suharto era. Sudharmono was also the then Minister of the State Secretariat that coordinated cabinet and provided direct support to the President. In the early 1980s, this ministerial position was highly influential as the ministry arranged all of the procurement and contracts for the state’s programs to expand and develop the country, which includes procurement for

projects under the auspices of the state-owned oil company (Sudharmono, 1997). As a member of this group of “Ginandjar Boys”, the founder of Tarakan received preferential treatment and many project contracts from the government greatly expanded his business.

Such preferential treatment was important in the founder’s personal life history and the ways he developed his businesses, and this has underpinned his nationalist commitment and later philanthropy. In 2010, *Forbes Magazine* (March, 2010) identified the founder of the Tarakan company as one of 48 global “philanthropic heroes”. Given this philanthropic commitment and the long history of relations between state and founder based on patronage and obligation; targeting the support of the founder on the part of influential political actors was compatible with the objective of the strategy of promoting environmental leadership.

Promoting nationalism was one of the founder's rationales for encouraging top-level management in the Tarakan company to aim for a beyond compliance commitment to PROPER and obtain either a Green or Gold rating. In his publications and public speeches he has used such discourse to bolster support for improved company performance in environmental management. For example, in his speech at the Institute Technology Bandung on January 23, 2010, he read a poem written by Prijono (the former Minister of Education and Culture) (Panigoro, 2010, p. 181):

With true love until the end of my life
I promise from the depth of my heart
My life and all my wealth
I serve you [my nation].

The founder of Tarakan stated that his decision to read this poem was motivated by both its inspiring words, and how it was aligned with his goal to create better business commitments to the environment, society, and promoting “national dignity” (*Kompas*, April 19, 2010). For the founder, performing at the highest level of PROPER and achieving a Gold rating was not only helpful for the reputation of the company, but also a way of “paying back the nation” through solving the fundamental problems in Indonesian

development, such as environmental degradation and poverty, given the benefits he had received in the past from the state (Panigoro, 2010). Further, the company had suffered some reputational damage previously, given the involvement of its subsidiary company, PT Lapindo, in environmental disasters such as the mud-flow disaster in East Java (FoEI, 2007; McMichael, 2009).

The case of Tarakan company shows that the enabling institutional condition of strong state-business relations in the oil and gas sector historically has had implications for the ways strategies can be used by the state in contemporary policy—in this case in the implementation of public voluntary regulation. The distinctive legacy of relationships between state and private (and state-owned) oil and gas companies based on patronage, reciprocity and obligation provided a strong entry point for influential state actors to directly pressure top-level management of the company. The interaction between this institutional condition and the PROPER strategy of promoting environmental leadership elicited the commitment of the company to aim for beyond compliance outcomes in its socio-environmental performance.

6.4. Public disclosure through “naming and praising”

Another strategy adapted by the state to bolster socio-environmental performance involves public disclosure of company activities through a distinctive “naming and praising” approach. This refers to activities undertaken by the state to publicly acknowledge the achievements of companies, such as in socio-environmental performance. Below, this section argues that this strategy was able to reinforce positive behaviours (such as those undertaken by the Tarakan company) and to encourage similar change in other companies. I also argue that the state varied this public voluntary regulation strategy based on different firm-level conditions between state-owned and privately-owned oil and gas companies. The environmental regulator used this naming and praising strategy to target behavioural change at the privately-owned Tarakan company, given it could not use its direct

authority to instruct the company to set environmental priorities, or indirectly induce company behavioural change through controlling senior appointments, as it was able to do at the state-owned Subang company (see Chapter 5).

Further, I will also argue that the configuration of the distinctive naming and praising approach (and promoting environmental leadership) of the state under its broader public disclosure strategy, together with the underlying institutional conditions of close, reciprocally-beneficial state-business relations, created informal mechanisms by which PROPER regulatory strategies could effectively induce improved socio-environmental performance at Tarakan over time. I contend strong performance in PROPER was critical for Tarakan to gain the support of the state for its business interests, and showcasing such performance offered greater legitimacy for the state in the regulatory effectiveness of the PROPER program.

6.4.1. PROPER strategy: “Naming and praising” as a form of public disclosure to improve socio-environmental performance

The naming and praising approach is a unique regulatory strategy used by PROPER to support behavioural change at the Tarakan company and to encourage other private-sector companies to follow suit. DITJEN PPKL (as host of PROPER) decided to employ naming and praising, instead of technical regulatory assistance for Tarakan, because the company already invested internally in building its technical capacity to change the ways its firm managed the environment and supported social development (to be discussed further in the next section).

The naming and praising approach offers company benefits, in particular reputation building which facilitates a company gain in market share (Prakash & Potoski, 2012; Van-Erp, 2011). With this approach, the DITJEN PPKL promoted outstanding socio-environmental performance at Tarakan in PROPER, especially at the Rimau plant. In so doing, the state reinforced its support for improved environmental performance. In reinforcing this behaviour, the state illustrated how the program met stakeholder demands in environmental management and encouraged similar

changes at other companies. This contrasts with the state-owned oil company that required technical assistance to develop its internal mechanism to improve socio-environmental performance.

To name and praise, the DITJEN PPKL used several tactics, such as conducting public seminars involving multiple companies and observers and hosting a talk show that widely promoted socio-environmental success at Tarakan to mass media.⁷¹ First, the DITJEN PPKL involved the company in seminars organised by the MOEF, and attended by other companies and members of the public. Tarakan representatives were invited to share best practice programs in these seminars, especially those that were environmentally and socially friendly. In so doing, both the state and the Tarakan company were able to demonstrate through this form of public disclosure how its commitment to improving environmental performance met third-party stakeholder and government socio-environmental demands.

For example, in 2018, the manager of the Safety, Health and Environment (SHE) Department at Tarakan was invited by the DITJEN PPKL to present 'green and gold programs' at two seminars: *"Learning from Gold Performers"* and *"Dialogue for achieving a Gold standard in PROPER"*. At these seminars, the Tarakan company shared its strategy for obtaining a Gold rating with other companies participating in PROPER, subnational environmental regulators, and members of the public who attended.

Second, in 2018, the DITJEN PPKL organised a radio talk show to share PROPER's contribution to achieving the Sustainable Development Goals (SDGs) in Indonesia. The DITJEN PPKL collaborated with universities and radio station KLCBS Bandung and invited the manager of SHE onto this talk show. A scholar from Padjajaran University who specialised in sustainable development also participated. In this talk show, the manager of the Environment Department at Tarakan outlined the benefits of naming and praising in PROPER. He stated that:

⁷¹ <http://proper.menlhk.go.id/portal/?view=x&desc=0&collps=274>. Accessed on June 25, 2019.

PROPER provides several benefits [for companies] in several stages. In the first stage, PROPER generates direct benefits for both employees [in green workplace programs] and local communities [in community development programs]. In the second stage, PROPER supports the company in gaining a social license to operate, reducing production costs, and improving investor trust. These benefits are important for a company that has high capital investments [like the Tarakan company]. Investors really care to [sic] the company's commitment to managing the environmental and social impacts of business production processes. Investors can see [the company's performance in environmental management] through the ratings given by PROPER.⁷²

Furthermore, the Tarakan company is also invited by the DITJEN PPKL to participate in its Environment Week Exhibition each year. Selected companies, such as Tarakan, are given free space to demonstrate their environmental and social performance. However, participating companies independently develop their exhibition booths. The Tarakan company received the award for the best exhibition booth at the Environment Week Exhibition in 2017.

In sum, naming and praising is the regulator's strategy to incentivise companies to adopt PROPER and to reinforce the behaviour of high performing companies with advanced knowledge and skills on social and environmental. This regulatory strategy for public voluntary regulation is shaped by conditions at the firm level—we can see that technical assistance was provided to companies that need to build their internal knowledge (such as the state-owned oil company) and high performing companies in environmental management under PROPER were instead named and praised. Regulators selected the appropriate regulatory strategy to induce behavioural change in companies based on distinctive conditions at firm level. The case of

⁷² <http://proper.menlhk.go.id/portal/?view=x&desc=0&collps=274>. Accessed on June 25, 2019.

Tarakan demonstrates that understanding firm-level internal capacity and other variables is important for determining the appropriate regulatory strategy in public voluntary regulation to induce social and environmental behavioural change.

6.4.2. Enabling institutional conditions for effective “naming and praising” strategies; close state-business relationships based on reciprocity and obligation

This section explores both the underlying institutional conditions of the regulatory target (the company) and the regulator which contributed to effectiveness of “naming and praising” strategies. Here, I show that the strategy of naming and praising was adapted by DITJEN PPKL due to conditions at firm level and the regulator's interests. This subsection argues that at firm level, employees have knowledge and skills to perform at beyond compliance level, and therefore they do not need technical assistance from the state. The company collaborates with private consultants to improve employees' knowledge and skills in relation to beyond compliance standards. The regulator of PROPER needs the naming and praising strategy to show the public that the PROPER program is successful in improving socio-environmental performance. Legitimation is not only needed by the regulatory target (companies) but also the regulator.

Socio-environmental performance at the firm level

With top-level management's commitment at Tarakan to go beyond compliance in its environmental management and social programs, the company took the initiative to improve employees' knowledge and skills in PROPER without state assistance. Tarakan sought various sources of knowledge and technical assistance from universities, education training centres, and consulting firms to improve employees' knowledge and skills on how to manage environmental and social impacts in business activities. For environmental aspects, for example, the company organised training on organic waste management, toxic and hazardous chemical waste management, and biodiversity and air pollution control for staff. It also sought to build

knowledge and skills for designing and carrying out community development programs. Table 6.2 details some of the training programs conducted by the company.

Table 6.2. Tarakan company training programs on managing environmental and social impacts of oil and gas production

No.	Training topic	Schedule	Training provider
1	Community Development	June 26-29, 2012	Corporate Forum for Community Development (CFCD) (a consulting company)
2	Law No. 18/2008 on Waste Management	April 3-5, 2013	Benefita (a consulting company)
3	Government Decree No. 74/2001 regarding toxic and hazardous chemical waste management	August 26-29, 2013	Centre of Education and Training of Oil and Gas (education institution)
4	Decree of Minister of Environment No. 29/2009 regarding biodiversity conservation	April 21-24, 2014	POWERINDO NS (a consulting company)
5	Government Decree No. 41/1999 regarding air pollution control	August 19-21, 2014	Sepuluh November Institute Technology (University)

Source: Tarakan company's environmental reports on PROPER, 2016.

With such commitment and investment in programs and staff training, the Tarakan company obtained the best level in PROPER (Gold rating) for seven consecutive years (data analysed until 2017). This performance

demonstrates that employees gained the knowledge and skills to design and implement programs that required a Gold rating in PROPER; and together with the financial investment in programs discussed in the previous section, the company was able to achieve observable results. All plants at Tarakan have met the beyond compliance standards in PROPER, either gaining a Green or Gold rating. The high socio-environmental performance at firm level influenced DITJEN PPKL's decision not to provide further technical assistance to build the capacity of the company to meet public voluntary regulation standards. This firm-level condition is different from that of the state-owned oil company, with many plants that still only meet basic compliance standards (Blue rating).

The Subang and Tarakan cases clearly demonstrate that technical assistance is critical for companies to reach the best level of performance (Gold rating) in PROPER. Government often subsidises technical assistance to attract companies to participate in public voluntary regulation (Lyon & Maxwell, 1999). Technical assistance improves employees' knowledge and skills to develop strategic planning and implementation of beyond compliance programs, in line with standards assessment of PROPER. However, the cases of the two oil companies—the privately-owned Tarakan company and the state-owned Subang company—show that while building the technical capacity of companies to meet public voluntary regulation standards is necessary to go beyond compliance, such technical assistance does not always need to be provided by the state. Companies can also draw on consultants and other expertise to improve employee's knowledge and skills on public voluntary regulation, especially if there are technical capacity gaps on the part of the state, although the support of top-level management is critical for ensuring sufficient budget allocation to invest in such knowledge-building initiatives.

The interest of regulators in "naming and praising"

In addition to understanding firm-level conditions when developing strategies to implement public voluntary regulation, we also need to consider what motivated the DITJEN PPKL's decision to employ a "naming and praising"

approach. This subsection argues that if public voluntary regulation is to influence the behaviour of firms, the state needs political backing and public recognition of the effectiveness of PROPER.

As a lower-middle income developing country, Indonesia has a limited financial capacity to finance its programs and strategies. Each ministry has a specific allocated budget from national government for its programs. Each ministry allocates budgets across directorates in its organisational structure. Each directorate must show that its programs, such as PROPER, perform well in meeting regulatory objectives to gain further funding allocations in subsequent years.⁷³ Naming and praising is one strategy used by regulators to demonstrate to influential political elites and the public (and to other companies) that its programs are working, and that participants in PROPER not only comply with environmental legal regulation but also go beyond compliance standards to achieve a Gold rating. This garners support not only for the program but also secures future budget allocations to finance the program.⁷⁴

To support the naming and praising approach, the DITJEN PPKL not only offered free “booth space” in exhibitions, but also used both formal and informal pressure to ensure that Tarakan participated in the government’s exhibition. As mentioned above, the MOEF regularly invites the Tarakan company to participate in its Environment Exhibition Week. A senior bureaucrat at the MOEF said that a formal invitation is necessary to exercise its authority and pressure the company to participate in the program.

A voluntary event does not mean [that participation occurs] without intervention. As a regulator in a developing country, we [the regulators] have to intervene to encourage them [the companies] to undertake actions to meet our regulatory objectives [in PROPER]. Approaching a company [through sending invitation letters] applies maximum pressure to

⁷³ Confidential interview with a high-level bureaucrat at ministry level on April 27, 2017.

⁷⁴ Ibid.

companies to join in the programs [publication events]
(Interview with Mr K, April 27, 2017, Jakarta).

In the Indonesia context, given its history of authoritarianism and the ways that decisions have long been communicated based on bureaucratic formalities and processes which entail sending instruction letters, edicts and other written orders, it is unsurprising that receiving an invitation letter from government elicits a high participation level from companies.

However, in addition to the formal invitation, the MOEF also frequently communicates personally with Tarakan managers to ensure their participation, including in exhibition events. For example, a senior bureaucrat at the MOEF frequently communicates through personal phone calls and the WhatsApp message with the manager of the Safety, Health and Environment (SHE) department at Tarakan to talk about PROPER and other government events (Mr I, April 28, 2017, Jakarta). Such informal interpersonal communication pressures companies to participate in PROPER.

Participating in government exhibition programs has reciprocal benefits for the company, in improving its reputation. Even though companies get free booth space, they must develop their booths themselves and according to interviews, such participation can be costly, particularly when events are held over several days. An employee at the Tarakan company explained that:

Participation in [annual MOEF] exhibitions needs up to IDR 300 million or about USD 22,146 (exchange rate at IDR 13,546). The funds are used for booth decorations, the extra time for labour to run the booth, to compensate local communities who live around the plant [to come to the event] to share information about community development programs at the exhibition, for accommodation, and for transportation (Mr E, April 18, 2017. South Sumatra).

Although it is costly from the company's point of view, Tarakan always participates in the exhibition week as participating in government-organised events improves not only the Tarakan brand image but also its relationship with the state. Interviewees revealed that Tarakan needs government support

to obtain valid environmental permits in a timely fashion; good relationships smooth this process. In the view of the company, delayed environmental permits are more costly when compared with the cost of maintaining a good relationship with government, for example, through participation in exhibitions and other promotional activities.⁷⁵

“Help me, help you” is the simple phrase used by interviewees to describe the relationship of reciprocal benefit and obligation between the DITJEN PPKL and the Tarakan company, which underlies both the ‘naming and praising’ approach used in PROPER and its strategy of promoting environmental leadership.⁷⁶ This is a good example of the way underlying institutional conditions of state-business relations, which have their basis in mutual reciprocal benefits for each (see Chapter 4), create informal mechanisms by which regulators are able to harness sources of pressure on companies that in turn render the strategies used by PROPER effective. From the discussion above, we can see benefits for both the firm (the regulatory target) and the state (the regulator).

6.5. The PROPER strategy: Public disclosure and harnessing pressure from third-party actors

This section focuses on PROPER’s other public disclosure strategy of sharing information on the environmental performance of companies with third-party actors (investors, CSOs and local communities) through its rating system (and other information). This section argues that this strategy, including the PROPER rating system, has helped to elicit pressure from these investors, international CSOs and local communities on the Tarakan company to improve socio-environmental performance. I discuss such pressure from each of these actors in turn, and the response from and benefits to the company through its participation in PROPER.

This section argues that the effectiveness of this strategy has been bolstered by the commitment and capacity of third-party actors to pressure

⁷⁵ Confidential interview with senior employee at the Tarakan company on April 18, 2017.

⁷⁶ Confidential interview with high-level bureaucrat at ministry level on April 27, 2017.

companies. Investors have high capacity to pressure companies given the needs of the oil and gas sector for capital, and high commitment as the reputation of global investors can be damaged by naming and shaming strategies used by international CSOs when environmental performance of investments is poor. Further, domestically, democratisation has bolstered the capacity of civil society to exercise voice and rights and contest business activities that are detrimental to local environments, or have little benefit for local communities.

6.5.1. International Financial Corporation (IFC)

In the oil and gas sector, as with the state-owned oil company (see Chapter 5), harnessing pressure from international investors through public disclosure strategies is critical for PROPER to induce behavioural change in companies. As a sector requiring a high degree of capital investment, oil and gas companies depend on international investors to expand their businesses. This subsection discusses how the Tarakan company used PROPER in its interaction with global social and environmental standards, particularly the International Financial Corporation (IFC), which provided investment services under the umbrella of the World Bank Group.

IFC is one of the most powerful global financial actors which adopts high standards on socio-environmental performance. IFC exercises such leverage via developing socio-environmental standards that must be met by debtors as a condition of its loans. Companies such as Tarakan can access capital from the IFC if they meet certain conditions. This subsection argues that market actors (particularly global investors) used information provided through public disclosure under PROPER to pressure companies to improve socio-environmental performance at Tarakan.

The Tarakan company needs high capital investment from international financial markets to develop its business. International creditors for the Tarakan company include the IFC, the Hongkong and Shanghai Bank Corporation Ltd., Standard Chartered Bank, ANZ Bank Ltd, Mizuno Bank Ltd and the Bank of Tokyo-Mitsubishi UFJ Ltd (Tarakan company's financial

statement, 2018, pp. 169-189). From these financial institutions, Tarakan had liabilities of USD 3.89 billion in 2018. This was more than twice that of Tarakan's liabilities in 2012 (USD 1.81 billion) (see Figure 6.1 below).

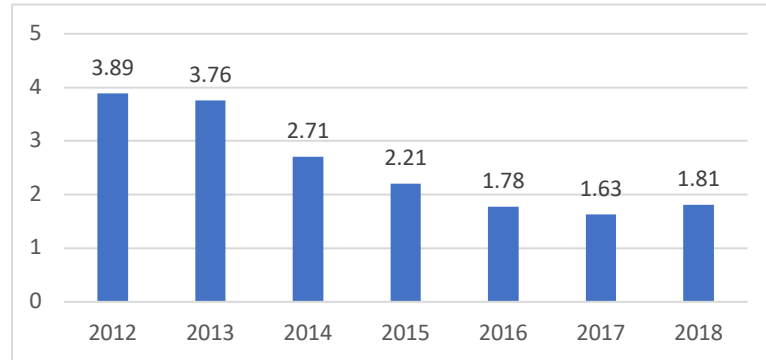


Figure 6.1. Total liabilities (short and long term) (USD billions)

Source: Tarakan company's financial reports, 2012-2018

Such reliance on international investment gives investors significant influence on the company. If investors have an interest in encouraging socio-environmental performance in environmental management in companies, they can apply pressure on their creditors. This is indeed the case with the IFC. The IFC uses both the compliance level (Blue rating) of PROPER in its criteria for companies to access capital, as well as its own beyond compliance Performance Standards that require implementing environmental conservation programs not required by law (Lyon & Maxwell, 1999). Global scholars of CSR perceive that the IFC Performance Standards are one of the strongest, existing CSR performance standards globally (Abbott & Snidal, 2010). Economic benefits provided by the IFC allows it to engage in "directive orchestration", imposing both minimum legal requirements and beyond compliance aspects of its Performance Standards as mandatory conditions on clients that access IFC capital (Abbott & Snidal, 2010, p. 327).

However, defining beyond compliance standards became a subject of debate between the IFC as an investor and the Tarakan company. Tarakan took the initiative to use its Gold rating in PROPER as a means of negotiating the criteria of what is understood to be beyond compliance performance in the eyes of the IFC. A manager in the environmental department at Tarakan explained that:

There are different local and international requirements [for environmental and social performance]. A Blue rating is sufficient for local banks; however, we need beyond compliance ratings [either a Green or Gold rating] to negotiate with the IFC (Interview with Tarakan company employee, Mr I, April 28, 2017, Jakarta).

The IFC fully accepted Tarakan's compliance (Blue rating) in PROPER, but it wanted to conduct its own verification that the company had met the IFC's beyond compliance Performance Standards in environmental and social performance. With its Green and Gold PROPER ratings for different plants, the Tarakan company was confident it could negotiate with the IFC in defining what beyond compliance environment and social commitment should be. An employee at Tarakan said that:

The IFC only recognises the Blue rating in PROPER to indicate compliance [in terms of meet the minimum legal requirements], as this is one of IFC Performance Standards. However, for beyond compliance ratings, the IFC does not recognise what the company has [already] done. In my view, this [beyond compliance ratings in PROPER] is relevant for IFC [standards]. For example, the IFC proposes [that companies introduce] biodiversity programs, but PROPER also has biodiversity programs. However, there are different perspectives between the IFC and PROPER. The IFC focuses on the impact of business activities [or impact based measures] on the environment. PROPER adopts an ecosystem-based approach. Based on this example, PROPER has better standards than the IFC (Interview with an employee, Mr I, April 28, 2017, Jakarta).

These statements demonstrate how the employee at the Tarakan company compared the IFC Performance Standards and PROPER's indicators. He argues that PROPER might adopt a stronger standard compared with that of the IFC, particularly from the standpoint of biodiversity. The IFC uses direct impact assessments for its Performance Standards. Direct impact assessment

in this instance refers to the loss of biodiversity, which is directly related to human activities (or company) activities (Geneletti, 2003). However, Geneletti (2003) argues that the impact of human activities on biodiversity can be both direct and indirect, including loss of habitat (p. 344). Thus, an ecosystem approach is needed to anticipate the indirect impact of business activities on biodiversity. The ecosystem-based approach in PROPER not only deals with direct environmental impacts, such as pollution, but also better accommodates indirect impacts of business activities on biodiversity.

However, at the time this research was conducted, negotiations continued and as the client, Tarakan was under pressure to comply with the IFC's existing Performance Standards. In general, Tarakan agreed with these Standards, but challenged some of the details and ways of practically implementing these Standards, such as the IFC's requirement of a baseline of study to mitigate the business impact on the environment (interview with an employee, Mr I, April 28, 2017, Jakarta). At the end of the negotiations, both the IFC and Tarakan compromised. For those projects/company activities financed by the IFC, Tarakan would fully comply with the IFC's beyond compliance Performance Standards (normally applied to all business activities of a company regardless of whether the IFC funded these or not). For those projects not funded by the IFC, a Gold rating in PROPER was sufficient.

The examples above illustrate that first, defining what constitutes beyond compliance is contested among stakeholders. Further, investors have the power to pressure companies to exhibit particular behaviours through financing arrangements. Companies with strong performance, in particular domestic beyond compliance programs such as PROPER, can increase their bargaining power vis-à-vis investors and could challenge beyond compliance standards used by international investors.

6.5.2. Friends of the Earth International

The Tarakan company also took the initiative to use PROPER's rating as an instrument to respond to 'naming and shaming' movements in global civil society, who criticised the company and damaged its reputation. Friends of the

Earth International (hereafter referred to as FoEI) led the global naming and shaming movement that publicly criticised the Tarakan company due to its contribution to the environmental mudflow disaster in East Java, Indonesia, described in Chapter 4 and in more detail below. When production activities have negative impacts on communities or the environment through public naming and shaming, this has the potential to damage the reputation of a company in the eyes of investors, consumers, regulators and local communities. This subsection argues that the naming and shaming approach by the FoEI motivated Tarakan to change its behaviour and meet beyond compliance standards in PROPER, so as to improve its reputation in the global oil and gas industry.

To summarise, in earlier discussions in Chapter 4, on May 29th 2006, hot mud began spurting from the ground near a PT Lapindo Brantas (a subsidiary of Tarakan) oil and gas well. This led to an environmental and social disaster—the mudflow continued to erupt for months, flooded 19 villages in three subdistricts, and 90,000 people became refugees (*Kompas*, June 15, 2016). The mudflow disaster polluted the marine and coastal environment of the nearby Java Sea. The livelihoods and subsistence of thousands of people who depended on marine and coastal resources (fish, shrimp, etc.) were impacted (McMichael, 2009; Muhtada, 2008).

In response, FoEI mobilised global actors, including the mass media and investors, to shame the parent company, Tarakan. The company had a 32 per cent share of PT Lapindo Brantas, while 50 per cent was owned by Mega Persada Energy, and 18 per cent was owned by Santos Ltd, an Australian company (FoEI, 2007, p. 6). The FoEI published three documents, which shamed the Tarakan company: (1) Major international banks finance catastrophic mud volcano: Lapindo Brantas is shirking its responsibility for the damage, (2) Lapindo Brantas and the mud volcano Sidoharjo, Indonesia, (3) The financing of the three Brantas PSC companies.⁷⁷

⁷⁷ <https://www.business-humanrights.org/pt/node/86461>. Accessed on May 17, 2019.

In these documents, the FoEI explores the contribution of Tarakan to the mudflow disaster. Furthermore, this CSO also sent a letter to investors that financed the Tarakan company, including Credit Suisse, Deutsche Bank, Standard Chartered Bank, UBS and United Overseas Bank, demanding they pressure the company to improve its socio-environmental performance. FoEI also threatened to publicise that these background financiers were contributing to environmental disasters through the companies they invested in (FoEI, 2007, p. 9). Such pressure from the CSO was successful. An employee at Tarakan stated that:

Yes of course [the impact of mudflow disaster], had an impact on the company because we are among those [that] were sued [by CSOs] at that time [2007] (Interview with an employee, Mr I, May 17, 2019, via phone).

As a publicly listed company, Tarakan had concerns for its corporate image from this public criticism by CSOs and the mass media, as both publicly reported that the company contributed significantly to the mudflow disaster (Ind, 1997, p. 21; Novenanto, 2009).

The Tarakan company responded to the naming and shaming by developing the “Green Achievements Project in PROPER” at its Rimau plant. This project was designed to improve its green reputation because of the mudflow disaster. Top-level management selected PROPER as one of the certification programs to show to international CSOs and investors that the company was committed to meeting not only the minimum legal requirements required by the Indonesian government, but also to meet the beyond compliance standards of programs such as in PROPER for all its production units. As illustrated in Figure 6.2, we can see from the timeline that the Green Achievement Project for the Rimau plant that improved socio-environmental performance at Tarakan cannot be isolated from the naming and shaming movements by CSOs that preceded the company’s participation in PROPER.



Figure 6.2. Background to “Green Achievement Project”

After three years (2006-2008) of facing corporate image and reputation problems, Tarakan implemented its Green Project at the end of 2008. The company, particularly its Rimau plant, obtained a Green rating, or met what was then the highest beyond compliance standards in PROPER for the first time in 2009. Tarakan maintained its performance at the Green rating level up to 2010, then improved its performance to the highest rating in PROPER in Gold in the ensuing years (2011-2017).

The interaction between the Tarakan company and CSOs demonstrates that public disclosure functions not only in the way CSOs use information provided by public disclosure, but also how a company takes the initiative to use public disclosure to improve its reputation to CSOs as well as investors. The Tarakan company used the public disclosure mechanism of PROPER to provide information about socio-environmental performance to CSOs and market actors: even though these actors did not specifically request information about its participation and performance in PROPER. However, these actors rely on certification programs, and there is no other program available for Indonesia that can be used to show socio-environmental performance in the Indonesian oil and gas sector. Therefore, PROPER’s rating is accepted by international CSOs and market actors in oil and gas for their decision to the Tarakan company. Third-party actors (investors and CSOs) enabled PROPER to shape socio-environmental performance at the Tarakan company.

6.5.3. International actors' environmental commitment and action capacity

The case of Tarakan company demonstrates that the public disclosure strategy used by PROPER provided a mechanism by which pressure is garnered from international actors, in this case the IFC and FoEI, on companies to change environmental management behaviours. These international actors used the Blue rating in PROPER to evaluate whether a company complies or not with environmental regulations in the Indonesian jurisdiction and beyond compliance (Gold rating) to assess commitment to environmental management. The company also used its publicly disclosed Gold rating in PROPER as the instrument to negotiate with international actors. The critical question then is, what are the conditions under which international actors are willing to use PROPER's ratings to evaluate socio-environmental performance at Tarakan?

This subsection argues that the commitment of influential actors to global standards on sustainable investment or finance, and their capacity to exercise this commitment by applying pressure on companies, is one of the institutional conditions which help the public disclosure strategy to be effective in encouraging behavioural change at Tarakan. In many cases, both investors and CSOs have developed standards on sustainability to guide businesses in how to undertake their activities in sustainable ways to minimise social and environmental impacts while adding value to firms (IFC, 2012, p. 1). This subsection illustrates such commitment applied through standards by third-party actors on companies.

The IFC developed its Performance Standards to ensure that all clients (debtors) manage their businesses according to guidelines on sustainable business practice. The IFC's performance standards cover eight issues and demonstrate their commitment to ensuring that the companies they finance are undertaking efforts to sustainably manage social and environmental aspects of their business. These standards include: (1) assessment and management of environmental and social risks and impacts, (2) labour and working conditions, (3) resource efficiency and pollution prevention, (4)

community health, safety and security, (5) land acquisition and involuntary resettlement, (6) biodiversity conservation and sustainable management of living natural resources, (7) indigenous peoples, and (8) cultural heritage.⁷⁸ The IFC developed its performance standards to help businesses manage risk and to bolster sustainable business practice in terms of managing social and environmental impacts. The concept of risk management refers to anything that might interrupt or disturb a company in meeting its business objectives, such as profit making and good corporate image (Felea & Albastroui, 2013, p. 57). As the IFC explained:

Businesses can act on sustainability concepts to capitalise on opportunities and to address risks, both in the short and long term. To improve financial margins, businesses can operate in a way that conserves resources, respects stakeholders and improves relationships (workers, employees, and communities), and manages and/or mitigates risks to business success (IFC, 2012, p. 1).

One risk the IFC is particularly concerned about is company compliance with domestic regulations. Each jurisdiction has different regulatory requirements—the same production activities could be compliant in one jurisdiction but not in another. Thus, the IFC relies on domestic certification systems, such as PROPER, to define regulatory compliance with domestic environmental regulations. The Blue rating in PROPER demonstrates that the company has complied with environmental legal regulations in the Indonesian jurisdiction. The significant negotiation of beyond compliance standards between the Tarakan company and the IFC is evidence of the latter's commitment and capacity to take action on pressuring companies to meet the standards. Such institutional conditions of third-party commitment and action capacity have given greater effect to PROPER public disclosure and other strategies in harnessing third-party actors to pressure companies to meet these standards.

⁷⁸<http://www.ifc.org/wps/wcm/connect/608f3a804942f69aaa86fe4f5ddda76e/SustainabilityPolicy.pdf?MOD=AJPERES>. Accessed on April 17, 2019.

As discussed above, Tarakan senior management is aware that international investors are concerned with the environmental and social aspects of business activities, both compliance and beyond compliance performance, and that this can affect their access to credit. Tarakan uses PROPER to demonstrate its socio-environmental performance to investors. A senior employee at Tarakan stated that:

At that time [2009], Mr Budi [President Director, 2008-2011] said, we [the company] are seeking a new loan. Then, he said to me, *Bang* [a term of address indicating close relations of that of an older 'brother'] please ensure we keep PROPER [our beyond compliance performance] (Interview with an employee, Mr H, April 18, 2017, South Sumatra).

Influential international non-government organisations, such as the FoEI, also capitalise on company dependency on loans to pressure companies. The FoEI involved investors in its naming and shaming movement in damaging the Tarakan reputation, who were willing to pressure the company after receiving the abovementioned letter from FoEI. The investors that agreed to participate in the naming and shaming, as previously discussed, included those international financial organisations that invested in Tarakan: Credit Suisse, Deutsche Bank, Standard Chartered Bank, UBS and United Overseas Bank to induce behavioural change at Tarakan (Friends of the Earth International, 2007, p. 9). Involving investors succeeded in pressuring Tarakan to change its behaviour and recover its reputation in the eyes of investors through PROPER.

In sum, the institutional condition of third-party actors environmental commitment and capacity to pressure companies provided mechanisms by which PROPER's public disclosure strategy was better able to induce behavioural change in the Tarakan company. International investors required the debtors (such as the Tarakan company) to comply with the domestic environmental legal requirements, which PROPER ratings for the company were able to demonstrate. Furthermore, Tarakan company also took the initiative to use PROPER as the tool for demonstrating the beyond compliance

performers, even though international actors such as the IFC did not fully accept the beyond compliance standards of PROPER.

6.5.4. Pressure from local communities

Local communities are another source of third-party pressure that PROPER can harness to induce behavioural change at the privately-owned Tarakan company. This subsection argues that local communities' demands motivated Tarakan to publicly disclose its PROPER rating to obtain a social license to operate in the region, so as to reduce conflict. Local communities pressured the company for strengthened social and environmental commitments through either 'soft' approaches such as proposals or discussions, or through more conflictual approaches such as public protests or demonstrations. To reiterate the discussion in Chapter 4, the concept of a social license to operate refers to the condition in which a company's behaviour meets societal expectations and avoids any activities that societies (or influential elements within them) deem unacceptable (Gunningham, 2004, p. 308). Under PROPER, indicators of community development are relevant for Tarakan to gain a social license to operate in relation to local communities.

Pressure from local communities was not discussed in Chapter 5 in relation to the state-owned oil company, as the Subang plant on which this research is focussed was established under Dutch colonial administration, when there were no communities living in the area at the time. Any recent arrivals living in the area do so with the permission of the company. This is a different situation to Tarakan, established more recently during democratic transition. Local communities now have stronger property rights and can challenge company activities in concession areas, giving them greater bargaining power vis-à-vis that of the company. Initially, the Tarakan company organised the relocation in order to establish its plant. These local communities are quite isolated and live in remote areas, with relatively limited access to services. It takes three hours by car to reach Palembang, the capital city of South Sumatra Province in which the communities are located, and much longer by public transport. Some of these communities continue to

contest company activities from their new location, which is still near the concession area and as such affected by its production activities.

One of the demands from local communities situated around the plant is for the Tarakan company to implement more Corporate Community Development (CCD) programs. CCD programs are those often grouped under the umbrella of CSR that have led to corporations increasingly playing a direct role as a development agent (McLennan & Banks, 2018, p. 119). Providing public infrastructure, income-generating activities, charity services and supporting religious organisations are common CCD programs in Indonesia (Chambers et al., 2003). CCD programs were introduced by Tarakan to address increasing problems emerging in relation to local communities and CSOs complaints in the post-authoritarian era in Indonesia.

Conflicts between local communities in South Sumatra Province and oil and gas companies in the province are common. According to the head of the Special Task Force for Upstream Oil and Gas (SKK MIGAS) for South Sumatera region, this region is one of Indonesia's oil and gas 'red zones' (Interview with a SKK MIGAS staff member, Mr T, April 20, 2017, South Sumatra). In red zones, conflicts between companies and communities are much more frequent than in other areas. Thus, oil and gas companies in South Sumatra are vulnerable to social incidents which disturb and delay their productivity.

The above statement from the Head of SKK MIGAS South Sumatera region confirmed secondary data published by SKK MIGAS, which shows that social unrest was one of the top problems in upstream oil and gas activities, contributing 28% of total business barriers in 2015 (SKK MIGAS Annual report, 2015, p. 23). Furthermore, the Head of SKK MIGAS also explained that democratisation at the national level, and poverty at the local level, explain why communities in South Sumatra attack companies more than in other areas where the standard of living is higher (Interview with a SKK MIGAS staff member, Mr T, April 20, 2017, South Sumatra).

Communities that see themselves as traditional owners of natural resources perceive Tarakan to be stealing their natural resources. Thus, disrupting company production is one strategy communities use to bargain for

more benefits from oil and gas extraction. The head of a local CSO illustrated this situation by stating that "like a tree, you [communities] have to shake it [company] to get the fruits [benefits]" (Interview with an CSO leader, Mr U, April 20, 2017, South Sumatra). Community protest, illegal tapping, pipe destruction, theft of well equipment, and blocking roads are common types of disruption in upstream oil and gas activities.

The regulatory design of PROPER, particularly the Gold rating, helps the company to reduce social unrest and gain a social license to operate. A senior employee at Tarakan said that:

Our community development programs have the aim of risk management [securing the business production and management of relationships with local communities]. So, this can reduce production costs. *Alhamdulillah* [Islamic expression to thank god for blessings] community development programs align with the Gold rating assessment in PROPER, as we [the company] can use the Gold rating to communicate with local communities (Mr H, April 14, 2017, South Sumatra).

This statement indicates that the company took the initiative to aim for a Gold rating in PROPER, to improve communications with local communities in seeking a social license to operate. Tarakan perceives PROPER as a credible national certification program, which is accepted by local communities.

Maintaining ongoing production is not an easy task for employees at the Rimau plant as they must mitigate a number of technical and social risks. There are challenges of technical failures, but also the disruption to activities from protesting communities. According to the production manager:

I am confident that staff responsible for production can handle the technical problems, but not I am less sure they can manage social issues. Every day, I spent more time handling social issues compared with technical problems (Interview with Mr D, April 19, 2017, South Sumatra).

Meanwhile, interviews revealed that communities are not familiar with global certification standards, such as the ISO 14001 concerning environmental

management, or IFC's Performance Standards. Local communities are, however, familiar with government programs such as PROPER. The PROPER rating provides official evidence and accessible language for observers, including communities, who describe the company's environmental and societal commitments (Interview with a company's staff, Mr I, April 28, 2017, Jakarta). PROPER simplifies the complex indicators that measure socio-environmental performance through the five colour codes (Black, Red, Blue, Green and Gold)⁷⁹, which help communities understand the complexity of companies' environmental compliance. One of the local CSO leaders said:

PROPER is only for the best companies [with environmental and social programs]. Only the best companies will get high PROPER [ratings]. In this area, only the Tarakan company gets good PROPER ratings. Other companies [mostly palm oil] do not get PROPER [ratings]. They have CSR budgets but do not deliver programs to communities. But only PROPER is able to minimise vandalism [illegal tapping of oil wells and pipes and illegal disruption], although this program [PROPER] is not able to stop those activities completely (Interview with an CSO leader, Mr U, April 20, 2017, South Sumatra).

Interviewee views, such as those above, demonstrate how communities perceive PROPER and its function in securing production. PROPER increases the company's public image in communities—a company with a Gold PROPER rating is perceived by communities as a “good neighbour”.⁸⁰ Many interviewees stated that a company with a Gold rating not only cares about environmental pollution but also provides many community development programs.⁸¹ Such views show that PROPER can be an effective instrument to communicate with local communities. While there may be varied views in communities on PROPER or company activities, nonetheless awareness of the program and its rating system was apparent during the research, as was the

⁷⁹ See the explanation of these five colour codes in the chapter introduction.

⁸⁰ Confidential interviews with a leader in local communities, on April 18-20, 2017.

⁸¹ Ibid.

fact that the company must undertake CCD programs to meet government beyond compliance requirements, and CSOs supporting communities use information provided through PROPER to pressure companies.

6.5.5. Democratisation: An enabling institutional condition

This research was undertaken to understand related institutional conditions in relation to how regulatory strategies of PROPER shape company socio-environmental performance. This section argues that democratisation in Indonesia has been critical for creating institutional conditions in which civil society organisations and communities have greater capacity to exercise voice and influence to hold companies accountable, and such conditions bolster the effects of PROPER's public disclosure strategies. While communities are not entirely dependent on companies for subsistence (thereby limiting the likelihood they will make demands on companies), under democratisation they are better able to exercise property rights and pressure companies to change processes which adversely affect them. This is less so in relation to the state-owned company (SOC) discussed in the previous chapter, as there are fewer people residing in the licence area, and the Subang company has long had complete control of the land where their plant is located.

Democratisation refers to political processes of movement aimed at establishing a democratic political system (Yu & Guo, 1997, p. 69), which acknowledge political rights and civil liberties including CSOs' freedom (Freedom House, 2019). As such, democratisation enables local communities to speak more freely than might be the case under authoritarian regimes, including competing company activities.

Indeed, democratisation has changed the institutional conditions around oil and gas, particularly in relations between the company and local communities. Under the prior authoritarian regime, oil and gas companies were not under pressure to build good relationships with local communities and seek a social license to operate, as they were supported by the Indonesian military. Rieffel and Wirjasuputra (1972) argue that companies in the oil and gas industry under the Suharto regime were essentially military enterprises.

Oil and gas companies could ignore local community demands for community development programs because of military support in suppressing such demands.

With democratisation, maintaining good relationships with local communities has been critical for all oil and gas companies, both state-owned and private-sector companies such as Tarakan. Civil society (both organisations and communities) gained momentum and became more active after the fall of the Suharto regime, which had previously restricted political and social rights in Indonesia (Nyman, 2009, p. 256). The manager of production at Tarakan stated that:

Disruption from local communities, for example demonstration(s), blocking the roads that access production facilities, destroying pipelines, is on the list of the top ten problems encountered in production activities....Euphoria over democracy has meant that local communities do as they wish [to contest and protest company activities] (Interview with Mr D, April 19, 2017, South Sumatra).

In the post-Suharto era, local communities can speak more freely when they disagree with the government or company activities. Both individuals and groups, including very large groups in the local community, can protest any time. In 2004, the number of conflicts was under 50, and this increased almost tenfold in 2015 (KPA, 2016).



Figure 6.3. Local community member blocking the way to the oil well in South Sumatra Province

Source: Tarakan company's logbook of conflict, 2016a: appendix 2.

This picture depicts a local community member protesting against Tarakan production activities by cutting down branches and placing them in the middle of the road to block company access to the oil well, due to land pollution. He waited at the location until company staff came to communicate with him. After negotiating with the protestor, the company resorted to providing compensation (money) as a solution to this kind of protest.

Furthermore, Tarakan has also faced large-scale collective protests. For example, hundreds of community members from Danau Cala Village blocked the dock for transporting crude oil from the oil well to the central processing unit in 2014—a continuation of action that began in 2006. The slogans on the protestors' banners basically stated:

Our natural resources [crude oil] is exploited [by the company] until they run out. We see the company get rich, but we do not benefit. Mr President [Indonesian President], please pay attention to the fate of our local communities (Tarakan company environmental report, 2014).⁸²

This protest created a financial loss for the company, as it could not transport crude oil for three days, with 1034 barrels being held up each day. Assuming a crude oil price of USD 98.98 per barrel, the company suffered a financial loss of USD307,000 (Tarakan's presentation at a seminar held by SKK MIGAS, 2017b, p. 16)

After several rounds of negotiations between the company and affected local communities, Tarakan agreed to build the road for the local community (see Figure 6.4 below). Infrastructure development is a common demand, given inadequate public facilities and infrastructure in many villages, including roads. In such cases companies often develop infrastructure instead of local governments. As a part of its increased commitments to PROPER and as a way of seeking a social licence to operate under democratisation, the

⁸² I visited the local village directly involved in this conflict and interviewed a range of village members, including village members who were pro- and anti-company in orientation. In addition to these community-level interviews, I conducted interviews with NGOs from the local area, including both pro-company NGOs, and anti-company NGOs who had organised prior public protests against the company's operations

Tarakan company has contributed to the development of public facilities in the villages near its production sites, even though protests from local communities have ceased.



Figure 6.4. Road conditions before and after community protests

Source: Tarakan Company's Environmental Report, 2016b

In most developing countries such as Indonesia, businesses are expected by communities to meet certain social obligations (Idemudia, 2007), for example, supporting public facilities for local communities. In the face of increasing resistance from communities under democratisation, the Tarakan company has had to develop good relationships with local communities, as they are subject to greater pressure from communities than under authoritarianism. This subsection argues that, given such institutional conditions, PROPER is designed in ways that harness these pressures from communities and the CSOs that support them. Tarakan adopted PROPER to both commit to improving social and environmental conditions—through environmental management and community development programs—to disclose its progress, and to better communicate its environmental and societal commitment to local communities. For Tarakan, participation in PROPER helped induce behavioural change in the company that improved its ability to obtain a social license to operate, which has been essential to commence and maintain production processes in the Indonesian democratic system.

6.6. Conclusion

This chapter has presented pathways by which PROPER strategies have harnessed pressures on the Tarakan company to improve its socio-environmental performance during its participation in the program between 2004 and 2017. Its socio-environmental performance improved significantly from basic compliance level (Blue rating) to the best level of beyond compliance (Gold rating). In terms how ownership structures might shape the political preferences of domestic tycoons, we can see here that the findings in this chapter also support those of Warburton (2017)—for the Tarakan company, the ownership structure between domestic and foreign capital is highly differentiated. The company is controlled by a domestic tycoon who has not only been highly supportive of the political orientation towards resource nationalism, but also domestic regulatory arrangements in the oil and gas sector, such as PROPER, albeit under the rubric of ‘paying back the nation’.

Moreover, the case of the Tarakan company further confirms arguments made in previous chapter about the state oil company: that improvement of socio-environmental performance in the oil and gas sector is due to two critical variables, namely continued commitment of top-level management and technical assistance to improve employees’ ability in relation to beyond compliance. The combination of commitment by top-level management and employees’ knowledge and skills to perform at beyond compliance level was also supported by third-party actors’ recognition.

However, operationalisation with regard to how top-level management and national government's role in technical assistance improves socio-environmental performance at Tarakan was apparent. The continuous commitment of top-level company management has been internally driven by the founder instead of externally driven by political elites, as is the case with the state oil company (SOC). The founder of Tarakan responded appropriately to the government on PROPER because of his historic life. He perceived that ‘doing more than others’ or performing at beyond compliance level in PROPER is part of his way to ‘pay back to the nation’ from received benefits of affirmative policy from political elites during the Suharto regime. Achieving

beyond compliance standards in PROPER can be analysed as part of its founder's political ethics and nationalist identity.

Moreover, the case of the Tarakan company also demonstrates that technical assistance is critical to attain beyond compliance level in public voluntary regulation. However, the source of knowledge and skills of public voluntary regulation does not only originate from regulators (state) but also from private consultants. Tarakan preferred to collaborate with private consultants to improve employees' knowledge and skills on PROPER, instead of national government in the case of the state-owned oil company in Chapter 5.

This decision was taken by Tarakan because this company integrated PROPER into an existing environmental system instead of developing a new system based on PROPER like the state oil company (see Chapter 5). For Tarakan, performing at beyond compliance is not only about PROPER (or PROPER oriented), but also about implementing the founder's business values which are compatible with stakeholders' demands in the oil and gas sector.

The private oil company and state oil company cases demonstrate that regulatory strategies of PROPER succeeded in improving socio-environmental performance from compliance (Blue rating) to the best level of beyond compliance (Gold rating). This raises the question of whether this could happen in another sector, particularly palm oil? The following chapters discuss how regulatory strategies of PROPER do or do not harness pressure to improve socio-environmental performance in the palm oil sector.

Chapter 7

The case of a state-owned palm oil company

7.1. Introduction

The two previous chapters discussed strategies used by the national public regulator of PROPER and the conditions under which such regulatory strategies contributed to improving social and environmental beyond compliance performance in the oil and gas sector, for which both case-study companies achieved a Gold rating. This chapter examines how both national and subnational public regulators adapted strategies to shape socio-environmental performance in the palm oil sector, focusing on the state-owned Tebing plantation company.⁸³ During the company's participation in PROPER between 2012 and 2017, social and environmental achieved an initial beyond compliance Green rating but then dropped to the minimum level of legal compliance (Blue rating). In this chapter, I explore both the public voluntary regulation strategies used by PROPER to encourage improved performance and how these strategies interacted with wider global social and environmental governance processes, particularly the Roundtable on Sustainable Palm Oil (RSPO). In this case, PROPER could induce an improved compliance level, but it was less likely to encourage strengthened beyond compliance performance because PROPER did not incorporate reference to several key sustainability issues prioritized by other global governance actors in the palm oil sector.

This chapter argues that the influence of PROPER's regulatory strategies on Tebing's socio-environmental performance decreased, especially due to the extensive influence of international organisations and buyers in relation to the global socio-environmental governance. This influenced the orientation of top-level management, political elites, and even third-party actors away from PROPER's beyond compliance standards, towards transnational certification schemes of the Roundtable on Sustainable Palm Oil

⁸³ I use "Tebing company" due to the confidential agreement. As the researcher, I cannot use the real company name in this thesis.

(RSPO), not entirely aligned with indicators of PROPER. In discussing the Tebing company, it is important to note that PROPER only focuses on two dimensions, namely managing the environment and Corporate Community Development (CCD). As such, this coverage may be different from other certification programs in the palm oil sector, which have broader coverage of social and environmental standards, such as attention to human rights, fair work, and reducing fraud and corruption, which is the case with RSPO transnational certification programs.

Moreover, this chapter also argues that decentralisation also constrained the ways the nationally-oriented PROPER program was able to support beyond compliance performance given that under decentralisation, subnational agencies have regulatory authority in the palm oil sector. In regards to the region where the Tebing company has its plant, there was limited interest from the subnational government to provide technical assistance to support beyond compliance performance because PROPER's design created financial disincentives to do so. Instead, subnational regulators sought to substitute technical assistance with a new strategy not discussed in other chapters thus far: "informal threat" to encourage companies to meet basic compliance with minimum legal standards. These constraining factors undermined the regulatory capacity of PROPER to improve beyond compliance socio-environmental performance.

To explore how PROPER operated to influence the state-owned palm oil company, this chapter is structured in the following ways. The next section presents an overview of Tebing's performance in PROPER between 2012 and 2017. The third section elaborates how the national government adopted the strategy of promoting environmental leadership at the Tebing company, with limited effect. The fourth section discusses how subnational governments adopted nationally-developed PROPER strategies of providing technical assistance in a way that "informally threatened" companies that participated in PROPER. The fifth and final section explores how PROPER's public disclosure strategies only legitimised efforts to meet basic minimum legal compliance standards in the eyes of third-party actors (i.e. investors, buyers,

banks and CSOs), but was unable to incentivise meeting beyond compliance standards. There was also limited evidence of PROPER's strategies being able to harness pressures on the company to meet beyond compliance standards from local communities, because most communities around plants supply the Tebing company. This business relationship decreased the bargaining position of local communities vis-à-vis that of the company.

7.2. Tebing company performance in PROPER (2012-2017)

It is important to highlight that the state-owned Tebing company is 100 per cent owned by the Indonesian national government. Yet, despite this ownership structure, international actors extensively influence the Indonesian palm oil companies' environment and social policies. As the biggest exporting country of palm oil products, Indonesia is the target of global governance strategies on sustainable palm oil production (Cattau et al., 2016). Both large and small companies and small holders can produce palm oil which means thousands of actors can be involved in production, and licences are issued by different levels of government depending on the scale of plots. Such conditions are extremely different from the Indonesian oil and gas sector. Even though Indonesia has oil reserves, it is nonetheless a net importing country of oil and gas products and therefore the sector is structured differently. Oil and gas production has a longer history (and more established practices to manage, for example, toxic waste) of being tightly controlled by a smaller set of national actors, as well as fewer actors involved in production/ employment in the sector, particularly given the higher capital investment needed for production. This has implications for the ways regulatory strategies influence each sector. As such, understanding the regulatory capacity of PROPER to shape socio-environmental performance in the palm oil sector must be explored in the wider global regulatory context of palm oil production, particularly in relation to the interaction between PROPER strategies and standards and those of the RSPO.

To examine how PROPER shaped socio-environmental performance at the state-owned palm oil company, this thesis draws on the case of the

Rambutan Palm Oil Mill (hereafter PKS Rambutan). PKS Rambutan is a palm oil mill owned by the Tebing company located in North Sumatra Province. PROPER is assessed at the mill level, but some of its strategies have implications for company-level corporate governance structures. PKS Rambutan has participated in PROPER for over six years, between 2012 and 2017 (beyond this period is not covered by this thesis), in which its performance dropped from a beyond compliance Green rating (2011-2013) to a basic compliance Blue rating (2014-2017), meeting minimum legal requirements only (see Table 7.1 below).

Table 7.1. PKS Rambutan's performance in PROPER

Assessment periods	Socio-environmental performances
2011-2012; 2012-2013	Beyond compliance level (Green)
2013-2014; 2014-2015 2015-2016; 2016-2017	Compliance level (Blue)

Source: MOEF, PROPER results, 2012-2017.

While company performance in PROPER decreased over the period 2012 to 2017, this trend is in strong contrast to company achievement in the private voluntary certification program offered by the RSPO. PKS Rambutan is one of ten palm oil mills owned by the Tebing company that are certified by the RSPO. On September 1, 2016, the RSPO issued certificate number 824 502 1641 for PKS Rambutan to remain valid until August 31, 2021.⁸⁴ Prior to PKS Rambutan gaining certification, PKS Sei Mangkei mill owned by the state-owned Tebing company received RSPO certification in 2010. This was the first RSPO certification for the Tebing company's state-owned mills.

The RSPO takes a different approach to PROPER to assess environmental performance. The RSPO focuses on environmental issues in

⁸⁴ RSPO (2016), Rambutan Palm Oil Mill Summary Report RSPO PTPN3. Accessed on June 4, 2018.

plantation areas, such as deforestation, biodiversity and High Conservation Value (HCV)(RSPO, 2020). For social dimensions of certification, the RSPO assesses Free, Prior and Informed Consent (FPIC)⁸⁵ processes and fair work standards for certification. Meanwhile, PROPER focuses on production processes at plant level, such as air emissions, water pollution, electricity consumption, and toxic and hazardous waste management. Assessments of plant-level environmental pollution are dominant features of PROPER (together with community development programs); but in terms of environmental management these are minor indicators in RSPO certification standards. Thus, it is interesting to note that while the company met the well-known RSPO certification standards for 2016-2017 that also have beyond minimum legal compliance dimensions, Tebing only met basic minimum legal requirement standards under PROPER.

The following sections discuss how the public regulators (both national and subnational governments) adopted the regulatory strategies of PROPER to shape socio-environmental performance at the Tebing company, with a specific focus on PKS Rambutan. In the regulatory design of PROPER, the national government is responsible for implementing both the strategies of promoting environmental leadership to top-level management and public disclosure, while the subnational government is responsible for implementing the strategy of providing technical regulatory assistance to companies to improve their knowledge and skills on how to meet beyond compliance standards required by PROPER.

⁸⁵ FPIC principles relate to ensuring affected communities give their consent for particular company/state/other actor activities, especially when it relates to land over which they have claims and livelihoods or environments where they live that may be affected. It establishes the basis on which equitable agreements between local communities and companies (and government) can be developed in ways that ensure that the legal and customary rights of indigenous peoples and other local rights holders are respected, and ensures that they can negotiate on a fair basis to ensure they gain real benefits from proposed palm oil developments on their lands (RSPO, 2008. p.3).

7.3. Promoting environmental leadership in the state-owned palm oil company by the national government

Promoting environmental leadership on firms through the Environment Awards Night is the first regulatory strategy explored in this chapter. At the Environment Awards Night, the regulator of PROPER employed political elites at national level in shaping company's socio-environmental performance in the Indonesian political context. I seek to show that the strategy used by national-level political actors to promote such leadership in the oil and gas sector did not change in the palm oil sector. Similar to the oil and gas sector, PROPER sought to engage political elites as influential actors and for these elites to persuade top-level management at the Tebing company to commit to meeting beyond compliance standards. However, this section argues that this strategy was only able to support behavioural change in the short-term, due to the changing orientation of influential political elites towards international markets. This influenced the orientation of the company (and the sector) away from domestic certification programs towards global governance arrangements, such as engaging with transnational certification programs, which, as mentioned above, had different standards to those of PROPER. I also seek to show how institutional conditions, in particular the relationship between business and state enabled this strategy to be effective in motivating top-level management at Tarakan to improve socio-environmental performance.

7.3.1. Promoting environmental leadership to top-level management

Similar to strategies used in the oil and gas sector (see sections 5.3 in Chapter 5 and 6.3 in Chapter 6), the national government, particularly the DITJEN PPKL - *Pengendalian Pencemaran dan Kerusakan Lingkungan* (Directorate General Pollution and Environmental Damage Control), used events such as annual "Environmental Awards Nights" to both promote environmental leadership among top-level management of companies across sectors and types of firm. Through these events the national regulator also sought to create

environments where influential political elites could directly pressure senior management based on prior history of strong state-business relations.

Top-level management at the state-owned palm oil company was also invited to attend the annual Environmental Awards Night to reward and promote performance when it first achieved the Green rating. Senior management were also invited to special dinners, senior figures in the Ministry of Environment and Forestry and other political elites, so as to support close relations between the government and the company.⁸⁶ This strategy temporarily persuaded top-level management at the state-owned Tebing plantation company to support changing business practice that favoured beyond compliance performance as required by PROPER. (The reasons for this are discussed further below in the next sub-section.) Indeed, after participating in these events, Tebing's top-level management supported its production unit (i.e. PKS Rambutan) to undertake actions to meet beyond compliance standards (Green rating) in PROPER (2012-2013). However, from 2014, Tebing's top-level management shifted its position in aiming for beyond compliance standards, instead supporting programs that only met minimum legal requirements, or a Blue rating, in PROPER.

Before 2014, the Environmental Subdivision at *Kandir* (headquarters of the Tebing company) supported its PKS Rambutan mill to design and implement programs to meet beyond compliance standards in PROPER. Similar to the actions of companies discussed in the previous two chapters, Tebing's top-level management translated its commitment to beyond compliance performance into concrete actions and programs, which helped it gain the beyond compliance Green rating, which was the highest rating at the time. First, Tebing's top-level management supported a program to establish a biomass generator, which was a milestone for PKS Rambutan in meeting beyond compliance standards in PROPER and obtaining a Green rating. This program was implemented by installing the biomass generator, which uses the shell of palm oil fruit (known as fresh fruit bunches) as its source of energy.

⁸⁶ Confidential interview with an employee at the state-owned Tebing company on April 12, 2017.

Traditionally, electricity generators use fossil fuels (diesel) as their source of energy. Top-level management allocated IDR 33.22 billion, or USD 3.46 in 2012 (exchange rate IDR 9,600), to establish the biomass generator (Tebing company environmental report, 2016, p. 4).

The biomass generator aimed to reduce fossil fuel consumption at PKS Rambutan. This generator was predicted to save fossil fuel consumption equivalent to 10,696,451 kg of diesel in 2012 and 11,572,251 kg of diesel in 2013 (Tebing company environmental report, 2016, p. 6). Such fossil fuel consumption efficiency helped the company meet beyond compliance standards in PROPER that specifically addressed energy efficiency. The then Ministry of Environment gave additional points to the Rambutan palm oil mill because the biomass generator program demonstrated the company's commitment to renewable energy policies.⁸⁷

Second, management supported the installation of a 'programmable logical control' for the boiler system (Tebing company environmental report, 2016, p. 4). This program is a computerised system to obtain an optimal composition between electricity supply and water levels in the boiler system. At optimal composition, the company can reduce electricity consumption in its production processes. The installed programmable logic control system also addressed beyond compliance standards in PROPER, particularly energy efficiency. PKS Rambutan reduced electricity consumption by 10,806 Megajoules (MJ) in 2012 and 11,076 MJ in 2013 (Tebing company environmental report, 2016, p. 6). Top-level management allocated IDR 2 billion, or USD 208,333 at IDR 9,600 exchange rates, for installation of the programmable logic control computerised system at PKS Rambutan (Tebing company environmental report, 2016, p. 6).

The national regulator for PROPER, the DITJEN PPKL categorised the biomass generator and programmable logic control system as environmentally friendly programs. Importantly, these programs are not required by legal environmental regulations but reduce electricity

⁸⁷ Confidential interview with senior bureaucrat at the Ministry of Environment and Forestry on April 27, 2017.

consumption in the company's production processes. Reducing electricity consumption also contributed to minimising air pollution. Furthermore, using the shells of palm oil fruits as a source of energy demonstrates an innovative renewable energy program at the PKS Rambutan mill. For these reasons, in addition to meeting other standards for minimum legal compliance, PKS Rambutan met beyond compliance standards in PROPER, or the Green rating, between 2012 and 2013. In community development, the Tebing company provided scholarships to local communities around the plant. However, this program was not managed properly. The company only was responding the proposal from local community to distribute scholarships to local communities (Mr. R, an employee at Tebing company, April 8, 2017).

It is also important to note here that, like companies in the oil and gas sector, the Tebing company invested in assets to support beyond compliance efforts in PROPER. However, we did not see the Tebing company management translate its commitment to PROPER into organisational changes in management structures, incentives, and corporate governance arrangements, the likes of which occurred in oil and gas sector case studies.

While the Tebing company met beyond compliance standards up to 2013 (Green rating), in 2014 changes occurred when the Minister of State-Owned Enterprises (SOEs) introduced a new policy on holding companies (requiring the state-owned oil company to restructure) and mandated that the state-owned palm oil company work towards becoming a global player in the palm oil industry. Thus, the company also faced different, direct, top-down pressures from two different ministries—one for the Environment and one for SOEs.

The result was that between 2014 and 2017, top-level management did not support efforts at PKS Rambutan to meet beyond compliance standards in PROPER. Its prior efforts to meet these standards did not contribute to beyond compliance scores in subsequent years for PKS Rambutan's PROPER rating because such efforts had already been accounted for in previous years' scores. PROPER requires companies to add new environmentally friendly programs once every two years.

From 2014 onwards, top-level management only prioritised programs that met minimum legal requirements. This policy influenced middle-level managers. An employee at the Environmental Subdivision explained that:

The manager said that he was dizzy from the program for PROPER. What company will invest in beyond compliance programs [such as PROPER] if they do not have impacts on [profit] margins? The purpose of business is these margins; a Blue rating is enough for us [at the Tebing company] (Interview with an employee at the Tebing company, Mr Z, June 20, 2018, by phone).

In response to top-level management's policy on PROPER, the Head of the Environmental Subdivision tried to explain to managers the positive economic impacts that PROPER can have, like reductions in production costs (Interview with an employee at the Tebing company, Mr Z, April 12, 2017, North Sumatra Province). Efficiency programs in PROPER help reduce electricity consumption, which reduces energy costs for the company. Between 2012 and 2015, the average saving from electricity efficiency programs was IDR 125.5 million per year, or USD 13,072 at IDR 9,600 exchange rates (Tebing company environmental report, 2016, p. 6).

Management, however, tends to compare the economic benefits of investing in meeting beyond compliance standards under PROPER with investing in certification under RSPO standards. Management perceives that the premiums resulting for the company from RSPO certification mechanisms provides more economic benefits to the company compared with PROPER.⁸⁸ The company charge a premium of about USD 40 per metric ton (MT) of Crude Palm Oil (CPO) with an Identity Preserved (IP) RSPO certification, which means that all Fresh Fruit Bunches (FFB) palm oil come from RSPO-certified oil palm plantations.

For example, PKS Sei Mangkei, one of the production units of the Tebing company, received RSPO Identity Preserved (IP) certification which means

⁸⁸ Confidential interview with manager at Tebing company, April 12, 2017.

that all sources of palm oil have met RSPO standards. Other palm oil mills received Mass Balance certification, which signifies a mix of RSPO certified and uncertified sources of fruit. Based on the publicly available PT TUV Rheinland report (this company conducts palm oil source certification for the RSPO) released on August 28, 2017, PKS Sei Mangkei produced 51,092 tons of CPO in 2016.⁸⁹ Assuming they gained the USD 40 per ton premium for RSPO-certified CPO, this means that the company received an additional income of about USD 2.04 million, or IDR 24.32 billion (assuming a conversion rate of USD 1 = IDR 11,900) directly due to the premium price. This is a tangible benefit resulting from compliance with RSPO IP certification. According to company management:

For [production] units that proposed programs to meet beyond compliance standards [in PROPER], management always asks a question, what are the benefits [of a Green rating in PROPER] (Interview with an employee at the Tebing company, Mr Z, April 12, 2017, North Sumatra Province).

In summary, the changing response of top-level management over time towards government strategies to promote environmental leadership in PROPER was influenced by direct pressure from the state and global governance arrangements for sustainable palm oil, or what might be considered competing programs with different beyond compliance standards. Top-level management compared the benefits from domestic certification (PROPER) and transnational certification (RSPO) to direct its choices as to which certification standards to pursue, with little significant overlap between certification. In the end, Tebing management chose to pursue RSPO certification that would align with the Minister of SOE instruction to become a world-class plantation company.

⁸⁹ [https://rspo.org/uploads/default/pnc/PA_PTPNIII_Sei_Mangkei_Bahasa_\(1\).pdf](https://rspo.org/uploads/default/pnc/PA_PTPNIII_Sei_Mangkei_Bahasa_(1).pdf). Accessed on July 04, 2018.

7.3.2. Political influence on the state-owned palm oil company: Enabling institutional conditions for promoting environmental leadership

Similar to the situation of state-owned oil company discussed in Chapter 5, this section argues that national-level state actors have significant influence over state-owned company senior management, which includes management appointments at the Tebing company, as they control appointments and can make regulatory decisions and issue directives that have implications for company priorities. Tebing is subject to the strong features of patrimonialism in the Indonesian state in which top-level managers need political support to secure their positions. Arguably, when the powerful ministry in charge of SOEs issued directives for business priorities to the Tebing company to gain world-class status, this in effect rendered pressures of PROPER as secondary considerations and constrained the ways PROPER strategies could induce beyond compliance behavioural changes specific to its own standards. The Tebing company instead switched preferences from domestic to international standards, considering transnational certification under the RSPO to be one mechanism by which to become a world-class plantation company.

Prior the Government Regulation No. 72/2014 on The Holding Company Status of the State-owned Plantation Company (i.e. Tebing), Minister of State Owned Enterprises (SOEs) adopted PROPER as one of key performance indicators (KPIs) to evaluate the performance of top-level management of State-owned Plantation Company. Because of KPIs (PTPN, 2012). This political commitment was critical to encourage the directors at State-owned plantation company to meet the beyond compliance standards of PROPER. As such, Tebing company III obtained beyond compliance (Green rating) in 2012 and 2013.

However, things had changed in 2014. The Government Regulation No. 72/2014 on The Holding Company Status of the State-owned Plantation Company (i.e. Tebing) was issued. This changed the structure of all state-owned plantation companies, amalgamating them to create a mega state-owned plantation company. Assets were amalgamated under the holding company status and thereafter the prior state-owned companies were

managed in a more centralised fashion. Aside from changing the structure, this regulation mandates that the new mega state-owned plantation company must become a world-class plantation company.

With the change in structure, the national-level political elite, particularly the Minister of SOEs desired the Tebing company to become a leading plantation company in global agriculture trading, both in terms of assets and market share (*Reuters*, February 2, 2012). The holding policy combined the company's assets of USD 5.7 billion (*The Jakarta post*, October 3, 2014). Prior to this, there were 14 state-owned plantation companies. When the company took on holding company status in 2014, it amalgamated all state-owned plantation companies into one, rendering the company one of the largest plantation firms in the world with one million hectares of palm oil and rubber (*Reuters*, February 2, 2012). With such significant assets, the Minister of SOEs could pressure top-level Tebing management to get 'back in [the] black' as some of the prior state-owned plantation companies had experienced a long period of financial loss - amounting to IDR 955 billion in 2015 and IDR 1.38 trillion in 2016, or USD 71.8 million at IDR 13,300 exchange rates and USD 102 million at IDR 13,500 exchange rates.

The Minister of SOEs focused on directing company priorities towards profit-making and efficiency, including in the selection of green certification programs, and evaluating top-level management at the state plantation company based on performance in these terms. Senior management pays attention to the demands of the Minister of SOEs because the Minister is understood as the 'big boss' of top-level management at Tebing, as well as at other SOEs.⁹⁰ Prioritising the demands of the Minister can be understood as a survival strategy, or as an opportunity for job promotion to top-level management at the Tebing company.⁹¹

The Ministry of SOEs recruits high-level positions (President Directors and Directors) at the Tebing company from within the internal ranks or from

⁹⁰ Confidential interview with manager at the Tebing company April 12, 2017. This interview also confirms the case of the state-owned oil company in Chapter 5.

⁹¹ Ibid.

among other SOEs in Indonesia. Commonly, the President Director or Director from one SOE moves to another SOE. The leaders of SOEs often comfortably move from smaller to larger companies. For example, after succeeding in bringing the Tebing company to a position of profit on the instruction of the Minister, the President Director of Tebing was promoted by the Minister of SOEs to President Director of the State-owned Oil Company—the biggest state-owned oil company in Indonesia. Good financial performance is a primary consideration for promotion of top-level management to higher positions at the Tebing company.⁹² Thus, prioritising a certification that contributes to profit-making is one of the strategies used by top-level management to secure their positions.

RSPO offered more opportunities for the Tebing company to improve its profits through the ways that certification allows for premium prices to be charged for CPO (Crude Palm Oil) and access to the international market. An employee at the Tebing company explained why the management chose to focus more on RSPO than PROPER:

[The Tebing company] focused more on RSPO than PROPER, because RSPO provides direct and tangible economic incentive through the premium price mechanism. The price gap between Mass Balance [certification] and the premium price [through Identity Preserve certification] can be around USD 25-40 per ton CPO [Crude Palm Oil]. This [direct economic incentive] does not happen in PROPER (Interview with an employee at the Tebing company, Mr Z, June 20, 2018, by phone).

As we can see, Tebing's top-level management largely adapted its business strategy to counteract the financial losses of the past. The profit-oriented policy now significantly influences internal decision-making processes, including choosing green certification programs. Top-level management evaluates programs to determine whether they contribute directly to profit-making or not, with RSPO certification perceived to be more attractive for

⁹² Confidential interview with manager at the Tebing company, April 12, 2017.

market competitiveness than PROPER, as RSPO generates more opportunities for the company to access international markets and thereby increase its profit.

In summary, the case of the state-owned palm oil company confirms the findings in Chapter 5 on the state-owned oil company, in that top-level management's commitment towards meeting PROPER's beyond compliance standards is influenced by the underlying institutional conditions of patrimonialism and the influence of political elites. When political elites expected the state plantation company to perform at beyond compliance levels in PROPER, top-level management invested in initiatives to meet PROPER's beyond compliance standards. When political elites supported international competitiveness and processes aligned with transnational certification, top-level management switched preferences and withdrew its support for new, beyond compliance initiatives under PROPER and allocated internal resources to instead obtain transnational certification, such as RSPO.

However, what differentiates the two sectors is that in Indonesia, there is no competing certification program in oil and gas for PROPER. Also, in contrast to the oil and gas sector, the Tebing company is subject to influence from national directives and the influence of subnational political elites, which is also discussed in the subsequent section.

7.4. "Informal threat": A subnational government strategy to influence palm oil companies

In the palm oil sector, subnational governments also have implementing authority for PROPER regulatory strategies, particularly in providing technical regulatory assistance to companies. This regulatory design is different from the oil and gas sector, in which all PROPER strategies are implemented by the national government. This section argues that this regulatory arrangement that differs across sectors is distinctive to Indonesia's decentralised political system which confers different authorities to different government jurisdictions, depending on the sector.

However, below, I also seek to demonstrate that while subnational governments have the authority to implement formal regulatory strategies such as technical regulatory assistance under PROPER, in the case of the Tebing company, providing technical assistance to companies that voluntarily participated in PROPER was substituted by local bureaucrats with discretionary actions such as the “informal threat” to “force” companies to participate.

The subnational regulator used “informal threats” because they were responsible for regulating the palm oil sector, but the regulator could not or would not provide technical assistance to the company, given the economic disincentives to do so. Such “informal threat” strategies are of course difficult to completely separate from broader aspects of informal power relations in the institutional conditions which might be considered more broadly as “informality”. “Informality” in this thesis is defined as a particular mode of interaction between the regulator (the state) and regulatory target (the company) that is marked by the use of personal influence, networks, and among others, informal directives from state actors to regulatory targets, which draw on underlying power structures of close state-business relations as a source of influence on regulatory targets. To my knowledge, this kind of regulatory approach has not been explored by scholars of public voluntary regulation. However, other studies do emphasise the importance of informal state-business relations to encourage particular forms of firm behaviour. For example, in a study of the infrastructure sector, Davidson (2015) shows how informal relations between the state and businesses was critical to explain the development of toll roads in Indonesia.

First, it is important to note that the concept of “informal approach” in this thesis is different to informal approaches used in soft regulation, explored in the literature, such as education or producing guidelines on how to implement standards commonly adopted in the tradition of regulatory studies (Gunningham et al., 1998). Informal approaches in this study refer to as socially shared rules, usually unwritten, that are created, communicated and enforced outside of officially sanctioned channels (Helmke & Levitsky, 2004,

2004, p. 727). Second, I discuss these discretionary “informal threat” strategies such as those adopted by the subnational government in the Tebing case separately, even though they are intertwined with underlying institutional conditions, so as to more clearly elucidate how the importance of close state-business relations provided impetus for the company to comply with government demands.

7.4.1. Subnational PROPER implementation strategy: “Informal threats” to companies

“Informal threat” is the distinctive regulatory strategy adopted by the subnational government to shape socio-environmental performance at the state-owned palm oil company. To exercise its implementing authority in PROPER, the subnational government of North Sumatra Province undertook a discretionary policy to substitute providing technical assistance, with the strategy of “informal threat” by “naming and shaming” companies to ensure they participated in PROPER, or risk having their environmental permits in the palm oil sector withdrawn. The state did not, however, help build knowledge on how to implement PROPER as was the case in the state-owned oil company.

The subnational government used a discursive strategy of threat: if local palm oil companies did not want to participate in PROPER, they would nonetheless be given a rating in the program for their lack of participation. Such companies would be rated Black or Red (not meeting minimum legal compliance). This constituted a more extreme form of “naming and shaming” for companies (c.f. Van-Erp, 2011) even though participation in the program is voluntary. “Naming and shaming” can inflict reputational damage that may be more significant to the firm than legal sanctions (Gunningham & Grabosky, 1998). This research has revealed the subnational government was not concerned as to whether the company was ready or willing to participate in PROPER. The subnational government sent letters to palm oil companies in the region inviting them to participate in the program. Once a company was “named” in the letter of invitation from the PPKL Subdivision (Pollution and

Environmental Damage Control [*Pengendalian Pencemaran dan Kerusakan Lingkungan*]) the company was thereafter obliged to participate in PROPER.

For example, there was a company which was not ready to participate in PROPER named PT Jaya.⁹³ This company did not know that its participation in PROPER had been proposed by the PPKL Subdivision. After finding out it had been listed as a participant in PROPER, PT Jaya sent a letter to us [the PPKL Subdivision] to cancel its participation in PROPER. We [the Subdivision PPKL] still involved this company in PROPER. In the end, this company obtained Red rating in PROPER (Interview with the regulator, Mr M, April 12, 2017, North Sumatra).

The example above demonstrates that the subnational government still assessed companies even if they did not agree to participate in PROPER. When companies did not participate or provide the necessary documentation to the subnational government, they were punished for their lack of cooperation by publishing a non-compliance PROPER rating of either Black or Red.⁹⁴ A Black rating indicates that the company has failed to comply with legally mandated regulations and has made virtually no efforts to comply. A Red rating indicates that the company has made some attempt to improve its environmental impacts and to comply with minimum legal requirements, but has failed to fully comply with the regulations.

The North Sumatra Provincial government shared this experience of what happened to PT Jaya as a part of its broader naming and shaming strategy, so as to informally threaten other companies to elicit their participation in PROPER. Most companies, including Tebing and other non-commercial actors in the palm oil sector in North Sumatra Province, are thus aware of the PT Jaya case and its initial Black rating.⁹⁵ Following on from its publicly disclosed poor performance in proper, third-party actors, in

⁹³ "PT Jaya" is a pseudonym for the name of the company due to confidentiality arrangements in the interviews conducted.

⁹⁴ Confidential interview with local bureaucrat at North Sumatra Province on April 12, 2017.

⁹⁵ Ibid.

particular its investor, the National Bank of Indonesia (Bank Nasional Indonesia – BNI), also pressured PT Jaya to improve its environmental performance, and has since taken steps to do so.⁹⁶

The use of this strategy of informal threat is somewhat different from the way public voluntary regulation is implemented in industrialised countries when it comes to using “background threats” as a way to encourage compliance with public voluntary regulation. In their strategies to implement public voluntary regulation, regulators in some instances in industrialised countries use “background threats” to enforce stringent mandatory regulation in the future, to encourage compliance with public voluntary regulation in the present, so as to avoid having to adhere to stronger legal requirements (Segerson & Miceli, 1998). In industrialised countries, companies participate in public voluntary regulation voluntarily to avoid more stringent command and control types of regulation in future. A firm is more likely to join a voluntary environmental program if the associated cost is lower, compared with the anticipated cost of compliance with mandatory [command and control] regulation in future (Koehler, 2007, p. 693).

In North Sumatra Province, Tebing company’s response to PROPER was not shaped by formal regulation (command and control, and sanctions), but by informal pressures from the subnational government. Such pressures constituted two types of threat. First, they would be named and shamed with a PROPER rating (Black and Red) of not meeting, or only partially meeting the minimum legal standards if they did not participate. Second, their own environmental permits would be delayed by the subnational government. An employee at Tebing company said that:

Bureaucrats at subnational government always have their own strategy to delay the environmental permit, if we [company] did not respond [to] their demand on PROPER. As such, we [company] have to participate in PROPER to gain environmental permit in time (April 12, 2017, North Sumatra Province).

⁹⁶ Confidential interview with local bureaucrat at North Sumatra Province on April 12, 2017.

Tebing considered the extra costs that would be incurred due to delayed business permits. Scholars in business management have noted that delayed permits cause cost escalation, particularly as during the delays, there are often changes in the costs of production, or the prices of specific goods or services in a given economy over time (Hollmann et al., 2007). Furthermore, Tebing also allowed for the impact of delayed business permits on their PROPER compliance status, in the event that informal problems might arise with the subnational government. For example, companies need environmental permits for water to be discharged in greater volumes needed in plantation areas. Companies must also have a valid water discharge permit within a given time period to meet minimum legal requirements or a Blue rating in PROPER. Thus, delayed environmental permits within a given time frame not only increase production costs and business uncertainty but also risk a reduction in a PROPER rating, which has flow on effects for public disclosure and pressure from third parties.

The case of the state-owned palm oil company (Tebing) demonstrates that the subnational government may switch regulatory strategies or adapt strategies not necessarily in the design of public voluntary regulation. In the Tebing case, the national government devolved the authority to subnational governments to implement technical regulatory assistance to state-owned plantation companies (discussed further in the next section). However, this authority was not used by the subnational government in PROPER. Instead, the subnational government preferred to take the discretionary policy of “informally threatening” companies to elicit participation. As such, the participation of the Tebing company in PROPER was not entirely voluntary, but rather the result of informal pressure from the subnational government. This strategy was implemented by the regulator in the local environment agency. While the District Head and other political leaders may have had some interests in how those firms with which they had close ties performed—especially given the extensive research on how frequently subnational political elites are involved in rent-seeking from the resource sector (see the discussion in Chapter 4)—and had the authority to influence the structure and

resourcing of this subnational regulator, according to confidential interviewees, they did not interfere in setting local rules or the ratings issued by assessors. Indeed, a number of firms in the region that had political ties to subnational leaders gained less than favourable ratings. Even the state-owned Tebing company, which has implicitly close ties to political elites, gained a less than favourable Black rating. In one example, PT. Bakrie Autoparts that was known to support the political party in the region Bekasi, West Java. The PT. Bakrie Autoparts nonetheless only achieved a Red Rating in PROPER 2017 (MOEF, 2017).

7.4.2. Decentralisation in the palm oil sector: Institutional conditions underpinning the influence of “informal threat” strategies

This thesis aims not only to explore how public regulators adapted regulatory strategies in the implementation of PROPER, but also the conditions under which public regulators can shape socio-environmental performance in companies. This subsection elaborates the institutional conditions which facilitated the subnational government to adapt a more discretionary approach to using “informal threats” to influence companies. This subsection argues that such an approach was adopted rather than offering technical assistance, due to the authority provided under Indonesia’s decentralisation system and the economic disincentives for subnational governments to invest in providing technical assistance. It also discusses the ways state-business relations influenced the company’s interest in responding to informal pressures from the state to participate in PROPER.

Under decentralisation, the central government must collaborate with the subnational governments to implement PROPER in the palm oil sector, as these governments are the main regulatory agency for this sector. Article 48 of Law No. 39/2014 on Plantations, states that local governments, either the District Head (*Bupati*), Mayor (*Walikota*) or the Provincial Governor are authorised to issue business permits for plantations (depending on size, scale and jurisdiction). This Law enacts the authority for subnational governments either at Provincial or District/Municipality levels to regulate plantation

businesses (particularly palm oil) within their jurisdictions. This Law also gives legal authority to the local environmental regulator (such as Subdivision PPKL) to issue environmental permits regarding palm oil companies. These conditions are different to those of the oil and gas sector, in which the national (central) government has both the regulatory authority to issue business licenses and environmental permits and associated power to influence the sector.

As discussed above, subnational governments use this devolved authority to pressure companies in relation to PROPER in North Sumatra. The Tebing company listened carefully to subnational government demands, both in informal discussions and through formal invitation letters.⁹⁷ For the company, participating in PROPER was a mechanism by which to build strong relationships with subnational government, so as to ease administrative and other processes that had implications for production. When faced with the informal threat of slow access to environmental permits for non-participation, Tebing chose instead to implement PROPER.

As a result of Tebing's participation in PROPER, environmental permits were issued quickly.⁹⁸ These findings support the previous argument in the oil and gas sector that businesses need to build strong relationships with political elites at the level of government with the appropriate authority to secure business licenses as well as environmental permits. Under decentralisation, similar to the national level in the oil and gas sector, subnational governments can reward or punish companies in the palm oil sector through mechanisms that go beyond the scope of formal rules and procedures, especially regarding issuing permits. Complex and often unclear administrative procedures and the slow release of permissions are a key feature of Indonesia's institutional context that creates uncertainty for businesses. Building informal connections with government staff at the relevant level is one way to minimise uncertainty for businesses.

⁹⁷ Confidential interview with employee at Tebing company, April 12, 2017.

⁹⁸ Ibid.

However, in addition to different regulatory authority structures in relation to institutional conditions in the oil and gas and palm oil sectors under decentralisation, other aspects regarding the way decentralised units are funded to deliver PROPER explain sectoral variation in the implementation of PROPER. This subsection argues the subnational regulator in the Tebing case adopted the strategy of “informal threat” as a result of economic interest of local government staff in relation to PROPER.

The regulatory design of PROPER mandates that national government must allocate budgets for inspection to support subnational governments in conducting company assessments under PROPER. The amount of funds for such inspection depends on the number of participants in the program. Greater numbers mean that a bigger budget for inspection is allocated. Interviewees explained that the aim of using “informal threat” was to mandate companies to participate in PROPER to secure bigger budgets. A senior bureaucrat in subnational government explained that:

When we inspect more companies, we receive more funds for inspection from the DITJEN PPKL [national government]
(Interview with a bureaucrat at the Subdivision PPKL, Mr M, April 12, 2017, North Sumatra Province).

In general, the assessment cost per company is USD 2,205 (exchange rate at IDR 13,600 (Interview with a PPKL Subdivision staff member, Mr M, April 12, 2017, North Sumatra Province). The amount also depends on where each company is located. The greater the distance, the higher the cost of assessment. Most of the evaluation budget is used for transportation allowances and inspection fees. The PPKL Subdivision government staff who are inspectors of PROPER get more fees and transportation money in their take home salaries with each additional inspection under PROPER. One government staff member explained the common refrain from government staff: “More companies, more activities, bring more money home!” or saving money from travelling activities in the inspection (Interview with a Subdivision PPKL staff member, April 12, 2017, North Sumatra Province).

Furthermore, the regulatory design of PROPER accounts not only for the number of participants in its budget allocation, but also the level of company performance in the previous assessment, when deciding on the amount of funds to be allocated. Budgets for inspection are allocated by national government to subnational governments to undertake the first company inspection, and thereafter for inspections of companies which have basic compliance levels or lower ratings (Black, Red or Blue). Beyond compliance performers (those companies with existing Green or Gold ratings) do not need to be inspected by subnational governments. Instead they were allowed to self-assess and submit their assessment online, which is evaluated nationally.

Self-assessment was one way national government could reduce the cost of implementing the program. Drawing on the literature of regulatory theories, self-assessment reduces the cost of regulation and encourages future compliance. Baldwin et al. (2010, p. 85) argue that self-assessment aims to stimulate modes of self-organisation within the firm to encourage internal self-critical reflection about its regulatory performance. In Indonesia, national government expected that self-assessment policy for beyond compliance performers would encourage companies to be self-critical of their environmental performance bypassing government inspections.⁹⁹

However, the national government did not calculate the impact of its self-assessment policy in terms of how subnational regulatory agencies would implement PROPER. The subnational government perceived that self-assessment for beyond compliance performers creates a financial disincentive for government assessors to encourage companies to achieve beyond compliance performance (either a Green or Gold rating), as they lose the personal financial benefits from conducting assessments. As such, subnational government bureaucrats did not provide technical regulatory assistance to improve company performance to beyond compliance level.¹⁰⁰ The

⁹⁹ Confidential interview with bureaucrat at Ministry of Environment and Forestry on April 27, 2017.

¹⁰⁰ Confidential interviews with bureaucrat at Tebing company on April 12, 2017.

subnational government instead preferred to adopt the “informal threat” strategy, which focused on companies’ participation in PROPER, and suggested them to stay on compliance level (up to a Blue rating). This development is discussed in more detail in the next chapter.

According to an employee at the Tebing company, environmental regulators of the subnational government who inspected the plant did not have comprehensive knowledge of and skills in technical environmental management.¹⁰¹ For example, they measured the air pollution of the biomass electricity generator (that used the shell of palm oil fruit) based on indicators for fuel or diesel generator.¹⁰² This demonstrates that bureaucrats did not update their knowledge and skills regarding renewable energy policy encouraged by national government. Renewable energy is but one of the beyond compliance programs suggested by PROPER standards.

In summary, decentralisation and the importance of state-business relationships help explain why and how the subnational government regulator in the Tebing case in North Sumatra province adapted the regulatory strategy of PROPER. While subnational government had regulatory authority in the palm oil sector, such authority was neither translated into both local bureaucrats’ knowledge and skills to implement PROPER, nor their interest in providing technical assistance and support to companies to reach beyond compliance performance. Instead, subnational government implemented a discretionary policy that shifted the emphasis from technical assistance to companies to meet beyond compliance standards for which there were financial disincentives to the subnational regulator in PROPER’s regulatory design, to a strategy of “informal threat”. This strategy was able to influence the Tebing company given the importance of state-business for business certainty and reduced production costs.

¹⁰¹ Confidential interviews with employee at Tebing company on April 12, 2017.

¹⁰² Ibid.

7.5. Public disclosure in the Indonesian palm oil sector

As discussed in the previous chapter, public disclosure is one regulatory strategy used by PROPER to shape socio-environmental performance of participants by harnessing pressure from third party actors on companies to induce change in company behaviour. The national government adopts public disclosure through its colour-coded rating system (Black, Red, Blue, Green and Gold). Black, Red or Blue ratings demonstrate company compliance with environmental legal regulations. Either a Green or Gold rating shows that company performance not only meets environmental legal regulations but also beyond compliance (or not required by law). In the literature on public disclosure explored in Chapter 2; the impact of public disclosure on socio-environmental performance depends on the response of third-party actors (investors, banks, buyers, consumers, CSOs and local communities). The following subsections discuss if and how PROPER was able to use this public disclosure strategy to harness pressure, from both domestic and international actors, on the Tebing company. In particular, this section focuses on how the domestic BNI bank, palm oil buyers such as Unilever, CSOs such as the IDH-Sustainable Trade Initiative, and the RSPO certification body shaped the regulatory capacity of PROPER. I seek to show that these third parties recognised compliance level ratings of PROPER (Blue) but did not recognise beyond compliance level ratings (Green and Gold).

As such, this chapter argues that PROPER's public disclosure strategy was constrained in its efforts to harness pressure from third-party actors to support Green or Gold levels of beyond compliance company performance in PROPER. Instead, in the palm oil sector, international actors recognised and pressured companies to meet the RSPO's beyond compliance standards, outlined in its Principles and Criteria (P&C). The case of the state-owned palm oil company shows that public disclosure strategies under PROPER work differently in the palm oil sector compared with the oil and gas sector.

7.5.1. Pressure from the domestic bank: PROPER “naming and shaming” strategies

Domestic banks are third-party actors in public voluntary regulation programs, which, as company investors that rely on socio-environmental ratings and other business indicators of performance, can pressure companies to improve environmental management practices. In this subsection, I explore the role of the domestic BNI bank as a third-party actor that supports the regulatory goals of PROPER to exert pressure on the state-owned palm oil company. All banks in Indonesia must comply with the Indonesian Central Bank’s regulation to ensure that debtors comply with environmental regulations, but that the case study data relates directly only to the BNI bank. This subsection argues that public disclosure through the PROPER rating system was able to harness pressure from the BNI on the Tebing company to comply with Indonesia’s minimum environmental legal regulations and thus achieve a Blue rating under PROPER. BNI was, however, less interested in pressuring the company to meet PROPER’s beyond compliance standards.

As creditor of the state-owned palm oil company, the BNI has the economic power to pressure the Tebing company to comply with environmental legal regulations. BNI was certainly displeased to see that one of the production units of Tebing received a Black rating in PROPER in 2015. This rating “shamed” the BNI because it had publicly committed to support sustainable finance policies in Indonesia (see sustainable finance commitments in the Indonesian banking sector discussed in Chapter 6).¹⁰³ This meant that the company to which the bank had provided a loan had not even met basic environmental legal regulations and had made virtually no effort to control the pollution for one of its production units. Thus, BNI undertook steps to make the real changes at company to meet minimum legal environmental requirements, detailed chronologically in Figure 7.1.

¹⁰³ According to the Director of planning and operational at Bank National Indonesia, the bank will not process the loan if a company obtains either a Red or Black rating in PROPER. These ratings will shame BNI as the creditor (SWA magazine, March 19, 2016).

On November 20, 2015, the Ministry of Environment and Forestry (MOEF) published PROPER ratings through the Minister of Environment Decree No. SK.557/Menlhk-Setjen/2015 (MOEF, 2015). This Decree stated that PKS Sei Meranti (one of the Tebing palm oil production units) had obtained a Black level rating in PROPER for 2014-2015. According to the inspection report from PROPER (MOEF, 2015), PKS Sei Meranti did not have any of the required environmental permits from the subnational government.¹⁰⁴ The letter of protest sent to the company from BNI focused not only on the poor performance of PKS Sei Meranti but also the entire Tebing company as a corporation. For BNI, a regulatory violation in one production unit impacts the whole company's regulatory compliance (*SWA Magazine*, 2016). BNI requires the company to ensure that all production units meet the environmental legal regulation within the Indonesian jurisdiction.¹⁰⁵ Based on the PROPER rating, BNI sent a letter to Tebing requesting an explanation for poor company performance in PROPER. In the letter, BNI highlighted two issues. First, BNI asked the Tebing company to explain why Sei Meranti had obtained a Black rating in PROPER. Second, the bank as creditor threatened to suspend its loan to Tebing if the company did not solve the problem(s) that had led to the Black rating (Interview with an employee at the Tebing company, Mr Z, April 12, 2017, North Sumatra Province).

¹⁰⁴ In addition, Eyes on the Forest, an environmental CSO, published reports detailing 29 illegal oil palm plantations in forest areas. One of the companies was the state-owned plantation company Sei Meranti, which obtained a Black level in PROPER in 2015.

¹⁰⁵ Confidential interview with employee at Tebing company, April 12, 2017.

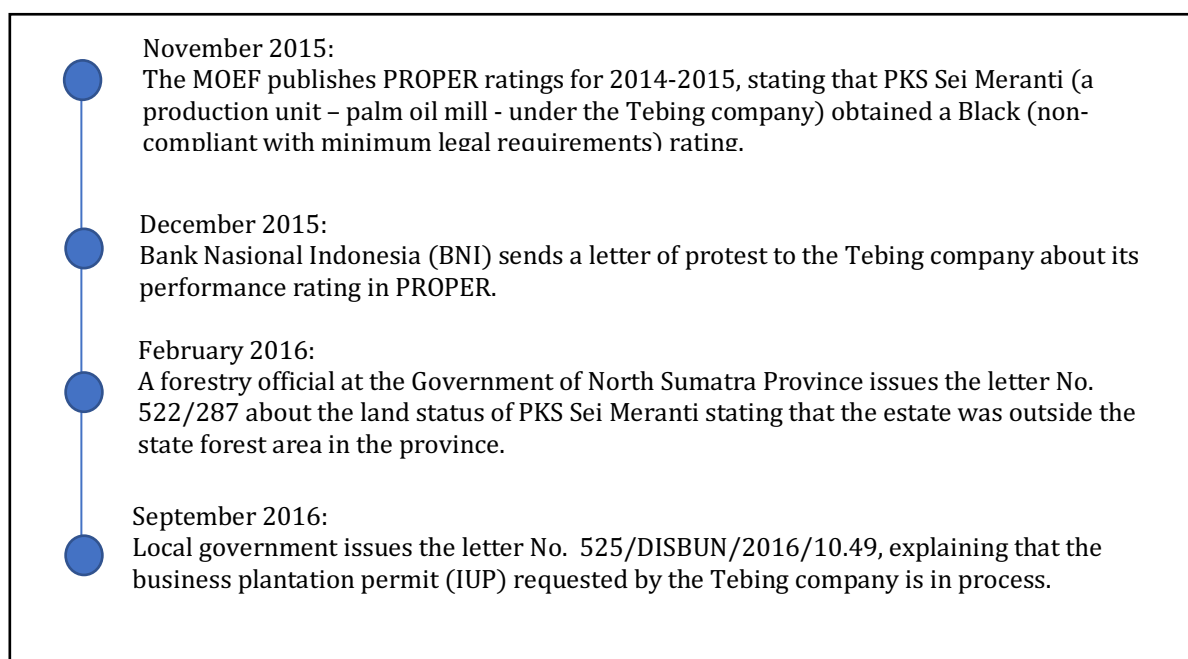


Figure 7.1. Chronology steps: how financial organisation underpins the regulatory impact of public disclosure

The case of the Tebing company confirms findings in the existing literature on the role that banks can play as creditors to improve environmental performance in business. For example, the Co-operative Bank in the United Kingdom has terminated some existing business relationships because of environmental concerns (Thompson & Cowton, 2004, p. 199).

The senior management at Tebing was displeased with BNI's protest, but nevertheless endeavoured to stop the environmental regulatory violations committed by PKS Sei Meranti.¹⁰⁶ The PROPER Black rating for this palm oil mill emerged in relation to the land status of PKS Sei Meranti oil palm plantation areas. Eyes on the Forest (EOF), an environmental CSOs, had published reports that some of the oil palm plantations owned by PKS Sei Meranti (a subsidiary of Tebing) were operating illegally in forest areas (managed by the government), for which they did not have concessions (access and usage rights) (EOF, 2018). Thus, EOF claimed that this subsidiary

¹⁰⁶ Confidential interview with employee at Tebing company, April 12, 2017.

of the state-owned palm oil company was conducting business illegally. However, letter No. 522/287, issued by North Sumatra Provincial Government Forestry Office, dated February 2016, states that PKS Sei Meranti's plantation areas were excluded from the North Sumatra Province state forest area. This exclusion was allowed by the provincial government based on the Minister of Environment and Forestry Decree No. SK.5358/MenLHK-PKTL/IPSDH/2015 dated November 20, 2015 (revision IX) (MOEF, 2015). After that, the company was able to gain a concession issued by the national government.

One of the reasons PKS Sei Meranti had not obtained other important environmental permits was because they didn't have an appropriate business permit for the palm oil mill, and this was because they did not have the initial concession licences for some of their oil palm plantations, as mentioned above. Once it was granted the appropriate concession, the Tebing company took steps to obtain the appropriate business and environmental permits. As a result, in September 2016, the provincial government issued letter No. 525/DISBUN/2016/10.49, explaining that the business plantation permit (IUP) for the PKS Sei Meranti palm oil mill was in process. After obtaining the IUP, the Tebing company was able to request specific environmental permits it needed such as a water usage permit (which allowed for water pollution levels up to a specified standard), air pollution permit (which allowed it to conduct activities that impacted air quality up to a specific standard), and a toxic and hazardous waste temporary storage permit. By 2019 Tebing had thus been given a Blue rating by PROPER.

BNI focused on a compliance level (Black, Red or Blue), and was less interested in beyond compliance (Green or Gold). An employee at Tebing remarked:

BNI has policy to increase the interest rate [for example, from 2 percent to 2.5 percent] for the existing loans, if company obtained a Black or a Red rating in PROPER. However, BNI does not have any policy to give an incentive for beyond compliance performers [either a Green or Gold rating] (Mr. Z, April 12, 2017, North Sumatra).

The role of BNI in PROPER confirms existing arguments in the public voluntary regulation literature: financial organisations are critical actors that can support regulators to achieve the regulatory objectives of public voluntary regulation through pressuring companies. Banks provide economic incentives and disincentives through capital markets to pressure companies for better socio-environmental performance. This was evident in both the private-sector oil and gas company case (see Chapter 6) and the Tebing case. Creditors and investors gained information from public disclosure under PROPER and used this to directly pressure companies to change their behaviours. Such mechanisms operate slightly differently from the way civil society organisations and communities use such information as a means of pressuring companies in negotiations over the “social license to operate” that companies need to maintain production processes at plants. This will be discussed in more detail in the next section.

7.5.2. Pressure from Unilever, the IDH-Sustainable Trade Initiative and the RSPO on the Tebing company

PROPER public disclosure documentation and ratings were also used by several other global governance actors, namely international buyers of palm oil such as Unilever, the IDH-Sustainable Trade Initiative, and the RSPO, to evaluate the state-owned palm oil company’s compliance with environmental legal regulations in relevant Indonesian jurisdictions. In the discussion below, this subsection argues that the interaction between third-party actors only partially supported PROPER to achieve its regulatory targets in the case of the state-owned palm oil company, as third-party actors only recognised the compliance level in PROPER.

Unilever, the IDH-Sustainable Trade Initiative, and the RSPO used PROPER’s Blue rating as a base indicator in their decision to support the Tebing company to obtain RSPO certification, both for the plants and smallholder farmers who supplied the company. While the domestic bank pressured the company to meet minimum legal requirement standards, these other organisations then used the Blue rating as the basis for their decision to

support the Tebing company as a partner for promoting sustainable palm oil production to smallholder farmers in Indonesia.¹⁰⁷ As strong global players in sustainability certification, RSPO must ensure that all partners comply with environmental regulations in the jurisdictions where they operate (RSPO, 2020). For these global third-party actors, the main function of PROPER was to demonstrate that the company had complied with environmental legal regulations in Indonesian jurisdictions.

Promoting sustainability in palm oil production to smallholder farmers came to be important to RSPO, given the very low levels of oil palm farmed sustainably in smallholdings in Indonesia. At the global level, smallholder farmers produce 40 per cent of the world's palm oil (prior to processing) up to mid-2016.¹⁰⁸ In Indonesia, in 2015 the total area of smallholder plantations reached 4,575,101 hectares or 40.5 per cent of oil palm plantations in 2015. Based on RSPO figures, there are 2.919 smallholders farmers in Indonesia who have met the sustainability indicators of RSPO (RSPO, 2020). These farmers form part of the 157,284 smallholder farmers certified by RSPO globally (RSPO, 2020). This only represents 5.2 % of the total global population of smallholder farmers (RSPO, 2020). At the Tebing company, the contribution of fresh fruit bunches (FFB) from smallholder farmers reached 600,691 tons, or 22.5 per cent of the total FFB processed in 2015 (RSPO, 2016).

Given the low rate of sustainable palm oil production, the partnership between RSPO and Tebing aimed to accelerate sustainable palm oil production among smallholder farmers.¹⁰⁹ This program succeeded in supporting UD Lestari, one of the Tebing suppliers, to meet the RSPO standards in 2017. UD Lestari, an independent group of smallholder farmers from North Sumatra Province, was the first smallholders' organisation in Indonesia to gain certification from the RSPO (IDH Sustainable Trade Initiative, September 20, 2017). This achievement has not only provided benefits to UD Lestari

¹⁰⁷ Confidential interview with employee at Tebing company, April 12, 2017.

¹⁰⁸ <https://rspo.org/smallholders>. Accessed on December 28, 2018.

¹⁰⁹ PTPN, "63 smallholder farmers UD Lestari certified by RSPO", accessed on June 12, 2018.

members (63 farmers, 19 of whom are women) but has helped improve Tebing's company image (Unilever, 2017).

From the company's perspective, UD Lestari's achievements in RSPO certification and sustainable palm oil production is seen as achieving a 'double green' standard, that is, holding a green certification for suppliers as well as green certification for the company.¹¹⁰ The 'green' contribution of UD Lestari certification has contributed to 'green' achievements for Tebing.¹¹¹ Furthermore, Tebing also perceives the successful project with RSPO to be a landmark example, bolstering its mission of 'developing a sustainable agriculture-based upstream industry'.¹¹² Top-level management at the Tebing company claimed that introducing sustainable agriculture to farmers has been an important way to drive sustainable palm oil production in Indonesia.¹¹³ However, paradoxically, focusing on the RSPO certification process has meant that the company did not meet PROPER beyond compliance standards, as discussed earlier in this chapter.

Unilever similarly stated that the success of UD Lestari would have a significant impact on Indonesian sustainable palm oil production ((Unilever, 2017). Moreover, the IDH-Sustainable Trade Initiative Director in Indonesia highlighted that farmers are the most important agents in creating sustainable agriculture, not just in the palm oil industry, but in the industries of other commodities, by both protecting the environment and increasing the welfare of rural communities (IDH Sustainable Trade Initiative, September 20, 2017). Similarly, RSPO Country Director of Indonesian Operations said that the achievement of UD Lestari could be a great example and motivation for other smallholder farmers (IDH Sustainable Trade Initiative, September 20, 2017). These three organisations not only have close networks that mutually reinforce the efforts of each in their promotion of sustainable palm oil production, but together they pressured Tebing to commit to beyond

¹¹⁰ Confidential interview with an employee at Tebing company, April 12, 2017.

¹¹¹ PTPN, "63 smallholder farmers UD Lestari certified by RSPO", accessed on June 12, 2018.

¹¹² Tempo, "Smallholder farmers UD Lestari certified by RSPO", September 24, 2017.

¹¹³ Ibid.

compliance RSPO standards rather than those of PROPER. Further, intensive interactions with these global partners shaped the company's motivation to commit to RSPO Principles and Criteria (P&C).¹¹⁴

In summary, the findings at the state-owned palm oil company show distinctive responses of third-party actors to PROPER, which are different from those of the oil and gas sector discussed in previous chapters. Third-party actors' preference for the RSPO undermined the regulatory impact of PROPER in achieving beyond compliance standards in the palm oil sector. Instead, third-party actors supported companies, in particular Tebing, to meet only the minimum legal requirement standards in PROPER (Blue rating) and use alternate transnational certification as the standards by which to aim for beyond compliance performance. Collaboration and networks among third-party actors in the palm oil sector provided a crucial challenge for PROPER to gain legitimacy as a certification program for beyond compliance performance that could cut across resource sectors in Indonesia. The Tebing company preferred to engage with the transnational certification program suggested by third-party actors, because of the tangible economic incentives this introduced through price premiums, which were greater than those of PROPER. As a result, PROPER lost out to the RSPO in terms of influencing key regulatory mechanism to shape social and environmental beyond compliance performance at the Tebing company regarding beyond compliance standards (Green and Gold ratings).

7.5.3. Domestic and international third-party commitment and action capacity

As explored previously, this thesis examines not only how public regulators adapted regulatory strategy (such as public disclosure), but also the conditions under which regulatory strategy can draw on multiple sources of pressure to shape socio-environmental performance. This section argues that the configuration of global and domestic interests in promoting globally-

¹¹⁴ Confidential interview with employee at the Tebing company, April 12, 2017.

recognised sustainable palm oil production standards, the aforementioned third-party actors (the RSPO, IDH and Unilever) in the case of the Tebing company were committed and had the capacity to promote transnational certification rather than that of PROPER to assess beyond compliance performance. At the same time, given that the main creditor of the Tebing company was the domestic (rather than international) bank, its limited commitment to support PROPER standards for anything other than meeting minimum legal compliance was a result of the mandatory regulations from the Indonesian financial regulators. Together, these underlying aspects of the Indonesian context undermined the ways PROPER's public disclosure strategies could garner the support of all relevant third parties to pressure the Tebing company to meet PROPER's beyond compliance standards.

Environmental commitment from banks: drawing from other mandatory regulations to support PROPER

As explored in the previous sub-section, the domestic BNI bank used PROPER's rating to pressure the state-owned palm oil company to comply with environmental legal regulations. The question is why did BNI want to use PROPER, even just the Blue rating standards, for its investment policy? This subsection argues that the willingness of BNI to draw on PROPER standards as a source of pressure on the Tebing company was not voluntary, but mandatory. The Indonesian financial regulatory agencies (both the Indonesian Central Bank and Indonesian Financial Service Authority [*Otoritas Jasa Keuangan*-OJK]) mandate that all banks in Indonesia must adopt sustainable finance policies and ensure their debtors comply with environmental legal regulations.

As the regulatory agency in the Indonesian financial sector, the Indonesian Central Bank issued the Indonesian Central Bank Regulation No. 7/2/PBI/2005 (updated No. 14/15/PBI/2012), which mandates that all commercial banks in Indonesia must use environmental performance as one of the indicators in their credit quality assessments. This regulation is the implementing regulation for Law No. 23/1997 (updated Law No. 32/2009) on Environmental Management, which mandates individuals and organisations

(banks) to protect the environment. Sustainable finance provides a means for the banking sector to participate in environmental conservation. Indonesian Central Bank Regulation No. 14/15/PBI/2012, Article 10 states that;

Credit quality is determined based on assessment factors as follows: (a) Business prospects; (b) Debtor performance; ... (e) Efforts undertaken by the debtor under the framework of environment conservation (Bank Indonesia Regulation No. 14/15/PBI/2012).

This regulation mandates the bank to examine a company's environmental performance before approving loans and defines environmental performance as the debtor's obligations to make efforts to maintain the natural environment according to legal environmental regulations. Bank Indonesia encourages domestic banks to consider debtors' PROPER ratings to implement sustainable finance in Indonesia (UNEP, 2015, p. 22).

In addition to the Indonesian Central Bank, the OJK is also the financial regulatory agency. Like Indonesian Central Bank, OJK issued Regulation No. 51/POJK.03/2017 regarding sustainable finance. This regulation also mandates that all banks and other financial service companies in Indonesia take responsibility for ensuring their debtors or clients comply with environmental legal regulations in Indonesia.

Mandating banks to integrate environmental management indicators in their investment policies is critical to supporting PROPER objectives because of their economic power over companies. Companies, such as the Tebing company, need access to capital to expand their businesses. As a debtor and, as mentioned above, the management at Tebing carefully listened to BNI's demands, especially those on environmental regulatory compliance and obtaining a Blue PROPER rating. Tebing needed loans to transform its business into a world-class agribusiness company (Tebing Company Annual Report, 2017, p. 21) and needed at least a Blue PROPER rating to both restructure its existing loans, and request new loans from BNI and other domestic banks. When it met the relevant standards the new, restructured mega holding company gained a total amount of IDR 13.2 trillion or USD almost 1 billion

(exchange rate at IDR 13,300) in 2016 in restructured loans and additional finance.

First, the Tebing holding company proposed restructuring its existing loans for each of what had once been separate SOE plantation companies (which became subsidiaries under the amalgamation) through an extension of its loan payment schedules. PROPER Blue ratings for all production units was one of the prerequisites required from the domestic banks to restructure its loans. Based on figures from 2016, Tebing company restructured existing loans to the amount of IDR 9.4 trillion or about USD 726 million across subsidiaries (exchange rate at IDR 13,300) (Table 7.2).

Table 7.2. Restructured loan amounts for Tebing holding company subsidiaries from domestic banks in 2016

No	Subsidiaries	Bank	Type of bank	Amount IDR (billions)
1	I	BRI, Exim bank	Domestic	650
2	II	BRI, BRI Agro, Bank Mandiri	Domestic	997
3	VII	BRI	Domestic	5,142
4	XIII	Bank Mandiri, BRI	Domestic	2,612
5	XIV	Bank Mandiri, Bank Agro	Domestic	37
Total				9,439

Source: Adapted from the Tebing company Annual Report, 2016, p. 134

Second, the Tebing holding company requested new loans from several domestic banks. At the end of 2016, the Tebing company had received new loans from domestic banks totalling IDR 3.7 trillion or USD 285 million, exchange rate at IDR 13,300 (see Table 7.3). The company described the

programs involved in this strategy as requiring ‘fresh fund injections’ (Tebing Company Annual Report, 2017, p.134). Domestic banks further required documents explaining how Tebing would meet minimum legal requirements. A Blue PROPER rating is the most straightforward ‘language or evidence’ available to show that a company meets minimum legal environmental requirements.

Table 7.3. Fresh fund injections from loans at Tebing company in 2016

Subsidiaries	Loans from corporate	Bank loans	Total IDR billion
I	168	-	168
II	180	640	820
V	-	1.000	1.000
VII	101	-	101
VIII	250	350	600
IX		500	500
XIII	182	350	532
XIV	74	-	74
Total			3.795

Source: Tebing company Annual Report, 2017, p. 135

In summary, while PROPER itself draws on public voluntary regulation, it was able to harness some support for its standards from banks due to other complementary, but mandatory regulations on sustainable finance. This provided the institutional conditions which enabled PROPER to harness support for its standards from banks that in turn pressured the state-owned palm oil company, but only to meet the basic compliance standard. Banks in Indonesia must comply with the regulation on sustainable finance while as debtor, the Tebing company must meet the environmental performance standards required by the banks.

Environmental commitment from international actors: switching voluntary standards

As explored previously, international actors also used PROPER's rating system, at least to the Blue level, to support the state-owned palm oil company. What then, were the institutional conditions that bolstered this commitment from international actors (Unilever, IDH-Sustainable Trade Initiative, and RSPO)? This subsection argues that a broader global commitment to sustainable palm oil production from consumers and CSOs motivated international actors to use the information provided by PROPER for their initiatives. Such global commitment has encouraged palm oil companies to adopt sustainable palm oil production (Schouten & Glasbergen, 2011). To meet the global standards on sustainable palm oil production, companies must comply with environmental legal regulations in the relevant jurisdictions where palm oil is produced. As such, PROPER's public disclosure strategies provided such information to global actors on whether Indonesian companies had met these legal requirements.

Under pressure from consumers to use more sustainably sourced palm oil in its products, the global giant Unilever led the program mentioned above to support the state-owned palm oil company to meet global standards on sustainable palm oil production required by RSPO (Unilever, 2017). Unilever is one of the founders of RSPO, formed with the World Wide Fund for Nature (WWF), MiGros and the Malaysia Palm Oil Association (MPOA) in 2004. These members of RSPO shared a strong commitment to improving environmental performance given pressure from consumers, members and other actors to do so. It has sought to establish voluntary standards and certification for sustainable palm oil production. It also has significant action capacity, given it had organised thousands of members from around the world (some 4,464 members in 2019) to promote sustainable palm oil production.¹¹⁵ Some members, such as Unilever and Nestle, are the biggest consumers of palm oil

¹¹⁵ <https://rspo.org/>. Accessed on December 4, 2019.

products and have the capacity to direct their suppliers to gain sustainable palm oil production.

RSPO promotes seven principles for growers to be certified as a sustainable producer by RSPO and provides technical assistance to its partners. These are (1) behave ethically and transparently, (2) operate legally and respect rights, (3) optimise productivity, efficiency, positive impacts and resilience, (4) respect community and human rights and deliver benefits, (5) support smallholder inclusion, (6) respect workers' rights and conditions, (7) protect, conserve, and enhance ecosystems and the environment.¹¹⁶ RSPO also has the technical knowledge to support companies to meet these standards as demonstrated in the discussion on smallholder support for Tebing suppliers, as discussed above.

Amongst those principles, only the principle of operating legally intersects with and overlaps directly with PROPER standards on meeting minimum environmental legal requirements (Blue rating), although indirectly some of PROPER's standards that incorporate community development might also indirectly overlap with those of the RSPO. The strong commitment of Tebing to maintain its Blue rating in PROPER, in part, results from this overlap with RSPO requirements, which, as mentioned above, the company prefers, given the premium price RSPO certification can provide and to support its goal. For example, Tebing's export of CPO to the global market, amounted to 2.5 million tons or 80% of total production in 2019 (*Ekonomi bisnis magazine*, July 23, 2018). The Tebing holding's orientation towards the international palm oil market after the amalgamation of all state-owned palm oil companies in 2014 was a highly significant move which constrained the regulatory influence of PROPER to improve company socio-environmental performance to meet its own beyond compliance standards (either a Green or Gold rating). These conditions were different from the oil and gas sector in which there were no competing transnational certification programs supported by third

¹¹⁶ https://rspo.org/library/lib_files/preview/872. Accessed on December 4, 2019.

parties that undermined the regulatory capacity of PROPER to shape socio-environmental performance.

Social and environmental commitment and action capacity from communities

One point to elaborate briefly is why this case study has not discussed at length if PROPER could harness pressure from communities on the Tebing company, particularly given democratisation was a key feature of the institutional conditions that helped apply pressure on the state-owned oil company, as discussed in the previous chapter. Similar to other cases, Indonesia's democratisation context has bolstered the commitment and action capacity of communities and civil society organisations broadly in North Sumatra, but this has not manifested as a pressure that PROPER was specifically able to harness in relation to PKS Rambutan (subsidiary of the Tebing company that is the focus of this case study) for several reasons.

First, while there were some initial pressures from communities on the company at the onset of democratisation¹¹⁷ (and certainly on other state-owned palm oil companies in other regions) in relation to land and the environment, these did not feature strongly in the period covered by this research in relation to the PROPER program. As discussed in Chapter 4, in regions where there is a long history of SOEs conducting extractive activities, land has often been (and continues to be) strongly controlled by the state. However, in the case of PKS Rambutan, any initial protests in relation to this were shortlived, given the control of the state over land and that increasing numbers of small holders were incorporated into the supply chains of the PKS Rambutan mill.¹¹⁸

Second, in addition to incorporating smallholders into its supply chains, when PKS Rambutan initially achieved beyond compliance Green status, the

¹¹⁷ Between 1998 and 2011, there were some conflicts between the community of Paya Bagas Village and the state-owned palm oil company. Local community reclaimed the lands (82.5 hectares) that have been occupied by the company. Twenty people were injured in the struggle and the head of the local community was jailed due to his action in leading local community movements. The Indonesian court concluded that the disputed lands legally belonged to the company. Multiple, confidential interviews with local communities on April 9, 2017.

¹¹⁸ Confidential interview with an employee at Tebing company, April 9, 2017.

company had undertaken community development programs, such as scholarships, financial aid to maintain mosques, food for poor people. At this point, it was able to temporarily harness pressure from communities to facilitate a social licence to operate (Tebing Company Environmental Report, 2017, p. 18). Third, there was little evidence in that PKS Rambutan mill was subject to pressure from communities to meet PROPER's beyond compliance standards, or solely rely on its public disclosure ratings. This in part relates to community involvement in RPSO certification programs in 2014. When the company shifted to meeting Blue minimum legal requirements under PROPER after 2014, but simultaneously sought to meet RSPO beyond compliance standards; in effect, the RSPO certification process for the mill and smallholder suppliers helped provide the social licence to operate for the company. As such, the Tebing company did not need PROPER's beyond compliance standards to gain this social licence to operate, as in the case of the privately-owned oil and gas company.

7.6. Conclusion

This chapter has highlighted how public regulators—in both national and subnational governments—adapted and implemented regulatory strategies in PROPER and conditions under which PROPER has been able to harness pressure to shape socio-environmental performance at the state-owned palm oil company. Some of the pathways by which PROPER was initially able to influence companies and ultimately performance was similar to the state-owned oil and gas company. Strategies that elicited direct pressure from national state actors to promote environmental leadership influenced behavioural change among Tebing corporate managers to initially meet beyond compliance under PROPER. This was particularly due to the ways in which senior appointments are made by political elites, and the political economy of close state-business relations. Public disclosure and pressure from third-party investors, in particular banks, also supported this process (at least in meeting basic compliance standards). These dynamics initially resulted in changes to PKS Rambutan's priorities and business practices to meet beyond

compliance standards (Green), and for other Tebing subsidiaries, such as the PKS Sei Meranti, to at least meet PROPER's basic compliance standards (Blue).

However, this aforementioned configuration of PROPER strategies was less successful in sustaining pressure on the company to continue to meet beyond compliance standards over time when institutional conditions are taken into account. This chapter has demonstrated that close state-business relations and the structure of state-owned companies renders PROPER sensitive to changes in the priorities of political elites. When their interests shifted in favour of international markets and transnational certification mechanisms, so too did the interests of the company. However, in so doing, this shift delegitimised PROPER and the domestic public voluntary standards it sought to promote. The influence of demands from international markets for particular forms of sustainable palm oil production (and transnational mechanisms which certify these forms of production) shape the dynamics in Indonesia's palm oil sector. They bolster the influence of third-party international actors and global governance arrangements in Indonesia. These features of context in the palm oil sector are helpful in explaining constraints on the influence of PROPER over state-owned palm oil companies.

The design of PROPER and the influence it exercised on the Tebing company was also sensitive to other institutional conditions, such as the decentralisation of the palm oil sector, in which the interests of designated subnational regulators that did not necessarily favour beyond compliance performance in PROPER, at least supported achieving blue-level basic legal compliance ratings. Using their regulatory authority, these actors substituted technical assistance in PROPER's design with their own strategy of "informal threat" to influence companies, a strategy which only partially aligned with PROPER regulatory goals. Using "informal threats", the subnational regulator sought to elicit the participation of increasing numbers of palm oil companies to participate in PROPER, so as to gain the associated funds for assessments from national government. However, PROPER's design presented financial disincentives for subnational regulators to support companies in beyond compliance performance because companies self-assessed their own

performance. It was thus in the interests of subnational regulators, for as long as possible, to encourage these companies to meet basic compliance standards. In comparison with the oil and gas sector, the state-owned company was particularly sensitive to the interests of subnational elites, given their authority to issue business licences and permits. To the best of my knowledge, informal threat strategies have not been documented in the existing literature on public voluntary regulation.

With this configuration of strategies and institutional conditions, instead of improving performance, the state-owned palm oil company's performance in PROPER dropped from the basic level of beyond compliance (Green rating) to compliance level (Blue rating). That is not to say it did not focus on environmental management and community development (it actually focused more widely on beyond compliance socio-environmental performance) but that this was not induced or measured by PROPER, and instead is possibly captured by RSPO transnational certification mechanisms.

In summary, the Tebing case study illustrates key aspects of Indonesia's broader context and institutional conditions that help explain why and how PROPER regulatory strategies were unable to encourage the state-owned palm oil company meet beyond compliance PROPER standards. Key conditions include: decentralised authority for the palm oil sector, the structure of state-owned companies that allow for direct political influence on decision making, the importance of informal state-business relationships at both the national and the subnational levels, and the market actors in the global socio-environmental governance of palm oil that tend to favour transnational certification programs. The next chapter will explore an alternative firm ownership structure. It illustrates further differences in the ways public regulators adopt PROPER regulatory strategies and the conditions under which these strategies shape socio-environmental performance at the biggest Indonesian private palm oil company, Ketapang.

Chapter 8

The case of a private palm oil company

8.1. Introduction

The previous chapter explored the ways PROPER was unable to sustain improved socio-environmental performance over time at the state-owned palm oil company (Tebing), due to several factors. First, is the lack of recognition of PROPER's beyond compliance standards by both commercial and non-commercial actors (third parties) in global social and environmental governance, the commitment and action capacity of which focused on more dominant and competing transnational Roundtable Sustainable Palm Oil (RSPO) in the palm oil sector. Second, the shifting interests of influential national political actors over time towards international markets, which reduced the influence of PROPER regulators over top-level management and their ability to induce sustained improvements in PROPER ratings. This was underpinned by a change in both the state-owned company's organisational structure and its corporate priorities, which were oriented towards transnational certification programs to access international markets. The third and final factor, the weak interest and capacity of the subnational regulator in supporting PROPER's beyond compliance regulatory goals, although it did support basic compliance (Blue rating). Decentralised authority for the palm oil sector and close but often informal state-business relations were important institutional conditions that helped explain the constraints on PROPER's influence over the state-owned palm oil company.

This chapter examines how both national and subnational public regulators have adapted PROPER's regulatory strategies and the conditions under which these regulatory strategies have been able to influence socio-environmental performance at the privately-owned palm oil company, which I have called the Ketapang company.¹¹⁹ Between 2014 and 2017, Ketapang company performance in PROPER fluctuated between the minimum legal

¹¹⁹ I use the name "the Ketapang company" because of confidentiality arrangements I made with the company for this research.

compliance rating (Blue), beyond compliance rating (Green), and reverted again to a Blue rating.

Similar to arguments made in the case of the state-owned palm oil company, this chapter argues that PROPER was unable to harness different sources of pressure to induce sustained improvements in socio-environmental performance of the privately-owned Ketapang company over time. This is due to lack of recognition of PROPER by commercial and non-commercial third-party actors in global socio-environmental governance, as the preferred certification mechanism for beyond compliance standards, given the international orientation of the palm oil industry. It also includes weak subnational government capacity and interest in providing technical assistance to support beyond compliance performance under PROPER under decentralisation. These factors undermined the influence of PROPER's public voluntary regulation strategies on the Ketapang company.

I also argue the support for PROPER from Ketapang's top-level management was underpinned by influential national political actors and close state-business relationships. When this increased to encourage the company to meet PROPER's beyond compliance as a way of reducing forest fires, so too did the commitment of top-level management. When there was less pressure, the company pursued global beyond compliance certification mechanisms and only basic compliance certification under PROPER.

To explore the argument above, this chapter proceeds as follows. The following section explores the Ketapang company performance in PROPER over four years (2014-2017). The third section discusses how political elites at the national level used their power to influence the commitment of Ketapang's top-level managers to PROPER to mitigate forest fires. The fourth section examines how subnational government switched strategies and supplemented technical regulatory assistance with "informal state inducement" pursued by subnational regulators, giving companies time to undertake corrective actions for regulatory violations before publishing PROPER ratings. This strategy differs from the "informal threat" used in the previous case by subnational regulators. Finally, the fifth section discusses the

struggle of public disclosure of PROPER to build legitimacy for its program in the eyes of both commercial and non-commercial international third-party actors. Third-party actors did not recognise PROPER's beyond compliance standards, and instead pressured the company to engage with global sustainability standards, particularly those used by the RSPO.

8.2. Performance of the privately-owned Ketapang PROPER, 2014-2017

This section presents an overview of Ketapang's ownership structure and socio-environmental performance in PROPER (2014-2017). Ketapang's ownership structure varies significantly to that of all three other firms explored in this thesis, each of which have either a high proportion of ownership share controlled by domestic private sector firms or by the Indonesian state. In the case of Ketapang, only 28 per cent is owned by the firms of Indonesian tycoons. 28 per cent is owned by shareholders that have purchased shares in the company through the Singapore stock exchange. 6 per cent is owned by international bond holders, 36 per cent is owned by a combination of international and domestic banks, and the remaining 1 per cent is owned by joint venture partners. With such an ownership structure, foreign and domestic capital are highly interdependent.

As detailed in Chapter 3, the assessment of PROPER focuses on the plant level. If a company has several plants or production units, each may achieve different PROPER ratings. However, some sources of regulatory pressure also target companies that have multiple plants. In this discussion, I focus on PROPER's rating of the Pekawai palm oil mill (hereafter PKS Pekawai), a production unit of the Ketapang company.

PKS Pekawai, located in West Kalimantan Province, has participated in PROPER since 2014, or four years after it was established by the company in 2010. This thesis explores the performance of the mill based on data available up to 2017. To reach the mill, the journey from Pontianak, the capital of West Kalimantan Province, to PKS Pekawai is 346km or seven hours by car. PKS Pekawai processes 60 tons of Fresh Fruit Bunches (FFBs) per hour to produce palm oil (Ketapang Company Environmental Report, 2016, p. 2).

Table 8.1 below shows that in the early years of participation, PKS Pekawai only met the minimum legal requirements, obtaining a Blue rating in PROPER. Performance then improved and the mill gained a Green rating for meeting PROPER's beyond compliance standards in 2015-2016. However, PKS Pekawai's performance in PROPER reverted to compliance level (Blue) in 2017.

Table 8.1. PKS Pekawai's performance in PROPER (2014-2017)

Assessment Period	Socio-environmental Performance
2013-2014; 2014-2015	Blue (compliance)
2015-2016	Green (beyond compliance)
2016-2017	Blue (compliance)

Source: MOEF, PROPER's ratings, 2014-2017.

The fluctuation in PKS Pekawai's performance in PROPER contrasts with the company's consistent improvements in meeting minimum legal compliance standards in another green certification program, in particular RSPO certification. In 2011, the Ketapang company began certifying its production units using RSPO certification standards. By 2018, 29 production units had been certified by RSPO. The Ketapang company plans for 39 mills—that being 39 production units—to be certified by RSPO by 2020 (Ketapang Company Sustainability Report, 2018, p. 1). Until April 2020, Ketapang has certified 31 plants as required by RSPO (Ketapang company website, 2020).

Such trends illustrate that analysis of the regulatory influence of PROPER must be situated in the context of wider environmental regulatory processes, including rival certification programs. Rival certification programs interact with and influence the ways regulatory strategies under PROPER are able to harness sources of pressure on companies, including top-level management and stakeholders. The following sections examine how both national and subnational PROPER regulators adapted the regulatory strategies of PROPER, including promoting environmental leadership, technical regulator assistance and public disclosure, in some cases switching these for other strategies in subnational jurisdictions. It also analyses the institutional conditions which enhanced or constrained these regulatory strategies to

shape Ketapang's socio-environmental performance. Similar to the state-owned palm oil company, explored in the previous chapter, incorporated in this analysis is discussion of the ways competing transnational certification programs in the palm oil sector constrain the influence of domestic public voluntary regulation on companies to meet domestic beyond compliance social and environmental standards.

8.3. Promoting environmental leadership in the privately-owned palm oil company

This section illustrates how PROPER regulators at the national level organised Environment Awards Night to promote environmental leadership at firm. This strategy draws on support from national political elites to pressure top-level management to support beyond compliance programs. I also explore how institutional conditions, in particular the relationship between business and state influenced the regulatory impact of PROPER's strategy to promote environmental leadership at the Ketapang company.

8.3.1. Strategy of promoting environmental leadership

Similar to the prior three case studies, every year, the national regulator organises the Environment Awards Night to promote high achievers in PROPER and to facilitate direct communication between national political elites, senior leaders of the Ministry of Environment and Forestry, the Director General and DITJEN PPKL staff and top-level management of targeted companies, including Ketapang, to improve socio-environmental performance. At the 2015 event, the Minister of Environment and Forestry spoke with top-level Ketapang management, seeking support for government efforts, in particular to deal with fires in the West Kalimantan forests and peatlands. The Minister sought to involve businesses, including Indonesia's largest privately-owned palm oil company, Ketapang, to implement President Widodo's commitment to solve the problem of annual forest fires in Indonesia. In 2015, reducing forest fires was a key agenda of political elites in Indonesia (*The Guardian*, October 29, 2015). Together with other political elites, the

Minister sought to pressure top-level management to meet PROPER's beyond compliance standards so as to take action to reduce forest fires.

In 2015, top-level management formed both a new division called Sustainability and Compliance and supported it to design and implement programs that would meet beyond compliance standards under PROPER and other programs. Top-level management wanted to demonstrate to political elites that the company was not in a situation of 'decoupling', whereby a disconnect is evident between high-level organisational decisions, plans and policies and concrete implementation and efficacious or organisational outcomes "on the ground" (Hironaka & Schofer, 2002, p. 2015; Meyer & Roman, 1977). An employee at the Ketapang company remarked:

As a national program, PROPER is the legitimate program to demonstrate to the MOEF Minister the company's commitment to addressing forest fires (Mr H, May 18, 2017, Jakarta).

The Ketapang company implemented its commitment to beyond compliance standards through four beyond compliance programs (Ketapang Environmental Report, 2016, p. 3). First was the introduction of a "Parallel Mixing Internal Chemical Boiler" at the PKS Pekawai plant, which used chemical materials (sodium silicate and calcium) to reduce the number of stirrers needed in the boiler engine from four to one. This reduced electricity consumption by the boiler engine by 3.8 kilowatts (KW) per ton of Crude Palm Oil (CPO) processed.

Second was the development of a "Parallel Injection Pump Flocculant" program at the water treatment plant. This program combined chemical materials from two pumps into one in the pump system. This reduced electricity consumption by 1.5 kilowatts (KW) per ton of CPO. Third, the company installed a "High-performance Line Application Pump". The pump is used by the company to send organic fertiliser (processed from waste) from the Water Treatment Plant (WTP) to plantation areas. This program reduced electricity consumption by 45 kilowatts (KW) per ton of CPO processed.

Fourth, and finally, a community development program was introduced called the '*Desa Makmur Peduli Api*' (Prosperous Villages Against Forest

Fires), hereafter referred to as the Sustainable Farming program. Sustainable Farming was the highest priority program of green project achievements at the Ketapang company, for which the top-level management allocated a budget of IDR 5 billion or USD 370,370 (exchange rate at IDR 13,500). This was a greater allocation of funds than for other initiatives that reduced the environmental impacts of the plant's production processes. Addressing forest fires was more relevant and urgent for the palm oil company than engineering/production processes at the plant, given the President had made addressing fires a priority (see further discussion below).¹²⁰ Global actors also were concerned with the loss of biodiversity in forests due to palm oil expansion, for which fire is often used for clearing (Fitzherbert et al., 2008).

The Ketapang company had experienced forest fires in some of its industrial-scale plantation areas and smallholdings (Greenpeace, 2008). The company implemented a “zero burning policy” to address international pressure regarding forest fires (Ketapang company website, 2020). In and around the PKS Pekawai concession areas, however, fire had not been used in its industrial plantations because they were long-established and no new clearing was needed. Fire had been used by some of its smallholder farmers and the Sustainable Farming program was used to try and change this behaviour.¹²¹

The Sustainable Farming program supported local communities around the plant in learning about “Good Agriculture Practice” (GAP) (see Amekawa, 2009) and ways to mitigate forest fires in their areas. Ketapang expected that the promotion of GAP would reduce those community activities which might result in forest fires. Moreover, the company also established five local community firefighter groups, each consisting of 15 people (Ketapang Company Environmental Report, 2016, p. 7). To support these groups, the company provided all equipment to meet the standards of forest firefighting, including a fire engine (Ketapang company environmental report, 2016, p. 8). Furthermore, the company also built a watchtower to monitor forest fires in

¹²⁰ Confidential interview with an employee at the Ketapang company on May 18, 2017.

¹²¹ Confidential interview with an employee at the Ketapang company on May 7, 2017.

the village (Ketapang Company Environmental Report, 2016, p. 9). This infrastructure improved local community capacity to mitigate forest fires in their neighbourhoods.

Based on satellite monitoring, the program significantly reduced the number of hotspots between 2015 and 2016. As demonstrated in Figure 8.1, the number of hotspots (indicated by red dots) in 2015 was 213. This dropped considerably to 23 hotspots in 2016. This program in particular increased the company's score under PROPER for meeting beyond compliance standards at PKS Pekawai.

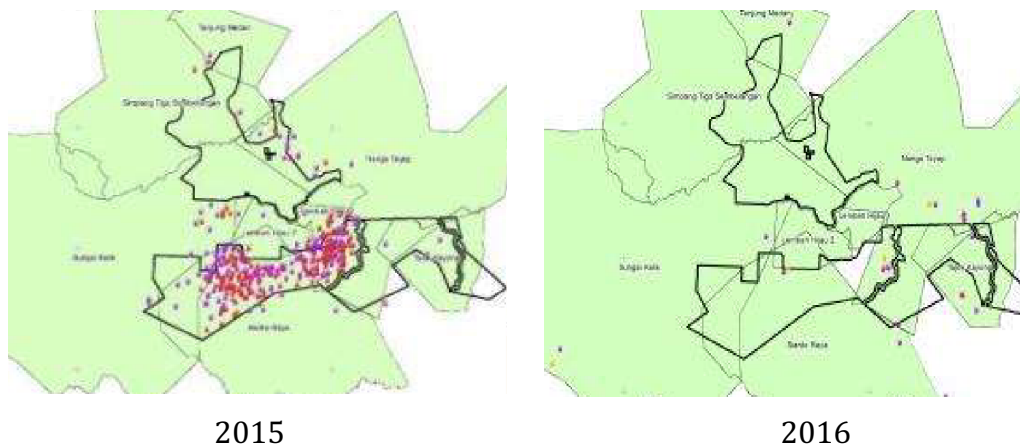


Figure 8.1 Map of fire spots around PKS Pekawai between 2015 and 2016

Source: Ketapang Company's Sustainability Report 2017, p. 28

In addition to supporting efforts to prevent forest fires, the Sustainable Farming program also improved economic conditions for local communities by developing small vegetable farms around their houses. The company promoted 'integrated ecological farming' to develop organic vegetable farming, teaching local communities to produce organic vegetables. This program reduced local community spending on vegetables by an average amount of USD 22.2 per month, exchange rate at IDR 13,500 per month (Ketapang Company's Sustainability Report, 2017, p. 26). This saving was equal to 12 per cent of the minimum wage in the Ketapang District in 2017 (BPS of Ketapang District, 2017). With the Sustainable Farming program, the company sought to make greater investments in communities to gain the

social license to operate and reduce the likelihood of conflict between the company and the community. The Managing Director of Ketapang stated:

The Sustainable Farming program, which began at the end of 2015, provided benefits for local communities, such as income-generating activities, food security, and prevention of conflict between the company and local communities, which helped improve local communities' participation in preventing forest fires (*Beritasatu*, Oktober 19, 2017).

Similar to the case of Tarakan, a privately-owned oil company (see Chapter6), to translate its commitment into on-the-ground initiatives, top-level management also hired private consultants to monitor and evaluate the plants' environmental and social programs so as to meet the beyond compliance standards required by PROPER.¹²² Private consultants spent time in the plants across Indonesia (four plants in South Kalimantan, one in West Kalimantan, two in Riau, and one in South Sumatra) to further develop and fine-tune green programs for PROPER.¹²³ However, in contrast to the privately-owned oil company, the Ketapang palm oil company did not focus on introducing processes to improve employee knowledge and skills of PROPER. Instead, private consultants invested their energies in improving documenting and reporting company activities against the standards of PROPER. At the Ketapang company, obtaining beyond compliance level in PROPER was considered an “ad hoc” objective that responded to pressure from political elites, to be explored further in the next subsection.¹²⁴

For such changes in company behaviour at PKS Pekawai that improved environmental management and social impacts based on the green programs above, the MOEF awarded PKS Pekawai the Green rating in 2016. The indicators of beyond compliance that measure not only the investment or activities undertaken but also the impact of programs showed improved performance. For example, one indicator of PROPER requires companies to

¹²² Confidential interview with an employee at Ketapang company on May 18, 2017.

¹²³ Ibid.

¹²⁴ Ibid.

explain the relationship between performance of community development programs and the number of conflicts between the company and local communities. The company improved against this and other indicators.

However, despite these initial investments in green programs, PROPER was unable to harness pressure on the Ketapang company to maintain PKS Pekawai's Green performance in PROPER for the subsequent period of assessment (2016-2017). After the initial focus on reducing the risk of forest fires, and improving efforts to reduce environmental impacts and support local communities, top-level management at Ketapang did not support the introduction of any new beyond compliance programs. To maintain a beyond compliance Green or Gold (the additional beyond compliance standard introduced in 2016) rating over time, PROPER requires companies to introduce new programs or expand existing ones. Continuous commitment of top-level management to keep prioritising such programs is critical to maintaining a beyond compliance level. While PKS Pekawai maintained its Sustainable Farming program to mitigate against forest fires and other programs, it did not go further and only gained a Blue minimum legal compliance rating after 2016.

8.3.2. Political influence and close state-business relationships: Enabling institutional conditions for promoting environmental leadership

When exploring how government adapted the regulatory strategy in PROPER, I again examine the conditions which helped or hindered regulatory strategies to induce improvements in socio-environmental performance. This subsection argues that the initial pressure of political elites on top-level management at Ketapang and the importance of maintaining close state-business relations produced temporary commitments to support the beyond compliance program required by PROPER. However, when such pressure no longer applied, the company did not continue to commit to maintaining beyond compliance standards.

As mentioned above, in 2015, reducing forest fires was one of President Widodo's key political agendas. As such, President Widodo pressured top-level

management of palm oil companies not only to comply with minimum legal requirements but also to obtain beyond compliance or green practices in palm oil production. The Minister of the State Secretariat said that President Widodo frequently asked about the efforts of top-level management of palm oil companies to prevent forest fires or reduce risks at special coordinated meetings (*rapat koordinasi-rakor*).¹²⁵ These meetings were hosted by the President and involved senior representatives from national government agencies (such as the MOEF and the Peatland Restoration Agency), subnational governments, the Indonesian police, the Indonesian military and top-level management of palm oil companies. The President only invited top-level management of large privately-owned Indonesian palm oil companies (including Ketapang) to the presidential palace to help organise a national program to mitigate forest fires in Indonesia.¹²⁶

At these meetings, President Widodo and the Minister of Environment and Forestry used their political power to pressure the private palm oil company to solve annual forest fires in Indonesia.¹²⁷ Obtaining a Green rating in PROPER was one certification program suggested by the Indonesian government to show sustainable palm oil production in Indonesia.¹²⁸ As some of its concessions cut across provincial boundaries, the Minister of Environment and Forestry, together with President Widodo, used his authority over large-scale business and environmental licenses and permits for inter-provincial concessions to pressure Ketapang's top-level management to introduce programs to achieve a Green rating in PROPER.

For example, Ketapang established a new plantation area located across provinces on Sumatra island in 2015.¹²⁹ To obtain the business license for this new plantation area, the Ketapang company needed the support of the national government, particularly the MOEF.¹³⁰ The senior bureaucrat at the

¹²⁵ Interview with the Minister of State Secretariat on April 26, 2017.

¹²⁶ The state-owned palm oil company was not invited by the President because its plantation areas had not experienced forest fires.

¹²⁷ Interview with the Minister of State Secretariat on April 26, 2017.

¹²⁸ Confidential interview with a bureaucrat at ministry level on April 27, 2017.

¹²⁹ Confidential interview with an employee at the Ketapang company on May 18, 2017.

¹³⁰ Ibid.

MOEF explained that granting this license provided the opportunity to pressure the company to obtain a Green rating in PROPER.¹³¹ As with the case of the state-owned palm oil company, "help me [the government], help you [the company]" was the basis of the close, reciprocal relationship between the MOEF and Ketapang. Such institutional conditions supported PROPER's strategy of promoting environmental leadership for beyond compliance performance at the Ketapang company. For other plantation areas, the Ketapang company only needed support from subnational governments (either provincial or district) because concessions are located in the subnational government's jurisdiction (see further discussion in the next section).

In response to the forest fires in 2015, President Widodo used the momentum to introduce and implement a new regulatory model for the palm oil industry.¹³² Both government and private oil companies had to address the catastrophic environmental crisis of uncontrolled forest fires in 2015 through efforts to achieve beyond compliance standards, rather than simply complying with legal regulation. The President also referred to international pressures relating to mitigating forest fires as one of the drivers for developing a 'national consolidation framework' for action among government, palm oil associations and companies. Both the state and companies agreed that forest fires had caused international actors to boycott Indonesian palm oil products, perceived to be both bad for the economy, and for the reputation, business and international market share of Indonesian palm oil companies.¹³³ Thus, both the state and companies were committed to avoiding forest fires and their impact on the Indonesian palm oil sector, as well as actions under the National Consolidation Framework. The Minister of State Secretariat noted:

We must collaborate for better compliance. The government told companies that they could not burn the forests [for clearing or other purposes] because of the impact on the

¹³¹ Confidential interview with bureaucrat at ministry level on April 27, 2017.

¹³² Interview with the Minister of State Secretariat on April 26, 2017.

¹³³ Ibid.

environment. If this happens, international actors perceive that Indonesian palm oil companies have not complied with environmental regulations and so on (Interview with the Minister of State Secretariat, Jakarta, April 26, 2017).

President Widodo's pressure on palm oil companies was also a part of his commitment to implement actions required under the Association of Southeast Asian Nations (ASEAN) Agreement on Transboundary Haze Pollution (AAHTP), ratified in September 2014 by former President Susilo Bambang Yudhoyono, a month before the end of his presidential term. President Susilo Bambang Yudhoyono provided the legal standing for President Joko Widodo to address the forest fires which caused pollution across ASEAN countries. Ratification of the Agreement by Yudhoyono was, among others, the result of pressure from international actors (CSOs, the United Nations, ASEAN and neighbouring countries). They had (and continue to) heavily criticised the Indonesian government and palm oil companies for their poor response to forest fires in the past, and that they perceive the fires as the 'normalised deviant' in oil palm plantation cycles (Hutter & Bostock, 2017, p. 3).

After several meetings between President Widodo, the Palm Oil Association and senior management of palm oil companies, it was agreed that they had to work in collaboration to save the reputation of the Indonesian palm oil industry.¹³⁴ This collaboration aimed to publicly demonstrate that actors in the Indonesian palm oil industry were committed to international principles of palm oil sustainability, as well as national green certifications like PROPER and Indonesian Sustainable Palm Oil (ISPO). In these discussions, it was suggested that PROPER be used as the beyond compliance certification program to address forest fires. This was especially so, because reducing air pollution due to forest fires is one of the main tasks of the Directorate General of Pollution and Environmental Damage Control (DITJEN PPKL), which is also

¹³⁴ Interview with Minister of State Secretariat on April 26, 2017, and confidential interview with an employee at the Ketapang company on May 18, 2017.

the regulator responsible for PROPER. A senior bureaucrat at DITJEN PPKL said that:

As one of the participants [in the high-level meetings], I always promoted PROPER to the palm oil companies in the high-level meetings between President Joko Widodo and top-level management [of the palm oil companies]. I persuaded them [top-level management] that the companies' programs to address forest fire can be reported in PROPER (Mr K, April 27, 2017, Jakarta).

Under the national consolidation framework, top-level management at Ketapang committed to protecting both its plantation areas and smallholders' plantation areas from forest fires.¹³⁵ For the company's plantation areas, Ketapang implemented an internal policy of zero-burning and avoiding planting in peatlands, which are particularly vulnerable to forest fires and difficult to put out (Ketapang company's sustainability report, 2015, p. 3). To prevent forest fires on smallholder farms that were a source of FFB supply for the company, Ketapang collaborated with local communities to implement the Sustainable Farming program discussed above. The program was launched by the company at the end of 2015 in response to pressure from President Joko Widodo to demonstrate to the Indonesian government that it was participating in forest fire prevention programs. A top-level manager explained that:

This program [the Sustainable Farming program] is our way of supporting the government's vision in Indonesia that is 'free from land and forest fires'... Participating in government programs [i.e. PROPER] is the best way to demonstrate our green commitment to the state (Interview with an employee at the Ketapang company, Mr H, May 18, 2017, Jakarta).

Derom Bangun (former Chairman of the Indonesian Palm Oil Association) explained that the National Consolidation program aims to avoid the

¹³⁵ Confidential interview with an employee at the Ketapang company on May 18, 2017.

phenomenon of “one rotten apple will spoil the whole barrel” (Bangun, 2010, p. 32). Thus, it was perceived that private palm oil companies in Indonesia must commit to implementing sustainable palm oil production. If one company breaks the principles of sustainable palm oil production, it will have a collective impact on all palm oil producers as well as the image of Indonesia as a significant exporter in the international palm oil product.

However, after 2015, the pressure on palm oil companies from the national government to achieve beyond compliance ratings in PROPER reduced, as the number of forest fires decreased and as such, this was no longer a critical political priority for President Widodo.¹³⁶ The burned areas across Indonesia in 2016 amounted to 438,363 hectares compared to the forest fires in 2015, in which 2,611,411 hectares burned (MOEF, 2020a). Moreover, the incentive for Ketapang to comply with such pressures had also dwindled, as it had gained environmental license from the MOEF for its new plantation areas in Sumatra.¹³⁷ Ketapang maintained its Sustainable Farming program and other previously introduced programs, but did not expand these or introduce anything new, so its PROPER rating dropped to Blue.

We can see from the discussion above how political pressure from elites and the regulator—through direct requests, inducements and the national consolidation program involving different actors in the palm oil industry—induced behavioural change in the initial commitment of Ketapang’s top-level management to achieve beyond compliance standards. The institutional conditions of close informal business-state relations bolstered the ways PROPER’s strategy of promoting environmental leadership was able to harness these pressures on the company. However, when political pressures reduced so too did the commitment of Ketapang’s top level management to meeting PROPER’s beyond compliance standards, reflected in the company’s Blue rating (minimum environmental legal standards).

¹³⁶ Ibid.

¹³⁷ Ibid.

8.4. “Informal inducement”: A subnational government strategy to influence the privately-owned palm oil company

Similar to the case of the state-owned palm oil company discussed in the previous chapter, decentralised regulatory authority of palm oil sector offered the opportunity for subnational regulator to introduce their own strategies to influence the socio-environmental performance of the privately-owned palm oil company, which is deviated from the design of PROPER. Below, I discuss the ways in which the subnational regulator in West Kalimantan Province used informal inducements to encourage behavioural change. The “informal inducements” strategy describes the particular approach of the subnational government that offers some benefits—such as remedial or corrective action to fix the non-compliance status of companies—for companies to participate in PROPER through informal mechanisms, without publishing the official ratings of company performance. This chapter that this strategy was only effective in pressuring the Ketapang company to comply with basic environmental legal regulations rather than to meet beyond compliance standards. Informal inducement did not aim to assist the company to meet the legal requirement likes the strategy of technical regulatory assistance.

Similar to the state-owned palm oil company, I also argue that subnational government took discretionary actions to substitute the strategy of providing technical regulatory assistance with the informal inducement strategy, as the subnational government did not have the regulatory capacity to provide such assistance. Again, this chapter argues that authority to take such discretionary actions is a distinctive feature of Indonesia’s decentralised context, and that institutional conditions such as state regulatory capacity have implications for the way strategies operate and induce socio-environmental behavioural change under public voluntary regulation. To the best of my knowledge, the strategy of “informal inducement” by the state has not been fully documented in the existing literature on public voluntary regulation.

8.4.1. Subnational PROPER implementation strategy: “Informal inducements” for companies

Implementing informal inducement was a discretionary policy introduced by the West Kalimantan Provincial government, and as such, this strategy is not recognised in the regulatory design of PROPER. Below I explore how the subnational government modified the PROPER strategy of technical regulatory assistance to instead use informal inducements, arguing this was due to limited state regulatory capacity at the subnational level. Informal inducements were used by the state to encourage the Ketapang company to meet PROPER standards through providing the opportunity to undertake remedial actions within an agreed period of time, to address regulatory violations before releasing assessment results.

First, the subnational government offered PKS Pekawai the opportunity to undertake actions to address the finding by PROPER inspectors that they had violated water waste regulations. In the assessment for 2014-2015, the subnational government found that the level of Biochemical Oxygen Demand (BOD) used by the company exceeded 100mg/litre. This finding indicated the poor quality of water around the company’s production unit. Minister of Environment Decree No. 5/2014 on Water Waste Pollution states that the level of BOD in water waste from palm oil production must not exceed 100mg/litre. Responding to this situation, an employee at the company explained that:

Inspectors of PROPER found the level of BOD [Biochemical Oxygen Demand] in the water waste line was higher than 100mg/litre. I [an employee] know this finding did not meet the regulation standards [Minister of Environment’s Decree No. 5/2014]. However, I explained that the company did not cause the level of BOD to exceed the maximum [in the regulation]. Local community activities [pig farming and coal mining] contributed significantly to the increase in the level of BOD in the river (Interview with an employee at the Ketapang company, Mr R, May 7, 2017, West Kalimantan).

In response, the subnational government allowed the company to provide additional documentation that explained the level of BOD. Based on this documentation, local inspectors conferred with the Head of the West Kalimantan Province Environment Agency on whether or not the company complied with the Minister of Environment's Decree No. 5/2014. For 2014-2015, the PKS Pekawai ultimately obtained a Green PROPER rating (MOEF, 2015), indicating that the subnational regulator had accepted the company's explanation. They retracted the assessment, finding that the company had violated environmental regulations. A staff member in the West Kalimantan PPKL subdivision stated that:

We [the subnational government] believed that the participants in PROPER were committed to complying with environmental regulations. Four plants in the company [the Ketapang company] participated in PROPER in West Kalimantan Province (Interview with Mr O, May 10, 2017, West Kalimantan Province).

Such interpretation by the PPKL subdivision officials was not based exclusively on good faith. It took into account the company's explanation about BOD levels in its water waste and made the assessment with some caveats. The same official explained:

The company's explanation about the high level of BOD [in the water waste] was rational. There are many pig farms and coal mines near the company's production units. However, we required the company to increase the number of 'sampling points' to monitor the wastewater quality. More sampling points would minimise the influence of those external conditions on the level of water pollution at the Ketapang company (Interview with Mr O, May 10, 2017, West Kalimantan Province).

A second example of the informal inducement approach was observable in relation to the regulatory violation of PKS Pekawai regarding its hazardous and toxic waste management. The company failed to provide evidence of its

permit for producing hazardous and toxic waste, particularly for their used batteries. Government Regulation No. 101/2014 on Hazardous and Toxic Waste Management states that every item of hazardous and toxic waste must be listed in its environmental permit, but used batteries were not listed in the permit for PKS Pekawai. In the regulatory design of PROPER, such a regulatory violation would normally result in assessors issuing a Red rating, which indicates that the company has not met legal administrative procedures.

However, the local inspectors allowed PKS Pekawai to take steps to revise its environmental permit, suggesting coordination with the District Environmental Agency that issues the permits. Granting this extension to revise the environmental license was an opportunity afforded by the good relationship between the regulator and the company, demonstrating the 'club' relationship between actors in the palm oil industry. An employee at PKS Pekawai stated that:

The [subnational government] inspectors from PROPER were very helpful. Like the company, the inspectors from PROPER did not want the company to obtain a Red rating in PROPER. A red rating is embarrassing not only for the company but also for [local government] regulators (Interview Mr R, May 7, 2017, West Kalimantan).

Not unlike the state-owned palm oil company discussed in Chapter 7, the state regulatory capacity of subnational government of West Kalimantan Province was also weak in implementing the strategy of technical regulatory assistance. The PPKL subdivision (responsible for PROPER in West Kalimantan Province) has a limited number of staff¹³⁸ to assist the 64 palm oil mills in West Kalimantan Province.¹³⁹ Moreover, staff trained by national government about PROPER moved to other functions unrelated to

¹³⁸ Confidential interview with a bureaucrat at subnational government on May 10, 2017.

¹³⁹ <http://www.gapki-kalbar.or.id>

environmental issues.¹⁴⁰ As such, existing staff have limited knowledge and skills to assist companies to meet minimum legal requirements.¹⁴¹

Moreover, the organisational structure of subnational government also indicated weak political support for the Provincial Governor in relation to environmental regulators. Subnational government combined the function of environmental regulators with other functions. The organisation was named “the Board of Citizen Housing, Residential Areas, and Environment”.¹⁴² Consequently, the organisational level of environmental regulator is a subdivision (echelon four) which has limited authority, budget and staff.

8.4.2. Decentralisation in the palm oil sector: Institutional conditions underpinning “informal inducement” strategies

This subsection argues that decentralisation of authority in the palm oil sector was a critical feature of the institutional context that explains the subnational government’s decision to adopt “informal inducement” instead of technical regulatory assistance. I also argue that, similar to the case of the state-owned palm oil company discussed in Chapter 7; for sectors in which regulatory authority is decentralised such as palm oil, the design of PROPER creates perverse incentives for subnational government to provide technical regulatory assistance to support companies to go beyond compliance performance.

Indeed, decentralisation provides critical challenges for national government regulators to implement PROPER. Tjiptoherijanto (2018) highlights that “disconnected governance” or the disconnect between national and subnational governments in supporting or enforcing regulatory requirements is a characteristic of Indonesian decentralisation. Only in particular sectors and for particular policy fields does the national government have the authority to direct subnational government to undertake designated actions. For example, the Ministry of Environment and Forestry does not have

¹⁴⁰ Confidential interview with a bureaucrat at subnational government on May 10, 2017.

¹⁴¹ Ibid.

¹⁴² <http://perkimlh.kalbarprov.go.id>

legal authority to pressure subnational government staff to implement PROPER or to use its specific strategies; but the national government nonetheless relies on subnational regulators to provide technical assistance to plants and other types of production units in the palm oil sector to implement PROPER. As discussed in Chapter 4, subnational government actors, particularly those in the bureaucracy, instead respond to the instructions of the Governor (at provincial level) or the District Head/Mayor (at district/municipal level). As such, subnational government staff are more sensitive to the interests and demands of subnational political elites rather than national demands.

Given these limits in the authority of the national regulator to direct subnational governments, one way national agencies seek to influence and control subnational government actors is through the allocation of the “deconcentrated budget” from the centre to each subnational jurisdiction. For PROPER, as explained in the previous chapter, the deconcentrated fund is the budget provided by the national government to support subnational governments to initially inspect companies, and thereafter for basic compliance performance inspections (Black, Red and Blue ratings) of participants in PROPER (companies that self-assess beyond compliance performance). In West Kalimantan Province, the national government allocated inspection funds of USD 2,205 (exchange rate at IDR 13,600), depending on the location of the company from the capital city of subnational government.¹⁴³ This amount was used by the PPKL subdivision for transportation costs and inspectors’ fees.

Similar to the case of the state-owned palm oil company, the regulatory design of PROPER created a perverse incentive for the subnational regulator and undermined the regulatory influence of the program to induce beyond compliance behavioural change in companies. Because the volume of the deconcentrated fund distributed by national government is based on the number of participants (and assessment at basic levels), similar to North

¹⁴³ Confidential interview with a bureaucrat at subnational government on May 10, 2017.

Sumatra, in West Kalimantan subnational regulators focused on increasing the number of participants instead of promoting quality of performance. The higher numbers of companies requiring inspection results in more income for subnational inspectors. A senior official in the subnational government highlighted:

For implementing PROPER, we [the local government] involved many people who needed "money for transportation" (*uang jalan*). Inspecting more companies means more money (*uang jalan*) (Interview with a regulator, Mr O, May 10, 2017, West Kalimantan Province).

However, ways in which the subnational regulator used the deconcentrated fund varied slightly from that of the regulator in North Sumatra (see Chapter 7). In addition to funding inspections aligned with individual interests of subnational officials, some of the budget was diverted to inspecting non-participants of PROPER on their compliance with environmental regulations in both the palm oil sector and other sectors for which subnational governments in West Kalimantan had regulatory authority and responsibility under decentralisation. A West Kalimantan Province PPKL subdivision staff member explained:

We have used the deconcentrated fund [from the central government] for [monitoring both] PROPER and non-PROPER participants. For example, out of the three days' allocated budget for PROPER [inspections], the budget for two days has been used to inspect a participant in PROPER and for the third day [to monitor] a non-participant in PROPER. We choose companies [a non-participant in PROPER] located near the PROPER participant [for monitoring on the third day] (Interview Mr O, May 10, 2017, West Kalimantan Province).

The example above indicates that subnational government perceived PROPER as a financial resource for supporting its wider responsibility for monitoring environmental performance and compliance of companies in West Kalimantan Province, not just the participants in PROPER. Subnational

government regulators argued they needed to use the deconcentrated funds for PROPER to meet its other responsibilities in monitoring companies in West Kalimantan Province due to budget limitation in the agency.¹⁴⁴ Scholars have identified that subnational environmental agencies are one of the most marginalised units of government under decentralisation in Indonesia, particularly in terms of budget and staff (Setiawan & Hadi, 2007). As such, local environmental regulators tend not to have sufficient budgets for environmental management, including all monitoring and assisting companies, in their jurisdiction (USAID, 2008, p. 16).

To maintain access to inspection funds, subnational government took the discretion policy to informally encourage performance of companies to meet the basic legal compliance level (Blue rating) for as long as possible and in some cases, to only give assessment results to this standard regardless of their actions. A regulator from West Kalimantan said:

‘A baby’ [as an analogy for a company] must repeatedly fall to be able to walk. So, it is impossible to obtain a Green rating in PROPER during the early participation [of the company]. The company must receive a Blue rating three times before it is promoted to a Green rating (Mr O, May 10, 2017, West Kalimantan Province).

The statements above indicate the highly discretionary treatment of PROPER and assessments by the West Kalimantan Provincial regulator. The regulatory design of PROPER does not require a company to obtain a Blue rating three times before being able to gain a Green rating. For example, PKS Rambutan at the state plantation company in this research obtained a Green rating during early participation. In addition, PT Jambi Merang Talisman, an oil and gas company, also achieved a Green rating in PROPER in its first year of participation (MOEF, 2012). In the case of PKS Pekawai, the subnational regulator did not encourage the company to make beyond compliance efforts once it reverted to a Blue rating.

¹⁴⁴ Ibid.

Thus, PROPER faces a dilemma under Indonesia's multi-level, but disconnected governance structure. It needs to use deconcentrated budgets as a lever to encourage subnational governments to support the program under their decentralised authority; but under the current design this has created perverse economic incentives for these subnational regulators to support its beyond compliance initiatives, as budgets are tied to assessments for basic compliance (Blue rating and below). At the same time, PROPER introduced self-assessment by companies for Green and Gold ratings in order to save budgets.

The case of the privately owned palm oil company demonstrates the ways PROPER regulators adopted the regulatory strategy, particularly technical assistance, and how this is influenced by institutional conditions, including state regulatory capacity under decentralisation. Subnational government did not adopt the technical regulatory assistance to support beyond compliance performance because of their limited knowledge and skills, limited budgets to implement their regulatory authority more widely than PROPER, as well as the perverse incentives in regulatory design of PROPER which don't reward subnational governments for encouraging beyond compliance company performance.

8.5. Public disclosure in the Indonesian palm oil sector: Influencing the privately-owned plantation company

This section discusses how regulators adapted PROPER's regulatory strategy of public disclosure by sharing information on the environmental and social performance of Ketapang company and its PKS Pekawai mill to apply pressure on the company from third-party actors (banks, buyers, consumers and CSOs) through its colour-coded rating system (see Chapter 3, Table 3.3 page 52). This section argues that this strategy has facilitated actors in socio-environmental governance (such as international banks, buyers, consumers and CSOs) to improve socio-environmental performance, but only to compliance level. I discuss the pressure exerted from each of these actors and the response from and benefits to the company through its participation in PROPER. I also argue

that key third-party actors' preferences for the RSPO have weakened PROPER's capacity to influence the Ketapang company to meet its beyond compliance standards.

8.5.1. Pressure from the international Mitsubishi Bank: PROPER "naming and shaming" strategies

International banks, as company investors that rely on social and environmental ratings and other business performance indicators, can pressure companies to improve their social and environmental management practices. The Mitsubishi Bank is an international stakeholder in the palm oil sector that PROPER sought to target directly with its regulatory strategy of public disclosure. I aim to show that the Mitsubishi Bank, as a Ketapang creditor, used the PROPER rating to evaluate company environmental performance, but only to the level of basic compliance.

In early 2015, the Mitsubishi Bank sent a letter of protest to Ketapang about its poor performance in PROPER in 2014, in which a subsidiary of the company (located in Lahat District, South Sumatra Province) received a Red rating. This rating communicated to stakeholders that the subsidiary had not meet the minimum requirements of environmental legal regulations or appropriate reporting standards. The letter understandably highlighted that the bank wanted to avoid a public image that supported environmental destruction. Such reasoning, a Ketapang employee based in Jakarta stated, 'is as simple as that'.¹⁴⁵

Subnational government inspectors had found that the level of Chemical Oxygen Demand (COD) in the subsidiary's water waste exceeded 5000 parts per million (ppm) (MOEF's PROPER assessment report, 2014, p. 2). This excess failed to meet minimum legal requirements on water waste pollution, which state that the COD must be below 3000 ppm. This employee explained that:

¹⁴⁵ Confidential interview with an employee at the Ketapang company on May 10, 2017.

The Mitsubishi Bank quickly sent a letter of protest to the company about the Red rating in PROPER [of one of its subsidiaries]. This was a big problem for me [as the Head of the Sustainability and Compliance Department]. The President Director called me in to explain the Red rating in PROPER. I not only had to explain why to Mitsubishi Bank, but also to provide reports of the corrective actions underway every month (Mr H, May 18, 2017, Jakarta).

After receiving the bank letter, the President Director of the Ketapang company mandated that the Head of the Sustainability and Compliance Department solve the regulatory violation. This employee then visited the plant in South Sumatra Province. He reported:

According to my staff [on the ground], the Chemical Oxygen Demand (COD) was above 5000ppm due to the analysis being done in a laboratory in Jakarta. So, the water quality worsened on the way [to Jakarta]. However, this explanation was unreasonable. I went to the plant to see the water treatment facility. I found that two of the three pipes in the water treatment facility did not work correctly. This explained why the COD level in the water waste was above the legal requirements, not due to the analysis in a laboratory in Jakarta (Interview with Mr H, May 18, 2017, Jakarta).

After visiting the plant in question, the Head of the Sustainability and Compliance Department realised that internal monitoring did not ensure all plants met minimum legal requirements. Thus, he revised the internal Standard Operational Procedures (SOPs) on environmental regulatory compliance. In the new SOPs, environmental staff must ensure all production facilities which produce environmental pollution (water, air, toxic and hazardous waste materials) meet minimum legal requirements.

That the Mitsubishi Bank had paid attention to PROPER's rating indicated this international finance organisation perceived PROPER as a relevant rating system. Such attention was essential for bolstering the

regulatory influence of PROPER to shape socio-environmental performance at the Ketapang company. However, the Mitsubishi Bank only required Ketapang to meet minimum legal requirements (Blue rating), instead of encouraging the company to reach beyond compliance standards (either a Green or Gold rating).

One of the reasons for this preference relates to the influence of the RSPO in global, sustainable palm oil production. The Mitsubishi Bank uses international norms and standards (such as RSPO) to encourage its debtor to go to beyond compliance levels.¹⁴⁶ For the Mitsubishi Bank, the RSPO is a more legitimate beyond compliance certification system for palm oil companies because this certification is accepted by wider actors.¹⁴⁷ Thus, for the bank, PROPER as a domestic certification system is only legitimate for demonstrating a company has met national regulatory standards with minimum legal compliance.

8.5.2. Pressure from Greenpeace, Unilever, and Nestle through “naming and shaming”

In addition to direct pressure exerted from international banks, in this section I seek to show how the regulatory impact of PROPER was indirectly influenced by the interaction of third-party actors in socio-environmental governance (such as international buyers and CSOs), and their “naming and shaming” strategies. I discuss indirect influence from these buyers and CSOs—international actors did not directly use the PROPER rating to pressure the company. However, their “naming and shaming approach” encouraged Ketapang to use PROPER to meet legal compliance standards to respond to global pressure to better its performance. Below, I discuss the ways in which Greenpeace campaigned about the role of the Ketapang company in deforestation in Indonesia. I seek to demonstrate that this campaign pressured Unilever and Nestle to suspend their purchase of palm oil from Ketapang. In response, the company took the initiative to meet PROPER standards and use

¹⁴⁶ Confidential interview with an employee at the Ketapang company on May 10, 2017.

¹⁴⁷ Ibid.

its rating system (particularly the Blue rating) to show international actors that company was complying with environmental legal regulations in the Indonesian jurisdiction.

Greenpeace published several reports which named and shamed the parent company, due to its contribution to deforestation in Indonesia. For example, in 2007, Greenpeace published the report *Cooking the Climate*, which uncovered Ketapang's role (under the Golden Agri Resources -GAR holding company) in deforestation in Indonesia. Following the release of this report, Greenpeace lobbied buyers and investors to pressure Ketapang to ultimately change company behaviour.

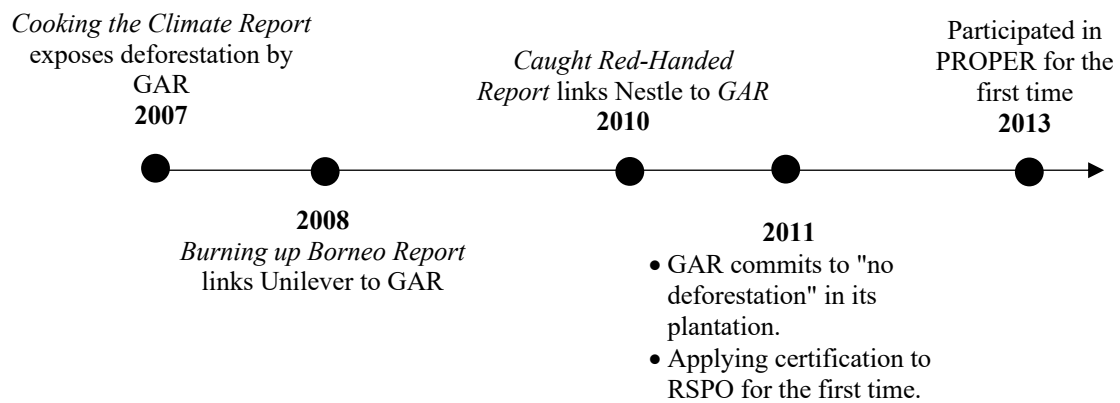


Figure 8.2 Timeline of the release of Greenpeace publications and subsequent green commitments

Source: Adapted from Greenpeace, 2007, 2008, 2010.

Following the release of another Greenpeace report *Burning Up Borneo* in 2008, Unilever announced its decision to suspend all future purchases of Ketapang palm oil, leading to the company's loss of its USD 32.6 million contract with Unilever (discussed further in the next section). In a similar fashion to Unilever, Nestle also suspended its business with Ketapang due to the company's contribution to deforestation in Indonesia.

A critical question arising from these suspensions is how did the Ketapang company respond to these global pressures? The findings show that pressure from these reputable global buyers was effective in changing the company's regulatory compliance. Given the loss of business that resulted

from suspended purchasing, the Ketapang company announced its commitment to 'no deforestation' in its plantation areas and applied for RSPO certification in 2011, ultimately committing to PROPER in 2013 (see Figure 8.2 above).

Global actors encouraged the Ketapang company to meet minimum legal requirements, but they did not stipulate that it must be through participation in PROPER. However, top-level management thought it easiest to demonstrate its compliance with minimum legal requirements by gaining a Blue rating in PROPER. The Head of the Sustainable and Compliance Department remarked:

[For us] the function of PROPER in the international market is only one: that is, communicating that the company has met the indicators [of compliance with] environmental legal regulations in the Indonesian jurisdiction [Blue rating]... Based on this, the company can go further to obtain global green certification, such as under the RSPO. Without the Blue rating in PROPER, the company cannot gain an international reputation to participate in bigger [global] green certification programs (Interview, Mr. H, May 18, 2017, Jakarta).

After naming and shaming by global actors, Ketapang focused on improving its international reputation. The company perceived that meeting PROPER standards (Blue rating) was one of the 'milestones' in working towards achieving international certification (i.e. through the RSPO, International Sustainability and Carbon Certification -ISCC) to address global shaming. According to a senior employee at Ketapang, obtaining a Blue rating in PROPER was the prerequisite for improved interaction with global actors after the extensive pressure they had encountered from the Greenpeace campaign.¹⁴⁸ The suspension of its contract with Unilever, the world's biggest palm oil consumer, effectively pressured the company to meet sustainable

¹⁴⁸ Ibid.

palm oil production standards, even though the amount of trading between Unilever and Ketapang was not significant.¹⁴⁹ According to the company staff:

The Unilever purchasing suspension was not too significant to the company, because the amount the contract with Unilever was not too much. This had little financial impact. However, we [the company] had been shamed by a large and reputable company. You [the researcher] know how that feels (Interview with an employee at the Ketapang company, Mr H. May 18, 2017, Jakarta).

The statement above shows the role of the buyer in shaping socio-environmental performance at Ketapang. The company thus responded to market pressures initiated by CSOs in terms of reputation rather than market size. Reputational damage creates complex problems for the company, because, put simply, reputation is an expectation that someone will keep their promise in the future, based on past behaviour (Ellickson, 1994; Macaulay, 1963; Van-Erp, 2011, p. 324). This can affect company access to credit, permits, markets and supply chains, among others.

The importance of its global reputation is critical to understanding how the Ketapang company responded to green certification programs, both PROPER and RSPO. Similar to the case of the state-owned palm oil company (see Chapter 7), the Ketapang company decided to meet minimum legal requirements (Blue rating in PROPER) and then intensively engage with global sustainability platforms to address the discourse about their global reputation through seeking RSPO certification. According to company representatives, “global issues must be addressed by the company with a global approach”.¹⁵⁰ RSPO provided an arena for the Ketapang company to directly demonstrate improvements to global actors who had damaged its reputation, such as Unilever and Greenpeace.

¹⁴⁹ Unilever suspended purchase amounting to USD 32.6 million. Meanwhile, the company's total revenue was approximately USD 7.2 billion (Ketapang company's annual report, 2018, p. 3).

¹⁵⁰ Confidential interview with an employee at the Ketapang company on May 18, 2017.

The specific benefit of the RSPO lies in its ability to communicate with global actors regarding Ketapang's commitment to sustainable palm oil production. In other words, the RSPO holds more legitimacy for global actors in the palm oil sector compared with PROPER.¹⁵¹ However, the Ketapang company still needed a Blue rating in PROPER to demonstrate it had met minimum legal requirements as an essential requirement for obtaining other global certifications.¹⁵² Most international certification programs only require companies to meet national regulations, but PROPER provides an easy segue for companies to communicate such compliance internationally. For non-participants of PROPER, they must submit all compliance documents regarding air pollution, water pollution, land pollution, and toxic and hazardous waste to international assessors at the RSPO. Participants in PROPER just need to submit their Blue rating certificate.

In the discussion above, we can see how the mechanisms by which behavioural change was encouraged at the Ketapang company by third-party actors is different from the state-owned palm oil company, Tebing. International actors used the confrontational strategies of "naming and shaming" and suspending the purchase of palm oil to pressure Ketapang to mitigate forest fires in its plantation areas and to seek compliance certification through various standards. International actors, however, used a more collaborative approach to encourage the state-owned Tebing plantation company to meet transnational certification standards, particularly those of the RSPO, in the form of a pilot project supporting sustainable palm oil production. In both cases, however, PROPER's public disclosure strategy and design standards were only able to harness pressure from third parties on companies to meet its basic compliance standards.

¹⁵¹ Ibid.

¹⁵² Ibid.

8.5.3. International third party actors' environmental commitment and action capacity

As explored previously, the aim of this thesis is not only to examine the regulatory strategies of PROPER, but also the conditions under which these strategies may induce behavioural change. This subsection discusses the environmental commitment and action capacity of third-party actors to pressure Ketapang to improve its socio-environmental performance against PROPER standards. About 68.8 per cent of Indonesia's crude palm oil is sold overseas (BPS, 2019a, p. 47). Given the orientation of the palm oil industry towards international markets, it is unsurprising that international actors influence domestic producers in Indonesia. This subsection argues that in using public disclosure strategies, PROPER was able to indirectly harness pressure from international third-party-actors as discussed above—with high environmental commitment and action capacity—to encourage the company to meet minimum compliance PROPER standards due to their environmental action capacity. However, their environmental commitment was expressed as preferences for RSPO beyond compliance transnational certification standards of sustainable palm oil production.

Greenpeace campaigns referred to in this chapter constitute examples of action capacity of international third-party actors. This environmental CSO is the leading global organisation that supports sustainable palm oil production. Greenpeace targets both producers and buyers of palm oil and products containing palm oil to create awareness of how the demand for palm oil and the increasing scale of oil palm plantations has been linked to the deforestation of tropical rainforests, such as in Indonesia. For example, April 21, 2008, was a busy day for Greenpeace's activists across Europe. In the UK, 60 activists held a public protest at the Unilever factory at Port Sunlight, near Liverpool. At the Rotterdam Headquarters of Unilever, Greenpeace activists also scaled the waterfront building and erected a banner that stated "Unilever, Don't Destroy the Forest". At the Unilever office in Italy, "activists held a similar public protest using a huge box marked 'Stop Dove [Unilever product] from Destroying Rainforest'" (Greenpeace, April 21, 2008).

According to Greenpeace activists, these efforts across Europe were a part of a new campaign strategy to stop deforestation on account of palm oil expansion in Indonesia.¹⁵³ As the largest buyer of palm oil, in 2008 Unilever purchased nearly 3 per cent of global supply (or 1.5 million tons of the global supply of 55 million tons) to produce a range of goods for 2.5 billion consumers worldwide (Unilever, 2016). Thus, Unilever could potentially play an important role in promoting a sustainable palm oil industry in Indonesia and beyond. Greenpeace's "naming and shaming" strategy not only targeted Unilever, but also specific brands such as Dove (soaps, shampoos and conditioners). In 2008, Greenpeace published the film "Dove Onslaught(er)" and sent an open letter of protest to the CEO of the Unilever group. Both the film and the open letter informed the public that well-known Dove products contained palm oil, the production of which had caused the destruction of rainforests due to uncontrolled expansion of oil palm plantations. Such rainforests were the habitat of the endangered Orang Utan.

By problematising the supply chain of Unilever products and brands such as Dove, Greenpeace's campaign strategy sought to elicit the support of customers to pressure Unilever to act to stop deforestation due to the palm oil industry. As a result of the campaign, Unilever received tens of thousands of protest emails from around the world (Greenpeace, January 14, 2009). Thus, on Friday 9 May 2008, a senior executive of Unilever invited Greenpeace activists to talks about the sustainable palm oil industry in Indonesia. In the meeting, they agreed on several points:

Firstly, Unilever agrees to support an immediate moratorium on deforestation for palm oil in South East Asia. Secondly, the company also agrees to use its leadership role within the industry to "aggressively" build a coalition of companies to support the moratorium. This includes them lobbying all the major players within and outside the Round Table on Sustainable Palm Oil (RSPO) including the likes of Kraft, Nestle

¹⁵³ Ibid.

and Cadburys. Thirdly, they agreed to put urgent and substantial pressure on their palm oil suppliers on the ground in Indonesia too. Once the suppliers are on board with the moratorium, then we have a real chance to stop the rainforest destruction. Finally, Unilever agreed that they would lobby the Indonesian government to support the immediate moratorium (Greenpeace, January 14, 2009).

Demonstrating its environmental commitment and action capacity, on December 11, 2009, Unilever publicly announced that the company had decided to suspend all future purchases of palm oil from the largest Indonesian private palm oil company (Unilever, 2009). This suspension resulted in the loss of Ketapang's USD 32.6 million contract with Unilever as mentioned above. Unilever's Chief Procurement Officer stated that Unilever had no choice but to suspend the future purchasing of palm oil from the Ketapang palm oil company (*Mongabay*, December 12, 2009). Unilever stressed the suspension would remain in place until the Indonesian privately-owned palm oil company could provide verifiable proof that none of its plantations contributes to forest fires (*The Jakarta Post*, December 12, 2009). In the discussion in the previous section, we saw how Ketapang responded to this direct pressure from buyers through its commitment to stop deforestation and change behaviours by participating in PROPER and RSPO certification programs.

The role of Unilever (and Nestle in the previous section) confirms several studies that have shown the important role of the buyer for sustainable industry (Straughan & Roberts, 1999; Young et al., 2010). Unilever and Nestle have the power to induce behavioural change for their suppliers, such as the Ketapang company. The power of companies such as Unilever, as a buyer, is augmented, given its position as the largest buyer of palm oil products—the changes it makes and encourages among its suppliers also influence other buyers, producing multi-player effects on palm oil companies. As mentioned above, its direct contract with Unilever was not significant for the Ketapang company, but it is dependent on the international market. Unilever's actions have potential wider knock-on effects regarding Ketapang's reputation.

Ketapang supplies a multitude of companies worldwide with palm oil, such as Unilever, Nestle, L'Oreal and Carrefour, and more than 30 widely known consumer brands contain palm oil products from the Ketapang company. These consumer brands are sold in more than 70 countries (Ketapang company Sustainability Report, 2015, p. 11).

Thus, as the one of the biggest players in the global supply chain of palm oil products, the Ketapang company is very sensitive to the demands of international stakeholders. As demonstrated in Table 8.3, the international market contributed significantly to Ketapang's income in the 2016 and 2017 financial years—more than half of its palm oil was exported.

Table 8.2 Ketapang company's net sales (IDR million) (in USD billion)

	Financial year					
	2016			2017		
	IDR	USD*	%	IDR	USD**	%
Export	17.283.707	1.2	58.09	19.179.898	1.4	54.29
Domestic	12.468.419	0.92	41.91	16.138.204	1.2	45.71
Total	29.752.126	2.12	100	35.318.102	2.6	100

*exchange rate at IDR 13,518

**exchange rate at IDR 13,357

Source: Ketapang company's annual report, 2017, p. 83.

Ketapang's dependence on the international market also renders the company subject to global agendas on sustainable palm oil production. For example, all suppliers of Unilever must commit to the Unilever Sustainable Palm Oil Sourcing Policy (Unilever, 2016). This policy was created to change the practices of global palm oil producers in Unilever's supply chain. The policy is also applied to Unilever's procurement system for which its suppliers, including Ketapang, must meet the indicators of its sustainable palm oil sourcing policy. These indicators are based on five principles. First, suppliers must implement the 'no deforestation' policy. Second, Unilever forbids suppliers from developing plantations in peatland. Third, suppliers must commit to upholding human rights for both their labourers and local

communities. Fourth, the activities of Unilever's suppliers must generate positive social and economic impacts for smallholders while protecting the natural environment, mainly forests. Fifth, the procurement policy requires companies to manage the business with transparency and disclose information to the public (Unilever, 2016).

These five principles strengthen the Principles and Criteria used by the RSPO. As the leading company in the RSPO, Unilever connects its internal procurement system with the RSPO certification system, which for palm oil companies is one of the most beneficial aspects of the RSPO (Unilever, 2009). An employee at the Ketapang company notes that:

The RSPO supports us [the company] to be an international player. The RSPO is accepted by most respected global buyers, like Unilever. Management [at the Ketapang company] always asks the question [about the global acceptance] of PROPER: What contribution can PROPER make to [our status in] the international market? (Interview with Mr H, May 18, 2017, Jakarta).

It is here that we see Ketapang management pit the domestic standards promoted by PROPER against RSPO global standards. This helps explain why the Ketapang company only needs to meet legal compliance standards in PROPER (Blue rating) as a precursor to fulfilling the requirements for global sustainable palm oil certification. We can see that, similar to the case of the state-owned palm oil company, competing international certification programs have the potential to undermine the influence of domestic public voluntary regulation. In both cases, PROPER was only able to harness the pressures from international actors (buyers, consumers and CSOs) to support PROPER's basic compliance standards, as the international market tends to recognise global certification programs and third parties use their environmental commitment and action capacity to encourage companies to pursue global beyond compliance standards.

However, compared with the state-owned palm oil company (see Chapter 7) that relies on domestic banks for credit, Ketapang is also reliant on international investors, which includes the Mitsubishi Bank, discussed above,

and many others (see Table 8.3). These international third-party investors also have environmental commitment and action capacity to influence the company, as we saw in the case of the Mitsubishi Bank discussed in the previous section (and discussed below); however, these actors demand minimum legal compliance from their creditors, rather than beyond compliance commitments.

Table 8.3. Creditors of the Ketapang company

No.	Bank	Amount of loan (USD million)
1	PT Bank Pan Indonesia	176
2	PT Maybank Indonesia	107
3	Rabobank International	110.5
4	PT Bank CIMB Niaga	90
5	Bank of Tokyo, Mitsubishi UFJ, Ltd	40.2
6	ABN AMRO Bank N.V. Singapore Branch	20

Source: Ketapang Company Financial Report, 2017, p. 59

Among those international financial market players, Mitsubishi Bank was the first organisation which directly used PROPER in its investment policy, using the publicly disclosed PROPER ratings to pressure the Ketapang company to meet its minimum legal requirements (Blue rating). Mitsubishi Bank had the power to compel Ketapang to improve its performance through its loan to the company of USD 40.2 million (Ketapang Company Financial Report, 2017, p. 59).

From the discussion above, we can see that PROPER's public disclosure strategy was only able to harness pressures from international actors—banks, consumers, buyers, and CSOs—on Ketapang to meet PROPER's basic compliance standards rather than its beyond compliance standards. PROPER's rating system provides an easy way to demonstrate that it has met minimum environmental legal requirements instead of providing reams of compliance documents regarding air pollution, water pollution, land pollution, and toxic

and hazardous waste management. This is sufficient for international (and domestic) banks, and provides an inroad for the company to commence the process of meeting global beyond compliance certification programs demanded by international buyers, consumers and CSOs in key markets.

The company's response to these pressures is shaped by features of the palm oil industry reliant on international markets, high environmental commitment and action capacity of banks and buyers concerned with their reputations, and CSOs concerned with sustainable palm oil production. However, such international influence has constrained the influence of PROPER strategies to encourage companies in the palm oil sector to meet specific beyond compliance standards. The two palm oil company case studies demonstrate that companies are not adverse to changing behaviours to meet beyond compliance standards, but there is a mismatch between PROPER standards and those required in the global palm oil industry.

8.6. Conclusion

Similar to the case of the state-owned palm oil company discussed in the previous chapter, this chapter highlighted the challenges for PROPER to harness multiple sources of pressure to improve and sustain beyond compliance socio-environmental performance, over time, of the privately-owned PKS palm oil mill operating under the Ketapang company. The discussion above demonstrated Ketapang/PKS Pekawai's fluctuation in beyond compliance performance against PROPER standards—moving from basic compliance to beyond compliance rating, before reverting to basic compliance. Overall, the findings from both companies in the palm oil sector show fluctuating performance compared with overall upwards improvements in the oil and gas sector (see Chapters 5 and 6)—this occurred regardless of the ownership structure of the SOE and the privately-owned palm oil companies. This indicates that despite the valuable insights from literature on the political economy of the resource sector (e.g Warburton, 2017), the underlying structural conditions of the sector in terms of patterns of firm ownership (and the interdependence or differentiation of foreign and

domestic capital) alone cannot fully explain variation in the way firms engage with the state and domestic institutions such as PROPER (as a domestic voluntary certification system) and its influence on their social-environmental performance, particularly when we include SOEs in the sample.

As with the case of state-owned palm oil company, key factors explaining the constraints on PROPER's public disclosure strategies to induce beyond compliance behavioural change at Ketapang include limited recognition of PROPER by buyers and CSOs in the socio-environmental governance in global palm oil sector, as a legitimate certification mechanism for beyond compliance performance. Instead, these actors recognised PROPER as a domestic mechanism suitable for supporting basic environmental legal compliance (as did international banks) and preferred to support global mechanisms that encouraged beyond compliance performance. They used their high action capacity and influence expressed through "naming and shaming" to pressure Ketapang to change its behaviour. This was in contrast to the more collaborative strategies used to support sustainable palm oil production, as was the case at the state-owned Tebing plantation company. Ketapang responded to these pressures due to the context and conditions of Indonesia's palm oil sector, highly reliant on international buyers and investors for its business, the effects such strategies had on its reputation, and access to markets and sources of credit.

PROPER's technical assistance strategy also encountered constraints due to Indonesia's decentralised regulatory context, and limited capacity (resources and knowledge) and interest of subnational regulators in West Kalimantan in supporting companies to achieve PROPER's beyond compliance performance standards. Subnational regulators used discretionary, informal policies, substituting deeper technical assistance with "informal inducements" for companies to participate in PROPER. This strategy allowed companies to undertake remedial actions to fix regulatory violations prior to publishing PROPER ratings.

These findings add to the literature on regulatory theory that identifies the undocumented strategies of the use of "informal inducements" by the state

to help companies meet basic compliance levels in public voluntary regulation. The informal inducement strategy introduced the positive benefits of a remedial policy, which is in contrast to the “informal threat” and “naming and shaming” shaming strategies used by subnational regulators in North Sumatra to influence the state-owned Tebing palm oil company.

Moreover, there were also constraints on PROPER’s strategy of promoting environmental commitment in Ketapang’s top-level management. It successfully harnessed direct pressure from influential political elites, including the President, to support its beyond compliance standards, as the regulatory goals of PROPER standards were aligned with the interests and key political commitments of these national elites—to reduce forest fires. There was a direct link between the national political agenda, top-level management’s commitment to ban the use of fire for clearing in its new industrial scale oil palm plantation, and the introduction of its Sustainable Farming initiative, which sought to change the behaviour of smallholders in using fire, among other goals. These and other changes bolstered Ketapang’s PROPER rating to Green. Ketapang also responded to these pressures, given the nature of close business-state relations in the sector, and that it needed support at the national level to secure new plantation licenses authorised by the national government.

However, when direct pressure from national political elites waned and PROPER had gained its nationally-issued license, Ketapang’s socio-environmental performance against PROPER beyond compliance standards diminished. While the company was also sensitive to the interests and pressures from both national and subnational actors, subnational regulators only encouraged a Blue rating due to perverse incentives for subnational governments in PROPER design (budgets are not received for beyond compliance assessments). As with the state-owned palm oil company, while Ketapang continued with its commitments and programs to reduce forest fires, the company then shifted its energies and investments into meeting beyond compliance certification programs recognised by international markets and thus PROPER could not compete.

In this conclusion, I also acknowledge many publications that have explored the conflict between companies and Dayak communities in West Kalimantan (Lavang et al., 2016; Potter, 2008). However, the Head of the Dayak Community in the vicinity of the Ketapang Company clarified that the company had already paid for the lands that were being used for oil palm plantations, enabling conflicts between the company and local communities to be avoided in this instance.” However, despite the valuable insights from literature on political economy (e.g. Warburton, 2017), ownership structure alone cannot fully explain variation in the way firms engaged with PROPER (as a domestic voluntary certification system) and its influence on their social-environmental performance.

Chapter 9

Comparative analysis

9.1. Introduction

This thesis was developed to build new understanding of how the capacity of public voluntary regulators to achieve their objective of improving socio-environmental performance is influenced by distinctive features of institutional context, understood to vary across countries, sectors and types of firm. This chapter returns to the two central research questions introduced in Chapter 1. First, how and to what extent do public regulators adapt voluntary regulatory strategies to accommodate the distinctive institutional contexts in which they operate? And second, how do variations in institutional context enable and constrain the ability of these voluntary regulatory strategies to induce improvements in socio-environmental performance of regulated firms, both within and beyond the requirements of the law?

In response to these questions, this chapter first explores variations in strategies used by PROPER regulators to induce behavioural change in socio-environmental performance across the four case studies. This chapter seeks to demonstrate that some strategies adopted were common to each case, while others were case specific. Second, this chapter aims to illustrate that the combination of strategies used at both national and subnational levels tended to operate via mechanisms of informal influence to pressure firms to improve their socio-environmental performance. Third, comparative analysis seeks to identify the ways in which specific configurations of PROPER's core public voluntary regulation strategies had different degrees of influence across sectors and types of firm.

Arguably, Indonesia's institutional conditions of state-business relations in socio-environmental governance shaped how PROPER strategies operated across all four cases across sectors and types of firm, albeit in different ways and to different degrees. Furthermore, other underlying institutional conditions in Indonesia, in particular state regulatory capacity in decentralisation and third-party actors (both commercial and non-

commercial), explain variation by sector. In relation to non-commercial third-party actors, particularly local community actors, their role occurred in the context of democratisation. However, not all local communities could mobilise their power to pressure the company due to their dependence on the company.

The chapter is structured as follows. The following section compares strategies used by PROPER's regulators in each case, demonstrating that strategies varied across sectors and types of firm. The third section presents how varied institutional conditions across sectors influenced the operationalisation of regulatory strategies of PROPER to shape the company's socio-environmental performance. The fourth section examines top-level management in response to PROPER across types of firm (state-owned versus privately-owned companies). This chapter uses these two sections to answer the second research question.

9.2. Variation in the use of regulatory strategies across sectors and types of firm

This section comparatively examines the regulatory strategies employed by both national and subnational regulators of PROPER. It highlights that these strategies varied across sectors (oil and gas, and palm oil) and across types of firm (state-owned and privately-owned). Moreover, this section presents how the institutional context of the patrimonial state enabled regulators (both national and subnational) to use informal approaches to influence companies.

9.2.1. Regulatory strategies

Table 9.1 summarises the five regulatory strategies used by PROPER national or subnational regulators that were identified across the four case studies. Promoting environmental leadership, technical regulatory assistance, and public disclosure are the formal strategies in Minister of Environment Decree No. 3/2014 on PROPER. Informal threat and informal inducement were identified in the case studies as additional strategies used by regulators (mainly at the subnational level) that were outside the regulatory design of PROPER.

Table 9.1. Regulatory strategies used by PROPER across sectors and types of firm

Regulatory strategies		Oil and gas (centralised/national authority)		Palm oil (decentralised/subnational authority)	
	Sub-type	State-owned oil company SUBANG/Rantau	Privately-owned oil company TARAKAN/Rimau	State-owned palm oil company TEBING/Rambutan	Privately-owned palm oil company KETAPANG/Pekawai
1. Promoting environmental leadership	Environmental awards night (involving regulators, national and subnational political elites, companies)	Yes	Yes	Yes	Yes
	Facilitated relationship building between influential national political elites and company leaders (rewards for strong performers)	Every year for Gold performer	Every year for Gold performer	Only in 2012 and 2013 when the Rambutan plant obtained a Green rating	Only in 2015 when the Pekawai obtained a Green rating
2. Technical regulatory assistance	Training and knowledge building on PROPER for company staff	Provided by national regulators	None (but provided by the company)	None	None
	Budgets/human resources for technical assistance	Provided centrally	Provided centrally	None, only for PROPER assessment	None, only for PROPER assessment
	Indirect technical assistance – discretionary policies to solve regulatory problems	Provided by national regulators	None	None	None
3. Informal threat	Naming and shaming – regulators directly threaten to publish non-compliance ratings for any company that refuses to participate in PROPER	None	None	Yes, threats from subnational regulators	None

Regulatory strategies		Oil and gas (centralised/national authority)		Palm oil (decentralised/subnational authority)	
	Sub-type	State-owned oil company SUBANG/Rantau	Privately-owned oil company TARAKAN/Rimau	State-owned palm oil company TEBING/Rambutan	Privately-owned palm oil company KETAPANG/Pekawai
	Direct threat of delayed environmental and other business permits	None	None	Yes, threats from subnational regulators	None
4. Informal inducement participation	- Participation benefits - remedial policies to fix regulatory violations	Yes, tied to technical assistance from the national regulator for ongoing participation (see above)	None	None	Yes, subnational regulators offer benefits
5. Public disclosure	National regulator publishes PROPER ratings of company environmental and social performance (five colour codes)	Yes	Yes	Yes	Yes
	Naming and praising to reward strong performers that participate in PROPER exhibitions/talk shows and promotional events	None	Yes, strong performer rewarded with an environmental permit for helping to promote PROPER	None	None

In all four cases, across sector and types of firm, the national government employed the first strategy of promoting environmental leadership to all participants of PROPER. This strategy aimed to encourage top-level management to support PROPER, in both meeting compliance and beyond compliance standards. The national regulator implemented this strategy through the annual Environmental Awards Night (discussed in Chapters 5 to 8), to which the national regulator invited top-level management of participating companies, political elites at both national and subnational levels, media, CSOs and other observers. Senior politicians, such as the Indonesian Vice President and the Minister of Environment and Forestry were not only guest speakers at the Awards Night, but they also spoke to top-level management to encourage them to support beyond compliance standards. Their engagement with and support of PROPER was a part of their wider politico-economic strategy to demonstrate their commitment to improved environmental performance, particularly given the pressures from international institutions over past violations and the need to attract international investment at various points in time.

At the Awards Night, PROPER ratings were also publicly announced for all participating companies for the first time, as a part of PROPER's public disclosure strategy and regulatory design. This strategy not only shared information, so as to elicit support from third-party actors to pressure companies to improve their socio-environmental performance, but announcing performance ratings at the Awards Night created a degree of competition between companies with regards to their PROPER ratings.

As part of its strategy to promote environmental leadership, the national regulator also specifically invited top-level management of the green performers (with a Gold and Green rating) to a special dinner with influential national-level political elites. Combining the formal event and informal dinner with political elites was how the national regulator, particularly national government, adapted the strategy of promoting environmental leadership to the Indonesian context.

While promoting environmental leadership and public disclosure was evident in all four cases, the case studies demonstrate that the second formal PROPER strategy (technical regulatory assistance) was not consistently provided. The regulatory design of PROPER mandated that both national and subnational regulators should provide technical regulatory assistance to the participants of PROPER to improve employees' knowledge and skills in both compliance and beyond compliance standards. Technical regulatory assistance was commonly implemented through providing in-house training for staff in participating companies to understand how PROPER worked and the indicators it used for assessment.

The national regulator provided strong technical assistance for the state-owned oil and gas company (the Subang company, an early adopter of PROPER) to meet compliance and beyond compliance standards. Before participating in PROPER, Subang did not have an environmental management system that could detect plant compliance or non-compliance with environmental legal regulation in the Indonesian jurisdiction. The national regulator collaborated with the company to organise training to not only improve employees' knowledge and skills, but develop a new environmental management system.

In-house training went so far as to extend this assistance to introduce discretionary policies to help the company solve regulatory problems. The state-owned oil company, for example, was able to use daily operational vehicles to transport toxic and hazardous waste from oil wells (rather than specially designated vehicles) to the central processing unit, so as to better accommodate business conditions in practice.

Yet, there was also a difference in the implementation of this strategy at firm level. The privately-owned Tarakan oil and gas company, for example, did not take up the offer of regulatory assistance from the regulator, as the company had decided to invest in private consultants for this purpose, given such consultants had been involved in initially establishing the existing environmental management system. Tarakan made this decision because it considered environmental excellence important for the company's

international reputation. Thus, while both oil and gas sector companies in this thesis had a strong understanding of how PROPER operated, the regulator's technical assistance strategy was only evident in one case.

Moreover, a sectoral difference in the implementation of the technical regulatory assistance strategy was also apparent. As was evident in both palm oil cases (Chapters 7 and 8), most of the budget devolved to subnational regulators with authority in this sector was used for assessment of compliance performance. There was no budget to build company knowledge and skills to meet beyond compliance standards. Thus in both cases, subnational regulators substituted technical regulatory assistance with discretionary policies of "informal threat" or "informal inducement" to attract palm oil companies to participate in PROPER. The subnational regulator in North Sumatra Province (see Chapter 7) used informal threat relating to the delayed release of environmental permits to companies that did not want to participate in PROPER. Red (non-compliance) ratings for those that did not acquiesce were also published.

Informal inducement used by subnational regulator in West Kalimantan Province (see Chapter 8) was also a discretionary policy adopted as a substitute for technical regulatory assistance to increase the number of participating companies in PROPER. However, rather than threatening companies, the regulator offered benefits to attract participants into the program, including the privately-owned Ketapang palm oil company, through informal remedial policies to correct regulatory violations before initial PROPER assessments were published. Companies such as PKS Pekawai, the subsidiary of Ketapang, had a chance to fix regulatory violations identified by inspectors and avoid the embarrassment of being awarded a Red (non-compliance) rating. This strategy was qualitatively different from discretionary policies used by national regulators in the case of the state-owned oil and gas company, Subang, rewarded by the regulator for seeking to meet beyond compliance standards.

As mentioned above, the strategy of public disclosure was consistently used by the regulator in all four cases across sectors and types of firm. By

publishing a company's environmental and social performance using five colour codes (Black, Red, Blue, Green and Gold) to designate ratings¹⁵⁴, this strategy harnessed pressure from third-party actors (commercial and non-commercial) on companies for better socio-environmental performance.

In addition to publishing performance results, the national government invited its best Gold performer—the privately-owned Tarakan oil and gas company—to participate in its promotional events as an additional aspect of its public disclosure strategy. The national government aimed to show that PROPER could be the alternative strategy to legal sanctions and punitive actions to improve socio-environmental performance in Indonesia. Tarakan obtained the highest level in PROPER (a Gold rating) for seven years in a row (to 2017) and helped showcase the success of the program.

From the discussion above, it is clear there was variation in the strategies used across sectors and types of firm. The use of both informal threat and informal inducement shows how public voluntary regulation strategies can be adapted by government regulators differently across sectors in multi-level governance systems where different agencies or different levels of government have regulatory authority for specific sectors. The regulatory design of PROPER aligned with the sectors for which the national regulator had authority—national bureaucrats adapted the official strategies in its regulation of the oil and gas sector. However, the national regulatory agency for PROPER, the DITJEN PPKL, had less control over strategies used by subnational governments for sectors over which they had authority. Here we see variation in strategies used by the regulatory authority that were outside program design.

9.2.2. Mechanisms of informal influence operating across PROPER strategies

This section focuses on how and to what extent these configurations of PROPER regulatory strategies adapted to the conditions in the Indonesian context, to partly answer the first research question. Here, this subsection

¹⁵⁴ See the comprehensive explanation of the five colour codes in Chapter 3 pages 52-53.

argues that country-level conditions are important. In all four cases, the underlying institutional conditions of close state-business relations mattered in relation to the ways PROPER's strategies operated. In the wider context of Indonesia's patrimonial state-business relations, PROPER strategies (i.e. promoting environmental leadership and providing technical assistance) operated through mechanisms that harnessed informal influence to elicit behavioural change in companies. This thesis defines such mechanisms of informal influence (see Chapter 7) as a particular mode of regulatory enforcement marked by the use of personal connections, networks and, among others, informal directives from state actors to regulatory targets (companies). These mechanisms drew on underlying power structures in Indonesia's patrimonial state.

Table 9.2 identifies the three mechanisms of informal influence that emerged in the way PROPER strategies were able to harness pressure on companies. One or more strategies operated via these mechanisms to elicit informal sources of pressure on companies to improve socio-environmental performance.

Table 9.2. Informal mechanisms of influence across regulatory strategies

Regulatory strategies	Informal mechanisms of influence to harness pressure on companies
Promoting environmental leadership strategy	1. Drawing on support from political elites to informally pressure companies to participate in PROPER (and sometimes meet its beyond compliance standards)
Technical regulatory assistance, informal threat* strategies and public disclosure	2. Informal facilitation (or delay/block) of environmental permits—environmental permits used as a reward for promoting PROPER, supporting PROPER (through participating in learning programs), or seeking to comply with beyond compliance standards

Technical regulatory assistance, informal inducement* and informal threat* strategies	3. Informal use of discretionary policies—to overcome regulatory problems or violations encountered by companies

*Adopted by subnational regulators when they do not have regulatory capacity to provide technical regulatory assistance

We can see that the strategy of promoting environmental leadership across sectors and types of firm operated via informal pressure on firms from national-level political elites. At the Environmental Awards Night and in other facilitated meetings and dinners, political elites together with the regulator encouraged top-level management of participating companies in PROPER to support beyond compliance standards (Green or Gold rating). The involvement of political elites in promoting environmental leadership leveraged the history of Indonesia's patrimonial state and its underlying close business-state relations as a way of garnering commitment from top-level management to the goals of PROPER.

The patrimonial state has its historical roots in Suharto's political-economic system which support crony capitalism (Choi, 2009; Crouch, 1979). This gave power to political elites to control state resources needed by business and build patron-client networks with specific business leaders, rather than providing equal access for all business players (Choi, 2009). Business leaders in return provided political support for aligned political leaders. As such, top-level management in Indonesia needed to develop a close personal relationship with political elites.

However, it is important to note that in both cases in the palm oil sector, when the preferences of influential political elites shifted in favour of Indonesian palm oil companies becoming globally competitive, the priorities for each company's top-level management shifted to prioritising the RSPO's certification standards so as to compete in global markets and gain price premiums, regardless of the ownership structures of these firms (cf. Warburton, 2017). (This is discussed later in this chapter.)

The second mechanism of informal influence on which PROPER draws is the power the regulator and associated political elites have to facilitate or block environmental permits. Many of PROPER's formal strategies rely indirectly on the power and authority that bureaucrats and political actors have to support environmental permits and many kinds of business licenses. It was evident in each of the case studies that the power to slow down or speed up access to such permits and licenses was informally used to reward and punish companies for particular types of behaviour. Bureaucrats, in particular, could informally use this authority to punish companies that did not comply with formal and informal requests to participate in PROPER, or to meet beyond compliance standards. They could also reward the companies that met their demands with easier, speedier and more predictable permit and license processes. Such power was derived not only from the formal authority of these actors, but also from business interests in securing licenses and permits in predictable ways so as not to slow production processes and increase costs associated with permit delays.

One example is evident in the case of the privately-owned Tarakan oil and gas company (see Chapter 6). The Ministry of Environment and Forestry (as both the PROPER regulator and as the Ministry responsible for many concession licenses and environmental permits) informally facilitated an environmental permit for the company as a reward for its annual participation in promotional events for PROPER, particularly exhibitions and radio talk shows. While such participation helped boost the reputation of the company, it also required a significant investment of company resources. Tarakan was supportive of the agenda; however, so as to develop a strong, close relationship with the regulator to gain access to permits.

We have also seen how this process worked in relation to other PROPER strategies. In the case of the privately-owned palm oil company, Ketapang, the strategy to promote environmental leadership operated through multiple mechanisms of informal influence. Political elites directly applied informal pressure on the company to meet PROPER's beyond compliance standards to demonstrate they were undertaking steps to mitigate

forest fires, a key issue in the President's political agenda. The President and the Minister for Environment and Forestry also had the power to block the company's application for a new, large-scale concession, if it did not respond to government demands. The company met PROPER beyond compliance standards (Green) to meet these demands, maintain a strong relationship with the state, and its new concession was secured (see Chapter 8).

The case of the state-owned palm oil company, Tebing (see Chapter 7), illustrated ways in which the state directly substituted technical assistance with informal threat to elicit participation in PROPER, regardless of whether companies were supportive of public voluntary regulation. Informal threat refers to the particular mode of enforcement style marked by the use of personal connections and power over broader regulatory processes (outside public voluntary regulation) as the means to pressure regulatory targets (companies) to meet state demands, in this case to participate in PROPER. The subnational regulator in North Sumatra Province made examples of companies that did not comply with their demands by issuing Red, non-compliant ratings, which, as mentioned above, was not a strategy articulated in PROPER's design. Again, they also threatened to use their power to slow down or block permit access. Tebing acquiesced to these demands, to maintain strong relations with subnational state actors and avoid any complications in administrative processes (or permit and license access) that could affect production costs, timelines and profits.

The strategy of using Informal threat contradicts the value of voluntarism that underpins the regulatory design of PROPER. Theoretically, voluntarism relies on the individual firm undertaking to do the right thing unilaterally, without coercion [from the state] (Gunningham et al., 1998, p. 56). However, the ways that PROPER strategies interacted with the features of the patrimonial state in Indonesia influenced companies to participate in public voluntary regulation. The risk of reputational damage from naming and shaming and the risk of permit restrictions motivated companies, including Tebing, to meet the demands of the state rather than purely acting on the principle of voluntarism.

Close state-business relations have reciprocal benefits for each actor. We also saw that in the case of Tarakan (Chapter 6), their support for PROPER's beyond compliance agenda helped the regulator maintain political and budgetary support for its policies and programs. The company also provided economic and political support for political elites who championed the program, via preferential treatment in assigning lucrative contracts in the company's production process and supply chain for actors and companies within the networks of these political elites. In return, the company was better able to access environmental permits in a timely fashion to avoid uncertain production schedules and cost escalation, and to continue to access business opportunities proffered by the state.

The third mechanism of informal influence evident in case studies is that in which subnational and national regulators informally used their authority and power over regulatory processes to undertake discretionary actions to help companies address regulatory problems or overcome regulatory violations. In the case of the state-owned Subang oil and gas company (see Chapter 5), such processes emerged under the umbrella of its technical regulatory assistance strategy. Traditionally, technical assistance offers knowledge improvements as a benefit to attract companies to participate in public voluntary regulation (Asfah et al., 2000).

However, Subang's experience demonstrates that technical assistance in the Indonesian institutional context operated not only by offering assistance to meet environmental legal regulations and beyond compliance standards, but also by offering the regulator the opportunity to undertake "informal discretionary actions" when business processes were not entirely compatible with some of the technical specificities of environmental regulations. As mentioned above, regulators agreed with the company that regulation on toxic waste management was not compatible with business in the oil and gas sector. Thus, based on the company's strong performance in PROPER, they did not assess how waste was transported during the production process as a regulatory violation. Such decisions, in turn, further bolstered the commitment of the state oil company to invest in processes to obtain the best

level of beyond compliance (Gold rating). From the regulator's perspective, increasing numbers of companies achieving a Gold rating improves the legitimacy of PROPER to be the appropriate regulatory strategy to improve socio-environmental performance in Indonesia.

The locus of regulatory authority for a particular sector or jurisdiction was also an institutional condition in Indonesia, which constrained or enabled the ways that PROPER was able to exercise influence on companies. In the above example, the national regulator was able to make such informal policies because the wider authority for regulating the oil and gas sector also sits with national government agencies. However, in other sectors, regulatory authority sits with subnational governments. In both cases in the palm oil sector, subnational governments also adopted mechanisms of informal influence, either threats or inducements, instead of technical regulatory assistance.

The case of the privately-owned Ketapang palm oil company also demonstrates that subnational government used informal discretionary policies instead of technical assistance, namely informal inducement. Informal inducement by the state refers to the government approach marked by offering benefits to persuade the company to participate in PROPER, such as remedial policies. In the case of West Kalimantan Province, such remedial policies were not offered by government via formal regulation. Rather, this benefit was offered by the regulator through informal or personal communication with regulatory targets (companies). The company was offered the opportunity to fix regulatory violations to avoid the Red rating (non-compliance) and being named and shamed in return for participation in PROPER.

The ways that configurations of PROPER strategies adapted to institutional conditions in Indonesia, in which regulatory enforcement is weak and the operation of the state is based on reciprocally beneficial relationships of patronage, show that public voluntary regulations are sensitive to such conditions. Scholars have tended to theorise how public voluntary regulation can induce behavioural change in companies based on analysis of country contexts where there is strong regulatory enforcement (see Khanna, 2002;

Lyon & Maxwell, 2002; Prakash & Potoski, 2012). In many industrialised countries, strong enforcement of mandatory regulations acts as a “background threat” for enacting stricter, future regulations in the operationalisation of public voluntary regulation. Such background threats are a critical motivation or pre-emption for a firm to participate in and comply with voluntary initiatives so as to avoid stricter mandatory regulations in future (Khanna, 2002; Lyon & Maxwell, 2002). Prakash and Potoski (2012) also argue that the opportunity for supplying public voluntary regulation is influenced by the stringency of public law. The Indonesian context, however, is different to that of many industrialised countries that have strong regulatory enforcement.

Analysing how influence is exercised under institutional conditions, such as those in Indonesia, offers alternative explanations of how public voluntary regulation operated to shape socio-environmental performance in a country with a history of patrimonial state-business relations and weak enforcement of mandatory regulations. The use of strategies by regulators that relied on informal influence in part helps us answer the first research question on how and to what extent do public regulators adapt voluntary regulatory strategies to accommodate the distinctive institutional contexts in which they operate.

As we can see from the case studies analysed in Indonesia, some combinations of regulatory strategies were used by both national and subnational regulators that operated via mechanisms which harnessed sources of informal influence on companies. These strategies drew their power from Indonesia’s political economy of reciprocally beneficial close state-business relations to meet PROPER’s beyond compliance (and in some cases compliance) standards, in an environment in which environmental regulatory enforcement is weak.

Simanjuntak (2010) argued that state environmental regulators are often challenged by influential political elites when they enforce or sanction firms that violate the law. Most companies involved in extraction are supported by political and bureaucratic elites who depend on business support to underwrite an expensive political system driven by patronage and

money politics (Warburton, 2017, p. 3). As such, legally enforcing regulations would likely “backfire” for environmental regulators. Indeed, one senior civil servant disclosed that they used informal persuasion instead of relying on the law or legal enforcement, because such formal or legal mechanisms simply cannot work due to broader political constraints—influential elites can override attempts at enforcing regulations.¹⁵⁵

Subnational regulators, in particular, relied on informal influence when they operationalised PROPER strategies by using threats or inducements to motivate companies to meet compliance standards. There were also perverse incentives in PROPER’s design that discouraged subnational regulators from pressuring companies to meet beyond compliance standards—they received more funds for subnational state agencies to fund first inspections or compliance inspections thereafter, as beyond compliance ratings are self-assessed by companies. Subnational regulators were able to deviate from the official technical assistance strategy in sectors for which regulatory authority was decentralised (i.e. the palm oil sector), which meant subnational government staff did not need to adhere to instructions from national government (which was the case in the centralised oil and gas sector).

Drawing on the comparative politics literature (e.g. Helmke & Levitsky, 2004), we can see how the informal approach adopted by PROPER takes a different informal institutional approach to be either complementary or accommodating at different levels of government. The informal approach adopted by national government can be characterised as “complementary” — Helmke and Levitsky (2004) defines complementary institutions as those that “fill the gaps” either by addressing contingencies not dealt with in the formal rules or by facilitating the pursuit of individual goals within the formal institutional frameworks (Helmke & Levitsky, 2004, p. 728). In the complementary institutions, national government used individual political network to achieve the regulatory objectives of PROPER. This type of informal

¹⁵⁵ Confidential interviews with bureaucrat at MOEF on April 27, 2017.

approach was successful in encouraging companies to perform at beyond compliance levels (achieving either a Green or Gold rating).

Meanwhile, the informal approach adopted by the subnational regulator can be characterised as “accommodating”— Helmke and Levitsky (2004) defines “accommodating” informal institutions as those that create incentives to behave in ways that alter the substantive effect of formal rules, but without directly violating them; they contradict the spirit, but not the letter, of formal rules (Helmke & Levitsky, 2004, p. 729). The goal of the informal approach used by the subnational regulator was under-rate the performance of companies in some instances so that they would remain in the Blue rating category for longer (basic compliance level) and as a consequence, the subnational regulator could continue to receive revenues from the national government for repeat assessments. This goal contradicts the formal objective of PROPER to encourage companies to meet beyond compliance level standards (achieving either a Green or Gold rating), and in effect distorts the spirit of the regulatory arrangements.

In summary, comparative analysis across regulatory strategies of PROPER shows that both national and subnational PROPER regulators used combinations of strategies which relied on mechanisms that harnessed informal sources of pressure to induce social and environmental behavioural change in companies. The patrimonial state provided the foundations for informal influence in the Indonesian context. Such mechanisms tended to rely on the use of informal incentives and disincentives for companies to access environmental permits and other privileges from influential state actors. In the institutional context of weak regulatory enforcement, the function of such mechanisms is a substitute for the “background threat” of introducing stricter, future regulations that might be evident in institutional contexts where there is strong mandatory enforcement of regulations. The following sections comparatively analyse how regulatory strategies shape socio-environmental performance across sectors and types of firm, and the ways that informal influence together with other institutional conditions enable or constrain the influence of PROPER’s beyond compliance standards.

9.3. Regulatory strategies across sectors

This section contributes to answering the second research question: how do variations in institutional context enable and constrain the ability of these voluntary regulatory strategies to induce improvements in the socio-environmental performance of regulated firms, both within and beyond the requirements of the law? Below, I compare how regulators of PROPER adapted core regulatory strategies across sectors, including promoting environmental leadership, technical assistance, and public disclosure, and how institutional conditions constrained or enhanced these strategies.

As evidenced in the discussion above, the institutional condition of close state-business relations in Indonesia was relevant for all cases across sectors; but public regulators adapted the ways that PROPER strategies responded to this condition in different ways via the mechanisms of informal influence. There was sectoral variation in the ways that other key institutional conditions shaped the influence of PROPER. Moreover, decentralised regulatory authority, which also affects the capacity of state regulators to support PROPER (through technical assistance), had different implications for the influence of PROPER strategies in the palm oil and oil and gas sectors. This section argues that different responses of third-party actors in each sector enabled and constrained the influence of PROPER. Third-party actors in the oil and gas sector, for example, committed to PROPER's beyond compliance standards. In the palm oil sector, however, such actors tended to influence companies to only meet PROPER's compliance standards, instead preferring other globally recognised beyond compliance standards.

9.3.1. The regulatory strategy of promoting environmental leadership

As explored in the previous section, the national regulator worked with political elites at the national level to directly persuade top-level company management to improve socio-environmental performance. As detailed in Table 9.1 above, this strategy was consistently used across all cases. However, as Table 9.3 illustrates, this strategy operated under different institutional conditions for each sector.

Table 9.3. Promoting environmental leadership across sectors

Cases	Company's performance, response and motivation			
	Oil and gas sector		Palm oil sector	
	State-owned oil and gas company SUBANG/Rantau	Privately-owned oil and gas company TARAKAN/Rimau	State-owned palm oil company TEBING/Rambutan	Privately-owned palm oil company KETAPANG/Pekawai
PROPER rating	From Blue (compliance) to Gold (top-level beyond compliance)	From Blue (compliance) to Gold (top-level beyond compliance)	From Green (beyond compliance) and back to Blue (compliance)	From Blue (compliance) to Green (beyond compliance) and back to Blue
Regulatory target: Top-level management commitment to PROPER	Continued commitment of top-level management to support PROPER through: • Extra budget to implement PROPER provided over time • PROPER included in departmental and staff KPIs • Direct involvement of senior management in field operations to institute PROPER • Developed a new environmental management system based on PROPER	Continues commitment of the founder to support PROPER through: • Extra budget to implement PROPER provided over time • Direct involvement of senior management in field operations to institute PROPER • Integrated PROPER into the existing environmental management system	Temporary commitment from top-level management to supporting PROPER • Providing extra budget only for two years at the beginning of participation (2011 and 2012)	Temporary commitment from top-level management to supporting PROPER • Providing extra budget only for a year in 2015
Institutional condition: The relationship between the state and business	Top-level management needs to build a strong, close relationship with political elites at the national level to secure business licenses and environmental permits because of centralisation authority in the oil and gas sector.		Top-level management requires strong relationships with political elites at the national level (for business opportunities and inter-provincial land concessions) and more frequently with subnational regulators for business licenses and permits. This is due to decentralisation of the palm oil sector (except for inter-provincial oil palm plantation concessions and associated permits which are issued nationally).	

Comparative analysis in Table 9.3 shows that employing political elites at the national level to persuade top-level management to commit to PROPER produced different responses, which in turn had implications for socio-environmental performance across sectors. In the oil and gas sector, both state-owned and privately-owned companies improved their performance from compliance level (Blue rating) to the best level of beyond compliance (Gold rating). In the oil and gas sector, under direct pressure from national political elites and to maintain their reputation in terms of PROPER ratings, top-level management continually supported beyond compliance programs. They provided extra budget allocations, involving PROPER in employees' key performance indicators (KPIs), changing environmental management systems and, in one of two cases, direct hands on involvement of company directors in operationalising PROPER at plant level. National political elites recognised the legitimacy of PROPER's beyond compliance standards and pressure on the company was sustained over time.

Meanwhile, socio-environmental performance in the palm oil sector either decreased or fluctuated, demonstrating a temporary commitment on the part of top-level management to achieve beyond compliance standards. Under direct pressure from national political elites, in both palm oil sector cases, the companies initially invested funds to improve beyond compliance performance. However, this commitment (additional budget allocation for continued new programs) subsided once direct pressure from national elites receded to implement PROPER's beyond compliance standards. In the case of the state-owned Tebing palm oil company, national political elites shifted their attention to accessing international palm oil markets, which had competing RSPO beyond compliance certification standards. In the case of the privately-owned firms, national elites shifted their attention elsewhere, once forest fires had subsided, and company commitment waned when a new oil palm plantation license had been issued.

Employees at operational level were not able to implement environmental and social programs to meet beyond compliance standards in PROPER without approval from top-level management. This finding confirms

the existing literature on organisational studies that suggest top-level management plays a critical role in establishing strategic formulation at the company, distribution of resources and power, socialisation, and a reward system to mainstream environmental values in organisational processes (Logson & Yuthas, 1999).

A distinct institutional condition that interacted with Indonesia's patrimonial state was the type of relationship between state and business, reflecting patterns of regulatory authority in the sector. While the commitment of top-level management toward PROPER was important in shaping company performance, this was also contingent on the level at which pressure was applied by influential state actors relative to their authority. Regulatory authority was centralised in the oil and gas sector but decentralised in the palm oil sector, with the exception of permits and licenses for large inter-provincial plantations. Thus, sustained pressure from national political elites to encourage top-level management at oil and gas companies to commit to beyond compliance standards was particularly influential because regulatory authority was also centralised. As Chapters 5 and 6 have illustrated, oil and gas companies needed to build a strong relationship with political elites at the national level for their business interests (i.e. business permits and environmental licenses).

In contrast, persuasion from political elites at the national level was only temporary in palm oil sector cases, and those with most regulatory authority (subnational political elites) did not step in to apply similar pressure on palm oil companies to meet PROPER's beyond compliance standards. Top-level management preferred and needed to engage closely with subnational political elites as under Indonesian decentralisation subnational authorities in the palm oil sector issue business permits and environmental licenses. However, PROPER was unable to harness pressure from subnational elites in the palm oil sector whose interests only extended to pressuring companies to meet PROPER's compliance standards.

Based on presented cases, it is evident that regulatory strategies which draw on pressures from political elites to persuade top-level management to

meet beyond compliance standards can prove influential in institutional contexts where there is otherwise weak regulatory enforcement. However, this strategy can have differential impacts across sectors in multi-level governance contexts depending on how regulatory authority is structured in each sector or jurisdiction, and how well public voluntary regulation strategies can accommodate multiple levels of regulatory authority.

9.3.2. Technical regulatory assistance across sectors

Different from the strategy of promoting environmental leadership, which was implemented by national government across sectors, technical regulatory assistance was implemented by the national government in the oil and gas sector, and the subnational government in the palm oil sector. As illustrated in Table 9.1, only in the case of the state-owned oil and gas company did the national regulator truly provide technical regulatory assistance, as the privately-owned oil and gas company sought its own private consultants. Table 9.4 below outlines the differences between cases and how institutional conditions intersected with the PROPER strategy.

Table. 9.4. The strategy of technical regulatory assistance across sectors

	Company's performance, response and motivation			
	Oil and gas sector		Palm oil sector	
	State-owned oil company SUBANG/Rantau	Privately-owned oil company TARAKAN/Rimau	State-owned palm oil company TEBING/Rambutan	Privately-owned palm oil company KETAPANG/Pekawai
PROPER rating	From Blue (compliance) to Gold (top-level beyond compliance)	From Blue (compliance) to Gold (top-level beyond compliance)	From Green (beyond compliance) and back to Blue (compliance)	From Blue (compliance) to Green (beyond compliance) and back to Blue
Adoption of technical regulatory assistance	The national regulator provided technical assistance	The national regulator offered technical assistance, but the company preferred to collaborate with private consultants	Subnational regulator adopted "informal threats" as a substitute for technical assistance (e.g. informally mandate company to participate in PROPER)	Subnational regulator adopted "informal inducements" to substitute technical assistance (e.g. informally offer the remedial policy to fix the regulatory violation)
Regulatory authority	Central government		Subnational governments	
Regulators' expectations	National government expected companies to perform at beyond compliance, either a Green or a Gold rating.		Subnational governments only expected companies to perform at a compliance level (a Blue rating)	
Institutional condition: state capacity (knowledge on PROPER)	National government has the capacity to provide technical regulatory assistance		Subnational governments does not have the capacity for conducting technical regulatory assistance	
Regulators' interest in PROPER	National government shows that PROPER can be the regulatory strategies to improve socio-environmental performance in Indonesia		Subnational governments are seeking the financial benefits in the PROPER by focusing on compliance level (a Blue rating)	

As detailed in Table 9.4, the national government offered technical regulatory assistance to oil and gas companies in the form of training to improve employees' knowledge and skills to implement PROPER to both compliance and beyond compliance standards. While the state-owned Subang oil and gas company took up this offer, the privately-owned Tarakan oil and gas company preferred to collaborate with private consultants, as discussed above. In both cases, employees had the skills and knowledge to design and implement environmental programs to comply with existing environmental legal regulations, as well as reduce the environmental impacts of production through participating in PROPER. Many environmental and social programs implemented by both oil and gas programs aligned with and were captured in PROPER's assessment indicators. The compatibility between employees' knowledge and skills, environmental management systems, and indicators of PROPER for both oil and gas company cases explain why they were able to obtain a Gold rating in PROPER.

In contrast, the implementation of technical regulatory assistance was absent in the palm oil sector. Chapters 7 and 8 have shown that such technical regulatory assistance was not offered to palm oil companies. Further, it was evident that subnational governments did not have regulatory capacity or budgets to adopt technical regulatory assistance in the palm oil sector and instead substituted this with alternate strategies of informal threat and inducement. Moreover, the regulatory design of PROPER that only finances inspections for compliance standards created a perverse incentive for subnational government officers to only promote these PROPER standards. There was no evidence that the state-owned palm oil company sought to independently provide training to increase employees' knowledge of and skills in PROPER's standards. In contrast, the privately-owned company temporarily tried to collaborate with private consultants to support staff training processes with the aim of increasing employee knowledge of PROPER. Overall, employees in both cases in the palm oil sector had limited understanding of how to manage the environmental and social program requested by PROPER,

instead investing their energies in establishing programs to meet RSPO beyond compliance standards.

Again, the impact of decentralisation on state-business relations across sectors is critical for understanding if and how institutional conditions could enable or constrain the influence of PROPER public voluntary regulation strategies and help explain sectoral variation. As the designer of PROPER, civil servants at ministerial level have been implementing PROPER since 1995 when Indonesia's entire *government administration* was centralised, and they have significant cumulative knowledge in how to implement the program. National government staff dominated the regulatory process, including the design, implementation and evaluation of PROPER. This is closely aligned with centralised authority to regulate the oil and gas sector.

In contrast, the subnational government staff responsible for implementing technical regulatory assistance in the palm oil sector had limited knowledge and skills in PROPER. They were frequently rotated and did not have extended experience in regulating the industry prior to decentralisation. After decentralisation, the national government transferred some of its authority to regulate business to subnational governments without considering their regulatory capacity. As such, subnational governments' regulatory capacity could not provide technical assistance to the participants of PROPER. Thus, they substituted technical regulatory assistance with either "informal inducement" or "informal threat" described earlier. Neither of these strategies aimed to improve company knowledge and skills in PROPER but rather increased the number of participants in PROPER to the level of basic compliance.

In addition to state regulatory capacity, the difference in the adaption of technical regulatory assistance across sectors was also due in turn to different expectations on the part of relevant regulators and political elites. Chapter 6 discussed that the national government expected oil and gas companies to perform at beyond compliance levels (either a Green or Gold rating) to showcase its success as an effective regulatory approach to improve company's socio-environmental performance. In the palm oil sector,

subnational governments had other interests, in securing budgets for both individual and departmental economic interests derived from Black, Red, and Blue levels (non-compliance or basic compliance) (see Chapters 7 and 8).

Overall, from the discussion above, we can see that institutional conditions, in particular state regulatory capacity in Indonesian decentralisation differentially constrained or enhanced the influence of PROPER's technical regulatory assistance by sector. Comparative case analysis illustrates that Indonesia's decentralised governance system structured the regulatory capacity of responsible agencies across levels of government. National bureaucrats with regulatory authority in the oil and gas sector were involved in the design of PROPER, had resources dedicated to training and knowledge building in companies, and had a higher level of cumulative knowledge of and skills in PROPER, compared to subnational governments responsible for regulating the palm oil sector. National political elites and regulators expected oil and gas companies to meet PROPER's beyond compliance standards and used their considerable influence to pressure companies to meet these standards. Such expectations of companies in the palm oil sector were only temporary on the part of national political elites, and no such expectations were evident for PROPER's beyond compliance standards on the part of subnational elites.

9.3.3. The regulatory strategy of public disclosure across sectors

This subsection focuses on how the national government adapted the strategy of public disclosure to shape socio-environmental performance across sectors. As discussed in Chapter 3, PROPER publishes assessment ratings of company performance through five colour codes with Green and Gold indicating beyond compliance standards have been met. Table 9.1 above shows that PROPER implemented its public disclosure strategy across cases. However, variation in the impacts of this strategy in harnessing pressure on companies to meet beyond compliance standards across cases is in part due to the way this strategy interacted with institutional conditions, particularly capital and product market structures in each sector. These structures shaped the

interests and preferences of third-party actors with environmental commitment and action capacity to pressure companies to meet PROPER's beyond compliance standards.

Table 9.5. The regulatory strategy of public disclosure across sectors

	Third-party actors' responses toward PROPER			
	Oil and gas sector		Palm oil sector	
	State-owned oil company SUBANG/Rantau	Privately-owned oil company TARAKAN/Rimau	State-owned palm oil company TEBING/Rambutan	Privately-owned palm oil company KETAPANG/Pekawai
PROPER rating	From Blue (compliance) to Gold (top-level beyond compliance)	From Blue (compliance) to Gold (top-level beyond compliance)	From Green (beyond compliance) and back to Blue (compliance)	From Blue (compliance) to Green (beyond compliance) and back to Blue
Adaption of public disclosure: national government published PROPER ratings	Yes	Yes	Yes	Yes
Third-party actors' responses to PROPER's public disclosure strategy: commitment to PROPER's standards				
National commercial actors (investors, banks)	None	None	Domestic bank used PROPER ratings for its investment policy, only for compliance rating	None
National non-commercial actors (CSOs, local communities)	None	Local community pressured the company to perform at beyond compliance, particularly on community development programs	None	None
International commercial actors (investors, banks, buyers)	International investors (Global Bond) used PROPER ratings for their investment policy, both compliance and beyond compliance	International investors (IFC) used PROPER ratings for their investment policy, both compliance and beyond compliance	Buyers (Unilever) used PROPER ratings for its supply chain policy, only compliance level	Mitsubishi bank used PROPER ratings for its investment policy. Buyers (Unilever and Nestle) used PROPER ratings for supply chain policies, only on compliance level

International non-commercial actors (CSOs)	None	International CSO (Friend of the Earth International-FoEI) used PROPER's rating to monitor the company's performance on socio-environmental, both compliance and beyond compliance	CSO (Eyes-on the Forest-EOF), IDH Sustainable Trade Initiative) used PROPER's rating to monitor the company's performance on socio-environmental, only compliance level	CSO (Greenpeace) used PROPER's rating to monitor the company's performance on socio-environmental, only compliance level
Institutional conditions: capital markets	Company required funds from international capital	Company required funds from international capital	Company required funds from the domestic capital market	Company required funds from international capital market
Institutional conditions: product markets	None	None	Company shifted focus to international product markets – these only recognise PROPER as a standard of legal compliance; prefer RSPO beyond compliance certification	Company focus on international product markets – these only recognise PROPER as a standard of legal compliance; prefer RSPO beyond compliance certification
Institutional conditions: Democratisation and local community-business relations	Local communities still have limited bargaining position to company because they live in the landowning by company, and company does not establish a new plant	Local community can pressure company because the company develop a new plant in post-Suharto regime	Local communities depend on companies for their life, as supplier	Local communities depend on companies for their life, as supplier

While across cases PROPER's strategies mostly relied on mechanisms that informally influenced the company, PROPER's public disclosure strategy operated somewhat differently. Only in the case of the privately-owned oil company was the benefit of informal facilitation of an environmental permit a motivation for top-level management to meet beyond compliance standards (see Table 9.1). Instead, the impacts of PROPER's disclosure strategies operated through engaging third parties to recognise both its compliance and beyond compliance standards as legitimate and use PROPER's colour-coded ratings (that simplified complex assessment results) as a means to pressure the company. The influence of these third-party actors, to a significant degree, was tied to the sector in which the company operated and the capital and product markets the company wanted to access.

The case of both state-owned and privately-owned oil and gas companies demonstrates that international commercial actors (investors) in both cases had significant influence on the company and used PROPER ratings to evaluate company performance and inform investment strategies. At the state-owned Subang oil and gas company, international investors who were interested in the company's global bonds recognised PROPER's standards as legitimate. They used PROPER ratings to pressure the parent holding company to improve its performance when some of its plants obtained a Red rating in PROPER. As such, international investors suspended their purchase of global bonds until the company resolved its regulatory violations. As 'green' investors were committed to their international reputation, international investors further encouraged the company to meet beyond compliance standards.

Similarly, the case of the privately-owned oil company also shows that PROPER's ratings were used by the company to communicate with its stakeholders, particularly international investors, international CSOs and local communities. The privately-owned Tarakan oil and gas company used a Gold rating (the highest rating in PROPER) as one of a number of ways to improve its reputation which had been damaged following an environmental disaster in East Java in 2006, the well-known case of the "mudflow volcano" that caused

considerable environmental damage and destruction of villages (McMichael, 2009). It began its “Beyond Compliance Project” two years later in 2008. The FoEI pursued various strategies (see Chapter 6) to globally shame the company. In response, the company sought to improve its performance in PROPER and used its Gold rating to maintain its social license to operate through community development programs.

The findings of both state-owned and privately-owned oil companies in this study demonstrate the effectiveness of public disclosure of PROPER to reach national and international third-party actors. These cases confirm the existing literature that third-party actors pressure companies through their access to capital markets or product markets, or the interplay of all potential buyers and sellers involved in the investment, production, sale and/or purchase of a particular commodity or service (Darnall, 2003, p. 4). The institutional conditions in the oil and gas sector that relied on significant capital investments enabled PROPER to utilise commercial actors to be the source of regulatory pressure to induce behavioural change. Third-party actors, through their environmental commitment and capacity to act provided economic incentives or disincentives to encourage companies not only to comply with environmental legal regulations, but also to perform at the highest level of beyond compliance (Gold rating).

International commercial actors (particularly investors) such as the IFC in the oil and gas sector required the borrower to show their environmental and social commitments in business. Compliance with environmental legal regulation was not sufficient to access the international capital market. As a borrower, the oil and gas company needed to meet international actors’ expectations toward socio-environmental performance. As such, the company allocated staff and financial resources to meet high ethical standards of global financial capital markets.

In contrast to the oil and gas sector, the strategy of public disclosure alone was less likely to pressure palm oil companies to perform at beyond compliance levels. The focus of both palm oil companies on international markets for the sale of a large share of their Crude Palm Oil (CPO) (which in

the case of the SOE was due to direct pressure from influential political elites) meant that predominantly international third party-actors (investors, banks, buyers, and CSOs) had significant influence. The cases in Chapters 7 and 8 demonstrated that international CSOs (e.g. Greenpeace) tended to be both environmentally committed and have strong action capacity to name and shame companies that damaged the environment or buyers who purchased palm oil from these companies. For example, influential buyers (e.g. Unilever, Nestle and others) were also able to pressure the privately-owned palm oil company to change its behaviour through restricting market access. Investors (i.e. those with sustainable investment policies and also concerned for their own reputations) could pressure companies in both cases to change their behaviour. All drew on information on performance from PROPER ratings, particularly legal compliance. These findings support a study by Gunningham et al. (2004) arguing that economic enforcement (by third-party actors) is one reason why businesses go beyond compliance.

However, many of these actors (with the exception of domestic banks) were focussed on beyond compliance standards that were relevant to international markets. These include RSPO certification programs which only recognise PROPER's compliance ratings as meeting legal requirements in the Indonesian jurisdiction. Instead of using their action capacity to encourage palm oil companies to meet domestic beyond compliance standards, they instead recognised transnational certification of beyond compliance performance or sustainable palm oil production. For example, Unilever and Nestle required the privately-owned palm oil company to show its sustainable palm oil production through RSPO certification. Domestic banks investing in these companies were mainly concerned with palm oil companies meeting legal requirements and did not pressure companies to go further under PROPER initiatives.

The case of the state-owned palm oil company shows that international buyers, CSOs and the certification agency engaged with the company to promote sustainable palm oil production. They collaborated with the RSPO to promote RSPO certification to companies as well as farmers who supplied

palm oil to the company. As such, top-level management at the state-owned palm oil company preferred to allocate resources to obtain RSPO instead of PROPER credentials. As such, PROPER could not match competition with transnational certification to regulate beyond compliance performance. Similarly, third-party actors in the privately-owned palm oil sector recognised PROPER's compliance ratings, but they preferred transnational certification for beyond compliance performance. Thus, third party investors in the palm oil sector weakened top management support to improve company performance to beyond compliance level, as a result of their preference for the RSPO

When we compare sectors, I contend in this thesis that the degree of compatibility between the regulatory design of PROPER (i.e. indicators) and key sustainability issues across sectors also explain sectoral difference in the ways PROPER's public disclosure strategy was able to harness pressure from third-party actors. The literature on environmental governance categorised key sustainability issues in the firms' production process into two groups, namely "Brown" and "Green" environmental impacts (McGranahan & Satterthwaite, 2000). Brown environmental impacts relate to pollution control and its impact on human health in the current generation and in particular areas or localities (McAllister & Studland, 1999). Meanwhile, the "green agenda" focuses on the effects of environmental degradation on future generations and broader global impacts (McAllister & Studland, 1999; McGranahan & Satterthwaite, 2000).

Based on the aforementioned categories, indicators at the compliance level of PROPER only address the key sustainability issues of the brown agenda. At beyond compliance level, only biodiversity addresses green environmental issues but this indicator only contributes 12.5 per cent of the total beyond compliance score.

Comparative analysis of public disclosure across sectors also demonstrates that each sector has specific key sustainability issues that influenced how third parties acted toward a sustainability standard. Third-party actors analysed whether public voluntary regulation did or did not

address key sustainability in a particular sector. Such actors in the oil and gas sector, for example, perceived that key sustainability issues, such as energy efficiency, water efficiency, toxic and hazardous waste management, were addressed by PROPER. These are well-known “plant-based” environmental management indicators for oil and gas production. Those indicators that focused on brown or plant-based environmental impacts addressed key sustainability issues in the oil and gas sector.

This contrasts with the palm oil sector in which key sustainability issues are less likely to be covered by PROPER. Global actors have defined key sustainability issues in the palm oil sector as deforestation, biodiversity loss, land conflicts, and climate change (Teoh, 2010). The indicators of PROPER are less likely to address all key sustainability issues in the palm oil sector. Instead, they only address biodiversity loss and deforestation, particularly in peatland areas.

As such, third-party actors in the palm oil sector did not recognise beyond compliance ratings of PROPER. Instead, they switched preferences to the RSPO which does address these issues. The mismatch between the indicators of PROPER and key sustainability issues in the palm oil sector explain why public disclosure of PROPER could not harness pressure from third-party actors in this sector.

In contrast with other third-party actors who played an important role across cases in this study, pressure from local communities was only evident in the privately-owned Tarakan oil and gas company. This case supports the existing literature that local communities can be a source of pressure in supporting beyond compliance standards in the context of democratic countries (Yang, 2005). However, the findings in this thesis show that not all local communities can mobilise power to pressure companies in democracies. The ability of local communities to pressure companies depends not only on the presence of a democratic system, but also characteristics of the relationship between local communities and companies. The more local communities depend on companies (such as by living on company property [Chapter 5], or for income [Chapters 7 and 8]), the weaker their bargaining

position. As such, characteristics at the plant level are important in explaining the ability of local communities to mobilise power to pressure companies to go to beyond compliance level.

All in all, the previous three subsections have shown that a broader institutional environment of patrimonial state-business relations affected both sectors, albeit in different ways. Top-level management required strong relationships with political elites at the national level (for business opportunities and inter-provincial land concessions) in the oil and gas and palm oil sectors, but more frequently with subnational regulators for business licenses and permits in the palm oil sector as most of the authority for this sector is decentralised. This indicates that the locus of regulatory authority in particular sectors (which may overlap or sometimes be contradictory in multi-level governance arrangements) can also have bearing on the level at which political interests will be concentrated in patrimonial states, and where different regulatory strategies might be needed to accommodate these dynamics.

Yet, the regulatory impact of PROPER further varied across sectors due in part to the way other institutional conditions—state regulatory capacity and third-party actors—constrained or enabled PROPER strategies to harness pressure on companies. The degree of decentralised authority in each sector was important for shaping state regulatory capacity and the extent to which elites could influence top-level management of companies in each sector. These conditions constrained the influence of PROPER in the palm oil sector but were supportive of PROPER's beyond compliance initiatives in the oil and gas sector. Meanwhile, third-party actors in the oil and gas sector, particularly international investors and international CSOs used PROPER's ratings as an indication of both compliance and beyond compliance performance to pressure companies to improve their performance. However, third-party actors in the palm oil sector only recognised PROPER's compliance ratings and preferred competing, international RSPO standards as a measure of beyond compliance performance. Thus, these actors were only committed to pressuring palm oil companies to meet PROPER's compliance standards. With

respect to beyond compliance standards, they used their action capacity to encourage the palm oil companies to use transnational RSPO certification programs to demonstrate sustainable production systems

9.4. The regulatory strategy of PROPER across types of firm

As explored in Chapter 2, the theoretical framework was also developed to understand the way in which public voluntary regulation shapes socio-environmental performance across types of firm, with firms disaggregated by ownership structure. This section contends that the regulatory dynamics and outcomes of PROPER varied between state-owned and private companies, reflecting different corporate governance arrangements and varied incentive structures for top-level management across types of firm. This was, in particular, shaped by the ways close state-business relations influenced corporate governance structures in each firm. It was also only partly shaped, however, by the distribution of ownership share between foreign and domestic capital and the degree to which such ownership was interdependent or differentiated.

On the latter point, in the oil and gas sector, both the state-owned (100 per cent government owned) and privately owned companies (two thirds owned by domestic companies) strongly committed to achieving high standards in PROPER. In the case of the palm oil sector, both private and state-owned firms with their different ownership structures (with only the private sector company having a corporate ownership structure in which domestic and foreign capital was interdependent) responded to global market pressures (rather than predominantly responding to domestic institutional pressures), preferring RSPO certification mechanisms (as certification supported economic interests in offering a premium price for palm oil). This indicates other dynamics are also important to take into consideration.

Table 9.6 shows how comparatively, the ownership structure and Indonesian institutional conditions of patrimonial state-business relations had implications for corporate governance structures and varied top-level

management responses to PROPER regulatory strategies, particularly promoting environmental leadership and public disclosure.

Table 9.6. The influence of PROPER strategies (promoting environmental leadership and public disclosure) on top-level management across types of firm

	State-owned companies	Privately-owned companies
Top-level management's interest in PROPER	Top-level management is sensitive to the demands of national political elites (that support PROPER) to secure appointments and business opportunities.	Top-level management is sensitive to demands from political elites to secure permits and business opportunities. Publicly disclosed PROPER ratings can affect the firm's reputation which influences the capacity of the company to access global capital and markets.
Institutional conditions Corporate governance structures shaped by close state-business relations	Senior management positions are appointed by the state and the state can set corporate policies and priorities. Permits and licenses are secured through state patronage.	Business opportunities, permits and licenses are secured through state patronage.

The table above illustrates that corporate governance arrangements at state-owned companies, particularly the authority of political elites to make top-level management appointments and set company policies, motivated firm managers to respond to pressure to implement PROPER to secure appointments. Meanwhile, underlying institutional conditions of close state-business relations influenced the interest of top-level management in

privately-owned firms via the kinds of business opportunities patronage could provide, the way production could be affected by permit and license access (which in turn could influence the firm's ability to meet PROPER's minimum legal compliance conditions recognised by third-party actors), and how poor PROPER ratings could affect company reputation and limit access to international finance and product markets.

Top-level management of SOEs are commonly politically appointed in Indonesia and beyond (Downs & Meiden, 2011; Fukuoka, 2012). For example, Downs and Meiden (2011) illustrated how political interests also influenced the selection of top-level management at the China state-owned oil company. In this thesis, it was evident that building strong relationships with influential state actors was key for top-level managers of Indonesian SOEs. The cases of state-owned companies (Chapters 5 and 7) demonstrated how the personal interests of top-level management influenced the operationalisation of the regulatory strategy of promoting environmental leadership. Top-level managers individually responded to political demands to gain beyond compliance ratings (Gold for Subang, and Green, temporarily, for Tebing) as appointments in these companies were made by political elites, regardless of sector. When, in the case of Tebing, political elites pressured the state plantation company to follow beyond compliance PROPER standards it did so. When influential political elites then shifted priorities in 2014 and encouraged the company to become a world-class plantation company, management then prioritised the transnational certification (RSPO) instead of PROPER as a domestic certification to secure their position at the company. This example illustrates how analysing the demands of political elites is critical to understand socio-environmental performance of SOEs in public voluntary regulation in the Indonesian context.

In both cases of privately-owned companies (see Chapters 6 and 8), the response of top-level management to demands from political elites was more organisational than individual, focused on securing business interests in business permits, business opportunities from the state, or for building business reputation to show that, at the very least, they were not violating

Indonesia's environmental laws. The ways that PROPER could affect business reputation via its publicly disclosed performance ratings, that had implications for securing continued business opportunities and capital both domestically and internationally, was also an important consideration for the management of private-sector firms, although it was evident that this was also a consideration for SOEs wanting to compete in international markets. Top-level management in the privately-owned Tarakan oil and gas company expected that performing at beyond compliance levels in PROPER would provide more opportunities for the company to access global capital and repair reputational damage (Chapter 6).

At the privately-owned Ketapang palm oil company top-level management was also sensitive to the issue of global reputation. In addition to pressure from political elites regarding transboundary haze, global naming and shaming (by CSOs and buyers) also significantly influenced the operationalisation of PROPER. Top-level management committed to obtaining a Blue rating (compliance) in PROPER as the firm's strategy to meet transnational certification (RSPO) as international CSOs and buyers required a Blue rating.

The case studies in this thesis have shown that different firm ownership structures interacted with institutional conditions—particularly patronage structures and market structures—to shape the nature of corporate governance structures and the priorities of senior managers in firms. This has implications for the ways in which strategies used by public regulators can influence top-level managers of firms. Top-level management at SOEs was more likely to be sensitive to the interests of political elites, particularly if this affected individual appointments. Privately-owned companies can also respond to the strategies used by regulators when organisational interests are at risk—particularly firm reputation, business opportunities, and ultimately profit. Corporate reputation or legitimacy plays a key role in the competitiveness of a given company, generating economic incentives for the business to respond to the subjective perception of third-party actors or stakeholders (Solomon & Lewis, 2002). Thus, improving the firm's reputation

to enhance competitiveness was a key objective of top-level management, which underpins the regulatory strategy of public disclosure of PROPER.

9.5. Conclusion

This chapter has comparatively explored variation in the regulatory strategies used by regulators in each case study, and how these strategies adapt to distinctive features in Indonesia's context. It has shown that unlike industrialised countries, which tend to implement public voluntary regulation in contexts where there is strong regulatory enforcement, this is less the case in Indonesia. PROPER's core strategies of promoting environmental leadership and providing technical assistance in particular, together with discretionary policies evident in specific cases (informal threat and informal inducement) tended to operate via mechanisms of informal influence to harness pressure on companies to change their behaviour.

This mechanism of informal influence was evident across sectors and types of firm and reflects a distinctive way in which public regulators adapted PROPER's regulatory strategies to features of the Indonesian patrimonial state. The ways in which PROPER was able to harness direct pressure from influential political elites, given the importance of close relationships between firms and the state for businesses to function, was helpful in eliciting social and environmental behavioural change in companies. Further, the ways in which state actors were able to informally use their power over permits and to make discretionary decisions in the implementation of regulations was an important component of mechanisms operated by PROPER to induce pressure on firms. This chapter has argued that informal influence has a similar function to that of the "background threat" of public voluntary regulation strategies identified in the literature, which traditionally have influence in contexts where there is existing strong enforcement of mandatory regulations.

Moreover, this chapter also highlighted the critical roles of decentralisation in Indonesia's multi-level governance system and market structures as institutional conditions that either enable or constrain the influence of PROPER as a public voluntary regulation initiative. These

conditions shape the nature of state–business relations, state regulatory capacity and third-party actor’s environmental commitment and capacity to pressure companies. Comparative analysis demonstrates that these conditions vary by sector and influence how PROPER can influence beyond compliance behaviour. PROPER regulatory strategies had greater influence in the oil and gas sector for which regulatory authority was centralised.

In contrast, decentralised authority in the palm oil sector constrained the ways national PROPER regulators were able to pressure palm oil companies. Subnational governments were responsible for technical assistance in PROPER and had limited capacity to support companies, compared with national regulators that had extensive know-how, resources, and long-term experience in PROPER. Palm oil companies were also focused on access to international capital and product markets. As such, they were significantly influenced by international commercial and non-commercial actors that influenced these markets. These third-party actors tended to recognise international beyond compliance standards, such as those of the RSPO, and to only recognise PROPER’s compliance standards as an indication that companies had met the requirements of legal environmental regulations.

Thus, decentralised authority of the palm oil sector, together with limited recognition of PROPER’s beyond compliance performance ratings by third-party actors, constrained the influence of PROPER to improve socio-environmental performance against its own beyond compliance standards. Both palm oil companies investigated in this thesis only temporarily met PROPER’s beyond compliance standards, and once pressure from national elites receded, their performance dropped to compliance level (Blue rating). Top-level management at palm oil companies did not consistently pressure companies to go to beyond compliance performance.

At firm level, comparative analysis across types of firm demonstrates that ownership structures explain how PROPER has been able to garner pressure on top-level management. Given that top-level management in SOEs are appointed with the authority of political elites and the state can set company priorities, such corporate governance structures rendered top-level

management particularly sensitive to demands from political elites about supporting PROPER's beyond compliance standards. Again, this was bolstered by Indonesia's contextual condition as a patrimonial state.

In contrast, privately-owned firms' management was more sensitive to pressure that affected broader business opportunities, permits, and reputation in the eyes of third-party actors. Overall, analysis has shown that the ways PROPER regulators were able to adapt strategies to Indonesia's institutional conditions, and how particular institutional conditions constrained or enabled the influence of PROPER strategies, explain variation in the influence of PROPER on socio-environmental performance.

Moreover, the comparative analysis also demonstrates that PROPER still encounters credibility problems, but these are less to do with the distortion of ratings due to the influence of rent-seeking political elites wanting to protect those companies that give them patronage as might be expected given other research on Indonesia in the resource sector. Instead, it is more to do with the perverse bureaucratic incentives within the funding structures for PROPER—national funding allocations to subnational governments are tied to assessments for mandatory compliance ratings and not beyond compliance ratings. Subnational regulators are thus less inclined to encourage beyond compliance performance. This is an important consideration for designing public voluntary regulation programs in multi-level patrimonial states.

Chapter 10

Conclusion

10.1. Introduction

As explored in this thesis, many governments worldwide have adopted public voluntary regulation as a means of regulating the socio-environmental performance of business. Since the 1990s, public voluntary regulation has been adopted not only by governments in North America and Europe (Koehler, 2007; Lyon & Maxwell, 1999), but also in a range of developing countries such as Mexico (Blackman et al., 2010), Indonesia (Afsah et al., 1996), India (Blackman, 2008), The Philippines (Kathuria, 2009), and China (Wang et al., 2004). The adoption of public voluntary regulation in developing countries gives rise to the central question that this thesis has set out to explore: namely, how public voluntary regulation operates across such widely varied developing country institutional contexts, which often differ markedly from industrialised countries in which public voluntary regulatory approaches were originally developed. The existing scholarship on socio-environmental governance has so far not developed a systematic framework for understanding how and why the effects of public voluntary regulation can be expected to operate differently across these varied institutional contexts; the central task of this thesis was to contribute to the development of such an analysis.

In response to such limitations of existing scholarship on public voluntary regulation, this thesis has aimed to build new understanding of how the capacity of public voluntary regulation to achieve its objectives of improving socio-environmental performance is influenced by varied country, sectoral and firm contexts and their interaction with the broader socio-environmental governance. This overarching aim has been explored through two central research questions. First, how and to what extent do public regulators adapt voluntary regulatory strategies to accommodate the distinctive institutional contexts in which they operate? Second, how do variations in institutional context enable and constrain the ability of these

voluntary regulatory strategies to induce improvements in socio-environmental performance of regulated firms, both within and beyond the requirements of the law?

The thesis has examined these questions through a detailed study of the case of the Industrial Environmental Rating Program (PROPER) in Indonesia. The thesis drew on a qualitative comparative study approach to support its analysis. This research method enabled exploration of how PROPER's efforts to influence socio-environmental performance in firms were influenced by contextual factors at country, sectoral and firm levels. Empirical analysis of this case study was informed by a range of data sources, including 95 interviews with regulators, firms and other key stakeholders, both published and unpublished documents relating to PROPER activities and firm responses, and extensive field-based participant observation at individual plants participating in PROPER.

Based on those data sources and analysis, the thesis has argued that public voluntary regulation offers significant potential to strengthen firm's socio-environmental performance within the distinctive context of a developing country, and across varied sectoral and firm contexts. However, both the specific regulatory strategies shown to be effective, and the extent to which these strategies succeeded in inducing desired improvements in socio-environmental performance, have been shown to vary significantly across sectors, and public versus private firms.

This chapter's concluding remarks first draw together key findings regarding how these varied institutional contexts influenced the public voluntary regulatory strategies that emerged, and how the effects of these regulatory strategies were in turn shaped by distinctive institutional conditions in which regulatory strategies were deployed. Broader theoretical and practical implications of these findings will then be presented.

10.2. Variation of regulatory strategies across sectors and types of firm

To some extent, public voluntary regulatory strategies adopted by the Indonesian government have reflected established regulatory strategies from

the experience of other countries (see Table 2.1. in Chapter 2 page 22-23. Such similarities are particularly evident in relation to three core regulatory strategies adopted by PROPER, namely: promoting environmental leadership, technical regulatory assistance, and public disclosure. However, while such strategies broadly follow established international regulatory practice, Indonesian regulators have adapted them in ways that inform the Indonesian context, and respond to varied sectoral and firm contexts. In addition, the thesis has also identified two regulatory strategies that have not previously been theorised in the scholarship on public voluntary regulation, namely: informal threats and informal inducement. The ways in which these strategies were used in practice also importantly responded to distinctive features of country, sectoral and firm contexts.

First, the strategy of promoting environmental leadership was implemented by the national government in all four cases examined in this thesis, through management from high performing firms being rewarded through enhanced access to influential political elites. However, the strategy operated differently when applied to state-owned as opposed to private firms. In the case of state-owned companies, national regulators were able to exert pressure on firm management as a result of dependence of senior management on support from influential political elites to secure their ongoing appointment and career advancement. In contrast, such pressure on private firm management operated through the capacity of elite patronage networks to block access to business licences, environmental permits, and other politically controlled business opportunities.

Second, the strategy of technical regulatory assistance was used in ways that varied significantly across sectors and types of firm. In contrast to the strategy of promoting environmental leadership, implemented by the national government, the strategy of technical regulatory assistance was implemented at various levels of government—by the national government in the oil and gas sector, and by subnational governments in the palm oil sector. This variation in regulatory practice reflected broader patterns of decentralisation in Indonesia, in which policy and regulation remain largely

centralised in the oil and gas sector, but highly decentralised in the palm oil sector.

There were also some differences in provision of technical assistance to state-owned versus private firms, in turn reflecting the varied willingness of state versus private companies to collaborate with government in the development of training programs and strengthen environmental management systems. While the national government collaborated closely with the state-owned oil and gas company in relation to both these elements of technical assistance; the privately-owned oil and gas company preferred to collaborate with private consultants in its development of training and environmental management systems.

Third, the national government implemented the strategy of public disclosure in various ways. In the majority of cases examined in the thesis the government employed a conventional “naming and shaming” approach to public disclosure, based on the publication of colour coded ratings of firm’s socio-environmental performance. However, in the case of the private oil and gas company—which had achieved beyond-compliance performance across all of its local plants—the government employed a distinctive “naming and praising” approach, in which the high performance of the firm was publicly showcased as a means of both rewarding the company for its positive engagement with PROPER, and providing legitimacy to the national government’s PROPER program, thus helping to secure ongoing financing of the project at ministry level.

Fourth, the thesis has documented a distinctive regulatory strategy described as the use of informal threats, in which government regulators explicitly used discretionary control over the issuance of business or environmental permits as a means of pressuring companies to participate in the PROPER program. This distinctive regulatory strategy involving explicit informal threats was only documented in the palm oil case studies. In part, this reflected the central role of sub-national governments in implementing PROPER in the palm oil sector, and sub-national government’s lack of alternative means of pressuring companies. The use of this strategy in these

cases also reflected perverse incentives created by the distinctive regulatory design of the PROPER program, in which the funds that subnational governments received for carrying out regulatory inspections were linked to the number of participating companies, thus creating direct financial incentives for local government to pressure companies to participate through such means.

Finally, the fifth regulatory strategy used by PROPER that the thesis has documented has been described as informal inducement, in which companies were incentivised to participate in the PROPER program in the form of discretionary opportunities to correct regulatory violations before official PROPER's ratings were published by the government. Similar to strategies of informal threats, this strategy was used very selectively in the palm oil sector, reflecting the same incentive structures described above.

10.3. How varied institutional conditions mediated the effects of public voluntary regulation

Not only did varied institutional contexts influence the public voluntary regulatory strategies that emerged, the findings have also shown how the effects of these regulatory strategies were in turn shaped by the distinctive institutional conditions in which the regulatory strategies were deployed. The findings have demonstrated, the impact of PROPER's public voluntary regulatory strategies varied across sectors and types of firm, particularly in relation to beyond-compliance performance. PROPER had a useful impact across both sectors examined by the thesis in relation to achieving compliance levels of socio-environmental performance, but its effects varied significantly between sectors for beyond-compliance performance. Such varied effects were shown to depend crucially on three categories of contextually-variant institutional conditions, namely: (1) business-state relations, (2) state regulatory capacity and (3) third-party actors' environmental commitment and action capacity. The third variable is influenced much by actors in the global socio-environmental governance, such as investors, banks, consumer, buyers, and NGOs.

Business-state relations

Patterns of business-state relations (both national and subnational levels) were shown to play an important role in promoting environmental leadership across both sectors and types of firm. As explored previously, the involvement of political elites at the national level was consistently used to persuade top-level management to invest in beyond-compliance improvements to socio-environmental performance. Employing pressure from national-level political elites to promote environmental leadership worked more effectively in the oil and gas sector than in the palm oil sector. This disparity reflected the different roles of national versus subnational governments in regulating the two sectors, with the national government retaining much more extensive authority over regulatory processes in the oil and gas sector under Indonesia's decentralisation arrangements. As a result, oil and gas companies depended on the national government for both business licenses and environmental permits, in turn leading national-level political elites to be viewed as more salient stakeholders from the perspective of top-level managers of oil and gas companies. Managers at these oil and gas companies were thus more consistently committed to pursuing beyond-compliance performance ratings under the PROPER program in response to pressure from national political elites.

State regulatory capacity

In addition to variations in state-business relations, differences in state regulatory capacity between national and subnational governments also contributed to varying impacts of PROPER's regulatory strategies across sectors. The effects of varied state regulatory capacity particularly impacted technical regulatory assistance. Improvements in socio-environmental performance require not only the commitment of top-level management but also employees' knowledge and skills relating to the requirements of PROPER. Where such skills are lacking, the government can potentially play an important role as a source of knowledge not only about PROPER's requirements, but also how to make technical or operational changes to facilitate compliance with these requirements. However, the extent to which

government actors possessed the requisite knowledge or skills to provide such capacity building varied significantly between sectors. In the oil and gas sector, the national government had relevant capacities to assist companies in meeting beyond-compliance standards required by PROPER, as a result of its long experience in regulating this sector since the 1960s under the Suharto regime's development agenda. Such government capacities to provide technical assistance played an important role in assisting oil and gas companies to obtain a Gold rating within the PROPER program.

In contrast, subnational governments lacked the requisite capacity to support palm oil companies to meet beyond-compliance standards required by PROPER. Government officers within the subnational government had limited knowledge and skills to provide technical assistance to palm oil companies, as a result of various factors, including mis-matched educational backgrounds of local staff, limited financial capacity, low staffing of regulatory functions and high levels of staff turnover at the subnational level. The weak capacity of local government to provide technical assistance to palm oil companies participating in PROPER limited their capacity to achieve beyond-compliance levels of performance.

Third-party actors' environmental commitment and action capacity

The findings across cases show that the institutional conditions involving third-party actors' environmental commitment and action capacity (both national and international) played an important role in explaining PROPER's public disclosure strategies across sectors. The configuration of (commercial and non-commercial) third-party actors involved in the regulatory processes promoted by PROPER also varied across sectors. Third-party actors (such as banks, CSOs and local communities) in the oil and gas sector played an important role in promoting not only compliance levels of performance by participating firms, but also beyond-compliance level improvements.

In contrast, third-party actors exerting influence over companies in the palm oil sector tended not to recognise PROPER's beyond-compliance standards. Instead, investors, banks, buyers and CSOs in the palm oil sector simply used the compliance rating to evaluate whether a company had

complied or not with minimum legal requirements in the Indonesian jurisdiction. Pressure from such third-party actors therefore only created incentives for palm oil companies to engage with the PROPER program to a compliance level of performance. Instead, these third-party actors in the palm oil sector pressured palm oil companies to engage with transnational certification programs, particularly the RSPO, as a means of demonstrating compliance with sustainable palm oil production standards at a beyond-compliance level. As such, this response limited the regulatory impact of PROPER on the palm oil sector.

The varied response of third-party actors was shown to result in significant part from the varied degree to which PROPER's standards aligned with the key sustainability issues which are prioritised by third party actors in the socio-environmental governance in each sector. Third-party actors in oil and gas sector perceived that the indicators of PROPER had satisfactorily addressed key sustainability issues through its focus on environmental impacts at plant level, such as air pollution, water pollution, land pollution, and toxic and hazardous waste management (McAllister & Studland, 1999).

In contrast, third-party actors in the palm oil sector perceived PROPER's standards to diverge in significant ways from key sustainability issues. Global actors defined key sustainability issues in the palm oil sector as relating to deforestation, biodiversity loss, land conflicts, and climate change (McGranahan & Satterthwaite, 2000; Teoh, 2010). Because standards relating to these issues remained largely underdeveloped within PROPER, such third-party actors in the palm oil sector did not regard PROPER as a legitimate certification system to demonstrate sustainable palm oil production. As a result, PROPER struggled to gain the support of third-party actors for beyond-compliance performance standards.

Another significant source of cross-case variation in the role of third-party actors related to the role of local communities in pressuring companies to improve socio-environmental performance in line with PROPER standards. Local communities operated as a significant source of pressure only in one of the four cases examined: the privately-owned oil and gas company. Several

factors account for the distinctive role of local communities in this case. First, this community had strong incentives to mobilise and engage the company as a result of the direct impact of the company's operations on their lives, when the construction of this company's local plant under the post-Suharto regime forced these communities to resettle in other areas. Second, because these communities neither lived on the company's land, nor depended on the company for their livelihoods, they had sufficient autonomy to mobilise and pressure the company in relation to its provision of community development programs. Third, the capacity of the community to mobilise was facilitated by the wider environment of democratisation in the post-Suharto era. In the other cases, local communities lacked either sufficient incentives or sufficient autonomy from the company's land, or provision of livelihood opportunities to mobilise and make social and environmental demands.

10.4. Theoretical significance of the findings

The central theoretical strategy of this thesis has involved bringing scholarship on public voluntary regulation into engagement with existing theoretical research on comparative political economy, socio-environmental governance, to provide a basis for systematically examining how the operation of public voluntary regulation varies across different institutional contexts. Drawing on these bodies of work together with insights from original case study analysis here has generated theoretical findings of potential significance for theoretical scholarship. The following discussion highlights three dimensions of particular potential significance for existing debates about public voluntary regulation, comparative CSR and socio-environmental governance.

First, I have drawn on insights from comparative political economy together with scholarship on public voluntary regulation to expand understanding of multiple and distinctive sources of regulatory pressure available to public voluntary regulators in different contexts. As explored earlier in the thesis, existing literature on public voluntary regulation has frequently argued that the presence of a "background threat" of mandatory

regulation is often a critical factor motivating a firm to participate in and comply with voluntary regulatory initiatives (Khanna, 2002; Lyon & Maxwell, 2002; Prakash & Potoski, 2012). Studies that focus on the importance of a background regulatory threat as the basis for establishing regulatory pressure are typically based on industrialised countries, in which formal sources of legal and political authority are assumed to play a central role.

In contrast, the findings of this thesis have shown how, unlike industrialised countries, Indonesian environmental regulators have limited capacity to make credible threats of legal enforcement, due to limited capacity to detect violations of regulatory standards, and limited political support (Dauvergne, 1997; USAID, 2008). Such findings resonate with broader studies on developing country regulators that have shown that regulators in these countries face an array of barriers such as weak institutions, incomplete legal foundations, and limited political will (Blackman, 2008; Eskeland & Jimenez, 1992; Russel & Vaughan, 2003).

Sources of regulatory pressure on which Indonesian public voluntary regulators drew were grounded not only in background threats of formal legal enforcement or stringent mandatory regulation, but also informal sources of pressure, in which the discretionary power of the state to provide or withdraw advantages to individual managers or firms is wielded as an alternative, informal 'background threat' to motivate improved firm's socio-environmental performance. Empirical analysis in this thesis has revealed that PROPER regulators commonly drew on multiple sources of informal regulatory pressure to motivate firms to engage with PROPER, and improve their performance. At various times, informal pressure was grounded in the discretionary power of the state to control the appointment or career advancement of top-level management, to award, delay or withhold environmental permits, to reward engaged and high performing companies by extending them discretionary opportunities to remedy documented regulatory violations, or to flexibly interpret the requirements of the standards to help engaged or high performing companies comply more readily with regulatory requirements.

These findings regarding the importance in Indonesia of informal sources of regulatory pressure speak directly to the central question about if and how public voluntary regulation can operate in developing countries. These findings highlight different pathways of regulatory influence through which public voluntary regulators can meet their regulatory objectives in distinct contexts, demonstrating that public voluntary regulation can offer considerable promise for regulating business in developing countries even in the absence of strong mandatory regulatory capacity, where regulatory strategies are suitably adapted to specific contextual sources of regulatory pressure. Acknowledging the importance of informal sources of regulatory authority or pressure in underpinning the effective functioning of public voluntary regulation highlights the potential value of more explicit exploration in future research of how such informal dynamics of regulatory influence might be better harnessed in support of regulatory aims across a range of different regulatory contexts.

Second, the thesis has brought together insights from different strands of comparative scholarship on CSR, environmental governance and political economy, as a basis for revealing the complex interactions between country and sectoral conditions that help us explain the varied functioning of public voluntary regulation across different cases.

On the one hand, as explored in Chapter 2, comparative scholarship on CSR and environmental governance has often highlighted sectoral variation in the incentives and leverage of third-party market and civil society actors as a basis for explaining varied regulatory outcomes across sectors (Campbell, 2006; Chapple & Moon, 2005; Dutta et al., 2008; Williams & Aguilera, 2008). On the other hand, comparative political economy scholarship has often recognised the importance of variables focused on state regulatory capacity and business-state relations for understanding distinctive country-level regulatory dynamics (Larson & Soto, 2008; Raik et al., 2008; Ribot, 2002). By bringing these insights together, this thesis has highlighted the importance of interactions between national (including central and subnational governments) and sectoral variables.

Such interactions were of particular significance in understanding how both state regulatory capacity and the structure of patronage networks linking government regulators to firm managers varied across sectors. Such variation was shown to be closely tied to patterns of regulatory decentralisation across sectors. Highly decentralised governance arrangements in the palm oil sector, in which firms' primary interactions were with sub-national governments, weakened both the capacity of the state to provide effective technical assistance, and the capacity of national regulators within PROPER to exercise direct informal influence over firm managers. In contrast, state control over the oil and gas sector within the national government tended to enhance both the capacity of state regulators to use informal sources of direct pressure over managers, and their capacity to provide technical assistance to aid improved socio-environmental performance.

This analysis helps us better understand the highly sector-specific ways in which dynamics of state capacity and state-business relations played out within Indonesia—in turn supporting broader understandings of how and why the functioning of public voluntary regulation varies *within* countries, as well as across different national institutional contexts. This analysis also helps us understand how regulatory dynamics and outcomes varied between public and private firms, reflecting different corporate governance arrangements and varied incentive structures facing firm managers across different firm-level contexts. These findings highlight the potential value of future comparative research that adopts an explicitly multi-layered approach to comparative analysis of regulatory context.

Third, the thesis has contributed to scholarship on public voluntary regulation that focuses on the role of third parties in promoting improved firm's socio-environmental performance. Public voluntary regulatory scholars have often emphasised the important role of third-party stakeholders in supporting the functioning of public voluntary regulation (Delmas & Toffel, 2004; Gunningham et al., 1998; Tietenberg, 1998). The findings of this thesis support this broad claim, but further expand our understanding of the contribution of third parties to public voluntary regulation.

In the oil and gas sector, the PROPER program was held in high regard by key firm investors, and was used as a reference point to assist their evaluation of both firm compliance with legal regulations, and their commitment to beyond-compliance socio-environmental performance. In contrast, third-party actors (consumers, investors and civil society organisations) in the palm oil sector considered PROPER's regulatory standards to be under-developed with regard to a number of priority social and environmental regulatory issues in particular sector. Thus, while they acknowledged its potential value as a means of demonstrating legal compliance, they did not recognise it as tool for verifying beyond-compliance performance, instead taking the private transnational certification program, the Roundtable on Sustainable Palm Oil (RSPO), as their preferred reference point. Different third-party actors were thus shown to generate highly varied forms of pressure in response to ratings provided by PROPER, depending on the configurations of third-party actors in a given sector, and the nature of the regulatory issues that they prioritised.

This finding has implications for debates about the varied contributions of public voluntary regulation to minimal regulatory compliance on the one hand, or beyond-compliance performance on the other. While existing literature on public voluntary regulation has often emphasised the role of third-party actors in pressuring companies to go to beyond-compliance level (Asfah et al., 2000; Dasgupta et al., 2000); these findings show that such pressure for beyond-compliance performance is highly contingent on the specific content of regulatory standards, and the extent to which these align with priorities and concerns of the relevant categories of third-party actors in global socio-environmental governance. Such findings highlight that future comparative research could productively be directed towards more systematic analysis of the conditions under which third-party stakeholders are likely to support compliance versus beyond-compliance firm performance.

10.5. Practical implications of the findings

This section elaborates on the practical implications of the findings on several levels, exploring implications for efforts by Indonesian regulators to improve the regulatory impact of PROPER, as well as transferability of the findings to other sectors and countries.

First, the findings have a number of practical implications for the design and operation of PROPER within Indonesia. A key finding related to the ways in which regulatory strategies need to adapt to accommodate the multi-dimensional features of given regulatory context. PROPER regulators demonstrated significant capacity to adapt regulatory strategies to the distinctive dynamics of informal regulatory authority within Indonesia, strategic adaptation of regulatory strategies to differences across sectors and firms was less developed.

One important way in which regulatory strategies could have been better adapted to varied sectoral contexts related to PROPER's efforts to promote environmental leadership amongst firm managers. As the above analysis has demonstrated; the relationship between state and business actors varied significantly between sectors, yet PROPER attempted to use the same strategic approach to directly influence firm management at the national level in both sectors. As a result, while this strategy was relatively successful in the oil and gas sector, it failed to generate intended effects in the palm oil sector, due to the relative lack of sensitivity of palm oil firm management to national political elites, and their greater dependence on subnational government within the context of highly decentralised regulatory arrangements. In this case, efforts to promote environmental leadership amongst palm oil firm managers would have been more effective if political elites from the subnational level had been engaged more directly in the regulatory process.

Likewise, PROPER could better adapt strategies of promoting environmental leadership amongst firm managers to accommodate difference in corporate governance and managerial incentive structures of public versus private firms. Whereas corporate governance arrangements for state-owned firms give national political elites direct leverage over top management, such

forms of pressure are less effective in relation to private firms. In response to these differences, PROPER could more systematically search for alternative sources of leverage over private firms, particularly through developing stronger relationships with commercial third-party actors such as major banks and other key investors.

Second, the findings have highlighted ways in which the design of regulatory standards by public voluntary regulators can influence their capacity to harness pressure from third-party actors in support of improved firm's socio-environmental performance. PROPER's regulatory standards focused primarily on plant-based environmental impacts that failed to capture key sustainability issues of concern to international investors, buyers and civil society actors in the palm oil sector. Although PROPER has made some preliminary moves toward broadening standards beyond plant-based environmental pollution issues; this misalignment has persisted in important ways, weakening the capacity of PROPER to gain sufficient leverage over palm oil firms to induce beyond-compliance improvements in socio-environmental performance. In part, this misalignment was a product of the history of the PROPER program, which evolved in response to concerns about plant-level pollution. To this extent, more extensive and systematic efforts to differentiate standards across sectors in response to the expectations of key stakeholders in a given sector could significantly enhance the effectiveness of public voluntary regulation across sectors, by more effectively harnessing third-party actors in support of the program's regulatory aims.

The findings have a number of implications for public voluntary regulatory strategies adopted in other sectors and countries, though some remain specific to the particular country and sectors on which the case studies focused. Specific findings regarding regulatory strategies used by PROPER and their effects on firm's socio-environmental performance reflected the distinctive configurations of state-business relations and firm stakeholders in the oil and gas and palm oil sectors in Indonesia. Such findings would most likely be directly transferable to other natural resource intensive sectors—

such as mining, geothermal energy and pulp and paper—to the extent that these have similar political and market profiles (Arif, 2019).

However, more general findings about the need for public voluntary regulatory strategies to adapt in accordance with particular forms of pressure available in a given regulatory context have important implications for the pursuit of public voluntary regulation across a broader range of sectors. For example, in very different sectoral contexts, such as knowledge-based or service sectors, the extent to which investors, buyers, consumers or communities are able to influence firm's socio-environmental behaviour in response to regulatory public disclosures, and the ability of governments to exert leverage through direct relationships with management or the provision of technical capacity assistance, vary widely. As the findings have demonstrated, such forms of variation have important implications for the mix of public voluntary regulatory strategies that are likely to generate intended effects in a given sectoral context.

Similarly, the findings would also need to be adapted in line with specific contextual features of individual firms being regulated. The public and private firms examined in this study possessed a distinctive set of characteristics, reflecting geographical location, history of community and government relations, key product markets, sources of financing, and so on. Such firm-level profiles in turn have important implications for firm vulnerability to the range of pressures that public voluntary regulatory strategies can potentially harness in support of regulatory aims. Such variation would likewise have implications for ways in which specific findings would need to be adapted to different firm-level contexts.

Likewise in relation to country-level factors, specific findings are particular to Indonesia, with some transferability to other countries with similarities in key dimensions of state capacity and business-state relations. Broader findings about the ways in which public voluntary regulatory strategies and effects vary with multi-level contextual dynamics also have potential implications for broader comparative studies of public voluntary regulation.

For example, findings regarding the importance of informal sources of pressure in support of public voluntary regulation were in one sense specific to particular patrimonial configurations of state-business relations prevailing in Indonesia. However, such findings could also be expected to have some transferability to other country-contexts in which state-business relations are characterised by similar patrimonial dynamics. Comparative political scholars have pointed to some similarities between configurations of patrimonial state relations in Indonesia and other developing countries such as Brazil, Nigeria and the Philippines, amongst others (Budd, 2004). Such scholars have also pointed to similarities with countries such as Mexico and India in which more moderate patrimonial characteristics are evident in the organisation of state-business relations. We may therefore expect some degree of transferability of these findings from Indonesia to other contexts, to the extent that such patrimonial relations generate similar opportunities for government leverage through public voluntary regulatory strategies. Future comparative research on public voluntary regulation could fruitfully explore such comparisons more systematically.

Similarly, the findings regarding the sector-specific effects of regulatory strategies involving promotion of firm environmental leadership and provision of technical capacity support were contingent in important ways on the distinctive forms of regulatory decentralisation prevailing in Indonesia (OECD, 2019). While there exists an extensive comparative scholarship on decentralisation, this literature often focuses on cross-country comparisons examining different dimensions of economic, political and administrative decentralisation (see for example Bardhan & Mookherjee, 2006).

In contrast, the findings highlight specific ways in which decentralisation can impact on the functioning of public voluntary regulation, both through its effects on state regulatory capacity, and through its effects on distributing both state regulatory responsibilities, and control over processes such as the issuing of licences which are important sources of informal regulatory pressure. Thus, while it is clear that patterns of decentralisation are likely to impact the transferability of findings here to other contexts, more

detailed comparative research regarding specific configurations of regulatory decentralisation in particular countries and sectors could identify other partially decentralised jurisdictions most likely to experience similar regulatory processes and outcomes, as documented in the Indonesian case.

More broadly, the findings have highlighted the importance of examining such multiple dimensions of contextual variation not in isolation, but rather as elements of more complex, multi-dimensional configurations of conditions constituting a given regulatory context. In particular, the thesis has underlined the central importance of interactions between business-state relations, state regulatory capacities and third-party actors' environmental commitment and capacity to pressure companies. Such configurations have been shown to vary in line with country, sector and firm-level contextual conditions.

By highlighting these complex contextual configurations and their implications for the regulation of firm's socio-environmental performance, these findings can serve the central aim of understanding the extent to which—and strategies through which—public voluntary regulation can be used effectively across a range of widely varying developing country contexts. By adapting strategies of public voluntary regulation to align with the prevailing configurations of institutional conditions within a specific context, public regulators may find new pathways through which they can boost their promise to improve the socio-environmental performance of business across varied institutional conditions.

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