

Curtin Business School

School of Management

**Analysis of Non-market Strategies Implemented by SMEs in an  
Emergent Economy: The Case of Indonesia**

Abdullah Sanusi

This thesis is presented for the Degree of

Doctor of Philosophy

of

Curtin University

February 2016

## **Declaration**

To the best of my knowledge and belief this thesis contains no material previously published by any other person except where due knowledge had been made.

This thesis contains no material which has been accepted for the awards of any other degree or diploma in any university.

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Date: 09/02/2016

## **Abstract**

The influence of the government on private sector businesses is now more pervasive than ever. The operations of firms, to a large extent, depend on how well the firms are tackling social, political and environmental issues. This situation forces the private sector to carefully examine not only the market environment, but also the non-market environment. Non-market players can be quite instrumental in the public policy decision-making process, which may also influence the company and relevant industry practices. This thesis examines the non-market environment and the non-market strategies of firms in Indonesia – an emergent economy.

The main objective of this thesis is to investigate the institutional changes in emerging economies and their impact on the firms' choice of non-market strategies using the case of Indonesia. Specifically, the objectives of the study are: to empirically identify the political and social antecedents in the non-market environment in Indonesia; to explore and examine the characteristics and nature of the non-market environment in Indonesia; to investigate how institutional changes in an emerging economy influence a firm's choice of non-market strategies; to analyse the relationship between non-market strategies and the performance of the firms, and to discuss the policy implications of non-market strategies. In this thesis, the South Sulawesi region of Indonesia was selected as the research area as it illustrates the dynamic changes that define an emerging market.

A qualitative research approach using grounded theory and case study principles was applied to provide a framework and to advance the description of the cases. In total, the study used data interviews from 27 participants as the primary means of collecting data. Twenty-three of the participants are owners or directors of small firms. In addition, there were two government officials, a journalist and a non-governmental organisation (NGO) member.

The main finding of the study is that the institutional environment in Indonesia, as with many other emerging economies, is characterised by an unstable environment with ongoing institutional changes. Firms engage in non-market strategies to help deal with the uncertainty and instability surrounding their non-market environment. These strategies also assist firms in managing the institutional and societal environments. Non-market strategies such as building political connections, political donations and social strategies clearly serve the primary objectives of the firms. Implementing non-market strategies also influenced the performance of firms as reflected in the firms' getting more government contracts, increasing number of workers, and receiving various assistance and supporting activities from government officials to mitigate the regulatory burden. Nonetheless, while implementing non-market strategies are seen by firms to be necessary,

firms should not have to resort to some of these strategies especially bribery, or any other strategy that involve corrupt exchange with government officials. Many of these non-market strategies would not have been necessary if supporting market institutions are well established and a supportive regulatory environment is put in place. Corrupt exchange will do more harm than good to the development of small firms in Indonesia. Moreover, unstable regulatory environments such as the situation in Indonesia will make firms earmark more resources to strengthen their non-market strategies rather than building their core company competencies. Hence, it is critical for the government to address the non-market environment through various measures including developing clear guidelines and improving transparency. Maintaining a corruptive and collusive non-market environment will become difficult if business-government interaction is made more transparent.

These findings imply opportunities for policy-makers and practitioners, as well as future researchers in the field of strategic management. This study suggests that the relations between government and firms should be more transparent. Several actions that may be taken in the short-term include creating clearer policies and measures that may lead to reducing the red tape bureaucracy. To have clear regulations and improve the current legal framework, the local government should include other stakeholders, especially small firms in setting up a business-friendly environment. Given the strong influence of the government on the business environment in emerging markets, policy-makers should also prioritise efforts to improve small firms' knowledge and expertise in dealing with market forces.

The significance of this research resides in two primary areas. First, this thesis contributes through an interpretive perspective to strategic management theory and practice, particularly for firms in emerging economies. This study contributes to knowledge on micro-level analysis of business-government interactions. Previous studies mostly focused on macro-level analysis such as country and industry analyses. In this study, we contribute to the extant literature on the non-market environment in emerging economies and non-market activities of small firms. Moreover, by studying the political embeddedness of the firms and their political behaviour, the knowledge in the field of non-market strategy can be further extended. Therefore, this study enriches our understanding on the importance of relational strategies as part of non-market strategies, particularly in economic transitional and weak institutional environment.

Second, given the lack of information regarding the political behaviour of small firms, this study fills in the gap in terms of how small firms behave towards regulation, which will allow policy-makers to design more effective policies for small firms. In addition, it will increase the knowledge of policy-makers on the impact of public policy on small firms' operations; which will be particularly useful, since small firms are increasing in number across all industries in Indonesia, and in emerging economies, in general.

## Acknowledgement

*In the name of ALLAH, the most Gracious and the most Merciful.* My journey as a doctorate student in Curtin University have benefited greatly from contributions of many people and institutions. I would like to wholeheartedly thank my supervisors, Associate Professor Fay Rola-Rubzen and Dr Bella Butler for their support, insights, encouragement and generosity with their time. I am also grateful to the staff at the HDR office, who have provided me assistance on many occasions. All my friends and colleagues in the PhD program, especially those at the CBS HDR Unit in 7B Watts Place, deserve many thanks for their constant support, encouragement and help on this journey.

I also want to acknowledge all participants who devoted their personal time to participate in this study. Special thanks to Adi, Irdam for their assistance during my field research and also my colleagues at the Faculty of Economics and Business at Hasanuddin University. I also would like to extend my fullest gratitude to the Directorate General of Higher Education (DIKTI) of the Indonesian Ministry of Education and Culture for the financial support during my PhD program.

To my beloved wife Rusni Fitri and my son, Rafi Aydin Nevandri, I would like to express my deepest gratitude for their enduring patience, unwavering support, unconditional love and understanding during my academic and career pursuit. Thank you for always believing in me. I also want to thank my parents and family in Indonesia for their invaluable support and prayers.

## Acronyms and Abbreviations

APBD	: <i>Anggaran Pendapatan dan Belanja Daerah</i> Local government budget
APINDO	: <i>Asosiasi Pengusaha Indonesia</i> The Employers' Association of Indonesia
APRSI	: <i>Asosiasi Pengusaha Reklame Seluruh Indonesia</i> The Association of Indonesian Advertising Firms
ASEAN	: Association of Southeast Asia Nations
BPTPM	: <i>Badan Perizinan terpadu dan penanaman modal</i> Investment and licence coordinating board
CBS	: Curtin Business School
CEO	: Chief Executive Officer
CPA	: Corporate Political Activity
CSR	: Corporate Social Responsibility
DPD	: <i>Dewan Perwakilan Daerah</i> Regional representative council
DPRD	: <i>Dewan Perwakilan Rakyat Daerah</i> Local Parliament
EU	: European Union
GDP	: Gross Domestic Product
GRDP	: Gross Regional Domestic Product
GT	: Grounded Theory
IDR	: Indonesian Rupiah
IMP	: Industrial Marketing and Purchasing group
IPAK	: <i>Ijin Penyalur Alat Kesehatan</i> Healthcare and medical equipment distribution license
KADIN	: <i>Kamar dagang dan industry</i> National trade and industry chamber
KPPOD	: <i>Komite Pemantau Pelaksanaan Otonomi Daerah</i> Regional autonomy watch
LKPP	: <i>Lembaga Kebijakan Pengadaan Barang/Jasa Pemerintah</i> National public procurement agency
LPI PBJ	: <i>Lembaga Pemantau Independen Pengadaan Barang/Jasa</i> Independent procurement monitoring agency
LPSE	: <i>Layanan Pengadaan Secara Elektronik</i> E-procurement
MENDAGRI	: <i>Menteri Dalam Negeri</i> (Ministry of Home affairs)
MICE	: Meeting Incentives Conference and Exhibition
MNC	: Multi National Corporation
MNE	: Multinational Enterprise
NGO	: Non-Governmental Organisation

PAC	: Political Action Committee
PAK	: <i>Penyalur alat kesehatan</i> (Medical equipment distributor)
PERDA	: <i>Peraturan Daerah</i> (Local Regulation)
Perpres	: <i>Peraturan Presiden</i> (Presidential decree)
PHRI	: <i>Persatuan Hotel dan Restoran Indonesia</i> Indonesian Hotel and restaurant organisation
PNS	: <i>Pegawai Negeri Sipil</i> (Civil servant)
RBV	: Resource Based View
RDT	: Resource Dependence Theory
SME	: Small and Medium Enterprise
Sulsel	: <i>Sulawesi Selatan</i> (South Sulawesi)
TI	: Transparency International
UMKM	: <i>Usaha Mikro Kecil dan Menengah</i> Micro Small and Medium Enterprise
WTO	: World Trade Organisation

## Publications and Awards

### Publications:

- “Operating small firms in the Indonesia political environment, a South Sulawesi case study”. *Presented at the Provincial Governance Strengthening Programme (PGSP) of UNDP Indonesia* at the Christian University Atmajaya, 9 April 2013, Jakarta-Indonesia.
- “Analysis of non-market strategies implemented by small and medium firms in emerging economies; the case of Indonesia”. *Presented at Doctoral Colloquium, the 29th Annual Meeting Industrial Marketing and Purchasing (IMP) Group*, 28-30 August 2013, Atlanta, USA.
- “Local politics and business in South Sulawesi: a non-market strategy approach”. *Presented at the 29th Annual IMP Conference*, 30 August – 2 September 2013, Atlanta, USA.  
<http://impgroup.org/uploads/papers/8139.pdf>
- “Non-market strategies of small firms in Indonesia; the South Sulawesi case study”. *Presented at the 34th Annual International Conference, Strategic Management Society (SMS)*, 20-23 September 2014, Madrid-Spain.
- “Critical constraints faced by SMEs in Eastern Indonesia: a case of government contractors in South Sulawesi”. *The International Conference on Organization and Management (ICOM) 2015*, 22-23 November 2015, Abu Dhabi, UAE.

### Awards:

- DIKTI Scholarship Award, Indonesian Directorate General of Higher Education, the Ministry of Education, 2011.
- Research grant from UNDP Indonesia for the Provincial Governance Strengthening Programme (PGSP), 2013.

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# Chapter 1

## INTRODUCTION

### 1.1. Introduction

The influence of the government on private sector businesses is now more pervasive than ever (Barron, 2011). The operations of firms, to a large extent, depend on how well the firms are tackling social, political and environmental issues (Bach & Allen, 2010; Bonardi, Hillman, & Keim, 2005). This situation forces the private sector to compete not only in their own market environment, but also in non-market environments (Aggarwal, 2001). Market and non-market strategies have become the instruments for firms to compete in an increasingly competitive environment. Market strategies are aimed at shaping the interactions between firms and their competitors or consumers, as well as creating value for economic performance (Baron, 1995a). Non-market strategies on the other hand, are aimed at influencing the institutional players in public policy arenas and tailoring non-market environments (Baron, 2010). In recent years, institutional players are not only limited to public institutions such as government and legislatures, but also include private interests such as the media and non-governmental organisation (NGO) activists (Baron & Diermeier, 2007b). These institutional players can be quite instrumental in the public policy decision-making process. Furthermore, they also influence company and industry practices.

While it is commonly recognised that non-market strategies differ in various institutional conditions (Doh, Lawton, & Rajwani, 2012), studies in non-market competition were mostly done in stable Western economies (Li, He, Lan, & Yiu, 2012; Yuanqiong, Zhilong, & Yun, 2007; Wright, Filatotchev, Hoskisson, & Peng, 2005; Peng, 2003), with large companies being the object of most studies (Bengtson, Pahlberg, & Pourmand, 2009; Gao, 2006; Peng, 2003). Scholars pointed out that non-market actions should be distinguished in different environments (Shaffer & Hillman, 2000), particularly in emerging economies, as they are not homogenous. In

addition, such economies may comprise of different stages of the economic, social and political models (Burns, 2012), which are characterised by weak and immature institutions (Peng, 2003). Emerging economies are defined as “low-income, rapid growth countries using economic liberalization as their primary engine of growth” (Hoskisson, Eden, Lau, & Wright, 2000, p. 249).

In emerging markets with ongoing institutional changes (Yuanqiong et al., 2007; Peng, 2003), private sectors are engaged in non-market strategies to deal with the uncertainty and instability surrounding the non-market environment, as well as to help the firms manage the institutional and societal environments (Faccio, 2006; Aggarwal, 2001; Fisman, 2001). Non-market strategies such as building political connections or obtaining political donations, play a strong role in influencing the financial and non-financial performance of the firms (Zhou, 2013; Deng, Tian, Li, & Abrar, 2012; Faccio, 2006; Fisman, 2001). Thus, examining non-market strategies of firms in emerging economies is important.

In addition, the constantly changing environment, aggravated by globalisation and technology developments, provide an even greater challenge to small firms. A firm’s size, which represents its resources (Cook & Fox, 2000), plays an important role in the choice of the degree of interaction between the particular firm and its political actors (Lux, Crook, & Woehr, 2011; Hillman, Keim, & Schuler, 2004). Thereafter, it will also influence the attitude of how the firm tailors its non-market actions. Unlike their larger counterparts, small firms are more vulnerable to the changing policy and political environment in general (Peng & Luo, 2000), thus forcing them to rely on intermediaries or act collectively when dealing with the political environment (Bennett & Ramsden, 2007; Wilts & Meyer, 2005; Cook & Barry, 1995).

## **1.2. The Research Problem**

The importance of small and medium enterprises (SMEs—hereafter small firms) to the growth of economies has been acknowledged by many scholars in various areas of studies. Small firms have widely been acknowledged as an important engine of national economies, particularly in developing countries

(Mourougane, 2012; Bruton, Ahlstrom, & Obloj, 2008; Hill, 2001). In particular, small firms provide employment opportunities for many people and are well-known for their adaptability. Adaptation is achieved because small firms service local markets and do not rely heavily on the support of formal financial institutions (Berry, Rodriguez, & Sandee, 2001).

The fact that small firms represent a large segment of the economy in many countries and are affected by the government, does not mean that the studies carried out on the political behaviour of this sector are sufficient. In fact, the growing body of research of small firms has overlooked their response behaviour to non-market environments, as well as their relationships with non-market actors.

There are several reasons for the above situation. Firstly, there is a lack of information about small firms in many countries, particularly in emerging economies with a limited number of scholars to cover the issue. Another reason is the difficulty in obtaining data and information, particularly their non-market strategies, from the owners of small firms. There is also an unclear separation between private and business information, which may reduce the clarity of the data and information. Also, small firms lack visibility as compared to larger firms. As a result, very few studies exploring the political activities and behaviour of small firms in political environments, let alone in emerging economies such as Indonesia, can be found. Hence, there is a call for studies to examine the use of non-market strategies in diverse contexts of emerging markets (Wright et al., 2005).

This thesis will cover mainly non-market environments faced by small firms in Indonesia and how these small firms deal with such environments. Indonesia is a classic case where non-market environments play an integral role in the operations of small businesses. In Indonesia, the development of small firms is constrained by a number of factors. These include the informality of operations (Zhou, 2013; Mourougane, 2012; Hill, 2001), the ineffective and insufficient support by the government (Berry et al., 2001; Hill, 2001), the lack of foreign market knowledge and experience (Bhasin & Venkataramany, 2010; Sari, Alam, & Beaumont, 2008), the lack of innovation and productivity (Mourougane, 2012) and the uncertainty of the market environment (Marino, Lohrke, Hill, Weaver, & Tambunan, 2008).

In this thesis, the South Sulawesi province of Indonesia was selected as the research area, as it illustrates the dynamic changes that define an emerging market. The region provides an ideal setting to study the non-market environment faced by small firms. Also, the economic development process in South Sulawesi represents the positive progress of the economic development in Indonesia. As the capital city of the South Sulawesi province, Makassar has one of the highest economic growth rates (7.64%) in the country during the 2009-2014 period. This high growth rate was also followed by an increasing amount of government budget on purchasing goods and service from firms, which to some extent, required a high intensity of business-government interactions. Apart from its positive economic achievement, Makassar remains one of the several cities that shows slow progress in the business climate reformation (World Bank, 2012). Another reason for choosing Makassar is that anecdotal information indicated that the business climate in the city and the province in general, is commonly characterised by a high intensity of government and private sector collusion. Many public areas in *Losari* and *Karebosi*, two of the most prestigious and historic public spaces in Makassar, were turned into private or business premises, which were driven predominantly by certain investors. Furthermore, access to reliable respondents from diverse backgrounds also supported the choice of this province.

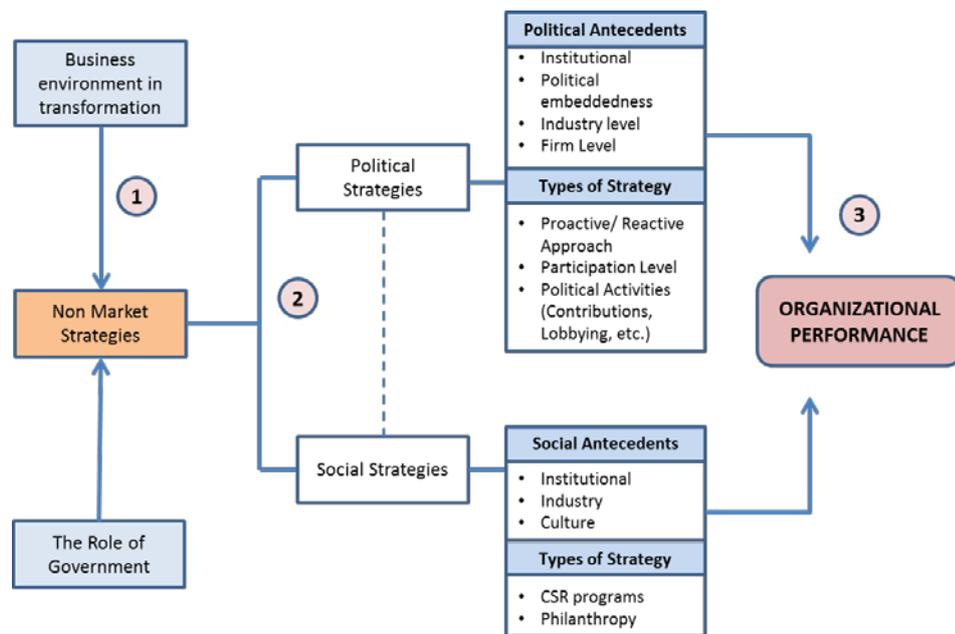
The constitutional and political reforms in Indonesia since 1998 have dramatically changed the relationship between businesses and the government, making Indonesia an interesting case for the investigation on how firms, in particular small firms, adapt to institutional changes and deal with uncertainties.

The key research questions that this thesis sought to answer are: (1) what are the characteristics of the non-market environment in emerging markets? (2) How does the non-market environment lead to a firm's choice of non-market strategies? (3) How do non-market strategies impact the performance of firms?

### **1.3. Conceptual Framework**

Building on Hillman et al. (2004) and Lux et al. (2011) frameworks, the structure of this research is conceptualized using the framework highlighted in Figure

1.1. The non-market strategy of a firm is influenced by the business environment and activities of the government (non-market environment). Non-market strategy can be divided into two general strategies, namely corporate political strategy and corporate social strategy. In terms of corporate political strategy, there are several factors that act as triggers of the strategy, namely institutional factors, political embeddedness, industry characteristics and social embeddedness. When implementing a particular strategy, the firm can choose to use either the proactive or reactive approach (Hillman et al., 2004).



**Figure 1.1: Conceptual Framework**

A proactive approach is one where the founder or owner of the business turns into a politician (Bunkanwanicha & Wiwattanakantang, 2009), or where there is the support of a particular politician through the election campaign and lobbying of certain laws (Lawton, McGuire, & Rajwani, 2013). On the other hand, a reactive approach could be achieved in the form of uniting all firms in the same industry through a formal organization, so as to influence public policies. A firm may also decide to implement this approach individually or through the co-operation of other firms in the same industry. The firms may then employ many tactics in implementing the strategy, such as political donations to political parties or candidates, lobbying, etc.

Apart from adopting the corporate political strategy, firms may also implement corporate social strategies such as corporate social responsibility and philanthropic activities. The antecedents or factors that influence the strategy are almost the same as that of the political strategy. Factors include institutional changes (through regulations), being industry driven and the increasing pressure surrounding the industry, as well as the culture in which the firms operate. A study by Rehbein and Schuler (2015) shows that a firm with a good history of contributing to social activities will gain easy access to the politicians and will often be listened to. Therefore, there is a link between corporate political strategy and corporate social strategy, in the sense that one can affect the other and both strategies are part of a firm's competitive advantage (Porter & Kramer, 2006).

Non-market strategies implemented by firms are driven by several motives (Oliver & Holzinger, 2008). In particular, there are three such motives. First, it may be part of the private interest from the owner(s) and founders (top management included), which generally drives the strategic orientation of the firm, particularly when it comes to social strategy and philanthropy (Sanusi, 2008). Second, the size of the firm also plays an important role in the implementation of non-market strategy. Large-sized firms give more attention to the non-market environment and implement more social activities. In Indonesia, when transitional changes occur, firms are expected to adapt to the strategy that meets the changes. However, little is known about the circumstances under which such strategic transitions are undertaken. More importantly, given the diversity of informal institutions (such as national culture) and formal institutions (such as legal frameworks) across countries, how firms, embedded in different institutional contexts, make different choices remains to be explored. This research endeavours to start filling in this void.

#### **1.4. Objectives of the Study**

The purpose of this research is to investigate institutional changes in emerging economies and their impact on a firm's choice of non-market strategies. The aim is to identify the non-market strategies of small firms and evaluate their impact on the firms' performance. To achieve this aim, the following objectives were addressed:

1. Empirically identify the political and social antecedents in non-market environments in Indonesia;
2. Explore and examine the characteristics and nature of the non-market environment in Indonesia;
3. Investigate how institutional changes in an emerging economy influence a firm's choice of non-market strategies;
4. Analyse the relationship between non-market strategies and the performance of firms.
5. Discuss the policy implications of non-market strategies

Given the lack of information regarding the political behaviour of small firms, this study will fill the gap in terms of how small firms behave towards regulations, which will allow policy-makers to design more effective policies for small firms. It will also increase the knowledge about the impact of public policy on the operations of small firms, which will be particularly useful for policy-makers, since small firms are increasing in number amongst the industries.

This study will also generate information that can be used to assist small firms in improving the economy in general. Moreover, this study can help small firms identify which political strategies they could use for particular problems. Acquiring this knowledge will help firms avoid unnecessary expansion of their resources, as the range of non-market actions that are available to firms will be identified. The firm may also enact appropriate non-market strategies if they understand the consequences that emerge, based on a careful examination of the social and political contexts and a good understanding of the institutional environment. Thus, the findings of this study will be beneficial for small firms.

### **1.5. Approach of the Study**

Research in the strategic management field is becoming more challenging with the rapid change of the technology and information system, along with other complex phenomena that surround strategic management (Arora et al., 2016; Brown & Eisenhardt, 1995). In addition, the recent advance of the resource based view (RBV) of the firm (Barney, 1991) means that research in the strategic management

field should not be framed within “a fixed paradigm” (Hoskisson, Hitt, Wan, & Yiu, 1999, p. 444). As a response to this challenge and given the nature of the research problem, this study employs qualitative methods.

There has been an explosion of qualitative research in the field of management studies, but it is still under-represented in the area of non-market research. A qualitative approach is used in this study to collect the data, so as to understand human experiences and discover the essential meaning of the problem under investigation. The output of qualitative research “may be of more relevance and interest to management practitioners than those of traditional methods” (Cassell, Buehring, Symon, & Johnson, 2006, p. 163). In addition, we consider the respective managers’ perceptions (obtained from interviews) as relevant to answering our research questions. In this context, we adopted an interpretivist approach which focuses on human interpretation and meaning (Yin, 2009) to reach the objectives of the study. This process encompasses interviewing, as well as analysing and writing of the case study — all of which are interconnected and not distinct phases in the process.

This research was guided by grounded theory as the overarching methodology to study data from the exploratory case study and to acquire data within and outside the case study. The grounded theory method has become one of the more important methods in qualitative study, since the seminal work of Glaser and Strauss (1967). The case study approach was used alongside the grounded principles, since the method can help the researcher to build a theory (Eisenhardt, 1989). Case studies also help the researcher when there is little control over the events and when the focus is on contemporary phenomena in a real-life context (Yin, 2009). Moreover, case studies are a preferred method of research in the evolving business context and the unfolding business and social processes (Eisenhardt & Graebner, 2007).

There are two kinds of informants for the interviews, namely internal and external informants (Piekkari, Welch, & Paavilainen, 2009). Internal informants are those who are directly related to the case, either the owner or directors of the firm, while external informants are the informants who are not directly linked to the firm,

such as the government officials. Diverse informants are expected to offer diverse perspectives (Eisenhardt & Graebner, 2007), which may help the researcher validate the information received from the informants.

Also, we interviewed only one respondent from each firm. We argue that interviewing only one respondent for each firm was acceptable because the research involved small businesses wherein each firm has only one or a few key individuals who are involved in the strategic decision-making. Moreover, our respondents explained that usually, only the owner or the director makes strategic decisions, particularly when it comes to business-government decisions, such as building political connections and contributing to political donations.

## **1.6. Significance of the Study**

Institutional changes highlighted the non-economic conditions for business operations in emerging markets (Scott, 2008a; DiMaggio & Powell, 1991). In both developed and emerging markets, the economic activities are regulated by the institutions in which the production, exchange and distribution are set by the rule and regulation. Therefore, following rules, norms and belief system is important for firms in order to adapt with the institutional environment. In addition, the firms also need to mobilize their social, economic and political resources, in order to adapt and change within institutional environments. Although scholars claim that the institutional theory has reached its adulthood (Scott, 2008a), there are gaps in the literature on the role of institutional changes in business operations within emerging economies. There is a strong need for a further coverage of open-ended questions relating to the applications of institutional changes for business strategies (Yang & Su, 2014; Grewal & Dharwadkar, 2002).

The study has addressed the following gaps in the extant literature. Firstly, existing research focus mainly on developed countries and relatively stable institutional environments such as the United States and European countries (Yuanqiong et al., 2007; Gao, 2006; Peng, 2003). However, adopting non-market strategies is also a common practice in emerging economies such as China (Tian & Deng, 2007; Yuanqiong et al., 2007) and Indonesia. As such, there is a need to study

non-market strategies in the context of emerging economies (Aggarwal, 2001). Moreover, extant studies consider non-market strategies as a whole, which obscures the differences among various non-market activities, especially when it comes to small firms. Studies on how small firms interact with the government and non-market environment were rather few and often even overlooked (Bengtson et al., 2009; Cook & Barry, 1995). This study is expected to increase the understanding of non-market strategy (through identifying different types of non-market strategies implemented by firms, particularly small firms in Indonesia, an emerging economy), and acknowledge the institutional factors that surround the issues (Marquis & Raynard, 2015).

The study is also expected to offer insights on the importance of the role of the government in emerging economies (through exploring the intertwined relationships between business and power). Moreover, it extends the knowledge in the field of non-market strategy by studying the political embeddedness of the firms (Welch & Wilkinson, 2004), as well as the political behaviour of the firms (Salorio, Boddewyn, & Dahan, 2005). The study will also have managerial significance in the form of recommendations on key strategies which firms can implement to improve their performance within conditions of institutional changes.

The substantial lack of studies on the political behaviour of small firms, particularly in emerging economies, is not the only justification for this study. It is important to develop studies and test theories on small firms to assess whether the common assumptions of studies on large firms can be applied to small firms or if they should be treated distinctly (Gilman & Edwards, 2008). It is also important to note that apart from exploring the development of political relationships of firms, this study will also allow us to understand the broader political environment and how it impacts the operations of firms (Keillor, Boller, & Ferrell, 1997).

## **1.7. Structure of the Thesis**

The subsequent chapter will discuss an extensive review of relevant literature in the non-market stream related to strategic management studies (Chapter 2), then small and medium enterprises (SMEs) in Indonesia, along with a general discussion

on the business environment in Indonesia will be covered (Chapter 3). Chapter 4 outlines the research methods and provides a brief discussion on grounded theory. Chapters 5 and 6 presents the findings from the field research and discuss how the findings of the study compare with current literature on non-market strategies. The conclusions are included in Chapter 7. At the end of the thesis, some final thoughts and points for possible managerial implications of the study, along with the recommendations for future research are also provided. Finally, the questions that were asked during the interviews and the documents used in this study are provided in the Appendices.

Chapter 2

**THE NON-MARKET CONCEPT:  
A REVIEW OF LITERATURE**

**2.1. Introduction**

This chapter provides a review of the literature on the concepts of non-market environment and non-market strategy, as they apply to firms. Section 2.2 focuses on non-market strategies and what makes them different with market strategies. This then leads to the discussion of what constitutes non-market activities and the differences between market and non-market strategies. Section 2.3 discusses the institutional environment and non-market opportunities. Various types of applied management research that characterise non-market activities are reviewed in Section 2.4. This is discussed alongside the importance of integrating market and non-market activities.

In Sections 2.5, the characteristics of the non-market environment in emerging economies and the theories often used in the non-market strategy literature are looked into respectively. In the next section (Section 2.6), the theoretical framework that shapes the discussion on the non-market literature is also reviewed. Section 2.7 outline the gaps that this study is expected to contribute in the literature of non-market and strategic management in general. This chapter finally concludes with a summary of the contribution that the literature reviewed has to offer to this research.

**2.2. What Does “Non-Market” Mean?**

A firm operates in an environment where market elements such as products and services, the organisation of supply chain and distribution channels affect the competitiveness of the firm. Other elements such as technology, the number of players in the industry, as well as the organisation of the firm are also critical in

boosting a firm's competitiveness. However, apart from market elements, a firm's performance also depends on the external elements of the markets or what is identified as non-market forces (Baron, 1995b) such as social, political and legal elements. The external elements of market and non-market environments of a firm create opportunities for the firm to improve its performance and at the same time, shape the firm's position to be competitive (Hillman & Keim, 1995).

According to Henisz and Zelner (2003), non-market strategy, as a strategic management stream, should be given more attention in multi-disciplinary analysis, so as to develop more literature in this area. Non-market factors should not be seen as merely exogenous to economic competition (Boddewyn, 2003; Boddewyn & Brewer, 1994); instead, they should be integrated into the strategic decision-making process to create value by improving the economic performance of a firm (Baron, 1995a).

Since the expression of "non-market" is increasingly used in the management and organisation strategy field (Yuanqiong et al., 2007), defining "non-market" is important (Boddewyn, 2003). In this study, the author used the perspective of Baron (1997, p. 146) regarding non-market environment as that which is "characterised by the social, political and legal arrangements that structure the firm's interactions outside of, but in conjunction with, markets and private arrangements". A non-market strategy, therefore, as defined also by Baron (1995a, p. 47) is "a concerted pattern of actions taken in the non-market environment to create value by improving its overall performance".

### **2.3. Institutional Environment and Non-Market Opportunities**

A firm may be regarded as being embedded in a broader social and political context. This influences the firm's behaviour in accordance with formal and informal institutions, as well as social norms (DiMaggio & Powell, 1991). Institutions can also be related to three pillars, namely regulative, normative and cultural-cognitive (Scott, 2008a). According to Scott (2005), the regulative pillar emphasises the importance of formal rules and their monitoring, as well as the enforcement mechanism governed by the state. The normative pillar, on the other hand, focuses on achieving value which develops legitimacy, while the cognitive

pillar refers to the beliefs and values derived from various interactions with other social actors. Organisational legitimacy refers to the quality of the relationship between an organisation and its environment or social values (Pfeffer & Salancik, 1978). The influence of the environmental context of the firm on organisational legitimacy has been widely used and “institutionalised”, as well as adapted to particular organisational strategies (DiMaggio & Powell, 1983). The cultural-cognitive pillar emphasises “the shared conceptions that constitute the nature of social reality and the frames through which meaning is made” (Scott, 2008b, p. 54).

The three pillars above also shape institutions that put pressure on the firms which, in turn, influences the behaviour of the firms. This broad view of the institutional environment surrounding a business actor is more specifically defined throughout this thesis as using the definition of “institutions” by North (1990a, p. 3) as follows: “The rules and laws of the game in a society or, more formally, are the humanly devised constraints that shape human interactions.” Baron (1995b) broadly conceptualised the institutions as the non-market aspects of social, political and legal institutions. In this study, the term “non-market actors” refers to the general public, civil society organisations and political organisations, while “institutions” are referred to as formal and informal rules of exchange. Therefore, following Davis, North, and Smorodin (1971), the institutional environment can be outlined as the set of fundamental political, social and legal ground rules that establishes the basis for production, exchange and distribution.

“Institutional environment” is a broad term that covers multiple dimensions. In this study, the dimension considered is the unique characteristic of the institutional environment in emerging economies such as Indonesia and how it shapes the actions of firms. Emerging economies are defined as “low-income, rapid growth countries that use economic liberalization as their primary engine of growth” (Hoskisson et al., 2000, p. 249). Emerging economies are also characterised as nations that are changing from formal planning to open and free market economies.

Many emerging economies are characterised by an institutional environment with inadequate market-supporting institutions (Zhou & Peng, 2012) and even weak and immature institutions (Peng, 2003). In addition, many studies noted that

corruption and bribery (de Jong, Tu, & van Ees, 2012) are prevalent in emerging economies such as Indonesia, where the institutional environment is characterised by unclear business-government interaction and low levels of law enforcement (Wu, 2005; Schwarz, 1997; Irwan, 1989). Peng (2001) and Aggarwal (2001) also emphasised that institutional factors play an important role in many emerging markets, particularly in the internationalisation aspects of a firm's operations.

Business actors will pursue non-market actions in situations when the institutions are ineffective and not well-enforced (North, 1990a). This thus leads to the presence of informal institutions. A non-market action is also the main choice when market-supporting institutions are poorly developed. Market-supporting institutions are expected to perform three functions that encourage market activities by market actors. Peng and Zhou (2005) argue that market-supporting institutions will encourage competition among market actors, reduce information problems in market competition and enhance the effectiveness of legal frameworks. On the other hand, the poor quality of the three dimensions expected from the market-supporting institutions may lead to non-market actions by firms, since all three dimensions reinforce one another. Therefore, the author argues that informal institutions may also exist as a result of the absence of formal institutions or as a form of modification of formal institutions.

The degree to which informal institutions exist may also determine the level of uncertainty in the institutional environment. The uncertainties surrounding the business environment, combined with poorly-enforced institutions, provide non-market opportunities to business actors (Baron, 1995b). Non-market opportunities are sometimes even perceived to be more interactive in certain institutional settings (Dieleman & Sachs, 2008). In other words, when the firm, as a market actor, perceives greater returns from non-market activities as compared to market activities, then non-market opportunities are likely to exist.

Firms react to the market environment by undertaking activities such as marketing, price reductions and research and development (Porter, 1980). However, the business environment is not just related to market issues, but also to the non-market environment (Baron, 2010). Thus, both market and non-market environments

should be considered when addressing market forces, as well as when searching for market alternatives (Baron, 1995a).

Previous studies suggest that firms have two choices of strategies in dealing with the non-market environment. Firstly, a firm may choose to engage in a market-based strategy featuring “arm’s length transactions” (Zhou & Peng, 2010; North, 1990b). Secondly, given the uncertainty surrounding market institutions, as well as the characteristics of most emerging economies, a firm may also choose to implement relational exchange strategies (Peng, 2003; Peng & Heath, 1996). Relational exchange offers an opportunity for a firm to reduce transaction costs through informal mechanisms with less formal agreement among the actors. In addition, relational transactions also allow firms to gain access to information with flexible coordination through social relationships. Ideally, the choice of strategy moves gradually from the latter to the first, along with the development of market-supporting institutions. However, a challenge for the literature in this stream is the diversity of informal institutions and legal frameworks among the nations with emerging economies.

The institutional environment in emerging economies is mostly characterised by the implementation of policies from the government to encourage the marketplace to become more competitive and to allow integration with the global economy (Aulakh & Kotabe, 2008; Zhu, Hitt, & Tihanyi, 2007). In the implementation of these policies, firms also have to deal with the changing political landscape, including changing the political regime that sometimes poses as a challenge to the firms. Uncertainty and instability due to the sudden change in political power, for example, becomes critical to the firm’s performance and long-term survival. This is because the government, as a political actor, typically has a high degree of control over market access, along with the resources that are needed by the firm (Peng & Luo, 2000; Peng & Heath, 1996).

In such situations, firms need to manage their dependence on institutional actors (Peng & Luo, 2000). The dependence on particular institutional actors and government officials, for example, means a much larger concentration of power in the hands of government officials. One of the main tactics in relational transaction is

having a political connection (Lester, Hillman, Zardkoohi, & Canella, 2008; Fisman, 2001). Such a network-based strategy is considered a valuable resource for a firm in dealing with such challenging conditions.

The proponents of the resource-based view (RBV) assume that institutional environment plays an important role in influencing the performance of a firm (Rehbein & Schuler, 2015). Firms need to effectively manage dependencies on the institutional environment and therefore, emphasise political connection as one of the main managerial resources (Li & Zhang, 2007; Barney, 1991). This is particularly important in emerging economies. Managerial resources associated with top managers can be in the form of knowledge, experiences, skills and good external ties with other stakeholders of the firm. Several empirical studies in emerging economies showed that political connections have a positive influence on a firm's performance, through securing operation licenses, financing and support for research and technology for the firm (Li & Zhang, 2007; Zhou, 2007; Peng & Zhou, 2005).

Political connections can be characterised in two general ways. First, a firm is perceived as politically connected, if at least one of the top executive members is an active/ former politician or closely related to a top politician/ political party (Lester et al., 2008; Faccio, 2006). Such a connection is common in more transparent countries, as a result of greater access to information. However, it is also popular in countries that are highly corrupt and have a centrally-controlled economy such as China and Indonesia.

Another characteristic of political connection is the form of relationships with government officials or political actors at various levels (Peng & Luo, 2000), even though they are not directly involved in the day-to-day operations of a firm. Firms that rely on government sales usually employ political connection as their non-market strategy (Lux et al., 2011; Bonardi et al., 2005; Hillman et al., 2004). Reliance on government sales is also a reliable predictor of the political activity of firms. Therefore, such firms are more likely to engage in political activities and develop political connections (Lawton & Rajwani, 2011; Lux et al., 2011; Hillman & Hitt, 1999). Two characteristics of political connection demonstrate the condition

that political connection is not universal, but instead, is embedded in the institutional context (Li et al., 2012; Scott, 2008a).

On the other hand, relational-based strategies could be risky, particularly in institutional environments that are inconsistent and rapidly changing, due to political instability (Leuz & Oberholzer-Gee, 2006). Moreover, even though non-market strategies are often more successful than market strategies in volatile non-market environments, firms also have to consider non-market competition in pursuing non-market activities (Bonardi & Keim, 2005). Non-market competition may involve both market and non-market actors. While market actors compete in obtaining resources or benefits from public policy outcomes, non-market actors compete in supplying policies and expect economic resources in return.

For decades, the firms' approaches to the environment can be described via the industrial organisation perspective (Porter, 1980) and RBV (Barney, 1991; Wernerfelt, 1984). Porter (1980) proposed that the external environment of a firm is evaluated along five critical forces: the power of buyers, the power of suppliers, threat of new entrants, threat of substitutes and the intensity of rivalry in the industry. All five critical forces emphasise industry-level competition. Hence, a firm can then evaluate the attractiveness of the industry and determine the appropriate strategy.

In contrast, the RBV (Barney, 1991) expects firms to examine their capabilities, which can be utilised to produce a sustained competitive advantage. This process can help the firm select strategies that maximise their strengths and minimise their weaknesses.

Despite the differences, both the industrial organisation concept of competition and the RBV strategies are selected by a firm through internal and environmental analysis. This analysis leads a firm to adopt generic strategies such as cost leadership, differentiation and focus. However, this traditional and competitive strategic tool only emphasises the market environment of the firm (De Figueiredo, 2009; Baron, 1995a). Baron (1995a) identifies the market environment as intermediated by markets or private agreements, which indicates a missing focus on the non-market environment. The non-market environment is governed by various

stakeholders, from the government and media to civil society organisations. It also shows that both approaches do not focus on the dynamics of the non-market environment faced by firms.

The institutional environment offers opportunities for both market and non-market actions to be taken by the firm (Hillman & Keim, 1995). Most developed and mature markets focus on investments in market activities (marketing, research and development) which provide better returns, while investments in non-market activities (lobbying) provide better returns in less developed and immature markets (de Jong et al., 2012; Lux et al., 2011). Non-market opportunities are available to business actors through two different outcomes. Firstly, it allows business actors to persuade non-market actors to shape the firm's market environment (Lawton & Rajwani, 2011; Hillman & Hitt, 1999; Baron, 1995a) through protecting firms from competition and changing the technology which will benefit the firm's market activities. Secondly, market actors can influence non-market actors by offering policies that change the competition which will benefit specific market actors (Lux, Crook, & Leap, 2012). In some situations, market activities can also shape non-market actors to create or modify existing institutions, to meet with the new forms of economic activity such as e-commerce.

To achieve the above outcomes, non-market strategies are perceived as more effective actions than market actions, because implementing non-market actions is often less expensive (Lux et al., 2011). The decision to invest in non-market strategies is often perceived to offer a sustainable competitive advantage (Keim, 2001; North, 1990b) and makes the firm invest less in market activities. Non-market opportunities, therefore, provide investment alternatives for the firm and in particular, social and political contexts, as they are more sustainable and less risky, as compared to market opportunities. In most underdeveloped institutions for example, corruption is typically present because of the high level of uncertainty faced by the firms. In most developed institutions, non-market opportunities also exist, but they appear in a different form such as lobbying and being actively involved in political activities. Given the role of institutions in determining the level of uncertainty in market environments, non-market strategies have become strategically important for the firms to overcome these uncertainties.

In the past, a firm's performance relied on the market environment. However, Bach and Allen (2010) argued that in the current situation, there are three reasons why firms need to put more attention on the non-market environment. Firstly, as institutions that have a big impact on society, firms are faced with increasing demands from society. Secondly, influencing politics is a capability that is vitally important, since many firms are affected by regulations issued by the government. Finally, the dynamic environment shapes different political situations within many places.

In addition, the non-market environment becomes important since the geo-political condition has changed (Doh, McGuire, & Ozaki, 2014). Globally, the arrangements of nations in the World Trade Organization (WTO), as well as the proliferation of regional treaties such as the Association of Southeast Asia Nations (ASEAN) have greatly influenced the firms' strategies (Aggarwal, 2001).

#### **2.4. Non-Market Strategies**

The growing interest in the study of the non-market phenomena is accompanied by the debate over the use of "non-market" as a concept (see Table 2.1). Boddewyn (2003) provides a clear description of various definitions of the concept, "non-market". Previous studies on market and non-market concepts mostly treated the two areas as distinct, where non-market simply categorised everything that is not included in the market area (Shaffer, 2000; Baron, 1995a, 1995b). The non-market environment is defined as consisting "of the social, political, and legal arrangements that structure the firm's interaction outside of, and in conjunction with, the markets" (Baron, 1995a, p. 48). This definition supports the industrial organisation framework of Porter (1980), in which the external environment is scanned and evaluated alongside five forces, from which appropriate strategies can be exploited to maximise opportunities and minimise threats. Other studies critically assess non-market institutions that distinguishes them from market ones (Boddewyn, 2003). Doh et al. (2012) for example, argue that the non-market environment differs from the market environment, where the firm only acts as a market actor in various forms (competitor, supplier, buyer, etc.), as previously indicated by Porter (1980).

**Table 2.1: Market and Non-market Strategies and Their Integration**

	<b>Market strategy</b>	<b>Non-market strategy</b>
Definition	A market strategy is a concerted pattern of actions taken in the market environment to create value by improving economic performance (Baron, 1995a).	A non-market strategy is a concerted pattern of actions taken in the non-market environment to create value by improving its overall performance (Baron, 1995b). A firm's non-market strategy is typically considered the firm's efforts to manage the institutional or societal context of economic competition (Boddeyn, 2003).
Environment	Interactions between the firm and other parties that are intermediated by markets or private agreements (Baron, 1995a).	Consists of social, political and legal arrangements that structure the firm's interactions outside markets (Baron, 1995b).
Purpose	Addressing and defending against market forces and realising market alternatives (Aggarwal, 2001)	To shape the firm's market environment (Baron, 1995a).
Strategic making process	Consists of external environment analysis, internal competence evaluation, strategic plan-making and selecting, action plan-making and exacting, as well as feedback (Baron, 1997).	Consists of issue-perceiving and prioritisation, issue-analysing, selecting and acting (Baron, 1995b).
Integrated strategy	Consists of market and non-market components that are integrated and tailored to the firm's market and non-market environments and firm's competencies (Baron, 1995a). The integration aims to generate synergies and superior overall performance for the firm (Baron, 1997).	

Source: Adapted from (Boddeyn, 2003; Aggarwal, 2001; Baron, 1997, 1995a, 1995b).

The definition which merely identifies non-market as the opposite of market, however, poses several problems. The term, "non-market", may serve as an umbrella expression for the external condition which may be different from one study to another and therefore, it may not help to develop an overarching definition. In addition, defining non-market in this way often neglects the complexity of the issues surrounding the non-market environments of a firm and is therefore only used as a definitional exercise without any theoretical implications (Boddeyn, 2003).

After critically evaluating four perspectives on the meaning of non-market based on the historical and conceptual context of the term, Boddewyn (2003, p. 320) offers an overarching definition of non-market which refers to:

*“(a) Values expressing the purposive pursuit of public interests; (b) internal and external interchange mechanism of coercion and cooperation that complement and balance competition in a reciprocal manner at various levels of interaction; (c) relationships among market and non-market organisations resting principally on their actors’ sovereignty rights; and (d) the conflictual integration in the light of their failures of society’s economic, political, social, and cultural organisations.”*

Contrasting with previous non-market studies, such dichotomous categorisation is, however, challenged by Devinney (2013) who argued that presenting non-market as the opposite of market is operationally useful, but it does not enrich our theoretical perspective, particularly in the management area. In addition, what was labelled as “non-market” is actually a “market” that exists in a different form. The categorisation of the strategies (market vs non-market) can lead a firm to believe that markets are homogenous and come in one form. Unlike Porter’s generic strategies, non-market cannot be used easily to describe the condition when, for example, a non-governmental organisation (NGO) promotes the boycott of a product.

Boddewyn (2003) argues that there are at least three reasons why scholars define non-market differently. Firstly, some scholars such as Baron (2010) follow the positive tradition that a firm is influenced by external factors (non-market) which will affect the performance of the firm. This industry analysis perspective is parallel with the positive political economy (PPE) approach, which examines how the formal political structure (government) affects firms. Therefore, a firm needs to act in order to deal with the non-market elements. The actions of a firm, as indications of interactions with non-market actors, might be in the form of lobbying or campaign contribution, which may help the firm in the public policy context.

Secondly, non-market factors are seen as endogenous rather than exogenous to the firm. This argument indicates that non-market factors cannot be included in 'market calculation', since the former is "non-tradeable" (Baron, 1995a; Boddewyn & Brewer, 1994). This is the perspective of neoclassical and institutional economists, a group of scholars who believe that markets are independent.

Thirdly, the different perspectives on the non-market environment result when scholars embed non-market components with social factors such as norms, rules and customs. Embedding the non-market environment with those factors means that a firm absorbs norms, rules and customs into the firm's function and use them to improve the firm's competitiveness.

The problem with such a simple categorisation is that it may send a misleading idea to a manager to treat market and non-market as separate environments. Therefore, Baron (1995a) argues that the non-market environment should be seen as endogenous rather than exogenous, in the strategy formulation of the firm. Both market and non-market competitions require instruments, which are the corresponding market and non-market strategies, respectively. These strategies must be integrated to help a firm achieve superior equilibrium performance (Baron, 1999).

In this study, the terms "non-market strategy" and "non-market action" are used interchangeably to capture the behaviour of firms in dealing with their social, political and legal parties, as opposed to the interactions of firms in traditional market settings (e.g., with respect to buyers, suppliers and competitors). Apart from actions taken in the non-market environment, non-market strategy also consists of actions taken in market arenas to influence certain aspects. As Ozer (2010) argues, implementing non-market strategy such as corporate political strategy is not just an alternative for the firm, but is also complementary to market strategy, where firms may influence decisions such as product pricing or local component sourcing levels. Firms may also employ non-market actions such as corporate political strategy to gain public policy that can help create a favourable environment for the firm in implementing its innovation strategy (Baron, 2010).

Why do firms engage in non-market actions? Despite the abundance of literature regarding non-market activities of firms, we found that the strategy literature provides inconsistent explanations as to why firms become politically engaged and how firms go about their political and public activities (Getz, 2002). The reason may be because defining the term “non-market” usually leads to confusion (as discussed earlier), as non-market and market strategies form a dichotomy, without any clarification on the details of each strategy (Boddewyn, 2003).

In addition, some scholars believe that there is not enough literature to explain how managers deal with non-market environments and stakeholders simultaneously (Mahon, Heugens, & Lamertz, 2004). This is due to the methodological difficulties of operationalising the interrelationships between non-market environments and stakeholders surrounding the non-market environments, so that they can be measured. Previous studies and research on non-market actions, particularly political action, also provide mixed results, which may be confusing and indicate inconsistencies (Mathur & Singh, 2011).

#### **2.4.1. Corporate Political Activity**

Scholars in the non-market strategy stream identify political strategy as central to a firm’s overall business strategy in many industries (Barron, 2010), as it affects a firm’s behaviour and performance (Keim & Hillman, 2008; Hillman et al., 2004; Hillman & Hitt, 1999; Getz, 1997). Political strategy is a non-market action to expand a firm’s strategy in order to influence government policy (Lux et al., 2011). Governmental policies have substantial power on the business environment. Moreover, they influence the processes and the outcomes of business activities. Governments also make firms highly dependent on legal and regulatory policy. To moderate such dependency and to influence a government’s regulatory policy, firms participate in political actions. Such actions are commonly referred to as CPA, which is defined as “corporate attempts to shape government policy in ways favourable to the firm” (Hillman et al., 2004, p. 838).

A more comprehensive definition is offered by some scholars who refer to corporate political strategy as “the strategy that enterprises employ to influence the formulation and implementation process of government policy and regulation, in order to create a favourable external environment for their business activities” (Deng, Tian, & Abrar, 2010, p. 372). CPA may also be conducted in different forms, such as the participation of interest groups (firms included) in the government process. In essence, all scholars agree that the strategic purpose of political activity and the importance of the political arena (Dahan, 2009) are the basis for the success of a firm.

There are four pillars that shape corporate political activity (CPA), namely strategic goals, strategic options, resources and capabilities, as well as institutions (Lawton, McGuire, et al., 2013). Previous studies also indicated that there are four types of antecedents of non-market behaviour of the firm, namely, the characteristics of the firm, as well as industry-level, issue-based and institutional factors (Hillman et al., 2004). Size is the prominent determinant of CPA which also provides an indicator of the resources that can be utilised in implementing CPA (Lux et al., 2011; Hillman et al., 2004).

Various political tactics are employed by firms in pursuing CPA. Scholars have identified general political tactics commonly used by a firm, even though such political tactics are mostly relevant to developed nations and refer mostly to the political environment in the U.S. Political strategies and tactics used by firms in CPA can be grouped into three broad categories. First, financial strategies, which meant that firms provide financial support and incentives to politicians and get access to the political process in return (Hillman & Hitt, 1999). Financial contribution strategies are mostly derived from the U.S context, where firms contribute through Political Action Committees (PACs). Apart from special channels such as PACs, firms may also contribute through donations to unspecified candidates or political ideologies (Schuler, Rehbein, & Cramer, 2002), as well as through bribery (de Jong, Tu, & van Ees, 2015; Lawton, McGuire, et al., 2013).

The political environment influences the strategies that are implemented by firms, including the intention to bribe government officials. Moreover, business

regulations are often subject to constant change, making it difficult for firms to predict the long-term business environment. Given this uncertain and complex situation, it is not surprising that many firms choose bribery as a quick way to tackle the situation or to gain market access (Keillor et al., 1997). A study by Transparency International even shows that bribery between companies across different sectors is just as common as bribery between firms and public officials (Transparency International, 2011). However, the issue of bribery becomes a concern for many scholars since it can be ethically problematic (Lawton, Rajwani, & Doh, 2013). In addition, bribery is an often used but rarely investigated strategy due to its dubious nature (de Jong et al., 2012).

The second strategy is relational strategies, which has been extensively reviewed by scholars in the CPA stream. Firms may build relationships with policy-makers and develop political connections (Chung & Ding, 2010; Faccio, 2006) through appointing a politician or a former politician to be a member of the corporate board (Gray, Harymawan, & Nowland, 2014; Dahan, Hadani, & Schuler, 2013; Goldman, Rocholl, & So, 2009; Faccio, 2006; Hillman, 2005; Fisman, 2001). Another form of building political connections is the business owner being involved actively in politics as a politician (Imai, 2006; Hillman & Hitt, 1999). Apart from actively being involved in politics, the business owner may also seek and build informal relations with key stakeholders such as religious leaders or youth organisation activists (Adhikari, Derashid, & Zhang, 2006).

The last strategy is through informational strategies, where firms provide specific information to the government agencies about their preferred policies (Hillman & Hitt, 1999). Other forms of informational strategies are lobbying, petitions and comments which unlike the first two strategies, are not specifically driven by a firm's objectives.

Scholars using the CPA framework mostly engage in positivist and normative analysis (e.g., Lux et al. (2011)), which may overlook the issue of societal demands and the absence of ethical analysis in CPA discussions (Dahan et al., 2013; Mantere, Pajunen, & Lamberg, 2009; Oberman, 2004). In addition, studies in CPA and non-market strategies in general have not made sufficient inroads about how firms should

deal with the many questions in the non-market environment (Henisz & Zelner, 2012), such as how much a firm should invest in political capital and how firms manage the capital to reach its objectives. Other scholars also indicate the lack of an international perspective, which prevents us from generating multi-variate knowledge, given the complexity of these phenomena (Skippari, Eloranta, Lamberg, & Parviainen, 2005). Therefore, cross-cultural management, which emphasises the importance of cultural understanding as a prominent factor in influencing the choice of strategic action of a firm, has emerged (Barron, 2010).

Albeit a less formal approach to the role of structural factors (Henisz & Zelner, 2012), it is worth noting that the CPA implemented by firms are not predominantly a management process. Instead, it occurs under the aegis of a broader public relations function (Doh et al., 2012). It is also important to note that since CPA represents a non-market strategy that is intended to influence political actors or governments, the expected impact on the firm is typically indirect (Hadani, 2007). As such, there must be a link between political tactics and public affairs capacity by firms, in order to tackle non-market environment factors, which are more demanding compared to the last decades.

Apart from firm-level outcomes, the CPA traditions which developed mostly from the U.S context were also illustrated by some scholars (e.g., Getz (1997), Hillman and Hitt (1999) and Hillman et al. (2004)). Hillman and Hitt (1999) for example, claimed that firms which rely on government sales are more likely develop a long-term relationship with government officials. Establishing long-term relationships with officials is a way to achieve favourable policy-making and improved power and legitimacy of the firm (Getz, 2002, 1997). Such favourable policy and legitimacy are mostly derived from the possible consequences of legislative outcomes. However, Keim (2001) advised on the importance for firms to understand the complicated nature of the legislative policy-making process.

To date, the CPA literature has focused mostly on firm-level analysis, such as the size of the firm, rather than external forces such as industry and interest groups of the firm (Hadani, 2007). Moreover, current studies focus mostly on the “resources” of the firm and how “structural attributes” could be used to influence political

processes and provide policy-based advantages to the firm. However, such firm-level engagement is not enough, given that the business-government landscape, including institutional structures, has changed dramatically (Lawton, McGuire, et al., 2013). Barron (2010), following Child (2000), also found that most research on CPA overlooks the influence of national culture on the political behaviour of firms. This situation is shadowing the intent to replicate CPA research based on the western context to outside regions, which may neglect different institutional arrangements.

#### ***2.1.1.1. Approaches to Corporate Political Activity***

There are two general approaches to CPA and each approach illustrates the firms' tendency towards implementing their political strategies (Hillman & Hitt, 1999). The first approach is the transactional approach. Most firms who adopt this approach are waiting for the issue to become salient, prior to embarking on a strategy. The focus of this approach is primarily the achievement of specific objectives and the issue-based orientation strategy (Getz, 1997) and tends to be more reactive.

Relational approach, on the other hand, is an attempt "to build relationships across issues and overtime" (Hillman & Hitt, 1999, p. 828). The focus of the latter is mostly on the long-term objectives and being proactive with nature. By adopting the relational approach, firms will build political capital (Shaffer, 2000), which can be used to reduce environmental uncertainty (Getz, 2002, 1997) and therefore, their economic goals would be better met (Hillman & Hitt, 1999).

#### ***2.1.1.2. Types of Political Activities***

Another way to categorise various political activities by the firm is whether the actions are taken individually or collectively (Olson & Olson, 2009; Hillman & Hitt, 1999). Typical examples of collective action can be seen from industry association activities, unions or industry groups. Surprisingly, little attention has been given to the conditions in which a firm prefers to do collective rather than individual action. However, scholars agree that the basic premise on which a firm chooses its level of participation is a matter of strategic choice of the firm (e.g.

Schuler, 2008; Hillman et al., 2004; Schuler, 2001). In addition, various factors such as industry concentration (Hansen, Mitchell, & Drope, 2005; Schuler et al., 2002; Hillman & Hitt, 1999), import protection (Hansen, Mitchell, & Drope, 2004) and government contract protection (Bonardi & Keim, 2005; Schuler et al., 2002; Rehbein & Schuler, 1999) also influence the firms' preferred level of participation. Olson (1965) asserts that the choice of working collectively in the political arena may help a firm reach its objectives, since all firms involved share common interests. However, collective action also invokes a key challenge, namely the free-rider dilemma.

#### **2.4.2. Public Affairs**

Corporate public affairs (also called, and sometimes synonymous with external affairs, corporate affairs, external relations, public relations and government relations) is essentially a tool that helps firms deal with ideas, issues and stakeholders surrounding the firm. It is driven by the increasingly complex business-government interaction, as well as the changing expectations from other stakeholders. The changing business environment, as well as the political and social environment, forces firms to engage differently and strategically. Therefore, public affairs is an externally-oriented function of the firm to build and maintain good relationships with the government and other non-market actors, such as local citizens, opinion makers, as well as advocates of business interests (Moss, McGrath, Tonge, & Harris, 2012; Griffin, Fleisher, Brenner, & Boddewyn, 2001).

Practically, resource allocation, especially commitment from the top management in the firm, plays an important role in the success of public affairs (Griffin & Dunn, 2004). The other factors include political preferences (Schuler, 2001), long-term impacts on the firm (Richards, 2003) and firm performance (Hillman, 2001).

Some scholars argue that public affairs should be called CPA, which is better conceptualised and more empirically driven (e.g. Lawton, McGuire, et al., 2013; Griffin, 2005). In addition, the function of public affairs encompasses tactics such as lobbying and issue management, which makes public affairs closely related to

corporate political activities (Moss et al., 2012). Moreover, it is also a subordinate element of political strategy (Windsor, 2002). Schuler (2001) argued that the field of public affairs is closely related to the internal process, with the assumption that the external condition works effectively. However, CPA literature focuses mostly on structural factors that determine how firms react to political and alternative public policies that may follow. Yet, there is no agreed theory of public affairs and external relations. As a result, it is difficult to draw a clear line between the broad research focus of business political strategy, where some scholars show interest in government relations, while others try to formalise public affairs (Getz, 2002; Hillman & Hitt, 1999). Griffin et al. (2001) provides a comprehensive chronological literature review of the public affairs field and found that the field is an interdisciplinary subject that influences both professional and academic perspectives.

Furthermore, research in the public affairs stream still faces both macro and micro level issues. Richards (2003) argues that simply quantifying the role of public affairs to a firm's performance is insufficient. Schuler (2001) also argues that the existing theoretical model in many public affairs studies is incomplete. Due to the circumstances, many of the studies were forced to make assumptions about the proper constructs. Therefore, the research work on the public affairs area should go beyond merely describing what public affair is and embrace more complex models and measurements instead. The researchers in this field need to properly capture what "managing relationship" means for the managers and clearly measure the influence of public policy on the performance of the firm. The performance of the firm, therefore, should be ruled as a basic point for public affairs to become an area of inquiry.

On the macro level analysis, this field lacks an international perspective due to its ethnocentric perspective. Most studies were based on the western context and lack coherence among studies in the same area that observe business-government interactions (Moss et al., 2012; Meznar, 2001). Despite the lack of agreement on the definition of public affairs and disorganisation surrounding research in the field (Getz, 2002), scholars agree that public affairs as a sub-area of inquiry in the non-market strategy area, is parallel with other fields such as corporate political strategies

and issue management (Hillman, 2001). Therefore, public affairs play an important role in sounding corporate voices (Moss et al., 2012).

### **2.4.3. Network Perspective**

Research on business-government interaction also attracted many scholars from the business network perspective such as the Industrial Marketing and Purchasing (IMP) group, an inter-organisational networks research group. While other studies in corporate political science focus on the behaviour of an individual firm, the network perspective gives more attention to the relationship level. This research stream studies the relationship as an implementation of the network theory. The relationship here is similar to the concept of embeddedness, which refers to firms' "relations with and dependence on the various types of network" (Halinen & Törnroos, 1998, p. 189) and the history of the relationships between the participants (Ford & Mouzas, 2010). This stream takes a relational study, not as an independent phenomenon (without influence from other relationships). Therefore, the role of managers in business interactions becomes greater than before. A business relationship is built based on the involvement of actors, resources and the activities performed by actors using available resources (Håkansson & Ford, 2002). The actors that aim to control the actions and perform various activities with resources and knowledge may be individual or collective. Hence, the three factors intertwine and interdependently connect to create a network.

Several studies highlighted the importance of firms to take advantage of their position in the network (Hadjikhani, Lee, & Ghauri, 2008; Welch & Wilkinson, 2004; Hadjikhani, 2000). This research stream takes a network view of the interaction between business, social and political actors. Given the traditional IMP views on inter-firm relationships (Bengtson, Ljung, & Hadjikhani, 2013; Bengtson et al., 2009), additional attention to the external parties of the firms will broaden our understanding of a firm's network, as well as the political and social networks in which the firm is embedded (Welch & Wilkinson, 2004). Nevertheless, to some extent, scholars such as Håkansson and Snehota (2006) emphasised the importance of adopting the concept of "context" rather than the environment of the firm. They also argued that focusing on the context is more useful when we want to refer to the

entities that relate to the firm. Furthermore, all firms, regardless of the size, may be embedded in multi-level institutional environments, from the local to national levels. As such, this influences the decisions made by the firms, in dealing with the external environment. Therefore, a firm should treat every relationship differently because each relationship has unique contents and a different effect on the network structure (Ford & Mouzas, 2010).

Embeddedness is a central concept in network studies. Moreover, the issue of how business networks are embedded in the non-market or political network becomes very important in this research stream. Halinen and Törnroos (1998) suggested that in the business networks perspective, there are six different types of embeddedness: these are temporal, spatial, technological, market, political and social embeddedness. Welch and Wilkinson (2004) also identified from the IMP stream literature, four dimensions of political embeddedness of the firm. The four dimensions are political institutions, political actors, political activities and the political resources of the firm. Political institutions hugely emphasise the ideological and political value dimension, which is always changing and affecting the other dimensions (Halinen & Törnroos, 1998). Meanwhile, political actors are a part of the dimension that could influence the change, which may come from the shifting of the political structure. The actors include bureaucrats, government officials, Members of Parliament, interest groups and the media (Hadjikhani & Håkansson, 1996). Business actors will try to convince political actors with any intentional effort, in order to get political support and at the end, lead the business actors to gain legitimacy (Hadjikhani & Thilenius, 2005).

Halinen and Törnroos (1998) stated that the dimension of embeddedness is indicated by the involvement of a business in a political system whose main objective is to influence public opinion. The degree of involvement ranges from adapting new regulations to supporting the government to formulating a policy or legislation. The involvement of firms in the political system indicates political connection, which may occur from the high dependency level among the actors in the network. Political actors may need support from the business actors with their resources in order to maintain their political position, while business actors expect to get positive political influences from the political actors in return.

In the business network approach, the political impact can be divided into two general types, namely coercive and supportive impacts (Hadjikhani & Sharma, 1999). Coercive impact indicates the rules and regulations produced by political actors using their legitimate power, which the firms should obey, even though the rules and regulations restrict the firms' activities. The impact signals the need for firms to adapt to the regulations. Supportive impact, on the other hand, leads to the initiative action that the firms may take in order to weaken and change the coercive behaviour. The initiative may then bring about positive impacts on the firms, which may come in the form of financial support, subsidies and other supportive rules and regulations. Both coercive and supportive impacts are also affected by the size of the firm. The size of the firm could be one of the main prerequisites of the political behaviour of the firm. Using the multinational enterprises (MNEs) and SMEs case in managing their relationships with the European Union (EU), Hadjikhani (2000) found that larger firms tend to be active rather than follow a situation. This thus signals the proactive approach that may be used by the firms, particularly large firms (Hadjikhani & Ghauri, 2001).

The last part of the dimension of embeddedness is political resources, which is basically explaining the intertwined position of the business and government. Apart from its regulative position, the government is also a source for the firm to obtain benefits in financial or non-financial forms. The benefits could be getting contracts in providing goods and services to the government, getting support for research and development funding, as well as tax concessions and also other forms of protection. In the end, firms target to reach institutional legitimacy by implementing such a strategy. The concept of legitimacy, in the context of the political environment, is about how political actors perceive the business actors (Hadjikhani, Lee, et al., 2008).

Legitimacy could be gained by a firm through two ways. First, this is obtained through the size of the firm, which influence its business exchanges. Large business are often supported by organised units that help the firm undertake business activities, while small firms are often forced to adapt to costly actions (Hadjikhani & Ghauri, 2001). The second way is by interaction with non-business actors, where such interaction indicates the importance of non-market exchanges among actors in

the network. The exchange is more than merely economic in nature. The firm gains legitimacy from the exchange, through the advantage of knowledge and expertise of the political settings (Welch & Wilkinson, 2004).

Apart from mere legitimacy, the interaction between political actors and enterprises could strengthen the competitive position of the firm and positively affect the performance of the firm (Faccio, 2006; Hillman et al., 2004; Fisman, 2001; Shaffer, 2000). Bonardi (2011) investigates the effect of the firm's performance from a situation where the political environment of the firm is characterized as a marketplace. As a marketplace, the government or politicians as policy suppliers will try to obtain support from businesses to retain their authority and power. On the other hand, firms that serve as policy demanders will try to lobby public policy that favours them in order to reach their objectives such as increasing profits (Bonardi et al., 2005; Hillman & Keim, 1995).

The government is a source of a wide range of political goods, from public procurement contracts, licenses and tax, industry regulations and financial support through to various other programs. Therefore, Hadjikhani, Lee, et al. (2008) cautioned that the relationship with political actors cannot be treated in the same way as a business-business relationship. Political knowledge and commitment are two factors that influence the success of business actors in gaining influence and support from political actors (Hadjikhani & Ghauri, 2001).

The performance of a firm is influenced by its business relationship and connections both with business and non-business actors (political relationship) (Hadjikhani, Thilenius, & Pourmand, 2009; Hadjikhani & Thilenius, 2005). Besides, changing the business environment requires business actors not to focus on the dyadic relationship alone. Small firms, given their resource-constrained conditions, are forced to attain alternative solutions apart from their dyadic network. Therefore, small firms often rely on collective form of actions and gain incentives from memberships in associations (Cook & Barry, 1995). The involvement in business association helps small firms feel that their interests remain represented and their knowledge and expertise can be enriched by the information held by the associations.

#### **2.4.4. Social Strategies**

As discussed above, the non-market strategy is typically considered as the way a firm manages its institutional and societal context (Boddeyn, 2003). Moreover, in recent years, private interests such as activists or NGOs have tried to affect company and industry practices using the arena of public sentiment and the media. Dannreuther (2007) argues that these stakeholders must be engaged proactively by the firm, particularly in this age of social media. The way that companies manage relationships with governments, NGOs, the media and society at large is a part of the non-market strategy (Bach & Allen, 2010).

This condition presents new strategic challenges for companies in the areas of reputation management, self-regulation and the integration of private and public non-market strategies, among others. In addition to explicit political strategies, scholars in the strategic management field have also examined firms' strategies in relation to corporate social responsibility (CSR). CSR has been increasingly acknowledged as an important part of non-market strategies implemented by firms (Doh et al., 2012; Baron, 2007, 2001) and involves a moral duty to perform social activities (Baron, Harjoto, & Hoje, 2011). The strategic use of CSR has received substantial interests from academic researchers, with an increasing number of proposals to integrate the social strategy of the firm into business and corporate-level strategies (Rehbein & Schuler, 2015; Doh et al., 2014).

Despite the growing awareness of CSR in the literature, there is no unified definition of what CSR is. Thus, CSR may have different meanings to different people (van Marrewijk, 2003). As a result, consumers and stakeholders of a firm, in general, have become more demanding. The firm's behaviour to the environment, as well as to the society at large, will always be monitored. This situation forces the firm to produce environmental and ethical products and services. Considering ethics and the environment may help the firm reach its objectives. Some scholars even argue that ethical operation may benefit the firms including better financial performance (Tang, Hull, & Rothenberg, 2012; Baron et al., 2011; Baron, 2007). However, this argument is seen by some scholars as not completely true. They argue that while some firms might benefit from CSR actions through which indicated by

good financial performance, some firms might find that there is no effect from implementing CSR to their performance (Vogel, 2005; Griffin & Mahon, 1997). The discourse on the issue of CSR and corporate financial performance over the decades illustrates that there are clearly associations between social activities and performance. Institutional conditions such as public-private regulation, social pressure from stakeholders (Campbell, 2007) and the context of the environment (Matten & Moon, 2008) may affect how CSR is implemented by a firm (Gjølberg, 2009). Apart from the debate on social responsibility and financial performance, as well as the specific institutional conditions in the implementation of CSR, the current trend shows that more firms adapt business responsibility along with ethical operations. It is even embedded across business functions, from marketing to supply chain. CSR answers the uncertainties that are faced by many firms in the changing social, technological and political arena (Carroll, 1979).

One can argue that the general reason why there is a shift in firms' attitude towards social and stakeholders' expectation is simply that firms want to protect their reputation. In addition, the force for the firm to absorb ethical and social issues in their operations is greater than before (Porter & Kramer, 2006). CSR could also be used as a political tool of the firm to achieve its objectives (Detomasi, 2008). The CSR concept itself can help to "introduce better ways for managers" to improve their service to shareholders and the society, considering the economic and social dimensions, along with the financial interests of the firm (Baron et al., 2011; Saia, Carroll, & Buchholtz, 2003). CSR may also lead to additional firm-level resources, which helps to improve the effectiveness of political strategies implemented by a firm (Rehbein & Schuler, 2015). Hence, implementing CSR could also become part of a company's competitive advantage (Porter & Kramer, 2006). To achieve those objectives, the firm must go beyond responsive CSR to strategic CSR. Strategic CSR means that firms do not just merely conduct altruistic activities, but also add social dimensions to the value of the firm.

But what is the real motive for the firm to implement CSR? Porter and Kramer (2006) argue that there are "four justifications" for a firm to implement CSR. First, it is a moral obligation for the firm to become a good citizen. Being a good citizen is reflected in the form of ethical activities in achieving its objectives. The

second reason is sustainability, where firms, apart from achieving its objectives, should also consider other issues such as environment and social factors in its operations. Thirdly, CSR is the company's licence to operate. Lastly, implementing CSR and considering ethical issues in its operations may improve the image of the firm that may also lead to the improvement of customers' awareness of the firm. The latter justification is also supported in the form of legitimacy gained by the firm, as a result of the good social behaviour of the firm (Chen, Patten, & Roberts, 2008).

The four justifications emphasise that CSR as a strategy, is a part of the effort of firms to face the non-market environment and, therefore, affects the firms' performance. Hillman et al. (2004) argues that a firm with a good history of contributing to social activities will get easy access to policy-makers and will often be considered by politicians. As a result, a firm's social activities (CSR) become a new form of corporate political action (CPA) and is not merely perceived as a synonym for business ethics and environmental policy (McWilliams, Siegel, & Wright, 2006). A greater reputation of the firm is an alternative source of competitive advantage and also a kind of differentiation of the company when compared to its competitors. As a result, it can increase consumer loyalty and productivity of its employees, which can affect the financial performance of the firm.

#### **2.4.5. Integrating Market and Non-Market Strategy**

The interest in the non-market strategy research stream is increasing, following the footsteps of previous research on market strategy. Non-market strategy, as a research field, has developed significant insights from various research streams about how firms strategically interact and shape their external environments (Lux et al., 2011; De Figueiredo, 2009; Shaffer, 1995). However, the trend in strategic management field studies separate the components of market and non-market independently (Holburn & Vanden Bergh, 2014). Unsurprisingly, recent studies reflecting the complementarities have begun to emphasise the relationship of non-market strategy and market strategy of the firm and the need to integrate both strategies (De Figueiredo, 2009; Peng, Wang, & Jiang, 2008; Hillman et al., 2004; Baron, 1995a). As implied by the resource dependency theory (Pfeffer & Salancik,

1978), both market and non-market environments are critical sources of resources and legitimacy for firms.

An integrated strategy is composed of the firm's strategy which integrates both the market and non-market environments, as a result of strategic analysis beyond traditional market analysis (Baron, 1999). Initially, market actors are likely to implement non-market strategies as complements to market strategies, according to varying degrees in a particular institutional environment (Baron, 1995a; North, 1990a) and the actor's ability to exploit both market and non-market opportunities. Non-market analysis and strategy formulation are then merged into an overall strategy process, as an action to address and defend against market forces and realise market alternatives.

Both market and non-market strategies, therefore, are important to achieve a firm's objectives and to generate superior performance (Baron, 1997). Apart from empowering itself with market strategies and market competitiveness, a firm must also develop its ability to deal with governments, non-governmental organisations and interest groups. Moreover, the competitive landscape of firms has transformed dramatically, where some dimensions of the non-market environment and the growing power of non-market actors have changed the fundamental role of the business model (Doh & Lucea, 2013). It has been argued by scholars that non-market strategies can be employed to reveal market opportunities (Baron, 1999; North, 1990a). Porter and Kramer (2006) especially highlighted CSR as an integral part of non-market strategies that can broadly be employed as a source of opportunity and innovation, as well as supporting competitive advantage of the firm if integrated with market strategies. Collaboration with interest groups and NGOs is also a combination of market and non-market strategies, which is certainly necessary for enhancing the legitimacy of the firms' commercial activities (Boddeyn & Doh, 2011). Therefore, the more closely tied a social issue is to a firm's market activities, the greater the opportunity for the firm to use its available resources to gain more benefit for both the firm and society.

Non-market strategies can also help firms manage their regulatory environment to seek support for creating regulatory barriers for competitors' entry to

the market (Baron, 1997) or to mitigate regulatory risks in merger and acquisition proposals (Holburn & Vanden Bergh, 2014). Shaffer (2000) supports the integration of market and non-market strategies with the empirical findings related to the particular organisational structure and the degree of diversification. In doing so, a firm may employ tactics such as lobbying (De Figueiredo, 2010, 2009), advocating and coalition with interest groups (Hillman & Hitt, 1999) or even financial contributions to political actors (De Figueiredo & Edwards, 2007).

The attempts of a firm to integrate both market and non-market strategies also attracted scholars to investigate it from the role of boundary-spanning functions (Yuanqiong et al., 2007). According to this function, integrating market and non-market components could be classified into two categories, namely buffering and bridging (Blumentritt, 2003; Meznar & Nigh, 1995). Buffering and bridging are the notions that indicate the level of integration of both market and non-market components by firms in their interaction with the external environment (Meznar & Johnson, 2005). Despite the differences, buffering and bridging activities are not mutually exclusive (Yuanqiong et al., 2007). While the buffering strategy is more enterprise-oriented, where a firm tries to either resist or control environmental changes, bridging strategies refer to the internal adaptation that is implemented by firms to changing external situations. In terms of implementation, the buffering strategy of the firm might be in the form of contributing to political action committee (PAC) and lobbying. A firm can also be perceived as implementing a bridging strategy when the firm adopts legitimate managerial and technical practices related to green products.

Despite the growing attention on integrating market and non-market strategies as a new perspective in the strategic management stream, the extant literature is conceptual in nature and lacks empirical evidence on what integration is and how it could occur (Xie, Li, & Xie, 2014). While firms in most developed nations have legitimate ways to pursue non-market strategies in influencing public policy and regulatory framework, the question for many firms in emerging economies, particularly for the smaller firms, is how systematically they can integrate and combine market and non-market components (Deng et al., 2010).

## **2.5. Non-Market Environment in Emerging Economies**

The non-market environment in many emerging economies is different from those in advanced economies in various ways (Hitt, Ahlstrom, Dacin, Levitas, & Svobodina, 2004). Many emerging economies are characterised by the institutional environment that lack market-supporting institutions with extensive information asymmetries (Xu & Meyer, 2012). Moreover, as Hoskisson et al. (2000) pointed out, the government and society are stronger with their influence in emerging economies than in most developed markets. However, Hoskisson et al. (2000) cautioned that the group of countries in emerging economies is heterogeneous and therefore, one must be careful not to over-generalise.

Emerging economies also often lack adequate infrastructure (Kim, Kandemir, & Cavusgil, 2004; Kim & Lim, 1988) and established political institutions (Hoskisson et al., 2000). In addition, most of the emerging economies have high levels of intervention from the government on the business environment (Dieleman & Boddewyn, 2012; Fan, Wei, & Xu, 2011) along with weak financial market development and other resources (Fan et al., 2011; Peng & Heath, 1996). Such a situation can lead to uncertainties surrounding the business arrangements of firms (Xu & Meyer, 2012; Choi, Lee, & Kim, 1999), as well as the need to focus mostly on network-based behaviours (Dieleman & Boddewyn, 2012; Boddewyn & Doh, 2011; Fisman, 2001) so as to deal with many subjects. In short, there are imperative differences both in the organisational and behavioural aspects of firms in emerging economies, that make them different from firms in more advanced economies (Fan et al., 2011). Emerging economies, therefore, provide a mixture of opportunities and risks for the firms.

### **2.5.1. A Weak Institutional Environment**

The available literature about firms in emerging economies is mostly related to the literature on the economics of corruption, which indicate a weak institutional environment context (de Jong et al., 2015, 2012). Emerging economies such as China, Brazil, Indonesia and Thailand are characterised by institutional environments with a lack of market supporting institutions (Zhou & Peng, 2012) and even weak

and immature institutions (Peng, 2003) that undermine markets (Meyer, Estrin, Bhaumik, & Peng, 2009). In addition, many studies noted that many countries in emerging economies are characterised by unclear business-government interaction and low levels of law enforcement (Wu, 2005; Schwarz, 1997; Irwan, 1989).

The two main market-supporting institutions which predominantly determine the economic performance of firms are property right and contracting institutions (Acemoglu & Johnson, 2003). Property right institutions symbolise the protection and commitment from the government, in which the absence of such institutions offers opportunities for the officials to engage in state predation activities such as extracting rents and collecting bribes (Hellman, Jones, & Kaufmann, 2003; Henisz & Zelner, 2003; North, 1990b). The lack of legal support to contracting institutions may also encourage economic behaviour from officials or public-private expropriation hazards, which may discourage firms from getting involved in productive economic activities (Li & Zhang, 2007).

The problem with the two institutions is that it may encourage firms to substitute weak formal institutions with private arrangements instead, in order to reduce hazards. Private arrangements also refer to 'institutional substitution', which may compensate for the missing formal market-supporting institutions through building personal networks or political connections (Peng & Zhou, 2005). Another form of private arrangement is when the owner of the firm selects to enter politics by becoming a member of a political party (Li, Meng, & Zhang, 2006) or seeking elections to be in top office (Bunkanwanicha & Wiwattanakantang, 2009), so as to gain economic incentives. The incentives can then be used to secure access to the financial resources and information regarding government contracts and other supporting programs, in order to alleviate expropriation hazards (Hellman et al., 2003).

In well-functioning legal systems, economic gains from political connections are not expected, since it may be risky both legally and politically for the firms and non-market actors (Goldman et al., 2009). In weak systems on the other hand, institutional voids may allow both firms and non-market actors to extract economic

rents and therefore shape the political behaviour (Hillman & Hitt, 1999; Hillman & Keim, 1995) and performance of the firm (Kim & Li, 2014; Faccio, 2006).

### **2.5.2. Institutional Transitions**

Institutional transitions are “fundamental and comprehensive changes introduced to the formal and informal rules of the game that affect organisations as players” (Peng, 2003, p. 275). Many emerging economies experienced transitions of political power from one administration to the other, which may affect the performance of the firm if the firm relied on the political connection to one administrative power (Faccio, 2006; Fisman, 2001). The transformation in the business environment in emerging market institutions may produce and alter the business strategy that fits with the new context (Dieleman & Sachs, 2008; Peng, 2003). Another dimension of institutional transition is the greater and broader effect of the government on the operations of the firm, which may affect the strategic decision-making process (de Jong et al., 2015). A good question to ask here is, “how do firms interact and cope with such delicate environments, particularly in emerging economies?”

In emerging economies, with the uncertainties surrounding the business environment and frequent transformations in the regulatory and legal framework, relational strategies is the leading strategy that is implemented by firms (Peng & Luo, 2000; Peng & Heath, 1996). Apart from lowering transaction costs, the actions also enable firms to pursue their objectives (with the advantage from public policies) (de Jong et al., 2015) and reduce the uncertainties caused by regulatory changes (Bonardi & Keim, 2005). Relational strategies are even referred to as a unique type of entrepreneurial capital that leads to a better performance of the firm (Fan et al., 2011; Peng & Zhou, 2005; Peng & Luo, 2000).

However, since continuous transformation is one of the main characters of emerging economies, the strategic choices of a firm should not be static. Peng (2003) argues that in institutional transitions, firms may need to switch strategies from relational to arm’s length transactions. Thus, this illustrates that even in developed markets, relational strategies also play a crucial role in the success of

firms in achieving their objectives. While interaction and building personal relationships between firms and regulatory entities are mostly on a voluntary basis in most developed markets, in many transition economies, such relationships are not just arbitrary but even compulsory (de Jong et al., 2015). The decision-making process in a firm faces a greater challenge with the institutional voids and the lack of formal legal and regulatory frameworks (Peng & Heath, 1996), where each level of government institution has its own discretion on administrative and license issues.

Given the uncertainties and constant challenges from institutional voids, organisational capabilities and the institutional capital are very important in a firm's process of strategic formulation. Building a personal relationship with the government in institutional transitions require these three capabilities - technical, social and personal. The combination of technical capabilities, along with personal networks and social capital, will help a firm manage its cooperative relationship with the government and other regulatory officials.

### **2.5.3. Informal Institutions**

Research on business-government interactions have concentrated mainly in more stable economies (Li et al., 2012; Yuanqiong et al., 2007; Wright et al., 2005; Peng, 2003), with large enterprises as the object of the studies (Bengtson et al., 2009; Gao, 2006). In other words, most of the studies only examined business-government interactions using theories developed in the context of well-established countries, which may not properly explain the phenomena in most emerging markets (Barron, 2010). In addition, most of the research in this area examined mainly multinational corporations (MNCs), particularly from an international business perspective, where the firms must interact with the home country's government. As argued by Barron (2011), the national culture and character may affect many aspects of life, including business interactions with other parties. Expanding the argument from Coen, Trumbull, Coen, Grant, and Wilson (2010), the current literature leads us to the condition which lacks the micro-theory of business-government interaction, specifically, the micro-theory that captures the business-government interaction in emerging economies, which explains the motivations and strategic choices by the firms. Therefore, an understanding of business-government interaction, particularly

from emerging economies, will help us improve efforts in theorising the non-market concept.

Although much is already known about how managers need to understand different cultures based on its operation areas, there are only limited efforts to reveal the local context of business-government interactions. As suggested by Shaffer and Hillman (2000), the future research of this topic should disaggregate non-market actions, given the different environments that are faced by the firms. In addition, Peng (2003) and Yuanqiong et al. (2007) argue that the institutional transition in emerging economies offers new perspectives in terms of strategic choices, which can help us practically understand the behaviour of the firm under a certain context.

Some scholars argue that the behaviour of the firm and how the firm adapts to its cultural environments is largely a rational process (Dacin, Ventresca, & Beal, 1999). However, this assumption is not entirely applicable in emerging economies, due to the condition that many firms face more information asymmetries (Xu & Meyer, 2012). The firms in emerging economies are also subject to more complex informal constraints.

Motivational considerations related to the cultural environment are also affected by the conceptions of culture, which may come as norms and values (Meyer & Rowan, 1977) and overlap with rules and schemas. Another different conception may characterise culture as constitutive and predominantly regulative. Culture, therefore, provides us with clear categories and understanding, which enables us to engage in economic and social actions. In addition, culture also helps us clearly identify norms and conventions that guide the actions (Dacin et al., 1999). To achieve these objectives, firms are required to acquire cultural capital. Cultural capital refers to “a subset of cultural resources (from those broadly available in a societal culture) and capabilities to manipulate them that are internalized by the firm and are deployed in its value-creation strategies” (Dalpiaz, Rindova, & Ravasi, 2010, p. 180). The knowledge and knowing-capability of cultural movements, as well as socio-cultural trends, are examples of cultural capital that may help firms in capitalizing its capital and achieve their objectives. While regulatory elements have been discussed as important factors that shape the behaviour of a firm, there is a

growing recognition that cultural cognitive frameworks are also important in providing deeper foundations of institutional forms (Scott, 2008a).

#### **2.5.4. Government as a Major Stakeholder**

Apart from the weak institutional environment, the business environment in most emerging economies is characterised by transitional phases which may reflect the need for different strategic implementation from firms. Several scholars emphasised that for such unique characteristics, different perspectives of strategies are needed, including building political connections (Bengtson et al., 2009; Hadjikhani et al., 2009; Faccio, 2006). However, as emphasised earlier, unique contexts and characteristics should be regarded as an important consideration, prior to the implementation of a strategy (Li et al., 2012).

Previous research on business-government relationships emphasised the low quality of market-supporting institutions as the primary factor that makes a firm choose a non-market strategy (Zhou, 2013). In addition, many studies noted that the economics of corruption are closely related to emerging economies, such as Indonesia, where the institutional environments are characterized by business-government collusion interactions and low levels of law enforcement (Wu, 2005; Schwarz, 1997). However, several studies argued that even in the western developed economies with advanced institutions, political connections are equally important (Bengtson et al., 2009; Goldman et al., 2009; Hadjikhani et al., 2009). Also, corrupt environments do exist (Wu, 2005), as firms also actively attempt to influence the decision-making processes (Deng et al., 2010).

The competitive environment (market environment) faced by a firm is often shaped by the government with enormous power and regulatory facilities. The power of the government is even greater in less developed markets, where market actors often face a lack of transparency and high interventions (Peng & Heath, 1996). Governments have the ability to alter the market environment through regulations, and therefore, public policy can become an important determinant of firms' behaviour (Baron, 1995b; North, 1990a). In most emerging economies, the government also holds the power to allocate strategic factor resources through

governmental projects, and therefore firms need a unique strategy such as political ties with government officials in every level (representing a managerial resource).

Given the prominent position of the government and other political actors, firms tend to compete in building good connections with political actors. Hillman and Hitt (1999) argue that the success of a firm in a political arena and generally a non-market environment is dependent on how the firm can provide three incentives to political actors: financial incentives (campaign contributions), constituency building (votes) and information (through lobbying and providing supportive information for the political actors).

In emerging economies, while studies show that the lack of regulatory frameworks influences the current state of corporate governance (Haque, Arun, & Kirkpatrick, 2011), the lack of regulatory framework coupled with the poor development of market-supporting institutions also provide opportunities (Henisz & Zelner, 2010) for the firm to rely on personal relationships. This “institutional void” has frequently been cited as the reason for a firm to implement relational transactions and extensively use personal relationships (Peng & Luo, 2000). The government influences the market environment through many ways: antitrust regulation, social regulation, economic regulation, as well as through government sales (Hillman, Zardkoohi, & Bierman, 1999). The decision of a firm to diversify is often also influenced by its political connections, especially in emerging economies (Li et al., 2012). Relevant literature has also placed government sales as one of the main determinants of a firm’s non-market activity (Hillman et al., 2004; Pfeffer & Salancik, 1978).

## **2.6. Non-Market Strategies and Firms’ Performance**

Porter (1985) defined two types of competitive advantage: cost and differentiation advantages. Given the discussion before, we can categorize “cost advantage” as a part of the market strategy of the firm, while “differentiation” is a part of the non-market strategy of the firm. Since competitive advantage is a company’s ability to perform in one or more ways that competitors cannot or will not match, non-market strategies (political strategy and social strategy) therefore, involve

differentiation, whereby the firm can try to perform better than its competitors. Non-market strategies can also provide a competitive advantage by defending against rivals (Baron, 1995a, 1995b). In terms of creating market opportunities, non-market strategies can be useful in defending new entrant firms.

Bonardi (2011) sees the effect on a firm's performance in a situation where the political environment of the firm is characterized as a marketplace. It can be argued that the motivation behind the involvement of firms in politics is to purchase desirable public policies. Within a marketplace, the interaction between suppliers and demanders in the public policy arena is important for both sides. After all, as a supplier, the government needs to consider the society, while from the other viewpoint, businesses will consider shareholders and the objectives of the firms (Hillman & Keim, 1995). Thus, the political strategy implemented by a firm can influence the firm's performance (Oliver & Holzinger, 2008).

The discussion of performance implication as a result of implementing non-market strategies, particularly political strategies, could be divided into three general arguments (Rajwani & Liedong, 2015). First, studies that indicate the positive outcomes from the implementation of political strategies by the firm. In this scenario, positive outcomes might be in many forms, such as effective tax rate (Adhikari et al., 2006), government-revenues derived (De Figueiredo & Edwards, 2007), access of funds from government (Faccio, 2006) and easy access to debt financing from government (Faccio, 2010). Accounting data and other financial indicators are widely used to measure firm performance. Various financial indicators that used to measure the performance of the firm such as return on sales (ROS) (Hadani & Schuler, 2013), return on asset (ROA) (Imai, 2006; Peng & Luo, 2000), return on investment (ROI) (Mathur & Singh, 2011), accrual quality (Chaney, Faccio, & Parsley, 2011).

In a study using data from firms in Malaysia, for example, Adhikari et al. (2006) found that firms with political connections may pay lower taxes, as compared to firms without any political connections. Another study indicated that politicians being appointed as members of the board also triggers a positive impact on the stock market (Hillman, 2005). Furthermore, political connections (Leuz & Oberholzer-

Gee, 2006) result in easy access to financing as well as preferential treatment in trade agreements (Schuler et al., 2002).

Bonardi, Holburn, and Vanden Bergh (2006) also developed a model and tested it using the U.S utilities context. They found that non-market strategies can help firms in this sector mitigate non-market pressure and gain a favourable regulatory framework. In another study, Faccio (2006) found that when a member of top management, such as a senior manager, enters politics, the corporate value (stock prices) increases significantly.

In terms of social strategy, when employing corporate social performance (CSP) as the mediator, Yuanqiong et al. (2007) found that context-specific non-market strategies such as the *guanxi*-based strategy, a form of network-based strategy through personal connections, plays an important role in firms' performance through preferential environment and indirect economic improvement. The same argument from Porter and Kramer (2006) showed that there is a link between competitive advantage and corporate social responsibility (CSR). They also argued that CSR could be important for the company since it can help the company gain a competitive advantage. CSR is becoming more important nowadays since consumers are demanding more from firms. Customers are more attracted to companies that care about social issues such as poverty, global warming, air and water pollution, as well as energy consumption (Kotler & Caslione, 2009).

Paying attention to such issues is important since it also makes a firm's reputation "good" from the consumers' perspective. A better reputation could also be gained when a firm treats its employees fairly and maintains good relationships with its suppliers and partners. This fine reputation, both from the internal and external aspects of the firm, is an alternative source of competitive advantage. Moreover, it is a kind of differentiation by the company when being compared to its competitors. As a result, this can increase the consumer loyalty and productivity of its employees, which can affect the financial performance of the firm. In the long run, when the firm is able to maintain the situation, or when the firm can adapt to the changing environment, this can help the firm attain a sustainable competitive

advantage (Smith, 2007). It is sustainable as the advantage from CSR and the good reputation of the firm is hard for competitors to imitate.

In addition, as the study by Saiia et al. (2003) revealed, when a firm operates in a positive manner, not only does it benefit the community; but it also improves the performance of the firm. Cooperation with other stakeholders, particularly government and non-governmental organisations (NGOs) will help the firm reach its objectives. However, Smith (2007) also cautioned that to get a competitive advantage through social responsibility, the firm must be proactive in engaging with its many stakeholders.

The second group of studies on performance implications of implementing non-market strategies, demonstrate the negative effect of political strategies to firm performance. The association of the firm's performance with relevant political activity has been challenged by Hadani and Schuler (2013). They found that such an assumption is not supported by empirical data when they studied 943 firms from Standard & Poor's (S&P) 1500 database over an 11 year period. In addition, the study also found that any political action taken by a firm is a risky business decision and therefore, may negatively affect the market value of the firm. The findings support the previous research of some scholars such as Faccio (2006), that a firm involved in political activities and takes unwarranted risks may not be better off, as compared to a firm with less involvement in politics, particularly one which appointed politicians to enter the board of the firm.

Aggarwal, Erel, Ferreira, and Matos (2011) also found that "soft money" donations are negatively correlated with returns and record lower abnormal returns on acquisition announcements. In Slovenia, having political connections, as well as politicians on the supervisory board, may lead to lower productivity and poor corporate governance (Domadenik, Prašnikar, & Svejnar, 2015). Chaney et al. (2011) also found that firms with political connection have poor accruals quality. In terms of social strategy such as philanthropy, Chen et al. (2008) found that there is no significant association between a firm's charitable actions and its performance. Instead, corporate philanthropy is a tool for the firm to gain legitimacy, rather than a tool to measure corporate social responsibility.

The third group of studies, despite the minority of this kind of studies, are studies that found neutral or mixed impact to firm performance. In this scenario, there is no significant impact resulting from the implementation of political strategies and non-market strategy, in general, to the firm's performance. Rajwani and Liedong (2015), for example, reported that few studies indicated that campaign contribution has no impact on the performance of the firm, while another study showed poor performance from the firm with political connection.

Despite the differences, the majority of the studies indicated the strong link between CPA and firm performance (Lux et al., 2011; Hillman et al., 2004), with particular emphasis on government impact on the performance of the firm. According to the survey conducted by McKinsey (2011) on "How business interacts with the government", government activities have an economic impact on a firm's performance. Since market strategies alone cannot handle the external environment of the firm, non-market strategies are needed to tackle the dynamics of the environment. In addition, many non-market issues come from market activities. Therefore, firms need to integrate both market and non-market strategies (De Figueiredo, 2009; Baron, 1995a). As a result, non-market strategies play an important role for a firm's performance, only when they are integrated with market strategies (Baron, 1999, 1995b).

Various arguments and empirical studies have indicated that scholars have not reached an agreement on the measurement issues of how firms' performance is affected by non-market strategies. Therefore, as suggested by some scholars (Hadani & Schuler, 2013; Lux et al., 2011), this mixed outcome outlines the lack of evidence and the requirement to employ different variables and constructs, as well as other performance metrics in future studies. Nevertheless, the above argument does not neglect the importance of political activities, particularly in regulated industries, where the position of the government in the political environment is recognised as critical (Hadani & Schuler, 2013).

### **2.6.1. Performance Outcome-Measurement Variables**

Firm performance has been a focus by scholars in the corporate non-market strategy stream (Lawton, McGuire, et al., 2013). Studies in this stream were conducted in various industries with different levels of competition and regulatory environment. The majority of the studies reported strong links between non-market strategies, particularly political strategy, with the performance of a firm (Lux et al., 2012; Oliver & Holzinger, 2008; Hillman et al., 2004). However, there is no agreed variables or constructs on how to measure performance outcomes. There are two possible reasons that lead to the disagreement among scholars in measuring the impact of political strategies to firm performance. Hillman et al. (2004) cited the difficulty in measuring political strategies, and secondly, the difficulty in isolating the effect of political strategies on performance.

Rajwani and Liedong (2015) categorised three general outcomes of firm performance as the basis for defining constructs and variables for measurement. They are stock performance, operating performance and policy performance. Stock market performance can be measured from the stock markets condition when politicians are appointed to corporate boards (Hadani & Schuler, 2013; Hillman, 2005), or the effect of news of politicians health to the firm's market value (Fisman, 2001). Apart from secondary data sources which are mostly in the form of financial indicators, some studies also use measurements that based on self-reporting approach. Yuanqiong et al. (2007) used attributes such as innovativeness, long-term investment values, responsibility to the community and the environment to measure social performance. To measure firm economic performance, they used accounting variables such as growth rate of profits, growth rate of market shares and growth rate of sales in the last 3 years.

Accounting data are also used to measure operating performance. Various constructs were used to measure profit such as return on asset (ROA) (Peng & Luo, 2000), return on investment (ROI) (Mathur & Singh, 2011), returns on sales (ROS) (Hadani & Schuler, 2013), and accruals quality (Chaney et al., 2011) are used to give a broad picture of the performance implication of the firm. Employing financial indicators from accounting data may come with drawbacks. It can lead the

researcher to get misleading information since it cannot portray intangible capital (e.g., personal relationship, political knowledge) perfectly (Hillman, 2005).

The third category of outcomes is policy performance. This kind of performance is not widely measured in non-market strategy impacts, with only a limited number of studies that measures the performance of firms in the policy arena. There are two possible reasons for this condition as argued by Hillman et al. (2004) that, first the difficulty in measuring political strategies, and secondly, the difficulty in isolating the effect of political strategies on performance. Examples of variables used to examine this type of outcome are voting patterns (Liebman & Reynolds, 2006), lobbying effects on particular regulation (Mathur, Singh, Thompson, & Nejadmalayeri, 2013; De Figueiredo & Edwards, 2007; De Figueiredo & Kim, 2004), and government bailouts (Faccio, 2006).

Apart from the three categories of outcomes above, some scholars offer new paradigms in measuring firm performance as a result of political strategy implementation. Instead of using financial performance indicators, some studies also use non-financial performance such as capability in product development and knowledge development in the firm (Hadjikhani & Thilenius, 2009; Hadjikhani et al., 2009). These indicators are expected to offer new perspectives on firm performance by exploring long-term growth and survival of the firms. These measurement indicators also discuss the non-direct effect of political strategy on firm's performance.

The discussion above reflects the difficulty or scholars' various perspectives in measuring the performance of a firm. The complexity of measuring performance is even greater in the context of emerging markets (Farashahi & Hafsi, 2009; Hoskisson et al., 2000; Peng & Luo, 2000) and small and medium firms (SMEs) (Blackburn, Mark, & Thomas, 2013; Kusumawardhani, 2013; Halabi, Barrett, & Dyt, 2010). Several factors that contribute to the complexity of measuring performance are lack of reliable financial and accounting systems (Farashahi & Hafsi, 2009), the lack of knowledge and resource to create accounting reports (Halabi et al., 2010) and the unavailability of financial data, especially for small firms (Kusumawardhani, 2013; Tang & Tang, 2012). As a result, studies on small firms' performance are

mostly conducted using subjective measures on the basis of managers' perception which serves as reliable proxy to capture actual performance (Peng & Luo, 2000).

Subjective measurements, especially in the study of small firms, usually used comparison with some base performance (e.g., previous year's performance) as the basis for assessment. The comparison usually related to the growth of profit, market shares and sales (Yuanqiong et al., 2007). Firms may be asked about the performance of the firm compared with the previous performance, with major competitors and with other firms in the same industry (Runyan, Droge, & Swinney, 2008).

Another study from Blackburn et al. (2013) utilised three main measures to assess the performance of small firms, namely, employment change, turnover change and profitability. While the first two simply compare the factors with previous conditions, the last factor digs more on the perception of the small firm on how they think they perform compared to previous conditions. The use of subjective perceptual measurement was also supported by Dess and Robinson (1984). They offer to use perceptual measurement using return on asset (ROA) and growth in sales (last several years) as an alternative to reflect firm performance. In addition, they also argued that a researcher can also include broader societal, community and environmental dimensions to subjective perceptual measurement.

While objective measurement clearly offers more credibility with the advantage of reducing the common method bias, subjective measurement based on the perception of respondents and self-reported data has also been accepted by scholars in strategic management field (Farashahi & Hafsi, 2009; Dess & Robinson, 1984). In addition, the reliance on secondary data may contribute to the lack of theoretical development in the field of CPA (Lux et al., 2011) since most of accounting data may not perfectly capture intangible political capital (Hillman, 2005) and could be misleading (Rajwani & Liedong, 2015). Therefore, subjective measurement and even field research utilising interview and survey is needed to broaden our understanding of non-market strategies and its implication to the firm performance (Lux et al., 2011). Refining and evaluating non-market strategies utilising primary data is also helpful in providing significant information for firms in assessing their progress in achieving their objectives.

## **2.7. Theoretical Foundations in Non-Market Literature**

Several different theories have been employed by scholars to explain firms' strategies in the political arena, as well as why and how firms engage in political activities (Getz, 1997). Theories such as institutional theory (DiMaggio & Powell, 1991; North, 1990a; Meyer & Rowan, 1977), resources dependence theory (Pfeffer & Salancik, 1978), institutional-based view (Peng et al., 2008; Peng, 2002), resource-based view (Barney, 1991) and social capital (Deng et al., 2012; Butler & Purchase, 2008; Carlisle & Flynn, 2005) have helped to explain the political behaviour of firms. The following section will discuss briefly these theories since these are necessary for understanding the non-market strategies of firms.

In exploring the non-market strategy, the institutional perspective has gained momentum and drawn attention from scholars (Henisz & Zelner, 2003). Various labels on theorising institutions may be confusing, since most labels depend on the origin of the scholars' disciplines and perspective orientations (Peng, Sunny Li, Pinkham, & Hao, 2009; Hoskisson et al., 2000). Scholars in the institutional-based view stream theorise that firms could produce an altered business strategy to fit with the new context, as a result of the dynamics of emerging market institutions (Meyer et al., 2009; Dieleman & Sachs, 2008; Peng et al., 2008; Peng, 2003). "Institutional theory" is commonly referred to as sociology discipline of institutional literature (DiMaggio & Powell, 1983), while "institutional economics" is proposed by scholars from the economics field (North, 1990a). Peng (2002) offered a new label of "institution-based view" from the management scholars' perspective. Various labels based on different emphasis and perspectives were also noted by Doh et al. (2012). They differentiate three institutional perspectives on non-market research, namely new institutional economics, neo-institutional perspectives and national business systems.

For the purpose of this thesis, we believe that the institutional perspective, (as mentioned earlier) as well as institutional literature, are relatively the same, with only minor differences in focus and perspective. Therefore, we believe that all available labels on institutional literature feature the same characteristics. The institutional theory and its various labels underline the importance of the systems surrounding the

organisations or the external environments that can influence the social and organisational behaviour (Scott, 1987). Institutions are treated as independent variables, while strategic choices are the outcomes developed through dynamic interaction between the institutions and firms. Therefore, when formal institutions are unclear and less supportive, informal constraints become very essential in reducing uncertainties and providing guidance for the firms (Peng et al., 2009).

The resource-based view (RBV) considers firms to be bundles of resources (Barney, 1991) and the resource dependence theory (RDT) also considers firms' resources as very essential in their respective performance. The resources are also the starting point for firms to develop their future strategies (Pfeffer & Salancik, 1978). The basic assumption of resources in the RBV are that all resources must be rare, valuable and non-substitutable, which could be the sustained competitive advantage of the firm (Barney, 1991). However, it should be noted that this basic assumption of resources is not context-free. Priem and Butler (2001) argue that in one context, the resources may be valuable and hard to imitate, while in the other context of high velocity and dynamic competition, the resource may be easy to imitate and thus becomes non-valuable. The RDT on the other hand, also emphasises the importance of resources, not just those that create a competitive advantage, but those that focus more on organisational effectiveness—the ability to create acceptable outcomes and actions (Pfeffer & Salancik, 1978).

Despite the fact that the three theories are different in focus, they are closely related to similar key elements, namely resources and the institutional environment. RBV and RDT differ in how firms obtain the resources; RBV is internally-focused, while RDT is externally-focused (Hillman, Withers, & Collins, 2009). Being internally focused means that all resources are accumulated internally by the firm and therefore are imperfectly imitable, given the long-time process in its accumulation stage. On the contrary, the RDT posits that no organisation is self-contained and therefore, its resources depend on other organisations and how firms manage their inter-dependencies with external organisations (Pfeffer & Salancik, 1978). However, both RBV and RDT explain that firms can acquire complementary resources from their external environment to capitalise their existing resources.

In terms of the institutional environment, there is a key difference between institutional theory and RDT. Institutional theory perceives firms as passive entities that comply with institutional pressures, while in the RDT, firms are assumed to be more active in dealing with the external environment through adjusting power relationships and developing strategic responses (Oliver, 1991). The supporters of the RDT focused on various active behaviours of the firm to reduce uncertainty and mitigate the dependency on the external environment (Hillman et al., 2009) through various political activities such as lobbying, legal actions and personal services. The primary goal of these political activities is for firms to be able to shape the public policies that favour them (Hillman et al., 1999). In emerging economies where institutions are less predictable and government intervention remains extensive, firms depend more on the domestic institutions (Dieleman & Sachs, 2008). The ability of the firm to influence its institutional environment through political activities is a key resource that distinguishes a firm from its competitors and this therefore, becomes its competitive advantage (Hillman et al., 1999; Boddewyn & Brewer, 1994; Barney, 1991). One of the main managerial resources is political activity, such as building connections (Li & Zhang, 2007; Barney, 1991). This is particularly important in emerging economies, where the power of the government is superior and can interfere with business operations (Li et al., 2012; Peng & Luo, 2000).

To create political resources, firms have to develop good relationships with external and political actors, which encourages the establishment of valuable resources such as human and social capitals (Lester et al., 2008). While some scholars differentiate between the two (human and social capitals), we believe that both capitals intertwine with each other conceptually and empirically (Nahapiet & Ghoshal, 1998).

The acquisition and accumulation of social capital evolved from Bourdieu (1986) in his seminal work on the various forms of capital. Social capital is an umbrella expression to label resources that are embedded within social networks (Adler & Kwon, 2002). Moreover, social capital is defined by Nahapiet and Ghoshal (1998, p. 243) as, “the sum of the actual and potential resources embedded within, available through and derived from the network of relationships.”

Social capital has been extensively used to describe the success of organisations in mitigating the uncertainties and lack of regulative support in the form of personal service (Hillman et al., 1999) and other factors related to the dependency relationship (Getz, 1997). The breadth of social capital can also be reflected in the social ties, which in the context of international business are also critically important for firms (Corredoira & McDermott, 2014; Hadjikhani, Lee, et al., 2008). An example of a response from the external environment is the *guanxi*-based relationship, a form of network-based strategy through personal connections, in China (Sheng, Zhou, & Li, 2011; Zhu et al., 2007; Carlisle & Flynn, 2005). In a different context of the U.S firms, Lester et al. (2008) also found that firms benefit from former government officials' social capital (personal ties) when they are appointed as board members.

## **2.8. The Gaps**

The nature of non-market factors varies over time and is related to a country and its respective firms and sectors within the economy. In Asia and most emerging economies in general, non-market issues are closely related to the efficacy of business-government interactions. Government intervention, through various protectionist policies, has been actively used in many emerging countries to support firms' competitiveness (Aggarwal, 2001). While scholarly investigations on non-market issues is quite abundant in most developed nations, scholarly investigations on non-market issues in emerging economies are still limited (Yuanqiong et al., 2007; Gao, 2006; Wright et al., 2005). Also, the current studies on institutional environment in emerging economies focus only on the impact of institutional variation on organisations (Marquis & Raynard, 2015; Peng et al., 2008). There are differences both in the organisational and behavioural aspects of firms in emerging economies that make them different from firms in more advanced economies (Fan et al., 2011). Moreover, in emerging economies, there is a mixture of opportunities and risks for the firm.

Given the importance of non-market environments to the strategic decision-making process of the firm in emerging economies, several important questions arise. What are the characteristics of the non-market environment in emerging markets?

How do small firms, given their resource boundaries, deal with the non-market environment in emerging markets? What is the motivation behind the non-market decisions made by the firms?

This study examines these questions, while focusing on small and medium firms (SMEs—also referred to in this study as small firms) in Indonesia. Extensive studies focusing on SMEs have been conducted and research in this field has matured into a body with multiple sub-genres such as entrepreneurship, marketing, finance, and leadership (Gao, Sung, & Zhang, 2013). However, studies that focus on SMEs and non-market environments are rare. Moreover, most studies on SMEs tend to assume that the models derived from larger firms can be applied to small firms (Gilman & Edwards, 2008). As pointed out by Taylor (2006), it is important that SMEs or smaller firms are studied in their own right, in order to understand how and in what way they behave under non-market environments, rather than contrasting them with the ideal image of what small firms should do.

## **2.9. Summary and Conclusion**

In this chapter, the literature pertaining to non-market perspectives concerning business-government interactions was reviewed. The literature reviewed included generic research and current empirical results in the fields of non-market strategy and strategic management. This review revealed three things. Firstly, existing research focused mainly on developed regions, such as North America and Europe, while the non-market environment is also challenging for firms in many emerging countries (Dieleman & Sachs, 2008). Secondly, extant studies focused mainly on large firms or MNCs (Doh & Lucea, 2013), which neglect the conditions of the non-market environment faced by smaller firms. Thirdly, existing research refers mainly to the non-market strategies as a whole, which raises the question of whether the same strategy may be implemented by smaller firms. Furthermore, there is still an interesting but unknown issue in micro-level studies on what the motivation for non-market action is (Devinney, 2013), as well as how small firms deal with its non-market environment, especially in the context of emerging markets (Bengtson et al., 2009; Dieleman & Sachs, 2008; Hadjikhani, Lee, et al., 2008). Therefore, there is a need for further theory development (Ghauri, Hadjikhani, & Johanson, 2005).

In integrating insights from various perspectives and disciplines, this study recommends the use of context-based study in strategic management to enrich our understanding of organisational behaviour (Meyer et al., 2009). Context-based strategy is very helpful particularly because the nature of non-market factors varies over time and is related to a country and its respective firms.

The outcomes of non-market and political strategies of the firms have been measured in various ways employing different performance metrics. As a result, scholars report different outcomes from their studies. Most studies examine the performance from stock prices, as well as the operating performance variables such as ROA, ROI, and market share of the firm. Assessing non-market strategy and its relationship to the performance of firms have also employed social strategy.

Information obtained as part of this literature review has helped to narrow the research focus in this study, to an investigation of the non-market business environment in emerging economies, as well as non-market strategies implemented by firms and the motives for such practices.

Considering the importance of firms' institutional environment in emerging economies, this study focuses on the unique characteristics of the institutions and the distinctive actions taken by firms in dealing with non-market environments. The non-market environment in most emerging economies could be characterised by a weak institutional environment, institutional transitions that shaped the behaviour of the firms, the important role of informal institution, good understanding of culture and a major governmental role. Possible theoretical frameworks about how firms shape the institutional environment, as well as the importance of the size of the firms as an antecedent in determining the political behaviour of the firm were also discussed.

The next chapter will briefly discuss small firms in Indonesia, along with the institutional environment they face.

## Chapter 3

### **SMALL FIRMS IN INDONESIA**

#### **3.1. Introduction**

In this chapter, we review relevant empirical studies and the current condition of small firms in Indonesia. As Baron (2010) noted, to a certain degree, the non-market environment faced by a firm is context-specific. The non-market environment also depends on the institutions, culture and the interests of the organisations within the country (Scott, 2008b). Therefore, in examining the non-market environment faced by small firms in Indonesia, we need to understand the context and characteristics of the business-government interaction in Indonesia.

This chapter is organised as follows. Section 3.2 presents the business regulatory environment in Indonesia. It includes the discussion of elements that affect the institutional environment in Indonesia. Section 3.3 discusses decentralisation as a product of institutional change in Indonesia. This is followed by the discussion of small and medium firms in Indonesia in Section 3.4. In Section 3.5, a discussion of why the size of a firm is one of the important antecedents of non-market strategies taken by the firm is provided. Finally, Section 3.7 provides the summary of this chapter.

#### **3.2. The Business Regulatory Environment in Indonesia**

The 1997-1998 crisis and its aftermath brought an era of political change and reform to Indonesia. Starting as a financial crisis, the magnitude and complexity of the crisis later turned into more multi-dimensional and complex situations. Apart from the economic crisis, Indonesia also had to deal with social and political changes which affected the business environment. One of the major changes for the business environment was the political instability and uncertainty after the implementation of political reforms (*reformasi*) (Brodjonegoro, 2004; Van der Eng, 2004).

In the 1990s, following successful macroeconomic policy reforms that supported political stability, the business environment in Indonesia became more conducive. The country opened up economic and business opportunities to the private sector, so as to hasten the development process. As with many East Asian countries, Indonesia also underwent a process of urbanisation and industrialisation. As a result, the contribution of agriculture as the primary sector to total gross domestic product (GDP) decreased by 35% during the 1967 - 2009 period. At the same time, the contribution of the manufacturing sector to the total GDP increased by more than 19% (Elias & Noone, 2011). Despite the economic growth and liberalisation of the foreign investment regime, various idiosyncrasies still occurred in the business sector in Indonesia (Aspinall, 2013; World Bank, 2012; Brodjonegoro, 2004; Van der Eng, 2004). The rampant corruption, military involvement in business and lack of good corporate governance initiatives indicated possible risks and challenges for firms. However, such risks were also accompanied by great opportunities for business enterprises. Various ways to mitigate risks have been explored and implemented by firms, including political patronage which involves establishing close ties with former President Suharto and his associates.

Under President Suharto, the groups that were advanced in economic activities were mostly his family and business colleagues (Dieleman & Sachs, 2008). Access to all political, military and economic elements was centrally controlled by Suharto and his family (Mackie, 2010; Schwarz, 1997). As pointed by (Dieleman & Sachs, 2006), “friendly capitalists”, who were competent and more importantly, willing to cooperate with the regime, benefited from the centrally controlled power and economic protectionism from Suharto. Chinese conglomerates such as the Salim Group, Astra International and Sinar Mas benefited immensely through investments, collaborative businesses and joint shareholding with the Suharto family (Chua, 2008). Even though many indigenous enterprises (*pribumi*) were also advanced in their political patronage, their control and dominance of the Indonesian economic share was not as successful as the Chinese enterprises (Tan, 2000). Indigenous enterprises also lacked the resources to collaborate with the Suharto family in raising funds and forming partnerships with the military, the main backbone of the Suharto regime (Chua, 2008; Dieleman & Sachs, 2006).

According to (Robison & Hadiz, 2012), the alliance of Chinese conglomerates and Suharto's political regime were bounded together by common strategic interests. For example, many organisational structures from Chinese businesses were designed to accommodate the Suharto family and his circle of friends as business partners or other top management posts. Designing such organisational structures was part of the Chinese conglomerates' strategy to survive in the Indonesian economic climate, given their politically weak position (Dieleman & Boddewyn, 2012). It was also a price that many Chinese tycoons "were willing to pay to maintain a stake in predatory, extremely profitable symbiosis with the state" (Chua, 2008, p. 8).

In 1997, when the Asian crisis took place, the weakness of the economic structure, where political connections drove the economy rather than fundamental instruments such as productivity (Fisman, 2001), hit Indonesia harder than other countries in Asia. In addition, the domestic trade regulations, ill-prepared banking system, lack of transparency and monopolistic environment during Suharto's reign, were mostly cited as reasons which made Indonesia more vulnerable to adverse external shocks (Fukuoka, 2012; World Bank, 2012; Basri & Eng, 2004). The Asian financial crisis, along with political tensions, was also the key factor that led to the collapse of the Suharto autocracy after 32 years in office (Mackie, 2010).

The transition from Suharto to his successors was followed by substantial political reform. Free and fair elections, the assurance of free press and release of political prisoners were examples of the policies that arose as a result of the political reform. The most important policies that influenced the business environment were the launching of the decentralisation process, which reduced the power of the central government.

### **3.3. Decentralisation**

A centralised government is often recognised as one of several burdens that slow down the development progress in many countries, including Indonesia. Prior to the decentralisation era, many development programs were created centrally in Jakarta by the central government and most of the programs were implemented in

Java. This led to a high welfare gap between and outside of Java. Given the intense centralist features of former President Suharto's regime, decentralisation (as a result of the political and social reform in the early 2000s) was believed to bring about promising benefits.

Decentralisation in Indonesia is commonly known as regional autonomy (*otonomi daerah*). Decentralisation is characterised by the dispersing of the central authority, which in the Indonesian case, was granted to two levels of local governments, namely the provincial, district (*kabupaten*) and municipal (*kota*) governments. An advantage of decentralisation is that delegating some authorities to local governments may increase public participation, transparency and ensure that public service is closer to the public (Hadiz, 2013).

Political and administrative decentralization was introduced through Law No.22/1999 on Regional Government and this was followed by the fiscal decentralization Law No.25/1999 on fiscal balance between the central and local governments. The central government then issued subsequent laws (Law No. 32/2004 and Law No. 33/2004 respectively) to improve many weaknesses in the previous laws, especially relating to the concept of decentralisation and public participation in the decentralisation process. One of the clear developments of decentralisation was the direct elections of the head of *Kabupaten* (districts) and *Kota* (municipalities) in 2005.

Under the decentralisation law, local governments can also exercise their rights to make laws on a wide variety of issues. However, this jurisdictional right was not used effectively due to the lack of legal drafting skills from many local governments, as well as the intention to produce more laws than what was needed (Butt, 2010). The lack of sufficient knowledge and resources made it harder for the local governments to produce sound regulations to create a favourable business climate. As a result, many local governments, along with local parliaments, created laws that contradict with other local and national laws. Extensive laws and the significant policy differences between districts and cities were also considered the main factors that brought about uncertainty within the business environment in Indonesia (von Luebke, 2009). As indicated in the first year of its implementation,

decentralisation laws require every local government to set new regulations to implement their new authorities. While small numbers of local governments successfully set new regulations to support their authorities, some others had difficulties doing so due to their lack of resources and capabilities.

Decentralisation provides greater autonomy for local governments to manage several authorities, which in the past was exclusively managed by the central government. The local budget proposals, recruitment of civil servants, local fees and charges, just to name a few, are the areas of authority of the local government. More authority meant more power to the local government. Direct elections also affected the business climate, with more local political actors involved, seeking support from their business actors. As a result, in the post-Suharto regime, political connections spread widely and are no longer merely related to the leader of the central government, but are now also linked to politicians and law-makers at the local level.

Fiscal decentralization comes with budgetary consequences. Many local governments, with their law-making powers, issued local laws primarily to increase their revenue through imposing more taxes (*pajak*), user charges (*retribusi*) and complicated licensing processes. Unfortunately also, many of the local laws were unclear, unnecessary and exploitative in nature (Butt, 2010), and as a result, caused high economic costs which affected the business actors (Brodjonegoro, 2004). High logistic costs resulted from uncertain custom clearance regulations and additional costs were incurred from the illegal collection or bribery of local government officials (Patunru, McCulloch, & von Luebke, 2012). In the past, such extra costs could be clearly estimated. However, the extra costs that are added to production costs in the decentralisation era are surrounded with uncertainties. Thus, the extra cost cannot be easily estimated (Brodjonegoro, 2004).

Unclear hierarchies and authorities between tiers of government (central, provincial and district governments) also create confusion for the stakeholders, particularly the business actors. According to the National Trade and Industry Chamber (KADIN), there were more than three thousand local regulations (*Perda-Peraturan Daerah*) that were not business-friendly and caused a high-cost economy (KADIN, 2013). In addition, in 2002 - 2009, 406 local regulations that conflicted

with higher-level laws/ policies were cancelled by the central government (Ministry of Home Affairs) (KEMENDAGRI, 2012). Several years later, the situation remained the same. From November 2014 until mid-2015, the Ministry of Home Affairs cancelled 139 local regulations (KOMPAS, 22/07/2015). Many of these local regulations were indicative of the ineffective and irresponsible services introduced by many districts in Indonesia, which may constrain domestic and international investments (von Luebke, 2009).

Political instability, the complexity of labour regulations and concerns for security that ultimately affects the cost of doing business also contributed to the uncertainties faced by the firms. In addition, ongoing changes of regulations, as well as the lack of law enforcement have become worse for business people and have affected their ability to cope with the numerous business regulations. There is no clarity on the local fiscal and business regulations and policies for business activities. Hence, many potential investors highlight a greater challenge from the local regulations, rather than the local economic potential in making their investment decisions (Brodjonegoro, 2004).

Decentralisation, apart from its benefits, has also created a complex and uncertain environment for private enterprises, due to the fact that they need to deal with multiple regulatory levels. While all firms are affected by the complexity surrounding the regulatory environment in Indonesia, this burden is even greater for small and medium enterprises.

### **3.4. Small and Medium Enterprises (SMEs) in Indonesia**

The definition of small and medium enterprises (SMEs) (also referred to in this study as small firms) is important, since the term can cause confusion and even constraints in policy implementation if each institution has a different classification and definition (Mourougane, 2012). We use the term 'small firms' to differentiate them from larger firms. However, to give a more detailed explanation in terms of size distinction, the criterion of the World Bank Enterprise Survey (World Bank, 2009) is commonly used in many studies wherein a firm size is defined by the number of employees; i.e., a firm with 5 - 19 employees is defined as a small firm,

while one with 20 - 99 employees is defined as a medium-sized firm<sup>1</sup>. In this study, both small and medium-sized enterprises are included and the number of employees is used as the criterion. We use SMEs and small firms interchangeably and only refer to them in the context of the formal sector.

The contribution made by SMEs to the economic development of many countries, particularly developing countries, has been widely acknowledged (Mourougane, 2012; Nichter & Goldmark, 2009; Berry et al., 2001). Many studies have emphasised the importance of SMEs in terms of their high proportion of overall business operations in various economies, as well as the contributions made by SMEs as providers of employment opportunities to economic development. In Indonesia, SMEs dominate the composition of enterprises in terms of proportion, even superseding large enterprises (Table 3.1). In addition, SMEs are also perceived as fostering a competitive environment with their large numbers within national economies, while having the ability to adapt to constantly changing business environments.

**Table 3.1: Composition of Indonesian Enterprises Based on Scale (2005-2013)**

Year	Enterprise Scale (in thousands)							
	Micro	Small	Medium	MSME	%	Large	%	Total
2005	45 217	1 694	105.4	47 017	99	5.02	0.01	47 022
2006	48 512	472.6	36.7	49 021	99	4.57	0.01	49 026
2007	49 608	498.5	38.2	50 145	99	4.46	0.01	50 150
2008	50 847	522.1	39.7	51 409	99	4.65	0.01	51 414
2009	52 176	546.6	41.1	52 764	99	4.67	0.01	52 769
2010	53 823	573.6	41.6	53 823	99	4.83	0.01	53 828
2011	55 206	602.1	44.2	55 206	99	4.95	0.01	55 211
2012	55 856	629.4	48.9	56 534	99	4.96	0.01	56 539
2013*	57 189	654.2	52.1	57 895	99	4.96	0.01	57 900

Source: Kementrian koperasi dan UKM (2009; 2012).

<sup>1</sup> There are several definitions and classifications of SMEs which vary across institutions and countries. The variables used to rank firms such as the number of employees, net assets and sales and investment levels. In Indonesia, the general term used is Micro, Small, and Medium Enterprise or MSMEs (*Usaha mikro, kecil dan menengah-UMKM*) and is used differently by various institutions and government agencies. It is even used as the name of a ministry -“The Ministry of Cooperative and MSMEs”. Micro enterprises are mostly informal and mostly in the agriculture sector. Also, they are usually located in rural areas. Medium enterprises comprise the smallest group of the MSMEs in Indonesia.

\* *Note: Estimated figures based on the latest available data.*

Table 3.1 shows the increasing number of total SMEs in Indonesia. SMEs in Indonesia account for almost 97% of all firms in all sectors. Meanwhile, Table 3.2 indicates the important influence of SMEs in the Indonesian economy in providing job opportunities, contributing to the non-oil and gas exports, as well as in alleviating poverty. From 2005-2011, SMEs make up more than 90% of the total workforce in Indonesia. Apart from employment creation, a huge number of SMEs also reflects the potential contribution of SMEs to the development of entrepreneurship, industry and the rural economy. During the financial crises in 1997-1998 and 2008-2009, SMEs played an important role in supporting the Indonesian economy. Not only did SMEs play a role through domestic activities, but they also provided employment opportunities (Mourougane, 2012) and contributed to value-adding, as compared to larger firms (Berry et al., 2001).

**Table 3.2: Indonesian Employment by Enterprises Scale (2005-2011)**

Year	Enterprises Scale (Millions)							
	Micro	Small	Medium	MSME	%	Large	%	Total
2005	69.96	9.20	4.41	83.58	96.80	2.71	3.15	86.30
2006	82.07	3.13	2.69	87.9	97.30	2.44	2.70	90.35
2007	84.42	3.27	2.76	90.49	97.27	2.53	2.73	93.027
2008	87.81	3.51	2.69	94.02	97.15	2.75	2.85	96.78
2009	90.01	3.52	2.67	96.2	97.30	2.67	2.70	98.88
2010	93.01	3.62	2.75	99.40	97.22	2.83	2.78	102.24
2011	94.95	3.91	2.84	101.72	97.24	2.89	2.76	104.61
2012	99.85	4.53	3.26	107.65	97.60	3.15	2.84	110.808
2013*	104.6	5.57	3.94	114.144	96.90	3.53	3.01	114.144

Source: Kementrian koperasi dan UKM (2009; 2012).

\* *Note: Estimated figures based on the latest available data.*

The Enterprise Survey conducted by the World Bank (2009) found that SMEs in Indonesia are more likely to pay a bribe as compared to the large firms. In addition, the survey also revealed that most SMEs seem to expect to bribe officials so as to obtain a license. Apart from the low level of law enforcement in Indonesia, such situations also reflect the less supportive environment for SMEs, compared to their larger counterparts. The World Bank (2009) found that small firms in

Indonesia need twice as many days to get an operating license, as compared to larger firms. Various intervention programs by the government to develop SMEs were ineffective, due to minimum comprehensive evaluation (Hill, 2001). A lack of coordination among government agencies at different levels with various SME-development programs also made the situation more complex for SMEs (Mourougane, 2012; Hill, 2001).

SMEs in Indonesia are mostly operating in the informal sector and are characterised by low value-added goods for the local markets (Tambunan, 2011). Compared with other leading Southeast Asian countries such as Malaysia, Thailand and Singapore, Indonesia has a heavy regulatory burden that influences the decision of SMEs to become formal or legally registered (Mourougane, 2012). Apart from less incentives for SMEs to become formal as compared to other regions, the complicated procedures and corrupt local authorities that informal businesses face (see Table 3.3) can hamper the formalisation interests of SMEs (Vial, 2011). In addition, being a formal institution does not stop the difficulty for SMEs, since they have to deal with labour regulations, local taxes, workplace safety and many other regulations as a result of decentralization.

**Table 3.3: Small Firms and Regulatory Environment (Regulation, Taxes and Business Licensing) in Indonesia**

<b>Indicators</b>	<b>Small firms</b>	<b>Medium Firms</b>	<b>Large firms</b>	<b>Indonesia</b>	<b>East Asia &amp; Pacific</b>
Days to obtain import license	n/a	11.8	10.0	10.5	16.4
Days to obtain construction-related permit	34.1	17.0	68.2	32.3	46.1
Days to obtain operating license	22.3	16.9	14.8	21.2	16.3
Senior management time spent in dealing with requirements of government regulation (%)	1.5	4.8	7.1	1.9	7.3
Firms are expected to give gifts in meetings with tax inspectors (%)	12.5	23.0	9.9	14.0	19.1
Firms are expected to give gifts to secure a government contract (%)	50.9	59.2	59.4	53.0	31.5
Firms are expected to give gifts to get a construction permit (%)	38.0	25.4	72.3	37.1	31.8
Firms are expected to give gifts to get an import license (%)	n/a	24.2	17.7	19.5	19.2
Firms are expected to give gifts to get an operating license (%)	25.2	29.5	26.0	25.9	17.7
Firms with bank loans/ line of credit (%)	16.5	27.6	47.1	18.2	40.4
Firms with a checking or savings account (%)	46.3	89.1	92.5	51.5	89.6
Firms formally registered at the start of their operations (%)	24.7	55.0	91.3	29.1	83.9

Source: World Bank Enterprise Survey, World Bank (2009). Retrieved from <http://www.enterprisesurveys.org/~media/GIAWB/EnterpriseSurveys/Documents/Profiles/English/indonesia-2009.pdf>

*Note: Size is defined by the number of employees: Small (1-19), medium (20-99)*

Table 3.3 above shows some of the enterprise survey indicators that signals the obstacles faced by firms from all levels. It also shows factors that may affect how firms deal with the challenging business environment in Indonesia. Some firms, for example, provide gifts to government officials to secure a construction permit and to secure an import license. The table indicates that business actors still face major administrative and financial burdens which represent serious barriers for small firms.

A study by the Regional Autonomy Watch (KPPOD, 2011) found that small firms were more negatively affected by regulations, since many of the regulations caused an increase in their transaction costs. Given their scale, small firms also had to pay more taxes and user charges per worker as compared to their larger counterparts. In addition, many small firm owners believed that the local government favoured large firms over them (KPPOD, 2011).

Despite the growth potential of SMEs in Indonesia, their performance is limited by a number of constraining factors. Some of these include the informality of operations (Zhou, 2013; Mourougane, 2012; Sari et al., 2008; Hill, 2001), ineffective support from the government (Berry, Rodriguez, & Sandee, 2002; Hill, 2001), lack of foreign market knowledge and experience (Bhasin & Venkataramany, 2010; Sari et al., 2008), lack of innovation and productivity (Mourougane, 2012), as well as uncertainty of the non-market environment (Marino et al., 2008).

The uncertainty caused by the lack of clear rules of interaction of businesses with political factors concerning local governments, the business environment, red tape and rent-seeking activities (Peng & Heath, 1996) can lead to a high transaction-cost economy for SMEs (Hoskisson et al., 2000). Some research studies have shown that institutional transitions in emerging economies offer new perspectives on strategic choices (Yuanqiong et al., 2007; Peng, 2003). A number of studies have highlighted the importance of implementing non-market strategies for small firms (Baron, 1995b) to deal with uncertainty. Non-market strategies include building political connections (Faccio, 2006; Fisman, 2001), lobbying (Lawton & Rajwani, 2011; Hillman et al., 1999), corporate social responsibility or philanthropy (Baron, 2007; Baron & Diermeier, 2007a) and business owners turning into politicians (Bunkanwanicha & Wiwattanakantang, 2009). Apart from the fact that such strategies can boost the performance of businesses and affect their respective values (Zhou, 2013; Deng et al., 2012; Faccio, 2006; Fisman, 2001), they might be the only choices available for these businesses to survive (Bengtson et al., 2009).

To sum up, SMEs in Indonesia are more affected by over-regulation and regulatory uncertainties when compared to their larger counterparts (Mourougane, 2012). Interestingly, based on the World Bank Enterprise Survey (World Bank,

2009), political instability is also one of the main constraints faced by businesses in Indonesia. However, it is worth noting that some improvements have been made through the One-Stop Service program and the nationwide introduction of a computerised system for company registration. These programs are expected to simplify the business licensing process in Indonesia, particularly for small firms.

Given the strategic position of small firms in the Indonesian economy and the complexity surrounding the operations of small firms in Indonesia, it is important to understand how they interact with the government in employing non-market activities. Despite the fact that firms, regardless of their size, display various managerial behaviours (Hadjikhani & Ghauri, 2001), the growing body of research in small firms has not sufficiently encapsulated the behaviour of small firms in non-market environments. Hence, this study fills this gap within the context of Indonesia.

### **3.5. Size Does Matter**

Research on the business-government interaction indicated that the size of the firm is one of the main antecedents that influence the level at which firms deal with their non-market environments. Hillman et al. (2004) and Lux et al. (2011) identified that in corporate political activity (CPA) literature, firm size is a part of a firm's political antecedents at the firm-level analysis. As mentioned by various scholars, the measurement gauge of a firm's size varies from sales, assets, market share to the number of employees.

While most empirical studies assess the size of the firm as an important antecedent, there is no clear explanation yet as to why size is a predictor of the political action of the firm. A compelling and practical argument is that larger firms are more visible, as compared to their smaller counterparts. Resource-based theories argue that a firm's contribution is mostly influenced by its resources (Barney, Wright, & Ketchen, 2001).

Hadjikhani and Ghauri (2001) argue that larger firms are more powerful as compared to small and medium firms in influencing policies. Larger firms also

provide more essential services to the government in its political activities. This is understandable since large firms have more resources (Lux et al., 2011; Hillman et al., 2004) that will affect their knowledge and commitment in the relationship (Hadjikhani, Lee, et al., 2008). Political knowledge refers to the know-how or understanding of the needs of political parties, which is important in maintaining the connection, as well as the knowledge about political decisions (Bengtson et al., 2009). Commitment, on the other hand, refers to the resources that the business actors have made in order to succeed in the relationship, which is used to deal with political organisations (Hadjikhani, Lee, et al., 2008).

Knowledge, as well as commitment dimensions, is important in the context of how firms organise their political initiative. Small firms, given their limited resources and bargaining power, are restrained to initiate a major political action (Bengtson et al., 2009). Small firms also often have limited choices when faced with rent-seeking attitudes from the government officials (Young, Ahlstrom, Bruton, & Rubanik, 2011). As a result, political tactics are only deployed when certain issues such as legislative requirements and any regulation-related matters arise. In implementing their political tactics, small firms often rely on the intermediaries in representing their concerns (Bengtson et al., 2009). On the other hand, larger firms may organise more structural tactics individually to target rules and regulations, in order to gain favourable treatment (Dieleman & Sachs, 2008).

The size of the firm is also important in the context of the political environment, since it is an indication of the preference for political involvement of the business actors. Rehbein and Schuler (1999) pointed out that apart from representing resources, the size of the firm also represents the political power that firms have. In other words, the larger the firm, the more stakeholders (voters) there are involved in the action and the more effects the government and politicians have to consider (Hillman et al., 2004). In the USA, firm size also influences a firm's resources and the condition by which they interact with the government, as well as the capabilities with regards to the level of lobbying (Drope & Hansen, 2006). In emerging economies, the size of the firm also influences its position as the target of bribery by government officials (Kuncoro, 2004). As a result, when faced with an

unstable institutional environment, small firms are more vulnerable than larger firms (Peng & Luo, 2000).

Cook and Fox (2000) however, indicated a different scenario as they found that small firms are more active as compared to their larger counterparts. Although a lack of resources mean that the smaller firms cannot match the larger firms' approaches, the latter has different patterns of how they engage in public policy processes. It should be noted that the result of such strategies are also affected by the level of the government which the firm deals with, as well as the issues related to the firm. Therefore, when small firms are affected by particular issues beyond their territories, they tend to form a collective action (Cook & Barry, 1995) and are forced to adapt to the political environment (Hadjikhani & Ghauri, 2001). Conversely, Hadjikhani and Ghauri (2001) also found that not all small firms are affected homogeneously but instead, they are affected based on the political issues, administrative commitments and connections to the political actors in the political arena. On the other hand, these varying factors may also become factors that bring small firms together as a homogenous group, which can then be employed to initiate a strategic decision, namely collective action.

### **3.5.1. The Role of Intermediaries**

Collective action is used by small firms through business association, so that their interests could be effectively represented. There are two main reasons for small firms to get involved in collective action through business association (Wilts & Meyer, 2005). First, collective action helps small firms exercise their influence in the industry and be aware of their position within the competitive map, through cooperation and acting collectively with their competitors. Second, small firms can gain expertise and information from acting collectively. This may be employed to improve the firm's individual performance.

According to Hillman and Hitt (1999), prior to the decision of acting collectively or individually, a firm should consider several factors such as industry concentration, government contract option and seeking import protection. Apart from these factors, another point to consider is the effort from all members of the

association to act collectively. As argued by Olson (1965), even though all firms have a common interest in engaging in collective action, in reality, there are no commonalities in sharing costs and efforts in pursuing collective action. Time perspective, therefore, is one of the common filters to accommodate the free-rider problem within the area of collective action.

Bengtson, Hadjikhani, and Pahlberg (2011) claimed that using the time perspective on the interaction of small firms within the political environment could be either short or long-term. The decision to use either of the two time perspectives would be based on the political factors. Given the limited resources of small firms, for the short-term approach, they tend to use *ad hoc* issue-related relationships, in which specific tactics would be implemented when the issue occurred. Long-term dimension on the other hand, has a tendency to reach a more general issue with more general political actors.

### **3.6. Chapter Summary**

The business environment in Indonesia has changed significantly as a result of the Asian financial crises that led to political and social changes. The implementation of decentralisation and the downfall of former President Suharto in 1998 made the business environment more complex and challenging. Political instability and uncertainty were due to unclear regulation, multiple state players and also additional costs that arose from illegal collection or bribery of local government officials. A positive impact of decentralisation resulted when some local governments became aware of the need to improve their regions and take the opportunity to implement good governance. However, decentralisation for business actors meant the opportunity for local governments to influence the local business climate. SMEs are one of the most affected sectors of the changing political landscape in Indonesia, particularly when the local governments can exercise their authority.

SMEs are commonly characterised as a significant source of employment and such is the case with Indonesia as an emerging market. SMEs are also the dominant firms' in many countries in terms of percentage composition, including in Indonesia.

However, this significant number does not make SMEs immune from uncertainties. Security concerns, excessive additional costs in licencing and administrative matters, labour problems and political instability are the main sources of the uncertainty faced by SMEs. Non-market strategies, such as building political ties and personal relationships with government officials, have become the choice for SMEs in dealing with changing environments. Apart from the fact that such strategies can boost the performance of businesses and affect their respective values, such actions might be the only choice available for these businesses to survive.

Extensive studies focusing on SMEs have been conducted and research in this field has matured into a body with multiple sub-genres such as entrepreneurship, marketing, finance and leadership (Gao et al., 2013). However, studies that focus on SMEs and non-market environments are rare. Moreover, most studies on SMEs tend to assume that the models derived from larger firms can be applied to small firms (Gilman & Edwards, 2008). As pointed out by Taylor (2006), it is important that SMEs or smaller firms are studied in their own right, in order to understand how and in what way they behave under non-market environments, rather than contrasting them with the ideal image or what small firms should do. In particular, identifying an economic, social and institutional context in Indonesia would be fruitful to seek an understanding of the non-market environment faced by SMEs in the country.

The next chapter will discuss the research method employed in this study, including the justifications for using the qualitative approach to address the research questions posed in this thesis.

## Chapter 4

# RESEARCH METHODS

### 4.1. Introduction

The objective of this chapter is to present and describe the methodological approach used in this research. This chapter attempts to describe the research design, beginning with a brief discussion on the research paradigm underpinning the research in Section 4.2. The chapter also explains qualitative inquiry as the research approach adopted for this study and the rationale behind the decision in Section 4.3. Furthermore, the use of grounded theory to generate substantive theory is explained in this section along with the case study approach and the decision to combine the case study approach with grounded theory. In Section 4.4, the selection of cases was provided, where the criteria used by the researcher in choosing the case studies to reach the research objectives was listed. It then followed by the discussion of how data were collected and also how the performance of the firm was measured using subjective perceptual measures in Section 4.5. Section 4.6 discusses the data analysis process applied, including details of the coding process, the steps involved in the coding process and how comparative analysis was used. This is then followed by Section 4.7, where the data analysis procedure is explained. In Section 4.8, the research site, as well as the focal industries in this study, was briefly discussed along with the reason for the decision. The chapter concludes with the steps that have been undertaken to ensure that methodological rigour has been adhered to, along with the ethical issues that have been considered in this study in Section 4.9 and Section 4.10 respectively.

### 4.2. Research Paradigm

The concept of paradigm is a common concept used in management research after the publication of Burrell and Morgan (1979) work, *Sociological Paradigms and Organisational Analysis*. Guba and Lincoln (1994) explained that a paradigm

influences the way in which knowledge is interpreted and studied. A paradigm is a systematic set of beliefs which is based on the approach of the researcher to the nature of the world and reality (ontology), the theory of knowledge (epistemology) and the application of method to study the reality assumptions (methodology) (Denzin & Lincoln, 2011; Lincoln & Guba, 1985). Paradigms can be characterised into five philosophical traditions namely positivism, post-positivism, critical theory, constructivism/ interpretivism and participatory (Lincoln, Lynham, & Guba, 2011). Table 4.1 shows how ontological, epistemological and methodological issues are addressed by these alternative inquiry paradigms.

As shown in Table 4.1, ontologically, both positivism and post-positivism share a common view that values, objectivism and reality should be separated from the researcher and should be value-free (Guba & Lincoln, 1994). Epistemologically, researchers employ scientific approaches through the application of the methods of natural science using quantitative methods to measure social phenomena. By doing this, researchers can draw generalizable inferences from mainstream deductive research (Eisenhardt & Graebner, 2007). The proponents of interpretivism on the other hand, believe that social reality may change, is influenced by multiple perspectives and is not merely a given (Locke, 2003). Therefore, the researcher needs to understand the subjective meaning of social reality and remain open for alternative perspectives (Leppäaho, Plakoyiannaki, & Dimitratos, 2015). Interpretivists believe in a dialectical process where researchers accept that people may have different means of events and objects which require the researcher to actively interpret it.

**Table 4.1: Basic Beliefs of Alternative Inquiry Paradigm**

<b>Issue</b>	<b>Positivism</b>	<b>Post-Positivism</b>	<b>Critical Theory et al.</b>	<b>Constructivism/ Interpretivism</b>	<b>Participatory</b>
Ontology	Naïve realism- 'real' reality but apprehensible	Critical realism— 'real' reality but only imperfectly and probabilistically apprehensible	Historical realism— virtual reality shaped by social, political, cultural, economic, ethnic and gender values, crystalized over time	Relativism—local and specific co-constructed realities  <i>Nature of social beings:</i> Voluntaristic and proactive	Participative reality— subjective-objective reality, co-created by mind and given cosmos
Epistemology	Dualist/ objectivist; findings true	Modified dualist/ objectivist; critical tradition/ community; findings probably true	Transactional/ subjectivist; value- mediated findings	Transactional/ subjectivist; co-created findings.  <i>Knowledge generated:</i> Idiographic, time-bound, context-dependant	Critical subjectivity in participatory transaction with cosmos; extended epistemology of experiential, propositional and practical knowing; co- created findings
Methodology	Experimental/ manipulative; verification of hypotheses; chiefly quantitative methods	Modified experimental/ manipulative; critical multiplism; falsification of hypotheses; may include qualitative methods	Dialogic/ dialectical	Hermeneutical/ dialectical	Political participation in collaborative action inquiry; primacy of the practical; use of language grounded in shared experiential context

*Note: Adapted from Lincoln et al. (2011) and Creswell (2007).*

To investigate and understand the nature of the non-market environment in Indonesia, this study employed the interpretive paradigm as the ontological perspective (Lincoln et al., 2011; Guba & Lincoln, 1994). Bryman (2012) argued that interpretivism asserts that social phenomena and their meanings are continually being accomplished by social actors. It implies that social phenomena are constantly changing and therefore, the “causal-functional” approach of natural science is not applicable, as argued by Max Weber (O’Gorman & MacIntosh, 2015). Interpretivism as a paradigm also provides opportunities for the voice, concerns and practices of research participants to be heard. As the research is focused on the nature of the non-market environment and actions taken by firms, the ontological assumption is aligned on the basis of realities being constructed by the firms under investigation. The interpretivist paradigm is thus suited for this study and consequently, these pre-suppositions are the foundations for designing the research strategies, data collection and the choice of methods utilised in this study.

### **4.3. Research Approach**

Given the complexity of the non-market environment, the author decided that it was more appropriate to conduct the investigation using a qualitative approach. The qualitative approach is a form of interpretive inquiry (Creswell, 2012). This approach is used to collect and understand human experiences and to discover the essential meaning of the problem-situation under the researcher’s investigation (Merriam, 2014). Qualitative research is also perceived as the best approach to study a particular subject in depth (Myers, 2013) and to uncover causal mechanisms through unconventional methods (Bluhm, Harman, Lee, & Mitchell, 2011), which may benefit both practitioners and policy-makers (Bloor, 2011). Myers (2009) suggested that qualitative methods offer the researcher a variety of options to analytically explore and approach various levels of analysis. It also provides multiple choices and the means to explore the complexity and depth of the phenomena with multiple perspectives (Creswell, 2012).

The same argument is shared by management scholars who argue that the output of qualitative research “may be of more relevance and interest to management practitioners than those of traditional methods” (Cassell et al., 2006, p. 163). In

addition, the qualitative research approach offers the means to identify general patterns relating to important questions in the field of strategic management (Bettis, Gambardella, Helfat, & Mitchell, 2015). It also offers holistic interpretations of realities beyond merely measured variables (Rynes & Gephart, 2004) and the understanding of the social processes in context (Denzin & Lincoln, 2011), which may improve the practical relevance of the findings (Barratt, Choi, & Li, 2011).

In this context, the qualitative approach is used to meet the objectives of the study; to identify the political and social antecedents in the non-market environment in Indonesia, as well as to explore and examine the nature of the non-market environment in Indonesia. Through qualitative research, this study can contribute insights and assist in the understanding of the non-market environment and strategies implemented by small firms in Indonesia, from the perspective of those experiencing the phenomenon (Bluhm et al., 2011). In this case, the qualitative approach allows the researcher to study a unique situation rather than to generalise data with the quantitative approach.

In this study, the managers' perceptions (obtained from interviews) are considered relevant to answer the research questions. In this context, as mentioned earlier from the assumptions of constructivist ontology, the study adopted an interpretivist paradigm as the appropriate epistemology (Lincoln et al., 2011; Guba & Lincoln, 1994). This epistemological position stems from the focus on human interpretation and meaning (Yin, 2009), which helps the researcher obtain the objectives of the study. In this case, the researcher needs to interpret and understand the realities presented by the participants, instead of merely measuring and explaining the realities. This process encompasses interviewing, analysing and writing of the case study — all of which are interconnected and not distinct phases of the process.

Interpretivism offers various scientific inquiry methods. Creswell (2012) identified five common qualitative research strategies, namely; narrative research, phenomenology, ethnography, case study and grounded theory study. Narrative research, sometimes also called as biography study, is a study that focuses on the stories of one or more individuals. Extensive information, as well as a clear

understanding of the participant, is required to capture the participant's experience. Phenomenology is a study that not only focus on the individual, but also on the experiences of the individual's lived experience of a phenomenon. This kind of study mostly focuses on what the participant(s) have in common. Unlike narrative studies, the objective of phenomenology studies is "to reduce individual experiences with a phenomenon to a description of the universal essence" (Creswell, 2007, p. 58). Participants, as objects of the study, particularly entire cultural groups, are also the focus in ethnographic research. Ethnographic studies are driven by the intention to describe and interpret the shared patterns of several factors (values, behaviours, beliefs) of a cultural sharing group through in-depth observations (Watson, 2011). A good understanding of the social-cultural system and cultural anthropology is a critical precondition in this approach. Case study, on the other hand, is an approach where "the investigator explores a bounded system (a case) or multiple bounded systems (cases) over time through detailed, in-depth data collection involving multiple sources of information and reports a case description" (Creswell, 2007, p. 76). Case study research may involve an individual, a program or a group as the unit of analysis. Meanwhile, the grounded theory approach moves beyond narrative study, phenomenology and case study. Apart from the stories and experiences, the orientation of grounded theory is also to generate or even to discover a theory through constant comparative analysis and theoretical sampling (Locke, 2003).

Given the nature of this study which requires an in-depth knowledge of the nature of the non-market environment in Indonesia and the experiences of small firms in dealing with the non-market environment in Indonesia, the grounded theory approach and the case study method are the most appropriate and most suited to this present research and hence, were then utilised in this study. A more thorough treatment of the grounded theory and case study approaches follows in Sections 4.3.1 and 4.3.2 respectively.

#### **4.3.1. The Grounded Theory Method**

Grounded theory has its roots firmly in Social Sciences, particularly Sociology (Goulding, 2002). It was devised by American sociologists, Barney Glaser and Anselm Strauss, during their research on patients with critical illness at the

University of California (Glaser & Strauss, 1967). The development of the usage of grounded theory can also be seen in the nursing field, where many studies benefited from the method; as it can help explain what happened (phenomenon), rather than simply describe the case (Benoliel, 1996). Recent studies also stated that grounded theory is a valid and useful method in management studies (Locke, 2015; Binder & Edwards, 2010; Fendt & Sachs, 2008; Locke, 2003; Goulding, 2002).

Since the initial development, the grounded theory method has diversified from both its initiators, as Glaser and Strauss disagreed on the meaning and procedures in implementing grounded theory. Creswell (2007) stated that there are three variations of grounded theory. First, the “classic grounded theory” or also known as *Glaserian* grounded theory which is associated with Glaser (1978). This version has its grounding in the original grounded theory work of Glaser and Strauss (1967). The classic grounded theory emphasised the concept of emergence, where data emerges from the coding procedure and is not forced (Glaser, 1998). The second, a systematic and structured approach from Corbin and Strauss (1990), is also known as *Straussian* grounded theory. Straussian proponents suggested that the coding paradigm needs to be verified using technical procedures, rather than merely comparative methods of analysis (Corbin & Strauss, 1990). The third version of grounded theory is the constructivist approach developed by Charmaz (2006). The latter version was developed as the refined version from the Glaserian and Straussian versions and emphasises that the theory is constructed rather than emergent.

Glaser and Strauss (1967) argued that a new theory could be developed by an interpretation from the actor who is involved in the “daily realities” through constantly and carefully paying attention to the contrast between “what is actually going on” in the substantive area. This can be reached especially when the researcher is not influenced by the knowledge acquired prior to the research. The proponents of Glaserian emphasised that “in grounded theory, we do not know until it emerges” (Glaser, 1992, p. 95). Straussian approach, on the other hand, does not emphasise the necessity to minimise the preconceptions. Instead, the approach even suggested that the preconceptions based on the literature and experience might “stimulate our thinking about properties or dimensions that we can then use to examine the data in front of us” (Strauss & Corbin, 1998, p. 44).

In this study, an early literature review was undertaken before data collection because firstly, it assisted the researcher in the development of the thesis proposal by understanding the current state of the art in the study area and thus, justify the decision to conduct the study. Secondly, the researcher also read literature on grounded theory methodology to understand clearly the method and review how other researchers conducted the grounded theory method practically. Thirdly, reading literature prior to the data collection and analysis phase aimed to identify gaps and the need for the study (Dunne, 2010; Heath, 2006). It also helped the researcher in addressing the concern of where the researcher's study resides within the field of management (Locke, 2003). However, as stated by Urquhart, Lehmann, and Myers (2010), any external idea derived from an earlier reading should not distract the researcher.

Apart from their divergences in philosophy and method, the three schools of thought have a fundamental agreement that grounded theory can be utilised to illuminate social process and associated behaviour (Annells, 1996). In addition, the contribution of grounded theory in the development of qualitative research is far more important than the epistemological discussion about the differences of grounded theory between each school of thought (Fernández, 2004).

The overall research design for this study follows the grounded theory approach developed by Strauss and Corbin (1998), as well as Corbin and Strauss (1990), since it provides a systematic procedures and approach (Creswell, 2007) for an elaborate process (Lehmann, 2010a). Such clear guidelines for data analysis is useful for the novice researcher (Heath, 2006; Heath & Cowley, 2004) to construct grounded theories in a consistent manner (Kendall, 1999). The Straussian approach also allows the use of existing literature relevant to the research topic (Dunne, 2010).

The general rationale for choosing a qualitative approach for this study, particularly the grounded theory method, is that it was seen as the most appropriate methodology. Moreover, it is most appropriate in the context of ontological and epistemological reasons, as the study is expected to explore the nature of non-market environments in emerging economies. Adapting suggestions from Locke (2003),

there are five reasons for the researcher to choose the grounded theory method combined with the case study approach for this study.

*Enables research objectives to be achieved.* The main objectives of this study are identifying the nature of the non-market environment in Indonesia as an emerging economy, as well as the non-market strategies implemented by firms in Indonesia. The aim of grounded theory is “to explore basic social processes and to understand the multiplicity of interactions” (Heath & Cowley, 2004, p. 142). The case study also serves as a means to investigate a contemporary phenomenon within a real-life context, with the support from multiple sources of evidence (Yin, 2009). Therefore, the combination of the grounded theory method with the case study could be utilised in exploring the experiences of small firms in dealing with the non-market environment in Indonesia. It is also suitable to understand the nature of the non-market environment (core phenomenon) and the antecedents that caused this phenomenon (causal conditions) from the participants’ experiences and perspectives (consequences) (Creswell, 2007). The adherence to the procedural steps demanded in the grounded theory method helped the researcher to formulate a substantive theory which is another objective of this study.

*It captures complexity.* Strategic management, which consists of non-market strategy, is very complex. The complexity stems from the environment where factors such as social, political and technology may also affect the decision-making process. Such complexity requires a comprehensive understanding. As such, the grounded theory style can help the researcher capture such complexities, since the method helps the researcher explore participants’ experiences and perspectives (Locke, 2003). Furthermore, the exploration can help the researcher reveal thoroughly, what is happening in practical life (non-market strategies) at a particular time (non-market environment) and at a particular context (Locke, 2003). As argued by Corley (2015, p. 2) that grounded theory is a “useful approach in studying organisational phenomena particularly those involving change”.

*Systematic procedure.* Charmaz (2006) argued that the grounded theory method consists of systematic, yet flexible guidelines for collecting and analysing qualitative data. Unlike most strategies of enquiry, data collection and analysis in

grounded theory is done simultaneously. A non-linear process in grounded theory also advocates the systematic rigour and thoroughness that helps the researcher reveal unexplored phenomenon, such as why the firm implemented a particular non-market strategy.

*Interpreting experiences.* Parry (1998) noted that central to the grounded theory method is the identification of a basic social process, which can then be used to explain the social phenomenon under investigation. Given the experience and perspective offered by the participants in the study, grounded theory was chosen to help the researcher seek the meaning of the action taken by each firm in response to the non-market environment. Grounded theory can also help the researcher explain the patterns from the phenomenon and clarify the process of the implementation of non-market strategies by the firms in Indonesia, as these areas are currently unexplored.

*Data management.* The grounded theory method was chosen for this study because of its suitability to manage qualitative data (Fendt & Sachs, 2008; Glaser & Strauss, 1967), as well as the fact that it offers a logically consistent procedure in the data collection and analysis stage (Charmaz, 2006). The grounded theory method also provides the means to analyse the relevance of the data related to the study (Glaser, 2008) and the applicability of the findings to be generalised to other substantive areas (Fendt & Sachs, 2008).

#### **4.3.2. The Case Study Approach**

Case study has been accepted and has become one of the popular and relevant research strategies in business and management research for decades (Piekkari et al., 2009; Cassell et al., 2006). Case studies have made a critical contribution in terms of theory building in many areas in management studies (Barratt et al., 2011). The adoption of case study in business and management studies can be traced back to the long tradition of teaching business to use real-life cases. Adapting real-life cases to the teaching process in business and management classes is very popular since it presents complex business issues in real-life dimension (Päivi Eriksson, 2008).

According to Yin (2009), a case study is a particular strategy that allows a researcher to conduct an in-depth investigation of a program, an activity, a process or one or more individuals. In the case study research, an issue is explored through one or more cases within a bounded system (Creswell, 2007). As a strategy for qualitative empirical research, a case study is very relevant in the field of management and organisation since it allows “understanding the dynamics present within single settings” (Eisenhardt, 1989, p. 533).

According to (Yin, 2009), using case studies is the preferred strategy to facilitate the answering of the “how” and “why” questions, when the researcher has little control over events and when the focus is on contemporary phenomena in a real-life context. Moreover, case studies are one of the preferred methods of research in the evolving business context. In addition, case studies assist in unfolding business and social processes (Eisenhardt & Graebner, 2007). Case studies are also used to study the social life and experience of an individual or group through systematically gathering enough information about a particular person, social setting, event or group (Berg, 2004).

Flyvbjerg (2006) pointed out that even though case study is a popular research strategy in many disciplines, there are still misunderstandings about case study that may undermine its credibility. These misunderstandings mostly relate to generalizability, tendency of generating hypothesis and the difficulties of developing general prepositions (Tsang, 2013). Dubois and Gadde (2002) also found that some case studies rely on statistical generalisation and has also stronger reliance on theory.

To avoid such misunderstandings, Cassell and Symon (2006) pointed out that case study, and qualitative studies in general, should be taken seriously at the first instance. Yin (2009) suggested that the researcher needs to select design and type of case study that will be conducted carefully. The types and design of case studies may guide the overall study objective. Case studies are also “necessarily exploratory in nature” to answer the problematic challenge of its generalizability (Tsang, 2013, p. 11). In addition, an exploratory case study may help the researcher to understand how a phenomenon occurs and to understand how organisational dynamics work (De Massis & Kotlar, 2014). Eisenhardt (1989) also argues that employing multiple cases

along with overlapping data analysis and collection may help the researcher in theory development. In addition, utilising multiple data sources such as interviews, focus groups, observation, archival sources and survey as means to collect primarily qualitative data can enhance the credibility of case study results (Barratt et al., 2011). Utilising multiple methods in collecting data can also be treated as an effort for “triangulation” and, therefore can help the researcher in producing meaningful results (Bluhm et al., 2011).

Given the exploratory nature of our research, case study analysis was also employed as part of the approach along with grounded theory. By doing so, we expect to systematically analyse from the case to mid-range theory (Eisenhardt, 1989) or by utilising perspectives of empirical phenomena with the specific context (Yin, 2009). Case studies are useful to explore and investigate real-life phenomenon and help to produce deep understanding about the phenomenon. We expect that such approach can help us avoid the “taken for granted” paradigm which leads us to less reflection of the study as some previous research on SMEs (Blackburn & Kovalainen, 2009). By doing this, we will need to overcome curiosity regarding case study and draw conclusions from the case (Eisenhardt & Graebner, 2007). Therefore, we are giving more attention on social and economic phenomena as an important element of theory building (Blackburn & Kovalainen, 2009).

#### **4.3.3. Combination of Grounded Theory and Case Study Approaches**

Lehmann (2010b) pointed out that traditionally, case study research followed positivist model of theory testing in controlled studies. This is different with grounded theory which tends to follow naturalistic approach of ethnography and interpretation. In case study research, for example, the role of literature is essential to verify the theoretical framework (Yin, 2009). In grounded theory, on the other hand, the role of literature merely is to create theoretical sensitivity in the data analysis process to help the researcher generate concepts and guide the researcher toward what to do next (Corbin & Strauss, 1990; Glaser, 1978; Glaser & Strauss, 1967). Therefore, utmost care must be considered in combining case study and grounded theory method. Fernández (2004, p. 47) proposed that in doing so, the researcher “must clearly specify which methodology is driving the investigation”.

In this study, the grounded theory is used as the overarching methodology and is also used as the research basis customised to the case studies (Fernández, 2004; Whiteley, 2004; Strauss & Corbin, 1998). Theoretically, there are similarities between grounded theory and case study research. For the context of this study, grounded theory is viewed as a research design and data interpretation style that is blended with the case studies' research designs. As argued by Locke (2003, p. 24) "the grounded theory style of handling and interpreting data may be incorporated into case studies". In particular, grounded theory was used as the basis in collecting and analysing data from the case study. The principles of the grounded theory method such as systematically collecting data, theoretical sampling and constant comparisons, were used throughout the case studies. Such "systematic combining" is helpful particularly for theory development, where theoretical framework, fieldwork and case analysis develop simultaneously (Dubois & Gadde, 2002). As pointed by Krueger, Mellat Parast, and Adams (2013), grounded theory enables researchers to investigate complex problems through broader research questions which help the researcher in theory development. Therefore, despite such differences, case study method with a more systematic approach can be blended with the grounded theory perspective with its informative aspect (Lehmann, 2010b).

Recent scholars highlighted the success of the combination of grounded theory with case studies (Binder & Edwards, 2010; Fernández, 2004; Locke, 2003; Lehmann, 2001; Taber, 2000). One argument to support the decision to combine grounded theory and case studies is that in investigating social and organisational contexts, the grounded theory method is consistent with an interpretive paradigm of case studies (Urquhart et al., 2010; Eisenhardt & Graebner, 2007). Lehmann (2001) also pointed out that grounded theory method can be utilised and designed to meet the requirement of what constitutes a good case study.

Moreover, case studies are "exploratory" and "descriptive" in nature and are thus, well-suited for this study. On the other hand, grounded theory's systematic data analysis procedure and techniques such as the constant comparative process and theoretical sensitivity coding steps advances the description of the cases. For the context of this study, grounded theory therefore facilitates the better understanding of the non-market environment faced by small firms in an emerging market.

For this reason, seeking theory grounded from case study data has strengths compared to other strategies, due to the creative insights in the process of study and the close connection between theory and data (Eisenhardt, 1989). Since the topic of non-market strategy is quite broad, this study was designed to be exploratory, which helps in clarifying and understanding the issues concerned. An exploratory study is a valuable means of finding out “what is happening; to seek new insights; to ask questions and to assess phenomena in a new light” (Robson, 2002). The principal ways of conducting exploratory research include a search of the relevant literature and conducting interviews. It is believed that newly found insights might demand a revision of the research problem and conclusion as the research progresses.

#### **4.4. Selection of Case Studies**

One of the frequently cited challenges for theorising from case studies is related to case selection. However, as argued by Eisenhardt and Graebner (2007), the focus should not be about the representation of the case to the population. Instead, they suggest that given the aim of the case studies is to develop theory, theoretical sampling is more appropriate. Consistent with grounded theory methodology (Glaser & Strauss, 1967), theoretical sampling was employed in conjunction with purposive sampling throughout the data collection and analysis processes.

Identifying politically connected firms or companies which are implementing non-market strategy is difficult as the firms might hide their political connections as much as possible (Imai, 2006). To simplify this, the researcher firstly collected data regarding the firm, if its members (Founder, CEO or directors) are active politicians, as well as the exact political positions that they hold. Publications such as government reports, election committee report and also news reports were chosen to identify the political figures that were connected to the firms.

Identifying firms that have connections to the government through government contracts was done through snowballing sampling, which comes from the participants of this study and also via discussions with several key figures in the region, particularly journalists and NGO activists. As discussed earlier in the

literature review (Chapter. 2), the firms that fulfil and rely heavily on government markets usually implement corporate political strategy as its non-market strategy.

In addition, during the interview period (January 2013 - April 2014), there were two political events that were held in the province. Firstly, an election for the governor position, which was held on 22 January 2013. In this election, apart from the incumbent, there were two other candidates, the current Mayor of Makassar and the head of the Sinjai district. Secondly, the election for the Mayor of Makassar city was held on 18 September 2013. For this election, there were ten candidates. Also, the current Mayor did not participate as it was the second period of his position.

The two events above made it difficult to find participants who were prepared to share their insights regarding the topic of the research. Even though the latter election was held after the interview phase, most of the potential participants remained reluctant to be involved in the study. Apart from the sensitivity of the issue, business people are always worried that they will be targeted by the political candidates; targeted in the sense that the particular candidate will think that certain firms support the opposite candidate instead. However, most business people chose not to show their support in active ways. As a result, it took the researcher more time to build up trust between the researcher and the potential participants. In the middle of the process, several potential participants refused to participate without providing a reason.

Prior to the interview process, the researcher sent a consent form and information sheet regarding the study. While letter for interview request was made in Bahasa, consent form was created in English first and then translated into Bahasa. The english version of the consent form was submitted for ethics review and approval from the supervisors. The translation process was done by the researcher and clarified by two research colleagues from Curtin Business School and Hasanuddin University for validation and consistency.

As indicated above, the process of gathering information on the business-government relationship in South Sulawesi was to some extent very challenging. To ensure that the participating firms would have rich data about the political

environment and the firm's strategy to be involved in the environment, a list of criteria for selecting respondents were used. It was expected that this would help the researcher make objective decisions. Based on the literature, the following criteria were formulated and used for choosing respondents for this study:

1. The case firms satisfied the grounded definition of "smallness". The definition of 'small' used in this study was based on Law No. 20/2008 for Micro, Small and Medium enterprise (SME).
2. The case firms were located in Makassar as the capital city of South Sulawesi, so it can be easily reached within daily travelling distance.
3. The case firms had been operating for a minimum of five years.
4. The case firms' owner/ director/ founder is an active politician, a government official or has a close relationship with a politician or a political party, OR;
5. The case firms reflect government sales dependency.

#### **4.5. Data Collection**

Following a series of discussions with journalists, NGO activists and research colleagues in Makassar prior to the collection process, the researcher identified and contacted 45 individuals to participate in the study. Prior to the interview process, consent forms, as well as formal letters of interview request, were administered to all individuals. Several potential respondents declined to participate, while other respondents postponed the initial time for the interview.

In the first phase of the data collection process, following the assurance of confidentiality, the researcher interviewed five SMEs owners. After the coding and initial data analysis process at the first stage of data collection, it was then decided that another stage of data collection was needed. Since the grounded theory concept of theoretical sampling (Corbin & Strauss, 2008) guided the interview process, additional information are needed to clarify certain emerging concepts. Additional information was sought through additional interviews which lead to another stage of data collection.

The second data collection stage involved ten more participants. The last data collection stage involved 12 participants. All interviews were conducted by two research assistants. The research assistants are postgraduate students at Hasanuddin University Makassar who have been trained by the principal researcher and were involved in the first two data collection stages. During the last stage of the interview, the principal researcher communicated regularly with the research assistants.

In total, the study used data interviews from 27 participants, which can be divided into three general categories, namely business actors, government officials and NGO activists. The researcher believed that by following such procedures, it can accurately reflect the situation where the same phenomenon is studied by multiple sources (Yin, 2009; Eisenhardt, 1989). Each participant represents different firms or institutions. These participants were assumed to have a good overview of their entire firm or institution, as well as be involved in the decision-making process related to the non-market environment. For the business actors, the author selected firms from three different industries, namely the hotel, government contractor and advertising industries, respectively.

The characteristics of the firms, as well as other non-firm informants are shown in Table 4.2. As agreed between the researcher and the firms' participants, all information that may directly be linked to the firm was made anonymous. Therefore, all names or initials are pseudonyms (using code PAR#), as can be seen in the table below.

**Table 4.2: Characteristics of Participants**

No. of Emp.	Firms'/Institutions' profile			Participants' Profile	
	Name/Industry	Years in Industry	Position	Age	Initials
93	Hotel 'AI'	19	Owner	42	PAR1
35	Hotel 'JJ'	23	Director	40	PAR2
30	Advertising 'AN'	35	Director	33	PAR3
55	Contractor 'YN'	30	Director	34	PAR4
25	General trading 'FD'	6	Director	35	PAR5
55	Contractor 'BL'	9	Director	40	PAR6
10	Contractor 'HH'	20	Director	56	PAR7
52	Contractor 'LG'	25	Director/ Head of Business Assoc.	53	PAR8
15	General trading 'DM'	10	Director	56	PAR9
50	Medical Equipment Provider 'AW'	11	Director	39	PAR10
10	Contractor 'BA'	25	Owner	70	PAR11
8	Contractor 'MS'	5	Owner	59	PAR12
8	Advertising 'MS'	6	Director	29	PAR13
50	Contractor 'AR'	7	Director	-	PAR14
15	Supplier 'AM'	11	Director	-	PAR15
8	Contractor 'YH'	14	Owner	-	PAR16
50	Advertising 'NH'	24	Director		PAR17
6	Contractor 'FI'	12	Owner	35	PAR18
8	Advertising 'AA'	10	Owner	35	PAR19
20	Contractor 'SD'	19	Owner	51	PAR20
5	Advertising 'IF'	13	Owner	37	PAR21
100	Hotel 'AT'	30	Owner	52	PAR22
-	Hotel 'AS'	8	Director	45	PAR23
-	Irman Yasin Limpo		Head of Trade and Industrial Agency,	46	NON1
-	Trisnode		Acting Head of Local Revenue Office, Makassar City	48	NON2
-	Syamsuddin Alimsyah		Director of Legislative Watch Committee	40	NON3
-	Amiruddin PR		Editor of Celebes Online	40	NON4

In terms of data collection, an in-depth semi-structured interview was chosen since it helps the researcher acquire more information from the participants. A general interview guide was developed prior to the interview to help the researcher conduct the interview thematically, despite the fact that the interview was intended to be conversational (Bryman, 2012). Interviews were started with open ended questions such as, “Please tell me about your company”, “Please tell me about yourself”, “What are your company’s market strategies”, “Do you have non-market strategies, what are they”, and “Do you think by doing this strategy you get more sales and government contracts”. Follow up questions were directed by answers provided by the participants. The full guide of open ended questions during the interview is provided in Appendix B at the end of this thesis.

The interviews were carried out with the unstructured questions (Corbin & Strauss, 2008) relating to the non-market environment faced by small firms in South Sulawesi. Such an approach has been recognised as particularly valuable when used to address sensitive issues. It is also useful when the researcher accesses the real experiences of the participants in dealing with the non-market environment in South Sulawesi. Following the pattern suggested by Strauss and Corbin (1998), earlier interviews were kept open-ended and broad. The subsequent interviews were more directed by emergent themes arising from earlier interviews and data analysis. All interviews were recorded using a digital recorder. Word processor software was used to do the transcription, which was then imported to NVIVO 10, a text-based computer-assisted program to store and manage the study data.

All interviews were conducted at a location and time that was most convenient to the participants. The interviews ranged between 45 to 90 minutes. Some interviews were held at coffee shops and restaurants, while others were conducted in the participants’ offices. When the interview was conducted in the coffee shops and restaurants, the researcher paid the bills and ensured that the participants did not need to pay for any expenses during the interviews.

All interviews were conducted in Bahasa Indonesia and then translated into English. The interviews were audio taped and transcribed. The transcripts served as the primary sources of data in the data analysis process. In order to ensure that the

translation was correct, we double checked the translation result with two other research colleagues. These two research colleagues served as the translation moderator (Nes, Abma, Jonsson, & Deeg, 2010). The first research colleague was an Indonesian that also a PhD student in Curtin Business School. Another translation moderator is a lecturer at the department of Management in Hasanuddin University Indonesia. The reason to choose the translation moderator was that both research colleagues were trained in qualitative research and has a close working relationship with the researcher. After completing all transcripts in Bahasa, the researcher then translated them into English. All English version of the transcripts then submitted to the translation moderators for clarification as part of collaborative work to bridge the language differences (Welch & Piekkari, 2006). Final check was conducted with clarifying all the translation result with one of the colleague at the language centre in Hasanuddin University. The interview data was complemented with a range of secondary data (statistics, government reports, news reports, web page information) that was publicly available, to help us ensure the reliability and construct validity and also served as a means of triangulation.

#### **4.5.1 Measurement of Firm Performance**

As mentioned earlier in Section 2.6, majority of the studies conducted on non-market strategies emphasised the strong link between non-market strategies, especially political strategy, and firm performance (Lux, 2008; Oliver & Holzinger, 2008). However, there is no single set of agreed variables or constructs used by scholars in measuring firm performance related to the implementation of non-market strategy. Rather, various indicators have been suggested in the literature. Hillman et al. (2004) argue that there are two factors that cause difficulties in reaching an agreement on common performance measures: the first is the nature of political strategy which reflects the complexity making it hard to measure performance; and second is the difficulty in isolating the effect of political strategies on performance. The situation is even more challenging in the context of emerging markets and small firms (Hoskisson et al., 2000; Peng & Luo, 2000). This issue is also confounded by many factors such as the lack of reliable accounting system, limited access to publicly available financial data, and even reluctance by the managers to provide their financial statement, especially the small firms.

In this study, firm performance was evaluated using subjective measurement, where the perception of managers of small firms was used to reflect firm performance. The reasons for employing subjective measures are as follows: firstly, there is no publicly reliable data available recording the performance of the small firms and secondly, even if the participating firms in the study kept their own data, they were reluctant to provide the data to the researcher. As discussed in Section 2.6.1, subjective perceptual measurement in the topic of firm performance is acceptable if objective measures are difficult to obtain (Dess & Robinson, 1984).

During the interview, participants were asked about their perception on the performance of the firm. The question asked from the participants include: “How did your firm perform this year”, “Did you get more contracts this year than in previous years”, “Do you think you are selling more products this year compared to last year”, “How do you think your performance is compared to other firms in the same industry?”.

#### **4.6. Data Processing and Coding**

In the grounded theory method, coding is the central action that is used for analysing the text and subsequently interpreting and judging by the researcher (Strauss & Corbin, 1998). Conceptual abstraction and reintegrating data as a theory takes place during the coding process. Corbin and Strauss (1990) proposed three layers of coding process that is rigorous and defined by technique, but still remaining flexible in certain circumstances. The three coding processes are open coding, axial coding and selective coding.

In this study, the purpose of coding is to generate theory for the case and not for validation (Whiteley, 2004). As a result, during the coding process, the researcher occasionally identified concepts using literary terms, or the terms that are commonly used in the literature of the field of study. For example, the term “non-market” has been used in this study regularly. This was influenced by the reading of the literature in the field of study. The use of literary terms in this study does not mean that the perspective of the researcher will be contaminated by the literature and will thereafter influence the analysis, as brought up by Glaser and Strauss (1967). Instead,

the literary terms will help the researcher to elaborate from existing theories, rather than directly or unconsciously test the hypothesis (Suddaby, 2006). As suggested by Heath (2006), knowledge from the literature prior to the study is important to identify the significance of the study, as well as to gain familiarity with the literature.

The next step is axial coding, where the researcher links categories to their sub-categories. In this stage, the categories are refined through examination and then compared and contrasted with other categories. By doing this, the researcher sought to understand the phenomenon of the categories and how it happens. During the axial coding process, the researcher also sought any details and contributing factors that are related to the categories such as organisation details or regulations. Major categories, as a result of continued examinations to the sub-categories, were tested in order to confirm or refute them. Hawker and Kerr (2007) suggested that in order to gain more insight from the process, the researcher should ask further questions and examine the available data.

The final step is selective or analytical coding, where the researcher tries to integrate and refine the categories from theoretical perspectives and subsequently develop the theoretical scheme. The theoretical scheme or core category can be drawn when a category is mentioned with high frequency and is well-connected with other categories. In this process, the core category is used as the thread for the study in integrating all aspects of the emerging theory.

The formal process of coding in this study began shortly after the first interview had been conducted. Inductive reasoning was used as a guideline for the data analysis process and grounded theory. In total, 215 codes (Appendix B) emerged from the interview transcripts during the initial coding process. NVIVO 10 (see Figure 4-1) was used to help with the management codes at this stage. It allowed the researcher to not only code the data, but also to rename and merge existing codes without disrupting the rest of the codes.

The screenshot shows the NVivo software interface. On the left, there is a 'Nodes' pane with a tree view containing 'Nodes', 'Relationships', and 'Node Matrices'. The main area displays a table of nodes with columns for Name, Sources, References, and Created On. The nodes are organized into two main trees: 'Node\_TREE\_1\_Institutional Environment' and 'Node\_TREE\_2\_Nonmarket'.

Name	Sources	References	Created On
Node_TREE_1_Institutional Environment	12	34	25/03/2014 11:30 AM
Complex Situation	10	18	11/03/2014 10:07 PM
Business Govt-Relationship	7	16	6/11/2013 11:14 AM
Insufficiency of Formal Institutions	0	0	4/06/2014 8:28 PM
External Conditions	0	0	4/06/2014 8:30 PM
Industry Characteristics	0	0	4/06/2014 8:32 PM
Stiff Competition	0	0	4/06/2014 8:33 PM
Market Imperfection_NEW	0	0	3/07/2014 1:48 PM
Political Embeddedness_NEW	0	0	3/07/2014 1:55 PM
Node_TREE_2_Nonmarket	11	28	25/03/2014 11:32 AM
Non-Market Actions	0	0	11/08/2013 3:27 PM
Social Strategy	19	37	11/08/2013 3:26 PM
Type of Strategy	10	31	11/08/2013 3:30 PM
Bribe	9	29	11/08/2013 11:37 PM
Relationship With Officials	13	35	11/08/2013 11:51 PM
Politician as Businessman	1	2	5/11/2013 11:26 PM
Lobbying	12	18	5/11/2013 11:43 PM
Businessman as Politician	4	8	6/11/2013 9:52 PM
Hospitality	9	13	27/05/2014 9:00 PM
Partnering or Subcontracting Project	6	13	27/05/2014 2:10 PM
Network	5	10	5/04/2014 12:45 AM
Philanthropy	2	4	24/06/2014 9:29 AM

**Figure 4.1: NVIVO Was Used to Manage Data during the Study**

The structure and organisation of categories in the open coding process was altered several times due to coding inconsistency and labelling ambiguity. In the following excerpt from an interview transcript (Table 4.3), the process of initial or open coding is shown. In the open coding process, the codes were more descriptive and multi-dimensional so as to identify what was happening in the data. The coding process also avoided the over-consideration of relevance (Glaser, 1978) and therefore, the researcher coded as many codes as possible. Common themes or issues were identified using line-by-line analysis and sometimes with labels that involved conceptually labelling responses, phrases or words taken directly from the participants' own words. During the process, coding consistencies were checked and rechecked using coding rules that were also revised several times. The same process was implemented to other interview transcripts.

**Table 4.3 Example of the Initial Coding Process**

Interview Transcript	Open Coding Framework
<p><i>We have more regulations now compare to the past 10-15 years. But again, the problem is usually in the implementation and law enforcement. For business, I think the most important thing is stability and clear of regulation implementation. We have ASEAN free trade agreement in 2015, and the government has to help the business to anticipate this, [PAR #2].</i></p>	<p>Over-regulation, Problem in regulation, Confusing Regulation, Law Enforcement, Regulatory Efficiency, Challenge for the future, The importance of the government for the competition</p>
<p><i>Look, they have already decided which firm wins the contract even before the bid invitation is announced. Our main problem is the low level of law enforcement. If you think about this, you can get frustrated, [NON #2].</i></p>	<p>Lack of Transparency, Law Enforcement, Frustration surrounding firms</p>
<p><i>Generally, you have to deal with all levels and treat them as an important part of your network. Top officials must be very important since they are the one who make decisions. For low level officials, we usually give them cigarette or small souvenirs to show our grateful, [PAR #3].</i></p>	<p>Government problems, Complicated matters with the government, Lobbying, Non-market actions, Hospitality, Bribe</p>

The categories that emerged from the open coding process were then sorted non-hierarchically into a range of categories and themes that were derived from the research questions. This was done through identifying commonality with words and phrases. To identify patterns of meaning and similarity of issues, each category from the initial coding process were constantly compared and grouped together in the axial coding process (Corbin & Strauss, 2008). Each category was also assessed to check for overlapping and similarity and was then merged together, resulting in a reduced list of categories (Table 4.4). Even though open coding and axial coding are two distinct stages, in practice, the researcher continuously alternated between the two (Corbin & Strauss, 1990). Memos, diagrams and relevant literature were used during the open and axial coding processes to check for accuracy and wider applicability.

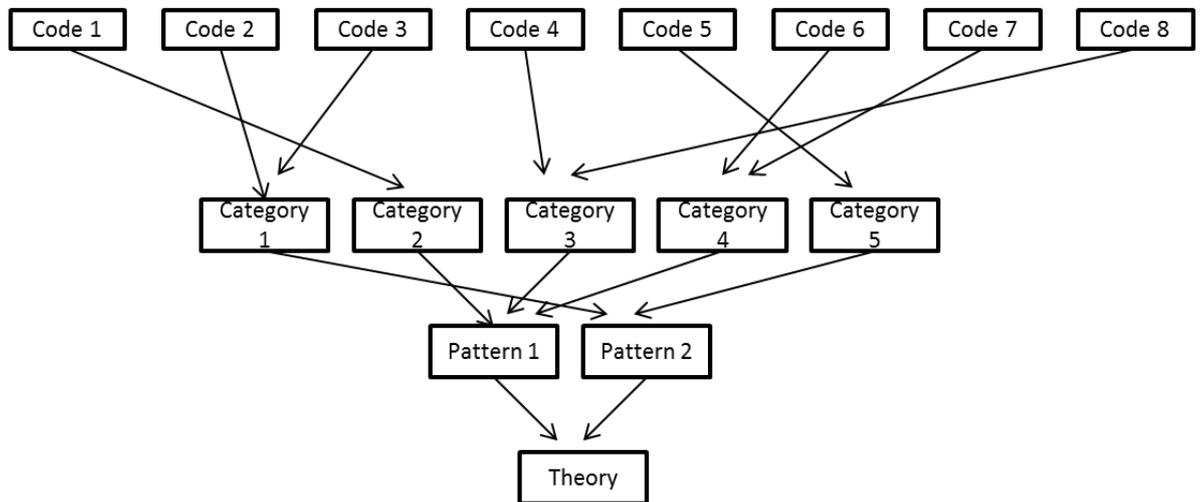
**Table 4.4 Final Coding Framework**

<b>Initial Coding Framework</b>	<b>Axial Coding Framework</b>	<b>Selective Coding Framework</b>
Administration process Confusing regulation Red tape and corruption Lack of transparency Bureaucracy Complex situation Economic stability  Cultural influence Industrial relations The role of business association	Structural problem  Non-structural Factors	<i>Institutional Environment</i>
Hospitality Comply with the regulation Networking Political strategy  Social strategy Philanthropy	<i>Proactive Approaches</i>  <i>Reactive approaches</i>	<i>Non-market Actions</i>
Size of the firm Personal interest Motivation Anticipated consequences	<i>Characteristics</i>	<i>Caused, Characteristics</i>

The third phase is the selective coding. Strauss and Corbin (1998) argued that the goal of this phase is to establish a core category or central phenomenon. A core category is expected to integrate all categories resulting from previous phases (open and axial coding). Major categories were integrated into theoretical schemes as a basis for refining the theory. Therefore, the core category was labelled sufficiently abstract and could be used in other research (Strauss & Corbin, 1998). In this study, “institutional constraints” emerged as the integrating theme of the research.

A workflow of how the coding processes in this study was conducted can be seen in Figure 4-2, which is built on the grounded theory practice (Richards, 2009). The workflow is not a simple linear process. The researcher moved back and forth,

even facing challenges such as over coding and consistency in coding. The problem with identifying and redefining codes also influenced the process. Constant comparison (Heath & Cowley, 2004) was used to evaluate the concepts against each other and among themselves. This process led the researcher to a theoretical level of abstraction (Richards, 2009).



**Figure 4.2: Workflow of Coding Process**

The workflow indicated that the process started with open coding to see the emergence of the initial coding. The researcher then developed tentative categories resulting from open coding activities. The tentative categories were constantly compared with the new emergent categories that are developed. Constant comparative analysis was employed during the coding process. Theoretical sensitivity was formulated at this stage based on the patterns that emerged. Once the theoretical and sampling saturation was reached, theory development subsequently started. During the coding process, memos were written to help the researcher develop ideas and clarify the coding process. It also helped the researcher identify the codes that were initially treated as analytical categories. The memos were written in the form of a narrative text and also in the form of questions such as “What is going on here?” and “How can I make sense of it?”

#### **4.7. Data Analysis**

Corbin and Strauss (1990) put forward eleven basic procedures to follow in the development of their method. Building on their procedures, the researcher

modified them to meet the objectives and context related to this study. The grounded theory research process implemented for this study is summarised in Figure 4-3. Even though the figure shows that the process may appear chronological and linear, the actual process of grounded theory in this study was not linear. The process was messy as the researcher had to simultaneously move backwards and forwards throughout the study. In the coding process for example, while coding the interview transcript, the researcher also continued to search through the literature to ensure that the label of coding used was a correct fit with the body of knowledge. In another step, once the open coding was done, the researcher then proceeded to the further data collection stage based on the result of the open coding. It was then followed with the coding process that provided output such as concept and categories. Thus, this shows the simultaneous process of data collection for the grounded theory method.



Following Locke (2003) and Corbin and Strauss (1990), the procedures in the grounded theory method for this study are highlighted and followed the steps outlined below:

- It began with general research questions which led the researcher to decide that the grounded theory method was the most appropriate method to be used for this study. The rationale behind this decision has been clarified in the previous section.
- A list of prospective participants was created based on the criteria as mentioned in the literature (theoretical sampling) and the decision for the sampling was discussed in the “case selection” section in this chapter. Theoretical sampling refers to the process of further data collection directed by the results from the earlier sample (Glaser & Strauss, 1967), as the theory emerges.
- Relevant data was collected. The researcher relied on interviews to best capture the experiences of the participants as the objective of this study proposed. Other relevant data was also collected, such as government documents and regulations. At the first stage, eight interviews were conducted. During the data collection process, memos were written to help the researcher with documenting the ideas along with the impressions during the interview. Data was then coded, where the researcher tried to generate concepts through identification and labelling. Similar phenomena were then categorised into concepts according to their meaning and relevance to the study. At this stage, the open coding process was conducted, with the constant movement back and forth during the coding process. This stage confirmed the need for the theoretical sampling and further data collection.
- Through a constant comparison of indicators and concepts resulting from the previous steps, the researcher reviewed, put back data and connected them with categories. Constant comparison indicated the simultaneous process of coding and analysing of data collected (Glaser & Strauss, 1967) and forced the researcher to reflect on the data. Each code then linked to the context of the text (interview

transcript). The contextualisation of the code led to the identification of a pattern. The constant comparison process was applied throughout the analysis stage of this study, where the researcher sought out the similarity and differences of selections of data. It also helped the researcher see whether the data selections confirmed the existing data or not. Constant comparison continued until theoretical saturation was reached during the analysis stage.

- Categories were saturated during the coding process. It was done by constant redefining and restructuring of categories, including reducing the number of categories which led to the higher level concepts.
- The next step was another coding process, where the researcher carefully selected the core category or central issue and systematically connected it to other categories. Validation of this connection was also carefully analysed. The outcome of the coding process was the proposal of a theoretical model.
- Categories were found saturated and core categories were identified. The core categories as the higher level concepts were checked, refined and integrated with the theory. The core categories were also systematically related to other categories and then further conceptualisation continued until the final report was completed.

Corbin and Strauss (2008) argued that the general rule of grounded theory is to gather data until each category is found saturated. Saturation refers to the situation where no additional data are found to add new concepts (Glaser & Strauss, 1967) or similar instances occur over and over again with no significant variation. Theoretical saturation is achieved through a constant comparison process where no new properties emerge from the coding process. Glaser and Strauss (1967) concluded that saturation does not relate to the number of cases or participants, but on how many different concepts are identified by the researcher. Therefore, the interviews conducted in this study will be stopped once saturation has been reached.

In this study, after conducting 27 interviews, the researcher did not find any new category or concept, which indicated that saturation has been reached. Reviews and briefings from supervisors also confirmed that there were no new or relevant

data emerging from the addition of new participants. It also indicated that the categories were well-developed and the relationship between categories was validated and well-established.

#### **4.8. Research Site and Selection of Focal Industries**

##### **4.8.1 Study Site**

In this thesis, the South Sulawesi province of Indonesia was selected as the research area as it represents an illustration of the dynamic change that defines an emerging market. The province, thus, provides an ideal setting to study the non-market environment faced by small firms with the economic development process in emerging markets.

South Sulawesi is one of the major provinces in Indonesia. The province is also a central place for trading, business as well as education, particularly for the eastern part of Indonesia. As shown in Figure 4.3, the province is centrally located. Due to its geographical position as the centre point of Indonesia, the province is viewed as a gateway to the eastern part of Indonesia. The opening of the new airport in 2008 has benefited the province's economy, particularly Makassar city. The airport serves as a hub for several international flights to other Asian countries. In addition, the province has Soekarno-Hatta port, which is one of the main ports in Indonesia for exports and imports. Supported by good infrastructure and its geographical advantage, the province is an attractive place for investors. Moreover, Makassar is the capital and administrative centre of the province of South Sulawesi. Historically, it is a major place for trade with regular domestic and international shipping connections.



**Figure 4.3: Map of Indonesia Showing South Sulawesi (*Sulawesi Selatan*-red circled) located at the central point of Indonesia**

Source: Google Maps, 2015. Retrieved from <https://www.google.com.au/maps/@-0.1777172,117.4253331,6z>, Copyright (2015) Google.

South Sulawesi province administrates 21 regencies (*kabupaten*) and three municipalities (*kota*), with 304 districts and 2,993 definitive villages. The total population of South Sulawesi, based on the latest population census, is 8.3 million (Statistics South Sulawesi, 2014), which makes the province the most populated province in the eastern part of Indonesia. South Sulawesi is one of the main producers of food crops in Indonesia, with rice as the main crop produced. In 2013, the Gross Regional Domestic Product (GRDP) of South Sulawesi was recorded as IDR 184.7 billion. The agricultural sector still dominates as the largest value-added sector followed by trade, hotel and restaurant sectors (Statistics South Sulawesi, 2014).

The excessive size of Losari coastal reclamation, a landmark of the city, in the last ten years, as well as Karebosi, a public square at the heart of the city, as a public space which turned to be a commercial arena, are two examples showing how business and government intimately tie-up in South Sulawesi. For the coastal reclamation itself, only a handful of entrepreneurs were involved in the process; most of them are well-known for their personal or political ties with the city/ municipal and provincial government leaders. Apart from violating the rules both on the local and national levels, the process also endangers the ecological system that is currently

already damaged. In Karebosi, a public square which consists of a dozen football fields and several other sports courtyards were converted into an underground mall and shopping centre surrounding the square. Although the development project of Karebosi shopping centre aesthetically improved the appearance of the city and also became one of the city's landmarks, such privatization of public spaces has faced criticism from groups of people. Students and non-government organisations (NGOs) in Makassar rejected the reclamation idea due to the violation of the rules and corruption allegations in the process of privatisation (Cora, 2012; Mulyadi, 2010). Furthermore, the development project was viewed as the product of clientelism that undermined political accountability.

Therefore, the reasons for selecting South Sulawesi, particularly Makassar as the research site are threefold. First, the dynamics of the business environment in Makassar are generally the same as in other big cities in Indonesia (Marketing, 2015). It is also one of several provinces that is characterised by patrimonialistic political culture, where personal connections predominantly influence local politics (Buehler & Tan, 2007). Anecdotal information from NGOs, activists and news reports suggest also that business rules in South Sulawesi are often violated in practice. Many public areas were turned into private or business premises, as seen in what happened in Losari and Karebosi.

Second, the unstable regulatory environment that characterises the business environment in Indonesia is also easily found in South Sulawesi province. Many local regulations (*peraturan daerah*) issued by the government of the South Sulawesi province and local regulation from local districts and municipalities in the province followed the implementation of decentralisation. However, many of these local regulations have been cancelled by the central government. One of the main issues related to these local regulations is the lack of substantial discussion prior to the issuance of the regulation and objection from the enterprises. Many local governments issued new regulations only to boost their locally-driven revenue (*pendapatan asli daerah*), which is mostly perceived as not business-friendly by business actors (Brodjonegoro, 2004).

The third reason is due to accessibility and practicality. Exploring the nature of non-market strategies implemented by firms in Indonesia required access to key policy-makers. The time frame limited the researcher in his ability to conduct research without using existing contacts in different provinces. In Makassar, the researcher utilised his contacts and managed to gain reliable access to key individuals and other supporting data sources.

#### **4.8.2 Focal Industries**

To provide a greater understanding of the non-market environment in South Sulawesi, three case study industries were chosen. This section presents descriptions of the three industries chosen as the object of this study, namely that of advertising, government vendors and hotels. This section is aimed at the clarification of the context of the case.

Contextualisation is important in this study given the complexity of the non-market environment issue. The three industries were picked for the following reasons. First, all firms in each industry met the case criterion stated above, specifically, the firms in these three industries interacted with political actors and institutions. The interactions between the firms of these three industries with political actors were intense, given the nature of the industries. Furthermore, all three industries are highly regulated by the government. The second reason is that the hotel and advertising industries are two of the main sources of local revenue in the city of Makassar. The contribution of both industries to the total local revenue for the city of Makassar has increased with time. From only around IDR 7 billion in 2009, the contribution of advertising tax to the total revenue of the city has increased to IDR 19.6 billion in 2013. The same situation can be seen for the contribution of the hotel industry, where in 2013, the tax revenue from the sector was IDR 44.6 billion, which was an improvement from IDR 26.3 billion in 2009. In 2015, the local government expects a total revenue of IDR 98 billion (approximately USD 720 thousand) from hotel tax (FAJAR, 21/05/2015).

Meanwhile, government expenditures at the local level, particularly for goods, works and services have increased every year. In 2014, the provincial

government expenditure for procurement was IDR 1.37 trillion, approximately 18% of the total provincial budget. However, in Makassar, IDR 810.4 billion was used for public procurement in 2014, approximately 30% of the total budget of Makassar. Given the strategic position of these industries, as well as the dependency of contractors on government sale, we expect the chosen firms to implement non-market strategies.

Thirdly, anecdotal information from our informal discussions with journalists, business leaders and research colleagues in Makassar suggested that these three industries are the most targeted by local politicians. Apart from their contribution to the local economy through taxes and retributions, the business players from the three industries are well-known for their political ties in the local political environment. Stiff competition and the high number of players in the industries force them to maintain good ties with politicians and government officials in order to be sustained in the competition. Below are the chosen industries for the case studies.

#### ***4.8.2.1 Advertising Industry***

The outdoor advertising (hereafter: advertising) sector is one of the main potential revenue sources for many local governments in Indonesia, including Makassar. According to the Local Regulation of Makassar City No. 3/2010, the format of advertising that will be taxed is billboards, street furniture and any other printed format of advertising, including the digital format which is used for commercial purposes. It also includes the advertising material that is placed on anything that moves, such as taxis and buses. The regulation also determined the tax rate for advertising to be 25% of the current purchase price which is IDR 25,000 (US\$2.5). There are two general categories of advertising namely, permanent and incidental advertising.

Every year, the contribution from the advertising sector increases rapidly. In 2009, for example, the advertising sector contributed more than IDR 7 billion (US\$ 705,290). In 2013, the contribution was IDR 19.58 billion while in 2014, it reached IDR 23 billion. Although the contribution of the advertising sector is less than 5% of the total local revenue of Makassar city (IDR 627 billion), the sector remains one of

the favourite channels for local government officials and politicians to boost local revenue. For the 2015 financial year, the local government is expecting to reach IDR 44 billion from advertising alone (Makassar-Corner, 02/10/2015). Given the strategic position of the advertising sector, the local government is thus trying to boost the revenue from this sector.

#### ***4.8.2.2 Government Contractor***

One of the objectives of the decentralization in Indonesia was to distribute financial budgeting and authorities from the central to the local government. Prior to the transition period, budget allocations were made by the central government. The transformation of the budgeting system began after the introduction of Laws No.225/1999 and No.25/1999 on regional autonomy and fiscal decentralisation, respectively. These laws indicated that the cities and municipalities are the key administrative units that play an important role in providing goods and services to the people and therefore, are responsible for public procurement.

As result of the budget development process and positive economic changes, the government expenditures at the local level, particularly for goods, works and services have increased every year starting from the year 2008 (Table 4.5). As shown in the table, by 2014, the South Sulawesi government's expenditure for goods and services reached more than IDR 1.1 trillion (approximately USD 83 million), approximately 19% of the total provincial expenditure. However, in Makassar, IDR 620 billion, or approximately 30% of the total budget of Makassar, was used for public procurement. The massive spending was mostly allocated to education, healthcare and infrastructure development projects. The considerable amount of government expenditure is a positive sign for many firms who see the opportunity in the government procurement sector.

**Table 4.5 Government Expenditure on Goods and Service in South Sulawesi and Makassar City, 2008-2013 (IDR, Billion)**

Year	South Sulawesi Province		City of Makassar	
	Good and service expenditure	Total Expenditure	Good and service expenditure	Total Expenditure
2008	457	2 141	233	1 144
2009	352	2 195	301	1 240
2010	527	2 390	329	1 368
2011	767	3 358	439	1 881
2012	853	4 739	532	1 766
2013	970	5 664	607	2 072
2014	1 145	6 080	810	2 335

*Note: Adapted from “APBD Sulawesi Selatan dan APBD kota Makassar 2014”.*

The procurement system in Indonesia has been formally strengthened since 2008. This process was implemented through various initiatives of the institutional reform. However, the public procurement system remains problematic due to legal inconsistencies, weak state capacity and insufficient enforcement of the regulatory framework.

The current Presidential Decree (*Peraturan presiden/Perpres*) No. 4/2015 on public goods and service procurement was updated and adopted in early 2015 as the fourth amendment and replaced Presidential Decree No. 70/2012, No. 54/2010 and No. 35/2011. The amendment streamlined many of the stipulations outlined in the previous decree, which is then able to boost the development process at all levels. It also provides clear descriptions of the implementation of the electronic system (e-procurement) at both the national and sub-national levels which is expected to increase transparency and create a healthy investment environment. Under the new regulatory framework, all government units are required to announce their procurement plans, tender invitations and other related information in designated national and local newspapers and on procurement websites. The new regulation also redefined direct awards/ sole sourcing (*penunjukan langsung*) and simple bidding (*pelelangan sederhana*), which eased the procurement process. However, the new regulation implicates the adaptations from firms, particularly in the matter of e-procurement.

### ***4.8.2.3 Hotel Industry***

The trade, hotel and restaurant sector plays an important role for economic growth in many countries, including Indonesia. In the South Sulawesi province, the contribution of the hotel industry to local government revenue indicates positive growth. In 2009, for example, local taxes on the total revenue from the hotel industry amounted to IDR 26.32 billion. The increasing number of hotels developing in the region also influenced the taxation income for the local government. As a result, in 2013, the taxation income, including the revenue from the hotel industry, reached IDR 44.57 billion, or 7.09% of the total local revenue of Makassar city (IDR 627.24 billion). In 2015, the expected revenue from hotel tax is estimated to be IDR 97.8 billion (FAJAR, 21/05/2015).

Market forces such as the increasing number of hotels in Makassar create stiff competition, particularly for small and medium hotels. More rooms have been offered by big players and Western hotel chains. In 2013, there were 316 hotels (classified and non-classified) in Makassar, an increase from 127 hotels in 2009 (Statistics South Sulawesi, 2014). In 2014, the local government approved the licenses and operations of more new hotels, which are mostly part of the national and international hotel chains. The increasing number of visitors (domestic and international) to Makassar and the South Sulawesi province drives the increase in the number of hotels. The position of Makassar as one of the main destinations for MICE (meetings, incentives, conferences and exhibitions) in Indonesia is also influencing the growth of the hotel industry.

The expansion and the increasing number of hotels will benefit the local government through the increase in tax and retribution from the hotel industry. On the other hand, such expansion will affect the small and medium players, which represent 80% of the industry (Statistics South Sulawesi, 2014). Unlike large enterprises, small and medium hotels often lack service innovation and thus are not as appealing due to the unknown brand and value (Tribun-Timur, 03/02/2015). Competition becomes stiff and small and medium hotels often fail to win the price war with larger competitors. Another issue faced by small and medium hotels, as with other industries in South Sulawesi, is the problem of labour and the unfriendly

regulatory environment (Rakyat-Sulsel, 02/05/2013). While large hotels, with support from chain operations have more resources to deal with such issues, small and medium hotels need to handle the problem directly and this often takes time and more resources.

#### **4.9. Quality Criteria for Rigour**

A common evaluation in grounded theory is how well the advised research process has been implemented and the consistency of the process (Corbin & Strauss, 2008; Strauss & Corbin, 1998). The rest of this section will describe the techniques adopted throughout this study, to ensure that the quality of the study has met the expected standard for the grounded theory method and general principles of the qualitative study.

- In the data collection stage, the researcher outlined the process of data collection and noted every step and action in this phase. The researcher also outlined the assurance of confidentiality regarding the identity of participants in this study. Every effort to ensure confidentiality was outlined in the previous section. The questions that were examined during the interview process, as well as the interview guides and the purpose behind each question have also been discussed to provide a broader context to the reader. As suggested by Whittemore, Chase, and Mandle (2001), the researcher has also discussed the process when the interviews were transcribed, so as to show the authenticity of the data.
- All interviews were transcribed as soon as the interviews were conducted, to ensure that the researcher did not lose the context of the interview. All interviews were digitally recorded and transcribed. Furthermore, the transcripts were rechecked against the recordings by another research colleague.
- A case-based memo was written for each interview. The memo was written right after each interview to ensure the researcher captured the initial ideas from each participant.
- Throughout the coding process, the researcher also explained the process of coding, starting with the initial coding and ending with the interpretive coding.

Each stage was described and along with the rationale, the researcher also showed the example of the coding process and categorisation in this stage. The early coding result was shown to supervisors and several research colleagues to check for the plausibility of the coding attributed to the interview transcripts.

- The use of constant-comparison method during data analysis allowed the researcher to produce not just a description, but also abstract concepts which were then developed as substantive theory.
- Member checks were carried out: several participants were contacted after the interview to clarify the findings from the interview. Some of them gave feedback but no major amendments of the interview transcripts were made.
- In presenting the data analysis process, the researcher employed the use of the Decision Explorer program and NVIVO 10, which provided a clear visual depiction of categories and emergent themes and their respective connections. The structure was then used to help in building emergent theories from the case. Apart from interviews, the researcher also employed accessible reports related to the case ensuring triangulation.
- Peer debriefing was also carried out: where the researcher sought feedback and comments from other colleagues during the study. Feedback from other colleague researchers were received on several occasions, such as at CBS doctoral colloquiums and CBS research cluster meetings at the Department of Management Curtin University, where the researcher presented the initial findings. Feedback was also received from the participants of the Strategic Management Society Annual Conference in Madrid, Spain, where the researcher presented a paper related to this study.

#### **4.10. Ethical Considerations**

Prior to commencing the study, the researcher had to get approval from the Human Research Ethics Committee at Curtin University. Since the study involved the participation of humans and given the sensitivity of the issue in the study, the research was categorised as “Non Low Risk” and therefore required an application for an ethical approval of a Research Project Involving Humans (Form A).

After two months, the approval for the application was given. During the study, the researcher maintained the confidentiality as requested by the ethics committee. Access to the original transcripts and recording was restricted and only available to the researcher and Supervisors. All data were kept secure during the study period and will be kept securely for five years on the premises of the Curtin Business School. Some participants of the study clearly stated off-the-record information to the researcher and such information have not been reported and included in the thesis.

Each participant was also informed about this study prior to the interview and signed a declaration that they understood and agreed to participate in this study. As mentioned earlier in this chapter, confidentiality has been maintained by the researcher. Exceptions have been made to the non-business actors who made it clear that they can be named for the purpose of this study. Considerable care has been taken to ensure that such initials, as well as quotes used for this study, cannot be attributed and identified to a particular person.

#### **4.11. Summary and Conclusion**

In this chapter, the case for investigating and understanding the nature of the non-market environment in Indonesia employing the interpretive paradigm as the ontological perspective was put forth. This chapter also discussed the reasons for using qualitative study which can summarised into three mains reasons: the nature of the research questions, the opportunities to explore qualitative data and the institutional context of the study. It also offers holistic interpretations of realities beyond merely measuring variables and an understanding of the social process in context.

Clearly, from the assumptions of the interpretivist paradigm, the reality of the non-market environment faced by small firms in Indonesia must be interpreted and understood. Therefore, the interpretivist approach was chosen as the appropriate epistemology. A central part of the chapter concentrates on the research approach, briefly discussing grounded theory and the case study approaches, including the rationale behind the decision to utilise these approaches in this study. Grounded

theory was chosen because the researcher believed that it was the most appropriate in the context of ontological and epistemological reasons, where the study is expected to explore the nature of the non-market environment in emerging economies. Grounded theory enabled the researcher to achieve the research objectives of this study with its systematic procedure and effective data management.

A description of how grounded theory and the case study method were used in this study was also outlined. Data from the selected case study participants were gathered via in-depth interviews with owners and managers of SMEs from three sectors namely hotels, advertising and government contractors.

This chapter also provided an explanation of the selection criteria for the case studies and the reasons for focussing on the three industries; the types of information elicited, the data collection; coding process, data management and the application of constant comparative analysis in the analytical process. Checking for quality criteria ensured the rigorousness of the study, along with the ethical considerations that the researcher applied during the study.

In the next chapter, the research findings based on the data analysis applying grounded theory will be presented.

# Chapter 5

## RESULTS OF THE STUDY

### 5.1. Introduction

It can be recalled that the purpose of this research is to investigate institutional changes in emerging economies and their impact on the firms' choices of non-market strategies. The aim is to identify non-market strategies of small firms in Indonesia and evaluate their impacts on the firms' performance. This chapter presents the findings of this research.

In accordance with the objectives of this study, the findings will be presented in several sections. Following this introduction, Section 5.2 discusses the identification of the political and social antecedents of non-market strategies and also illustrates the nature of the non-market environment in Indonesia. Section 5.3 explores the non-market strategies implemented by small firms in Indonesia. The tactics used by firms are presented. The patterns of strategic behaviour of these firms in dealing with the non-market environment in South Sulawesi are also presented. Political resources which may come in the form of financial and managerial skills are discussed in Section 5.4, while the different levels of participation by firms in implementing their non-market strategies is discussed in Section 5.5. This is followed by Section 5.6 where the strategic tendencies of firms are described. Finally, the impact of implementing non-market strategies on the firms' performance is discussed in Section 5.7.

### 5.2. Social and Political Antecedents of Non-Market Strategy

As established in the previous chapter, this study followed the constant comparative analytical feature that is consistent with grounded theory. The findings here represent the views of the participants in relation to their experience in dealing

with the non-market environment in Indonesia. To clarify the findings, overall quotes from the interviews with participants were extracted.

The first major data set in this study was obtained from the case text based on the interviews with 23 participants from small and medium enterprises, two government officials, one non-governmental organisation (NGO) activist and one journalist (total of 27 participants). The case text is based on more than 40 hours of interviews and several volumes/ items of secondary data (government regulations and documents, as well as news clipping from several reputable news agencies in the region). For anonymity and confidentiality reasons, real names of the participants were not used except for the participants from government and non-governmental organisations (NGO) who agreed to be named.

The following sections present the factors for the implementation of non-market strategies by firms in South Sulawesi (see Table 5.1). The results show that the factors are mostly exogenous to the firm and initially triggered the use of non-market strategies by firms.

**Table 5.1: Highlights of Political and Social Antecedents**

Firm/Industry	Political and social antecedents
<i>Hotel</i>	<ul style="list-style-type: none"> <li>- Labour constraint. The demand of the employee, with support from the trade union, to be recruited permanently and not on a temporary contract basis.</li> <li>- The rising influence of Interest groups such as trade unions and NGOs. They become so powerful and cause substantial changes to the way of doing business in the country.</li> <li>- Unclear jurisdiction among different technical government agencies. Having obtained a construction permit to expand the hotel, the owner needs also to deal with several other technical agencies such as tax and retribution agencies at the same time. A ‘crowd license’ also needs to be obtained from the district and village-government level.</li> <li>- Political risks. The involvement of the local parliament means that the business issue will be solved politically.</li> <li>- Low level of law enforcement related to the problems (such as labour and local tax) in the industry. No support from the local government when the industrial relations (strikes) happens in the firm, even though serial strikes by</li> </ul>

	<p>the employees tend to directly influence hotel operations.</p> <ul style="list-style-type: none"> <li>- Legitimacy, be perceived as a good citizen and useful to others.</li> </ul>
<b><i>Advertising</i></b>	<ul style="list-style-type: none"> <li>- Unclear interjurisdictional regulation between government tiers.</li> <li>- Myriad of administrative desks and article works.</li> <li>- ‘Free judgement’ administrative behaviour. The absence of specific regulations and unstandardized interpretation of laws and regulations.</li> <li>- Rent-seeking, particularly in the licence and administrative processes.</li> <li>- Constant pressure from politicians and political parties.</li> <li>- Discriminatory policy. The firms owned by relatives of government officials or have close connections with politicians usually receive preferential treatment from government bureaucracy.</li> <li>- Insufficient formal institutions. The firm has to deal with several unofficial retributions from non-official and legal people.</li> </ul>
<b><i>Government Contractors</i></b>	<ul style="list-style-type: none"> <li>- Inconsistency of procurement regulations and lack of transparency during the procurement process.</li> <li>- Myriad of administrative desks and article works.</li> <li>- Heterogeneity of political actors. The firms need to deal with government officials and legislators, as well as interest groups with different agendas.</li> <li>- The lack of necessary skills from government technical agencies in dealing with the new system.</li> <li>- Underutilisation of the new system. Many complaints which were submitted electronically through the new system were not responded to thoroughly.</li> <li>- Opportunistic behaviour in the process of bidding from the procurement officials.</li> <li>- No clear dispute resolution mechanism.</li> <li>- Different political priorities make the political configuration in the local procurement system complex. Sometimes, the executive and legislative change the priority in the development process, without considering the efforts and cost from the enterprise.</li> <li>- Legitimacy, be perceived as a good citizen and useful to others.</li> </ul>

As can be seen in Table 5.1, the three industries included in the study are facing identical problems such as rent-seeking, a myriad of administrative work and discriminatory policies that highlighted their political actions on issues that are specific to their particular industry. Even though other industries may also face the same challenge and issue, the level of importance and the impact to the industry

might be different. The hotel industry, for example, is dealing with labour problems more than the other two industries after the government's new initiative on minimum wage and revisions in the legislation concerning pay for laid-off workers. On the other hand, unclear interjurisdictional regulation between government tiers was the problem for the advertising industry. Government contractors, meanwhile, had to deal with new institutional environment which is strongly reliant on technology compared to the previous situation.

Table 5.1 also indicates that social and political antecedents that drive the implementation of non-market strategies by the firms were influenced by substantial political reforms as a result of decentralisation. Political antecedents, extensive laws and the significant policy differences between districts and cities were also considered the main factors that brought about uncertainty within the business environment in Indonesia. Red-tape and rent-seeking activities also affected the decision of firms to choose non-market strategies over market strategies. A myriad of administrative burdens along with the firm dependency on government made the firms willing to engage in formal political participation.

Social and private interests also stimulated the decision to apply non-market strategies. The pressure for the firm from non-governmental organisation (NGOs) and other social civil society organisations regarding labour contract, for example, has affected the firm in its operations. Personal giving, a desire to be perceived as a good person and useful to others along with ideological beliefs have motivated most of the social actions taken by the firm. The key antecedents of non-market strategy include: regulatory uncertainty, unstandardized interpretation of regulations, government top level political game, political embeddedness, rent-seeking, and unclear interjurisdictional coordination between government tiers. Each of these findings is presented in more detail below.

### **5.2.1. Regulatory Uncertainty**

The regulatory environment in South Sulawesi, in particular, is also affected by decentralisation. Like most local governments in Indonesia, local governments in South Sulawesi have also passed local regulations (*Peraturan daerah*) to boost their

local income through tax and retribution. However, the legal justification for these local regulations remains unclear since the communication and coordination between the local and national governments is often poor. In addition, the process of creating new laws and regulations is not adequate and often without prior consultation with the business actors as the object of the law. On many occasions, the firms receive unequal treatment from government officials and limited access to information related to the certain laws from the local government officials. This situation caused the firms to suspend their strategic activities such as expansion and the acquisition of new customers. As one respondent mentioned:

*“(...) I do not think it can be called a clear regulation. Let me give you an example. Ideally, the office should provide details on how much we should pay based on the size of the billboard, the location and also based on the time frame. In reality, the regulation is not really clear. Sometimes, the tax that I pay for a billboard is not the same as the amount I paid in the past, although the size and location of both the billboards are relatively the same.” [PAR #3]*

All participants in this study asserted that generally, the regulatory environment in South Sulawesi is complex and confusing. The local bills (*Peraturan daerah*) that are related to business activities have actually regulated many things. However, these are confusing when it is implemented by the government officials. Almost all participants expressed their frustrations about the government, which according to them, are not represented as expected. The participants also asserted that the lack of support from the government and the inadequate local regulations leave firms in confusion. The confusion becomes greater when the number of regulations introduced keep continuously increasing. One participant (PAR #2) admitted that he had difficulties keeping up with the current local and national regulations. As this participant indicated:

*“We have more regulations now compared to the past 15 years. But again, the problem is usually in the implementation and law enforcement. I recently found that this government is not sensitive to business. For business people, I think the most important things are*

*stability and being clear of the implementation of regulations. Unlike now, we, business actors, get confused every day.” [PAR#2]*

Another participant (PAR #7) from the construction and procurement industry also pointed out that the current situation does not show much progress as compared to the past. Previously, with the centrally planned economy and authoritarian regime, the economic condition could easily be handled. The current situation, however, creates confusion and uncertainties, which are worse than the previous regime. Besides, the corrupt and manipulative system that is embedded remains and the market condition is also hard to predict.

*“I think the current situation is much worse. But that’s my personal opinion. At least in the past, we know exactly what happens. We are even able to know exactly who will win the bid before the bidding process actually takes place.” [PAR #7]*

The factor of confusion and uncertainty also affects the labour issue. All participants were concerned with the lack of and inadequate labour laws as this issue affects the firms’ operations. Theoretically, current laws on labour are more employee-friendly than before. However, in the implementation, the laws often create huge disagreements between employee and employers. One participant (PAR #1) from the hotel industry expressed his frustration after facing a disagreement with his casual workers. The involvement of the labour union and the ignorance of the local government made the situation worse.

*“After several strikes, the union finally brought the issue to the legislative office. The local parliament invited me for a hearing. (...) However, as you may know, the labour issue and even any issue could be brought to politics here, especially during this time when we have the governor election and next year, when we will have the national elections.” [PAR #1]*

The above case from the hotel owner shows how the firms are facing difficulties in dealing with the non-market environment, particularly from the interest groups representing employees as stakeholders and affected interests. The demand from the interest groups such as the labour union and NGOs forces the regulatory uncertainty and constrain the firm's ability to build legitimacy and solve its internal problem.

Another participant from the hotel industry also noted that social pressure from NGOs and civil society norms forced changes to take place for government policies. Such external pressures regularly arise when the issues related to the labour code such as minimum wage, worker compensation or unemployment benefits, attract unintended attention to the firm. In their actions, local NGOs usually call for immediate attention which is sometimes very time-consuming. As such, this affects the operational function of the firms.

To make the situation worse, on the supply side, there was rivalry for power among political actors. Instead of acting in the form of check and balance, government agencies and local legislative members compete to attract votes and influences. On one hand, government agencies did not want to be blamed by enterprises nor labelled as not-business friendly. On the other hand, the legislative members wanted to be known as a labour-friend and perceived as good legislators since it was nearly election time. In the case of minimum wage, for example, the issue was used as one of the main references to get votes from the union members and not purely as a basis for a social safety net for poor workers. As a participant (PAR #1) from the hotel industry pointed out:

*“For example, at the first demonstration, the employees insist that contract workers should be paid 32 times of the salary. Can you imagine this? Look, the salary of a casual worker is IDR 1.3 million, and they asked me to pay 32 times as compensation? At that time, I just wanted to make the hotel go back to business as usual, that's why I paid that. The next demonstration, they thought that I was in a weak position, therefore, they insisted in implementing this policy to other casual workers. Financially, I can predict my loss. But what*

*about non-financial loss such as my hotel image and my image as a businessman? The worse thing is that it sends a bad and negative message to other workers. Other workers believe that they can do anything and will not get punishment for what they have done.”*  
[PAR #1]

In a different situation, both government and legislative members are competing to acquire more power. Furthermore, they would trade the influence with the enterprises and expect some form of financial support in return. Each section competed for continuing support from firms and business people. In general, the competition includes the implementation of the development program, especially in infrastructure. A particularly big infrastructure project will be evaluated thoroughly by a group of parliament members. This big project will then be broken down to several small projects with the help of local officials and using resources and information from firms who wish to be selected as contractors for that particular project. One respondent (PAR #11) expressed his evaluation of the situation of collusive cooperation between local government officials and legislative members:

*“Let’s say that the local government and parliament agree to the road building project. In particular, they agree to build 7 km long for this financial year. In the middle of the project, the local member of parliament decide to divert 1 km of the project to a particular village, just to increase his chance of getting more electoral votes for the next election. Let’s assume that 1 km of road costs IDR 1 billion. This 1 km is then divided again into ten different small projects. So, each small project costs IDR 100 million, which according to the regulations, does not need to be tendered publicly. By doing this, there are now ten different contractors. Let’s just assume that each contractor paid me 10 percent of the total project’s budget. Apart from money, I also get my name in the society. So, you know the end of the story. This only happened in one district with one project. So you can imagine what will happen at the provincial and national levels.”* [PAR #11]

The same collaboration initiative may occur in a different situation, where such an initiative is initiated by government officials. Often planned projects are regularly followed by slow administrative processes, which result in limited resources for the local government to commence the project. Furthermore, the transfer budget from the central government to finance the programs often comes late. Therefore, the local government officials have to find necessary financial resources and make the project happen. Government officials usually ask for help from business people for this matter. The local enterprises are able to choose which project to contribute to and often have a hard time refusing. Such a situation may benefit all parties involved, as the politicians can earn electoral votes, while small firms can obtain the contract and local officials can implement their programs and avoid being penalised.

Another side of regulatory uncertainty is the informal patronage behaviour that still dominates the business-government interaction. Government officials become more pervasive and get considerable discretionary allowance, where they can accept kickbacks or bribes and other illegal payments from enterprises. A participant from the advertising industry asserts that such action is regarded as normal when dealing with license and administrative matters.

*“I do not think it is a bribe. Let us put it this way. You have to understand that most of the staff there are only casual staff and are not public servants. Unlike public servants, they will not have a pension fund and other bonuses from the state. Unlike public servants, they have to busy themselves every day, while public servants have the same salary even if they just sit there doing nothing. We understand this and realise how hard the job of the casual staff are. Therefore, we sometimes provide them with cigarette money or what we call, ‘thanks payment’. Every year, we*

*also provide them with 'Ied Fitri'<sup>2</sup> allowance, as well as send them food and some money". [PAR #9]*

The above comment from one participant (PAR #9) regarding casual staff in the local tax and revenue office indicated that regulatory uncertainty might also be caused by different political controls over government agencies. The bureau or a government agency is given the authority to recruit casual staff based on the need of the organisation. The recruitment of casual staff is expected to fill the gap so that the agency can perform well with limited resources. However, since this authority is not fully supported by financial support from the government, the head of local agencies sought financial contribution from enterprises illegally to cover the cost for extra employees. The extra employees were usually friends and relatives of officials in the bureau or other bureaus of the city.

Among the respondents, the majority of them see the uncertainties caused by the constant regulatory changes, particularly after the fall of President Suharto. Given the size and limited resources of small firms, constant changes affect their operations in the short term. Constant changes usually occur given the fact that many existing regulations need to be amended with new regulations, due to incomplete coverage, as well as the opaqueness in the process of conceptualisation of the regulations. As one respondent from the advertising industry conveying her concern said:

*"You know, the regulation itself is very funny and unbelievable. In submitting your proposal for installing a new billboard, for example, the licence office requires you to provide letters of approval, ranging from the village, district and municipal offices and even some national government agencies. Imagine how time-consuming this process is for us." [PAR #3]*

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<sup>2</sup> Ied Fitr: A religious holiday celebrated by all muslim around the world that marked the end of Ramadhan (fasting month). In Indonesia, Ied Fitr is two days celebration and marked as public holiday.

The same situation has also challenged the firms in the procurement industry. The concern from the small firms' owners is not in terms of the implementation of e-procurement, but in the complexities surrounding its implementation. During the 2010 - 2015 period, the regulation of government procurement was changed five times. The constant changing alone brought about confusion for the firms and also for the government officials. Furthermore, the lack of support and technical assistance from the government made the firm rely on government staff to help them deal with technical issues. This condition became an opportunity for government officials to gain financial advantage. As one participant from the procurement industry noted:

*“The current system is very complex and time-consuming. Unfortunately, there is not enough support from the government for us, small business contractors. Knowing the officials who handle the procurement is an important factor.” [PAR #4]*

This indicated that the impacts expected from the introduction of new laws and regulations were perceived as being more coercive, rather than supportive to small firms in general. Consequently, common to all respondents, enterprises need to adapt to the regulatory uncertainty since there are not enough options available to them. All interviewees' responses also illustrated that a more proactive approach is the less attractive option, given the imbalance of power among small firms with authoritative stakeholders such as the government and local parliament. The role of intermediaries, in this case, the business/ industry association, is important as indicated by the participant (PAR #1) from the hotel industry. Incapable of solving its problems internally, participating in more than one business association helped him stabilise the situation in his firm. It helped in the sense that the business organisation was perceived as more powerful to the government, despite the demographic size of the firm.

### **5.2.2. Unstandardized Interpretation of Regulations**

Current regulations and laws on tendering and the government's procurement system were made to minimise mismanagement and fraud. The new regulations, for

example, do not allow government officials to grant contracts to parliament members and other government officials. However, according to the participants in this industry, these rules are often violated in practice. Firms may engage in political activities simply to enter into ‘economic barter’ with the government or legislators, in order to gain a contract from the government agencies.

Another small firm owner also pointed out that in terms of government projects, the firms with close connections to government officials or politicians in the parliament will benefit the most.

*“I do not know. I am just mad at the officials here. They always refer to the regulations when we try to protest against them. But when you insist for them to act based on the regulations, they always refuse to do so just because it is related to the relatives of top officials. As a result, some of us, especially the firms that do not have direct connections with politicians and top officials, usually just ignore them. Ignore in the sense that we usually install our billboard and then work on the license later. If we did not do this, we would be wasting our time on the licensing process alone.” [PAR #3]*

The current Presidential Decree (*Peraturan Presiden/Perpres*) No. 70/2012 on Public Goods and Services Procurement was adopted in 2012 as the second amendment and replaced Presidential Decree No. 54/2010 and No. 35/2011. The latest version of the decree, No. 4/2015 was introduced in early 2015. The amendment streamlined many of the stipulations outlined in the previous decree, which can boost the development process at all levels. It also emphasised the importance of the electronic system (e-procurement) for both the national and sub-national levels, which is expected to increase transparency and create a healthy investment environment. Under the new regulatory framework, all government units are required to announce their procurement plans, tender invitations and other related information in designated national and local newspapers and on the procurement website. The new regulations also redefined direct awards/ sole sourcing (*penunjukan langsung*) and simple bidding (*pelelangan sederhana*), which helped to

ease the procurement process. However, the new regulations require the adaptation of firms, particularly in the matter of e-procurement.

Although new regulations are expected to ease the process of the procurement system, in reality, many firms in the procurement industry found the new system to be quite confusing. In addition, many firms found the new system to be complicated. To complicate the situation, there was also inter-agency confusion, as well as slow implementation of necessary actions to ease the process. For small-scale direct awards, for example, the interpretation of who can get the contract may differ from one government official to another. Moreover, getting a contract on the basis of direct awards in one government agency does not mean the same situation with other government agencies. The interpretation, along with the personal discretion of top officials, is the key to this matter.

A lack of understanding regarding the new regulations make the vendors rely on local procurement bureaucrats to help them navigate the cumbersome nature of the administrative process. The new regulations introduced the electronic procurement system that some vendors find difficult to be adapted. The Indonesian Employers Association (APINDO) reported that more than 20% of firms do not understand the electronic procurement system<sup>3</sup>. Also, the new regulations were not followed by a new attitude, neither from the local procurement bureaucrats nor the bidders. According to one interviewee (PAR #7), many local procurement bureaucrats approached the vendors to offer their help in filling out complex procurement documents. After which, they demanded payment in return.

*“I mean, the system could be very complicated and modern, but in the end, based on my experience, it could be directed to favour several firms. Put it this way, to get 1000, you have to provide 100 first at the beginning of the procurement process. I did this, but at the end it wasn’t me who won the bid, but some other firms instead.*

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<sup>3</sup> Tribun-timur. (27/05/2013). GAPEKSINDO benarkan banyak kontraktor masih gaptek. *Tribun-timur print edition.*

*It happens sometimes. The officials then have so many reasons to tell you. But I believe, it is not only about the rules.” [PAR #7]*

Despite the fact that the new regulations require the signing of integrity pacts (both from the government and the respective firm), the participants in this study expressed that apart from the complexities, the new regulations have not yet eliminated corruption and collusion. A study by The Independent Procurement Control Board (*Lembaga Pemantau Independen Pengadaan Barang dan Jasa*) noted that in 2012, in Makassar, only 40% of the total procurements used the e-procurement information system. The study also showed that many procurement items were won by the same firms. As such, this caused an uncompetitive climate and affected the general business environment (Tribun-timur, 20/06/2013).

*“The last time we bid for a project, I did not win. I decided to complain and file a report since I believe that the process was unfair. Someone called me and I believe the person was part of the Rector’s son’s team. He then asked me not to file a report and suggested to me to understand his position. This project was the one that they really needed. I then decided not to file a report.” [PAR #10]*

Some participants in this study also expressed that the procurement information are usually limited to firms that have close ties with the elite in the industry association. Even though the law clearly stated that the tender information should be publicly announced through media, some government officials chose not to announce it. According to one participant who usually participates in public tenders (even when the tender information is publicly available), often, the winner of the tender has been predetermined.

Another option to get a contract in the public tender is to personally approach the family of the top officials or use intermediaries. The intermediaries are usually people who have close ties with top officials in the agency. Such situations may result in significant barriers for small firms as compared to their larger counterparts due to the lack of resources and capabilities. All respondents agree that policies and

administration should be neutral to all enterprises, regardless of the size, even though it is not the case in reality.

Poorly defined and ineffectively-enforced systems foster opportunistic behaviour and increase the expropriation by governmental and regulatory authorities with their own interpretation of the regulations. The cases above also show that a weak market-supporting institution is compensated by the firms with private arrangements such as giving illicit payments to the governmental authorities.

Most of the participants argue that the rent-seeking environment and insufficient support for law enforcement force the firms to choose private arrangements and have resource-based relations with politicians and government officials. This decision allows them to operate under the most suitable interpretation of the law and is based on the future benefits that the firms can expect from the government.

As expressed by all respondents, the role of the leaders in the government and legislative office is critical and powerful. However, in the case of the advertising business sector, the situation becomes more complex, since the mayor and his deputy race to control the advertising sector. The race is not only to boost local revenue for the city, but also to provide “additional income” for relatives, political parties and organisations for each mayor and deputy mayor. The leadership game played by the mayor and his deputy is driven by the different ideological and political parties, which create a dilemma and bring about excessive burden to firms. Apart from meeting all formal regulations and paying all taxes, firms also need to deal with the broad discretion on how to interpret and apply the regulations among the government officials.

### **5.2.3. Aligning with Top Level Politicians (Playing the Top Level Political Game)**

Another issue faced by small firms in the region is the party affiliations that control political institutions (which contribute to political constraints). Participants from the advertising sector for example, expressed that the sector is one of several

main sources for both the mayor and his deputy to gain political donation. The involvement of top leaders even turns into rivalry since the mayor and his deputy are coming from different political parties. The mayor is the chairman of the Provincial Democratic Party (*Partai Demokrat*) office, while his deputy is the chairman of the Golkar Party (*Partai Golkar*) in Makassar. The two parties were the first and second most voted in the recent direct elections in South Sulawesi recently.

The involvement of both the mayor and deputy mayor affects the market competition of the advertising sector. The chairman of the advertising firms' association (ASPRI) indicated that many advertising firms who violated the rules were backed by top officials<sup>4</sup>. The majority of the participants in this study also expressed the existing conflict of interest that occurs as a result of top officials' favourable policies to their cronies. One participant shared his experience where he planned to install a new roadside billboard on one section of the national highway route in the province. After submitting his application and waiting for the decision for about three months, he was finally told that his application was denied. The reason for this decision was that installing new roadside and gantry billboards were not allowed for this national route. However, not long after the refusal, several new roadside billboards were installed on the same route. The participant said that according to rumours, the instalment was done by an advertising firm owned by relatives of the deputy mayor.

The worst situation occurs when individuals from different sides (either from the mayor or deputy mayor of the city) offer an available spot for the installation of a new billboard at the same time. It is confusing for the advertising firm as it needs to deal with two different parties (both the mayor and deputy mayor's associates). In this situation, having connections with the official in the revenue office will help the firm navigate the cumbersome administrative process. The uncertainty in regulations and officials who handle the administration process make some firms proceed to build a billboard without obtaining license. Afterwards, the firm then arranges for the permit. In another case, a firm had built a billboard in an area that prohibited outdoor commercial advertisements. However, the local office finally approved the

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<sup>4</sup> Interview with Chairman of Indonesian Advertising Firms Association (ASPRI) branch South Sulawesi (Source: *Rakyat Sulsel Online* (20 August 2014): <http://rakyatsulsel.com/kami-akan-mempidanakan-bbjn-dan-pemprov-sulsel.html?postcomment=true>).

installation on the condition that the firm pay some discretionary fees to the intermediaries.

Some firms with no direct link to top officials prefer to build good relationships with staff in relevant agencies. Providing food and a small amount of money facilitates administrative procedures. The firm usually provides an annual “Holiday Allowance” (*Tunjangan hari raya*) which is paid every “*Ied Fitri*” to all front and administrative staff. This is important since they manage and administrate many papers, not just paperwork from the advertising firms. For higher level staff, firms usually do not provide any special occasions allowance. Instead, they must be prepared for “special demands” from higher level staff for transportation and accommodation expenses when they have official visits outside the city. Despite the government having allocated a special budget for such expenses, firms remain an object of the officials for gaining additional income. One participant (PAR #3) from an advertising firm was asked if the same formula is also employed by other firms in the same industry, and as he explains:

*“I believe other firms do the same. I know this because we usually meet and share experiences. We usually meet to discuss the regulations and how to deal with the local bills. We also share our experiences in handling particular officials.” [PAR #3]*

In implementing such strategies, firms prefer to perform individual approaches based on their interests. The role of the association in the industry is only for matters that involve the industry, such as representing members in discussion with the local government and the local parliament. This is understandable since several players in the industry are related to politicians or even owned by some politicians or their relatives.

Having a connection with politicians can help firms. However, for one participant who does not have any connection with politicians or their relatives, he felt that having a connection with certain politicians is not a sustainable way for the firm. After all, he shared the experience that politicians will come and go. Instead, having a good knowledge of the politicians, the environment and the issues in the

industry are the main points. To build this relationship, his firm usually allows a politician, especially from the ruling and big parties in local politics to use his firm's asset such as a billboard. For instance, in last year's governor election, many of the firm's assets were used by governor candidates. The candidates used the roadside billboard for political campaign and the firm let them use it if there were no commercial materials from clients for the billboard. However, the firms and the candidates have an informal agreement that once the firm wants to use the billboard, the candidates will have to remove its material campaign.

Apart from the myriad of administrative desks and article works, firms also need to deal with several external parties. These parties are not part of the government agencies, nor from other market supporting actors. They are people who always ask the firm to pay an informal "security expense". They either live near the firm office or around the area where the billboard is installed. Refusing to pay may cause the billboard to become a target for vandalism. Such ad-hoc substitutes exist because of the absence of laws and missing formal institutions.

Meanwhile, an official (PAR #26) at the revenue office unsurprisingly refuses to comment on the bribery issue. However, he is aware of the situation, including the uncertainty caused by the regulations that affect firms in the sector. According to him:

*"Sometimes it is the firm itself who makes the situation complex. The firm naturally wants to pay as little levies and taxes as possible and sometimes manipulate the report. Such situations therefore initiate rent-seeking and collusion." [PAR #26]*

He also mentioned that some of its officials, particularly in the front and administrative offices are seasonal staff and not public servants (*Pegawai Negeri Sipil/PNS*). Therefore, "it may be an opportunity for them to get additional income since they are not paid by the government like any other public servants", explained the participant from the local revenue office. As seasonal staff, they do not get pension funds or any other allowances.

The government official emphasised that the city government has made some progress with the use of technology to minimise the interaction between staff and firms in the process of obtaining business license. Furthermore, as a higher level official, he is frequently approached both by firms directly or through politicians related to the firms for a particular matter. However, he stresses that since the office is always targeted by social organizations, government watch organizations, and the media, the opportunities for "illegal interaction" have decreased rapidly.

To tackle problems in the licensing process and to minimize rent-seeking activities, the Makassar city government has established the Unified Licensing and Investment Agency (*Badan Perizinan Terpadu dan Penanaman Modal/BPTPM*). The main objective of this establishment is to ease licensing processes and procedures. In this way, all licensing procedures will be managed solely by this agency. The office consists of several technical teams which include cross-agency officials.

#### **5.2.4. Political Embeddedness**

While there are several respondents who are aware of the importance of giving more attention to the marketization process, majority of the respondents realised that apart from market issues, political ties remain important. One possible explanation for such a condition is that small firms rely heavily on the government for critical information and resources. Decentralisation also offers more substantial authority and advantage to local government authorities and makes the firms more dependent on the local authorities. However, resource dependency creates uncertainties for the firm.

In South Sulawesi and in Indonesia generally, local government authorities took advantage of this regulatory uncertainty (Brodjonegoro, 2004). Therefore, political embeddedness became increasingly beneficial due to the uncertainty. Political embeddedness is the political strategy implemented considering political commitments, political knowledge and legitimacy in the context of networks (Welch & Wilkinson, 2004). This is different from the strategy of aligning with top level politicians (Section 5.2.3) in that the latter mostly favoured larger firms which have

more resources compared to small firms. This is also due to the fact that small firms are not well-positioned to handle stiff competition as owners of small firms compete in a saturated market such as government vendors. One of the participants stated that political connections or knowing someone with a good knowledge and relationship with politicians is very important. His statement came from his experience in dealing with problems related to his business:

*“As you may know, Mr L has good connections with many people, particularly politicians. His family is also well-known in politics and business. I went ahead with his solutions and everything was soon back to normal. I didn’t even need to meet with parliament members or sit with the labour organisation before an agreement could be reached. I couldn’t believe this actually, but it just happened. All negotiations with the employees are led by Mr L. I also applaud him on his comprehensive knowledge of law and administrative solutions.” [PAR #1]*

The decision built networks with other political actors apart from top level politicians is also based on the situation where formal institutions are not proper and intra or inter-agency problems affect business processes. As a result, this situation confused the business actors and firms since the firms have to deal with various regulation on different level of governments. Therefore, many firms choose to pursue political process to moderate the uncertainties they faced. The current system provides opportunities for both local authorities and business enterprises. The decentralisation system allows business actors to recognise the opportunities and negotiate with local bureaucrats and legislators so as to profit from the negotiation. The political actors, government officials and legislators, on the other hand, depend more on the extra budgetary funds derived from fees and other unofficial payments. Thus, this shows that the relation between business enterprises and local authorities is a kind of power-dependence relationship that works both ways; one that complements rather than contradicts.

Also, as indicated by one participant (PAR #19), political embeddedness is even more vital for enterprises in the public procurement sector, in order for them to

create and maintain their competitive advantage. Political networking is also used by firms to capture non-market resources and gain preferential treatment.

*“Every year, when preparing the budget and programs, each government agency discusses and seeks approvals from the legislative office. Each legislative member usually proposes its own program, along with the budget put across on behalf of the department or other governmental agencies. On paper, the budget is written as the government agency’s expenses, while in reality, the budget is allocated and used by the legislative member. What I mean here is that the legislative member can promote its contractor or vendor to provide goods and service and as such, use that specific budget allocation. The official in the government offices usually allow this as a way to thank the legislative member who approved the proposed budget or even increased the budget allocated to the office.” [PAR #19]*

Another participant (PAR #5) similarly emphasized the importance of political connections to ease access to valuable resources such as tender information as well as relaxed treatment in licencing and administrative procedures. It was indicated by the participant that political embeddedness is a complement rather than a substitute for formal legal institutions during institutional development. Such efforts to build political connections were even referred as a normal strategy by participants in the current business environment.

*“If you question whether I got some advantages from knowing some people, I do not think so. I think it is common sense that you will help people whom you know from before (...) if some people have political connections and gain some advantages from the connection, I think that’s fine. It is a part of the strategy, which for me, there is no problem at all.” [PAR #5]*

Political embeddedness is also derived from the intense competition and demographic nature of small firms. In this case, small firms are more exposed than

larger firms. In the hotel industry, for example, according to the Indonesian Hotel and Restaurants Association (PHRI), in Makassar alone in 2014, there were 125 hotels or 8,800 hotel rooms, which increased from only 7,700 hotel rooms in 2013 (Table 5.2). In 2016, the total rooms are expected to increase, since the local government has approved the development of new hotels, mostly from the big hotel chains. The total number of hotel rooms is mostly contributed by hotels with three and more stars.

**Table 5.2: Number of Hotels in South Sulawesi Based on Classification**

Hotel classification	Year			
	2011	2012	2013	2014*
Classified (3, 4, 5 stars)	58	57	45	125
Unclassified	455	491	n/a	n/a

Source: Indonesian Hotel and Restaurants Association (PHRI, 2014) and BPS (Statistics Indonesia, 2014)

*\*Note: Estimated figures.*

The increasing number of new hotel developments in South Sulawesi concerned the current players in the industry, since it may cause more uncertainties and stiff competition, particularly since the entry barrier to the industry is so low. Intense competition forces firms to gain political support through political connections or to lose more without it. This is because regulatory institutions provide incentives that most small firms need in dealing with their competitors.

All participants from the hotel industry in this study also mentioned the significance of facilities offered by financial institutions for hotel developments. Unlike several years back, financial institutions, both state-owned banks and private banks, are competing to fulfil a niche market. One participant (PAR #2), who owned several hotels in the past, decided to sell all his hotels, leaving only one.

*“I mean it is simple. In the past, we operated a hotel in a very normal way. We were lucky because at that time, there were only a few hotels in this city. However, as you can see, there are more than 100 hotels now with different classifications and facilities. It is*

*currently like a war in this industry. So, we decided to operate only one hotel. I tell you, the price war for this industry is very cruel. I think hotels in Makassar only rely on MICE (meetings, incentives, conferencing and exhibitions) as the main target and not tourists or businesses. As a result, a price war is the only option available for the players. Our hotel is only three-stars, and you can get almost the same price from four or even five-star hotel, with more features and facilities.” [PAR #2]*

*“(…) the price war among players in this industry is currently not healthy. I think if the association wants to be useful, this kind of problem should be solved first. We should stick to the rules and the association can act as a stabilizer. The current condition shows that even four and five-star hotels want to compete with three-star hotels, where they offer the price almost the same as we did, but with even better facilities. If this situation remains the same, at the end of the day, nobody wins, everybody loses. [PAR #1]”*

The same concern was also raised by the chairman of the South Sulawesi Hotel and Restaurant Association (PHRI). As such, a moratorium or government intervention may be needed to regulate the industry structure.

*“Apart from its geographical advantage, Makassar is not yet the main destination for tourism. With an average 60 percent growth annually, a moratorium for developing new hotels is needed, unless we want to see trouble for this industry in the future.” [PAR #23]*

Similarly, another participant from the advertising industry also perceived the current competition as chaotic and full of uncertainties. She described that the collusion and political connections of her competitors made the challenge even more difficult for her firm.

*“The worst thing is that the firms owned by the relatives of top officials usually do not have any experience in this industry. Also, the firm has not been in operation for long, or is relatively new in the industry. They do not have any workshop and production workers. I do not even think they have an office at all. Since they have a good relationship, they can ask for many spaces and then sell those to us, the main and proper advert firms.” [PAR #3]*

Apart from the advantages, the participants also raised the issue of unsustainability of political embeddedness. The value of political connections for a firm may decrease quickly and may change from an asset to a liability. As a result, the value of such political connections becomes negative, especially when an unexpected event, such as the decentralisation movement that took place in early 2000, occurs. It could also happen when the ruling parties fail to win elections and therefore, the political regime is changed.

To overcome these negative consequences, some firms, especially medium and large firms, split their contributions; some firms choose to support each candidate, while others spread their influence with many politicians. In other words, there are no political preferences that lead firms in terms of their political contribution. The support in the form of donation could be the same amount or different, depending on the observation of the manager - whether the chance of a candidate to win is high or low. By doing this, firms are trying to mitigate the problem with the win-lose politicians and therefore, they can expect preferable policies.

#### **5.2.5. Rent-Seeking Bureaucracy**

The majority of the participants underlined red tape bureaucracy as one of the main obstacles to doing business in the region. Many illegitimate payments have to be paid by firms even though from the government officials' perspective, this was “voluntary payment”.

*“The officials now are very careful and reluctant to show their interests. You have to understand this situation. But usually we understand and keep it confidential. We proceed to make unofficial payment to officials only after the bidding process. As I said, it is only like a ‘relational fee’ because they chose you as a winner.”*  
[PAR #4]

Similarly, another participant (PAR #7) asserted that voluntary payments need to be paid to get a contract from the government.

*“I was once asked by the government officials from the mayor of the city office to conduct some training. In the end, I have to deal with many government officials only to get the money and too many officials want a portion of the budget.”* [PAR #7]

The voluntary payments or ‘relational fees’ paid by the firms are in different forms and are usually unrelated to the business and administrative processes. One participant (PAR #11) who has enough experience in tendering notes stated that the demands from the government officials were sometimes crazy.

*“Let’s say you apply for procurement in Palopo, for example, you have to be there, which means you have to cater for transportation costs. Second, you have to meet several people, the government officials, bidding managers, where you have to prepare the ‘entertainment cost’. (...) Entertainment costs could be in the form of food allowance when you treat them in a restaurant, buy cigarettes and small souvenirs, take officials to karaoke or simply give cash.”* [PAR #11]

The majority of the participants agreed that such informal and illegal payment is a form of gratitude from the business actors to the government officials for good services. As a result, such voluntary payment is viewed as normal for business

dealings, even though all participants agreed that it is common place in the region for rent-seeking activities to be implemented by government officials.

*“Look, I always believe that if someone helps you, you have to think to pay it back and do good things for him too. It’s nothing, just to give them money for buying cigarettes or food; it’s not a big deal. After all, you have to deal with them not just once, so you have to be good to them. At least you have to be grateful that they helped you and eased your problems.” [PAR #12]*

The risk of not paying such ‘voluntary payment’ is unavoidable if the firms decide to get involved in business. One participant (PAR #19) expressed his frustration when he avoided paying bribes:

*“Well, the result will be very clear that you will not get any project. I can say that I am 100 percent sure about this based on my experience. You also need to provide what we always call ‘after sales service’, where you invite government staff for dinner or provide small souvenirs after the contract is granted to you. You have to show your gratefulness and share it with them. I think it makes them comfortable doing business with you.” [PAR #19]*

Even though paying a bribe is unlawful and most business actors tend to avoid doing unlawful things, another participant (PAR #23) indicated that he is keen to do it. However, he states that he only chooses to pay kickbacks to the low-level staff.

*“I personally do not like the term ‘thank you’ in the form of payments that need to be paid by us, business people, to the government officials. However, as you may know, we cannot just ignore it as it does exist. For me, I choose to pay bribes to low-level staff instead of their bosses.” [PAR #23]*

Referred to as “*uang terima kasih*”, Indonesian, for “thank you”, this practice is a framework for distribution of bribes and mark-ups in the public procurement sector. The complexity of the new procurement regulatory framework does not prevent local procurement bureaucrats from finding a chance to exploit it. One of the several methods to do this is to help bidders fill out complex procurement documents in exchange for money.

Other various forms of red tape enforced on business enterprises include unnecessary official routines and lengthy procedures that cause delays. One respondent noted that he wasted a considerable amount of time in dealing with administrative procedures, just to find that it has nothing to do with the actual procurement process. Such unfavourable treatment typically occurs when the firm and government officials engage in disputes or disagreements.

Local parliaments which are expected to supervise the budgetary and procurement processes are also the subject of this power-abuse action. As a result, horizontal accountability on the level of local politics remains weak and meaningful change in the sector remains difficult to achieve. In addition, the dynamics of businesses, particularly in the public procurement sector, are motivated politically rather than economically.

The poorly crafted laws, inconsistency in regulations and weak capacity of local government officials may explain some of this situation. Likewise, the stiff competition and lack of resources, as well as the inability to compete with larger counterparts is arguably one of the reasons why business enterprises choose this strategy.

#### **5.2.6. Unclear Interjurisdictional Coordination between Government Tiers**

The interjurisdictional coordination is unclear since the liaison between the government tiers (local, province and national levels) is poor and time-consuming. According to the Ministerial Regulation of Public Works No 20/PRT/M/2010, advertising firms are not allowed to put their gantry billboard (*iklan bando*) permanently on the national highway (national routes). According to the regulation:

“Construction of building advertising and media information cannot be a portal and/ or other construction types that cross over the road, which is specifically intended solely for advertising and media information.” [Ministerial Regulation No.20/PRT/M2010, Article 18]

Unlike the roadside billboard, the gantry billboard (see for example **Figure 5.1**) is built solely for advertising purposes without any other functions. The structure of the gantry billboard is also visually intrusive, as it is positioned right in front of approaching motorists. Thus, this becomes an issue with road safety. Therefore, in May 2013, the National Road Agency insisted that all gantry billboards that have already been built are to be removed by the end of 2014, since most of them did not comply with the safety regulations and were situated on the national highway routes.



**Figure 5.1: A Gantry Billboard (*Reklame Bando*) at One of the National Highway Routes in Makassar, South Sulawesi**

In Makassar, there are four national highway routes. According to the ministerial regulations as mentioned, all national highway routes have to be cleared

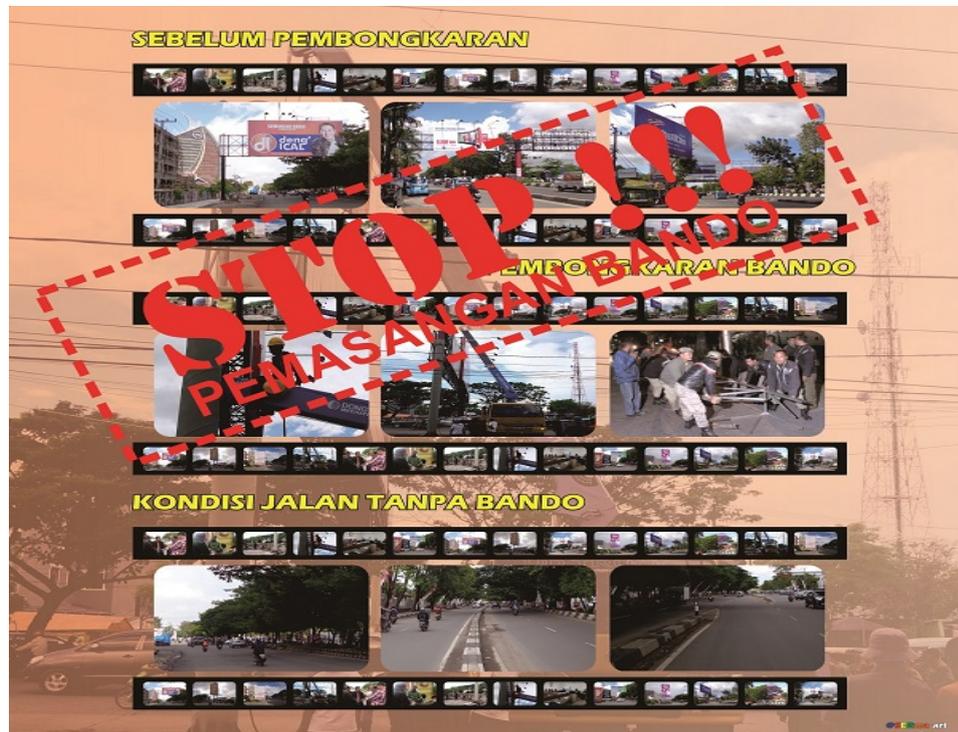
of gantry billboards that are situated over the road (see Figure 5.1 and Figure 5.2). While the gantry billboard is prohibited on this national route, roadside billboards are still allowed. However, the local government of Makassar city refused to remove the billboards or even limit the license for new billboards due to the income derived from this sector. The decision from the local government was supported by the Advertising Firms Association (ASPRI). The decision was made after several meetings, including lobbying to the local House of Representatives (DPRD). The association also argued that the law enforcement process should honour the contract between the advertising firms and city office. The local tax and revenue office of Makassar city argued that the central government did not comprehensively consider the laws before implementing it. In addition, the central government should consider the potential loss of revenue that will affect the development process in Makassar.



**Figure 5.2: A Gantry Billboard (*Reklame Bando*) Located Over a National Route in Makassar, South Sulawesi**

After several meetings and discussions, the national road agency through the provincial agency office insisted that the removal should be started. To make things even more complicated, there was a rumour that such action taken by the provincial government office was caused by the rivalry between the mayor and governor of

Makassar city. In January 2013, there was a gubernatorial election to elect the governor of South Sulawesi province for the next five year term. In these elections, the candidates were the mayor and the incumbent governor. The electoral competition between the two candidates was so intense and divided businesses into two different poles based on political choice and support.



**Figure 5.3: Gantry Billboard Removal Campaign Created by the National Road Agency and Provincial Office (Provincial Highways Directorate-Dirjen Binamarga)**

An owner (PAR#3) of an advertising firm conveyed her frustration from such situations:

*“We face so many uncertainties regarding the regulations here. The local regulations allowed us to build a billboard for a particular roadside, while at the provincial and national levels, this is considered violation of the law. The government, at all levels, should speak in one language. I just thought that the current government regime is very appalling.” [PAR #3]*

Being in an uncertain situation for such a long time, the association finally decide to file a lawsuit to challenge the decision from the national agency and provincial office to remove their billboards. The lawsuit was submitted to the State Administrative Court. In December 2013, the decision from the court emphasised the responsibility of the national road agency to remove all gantry billboards from the national highway routes. The national road agency decided to continue the removal process. The agency targeted 620 billboards and posters that should be removed by the end of 2014.

After their first court effort failed, the association appealed to the high court. The association believed that the decision to allow the national agency to remove their billboards did not consider the arguments from the advertising firms. It also indicated the lack of coordination between the government agencies, which affected the advertising firms. By the time of the writing this thesis, the advertising firms association had filed an appeal to the Supreme Court (Berita-Kota, 25/07/2015).

### **5.3. Non-Market Strategies**

Business-government interactions in Indonesia have dramatically changed following the implementation of decentralisation. One of the main differences is the fact that the firm is now have to deal with many levels of government and no longer centralized in the central government. Firms needed to balance the strategic implications for dealing with the dynamics of the business environment and the importance to comply with governmental rules. Compliance strategies could be categorised as attempts by firms to show how much they are in agreement with the government.

Many attempts have been made by business actors to influence the non-market factors that affect businesses in the volatile environment in the region (see Table 5.3). In those attempts, the firms tried to insulate themselves from the external environment with generally one major objective: influencing the non-market environment in the firms' favour. One of the key questions asked of participants in the study is the type of non-market strategies they employ. The participants were asked with questions such as "do you have a non-market strategy?", "How do you

deal with a (particular) situation?” and other questions related to their strategies in dealing with non-market environment. The following sections present the findings of the study and reveal the patterns of strategic behaviour among small firms in South Sulawesi based on the interviews with the study participants.

Table 5.3 summarises the participant firms' non-market strategies and patterns of action.

**Table 5.3: Firms' Non-market Strategies and Patterns of Action**

Industry/ firms	Firms' Specific Actions	Non-market Analysis
<b>Hotel</b>	<ul style="list-style-type: none"> <li>• Provide financial information of the firm to the government voluntarily to help the government calculate the tax and retribution.</li> <li>• Support local government tourism campaign in the form of providing flyers and other tourism information to the customers in the hotel.</li> <li>• Build connection with high-ranking local political actors to help the firm negotiate with the trade union.</li> <li>• Lobbying local government agencies, especially tax and revenue office, as well as the manpower office to support the firm in dealing with the labour issue.</li> <li>• Attend invitations from local House of Representatives (DPRD) for hearing sessions in tripartite meeting with the local government, employees/ trade union and hotel management.</li> <li>• Build connections with another business association (APINDO), apart from industry (hotel) associations.</li> <li>• Relocate families who lived around the hotel for hotel parking expansion.</li> <li>• Provide financial support for NGOs and youth organisations around the hotel, in particular on occasions such as <i>Ied Fitr</i> and Independence Day celebrations (sport and competition every 17<sup>th</sup> August).</li> <li>• Get involved in charity work with orphans and mosques</li> <li>• Build communication with the media to inform on the firm's position on a specific issue.</li> <li>• Providing counter information, by inviting journalists for a media conference to explain the position of the firm regarding the labour issue.</li> <li>• Engage in grassroots' activities.</li> </ul>	<ul style="list-style-type: none"> <li>• Firms in this industry mostly exercise typical strategies that involve intermediaries with the combination of direct involvement in its implementation.</li> <li>• The role of intermediaries, particularly business associations and the media, is important to create pressure for the authorities.</li> <li>• The risk of using financial donations is high, since the issue (labour and sub-contract employee) is very complex and involves multi-agencies and multi-tiers of the government.</li> <li>• Philanthropy and charity remain the main option in getting legitimacy from the authorities and civil society.</li> <li>• Decision to take individual or collective action was highly dependent upon the firm's resources.</li> </ul>

Industry/ firms	Firms' Specific Actions	Non-market Analysis
<b>Advertising</b>	<ul style="list-style-type: none"> <li>• Meet local tax and revenue officers regularly to seek options for billboard permits.</li> <li>• Negotiate when and how much local retribution such as property tax, building permit and advertising tax would be paid by the firm.</li> <li>• Bribe local staff in several government agencies to drive permits and licenses administration.</li> <li>• Provide transportation allowance for high-ranking officers in the tax and revenue office.</li> <li>• Support collective movement by the industry association to take legal action on national regulation on the billboard development moratorium on the national road.</li> <li>• Contribute actively in counter lobbying by the industry association to pressure the local government not to follow regional and national regulations on the billboard moratorium.</li> <li>• Build public opinion by being an expert source for a news reports or articles in the local papers.</li> <li>• Allow politicians and political parties to use the firm's resources, such as billboards, for political campaigning purposes.</li> <li>• Provide non-cash support for a few politicians and political parties (ruling parties) by designing and making copies of their respective political campaign posters.</li> <li>• Donate to mosques and orphans (as part of the obligatory charity actions or <i>zakah</i> and optional charity or <i>sadaqah</i>).</li> <li>• Support local community around the firm's workshop by supporting them with printing and campaign materials for several occasions such as Youth Games and Independence Day celebrations.</li> </ul>	<ul style="list-style-type: none"> <li>• Firms in this industry are facing issues mostly in the short-term basis. Political connection is relatively weak, given the rather simple issue (fees, processing time and supporting documents).</li> <li>• Legal action was used to show clear reaction in counter action by industrial association. Since the issue related to the regulation affected all firms, collective action was taken instead of individual action. Financial strategies were mainly used to overcome administrative barriers.</li> <li>• Collective action is critical but does not dominate the movement of the firm in the industry. Collective action was chosen based on the specific issue basis.</li> </ul>

Industry/ firms	Firms' Specific Actions	Non-market Analysis
<b>Government Supplier</b>	<ul style="list-style-type: none"> <li>• Bribe procurement staff to obtain procurement information.</li> <li>• Be actively involved in several business associations.</li> <li>• Pay administrative staff in the procurement office for help in dealing with myriad and complex forms and administrative procedures.</li> <li>• Shared the project awarded to other firms particularly to the firms that have relationship with the local elites through sub-contracting method. By doing this, the firm may save time and cost in dealing with any dispute from the award decision and in administrative process.</li> <li>• Negotiate with procurement staff for budget allocation and to split a program to several projects, so that it can be appointed directly without public tender.</li> <li>• Provide 'entertainment cost' which may be in the form of hospitality (karaoke) or transportation allowances to the supervisory board for each project, so as to avoid thorough examination.</li> <li>• Provide financial support and bribe to legislators in order to get contract.</li> <li>• Recruit technical expert (hackers) to disrupt the local procurement system, so that competitors cannot submit their application, in particular for public tender.</li> <li>• Provide campaign materials to legislators.</li> <li>• Provide political donations to legislators.</li> <li>• Use relatives or family from top officials as the help in order to get the contract in public tender.</li> <li>• Co-operate with NGOs and other interest groups as a counter lobbying move to prevent competitors from being awarded the contract.</li> <li>• Simultaneously work with the industry association, to pressure authorities to provide technical and administrative support, in order to cope with the new system.</li> </ul>	<ul style="list-style-type: none"> <li>• Networking and personal relationships with procurement staff and legislators dominated the non-market action by firms in this industry.</li> <li>• Aggressive lobbying and financial donations and bribes are implemented for the short term basis and in return, the contract is secured.</li> <li>• Build coalitions with other relevant stakeholders so as to influence public opinion and avoid a negative perception of the firm.</li> <li>• Collective action, as well as inter-firm relationship and co-operation dominated the non-market environment in this industry.</li> <li>• Political embeddedness is perceived as very important, since it brings about positive impacts in some context for some firms.</li> </ul>



As shown in Table 5.3, the firms' actions and tactics are not necessarily singularly driven. The majority of the participants in this study agreed that given the complexity of the institutional environment in South Sulawesi, non-market actions cannot be associated with only one driving force. Compliance strategy for example, cannot be driven only by political factors. In fact, empirical findings indicated that the compliance strategy could be attributed to both political and social factors.

As can be seen from Table 5.3, the role of intermediaries, through industry association or general business interest organisation, is important in supporting the non-market actions taken by the firm. The role of intermediaries is particularly important in legal action which is usually used to represent the interest of small firms. Individual actions taken by the firm are mostly driven by the issue that are mostly of a short-term basis.

### **5.3.1. Compliance Strategies**

The majority of participants agreed that when dealing with the non-market environment, firms should also consider formal tactics such as complying with regulations. Complying regulation strategies implemented by firms are varied between three industries, but in general have the same in common. Meeting the local regulation, acquiring the necessary license and how each firm interact with the government agencies are part of the firm's actions. Table 5.4 summarises the compliance strategies of firms.

**Table 5.4: Compliance Strategy of Firms**

<b>Hotel</b>	<b>Advertising</b>	<b>Government contractor</b>
<ul style="list-style-type: none"> <li>- Report revenue for tax purposes</li> <li>- Ask for instructions from the government and security officials regarding the labour issue</li> <li>- Get involved in several meetings and discussions held either by government offices or trade associations</li> <li>- Visit the relevant government office regularly</li> <li>- Agree to be involved in the tourism program organised by the tourism office</li> </ul>	<ul style="list-style-type: none"> <li>- Administrative licenses and permits prior to building billboards or other types of advertising</li> <li>- Pay local tax retribution</li> <li>- Pay land and property tax</li> <li>- Obtain licenses to build billboard from government technical agencies and municipalities</li> <li>- Ensure that the property complies with road safety regulations.</li> <li>- License and permit processing time usually takes 6 days</li> </ul>	<ul style="list-style-type: none"> <li>- Register to government agencies for procurement purposes</li> <li>- Meet regularly with officials to get information on public procurement opportunities</li> <li>- Invite government officials to supervise the work under contract</li> <li>- Collaborate and form alliance with government technical agencies in developing technical standards and procedures for specific procurement</li> <li>- Comply with technical and safety standard</li> </ul>

One participant (PAR #4) from the procurement sector emphasised the changing regulations as an important factor that needed to be considered by any firm in the industry. The introduction of e-procurement in many government agencies at all levels has forced the firms to develop their knowledge and catch up with the latest development. The participant further underlined the importance of meeting market obligation, which is that of completing other non-market related actions.

*“You have to know and have good knowledge in the procurement sector. You also have to have knowledge about the system, since the current system is very complex and time-consuming. We have a new version of the presidential decree on this matter and you have to understand the differences. Knowing the officials who handle the procurement is also an important factor. At least, by knowing the officials, you can play the game and know who you fight with.”*  
 [PAR #4]

An understanding of the regulations and other essential information related to the business is also important regardless of the industry. Compliance policies can also be found in the advertising sector. One participant (PAR #17) who has been involved in the business for more than 20 years noted that the compliance policies in the advertising industry have become more important, particularly since the industry is viewed as one of the main revenue generating means for the local government. The participant explained that the implementation of a new law for obtaining a license (in order to install a new billboard) or renewing a license needs to be considered carefully. There are now more agencies involved in the process compared to the past. The increasing number of stakeholders in the business means the firms will need to provide more knowledge and resources.

*“To get a new license for installing a billboard, you have to prepare seven items; while, there are only two items for renewing the license. It looks easy and you may think to intentionally violate the rules. But remember, by doing that, you just fool yourself. After all, you just need to comply with the regulations, albeit the consequence of time and money that goes beyond what was stated.” [PAR #17]*

One participant (PAR #4), who has been involved in government tendering for years, noted that the changing environment is unavoidable. In the past, it was easy to violate the rules and the subsequent risk could be avoided with bribery. However, under the current business environment, such an action is not enough to control the situation. The participant acknowledges that the frequency of violation of rules is not entirely declining. However, the pressure for firms to comply with regulations has become greater with increased public scrutiny. Some areas even enforced stricter conditions for business actors to be involved in government procurement. As mentioned by another participant (PAR #11), the current regulation requires firms to be registered at the national level if the firms want to get a contract to supply medical devices to the government hospital:

*“In our industry, there is a new regulation that all medical devices distributors (Penyalur Alat Kesehatan-PAK) should have the registration number (Ijin Penyalur Alat Kesehatan-IPAK) issued by*

*the Ministry of Health in Jakarta. In the past, such registration numbers could be obtained from the provincial level, but now we have to also register at the national level. The cost of obtaining such a registration number could reach IDR 50 million (\$5,000).” [PAR #11]*

An understanding of the fundamental conditions in doing business will shape the behaviour of a firm in implementing its non-market actions. One participant (PAR #17) expressed the general approach by all firms, where short term objectives mostly affected the decision of the tactics chosen:

*“(...) Doing business with the government means that you have to deal with many regulations and procedures. It is a long and time-consuming procedure, but you have to deal with it anyway. If not, how are you going to get a contract?” [PAR #17]*

Similarly, another participant, who also served as the chairman of a business association in the region, emphasised the importance of a firm to comply with the regulations. However, he realised that the greater effect usually comes from non-market tactics. Once the formal prerequisite is met, the firm needs to implement its non-market actions carefully at the start. One participant (PAR #9) asserts that such carefulness requires experience and resources in order to attain favourable outcomes. Lump sum payment, another form of bribe, should be treated confidentially (with one-way interaction only). The owners of small firms hardly ever meet directly with high-ranking officials who asked for the lump sum payment. This approach is taken to avoid any attention from external parties, such as non-governmental organisations (NGOs), competitors and legislative members.

*“With government officials, you have to deal with both the high and low-level ranking officials who handle your documents on a daily basis. For the high-ranking staff, we don’t know the suitable amount and as such, if we give them money, it will be useless since they may find that it’s not enough. Instead, what we provide is a ticket for travel. Usually they will never outrightly ask for that. You will need*

*to understand their unspoken hint. For instance, sometimes, the secretary will call me and say, “the boss wants to go to Bali”. From that point, you will need to read between the lines and understand that it means, ‘please provide the travel ticket and accommodation for the boss.’ [PAR #9]*

Violating regulations with bribery is usually driven by the fact that the regulations are hard to follow and weak in compliance policies. Bribery is thus used as the means to smoothen regulatory burden, even though all participants agreed that such actions should be taken carefully. Pressure from the society and massive corruption eradication campaigns have resulted in many business actors being prosecuted.

Apart from meeting regulatory requirements, all participants agreed that they also implemented other forms of compliance strategies. Consultations and meetings with the government officials to discuss important issues in the industry are also carried out by the firms. For instance, such actions have been conducted by the firms in the advertising business sector. When the central government intended to abolish all billboards that violated the rules on the national highway, the firms tried to postpone the action by seeking opinions from the provincial and city governments. The firms in the advertising industry also had consultations with the local parliament to seek support for this matter. Another compliance strategy adopted by government contractors is to invite the government officials to supervise their work. Firms also regularly report on the progress of the respective work, as stated in the contracts.

### **5.3.2. Participation Strategies**

The interviews also revealed that firms often pursued more than one strategy at the same time. This is especially where the two strategies were easy to initiate. For example, participation in the trade association took place alongside bribery of officials. As a result, some participants were not always sure which strategy or action adopted was more effective for them.

Based on the information from the respondents, the knowledge on the issue, as well as the regulatory environment at the local government level, is important for small firms, in their attempt to gain political influence at the local level. The impact of local government regulation is perceived as coercive rather than supportive. This is understandable, given the status of the local government within the governmental structure at the national level. Many local governments experienced decentralisation euphoria, where they can propose new laws and regulations that disrupt the licensing process.

Albeit the perception of coercive pressure from local government regulations, the majority of small firm owners believe that there are always options for them to utilise their influence on the local government. The options will be taken when the firms recognize the available political resources (knowledge and political connections) that they have. Several participants clearly indicated their involvement in a political party, either as a registered member or a supporter, is a part of their participation strategy. By doing this, firms may take advantage of first-hand information from policy-makers or even participate in the formulation of government policies and laws.

Given the nature of the three industries, organising collective action is more complicated, since such initiative may encourage free-riding from other firms in the same industry. Collective action will be selected when such action matches with the general interest in the industry. However, the intra-industry competition remains high for the three sectors, even though they belong to the same industry.

In the case of one participant from the hotel industry a reason for belonging to the business association or collective organisation was to benefit from group insurance policies. After two years of dealing with the labour issue, which affected the operations of his hotel, the owner decided to seek an alternative solution from the trade association. In addition, firms in the government contractor sector may pursue broad networks or find options with other firms within the group. In sum, the general view of the participants indicated that the variety and diversity of political actions, either inter-sector or inter-firm, is large.

### 5.3.3. Political Strategies

Regulatory uncertainty, stiff competition and red-tape bureaucracy have forced firms to become more dependent on political strategy. Political strategies of firms consist of political knowledge and competency, as well as political legitimacy and commitment. Political strategies can help firms exploit political resources managed by the government (through regulations or personal intentions of the government officials), which can help firms smoothen their operation and ease the uncertainty. As one respondent (PAR #9) from the advertising industry describes her experience:

*“A good relationship with staff at the revenue office will help, but what about other government bodies? Dealing with all of them is difficult, since they have different opinions regarding one matter. I have several contacts in various government agencies, but it is just one thing. The main thing to do is to approach the top officials. Therefore, we contacted them to have a chat and sometimes we invited the officials to a restaurant. Some of them refused to ‘cooperate’, but others were keen to do so and offered some help.”*  
[PAR #9]

The majority of the participants viewed political strategies as dominant as compared to market strategies, because the latter does not provide incentives for firms. Given the current institutional environment in Indonesia and particularly in South Sulawesi, all firms agreed that the key success factor for firms is not just market capability. The domination of political strategies could also be caused by the raising of social pressure from other interest groups and stakeholders. All participants expressed that the best way to deal with social pressure is through informal institutions, where personal relationships and providing lump sum payments or bribing is more powerful to facilitate economic activities. All participants interviewed admitted that such unlawful actions are beneficial to the firm in its operations, where the legal framework and economic institutions are weak.

When asked why such unlawful actions are preferable than legitimate ones, one respondent (PAR #19) from the government contractor sector indicated that the chance for the firm to get a contract is nearly impossible, without any connections with officials:

*“Well, the result will be very clear (if you do not bribe or have connections) that you will not get any project. I can say that I am 100% sure about this, based on my own experiences. You also need to provide what I call ‘after sales service’ where you invite government staff for dinner or give them small souvenirs. I think it makes them comfortable to do business with you.” [PAR #19]*

The nature of a firm also affects its legitimacy in dealing with its non-market environment. The larger the firm, the easier it can acquire legitimacy. Therefore, the only way a small firm can enhance its legitimacy, is through interaction with political actors. The difference in treatment and support that small firms get is clearly expressed by one participant. He noted that large firms usually have the support from high-ranking national officials or top security officials. Therefore, they do not need to deal with day-to-day activities, which for small firms, can be very time-consuming.

The implementation of the political strategy is also affected by the attractiveness of the political market. One participant (PAR #21) expressed his interest in entering public procurement as a government contractor, as he saw that the market was attractive and the likelihood of success was high; even though he was aware of the high level of competition in the sector, which to some extent made it more competitive to get benefits from the political strategy. Given the good connection he has with government officials, politicians and other political actors in the region, it made him believe that he could exchange his resources with some financial advantages in return. As he expressed:

*“I have many friends there (mentioning a government agency). After several years, my friends then got promotions and became important persons in the office. They then offered me a contract to do a certain*

*job. Since the job was not exceeding IDR 100 million (AU\$ 10,000), there was no need for an open tender and it was just based on my friends' assessment." [PAR #21]*

Implementing political strategies, by building connections with political elites and government officials, eases the way for business actors to acquire first-hand information. In such stiff competition, superior access and accurate information can help the firm reduce expropriation hazards, in situations where general communication in the public domain is inadequate. In return, the firm will provide financial incentives to the government officials by paying their business-related travels.

Two main instruments used by firms in implementing their political strategies are financial support and information. The participants in this study found that legislators and other regulatory authorities in government agencies are responsive to these instruments. Bribes and kickbacks offer financial incentives for the government officials and members of parliament, while receiving information from the firms could help agencies in their decision-making process. Most information transmission from business enterprises is delivered through the business association, which may come in the form of data, statistics and other market-related information.

While non-market strategies is perceived as highly important, in the case of political strategy, the majority of the firms in the government procurement sector agree that political strategy is more than just a complement to market-based competitive strategy. For the firms in the sector, competition in public procurement is determined by non-market strategies, as well as political strategies (how to maintain the mutual exchange of favour with government officials and legislators).

#### **5.3.4. Social Strategies Mainly Driven by Shared-responsibility Culture**

In terms of social performance, findings from the study show that the values and cultures, as well as religious value, of the firms presumably affect how they implement their social strategies. Philanthropy or charity is driven mostly by the personal value of the small firm's owner. Personal value is most important in social

activities when most activities are carried out by the owner. All participants were aware of the notion, “Corporate Social Responsibility” or CSR; nevertheless, they did not want their social activities to be classified as CSR. Unlike large firms, all the small firms’ owners in the study do not recognise the specific issues regarding social responsibility, which is to be handled separately by the firm.

The shared responsibility culture which is driven by religious value also motivates the firm in its social strategies such as charity and philanthropy. It is also driven by the encouragement from the value of the society to act in accordance to Islamic and good values in general. Many participants believe, regardless of their religion, that doing good for others can stimulate *rezeki* (blessing from God) and doing the reverse will cause punishment on the day of judgement. As indicated by one participant (PAR #7), the values that arise from donations or charitable actions are very important:

*“We always deduct our profit for that purpose. First we pay tax and we also pay zakat (obligatory charity in Islam). As a Muslim, I always insist that the firm has to pay zakat, which will be directly distributed to the poor people. It is what we believe and were encouraged to do since we were young. It is a good thing and I also believe that it will be beneficial for us.” [PAR #7]*

The influence of religious values shapes the approaches taken by the firms’ owner in engaging in charity activities, which are mainly in the form of *zakat* (compulsory giving), *Sadaqah* (non-obligatory charity and is not subject to any conditions) or *Infaq* (general giving). In doing charitable actions, the locus of responsibility is dominated by the people in need (orphans, Muslim organisations and targeted beneficiaries) around the firm’s location. No financial return is expected by the firms, instead it is merely a sign of altruistic value, as well as a desire to maintain the image of the firm. The latter involves the enjoyment of giving, which will lead to longer relationships with people around the firm.

*“We usually support sports activities held by communities around our workshop. I think every time the community has activities, they*

*usually request for us to participate; at least they can get their flyers/posters for their events printed here for free.” [PAR #9]*

A small firm’s owner’s individual discretion dominates the decision on how and what social strategies are implemented. A respondent (PAR #10) from the hotel industry shared the experience in philanthropy actions:

*“We also donate to the orphans and social organizations such as the Red Cross organization on a regular basis. We have a lot of food containers, oil containers and used newspapers from our customers that we regularly donate to the people around us, so that they can sell or use it for their own purposes.” [PAR #10]*

From the participants of the study, it was found that there was no formal request from the government authorities to do social activities. Instead, it would be up to the discretion of the owners of the small firms, who based their social activities on personal values and the importance of the beneficiary; although most of the time, the beneficiaries are the relatives or people around the firm. Although there is no formal demand from the government and no financial incentives are expected, the firms are keen to implement social strategies, as it exhibits good attitude from the owners.

#### **5.4. Political Resources**

When it comes to political resources, small firms are assumed to have lesser financial and managerial resources compared to their larger counterparts. However, from a different point of view, small firms essentially have a political resource in common with larger firms. The results of this study showed that regardless of the firm’s size, in the turbulent economy, a firm needs to invest in political connections in order to exert legitimacy and influence. Legitimacy is important for a firm, as shown by the majority of the firms in this study.

The findings show that legitimacy is important since it serves as the currency in developing a relationship. Furthermore, it is also critical for continued market

access, particularly with the government. As noted by one participant (PAR #4) based on his experience in building relationships with regulatory authorities:

*“I think you know what I mean. You have to lobby and build good relations with officials, especially in the districts, so they can share information with you. It is all about optimizing opportunities. It is not a difficult thing. I mean, it is common sense. If you do good things to other people, you can expect that they will do the same for you. So, you have to do good things, right?” [PAR #4]*

Governments are the source for firms to benefit through market exchanges. They are also the source of market information specific for firms. The government offers not just support, but also market opportunities for firms, in the form of various public contracts, licenses and approvals, policies and regulations, taxes, as well as other forms of financial support.

Heterogeneity of political actors in the institutions also forces firms not to have a homogenous view and treatment of political actors. Furthermore, all participants in this study emphasised that they need to deal with heterogeneous political actors within a certain institution, inter-institution political actors and also a heterogeneous set of interest groups. Given the locality of the context, firms in this study did not need to be aware of the heterogeneity between different political systems. All participants in this study exerted different strategies for each level of government officials.

*“(...) generally you have to deal with all levels and treat them as an important part of your network. Top officials must be very important since they are the one who make decisions. For low level officials, we usually give them cigarettes or small souvenirs to show our gratitude.” [PAR #13]*

One difficulty however, is that small firms are more heterogeneous. Therefore, each firm has to deal with a specific problem, even within the same industry. The majority of the participants agreed that there was a need to invest in

political commitments by meeting all administrative requisites and allocating more time in building political connections. One participant (PAR #4) from the government procurement sector explained the process in implementing its political actions, which required time and commitment:

*“It is simple. Don’t just contact them if you need something. Contact them regularly, make a conversation, help them with small things and the rest will be yours.” [PAR #4]*

Political connections give firms an advantage to have superior access to the first-hand information from political actors in government institutions. In addition, firms may build personal connections and special relationships with officials to rectify expropriation behaviours or political influences. Good connections also provide firms with valuable resources that are insufficient in imperfect markets. For example, small firms’ participants who work in the government contract sector mostly have difficulties in dealing with complex and myriad administrative procedures in government tenders. A personal relationship with officials will provide an advantage as the firms can have access on how to complete forms by providing lump sum payments for officials in return. It also helps them when dealing with supervisory matters, during and after the contract has been awarded, as one contractor (PAR #23) indicated:

*“You know how I can survive in this hard and cruel business? I invest most of my time building connections, not just at the top level but also with the low-level staff. They are also important. Do not forget supervisory officials too, they can make a difference when you have a good personal relationship with them. Every contract that I was awarded, I always check with the supervisor regarding the project, to make sure that everything was good. In return, I provided him with transport allowance and a lump sum payment. I don’t think it is a bribe, no, it was not a bribe.” [PAR #23]*

## 5.5. Level of Participation

The participants of this study also acknowledged the existence of different levels of participation in implementing their non-market strategies - the collective and the individual levels. The decision of the participation level is context-based and depends on the nature of the industry. In addition, the decision to involve and act collectively does not eliminate the choice to act individually. Free-rider problem is the main concern for firms in choosing between collective and individual levels. However, for certain issues, collective action through participating in a business association is the only choice for the firm. As a result, business associations are viewed as one of the political resources available to firms. Several collective business organisations are recognised by the government and therefore, the involvement with the business associations can provide access to a particular firm.

According to the participants in this study, collective business organisations can be divided into two general categories, namely business associations with a broad membership base and single sector business organisations or trade organisations. In general, these collective business organisations served as intermediaries for the firms in implementing their political initiatives.

All participants agreed that by being involved in a collective business organisation, a firm can get two collective benefits, namely securing essential information for the members and the power to change legislation. For small firms, being involved in a business association is a reasonable choice, since pursuing political objectives such as legislative changes with private and individual political action, is very costly.

Participants from the three sectors in this study indicated that in most cases, being involved in a business association can help the firms in seeking favourable legislative changes as another political resource. Small firms in the advertising sector which tried to legally oppose the decision to limit new billboard developments can only voice their concerns through the Indonesian Advertising Enterprise Association (APRSI - *Asosiasi Pengusaha Reklame Seluruh Indonesia*) as a recognised organisation. Firms in the government contractors sector often pursue

their interests through several collective business organisations. Moreover, being a member in one of the recognised collective organisations is one of the essential requirements for a firm in the procurement sector. A firm who wants to participate in a tender has to obtain a recommendation from a business association that is recognised by the government.

Meanwhile, one participant (PAR#1) from the hotel industry sought other options from another business association that does not represent a single industry (APINDO - *Asosiasi Pengusaha Indonesia*), as its specific industry association Indonesia Hotel and Restaurants Association (PHRI - *Persatuan Hotel dan Restoran Republik Indonesia*) was unable to facilitate its labour issue with the trade union. According to the interviewee, most of the members of the hotel association might be uninterested because the issue affects their firms differently:

*“I got frustrated and I didn’t know what to do. I should have got the support from my industry association, in this case PHRI. However, after several meetings and consultations, I felt that the members, or the organisation elites, were not interested in my case, until I met Mr L, the chief of The Indonesian Employers Association (APINDO). I consulted with him and hoped that he could offer me some solutions. Since I was not a member of his association, he asked me to join and register. Finally, the association led by Mr L started to observe the problem and identify alternative solutions and important stakeholders who were involved in this case. As you may know, Mr L has good connections with many people, particularly politicians. His family is also well-known in politics and business. I went ahead with his solutions and everything was soon back to normal. I didn’t even need to meet with parliament members or sit with the labour organisation before an agreement could be reached. I couldn’t believe this actually, but it just happened. All negotiations with the employees are led by Mr L. I also applaud him on his comprehensive knowledge of law and administrative solutions.”*

*[PAR #1]*

The above case demonstrates that the decision to be involved in the collective business organisation could help a firm to pursue its private political actions. Here, the collective business organisation served as an access provider for the individual firm. In addition, non-economic factors, such as the sense of belonging to a group, also influence firm owners' decision to get involved in a collective business organisation.

However, one firm from the advertising industry expressed their negative experience from being involved with a collective business organisation. This organisation is very specific as it focuses on small-scale advertising business, such as office printing, personal printing and small-scale promotional materials (banners, brochures, stickers and labels). The low political bargaining from the organisation in dealing with related government agencies is one of the factors that affected the perceptions of several members of the organisation, including the informant of this study. Another factor is the unclear and less strategic thinking that dominated the decisions made by the organisation. One participant (PAR #20) from the advertising industry expressed his frustration about the business association that his firm is involved with:

*“What amazed me was that the members of the association tried to fight with a big business player. This big business not only provides printing services, but also sells printing materials. The members of the association tried to fight against him by boycotting his company and not buying any printing materials from him. I didn't participate at all and I told them that we are not in the same league with this big business. I said that because I knew he has a big warehouse, with plenty of supply and huge capital. I remember also that I had a debt of more than IDR 48 million (\$4800) with the big company and he did not even send a debt collector my way. Thus, it was clear that he must be a very big player and I didn't want to be involved in a war that I certainly could not win. Some of the members even tried to call and blackmail him. (...) In this industry, paying cash for printing materials is almost impossible since you also haven't been paid by clients. That's the rule. Thus, this big business even refused*

*to accept cash and all the small players were soon running out of printing materials. It was terrible.” [PAR #20]*

## **5.6. Strategic Tendency**

All the participants in this study agreed that the rules, regulations and other political factors influenced the operational aspect of their firms. The impact is even greater during the decentralisation era, where local governments introduced various rules and regulations. The new regulations required firms to spend on some adaptation costs.

The findings indicated that in general, there are two kinds of strategies that represent how firms deal with the regulatory pressure.

The first strategy is that firms tend to adapt to the rules and regulations, regardless of the position the firms have of the rules. One participant (PAR #10) from the hotel industry expressed that several rules and regulations are imposed without the consideration of the conditions of firms. For example, the new labour regulation regarding casual workers is one of the critical issues for firms. Yet, firms have no choice but to obey the rules, even with the risk that the demand from the workers to get financial compensation is often more than what the rules state.

*“For example, at the first demonstration, the employees insisted that casual workers should be paid 32 times of the salary when their contracts are terminated. Can you imagine that? Look, the salary of a casual worker is IDR 1.3 million (US\$ 115) and according to the latest regulation, the compensation for workers with less than two years’ of work is only 2 or 3 months wages. And they asked me to pay 32 times as compensation? At that time, I just wanted to make sure that business at the hotel can go back to normal, therefore I paid the amount as requested. At the next demonstration, as they knew that I was in a weak position, they insisted on the implementation of this policy to other casual workers as well. Financially, I could predict my loss. How about my non-financial*

*losses, such as my hotel image and my professional image as a businessman? The worse thing is that it sends a bad and negative message to other workers. Other workers will believe that they can do anything and will not get any punishment for what they have done.” [PAR #10]*

Another participant, (PAR #13), a government contractor, also pointed out the effects of the political units’ coercive actions. The coercive actions, where political actors exercise their legitimate power for businesses to follow, have affected the performance of many firms. The implementation of e-procurement has forced the firms to adopt new technology. It also required the firms to deal with administrative and financial costs (related to fees and taxes).

*“We used to be able to get a contract from government agencies by simply sending them brochures or just calling the staff to ask for the bidding options. But now, you have to log in, open an account and provide documents electronically. You also have to spend some money on the installation of the Internet, purchasing of the equipment, paying someone to help you and many more. I know it’s hard and time-consuming. But you have to face it and deal with it. Otherwise, you will lose and will not get a single contract.” [PAR #13]*

The second strategy is by modifying how firms adapt to the regulations. By this, we mean firms are offering alternatives to the implementation of the rules. This also refers to changing the established political rules. Adaptation suggests that firms can also be active and not merely passive in dealing with the political actors. The findings indicate that not all firms have the capacity to convert the adaptation and become more active in changing the established political rules. However, when the firms act collectively, the outcome might be different. As firms in the advertising industry pointed out, with collective action and intensive lobbying, some of the problems related to regulatory problems can be solved. One of the successful outcomes of collective action in the advertising business sector is the rescheduling of

the deadline for firms to remove the billboards that violated the rules, which provided firms more time to comply with the new regulations.

### **5.7. Non-Market Strategies and Firm's Performance**

One of the research questions in this study is on how non-market strategies affect firms' performance. Even though all participants were reluctant to share their financial information, the majority of the participants agreed that the implementation of non-market strategies, regardless of the types of actions, influences the performance of their firm. When asked about how they measured the performance, the majority of participants indicated that sales turnover, employment growth, getting a contract from government agencies and profits are some of the indicators that reflect their performance. As discussed in Section 4.5, the performance of the firm used in this study were mainly based on subjective perceptual measures from the managers during the interview since objective measures were not available as mentioned earlier in Section 4.5.1. In addition, the performance indicator used by a firm may differ from one firm to another and from one industry to another.

All participants from the government contractor sector agreed that non-market strategies are important for them to be successful and to get more contracts from the government. It can also be assumed that without non-market strategies, firms that have a high reliance on government sales will have difficulties getting a contract from the government. In other words, non-market strategies directly affect the performance of a firm as indicated by the number of contracts the firm successfully got from the government.

*“You know, there are hundreds of companies out there. We offer almost identical products and service. We are in the situation where ‘too many bidders with so little projects’. Without friendship, lobbying and bribe, how can you get a contract? The government has plenty of options to choose, you just need to do your homework to get a contract. “[PAR #9]*

The interviews with the firms that also served as government contractors revealed that unless the firm offers a very specific and unique product or service, the government will always have more options to choose from. Along with the firms' market strategies, firms also tried to offer further incentives to government officials using non-market strategies. As one participant (PAR #11) indicated, the incentives to implement non-market strategies are therefore higher than doing business without the non-market strategies as it increases their chance of getting a contract:

*“Before the bidding process, I sent my brochures and catalogues from the factory, so that the officials will consider using my product specification in the bidding process. At the same time, I also sent the brochures to the hospital director to make sure that he is also aware of the specifications. Apart from that ‘normal’ strategy, you have to prepare a ‘commitment fee’ and propose an option for profit-sharing with the tendering officials. So yes, having just a brochure and a good product is not enough in this business.” [PAR #11]*

The participant above (PAR #11) illustrated the non-market strategies that he took in order to get a contract from government agencies. Non-market actions in this case included providing a commitment fee and also ensuring that the firm will provide what the participant called, “facilitating fee”, such as entertainment and travel expense for tender officials. In terms of the commitment fee, prior to the bidding process, informal negotiation along with illegal payment (bribe) were paid so that the officials will consider using the product specification from the firm in the bidding process. The commitment fee also serves as a guarantee to officials that the firm agrees to share the profit if the firm was granted the contract. The participant expressed that by doing all these actions the chance for the firm to get a contract from the local government is greater than simply following the normal procedures.

Being granted more contracts from the government means that the business is running well. It also means that the firm may require recruiting more workers. Contractors in the infrastructure development sector, for example, indicated that one way to see the performance of the firm is to see how many workers they have.

*“I always believe that doing business is not just about money and profit. If you work hard and do good things, this means your business can continue and grow. It means that you can recruit more workers. Employing more people means your business is doing well.” [PAR #8]*

For firms that have less dependency on government sales, the purpose of non-market strategies is mainly as a bridge to ease procedural applications, such as getting licenses and renegotiation of local taxes. It can also be said that the non-market strategies have no or little relation to the core business of the firms.

*“We tried to comply with all regulations. We have done this before, and I think all the procedures have been conducted, include those ‘thanks’ allowance and everything. We also believe we have done nothing wrong. So we build our billboard and in the meantime we deal with licence procedure. We negotiate the time frame for advertisement to be displayed. Besides, everything will be fine if you handle it with care and meet their expectations. Our intention is actually just to deal with time and try to meet our client’s expectation.” [PAR #3]*

Building informal political ties with local tax officials through providing travel expenses and “thanks allowance” clearly ease the administration process. According to the participant (PAR #3), such tactics can make the processing time in getting a license faster than without doing them. He even emphasised that the impact of those tactics allowed him to build the billboard and arrange the license after that, even though the regulation required the firm to get the license before building a billboard. The participant also mentioned that this helps the firm accept more order from clients since they can assure the client that the billboard can be built and that they can meet the client’s time frame.

One participant from the hotel industry revealed that he adopted non-market strategies as a form of protection for the hotel. Actions, such as paying an entertainment fee to government officials and paying “security expense” to the

various thug organisations, have no direct relation to the market environment. The non-market strategies, in this case, were used not to get profit or financial incentives, but to “protect” the firm. In Indonesia, firms also need to tackle the problem of organised thuggery which may come from formal or informal organisations. These organisations are usually affiliated with ethnic groups or even serve as the backbone of some political parties and are usually used to intimidate political rivals, or to force resolution of business and land disputes.

Many informal organisations or gang-related organisations regularly ask for lump-sum payments from business organisations. They use various reasons such as support for youth activities, security incentives, support for local sports team, and some even claim the organisation is a community shareholder and therefore, the firm need to support them financially. However, implementing such strategies required cash outflows that may affect the operational costs for the firms. But paying the fees ensures that the firm gets a better environment for the business to run well. As one participant from the hotel industry acknowledge, his firm faced fewer protests from gang-related organisations compared to the condition before he implemented such non-market tactics. He also acknowledged that doing such tactics makes him less stressed with “security” problems and he feels protected, even though he also emphasised that security and safer business environment should be the responsibility of the police and the local authority.

One participant from the advertising industry (PAR #13) supported this argument as his firm also implemented non-market strategies. In this case, the firm allowed a politician or political party to use their billboard for political campaigning, which did not directly bring about profits for the firm. The participant claimed that allowing politicians or political parties to use the billboard is cheaper than giving the politicians financial donations for election campaign. As the participant said:

*“I think it is much better than we donate our money to the campaign team. It is hard for us actually since the mayor of the city is going head to head with the incumbent governor. Both of them are the important person in this province. Besides, the vice major is the main supporter for the governor. You can imagine we have to deal*

*with two candidates. It is hard to choose only one candidate at this time. Besides, my billboards were usually used by other politicians too. When they saw that the billboard isn't used by our clients, they will call me. I usually let them use the billboard, as long as they don't ask for other things. If they want to use my labours, they have to pay them directly. Not to me, but directly to the workers.” [PAR #13]*

Being involved in a business organisation is also one of the non-market strategies that make ones firm improve its performance. For instance, a participant agreed that in terms of financial indicators, the involvement in more than one business organisation mostly impacts the firm performance indirectly. The participant is aware that he needs to deal with various issues which are not all business-related. He gave an example of when he was frustrated by industrial relations matters in his firm. The business organisation that he is a member of helped the manager to negotiate suitable terms which worked for the firm and also was accepted by the employees. The organisations also helped the firm lobby the parliament so that the hearing session in the parliament house requested by the employees was cancelled. The participant admitted that his involvement in the business organisation helped him solve this problem and therefore, avoid him spending so much money unnecessarily. However, he argued that not all issues are best solved by the organisation, as he expressed:

*“I think it depends on the problem. Based on my case, I have tried to solve it by myself without external help. But as you may know, it didn't work. So, association, in this case APINDO, is the right way to solve the problem particularly since the problem was very complex and involved so many parts”. [PAR #22]*

The advantage of participation strategy described above (in addition to collective action through business associations) has also helped the firm in the advertising sector to gain political benefits, albeit the benefit did not directly provide any financial profits. A political benefit for the advertising firm came in the form of

consultation and negotiation opportunities. With the support of the advertising firm's association, the firm was able to consult and renegotiate the deadline for the billboards' removal with the government.

## **5.8. Summary**

Following the constant comparative analytical feature that is consistent with grounded theory, this chapter presented the research findings related to the antecedents of non-market strategies implemented by firms in Indonesia. The general experience of the participants in this study indicated that decentralisation, as an outcome of political reform, came with significant changes that influenced the operation of firms. The changing institutional environment after the resignation of President Suharto made the challenge even greater for small firms. The institutional environment based on small firms' owners' perspective was more complex and full of uncertainties.

Regulatory uncertainty was one of the main factors that affected the business environment in Indonesia. The uncertainties were due to the situation where the local governments issued more laws and regulations in favour of generating more income for the local government. However, instead of clarifying what business actors should do, the laws created confusion since many of the laws have been established without consultation and thorough discussion with stakeholders. As a result, firms often faced different interpretations of a particular law from various government agencies. Apart from such regulatory burden, the non-market environment in South Sulawesi remains characterised by rent-seeking and red-tape bureaucracy.

It is necessary to recognise the antecedents of non-market strategies that small firms face as well as how they influence the firms' decisions regarding how they implement their non-market strategies. The complexities surrounding labour factors, unclear jurisdictional authority between government agencies, rent-seeking and cultural boundaries in doing business are some of the social and political antecedents that influence non-market strategy of the firm.

The study found that non-market strategies are utilised to overcome social and political pressures. Firstly, the compliance strategy was perceived as an important non-market strategy, given the complexity of the regulatory environment in Indonesia. Participation strategy is another form of non-market strategy implemented by firms, where firms are involved in a political party or are supporting one informally.

The findings in this study also confirmed the importance of political strategy in the non-market strategies implemented by firms in Indonesia. Political strategies can help firms exploit political resources managed by the government (through regulations or personal intention of government officials), which can help firms smoothen their operations and ease uncertainties. The incentives for implementing political strategies as part of non-market strategies of firms are perceived to be greater than market strategies. Social strategies, on the other hand, are mostly implemented on the basis of religious values and are personal-satisfaction driven. Social strategies are also seen as indications of the owner/ firm's desire to share responsibilities with others.

The next chapter will be devoted to the discussion of the findings in relation to the research questions.



## Chapter 6

### DISCUSSION

*“Market success depends not just on their products and services, the efficiency of their operations, their internal organisation, and the organisation of their supply chains, distribution channels and alliance networks. Success also depends on how effectively they deal with government, interest groups, activists and the public” (Baron, 1995b, p. 73)*

#### 6.1. Introduction

In the previous chapter, the results of the study were presented following the constant comparative analytical feature of grounded theory. Four concepts based on the research objectives of this study were presented. First, the political and social antecedents have been identified which give the broader picture of the nature of the non-market environment in Indonesia. Second, the choices of non-market strategies implemented by the respondent firms were also identified. Third, the forms of non-market actions and firms’ non-market strategy behaviour in dealing with the non-market environment in South Sulawesi were also identified. Lastly, the effect of the implementation of non-market strategies on the performance of the firms was also presented.

It was also established from the findings that small firms in Indonesia face challenges related to the non-market environment as a result of decentralisation wherein the local government was given more discretion in economic decision-making. Generally, small firms become a target for extra fees and charges, as a result of the low quality legal environment due to macro level instability and the inconsistency and lack of law enforcement of the local government.

This chapter contextualises the findings within the existing literature on non-market strategies in emergent markets. It also examines the findings and compares it with extant literature. Corbin and Strauss (1990) argue that such action is not just intended to validate the findings, but also to position the study within the existing literature.

This chapter is structured as follows; Section 6.2 seeks to answer research question 1 on the nature and characteristics of non-market environment in emerging markets such as Indonesia. Section 6.3 deals with research question 2 in regards to how non-market environments lead to the choice of non-market strategies. This is followed by Section 6.4 which explores research question 3, how non-market strategies impact the performance of firms. In Section 6.5, relationship-based strategies that employ political resources are discussed followed by the caveats that need to be considered in implementing non-market strategies in Section 6.6. The chapter concludes with a summary of the key points from the chapter.

## **6.2. Nature of the Business Environment in Indonesia - an Emerging Market**

As mentioned in Section 2.4, market and non-market strategies have become the instruments for firms to compete in an increasingly competitive environment. Market strategies are aimed at shaping the interactions between firms and their competitors and customers, as well as creating value for economic performance (Baron, 1995a). Non-market strategies, on the other hand, are aimed at influencing the institutional players in public policy arenas and tailoring non-market environments (Baron, 2010).

Non-market strategies differ in various institutional conditions (Doh et al., 2012; Shaffer & Hillman, 2000). As mentioned in Section 2.7 of the literature review chapter, previous non-market strategy literature focused mostly on Western and developed nations (Wright et al., 2005; Peng, 2002), with large firms as the objects overlooking strategic choices and its relationship with institutional frameworks (Bengtson et al., 2009; Peng, 2003). The condition in most developed nations may not be homogenous with most emerging markets, which consists of different stages of economic, social and political conditions (Burns, 2012).

Currently, there is a lack of empirical research from emerging market settings, such as Indonesia.

In Indonesia, political change and reform have affected the magnitude and complexity of the business environment. The Asian financial crisis in 1997 has also uncovered the weakness of the economic structure of the country which was mostly driven by political connections rather than market fundamental instruments (Fisman, 2001). Lack of transparency and monopolistic environment also contributed to the vulnerability of the Indonesian economy. The combination of these factors led to the resignation of Suharto as President after more than 32 years in office as well as a deep social and political crisis.

The transition to power from the centralised government to decentralised democracy took place with the direct parliamentary election in 1999 followed by the presidential election in 2004. Major constitutional revision along with new regulations in the level of local governments was introduced. Fundamental transformation and reform in the financial sector were also introduced to avoid economic deterioration as what had happened during the Asian financial crisis. As a result, the Indonesian economy gradually went back to track with economic growth recovery to almost the pre-crisis level (Hill & Shiraishi, 2007).

Despite the economic growth and other improvements at the macro level as a result of decentralisation, many observers believed that fundamental improvements are still needed and therefore, the business environment in Indonesia remains challenging (Van der Eng, 2004). Ongoing institutional changes as well as the necessity for informal relationships in dealing with institutional voids, the main characteristics of emerging markets (Peng, 2003; Hoskisson et al., 2000), typified the situation in Indonesia.

The literature on non-market environments in emerging markets setting have also mostly focused on institutional and infrastructure deficiencies (Kim & Li, 2014; Hoskisson et al., 2000). Institutional deficiency is mostly present in the case where the country lacks market-supporting institutions (political and legal institutions) (Meyer et al., 2009; Hoskisson et al., 2000) and weak financial markets and other

resources (Choi et al., 1999; Peng & Heath, 1996). The following sections elaborate the macro perspective from participants of small firms in relation to the characteristics of business environment in Indonesia, namely, weak institutional environment and institutional transition.

### **6.2.1. Weak Institutional Environment**

One of the main characteristics of Indonesia is the weak institutional environment. As discussed in Section 2.5.1, the institutional environment surrounding small firms in Indonesia is still characterised by the absence of market-supporting institutions. For example, insufficient protection of property rights (Van der Eng, 2004) and extensive laws and policy differences among government bodies in the process of investment decision-making (von Luebke, 2009) remain characteristics of the business environment in Indonesia. This situation is not unique to Indonesia and is generally found in emerging markets (Dieleman & Sachs, 2008; Peng, 2003; Hoskisson et al., 2000).

The absence of market-supporting mechanisms where the firms have to deal with imperfect market mechanisms, as well as a strong but unstable government makes it “a paradox of tensions and contradictions” (Li, Peng, & Macaulay, 2013). On one hand, the firms face stiff competition with an increasing number of competitors, as in the case of the three industries in this study. At the same time, the firms are also forced to pay more attention to the powerful but unstable governments which continuously assert their importance for the business to operate.

The findings in this study showed that the government, on every level, have continued to preserve and even impose their importance as a result of decentralisation. While decentralisation means a reduction in the central government’s intervention, local governments still possess and even foster power in approving and allocating resources. This finding is consistent with previous studies showing that government interventions dominate the market environment in emerging markets (Peng et al., 2009). The regulatory dimensions within the national and local governments in Indonesia are characterised by a relatively loose system where the central government allowed too many local governments’ regulations with

limited supervision and coordination. Lack of clear coordination among government agencies and the tendency to over-regulate also contributed to the poor implementation and enforcement (Butt, 2010).

The poor implementation and enforcement by government agencies at all levels have significant impacts on small firms. As a result, the situation creates more uncertainties for firms, particularly small firms, as can be seen from the case studies. Take the advertising firm industry, for example. The firms have to deal with uncertainties due to unclear jurisdictional coordination between the municipal, provincial and central government. After installing their billboards on the national highway route, the firms had to uninstall all the billboards as instructed by the central government. The situation is the same for the players from the hotel industry. Apart from facing stiff market competition, firms also have to deal with labour issues such as wages, overtime pay and dismissal payment. In addition, firms also faced high pressure with extra demands from other stakeholders and became a target for financial support by political candidates in the local election.

From all the firms interviewed in this study, all 27 participants, small firms' owners and directors from the three different industries (hotel, advertising and government supplier), confirmed the importance of informal political relations with politicians as a substitute for weak formal market support institutions. These findings show that social relationship with other actors are crucial for the firms which is consistent with other studies in emerging markets (Fisman, 2001). One can argue that when the non-market environment is surrounded with uncertainties, the strategic market-based choice is ineffective or not sufficient and offers less incentive for the firms.

Given the prominent position of the government and other non-market actors that often force frequent transformations in the regulatory and legal framework, relational strategies are the leading strategies that are implemented by the firms (Rajwani & Liedong, 2015; Peng & Luo, 2000; Peng & Heath, 1996). Apart from lowering transaction cost, relational strategies also enabled firms to pursue their objectives with advantages from public policies through licensing and acquiring government contracts (de Jong et al., 2015) and reduce the uncertainty caused by

regulatory changes (Bonardi & Keim, 2005). Relational strategies are even referred to as a unique type of entrepreneurial capital that leads to better performance of firms (Fan et al., 2011; Peng & Zhou, 2005; Peng & Luo, 2000).

### **6.2.2. Institutional Transition**

Apart from the weak institutional environment, the business environment in Indonesia, as with most emerging economies, is characterised by transitional phases which reflect the need for different strategic implementations by the firm. Decentralisation, as a product of political reform in Indonesia, comes with significant changes that influence the operation of the firms, particularly for small firms. The economic and political transition from the Suharto regime to the decentralisation era has resulted in different impacts for different actors. Local political actors enjoy the new jurisdictional power which creates a dilemma for the firms. However, the empirical findings in this study showed that decentralisation means increasing uncertainty in doing business.

The findings in this research indicated that all firms, regardless of the industry, are facing the same situation. Problems such as unclear jurisdiction among different technical government agencies, labour issues, low level of law enforcement and constant pressure from politicians and government officials force the firms to increase their use of private arrangements.

The importance of informal political relations with government officials and other private interests such as activists or non-governmental organisations (NGOs) is a result of public and private expropriation, which considerably restrains firms from engaging in market activities. All participants confirmed the importance of private arrangements or institutional substitution strategies to compensate for missing market-supporting institutions. The range of institutional substitution strategies implemented by firms is broad and includes lobbying, creating personal networks, and personal donation to politicians and soft money to government officials, which were meant to substitute for weak formal institutional protection.

The majority of the participants asserted that the government authorities did not give credible commitment not to expropriate from the business actors during the transition period. Government officials and politicians were able to extract rents and collect bribes, just two of the methods that reflected weak market-supporting formal institutions.. Other forms of public expropriation hazards from government officials were excess red-tape bureaucracy, interventions to market activities and rent extractions. Such activities were very time-consuming due to the number of procedures required and the cost incurred to secure smooth operations for small firms.

The firms in the three industries involved in this study faced rampant opportunistic behaviour from the regulatory authorities. Interestingly, the evidence also indicated that such a challenge is not uniquely related to government officials or politicians, but also to the civil society at large, including social organisations around the operations of the firm. This implies that firms should also think about including an informal exchange with other external counterparts, as a result of these external demands.

Relational strategies are the main activities preferred by most participants in response to the institutional constraints they face. Relational strategies refer to the integrated set of organisational activities in managing relationships with the stakeholders of the firms (Marquis & Raynard, 2015). Firms in the government contractor industry in this study believe that such actions will effectively insulate the firms from market competition. This is consistent with previous studies that have the basic premise that firms tend to use rent-seeking activities and relational actions to substitute market capabilities (Galang, 2012; Ivy, 2012; Chen, Li, Su, & Sun, 2011; Keim & Hillman, 2008).

Unsurprisingly, according to the cases in this study, the government is perceived as one of the most difficult environmental dependencies to control and therefore, is considered one of the main constraints of the firms. This echoes previous studies that viewed the government in emerging economies as a key constraint in shaping economic and social and cultural concerns (Hoskisson et al., 2000). Poorly-enforced institutional rules have dissuaded economic activity and

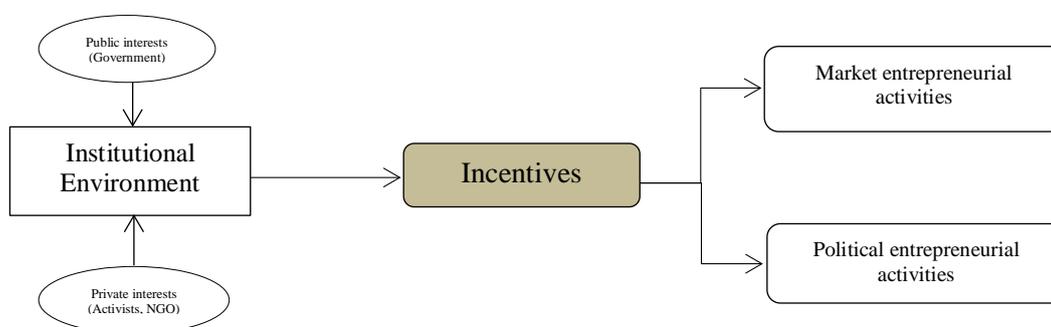
made non-economic actions the priority (North, 1990b), since such actions are perceived as more attractive and rewarding. Another reason a firm pursues non-economic actions is related to the survival of the firms. It is understood that non-market activities can increase the probability of survival of a firm or even help a firm generate rent by neutralising the advantage of competitors.

The findings in this study also indicated that the absence of strong institutions, combined with rampant opportunistic behaviour from regulatory authorities, places pressure on firms to be involved in corruption and extensively use their connections. Corruption and bribery, as indicated by firms in this study, is seen as political action and a part of non-market strategies in response to competitive pressure (Collins, Uhlenbruck, & Rodriguez, 2009). Managers and owners of small firms rationalised the action of corruption as necessary to counter similar actions taken by their competitors. Corrupt practices, as a strategy for dealing with red-tape bureaucracy, are seen as important competitive activities aimed at stifling competing firms (Lawton, McGuire, et al., 2013). Such a strategy is particularly important for firms with a high dependency on government contracts and those in a more regulated industry. The research outcome also shows a predominant reliance on the network-based strategy to avoid unfavourable outcomes, as a result of weak formal market-supporting institutions (Peng et al., 2009; Peng, 2003).

The empirical findings in this study illustrated that institutional-based strategies are the main choices for small firms in Indonesia. This is because these strategies can be perfectly implemented utilising the intangible resources (e.g., political knowledge, personal political ties) that the firms have. The lack of incentives for a firm to invest in firm-specific assets is one of the reasons why firms pursue institutional-based strategies. As a result, personal connections served as an institutional substitution. This is consistent with other studies (Peng, 2002; Fisman, 2001). In the case of emerging economies such as Indonesia, despite their illegality, such actions are expected by most firms.

### 6.3. Non-Market Environment and the Choice of Non-Market Strategies in Indonesia

Given the prominent position of the government and other political actors, along with the uncertain and complex nature of the non-market environment, the firms in this study chose to engage in non-market strategies. The findings of this study confirmed that the main driver for firms to implement non-market strategies was to overcome the hazards of public (government) and private expropriations such as those given to activists and NGOs. Generally firms have two options in dealing with the institutional environment – (1) through market entrepreneurial activities and (2) through Political entrepreneurial activities (see Figure 6.1). The use of non-market strategies to handle the non-market environment was perceived by the firms as their best strategy to generate the best returns for their firms, as compared to market entrepreneurial activities.



**Figure 6.1: Institutional Environment and Incentives**

Firms in this study confirmed that non-market strategies helped them attain advantageous positions and profits. The “institutional void” has frequently been cited as the reason for a firm to implement non-market strategies, such as political strategies, relational transactions and extensive use of personal relationships (Peng & Luo, 2000).

#### 6.3.1. Political Strategies

Firms in this study demonstrated two different behaviours in terms of implementing political strategies. In the case of government contractors, the trend

was to use political strategies for rent-seeking purposes. The firms in this industry tend to insulate themselves from competitive forces with rent-seeking behaviours such as bribery and providing facilities for government officials. This behaviour is common in small firms not only to secure public procurement contracts but also to block competitors from entering the competition.

On the other hand, firms from the hotel and advertising industries showed different behaviour in the implementation of their political strategy. Firms in these two sectors implemented political strategies to decrease the level of illegal payments imposed by local government authorities. Political actions were also implemented to force regulatory authorities to provide better protection for small firms in entrepreneurial activities and market production.

The two different behaviours of firms in the implementation of political strategies in this study lead us to the proposition that firms which focus mostly on rent-seeking purposes are firms that have fewer capabilities to survive in the market competition. These cases also demonstrated that firms will invest more in hazard-reducing strategy when they believe that the rent generated is unrelated to the firm's market activities. Apart from the differences, this study confirmed that in an institutional environment characterised by weak market-supporting institution, political strategies can reduce the level of uncertainty faced by the firm.

When faced with public and private expropriation hazards, small firms substitute institutional challenges with political strategies, which can help them influence political decisions and policies. Political strategies are an important part of non-market strategies, which influence the competitive strategy of the firm (Baron, 2010). The variety of political strategies taken by small firms ranges from campaign contribution, informal personal network with regulatory authorities to direct political participation.

Furthermore, the findings showed that political strategies of small firms serve as antithetical to the development of market capabilities of the firm, given the fact that the small firms implementing such strategies have low market capabilities. The consequence is that these small firms do not pay more attention in improving their

market capabilities. Instead, they become reliant on non-market strategies for their business activities. As can be seen from small firms that rely heavily on government sales, they tend to avoid and even prevent regulation changes. For firms with this character, non-market strategies serve as a substitute for market strategies. This is in line with the argument from previous studies that non-market strategies, in this case political strategies, can help the firm replicate the functions provided by market-supporting institutions (Hellman et al., 2003). Apart from fewer incentives which might be obtained with market activities, the firms also understand that network-based strategy and personal trust can help them overcome uncertainties (Peng, 2003; Peng & Heath, 1996).

The above behaviours of the firms in implementing their political strategies also emphasised the importance of the discussion to integrate market and non-market strategy of the firms, as previous studies have demonstrated (Kingsley, Vanden Bergh, & Bonardi, 2012; De Figueiredo, 2009; Hillman & Hitt, 1999; Baron, 1997, 1995a).

Another perspective in discussing political strategies could be seen from whether the political strategies were implemented in the form of relational or transactional approaches. The findings in this study also showed that the direct relational approach was used more by firms with high dependencies on the government, while firms with less dependency tend to adopt the transactional approach. It confirmed the conclusion from Pfeffer and Salancik (1978) that political activities implemented by firms can help reduce uncertainties related to dependence on the government. However, each firm has a different influential capability, which is mostly related to asymmetrical capabilities, as argued by Oliver (1991). A few of the participants indicated that the absence of a stable institution, as in the case of South Sulawesi, created great enthusiasm for firms to be involved in political actions and actually served as an attractive political market (Bonardi et al., 2005; Schuler et al., 2002; Shaffer & Hillman, 2000).

According to Peng (2003), after experiencing environmental turbulence and calculating the possible incentive of the network-based strategy with regulatory authorities, firms tend to develop new market capabilities. Such an intention requires

supportive regulative pressure, which helps create a competitive environment. In this phase, firms which implement hazard-reducing strategies explore an alternative approach beyond network-based and informal relationships, since such relations are no longer sufficient (Peng & Luo, 2000).

The findings from this study also confirmed that the size of the firm determined the choice of political strategy and actions taken by the firm. All cases illustrated that as small firms, they generally had the tendency to wait for the signals and chose to be passive instead of active. This situation is in line with previous studies which showed that the size of the firm could be one of the main prerequisites of the political behaviour of the firm (Lux et al., 2011; Hillman et al., 2004; Hadjikhani & Ghauri, 2001; Hadjikhani, 2000). In the environment that characterised with high level of corruption, small firms often have limited choices when faced with rent-seeking attitudes from the government officials (Young et al., 2011). However, in some cases, the firms may take initiatives to conduct corrupt exchanges (e.g., bribery and providing “facilitation fees”) with government officials, especially for the government contractor firms in order to secure public procurement contracts. This tactic was used where the firm’s manager cannot develop independent strategies and has no choice other than engage in the corrupt exchange to gain favours and protections.

Such resource-based arguments could also be employed to identify the interaction of small firms in the network. For small firms, the alliance with political actors may be seen as relatively ad-hoc, depending on the particular objective (e.g., license for government contract) and the political actors targeted for the particular objectives. Government officials are often rotated and their positions highly depend on the new regime policy which may differ from the previous government. The unstable position of political actors and competition among political actors through media and other social movements are also among the factors that influence the stability of the network. As a result, the political ties of the firm are conditional on the institutional environment. In other words, the relationships between businesses and political actors therefore lack direct mutuality.

One can argue that the more political knowledge and commitment that a firm can assure in the network, the more influence it will have. However, such conditions do not happen to small firms where the relationship is perceived as coercive. The findings reflected the implication that political strategies implemented by firms in emerging markets may not be as effective as political strategies in most advanced markets. While a firm's financial contribution and political actions are relatively well institutionalised in most developed countries, the regulatory and political environment of emerging markets are generally non-transparent (Peng et al., 2008) and therefore, its effectiveness cannot easily be measured.

One thing that is also worth considering from the findings in this study is that all the participants considered relationship strategies as political ties and not business ties. While political ties reflect the informal social connection between the firms and government officials, business ties emphasise the informal social connection that the firms have with other market actors such as buyers, suppliers and competitors. All participants agreed about the importance of business ties apart from political ties. However, as complexity and uncertainty characterised the business environment, political ties were chosen and preferred since they provided direct effects through regulatory resources and are also short term in nature. This confirms the previous studies that in emerging economies where market supporting institutions are lacking and strategic choice are mostly created on a short term basis, political ties are the alternative for the firm (Sheng et al., 2011; Peng, 2003).

Another way to categorise political strategies implemented by small firms in this study is by looking at how firms organise their political actions. The findings from this study illustrated that the issue of collective versus individual action was driven by the benefits experienced by the firms in their institutional environment. The case also clarified the influence of both formal and informal institutional arrangements as a consistent predictor for firms to use either approach when implementing a firm's political strategy.

The evidence from the cases indicated that given their demographics, small firms preferred individual involvement but will act collectively when they are affected by a particular issue beyond their territory, as can be seen from the case of

the advertising firm. Each firm has a different approach in building personal relationship and implementing relationship-based strategy in relation to their operations. However, when it comes to political issues such as unclear interjurisdictional and regulatory uncertainty in different levels of government, collective action is the preferred solution for the firm. These findings are consistent with the collective action theory (Cook & Barry, 1995; Olson, 1965) and the importance for the firm to adapt to the political environment (Hadjikhani & Ghauri, 2001).

Unlike previous studies on firms' political strategies in advanced economies, the findings in this study indicated that small firms in Indonesia tend to pursue informal political network connections rather than direct political participation. It led to the argument that the decision to implement political strategies by firms was based on two reasons, rent-seeking purposes or hazard-reducing purposes, given the fact that the institutional environment was mainly characterised by the lack of market-supporting institutions.

Related to the above, the introduction of the e-procurement system in Indonesia and the improvement in the government budget assessment for the procurement sector have shifted the institutional environment faced by most government contractors. Firms in this industry often need to deal with various regulations that sometimes contradicted each other. In such unstable and challenging environments, a firm's demographics such as age, size and relevant experience plays an important role that influence the decision to adapt with the new institutional environment or not.

The findings also indicated that in dealing with the regulatory environment, the firms may take two options – passive (where they follow and meet the institutional requirements) or active (where they formalise their non-market strategies). The government contractors tend to follow and meet all the requirements that the firms must follow. Small firms in this sector were characterised by the lack of initiative to actively shape their external environment. Meanwhile, the firms in the hotel and advertising industries responded to the regulatory environment with active actions and did more than just simply meet the requirements. They also tended to formalise their non-market strategies. This is the case of the advertising

firms who filed a lawsuit to cancel the central government policy. The firms in the hotel industry also actively sought out a political channel to voice their concern on the industrial relations issue. This confirms the argument from previous studies, that the more negotiation power a firm has, the more likely its non-market strategy will be implemented formally. As Meznar and Johnson (2005) argue, formalising non-market strategies is needed when merely adopting the regulation is not enough.

The interaction of the firm within a regulatory environment might also be seen from coercive and supportive initiatives. The three cases indicated that the small firms did not actively attempt to challenge the public policy process. Despite their objections on several legislative rules, the firms tend to follow the rules imposed by political actors. However, such coercive initiatives do not remove the option for the firm to create interdependency with political actors, as can be seen from the case of one firm from the hotel industry. After suffering from industrial relations issues for more than two years and after meeting all legislative rules enforced by the local government, the firm choose to exert influence as its strategic response. This particular situation demonstrates the firm's choice of interaction and how it adapted to the particular situation. This finding is in line with the previous studies that showed that firms may choose to take initiatives and create interdependencies (Hadjikhani & Ghauri, 2001; Hillman & Hitt, 1999). It also concurs with the findings from Bengtson et al. (2009) that small firms are not always passive when it comes to political decisions, even though the decision to be active is influenced by various levels such as size of the firm, the political issue and the industry.

### **6.3.2. Social Strategy**

Political strategies that dominated non-market strategies implemented by firms were driven by economic motivation. On the other hand, philanthropy and charity are the preferences in its implementation with less market reward as the motivation. The majority of the firms in this study consider philanthropy and charity as indirect support (North, 1990b) to their business. This is in line with observations made in other studies (Porter & Kramer, 2006) . Furthermore, this indirect support is often implemented without careful planning and any program-orientation. The

owner's discretion and religious values are the main elements in the implementation of social activities. Such mechanisms, where ownership is institutionalised in a firm, are understandable given the size of the firm with a less hierarchical structure. Moreover, the owner of the firm plays a critical factor in almost all decision-making processes.

In contrast to previous studies, e.g., (Pei, Mellahi, & Wright, 2012; Lyon & Maxwell, 2008)), social actions such as philanthropy or other strategic corporate social responsibility actions taken by the firm are not seen as merely economic complements (Pei et al., 2012). However, it does not mean that there is no intention to use social actions proactively to strengthen the value of political actions. Overall, the findings did not coordinate social actions' initiative with political activities, in order to enhance the competitive advantage of the firm, as previous studies documented (Baron, 2007; Baron & Diermeier, 2007a; Baron, 2001). In this study, such actions were mainly implemented to reflect the personal values of the managers/firms' owners or are driven by religious motives. As can be seen from almost all small firm owners in this study, the religious value as a Muslim drove their actions to share and do charitable actions. This is in line with the study of Hemingway and Maclagan (2004) that showed that commercial imperative is not the main factor that drives a firm to implement CSR. The desire of the manager or the owner to be perceived as an individual that makes a difference also influenced the decision to implement social strategies. It also cannot be seen easily as a strategy-driver approach (Del Baldo, 2012). The discretion of owners and managers dominate many decision-making processes in small firms. This further illustrates the simplification of values where an individual's value is not necessarily replicated in the firm's value.

The findings also reflected the embeddedness of small firms in the local environment and therefore, their actions are to some extent defined by the other actors in the environment. Despite the personal value of the managers/owners as the main driver of social action, the embedded circumstances of the firm also influence the decision to do philanthropic actions. The case of one firm in the hotel industry illustrated this condition. The owner of the hotel conduct philanthropy activities to the people surrounding the hotel because most of the people are his childhood friends

and they know each other for a long time. This finding concurs with Spence (2014) argument that philanthropic contributions from small firms are not entirely principally of their own and in some cases, they might not be at the centre of the stakeholder map.

### **6.3.3. Degree of Involvement: Individual Vs Collective Action**

The nature of the business environment also influences the decision of the firm on how to pursue its non-market strategy, whether to act individually or collectively. Based on the empirical findings, a collective action is important for the firms as it directly emphasises the importance of the intermediaries. Furthermore, these intermediaries can be divided into two general actors. First is the non-public intermediary actor such as the trade association. The three cases from the three different industries indicated that each industry has a collective mechanism in acting collectively. The second intermediary actor is the public intermediary such as the municipal government.

Intermediaries help small firms in alleviating the institutional environment's constraints. The case from the hotel industry, as well as from the government contractors, clearly illustrates the important role that intermediaries, such as business associations and other civil society organisations, play as part of a firm's business network. This is in line with the discussions in the literature that intermediaries are involved in setting political rules and regulations (Bengtson et al., 2009), which help the firms reduce the distance between themselves and their regulatory authorities. However, pursuing political actions through business association or other intermediaries is likely to be a complementary, rather than a substitute for individual action.

The findings indicated that the role of intermediaries is more critical when the interaction between two parties is limited. As illustrated by the case from the hotel industry, the intermediaries were task-oriented and were employed to deal with specific issues, whereas intermediaries in the other two industries function mostly to perform long-term oriented activities.

The findings suggested, however, that business associations which served as intermediaries were not entirely capable of providing help, particularly when dealing with a higher level of government. As a result, as illustrated in the case of the hotel and advertising industries, firms tend to combine individual with collective action, so as to facilitate both firms' individual and collective targets. The reason for this decision is not just because collective action is a less costly alternative as compared to individual action (Hillman & Hitt, 1999), but also that collective action through salient experience and knowledge from its members can help firms become more effective in pursuing their individual actions (Hansen et al., 2004).

Collective action also serves as a preferable choice when it relates to common interests in the industry (Jia, 2014). Alleviating hazards and suspending new regulations are the main interests in the advertising industry, while avoiding a price war and having a fair competitive market are the main issues in the hotel industry. For such common interests, a firm will not pursue individual actions since it offers less incentive for the firms, given the limited knowledge and capabilities. However, the problem with the free-rider issue (Olson & Olson, 2009) remains a challenge when the collective action is selected as the main channel for pursuing political actions.

The natural process in alleviating this free-rider problem might be in the form of group size, selective incentives and certain political connections and affiliations. The institutional environment, therefore, profoundly influences the decision of the firm to work individually or collectively, based on the benefits available from each method. Such a decision also tends to be context-dependent, where specific issues may affect the firms' strategic choices. In the government contractor sector for example, firms with relative common interests and similar dependency on certain political actors tend to work collectively. Such electoral engagement occurs when firms are guaranteed to be granted a contract for the next budget year, while the political actors will be supported through political donations.

When collective benefits such as challenging current regulations faced by the advertising industry evenly affects the firms, the collective action remains a major source of political support required by the firm. The prohibition of building new

billboards on the national road, for example, as well as solving the price war between small and medium players with larger players in the hotel industry could only be solved by the respective industries. In this case, the industry association is expected to be a vehicle to institutionalise the new organisational form and to bridge the gap between the members, since it takes on a much wider range of issues.

In response to the political issue, advertising firms also used public intermediary actors, in this case, the local government of Makassar city. By approaching public intermediary actors, the advertising firms committed to being more proactive in mitigating regulatory policy from the national government agencies. Otherwise, it would be difficult to achieve changes in regulations with individual actions, especially with the limitations of resources and capabilities of small firms.

However, the findings also indicated another interesting fact where not all issues related to the institutional environment could be positively dealt with by collective action. Elites in the particular industry's organisation are usually controlled by big players in the industry and have different political and economic interests from other members of the association, particularly for the small firms with limited resources and capabilities to offer. Having such resource-based linkages (Pfeffer & Salancik, 1978) is a stark reminder that narrow political and economic interests from the members of the industry's organisation may serve as a fundamental difficulty for businesses. Political cohesion and common economic interests therefore play an important role in shaping the decision of collective action by small firms.

#### **6.4. Non-Market Strategies and the Performance of the Firm**

In many industries, the performance of a firm depends on the ability of the firm to shape the non-market environment, as well as its capacity to compete in the market environment. While there are various measurement tools in evaluating the performance of the firm from the market environment perspective, measuring performance from the non-market perspective is rather difficult. However, as discussed earlier in previous chapters, a subjective perceptual measure is considered

when there are no objective measures data available (Singh, Darwish, & Potočnik, 2016; Dess & Robinson, 1984). In this study, small firms' owners who participated were asked about the overall performance of their firms as a result of implementing non-market strategies. The overall performance was reflected by the sales compared to the previous year or the contracts that the firm gained (in terms of value and number) compared to previous years.

The benefits from implementing non-market strategies differ from one firm to another and from one industry to another. In general, the findings suggested that all firms in this study agreed on the positive outcome from implementing non-market strategies. Firms in the advertising industry, for example, exercised their resources and capabilities in dealing with non-market forces. Relational strategies with government officials along with financial donations have helped the firms gain positive outcomes. Positive outcomes were demonstrated through the firm's success in extending the use of the billboards which meant longer time available for leasing to customers, and the negotiation of flexible tax payment time when the firm has enough resources to pay.

A certain positive outcome for government contractors was that they were able to mitigate the impacts of their lack of knowledge and resources in dealing with the e-procurement. New regulations can be mitigated through informal political ties with procurement officials. Having a political connection implied the preferential access to the information of government procurement so the firm can manage to meet the requirements, or even provide information as the basis for defining the tender. Political ties have also helped the firms in this sector to influence the decision to use certain specifications that can be met by the firm. By doing this, the firm may limit the access for the competitor to enter the market.

The findings also showed that at the micro-level, government contractors were mostly awarded contracts after "internal processes" with politicians or government top officials, whereas small firms were awarded the non-bidding contracts. Such "internal processes" occurred when firms collaborate with government officials or legislative members to reinforce arranged-bidding or direct appointment, instead of the public bidding process. Obtaining bidding information

and sub-contracting opportunities are several other benefits accrued through the leveraging of social capital. Therefore, although new and stricter regulations have been issued for the procurement industry, for example, the same firms, given their salient experiences and personal networks, can still generate supra-profit in the sector.

While government contractor firms perceived positive outcomes when they obtained more contracts in terms of number and value of contracts, the advertising firms have a different perception of what are positive outcomes. The firms in the advertising sector felt that non-market strategies had no direct effect on their performance or have brought profits to their firms in the short term. However, they felt that implementing non-market strategies created a beneficial environment for the firm to operate safely within and which in turn will allow them to gain profit from their businesses. In which case, the effect on their performance is indirect.

These findings suggest that non-market strategies are positively related to the performance of the firms which are consistent with previous studies, albeit some effects are direct and others, indirect. Employing subjective perceptual measure, the findings in this study confirmed that the performance of firms is improved. However, given the complexity surrounding the regulatory environment in all three industries, and the uncertainty surrounding the institutional environment in South Sulawesi, maintaining their position in the competitive market place can be considered an indicator of success. This is in line with the previous studies that show that implementing non-market strategies, especially political strategies, may contribute to the survival of the firm amidst the competition (Pfeffer & Salancik, 1978).

Peng and Luo (2000) postulate that ties with politicians and personal relationships of the manager with government officials positively influence performance of the firm. In the context of emerging markets, the findings in this study also confirmed findings by Li and Zhang (2007) that political ties of the manager can boost the performance of high-tech ventures in China. The combination of political and relationship-based resources also improves the family-owned firms in Thailand (Imai, 2006) whereby information regarding government contracts can be

obtained before other firms, giving the firm a competitive advantage. In the case of the advertising industry, the findings support the proposition from previous studies that buffering strategies through implementing non-market strategies may improve the performance of the firm through preferential government policies (Yuanqiong et al., 2007; Meznar & Nigh, 1995). Personal ties and involvement in the political process also help firms mitigate uncertainties (Getz, 2002).

When these non-market strategies are implemented integrally with market strategies, the influence on the firm's performance is even greater as suggested by scholars in previous studies (Holburn & Vanden Bergh, 2014; De Figueiredo, 2009; Baron, 1995a).

## **6.5. Non-Market Strategies and Political Resources**

While the non-market environment factor is important in influencing a firm's non-market decision, the next question to ask is how non-market strategies are related to the firm's resources. Each firm, regardless of the industry, has different resources and therefore has a different effect on the usage of non-market strategies (political and social strategies).

All firms in this case particularly those that rely on government sales have developed relationship-based resources with government officials. The majority of the firms even emphasised that relationship-based resources are more important than market factors, as firms can strategize the non-market opportunities and have incentives for such actions. As shown by the firms in the advertising industry, the ability to influence institutional environments, in this case postponing the demolition of their billboards, lawsuit and getting support from the city government, is a result of building upon the political resources. In addition, the case of the government contractors clearly illustrates that building relationship-based resources provide certain benefits for the firms. Getting first-hand information about upcoming tenders and assistance on navigating the cumbersome nature of the tender process are some benefits that firms get by employing relationship-based resources.

The relationship-based resources often include skills that are activated to cement the relations with non-market actors. Practically, the skills are the important bond for the firm to be successful in the non-market environment, particularly in emerging markets. Supporting resources, for example, such as recreational services, dinner parties and karaoke, financial incentives and travel arrangements can help the firms gain personal and favourable contacts from their non-market actors.

From the resource-dependence theory perspective, the findings from this study also showed that firms will likely prioritise cooperation with the government agencies and departments which they are most dependent on. In the case of the advertising firm for example, the relationship with licensing agencies and also the local tax authority is more important for the firm than the provincial or national level governments. This is because the local government has greater discretion and incentives to address the local firms' needs after decentralisation was implemented in Indonesia. In addition, the heterogeneous interests among governmental agencies and departments made it more complex for the firm. Such power imbalance has led the firm to adopt a variety of actions, so as to deal with the external environment. This is in line with the previous studies related to resource dependence theory showing that firms engage with political actors to create a favourable environment for their firms (Hillman et al., 2009; Meznar & Nigh, 1995).

The findings in this study also showed that the lack of market-supporting institutions was compensated with political embeddedness (Welch & Wilkinson, 2004) and social capital, where personal relationships and other forms of informal ties (Li & Zhang, 2007) played a crucial part in gaining political favouritism (Fisman, 2001). The findings indicated that the relation between the owners of the small firms within the political network is the main source of social capital.

The absence of strong institutions contextualises the importance of social capital in emerging economies as indicated by Peng and Luo (2000), using cases from China. The majority of the firms indicated the incorporation of norms, trust and networks to enhance their economic performance through getting government contracts or getting discretionary decisions regarding rules and regulations (Meznar & Nigh, 1995). Another option might be in the form of enhancing legitimacy

(Hillman et al., 1999) and hindering competitors from entering the market. However, it is worth noting that such an advantage is also influenced by the configuration and stability of the network. In the case of Indonesia, decentralisation and direct elections made maintaining political networks even harder for firms.

From the micro-level analysis, the use of a relationship-based political strategy also gave certain advantages to some firms in this study, particularly in getting access to additional labour when additional work needs to be done. In the contractors and advertising industries for example, firms sustained strong networks through sharing information regarding potential work or sub-contracting options available and potential employees available for additional work. This situation is understandable since many of their workers are part-time and casual workers. A different situation appears in the hotel industry, where the labour issue is highly regulated and constantly scrutinised by government and non-governmental organisations.

However, as illustrated by the small number of firms in the study, personal relationships or political ties may become significant liabilities to the firms. Unstable environments and strong political ties developed by firms require a strong effort to maintain, even though such connections offer less advantages to the firm (Uzzi, 1997). Such unbalanced-exchange relationships may lock the firm among narrowly-connected actors that contribute to the low attention of competitive pressure from the market environment. Small firms in the government contract case were insulated from the information and perspectives from the outer environment and were not aware of the development of market-based capabilities.

The findings also indicated that given the limited resources of small firms, they have to subsequently employ external actors' resources. However, when it comes to the external actors' resources, a firm has to have critical elements namely political knowledge and commitment, as well as legitimacy (Bengtson et al., 2009; Hadjikhani, Lee, et al., 2008; Hadjikhani & Thilenius, 2005; Boddewyn & Brewer, 1994). Political knowledge refers to the situation where business actors understand the needs in maintaining the connection, as well as the knowledge about political decisions. Political commitment, in addition, refers to the resources that the business

actors own to make a successful relationship, which may take place in the form of time and is used in dealing with political organisations. Legitimacy in the different spectrums is about how political actors perceive the business actors (Boddewyn & Brewer, 1994).

Political knowledge was indicated by most firms in this study as acquiring specific knowledge on the specific issue, either by self-attempt or by employing external actors. Political knowledge was also obtained by firms from their involvement with business organisations, where a firm can get information on the political system and decision-making process in the industry. The firm can also identify key political actors and decide how to approach them and use various ways to build a relationship with them, as indicated by the firms in the advertising industry.

The empirical findings from this study extended the discussion on organisational capabilities that matter to the firm, in the successful implementation of their political strategies. The cases in this study revealed that apart from technical capital, which arguably not all small firms are able to successfully develop, social and institutional capital have contributed to the development of the cooperative relationship between firms and government officials. The case also indicated that firms' social and institutional capitals play a significant role in an inter-organisational relationship through trust and information, which cannot be represented by technical capital.

## **6.6. The Implementation of Non-Market Strategies — Some Caveats**

The general postulate in this study is that the implementation of non-market strategies will lead to a positive impact on the firm's performance. However, it can be contended that the idea of "hard to imitate" resources do not fit well with the empirical findings. Various political resources owned by the firms cannot be classified as something that is "hard to imitate" by the competitors.

For example, financial incentives and recreational activities can be easily carried out by other firms. Participating in the business association and other

collective business organisations can also be replicated by other firms. As such, political connections and personal relationships with political actors often do not reflect a speciality. Therefore, in the case of unstable governments and shifting institutions, implementing non-market strategy should consider many factors.

The empirical findings in this study showed that in the case of emerging markets such as in Sulawesi, the implementation of non-market strategies should consider the subtle characteristics of the political context. As can be found in many emerging markets, the position of the government in Indonesia is strong and remains the major source of power and legitimacy. As a result, non-market strategies implemented by the firms, as confirmed by the empirical findings in this study, mostly emphasises cooperation rather than confrontation with the government. In influencing government policies, the difference between one firm to another is related to asymmetrical resources. In many cases, it is the firm that is influenced by the governmental and political actors. The implementation of non-market strategies, therefore, becomes a response to the signal from the political actors. This confirms the study by Oliver (1991), which suggests that the nature of institutional pressure is the most important determinant in strategizing. Other studies also advanced the dominance of the government and required non-market strategies to be related to the nature of the firms' resources (Tian, Hafsi, & Wei Wu, 2009; Tian & Deng, 2007).

## **6.7. Conclusion**

The central concern of this study is to explore the nature of the non-market environment in South Sulawesi and how firms react to non-market environments. The findings emphasised that many challenges faced by small firms emerge from the changing institutional environment in South Sulawesi and Indonesia in general. The basic characteristics of the non-market environment in Indonesia are uncertainty surrounding the regulatory environment and the lack of social and political infrastructure. Various issues also specifically affected the non-market environment such as labour restrictions, the myriad of administrative procedures, red-tape bureaucracy and lack of governmental support for the firms.

While firm-specific political resources and relationships remain important in most developed nations, they are even more important in emergent economies such as in Sulawesi in Indonesia. At the micro-level, the never-ending transitional phase leads businesses to chaotic competition, where the non-market environment plays a major role. The unstable institutional landscape and unbalanced competition leaves businesses vulnerable to uncertainties. However, all participants agreed on the fact that the political process may moderate the uncertainties.

Apart from the effective results achieved through non-market actions, all participants also indicated that there were existing barriers that limit their achievement and obstructed their response to non-market issues. Such institutional conditions mostly occur in emergent economies for two reasons - a less stable (Hoskisson et al., 2000) and conducive environment for economic actors to have a mutually beneficial economic exchange between them (Peng, 2003; North, 1994).

This study has shown that implementing non-market strategies in South Sulawesi has improved the performance of the firm, albeit in various ways – directly or indirectly. The improvement of the overall performance of the firm varied and was mostly reflected in a better situation for the firms. These may be in the form of sales, government contract awarded, or faster processing due to the assistance received in mitigating regulatory burdens, compared to the previous time. Relationship-based strategy is also one of the main preferable strategies for firms in dealing with the rent-seeking environment. The findings in this study are consistent with previous studies that have the basic premise that firms tend to use rent-seeking activities and relational actions to substitute for market capabilities (Keim & Hillman, 2008). However, not all participants agreed that personal ties and political involvement will benefit them in the long-term and will necessarily lead them to a better competitive environment. While companies who practice non-market strategies gain short-term benefits, the insecure business environment in Indonesia poses great challenges to SMEs.

Despite the fact that regulatory uncertainties remain challenging for small firms, the incentives to integrate non-market with market strategies are increasing. The non-market strategy serves as a bridge for the firm with the external

environment, which also reflects the level of firms' adaptations. A more regulated business environment and high pressure from stakeholders forces small firms in the public procurement industry to obey the rules and regulations.

Following the implementation of decentralisation, small firms in South Sulawesi, Indonesia, faced a strong institutional environment, which remains characterised by poorly-enforced institutions with insufficient market-supporting institutions. Stiff competition and market maturity also influence the existence of non-market opportunities. Non-market strategies such as political strategies were preferred by firms due to the high policy uncertainty, weak legal systems and pressure from the civil society.

Despite the fact that the findings described in the previous chapter are based on small firms in Sulawesi, Indonesia, the findings provided some general clues about the behaviour of firms in emerging economies which face unstable environments. This study intends to provide a more systematic understanding of firms' behaviour towards their non-market environment in emerging economies such as Indonesia.

While most of the findings are consistent with the literature on non-market strategies in most developed countries, the findings also indicated that non-market strategies come in the different forms and characteristics under different context and cultures. Approach to political strategy is also different in the context that firms in developed countries formulate their non-market strategies based on an issue-by-issue basis. In most developed countries, the firms are also taking advantage of well-established market supporting institutions to channel their concerns. Firms in South Sulawesi and most emerging countries, meanwhile, tend to take the relational approach and employ social capital to get things done. Financial incentive strategy is common in both developed nations and emerging nations. However, the range/scope and degree of such tactics are different since many financial incentive strategies in many emerging countries are in the form of corrupt-exchange actions that are influenced by the uncertainties surrounding the regulatory environment.

The next chapter will draw conclusions from the overall findings from this research. Practical and theoretical implications of this study will also be presented at the next chapter.



## Chapter 7

# SUMMARY, CONCLUSION AND POLICY IMPLICATIONS

### 7.1. Introduction

The central concern of this study is to explore the nature of the non-market environment in emerging economies, using South Sulawesi province in Indonesia as a case, and understand how firms react to the non-market environment. Social and political forces create an institutional environment which can be challenging for the firm. The theoretical reflections on the empirical findings of the study were presented in the previous chapter.

This chapter draws the summary and conclusions from the overall findings of the study. In Section 7.2, a summary of this study is provided while key findings of the study are identified in Section 7.3. Section 7.4 provides the theoretical gaps and contributions of this research, while managerial and policy implications of this study are identified in Section 7.5. The limitations of this study are provided in Section 7.6 which also indicates directions for future studies in this field.

### 7.2. Summary

The business environment consists of market and non-market components. Both different environments need to be handled carefully in order to achieve a firm's objectives. While almost all firms at all levels are familiar with the market environment, many firms are still searching for good strategies to deal with non-market environments. Current studies in the non-market strategy field were mostly conducted in more stable countries, mainly with large firms as the object of most studies. This study is responding to the call to examine the phenomena of non-market strategies in the diverse context of emerging economies.

In Indonesia, an example of an emerging economy, the challenge for firms became greater after the implementation of decentralisation. Decentralisation shifted the power from the central government to the local governments. Reforms in the economic and political system were implemented with the expectation that such actions will improve the investment climate, particularly for the development of SMEs in Indonesia. The collapse of the authoritarian and centralised system and the rapid embrace of democratic and decentralised systems were expected to create a supportive environment for SMEs. However, in reality, the changing political and economic systems did not create the expected supportive environment for local investors, particularly small firms. Rather, it has created uncertainties and confusion and opened up new challenges for small firms resulting from the non-market environment.

The key research questions that this study tried to answer are: (1) what are the characteristics of the non-market environment in emerging markets such as Indonesia? (2) How does the non-market environment lead to a firm's choice of non-market strategies? And (3) how do non-market strategies impact the performance of the firm?

The overriding objective of this study is to explore the nature of the non-market environment in South Sulawesi in Indonesia, identify social and political antecedents of non-market environment faced by small firms. Another objective of this study is to investigate how firms react to the non-market environment. This study also aimed to examine how the non-market strategies implemented by the firms influence their performance. Finally, this study is expected to provide a discussion of policy implications that impacted from non-market strategies.

The literature pertaining to non-market strategies mostly focus on developed countries (Dieleman & Sachs, 2008) with large firms as the object of the study (Doh & Lucea, 2013), but neglects the unique situation of the non-market environment that are faced by the small firms. As a result, there is still a gap in micro level studies on what the characteristics of non-market environment are in emerging markets and how small firms are influenced by the non-market environment.

The study was conducted in South Sulawesi, Indonesia as it represents an illustration of the dynamic change, a characteristic in most emerging markets. As one of several major regions in Indonesia, South Sulawesi is a centre for trading with the complexities inherent in big cities in Indonesia. The province is also characterised by a patrimonialistic culture where personal ties and political connection predominantly influence business and political environment. Another reason for choosing the research site was practical reasons. Exploring the nature of non-market strategies implemented by firms in South Sulawesi in Indonesia required access to key policy-makers. The time frame limited the researcher in his ability to conduct research without using existing contacts in different provinces. In Makassar, the researcher utilised his contacts and managed to gain reliable access to key individuals and other supporting data sources.

To accomplish the objectives above, in-depth interviews with 27 participants were conducted. The participants are small firm owners and managers from three industries, namely hotel, advertising, and government contractors. The three industries reflected the industries where firms implement non-market strategies either because of the nature of the industry which is highly regulated or there is a dependency on government sales. Four participants are not business actors; they consist of government officials, a journalist and an NGO activist. Given the nature of the study, grounded theory and the case study method were used as the overarching methodology for the research. Grounded theory was chosen because it enables the researcher to achieve research objectives with its systematic procedure and effective data management technique, while the case study method was chosen because it allows the researcher to develop deep insights about the target case respondents.

### **7.3. Key findings**

The key findings of this study are outlined below:

### **7.3.1. Characteristics of the Non-Market Environment in South Sulawesi in Indonesia as an Emerging Markets**

One of the main characteristics of the non-market environment in South Sulawesi in Indonesia is the strong influence of the government and society on small firms. Although the cases analysed in this study do not belong to one industry, the strong influence of the institutional environment was evident in all these cases.

Regardless of the industry, all interviewees from small firms described their dissatisfaction with the business climate caused by dynamic and uncertain changes in the regulatory environment. As in many other places in Indonesia (Patunru, McCulloch, & von Luebke, 2009; Brodjonegoro, 2004), the regulatory environment in Makassar is affected by decentralisation where all local governments have passed local bills (*peraturan daerah*) in order to boost their local income through tax and retribution. However, the legal justification for these local bills remains unclear since the communications and coordination between the local and national government is often poor.

The constant regulatory change, particularly after the fall of President Suharto, also caused the uncertainty in the institutional environment faced by small firms. These changes matter to the firms, since given the size of the firms and the limited resources they have, constant change affects their operation in the short and long term. Constant changes usually occur given the fact that many existing regulations need to be amended with new regulations due to incomplete coverage as well as opaqueness in the process of decision making.

Unsurprisingly, rent-seeking bureaucracy remains salient which influence the opportunistic behaviour from government officials. Many illegitimate payments have to be paid by firms even though from the government officials' perspective, this was a "voluntary payment" or a "relational fee". The majority of participants perceived such informal payment as a form of gratefulness from business actors to government officials for good services. As a result, such voluntary payment is perceived as a normal thing in doing business, with all participants agreeing that rent seeking activities implemented by government officials is commonplace in the

region. Several participants even emphasised the importance of bribery for the success of their business and claimed that they cannot afford to avoid the action. Referred as “*uang terima kasih*”, translated in Indonesian for “to share”, a framework exists for the distribution of bribes and mark-ups in the procurement world in Indonesia. The complexity of the new procurement regulatory framework does not prevent local procurement bureaucrats to find chances to exploit the system. For instance, one of the methods to extract payment is to help bidders fill out complex procurement documents in exchange for money.

### **7.3.2. How Does the Non-Market Environment Lead to a Firm’s Choice of Non-Market Strategies?**

Firms’ demographics such as age, size and experience influence the choice and the effectiveness of non-market actions. The choice of non-market actions of the firms may differ in form, such as: 1) passive reaction, where management adjust the firm’s policy based on the changes that already happened; 2) positive anticipation, where firms try to anticipate changes before they occur, and 3) proactive public policy shaping, where the firm is actively involved in the process of changes.

The complexity surrounding the institutional environment of small firms made them deal with different types of political issues, various administrative commitments and numerous connections with individuals or groups. In general, respondents believed that the situation makes small firms react similarly and engage as a homogeneous group which affect the whole industry. The political action by firms relies heavily on the resources and the environment they encounter. The diversity of the firms’ resources influenced the decision of firms to implement their non-market action, especially for small businesses. Such restraints forced small businesses to act collectively and made business associations an important factor in the business environment.

The involvement of a firm in the association is based on the interest of the firm which converge with the industry interests. However, in the case of the hotel industry, we found that the association sometimes inaccurately communicate the interest of its members. The association is generally perceived as accommodating

predominantly the larger (business) members' interest. The current price war among members supports this argument, where small firms have to face stiff competition with large firm. However, given the nature of competition and market coverage, specific actions were taken individually by firms to meet their goals.

### **7.3.3. How Do Non-Market Strategies Impact the Performance of Firms?**

Given the weak formal institutions faced by small firms in Indonesia, firms tend to rely on informal institutions, since they have more significant influence on their performance. In this study, the performance of the firm was based on the subjective perception of the managers/owners of small firms. In reflecting the performance, the participants used various indicators such as the number of contracts that the firm get from the government, the number of workers (casual or permanent) employed and the assistance that the firm gets from government officials in dealing with regulatory burdens. The finding of this study is that the implementation of non-market strategies leads to the above indicators. Relational strategies and informal political ties with government officials, for example, may help the firms getting a contract in public tender. The same goes to the advertising firms, where relational strategies may help them mitigate the regulatory burdens which influence their capability to acquire more clients.

Having resource-based relations or personal ties with authorities in various levels is beneficial to the firm and is also one of the main preferable strategies in dealing with rent-seeking environment which help firms in any political process. Personal ties and involvement in the political process may help firms mitigate the uncertainties, especially for the firms that rely on government sales as their main business. It can also be assumed that without non-market strategies, firms with a high reliance on government sales will have difficulties getting a contract from the government.

This is consistent with previous studies with the basic premise that firms tend to use rent-seeking activities and relational actions to substitute for market capabilities. However, not all participants agreed that personal ties and political involvement will benefit them in the long-term and may not necessarily lead them to

a better competitive environment. Such an environment poses great challenges to SMEs but at the same time provide immense opportunity for others.

#### **7.4. Contribution of This Study**

Baron (1995a) argue that market forces such as products and services, the strength of internal organisation as well as the efficiency of the operations within the firm are not the only forces that influence the success of the firm. How firm effectively manage and deal with non-market forces is also important. This study contributes to knowledge on micro-level analysis of business-government interactions. Previous studies mostly focused on the macro-level analysis such as country and industry analyses (Shaffer & Hillman, 2000; Hillman & Keim, 1995).

Secondly, this study enriches our understanding on the importance of relational strategies, as part of non-market strategies, in economic transitional and weak institutional environments. As mentioned in this study, relational strategies are influenced by resource-based factors and social relations-based factors.

This study also addressed the gaps in the extant literature in this area in a developing country context. Previous studies mainly focused on developed countries and relatively stable institutional environments. Non-market environments, however, are even more challenging in emerging economies such as Indonesia. As such, there is a need to study non-market strategies in the context of emerging economies (Aggarwal, 2001). This study is the first of its kind in Indonesia that focused on how small firms manage their non-market environment, and therefore, contributed to enhance our understanding in this field.

This study contributes to the literature on small firms' adaptation to institutional changes, particularly in the context of emerging economies. The study also offers a distinct contribution in looking at how the institutional environment influenced strategic decisions of small firms, particularly in dealing with regulatory uncertainty, a key feature of emerging economies.

This study also contributed in deepening our understanding of SMEs' relationship with government in a rent-seeking environment. Furthermore, while the

current non-market literature based on the stable economies emphasise the importance of political connection (Goldman et al., 2009; Hadjikhani, Johanson, & Thilenius, 2008; Adhikari et al., 2006), this study found that this is not enough. In emerging economies characterised with a rent-seeking economy, unofficial mechanisms such as bribery and cronyism and nepotism are very important or even almost expected to solve the formal and informal constraints. This study, therefore, extends our knowledge by highlighting the importance of formal and informal institutions (Child & Tsai, 2005; Peng & Heath, 1996; DiMaggio & Powell, 1991) particularly in emerging markets with their unique characteristics (Wright et al., 2005; Hoskisson et al., 2000).

The findings of this study also extend our understanding on the network perspective (Bengtson et al., 2013; Welch & Wilkinson, 2004; Hadjikhani & Ghauri, 2001), particularly from the point of view of small firms. While most studies in the current literature of network perspective emphasised industrial-based relationships, this study expanded network context to political and social actors.

Albeit in the form of normative discussion, this study contributed to the management literature on the importance of non-market strategies to the performance of the firm, particularly for small firms. As also found in other relationship-based capitalism, social and political capital is more prominent in enabling firms to extract rent from the government.

Therefore, in sum, this study contributes to the discussion on non-market strategies with an emphasis on emerging markets. The academic significance of this study is highlighted by the following: (1) it investigates the nature of the competitive environment under the condition of institutional changes; (2) it contributes to the literature on the role of institutional changes in firms' choice of non-market strategies in emerging economies and (3) it explores the intertwined relationships between businesses and power.

## **7.5. Managerial and Policy Implications**

The managerial and policy implications of this study are as follows:

### **7.5.1. Managerial Implications**

The findings of this study indicated that the implementation of non-market strategies by small firms in South Sulawesi in Indonesia was mainly driven by their desire to deal with the uncertain environment as well as gain benefits. This is expected to provide a starting point for deep understanding of non-market environment in emerging economies which offers different institutional challenges for the firms. The implications of the findings underline the complexity surrounding small firms' business environment in emerging market. The findings clearly indicated that there are structural and unstructured constraints that create challenges for small firms. The findings also showed that a firm's performance is determined mostly on how the firm deals with structural conditions within which the firm operates. Therefore, as for practical implications, this study suggests that small firm owners consider the impact of political and social actors and find ways to strategically interact with them.

The necessity for acquiring institutional knowledge and network skills is critical in such a non-market environment. Institutional knowledge about the political and social issue and how to take advantage of opportunities in the political landscape is essential in the business environment characterised with instability and uncertainty. An understanding of the heterogeneity of political actors including the heterogeneous sets of interest groups such as NGOs and media is also important to respond to the non-market environment. This study suggests that the manager can no longer rely on passive political strategy, even for the firms in the industry that are seldom affected by government decisions.

Another insight, this study has shown is that apart from its limited resources and skills, small firms have the capacity to influence non-market actors. To achieve this objective, the firm should create and maintain long-term political commitments both internally (with other firms within the industry) and externally (with the government and other political actors). In addition, albeit the absence of a clear-cut answer, this study demonstrates how small firms in South Sulawesi deal with their non-market environment to reduce hazards through non-market strategies.

### **7.5.2. Policy Implications**

This research also has important policy implications from the understanding of the social and political antecedents of non-market environments faced by small firms in Indonesia. The findings indicated that small firms are more affected by problematic regulations, particularly with the inconsistencies and unstandardized interpretation which cause confusion to small firms, and which has led to the proliferation of non-market strategies. These non-market strategies include political strategies for rent-seeking purposes, such as bribe and paying facilitation fees, informal personal networks with government officials, and direct political participation.

Government policies have not yet adjusted with the attitude and practices of government officials to increase transparency. Many of these non-market strategies would not have been necessary if the correct policies and supportive regulatory environment are in place. Although these non-market strategies are seen by small firms as necessary to their survival, these are coming at a cost to small firms and should therefore, be mitigated.

Therefore, this study suggests that the relations between government and firms should be made more transparent. Several actions that may be taken in the short-term are creating clearer policies and measures to reduce red tape bureaucracy. The government needs to develop clear regulations and improve the weaknesses of the current legal framework by including other stakeholders, especially small firms in discussions on setting up a business friendly environment.

Given the strong influence of the government on the business environment in emerging markets, policy-makers should also prioritise efforts to improve small firms' knowledge and expertise in dealing with market forces. The support may also come in the form of a supportive business environment with less administrative burden and more friendly policies that encourage the development of small firms. Policymakers should also improve the predictability of its policy creation and implementation. In the long-term, the government should systematically design

efficient market-supporting institutions that can help reduce the use of unofficial mechanisms which most small firms used.

Government officials should also be aware of the heterogeneity of small firms. Hence, methods on how to handle small firms should also include and consider that factor. In addition, supporting programs from various government agencies will be much better, if conducted simultaneously, with better coordination between government agencies, and are based on the needs of the small firms.

In the procurement sector, there are obvious opportunities to improve the current SMEs' contribution to the Indonesian economy beyond economic growth and as a provider of job opportunities. Technological improvements through the implementation of e-procurement along with simplified procedures and improving consistency in public procurement policies and procedures can help achieve these objectives. A comprehensive capacity building program is needed for the local government officials as well as for the small firms through their business association. By doing this, small firms managers can develop their knowledge and understanding of regulatory and technical issues in e-procurement. Better knowledge and skills in the procurement sector along with more transparent process of tender can help small firms avoid being involved in corrupt exchanges with government officials.

Government officials need to have training on good governance and on avoidance of graft and corruption in line with the push by international aid agencies (World-Bank, 2012; Meijer & Oey, 2002). Coupled with this, systems must be put in place that encourage transparency and a mechanism for reporting attempts on both sides (government and business sector) for corruptive behaviour to discourage bribery and graft and corruption.

Trade associations and other business organisations have served as the intermediaries for small firms in dealing with external forces in the industry. However, it seems that some members remain unaware about the support that they can get from being a member of the association. It was also found in this study that small firms do not know where to turn to when they need assistance. The local government with cooperation from trade associations and other intermediaries must

begin to working together in findings new ways of reaching out to small firms. Apart from reaching out, it is also important to provide better information for small firms to reduce confusion so that they do not have to resort to non-market strategies.

The study also found that there is a growing trend in the region that many owners of small firms with strong dependency on government contracts are earmarking more resources to strengthen their non-market strategies, especially in the illicit side, than building their core company competencies. Furthermore, the findings showed that political strategies of small firms serve as antithetical to the development of market capabilities of the firm, given the fact that the small firms implementing such strategies have low market capabilities. The consequence is that these small firms do not pay more attention in improving their market capabilities. Instead, they become reliant on non-market strategies for their business activities. In the short term, this would be a value-creating strategy, but in this free market of political party and the growing public demand for clean governance, this kind of non-market strategy is not a sustained competitive advantage. SMEs have to stick to the improvement of their market strategies and improving their core competencies.

## **7.6. Limitations and Future Research**

The limitation of this study is mainly associated with the limited number of case study industries, which had to be limited to only three industries due to time and budgetary constraints. The restricted time for fieldwork and also inadequate secondary data to support the findings are factors that contributed to the limitations of this study. However, the researcher believes that the findings of this study accurately reflect the situation where the same phenomenon is investigated with multiple sources (Yin, 2009; Eisenhardt, 1989). The findings in this study, albeit unsurprising, were not only provoking, but are also exploratory, thus require further research. The theoretical view in this study, for example, is examined by only several empirical cases from only three industries in South Sulawesi. As a result, it is providing limited possibilities for generalisation. This limitation, in turn, calls for further studies that can enhance the understanding of non-market strategies in the context of emerging markets, including better measures of the performance of the

firm. A longitudinal perspective on the outcome and the effectiveness of non-market strategies would further advance the study on this topic.

This study has also found that social capital and formal institutions, particularly in emerging countries such as Indonesia, are two aspects that are difficult to separate. The study also suggests that social capital is critical to ensure long-term business survival. Therefore, further research into social capital is required if we are to gain a deeper understanding of non-market strategy in Indonesia.

The majority of studies in the non-market strategy field reported strong links between non-market strategies with the performance of firms. However, as indicated in this study, measuring performance remains problematic, particularly in the context of emerging markets and small firms. While employing objective measures is widely supported, the field still needs qualitative work with various subjective perceptual measures that could complement and provide meaning beyond solely financial indicators.

Further research might also focus on the different outcomes from specific non-market strategies, including the conditions related to the outcomes. In addition, it would be interesting to know the nature of non-market strategies from other industries outside the three industries discussed in this study.

## **7.7. Conclusion**

The central focus of this study is to explore the nature of the non-market environment in South Sulawesi and how firms react to non-market environments. The findings emphasised that many challenges faced by small firms emerge from the changing institutional environment in South Sulawesi and Indonesia in general. The basic characteristics of the non-market environment in Indonesia are uncertainty surrounding the regulatory environment and the lack of social and political infrastructure. Various issues also specifically affected the non-market environment such as labour restrictions, the myriad of administrative procedures, red-tape bureaucracy and lack of governmental support for the firms.

While firm-specific political resources and relationships remain important in most developed nations, they are even more important in emergent economies such as Indonesia. At the micro-level, the never-ending transitional phase leads businesses to chaotic competition, where the non-market environment plays a main role. The unstable institutional landscape and unbalanced competition leaves businesses vulnerable to uncertainties. However, the political process could potentially moderate the uncertainties.

Apart from the effective results achieved through non-market actions, all participants in this study indicated that there were existing barriers that limit their achievement and obstructed their response to non-market issues. Such institutional conditions mostly occur in emergent economies for two reasons - a less stable (Hoskisson et al., 2000) and conducive environment for economic actors to have a mutually beneficial economic exchange between them (Peng, 2003; North, 1994). Having resource-based relations or personal ties with the authorities on various levels was found to be beneficial to the firm. Moreover, it is also one of the main strategies preferred by firms in dealing with the rent-seeking environment, which helps firms in the political process. This study is consistent with other research (Getz, 2002) that showed that personal ties and involvement in the political process help firms mitigate uncertainties. This is also consistent with previous studies that have the basic premise that firms tend to use rent-seeking activities and relational actions to substitute for market capabilities (Keim & Hillman, 2008). However, not all participants agreed that personal ties and political involvement will benefit them in the long-term and will necessarily lead to a more competitive environment. Such an environment poses great challenges to SMEs, but at the same time, provides immense opportunities for others.

Despite the fact that regulatory uncertainties remain challenging for small firms, the incentives to integrate non-market with market strategies are increasing. The non-market strategy serves as a bridge for firms faced with such external environment, and also reflects the level of firms' adaptations. A more regulated business environment and high pressure from stakeholders can however force small firms in the public procurement industry to obey the rules and regulations.

Following the implementation of decentralisation, small firms in South Sulawesi Indonesia, faced a weak institutional environment, which remains characterised by poorly-enforced institutions with insufficient market-supporting institutions. Stiff competition and market maturity also influenced the existence of non-market opportunities. Non-market strategies such as political strategies were preferred by firms due to lack of market supporting institutions which leads to the high policy uncertainty and weak legal systems.

The conclusions of this study open the way for future discussion on small firms and how they respond to the non-market environment. Given the fact that small firms represent a large segment in many countries, this study has contributed to the knowledge in this important field and is expected to offer a broader and systematic understanding of small firms' interactions in non-market environments.



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## Appendix A: Participant Consent

### RESEARCH LETTER

#### *Confidential*

Dear Sir/Madam:

**RE: Request to participate in research interview on “*Analysis of Non-Market Strategies Implemented by Firms in Emerging Economies: The case of Indonesia*”**

I am a Doctoral student at Curtin University. I would like to invite you to participate in the research I am undertaking as part of my studies. The research has been approved by the University’s Human Research Ethics Committee (Approval No. HR. 148/2012). The Committee is comprised of members of the public, academics, lawyers, doctors and pastoral carers. If needed, verification of approval can be obtained either by writing to the Curtin University Human Research Ethics Committee, c/- Office of Research and Development, Curtin University, GPO Box U1987, Perth 6845 or by telephoning 9266 9223 or by emailing [hrec@curtin.edu.au](mailto:hrec@curtin.edu.au).

My research project will explore the nature of non-market strategies implemented by firms in Indonesia. Your participation in this research will be in the form of an interview. An information sheet is attached with further details about this research project.

If you are willing to participate, please sign the attached Consent Form to confirm your consent. This will be collected when we meet and prior to the interview. Participation in this research is entirely voluntary. Therefore, should you wish to decline, simply contact me via email: [abdullah.sanusi@postgrad.curtin.edu.au](mailto:abdullah.sanusi@postgrad.curtin.edu.au) or [abdullah.sanusi@gmail.com](mailto:abdullah.sanusi@gmail.com) or mobile: +61 452 390800. No explanation is necessary.

Thank you for considering your involvement in this research.

Yours sincerely,

Abdullah Sanusi  
*Doctoral Student*  
*Student ID: 14986576*  
*Curtin Business School*  
*Curtin University*

## RESEARCH PARTICIPANTS INFORMATION SHEET

### *Study Title:*

*Analysis of Non-Market Implemented By Firms in Emerging Economies – The Case of Indonesia*

#### **1. What is the purpose of the research?**

The purpose of this research is to investigate institutional changes in emerging economies and their impact on firms' choice of non-market strategies. The aim is to identify non-market strategies of firms and evaluate their impact on firm's performance. To achieve this aim, the following objectives will be addressed: 1) identify the political and social antecedents in non-market environment in Indonesia; 2) examine the nature of non-market environment in Indonesia; 3) investigate how institutional changes in emerging economies influence firm's choice of non-market strategies.

#### **2. Who is participating in the research?**

Conducting this project is Abdullah Sanusi, post graduate student undertaking PhD degree at Curtin University. Supervising this project are *Associate Professor Fay Rola-Rubzen* and *Dr Bella Butler*, both are academic staff at Curtin University. Participants are founders, managers, and directors from several companies in Indonesia selected for the case studies.

#### **3. Why have I been invited to participate?**

We are asking you to take part in the research because you are a stakeholder in the business-government relations and hold a leadership position in a firm in South Sulawesi. We also believe that you can provide important information to us that may be relevant to the research that we are undertaking.

#### **4. Do I have to take part?**

Your participation in this interview is entirely voluntary. If you choose not to participate you do not have to explain your reason.

If, after the interview, you decide that you no longer wish to be involved in the research project, you can withdraw your participation at any time up to the point where the research has been written up. No reason is required to withdraw from the research.

#### **5. What do I have to do?**

If you are happy to participate in the research we will ask you to read this information sheet, sign the consent form and return it to me. If you are willing to participate in this research, please let me know by emailing me at [abdullah.sanusi@postgrad.curtin.edu.au] or by calling me on [081355921292]. Alternatively, I will contact your office in a few days to establish if you are willing to participate in this research and arrange a convenient time to meet with you.

Your participation will consist of a face to face interview of up to 60 minutes. This interview can take place wherever is most convenient for you. With your permission, the interview will be recorded on a hand held audio recording device and I will also be taking notes.

**6. What happens to the information I give at the interview?**

The information you give at the interview will be anonymised. Unless you agree, your name will not be published or noted in any report or publication relating to the research. Interview transcripts will be shown to you for review before it is published. De-identified information will be recorded and analysed alongside other de-identified interviews on the same topic using N-vivo software. This software is a tool used by researchers to identify themes from qualitative research.

**7. What are the possible disadvantages and risk of taking part?**

Whilst you may be asked to answer questions on non-market strategies implemented by your firm, we are aware that this situation will may cause discomfort of disclosing several issues. If you do not want to answer certain questions, that is fine. If you consider that a risk to your work or careers exists then you may choose to remain anonymous. Every care will be taken to ensure that you and your organization will not be affected. Therefore, all information provided by you will be kept confidential at all times. The researcher will take every care to remove responses from any identifying material as early as possible. All responses to the questions and information provided by you will be anonymised i.e. no personal and organizational details relating to you or where you work will be recorded anywhere. Only members of the research team will have access to the information you provide to us.

**8. What are the possible benefits of taking part?**

Whilst there may be no personal benefits to your participation in this study, the information you provide can contribute to the future development of strategic management literature. The proposed study will also seek the recommendations on key strategies which firms can implement to improve their performance in conditions of institutional changes.

**9. What will happen to the results of the study?**

The content of the interview may be used to contribute to the development of the researcher's thesis at Curtin University. The results from this analysis will be available in one or more of the following sources; scientific papers in peer reviewed academic journals; presentations at conference and seminars. The publications will not contain any reference to individual participants unless participants have agreed to be referred to as appropriate in scientific referencing systems.

**10. Will my taking part in the study be kept confidential?**

All information you provide to us will be kept confidential. Only members of the research team will have access to it. All data collection, storage and processing will comply with the principles of the Privacy Act 1988. All data collected will be stored at the School of Management (Curtin University Network) and will be

retained for a period of five years after the publication of the thesis. Information will be stored in the form of electronic files in CD's, and hardcopies.

Under no circumstances will identifiable responses be provided to any other third party. Information emanating from the interview will only be made public in a completely un-attributable format or at the aggregate level in order to ensure that no participant will be identified. The researcher will take every care to remove responses from any identifying material as early as possible.

We must however inform you that if you disclose information that may result in you or anyone else being put at risk of harm we may have to inform the appropriate authorities. If this situation arises we will discuss all possible options for ourselves and you before deciding whether or not to take any action.

### **11. Who is organising the funding of the study?**

This study is funded DIKTI Scholarship and Curtin University through research consumable fund scheme. Any additional costs associated with the interview will be borne by the interviewer. The N-vivo software has been provided for academic purposes by Curtin University.

### **12. Who has approved the study?**

The study is being overseen by Associate Professor Fay Rola-Rubzen and Dr Bella Butler from Curtin Business School. The study has been approved by the Human Research Ethics Committee of Curtin University (*Approval HR No.148/2012*). The Committee is comprised of members of the public, academics, lawyers, doctors and pastoral carers.

### **13. Contact for further information**

If you have any query in regards to ethics, you can contact:

Human Research Ethics Committee  
Office of Research Ethics Committee  
Curtin University  
GPO Box U1987  
Bentley, WA 6845  
Phone: +61 9266 9223  
Email: [hrec@curtin.edu.au](mailto:hrec@curtin.edu.au)

For further inquiries about the study or any matter in relation to this research, please contact:

***Abdullah Sanusi***

*Email:* [abdullah.sanusi@postgrad.curtin.edu.au](mailto:abdullah.sanusi@postgrad.curtin.edu.au)

*Phone :* +61 452 390800

***Associate Professor Fay Rola Rubzen***

*Office :* Building 608.HDR Unit

*Phone :* +618 9266 2122

*Fax :* +618 9266 7694

*Email :* [F.Rola-Rubzen@curtin.edu.au](mailto:F.Rola-Rubzen@curtin.edu.au)

## CONSENT FORM

### ANALYSIS OF NON-MARKET STRATEGIES IMPLEMENTED BY FIRMS IN EMERGING ECONOMIES: THE CASE OF INDONESIA

Name and position of researcher: *Abdullah Sanusi*,  
PhD Student, School of Management, Curtin University, Australia

*Please Tick*

1. I confirm that I have read and understood the information sheet for the above study and have had the opportunity to ask questions.
2. I understand that my participation is voluntary and that I am free to withdraw at any time without giving a reason.
3. I agree to take part in the study.

<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	<input type="checkbox"/>

*Please tick*

4. I agree to the interview being recorded.
5. I agree to the use of anonymised quotes in publications.

<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	<input type="checkbox"/>

*I \_\_\_\_\_ (participant's name) agree to participate. I consent to my interview being audio recorded and understand that all content remains confidential. I understand that I can withdraw at any time.*

Signature: \_\_\_\_\_

Participant: \_\_\_\_\_

Date: \_\_\_\_\_

Researcher: \_\_\_\_\_

Date: \_\_\_\_\_

**Revocation of Consent**

I hereby WITHDRAW my consent to participate in the research project described above and understand that such withdrawal will be without prejudice or negative consequences to my employment.

Signature\_\_\_\_\_

Participant\_\_\_\_\_ Date\_\_\_\_\_



## Appendix B : Questions for Interview

### Part 1: Introduction

Questions
<ol style="list-style-type: none"><li>1. Please tell me about your company including the history, the operation, the business and the coverage of the business<ol style="list-style-type: none"><li>a. Could you say something more about it? How about the product/service?</li><li>b. How long has been your firm in this industry?</li></ol></li></ol>
<ol style="list-style-type: none"><li>2. Please tell me about yourself, your position in the company<ol style="list-style-type: none"><li>a. How do you feel with your work, any personal experience in relation to your role in the company?</li></ol></li></ol>
<ol style="list-style-type: none"><li>3. Can you name a person who has had a tremendous impact on you as a leader?<ol style="list-style-type: none"><li>a. How about the founders, are they still involved in the company's activities? Could you give me an example of their involvement?</li><li>b. Is it positive to the company or not?</li></ol></li></ol>
<ol style="list-style-type: none"><li>4. What are the company's market strategies? Could you please explain a little bit about what kind of market strategies the company employs?<ol style="list-style-type: none"><li>a. Compare this to what others have done, how do you rate your company compare to others in the same industry?</li></ol></li></ol>

## Part 2: Internal Conditions

Questions
<p>1. Does the company have a values statement?</p> <p>a. Can you give more detail about the statement? Is it formally documented and known by all the employees?</p>
<p>2. Does the company have rules of conduct?</p> <p>a. Can you give more details about the rules? Is it formally documented and known by all the employees?</p>
<p>3. Does the company have a formal policy of CSR?</p> <p>a. Please explain more about that. How did others see the policy? Is there any different perspective on implementing the policy?</p> <p>b. How does the company formulate this policy? What led the company to have this formal policy?</p>
<p>4. Does the company have a formal policy in dealing with the government?</p> <p>a. Is the policy made as an initiative from the company? Does it meet the regulation from the government?</p> <p>b. You may want to explain more regarding the situation of the company and its relation with the government?</p> <p>c. How does the external environment of the company affect the way the company deals with the government?</p>
<p>5. Does the company have a political connection or some of its members are active politician(s) or former politician(s)?</p> <p>a. Please provide more details about that, (position, active or past politician). Is it strategically discussed by the board of directors or an initiative from the founders? How did others see it?</p> <p>b. What about other companies, do you know if they use the same strategy?</p>

<p>c. What are the impacts to the company?</p>
<p>6. Apart from your market strategies, does the company have non-market strategies? What are they? Please explain</p> <p>a. Can you think of examples of this?</p> <p>b. How about lobbying or political donation?</p>
<p>7. How does the company set its non-market strategies? Does the company have a specific procedure in setting the strategies? Can you please explain about these procedures?</p>
<p>8. Does the company have a department or manager that is specifically responsible for non-market strategies? What was the situation behind the decision to make a special department? How did others see it?</p>
<p>9. In implementing its non-market strategy, does the company integrate it with the company's market strategy? Can you give me examples of this? How does this impact the company?</p>
<p>10. So, do you agree that the company has both social and political strategies?</p> <p>a. If the strategies have not yet been formalized, do you think in the future the company should formalize this?</p> <p>b. Why do you think so?</p>
<p>11. In deciding both strategies (political and social strategies), how does the company see the influence of the industry organization?</p> <p>a. What about the company's level, what are the procedures in deciding the strategies?</p> <p>b. Are there any standard procedures, who are involved in the process?</p>

### Part 3: External Conditions

Questions
<ol style="list-style-type: none"><li>1. Does the fact that your company is a family business play a role in its relationship with stakeholders?<ol style="list-style-type: none"><li>a. What is the role of the owner?</li></ol></li></ol>
<ol style="list-style-type: none"><li>2. How does your company analyse its external environment?<ol style="list-style-type: none"><li>a. How did the company adapt with the institutional environment in Indonesia?</li><li>b. What do you think about the political condition? How does the company adjust with such changes? Please provide examples.</li><li>c. Does the changing political landscape affect the company? What else can you remember about the situation?</li><li>d. In terms of adapting to the political situation, does the company prefer active or passive approach?</li><li>e. Does the company discuss the situation with other players in the same industry or just wait for the situation clear and then take an initiative to adapt with the situation?</li></ol></li></ol>
<ol style="list-style-type: none"><li>3. Do you think that personal intention to gain more political access from the owner plays an important role for the company in deciding its strategy?<ol style="list-style-type: none"><li>a. As a Director, how do you handle this situation? How did others see it?</li></ol></li></ol>
<ol style="list-style-type: none"><li>4. Are the customers are considered in social and political strategies decision making process?<ol style="list-style-type: none"><li>a. Does the company get feedback from the customers?</li><li>b. What kind of feedback did you get?</li><li>c. How does the company get the feedback?</li><li>d. How the company use the feedback from the customer in its decision</li></ol></li></ol>

making process?
<p>5. Are there any specific issues that you want to discuss regarding the non-market environment of the company? Please expand.</p> <p>a. What eventually happened? How did the company respond to the situation?</p>
<p>6. Does the company have a business that is related to a government contract or sale? Please explain.</p> <p>a. Can you think of another example of this?</p>
<p>7. Kindly explain how the company won the government contract? Do you know how many companies are involved in the bid?</p> <p>a. What else can you remember about that situation?</p>
<p>8. Do you find it easy to get the government contract? Why or why not? Are you happy with the process in getting contracts?</p> <p>a. Compare this to what others have done, what do you think your company has done, similar or different from other companies?</p> <p>b. What else can you remember about that situation?</p> <p>c. What led you to do that?</p> <p>d. What was the outcome?</p>
<p>9. Is the company ever involved in lobbying political parties or political actors for the sake of the company's objectives?</p> <p>a. What eventually happened? What did your supervisor/owner say / do?</p> <p>b. How did others see it?</p> <p>c. Is this typical for your company or is it typical for the industry, or even the country? Kindly give me more details about what you did, please.</p> <p>d. Do you mind to discuss what you have done in the lobbying process?</p>

<ul style="list-style-type: none"> <li>e. What did other companies do in lobbying?</li> <li>f. What do you think about lobbying activities, and what was the financial impact to the company?</li> </ul>
<p>10. Is the company ever donating to political parties or other organizations?</p> <ul style="list-style-type: none"> <li>a. What eventually happened? What did your supervisor/owner say / do?</li> <li>b. How did others see it?</li> <li>c. Is this typical for your company or is it typical for the industry, or even the country? Kindly give me more details about what you did, please.</li> <li>d. Is this typical in the industry?</li> <li>e. What was the financial impact to the company?</li> </ul>
<p>11. What other contracts with the government or other third parties does the company have apart from what you have explained before? Please expand.</p> <ul style="list-style-type: none"> <li>a. Can you think of another example of this?</li> </ul>
<p>12. Can you think of other motives why the company needs to be involved in lobbying and political donations activities?</p> <ul style="list-style-type: none"> <li>a. Please provide examples.</li> </ul>
<p>13. Has your company had any involvement by other stakeholder such as NGOs? Please explain the nature of this involvement. How has this affected your non-market activities and strategies?</p> <ul style="list-style-type: none"> <li>a. How about social conditions and culture, does your company also consider this in deciding and implementing its programs? Tell me more about that.</li> <li>b. How do you find NGOs and other social organizations in relation to the company?</li> </ul>
<p>14. Do you have a CSR program? If yes, in implementing your CSR program,</p>

are there any barriers and challenges that the company still face in its effort towards further integration of social aspects of doing business?

- a. Does the company implement its CSR program by itself or involving others organization?
- b. What was the outcome? What was the financial impact to the company?
- c. Does the company report its CSR programs?

15. Can you explain about the company's social activities?

- a. What are the main activities of the programs?
- b. Are there any specific targets from the activities?
- c. What are the impacts of the social activities to the company?



## Appendix C: Initial Codes

Administration process	Collective action
Bureaucracy	Experience in Non-Market
Business as Target	Integrated strategies
Business Association	Market Advantage
Business Expectations	NO to Collective Action
Business Government-Relationship	NO to Non-Market Strategy
Changing Environment	Non-Market Actions
Competition	Bribe
Complex Situation	Businessman as Politician
Confusing Regulation	Hospitality
Contract Fraud	Entertainment expense
Cultural Influence	Higher Incentives
Current Progress	Lobbying
Economic Stability	Meet the regulation
E-Procurement	Network
Ethical Consideration	Partnering or Subcontracting Project
External Environment	Political Connection
Favourable Policy	Political Donation
Firm Identity	Political Strategy
Industrial Relations	Politician as Businessman
Industry	Relationship With Officials
Interest Groups	Social Strategy
Lack of human resource	Type of Strategy
Lack of Support	Passive Approach
Lack of Transparency	Proactive Approach
Law Enforcement	Businessman as a politician
Legislative Intervention	Consequences of NO Non-market

Local Election	Strategy
Market Strategy	Firm Performance
Opportunistic Behaviour	Government Contract
Past Condition	Importance of Non-Market Strategy
Political Condition	Motivation to Non-Market Action
Red Tape and Corruption	Personal Intention
Regulatory Efficiency	Personal Opinion
Role of Business Association	Problems
Social Condition	Refuse to Work with Government
Structural problem	Response to Environmental Demand
Being a Muslim	Size of the firm
	Religious
	Social pressure
	Coping others