

## Cooperatives: Indonesia's Sleeping Giant or a Total Failure? A Legal Perspective

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**Abstract:** Cooperatives were once the economic pillars of Indonesia. However, the trend shows that the population in general are currently starting to stray away from cooperatives. This research aims to answer two questions: whether the current regulatory framework in Indonesia provide adequate support to the development of cooperatives and what solutions are available to improve the regulatory framework for cooperatives. It was found that the current legal framework still presents a number of difficulties for the establishment of cooperatives; namely the complex and lengthy establishment procedures. To overcome the challenges faced by cooperatives, the government must simplify the complex and lengthy establishment procedure harmonize the regulatory framework with the adat law framework, establish government institutions for the monitoring and evaluation of cooperatives, create third party grievance mechanisms and provide financial assistance and funding schemes to help cooperatives compete with companies.

**Key words:** Cooperatives, Indonesian regulatory framework, economic organizations, evaluation, financial

### INTRODUCTION

In a recent interview with The Jakarta Post, Vice-President Jusuf Kalla discussed a worrying economic phenomenon: over 30% of all cooperatives in Indonesia are no longer active. This is a highly unfortunate trend, seeing as cooperatives were once among the economic pillars of this country. Historically, the founding fathers of this nation had envisioned cooperatives as the central economic unit by which the people could attain prosperity. This could be seen from the provision of Article 33 of the 1945 Constitution of Indonesia which states that the economy shall be organized as a common endeavor based on the principles of the family system (gotong royong). All these characteristics are exemplified in the underlying principles of cooperatives: it thrives based on the collective efforts of the unit and it is built by the values of togetherness among its members.

Although, globalization and the liberalization of the economy have undoubtedly affected the way the population conducts its economic activities, there are still questions which are yet to be answered in relation to the cause of the decline in the development of cooperatives. Specifically, the question which is most urgent to be answered is whether the lack of a conducive regulatory environment contributed to the stagnation in development of the cooperatives in Indonesia.

**Research questions:** In light of the aforementioned issues, this legal research will therefore attempt to answer the following research problems in order to obtain such insight:

- Do the current regulatory and institutional framework in Indonesia provide adequate support to the development and growth of cooperatives?
- What are the possible solutions to improve the regulatory and institutional framework in order to overcome the challenges faced by cooperatives in Indonesia?

### MATERIALS AND METHODS

This research uses a diachronic approach in analyzing the body of laws relevant to the discussion. Inductive and deductive methods are used for analyzing the data. Data for this research will be collected as primary data (legal instruments: law, regulations, etc.), secondary data (results from previous research, books and journal articles).

**Understanding cooperatives:** Cooperatives, as defined by the International Cooperative Alliance ("ICA") are "autonomous associations of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through jointly-owned and democratically-controlled enterprises". Cooperatives operate in a manner which is distinctly ethical and communal compared to any other economic institutions as they possess a 'social character' and they are not established merely for the purposes of profit-making (Arsad and Anggraeni, 2011). Hence, their business models are centered around the values of self-help, self-responsibility, democracy, equality and solidarity. Having examined these principles, it is easy to

see why, cooperatives were favored by the founding fathers of Indonesia. At its core, cooperatives share the same ideological values laid out under the 1945 Constitution; that economic activity shall be conducted in pursuit of a common endeavor' based on the principles of 'kinship'.

**History of cooperatives in indonesia:** Generally, the cooperative movement in Indonesia could be divided into two eras: the pre-independence and the post-independent eras. The pre-independence movement could be traced to the establishment of the first consumer cooperative in 1910 by Budi Utomo, an association of Javanese Medical Students in Jakarta (European Commission, 2012). The movement was then continued by a cooperative built by a religious political organization called the Sarekat Islam, in 1913. These two movements were greatly opposed by the Dutch Colonials, as it encouraged independence from the Dutch Colony.

During the Post-Independence era, the cooperative movement evolved into two different categories: the Village Unit Cooperative or Koperasi Unit Desa ("KUD") and the Non-KUD Cooperatives. The primary difference between the two types of cooperative is that the KUD are established in villages to facilitate the production and distribution needs of farmers while the Non-KUD cooperatives were organized by the civil servants, armed forces, industrial workers and traders for the purposes of thrift and credit facilities.

In the modern context, following the enactment of Law No. 15 of 1992 on Cooperatives ("Law No. 25/1992"), these 2 delimitations no longer exist. What Law No. 25/1992 does regulate is that cooperatives could either be a primary or secondary cooperative. Primary cooperatives are those cooperatives which are established and has members comprising of individuals, whereas secondary cooperatives are those which are formed and has members comprising of other cooperatives.

**Development of regulations governing cooperatives in Indonesia:** The first legislation which specifically regulates the conducts of cooperatives was Law No. 12 of 1967 on the Principles of Cooperatives ("Law No. 12/1967"). Law No. 12/1967 contained 57 Articles, governing the most basic aspects: the functions of cooperatives, the rights and responsibilities of its members, the structure and organization of cooperatives, capital requirements, establishment, and dissolution of cooperatives. Subsequently, the law was amended by Law No. 25/1992 which cover basic provisions on its functions, role and principles, its membership, its

structure and organization, capital requirements, its establishment and its dissolution. In this regard, Law No. 25/1992 showed progress, as it contained provisions on matters which were not previously regulated, namely; the legal status of cooperatives, the distinction between the primary and secondary cooperatives, delimitation of businesses activities, division of profit, and the establishment of government supervision and assistance.

Unfortunately, Law No. 25/1992 was the last positive development. Although the parliament did amend the law through Law No. 17 of 2012 on Cooperative ("Law No. 17/2012") such statute is no longer in force as it was revoked in 2014 through the decision of the Constitutional Court in Decision No. 28/PUU-XI/2013 regarding the Review of Law No. 17/2012 ("Decision No. 28/2013").

In order to avoid a legal vacuum, the Court declared that Law No. 25/1992 will be temporarily in force until a new law is enacted. Since there has yet to be any new laws passed by the parliament on cooperatives, the legislation has taken a backward step and the old Law No. 25/1992 is the law which is currently in force.

## RESULTS AND DISCUSSION

**Do the prevailing laws provide adequate support to the development of cooperatives?** There are two major issues which exist under the current regulatory framework for cooperatives.

**Complex and lengthy establishment procedures:** One of the major disincentives faced by those who are interested in establishing cooperatives in Indonesia is the complex and lengthy establishment procedures. Law No. 52/1992 provides 10 Articles related with the procedure for establishment of cooperatives. Based on Law No. 52/1992, as well as MoC Regulation No. 01/2006, cooperatives will only attain its status as a legal entity once its Deed of Establishment has been approved by the Government. However, Minister of Cooperatives and Small Medium Enterprises ("MoC") MoC Regulation No. 01/2006 require numerous additional procedures. In comparison, these additional procedures do not exist for the establishment of any other legal entities. These procedures could be summarized into five stages as follows.

**Preliminary meeting:** First, the founding members are required to conduct a Preliminary Meeting (Rapat Persiapan) to discuss all matters related with the establishment of their cooperative. What complicates matters is that the MoC Regulation requires an official from the MoC to be present during this meeting.

**Formation meeting:** In the formation meeting (rapat Pembentukan), the founding members will agree on the most essential matters on the cooperative's establishment, e.g., contents of the Articles of Association, structure and management of the cooperative, etc. Not only does the MoC Regulation require at least 20 members to be present, it also requires the attendance of an MoC official to supervise the meeting. The Regulation also states that the results of the Formation Meeting must be transcribed in a Minutes of Meeting.

**Submission of establishment documents:** The Minutes of Meeting will then be used as the basis for drafting the deed of establishment. In this regard, the MoC Regulation allows either the members of the cooperative or a notary to draft the Deed of Establishment. However, the process would take longer if it were drafted by the members themselves, as there are lengthier requirements.

**Verification:** Following the submission of the documents, the MoC will then need to manually verify the contents of all the establishment documents including the the Deed of Establishment and Articles of Association.

**Approval:** Once the MoC considers all the submitted documents as verified, it will make a determination as to whether the proposed Deed of Establishment will be approved. Once it is approved, the Ministry will notify the founding members and they will receive the approved Deed of Establishment.

Based on the process above, the major constraints in would occur in the second, fourth and the fifth stage. In the second stage, the two main sources of delays are; at least 20 members must be present and MoC officials must be present in the meeting. Gathering 20 members might not always be feasible, especially in rural areas where the financial capital of individuals is relatively low. Additionally, requiring MoC officials to attend the meeting would also cause undue delay due to their unpredictable schedules and the fact that certain rural/remote areas might not be easily accessible for the MoC officials.

In the fourth and fifth stage, the biggest problem is that both the submission and verification process must all be done manually. Currently, there are no electronic systems available to facilitate a simpler and more efficient process. It is then no wonder that the verification and approval process alone could take up to 3 months. Hence, in addition with the other stages, the process as a whole could take up to 5 months in total. In contrast to

the establishment of limited liability companies, this process is exceedingly lengthy. Law No. 40 of 2007 regarding Limited Liability Companies ("Law No. 40/2007") stipulates that companies will only attain its legal-entity status after the issuance of the Minister of Law and Human Rights ("MOLHR") Decree on the approval of the establishment. Undeniably, the existence of the MOLHR electronic verification system established for the approval process of companies is a major factor to the efficiency and swiftness of the establishment process.

#### **Difficulties arising from minimal members requirement:**

Both Law No. 25/1993, as well as MoC Regulation No.01/2006, states that primary cooperatives must be established and formed by at least 20 members who share the same economic interest and activities. As aforementioned, this presents difficulties, especially for those who wish to form cooperatives in rural areas.

Aside from the apparent reason that it is difficult nowadays for anyone to find 19 other people who would want to establish cooperatives with them; financially, those who live in rural areas are most affected by poverty and would thus have difficulties in amassing the capital necessary to establish cooperatives. In 2014, out of the 28 million people who live below the poverty line in Indonesia (Badan, 2014) over 16.8 million of those live in rural areas (World Bank, 2009).

As a comparison, under Law No. 40/2007, a company may be established by 2 persons or more which is 10 times less than what is required for cooperatives.

Secondly, the large membership requirement also results in its decision making process. Under Law No. 25/1992 as well as MoC Regulation No. 19/PER/M.KUKM/IX/2015 of 2015 regarding the Implementation of the Cooperative's Members Meeting ("MoC Regulation No. 19/2015"), the cooperative's Members Meeting, parallel to the General Meeting of Shareholders in the context of companies, is the highest governing body within the cooperative. Decisions of the Members Meeting must be made based on consensus based on deliberation (musyawarah untuk mencapai mufakat). If such consensus cannot be attained, the decision will be made through voting process. Unlike its corporate counterpart, each member will be entitled to one vote, irrespective of their capital contributions to the cooperatives. This principle of "one man one vote" is one of the distinguishing features of cooperatives. The issue arises when the law requires at least half of all the members of the cooperative to be present in the General Members Meeting and at least two-thirds of all the members to be present in cases of Extraordinary Members Meeting. However, if the cooperative is a large-scale,

national-level cooperative with thousands of members, the existence of this large group would present difficulties not only in the decision making process; it would be challenging to even establish the quorum necessary to hold the cooperative's Members Meeting.

**Solutions to improve the regulatory framework to overcome challenges faced by cooperatives in Indonesia:**

Aside from the issues analyzed above, there are numerous other challenges faced by cooperatives. These other challenges can be grouped into several categories, namely: the dis-harmony of the legal framework of cooperatives with the adat regulatory and institutional framework; the lack of trust to cooperatives, due to the numerous corruption cases in rural areas involving KUD under the Suharto era and the lack of ability of cooperatives to cope with competition from companies. The following analysis will elaborate the solutions which could improve the regulatory framework for cooperatives to overcome those challenges.

**Harmonization of the legal framework for cooperatives with adat law:**

As aforementioned, the majority of cooperatives which are currently active in Indonesia operate in rural areas and these local communities are still predominantly governed by their respective adat laws (International Development Law Organization, 2008). Adat is an Indonesian term used to describe a certain social structure encompassing "law, rule, precept, mo rality, usage, custom, agreement, conventions, principles, the act of conforming to the usage of society, decent behaviour, ceremonial, the practice of magic, sorcery, rituals" (Sopian, 2015). Meanwhile, adat law refers to the diverse customs and customary laws prevalent in the adat communities. Essentially, it is the adat community's way of live which holds the center argument as to why the values of cooperatives perfectly align with the societal values in Indonesia. The need to harmonize the legal framework of cooperatives with the current laws of the adat communities is urgent if cooperatives are to thrive and prosper.

Cooperatives, as previously described are primarily centered around the values of self-help, self-responsibility, democracy, equality and solidarity. As an economic entity, cooperatives do not merely focus on the prosperity of the individual but even more important is the prosperity of the community as a whole. Incidentally, all of these principles coincides with the basic foundations of adat law. Adat law is a set of unwritten laws which live within the adat community based on the belief that they are legally bound by those rules and that those rules are necessary for the greater

good of the community (World Bank, 2009). Hence, many of the principles found in cooperatives are also shared by those values in adat law such as the view of property as a common property and the need to achieve a common benefit.

**Increasing trust through monitoring and evaluation for Cooperatives:**

The distrust created through the numerous corruption cases involving cooperatives during the Suharto era has created a need for a transparent and accountable monitoring and evaluation system for cooperatives.

Fortunately, there is already a government institution established for the purpose of supervising and assisting cooperatives, namely the MoC. In this regard, the MoC should establish a publicly accessible department within the ministry whose task is to monitor and evaluate the compliance of cooperatives from three areas: legal compliance, financial and fiscal compliance and business activities compliance. The creation of such department or body within the Ministry would not be unfeasible, in fact Law No. 25/1992 already provides a legal basis for the Ministry to establish such department. Such provision is reflected in Article 60(2) of Law No. 25/1992 which stipulates that the government must provide supervision, assistance as well as protection for cooperatives.<sup>79</sup> Hence, in this regard the monitoring and evaluation of cooperatives could be interpreted to fall under the scope of supervision of cooperatives.

Secondly, there is also a need for a grievance mechanism for members and/or third party's grievances. Adat institutions would provide an excellent third party grievance mechanism, especially for those cooperatives which operate in rural areas, since the people in the adat communities recognize and respect the decisions made by their community heads or chiefs.

For those cooperatives which are established in major cities, a more modern third party grievance mechanism could be established by the MoC. Such grievance mechanism could be established also in the form of a government body and can include mediators appointed by the ministry. With the two mechanisms/instruments installed in the cooperatives, the hope to gain trust from the Indonesian people can be restored.

**Increased government measures for cooperatives tocope with competition with companies:**

Indonesia is in need for government's subsidy for cooperatives in order for cooperatives to be able to compete with companies (public and private). Aside from the scale of business activities, one of the disadvantages suffered by cooperatives is the relatively lower amount of capital (Fredrick, 2015).

The forms of financial incentives and/or funding which could be referred to by the Indonesian government are the schemes applied by the European Union. One of the ways that member states in the EU facilitate growth of cooperatives is to provide them with more favorable taxation methods. Specifically, for the agricultural sector, in several East European countries cooperatives are considered to be an extension of the members' farms. Another form of support which could be granted by the government is through the use of investment, funding and/or subsidies for cooperatives. In order to avoid moral hazard or a spill-over in budget, the investment/subsidy can focus on a certain issue in rural areas: agriculture or food, cattle management or farming, craft-sustainable livelihood which directly touches the livelihood of the rural areas. There is also a need to initiate and engage in collaborations State Owned Companies, Private Owned Companies and Desa/Village Owned Companies.

Such support measures from the government could legally be justified, seeing as Law No. 25/1992 contains provisions which obliges the government to support the growth of cooperatives. This is most evident in Article 60(1) which states that the government must create and develop a conducive climate for the development and societal participation of cooperatives. Hence the provision of a more competitive taxation regime or financial aid for cooperatives would clearly be in line with such goals.

### CONCLUSION

Cooperative in Indonesia is facing numerous challenges. They are, among others: complex and lengthy regulatory framework, disengagement of its regulatory framework with adat/local community's regulatory framework, lack of trust from the people and lack of ability to compete with companies. But from these shortcomings, Indonesia cooperative must take them as opportunities in facing these challenges. Indonesia's cooperative must simplify its complex regulatory framework and yet make it harmonized with adat's regulatory framework in order to

serve the adat people's way of life; gain trust from the people by establishing instruments for monitoring, evaluation and grievance mechanisms and cope with the competitions from limited liability companies, as well as other types of companies with initiating collaborative activities with them. The government of Indonesia also need to increase subsidy and investment for cooperative to be able to strive in the competition. In short, although the road is still winding to cooperative's success in Indonesia but there is a light in the end of the tunnel.

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