

Calculated growth:
The Garuda
takes flight





Cover photo: The *Garuda* is a mythical bird massive enough to block off the sun. As Indonesia's national symbol, the *Garuda* signifies power, bravery, knowledge, loyalty and discipline.



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By SYLVANO DAMANIK – Managing Director, Indonesia
sylvano.damanik@haygroup.com

Sylvano specializes in a broad range of consulting services. He leads Hay Group's operations in Indonesia, and advises senior decision-makers on strategic issues relating to organization, leadership and reward. His expertise includes job design, manpower planning, performance and talent management, executive coaching and development, as well as leadership and change management for large-scale organizational transformation.

Calculated growth: Managing performance in Indonesia

Scaling new heights

Indonesia offers endless business opportunities. For a country at its level of economic development, it has weathered the global downturn remarkably well. The archipelago is blessed with natural resources, a projected population of 312 million by 2030 and a rapidly rising middle class – suggesting not just the size of its domestic market potential, but also, its significant purchasing power.

The country's prospects are supported by varied industries ranging from agriculture, to oil and gas, tourism and services. Rising stars such as creative industries have added to the diversity of its vibrant economy and its employment portfolio.

In 2011, Indonesia stepped onto the world stage as GDP figures breached the trillion-dollar mark. The Euro-zone debt crisis Notwithstanding, the Indonesian economy has maintained a steady pace of growth, while foreign direct investments surged to record levels. With GDP per capita crossing the USD 3,000 mark, Indonesia is poised, not only for higher living standards, but also for accelerated growth in the imminent future.

Priming for growth

The Indonesian government is focused on success and performance. Market liberalization, the fight against corruption and bureaucratic reforms are among the many initiatives being rolled out by President Yudhoyono's administration in order to strengthen investor confidence and realize the full potential of its renewed market position.

Despite all of these achievements, the road to full-fledged democracy and a sustainable market economy with socio-political safeguards remains long. Market-based competition in Indonesia remains constrained, and efficiency in results and the deployment of organizational resources could be vastly improved.

Driving organizational effectiveness

To deliver calculated growth, public and private sectors are increasing evolving seniority-based reward practices towards performance-based incentives. With underlying paternalism intrinsic in Indonesia's diverse cultures, this can be difficult to achieve.

“ Indonesian organizations have arrived at the crossroads where they will have to decide – based on their opportunities, constraints and resources – what would be their unique roadmap for success. ”

In the first two chapters, our practice leaders share useful insights based on their work with civil service organizations and state-owned enterprises to explain how remuneration policies, among other interventions, can heighten Indonesia's productivity, revenue-generating potential and economic growth drivers. This is backed by our leading perspectives section on Indonesia's latest pay trends and reward practices in Chapter 7.

Grooming leaders for higher performance

As the key driver for organizational performance, the role of leaders cannot be overemphasized. From supervisory styles to leadership alignment when companies come together through merger and acquisition, today's leaders are expected to do more than visioning and directing – they must also motivate, coach and inspire. In Indonesia, this is compounded by the divergence between Western theories and Eastern idealisms.

For example, studies indicate that Indonesian leaders display greater inclination towards maintaining harmony, affinity towards others (*paguyuban*) and conflict avoidance. This is fine in good times, but under intense competition, leaders and managers must make the right, but often, difficult decisions related to people performance. In Chapters 5 and 6, we reveal strategic insights on leadership as powerful organizational enablers.

Quantifying the intangibles

Family-owned businesses are an integral part of our economy. While family members are concerned about the sustainability of their inheritance, we leverage research-based insights in Chapter 4 to explain why the management of family capital is just as, if not, more important than financial capital when it comes to professionalizing family enterprises.

Likewise, in Chapter 8, we discuss the importance of identifying hidden employee potential using Hay Group's Growth Factor Inventory – an invaluable tool developed through extensive research to help companies make a sharper distinction between past performance and true potential when it comes to selecting the right candidates for promotion.

Ensuring calculated growth

Indonesia is on a growth trajectory. At the same time, Indonesian organizations have arrived at the crossroads where they will have to decide – based on their opportunities, constraints and resources – what would be their unique roadmap for success.

And for companies prowling for good buys, would a closer look at intangible assets unlock the secrets to M&A success? We discuss this in Chapter 5.

We hope that this first edition of Indonesia Focus will stimulate new ideas for calculated growth. We believe there are serious challenges that need to be tackled as the market expands and as organizations grow more complex organically and strategically. My team and I would be extremely interested in your feedback, and look forward to discussing our insights with you further.







In Indonesia, government reforms have paved the way to a vibrant economy. Backed by renewed policies and robust infrastructure, the civil service is poised to scale new heights.



By **NOVITA PRIMADEWI** – Managing Consultant
novita.primadewi@haygroup.com

Novita leads Hay Group Indonesia in its work with government departments. Her consulting and professional experience in top-level management has strengthened her approach in organization development and talent management. She has helped leading companies with their mergers and acquisitions, and brings practical insights on issues surrounding organizational change and restructuring.

Soaring above challenges: What's beyond the government's bureaucratic reforms?

Despite the complex bureaucracies surrounding the government, Indonesia remains one of the world's hottest emerging markets. In 2011, the Indonesian economy grew by 6.5 per cent, while foreign direct investments hit a historic high of US\$19.3 billion. More recently, the "investment grade" status conferred by two credit rating agencies affirm the potential inherent in Indonesia's size, population and natural resources.

In achieving its economic success, Indonesia has been on the warpath against corruption, reforming the civil service and investing heavily in new infrastructure. Among these, civil service reform is the fundamental that will accelerate the national agenda and safeguard the nation's long-term competitiveness.

More importantly, the robustness of the government's regulatory systems matters – an outcome driven not only by strong leadership, but also by effective organization design and a competent workforce.

A reality check

The decentralization of functions and resources aimed at creating a more responsive government has resulted in regional agencies with operating models that are limited in scope. According to the World Bank, Indonesia fared unfavorably compared to its Asian neighbors and was ranked 47.8 percentile among all nations when it comes to public service quality, policy formulation and the credibility of government's commitment to its policies (Figure 1).

Figure 1: Government effectiveness (2010)
 Source: Worldwide governance indicator

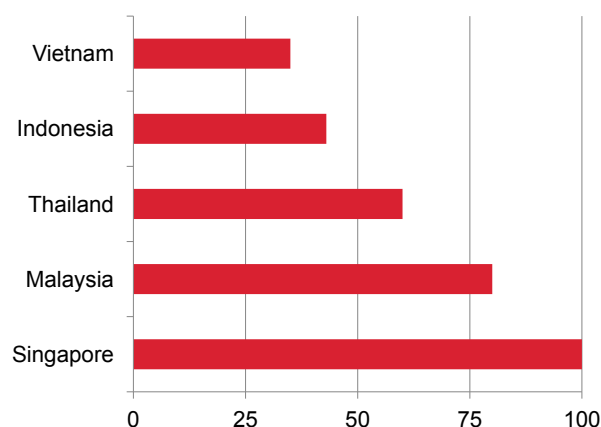


Figure 2: Doing business in Indonesia

Source: WorldBank, 2011

Country	Ease of doing business ranking	Starting a business	Enforcing contracts
Singapore	1	4	13
Hong Kong	3	18	3
United States	4	8	8
Thailand	12	55	24
Malaysia	23	88	59
Indonesia	122	161	146

Figure 3: ASEAN Human Development Index (HDI) ranking, 2011. Source: UNDP

2011 HDI ranking	ASEAN countries
26	Singapore
33	Brunei Darussalam
61	Malaysia
103	Thailand
112	Philippines
124	Indonesia
128	Vietnam
138	Laos
139	Cambodia
149	Myanmar

Not surprisingly, a separate World Bank survey identified Indonesia as one of East Asia's toughest places to do business (Figure 2); while the Human Development Index (HDI) ranked Indonesia 124 out of 187 countries (Figure 3) covered in the United Nations Development Program. As alternative measures of national development, these indices place Indonesia well below the regional average, exposing large gaps that exist in terms of public education and income levels.

Although there have been some successes in the government's reform, progress has been slow and unable to drive public service performance. Unfortunately, emphasis on regulatory compliance continues to outweigh performance outcomes.

The restructuring of the civil service compensation system has created a readiness for change towards a performance-oriented working attitude among civil servants, making government sector careers an option for Indonesia's top talents. However, it will take more than just a reward system to deliver an impactful bureaucratic reform.

From strategies to action

We see people development as the first step to equitable economic and social development in Indonesia. For example, the Ministry of Education (MoE) plays a significant role in ensuring

good education for every citizen. Its reform programs are targeted at improving the public education system.

Within this context, we have helped MoE to improve its people and organizational capabilities by translating the newly re-defined culture into actionable programs and outcomes, conducting workforce analysis and performing job analysis and evaluation to help MoE decide on the optimal size of its workforce. We also developed guidelines and tools for performance management system, enabling MoE to cascade organizational goals into individual goals for everyone in the ministry and its operating units.

While plans were in place to make public education more accessible, the shortage of qualified and motivated teachers proved the bigger challenge. A better reward may be the solution; however, we believe that reward can be a double-edge sword if it is implemented without robust strategy and plan.

Our extensive experience in working with government clients worldwide, coupled with insights on reward practices in Indonesia, have enabled us to understand the formula for an effective reward system in the Indonesian context which incentivizes as well as engages people to perform better.



High-caliber leadership

Leaders at the government's top echelons play a key role in bureaucratic reform. The appointment of Indonesia's top talents with international reputation in President Yudhoyono's new cabinet was accomplished with the view that a new 'breed' of government leaders would bring about new culture and performance standards among the ministries, strengthening public and foreign investor confidence in Indonesia.

While these officials drive the agenda and priorities of reform in their respective ministries, they are also looking at the people aspects of transformation – placing greater emphasis on the selection of second liners, upgrading strategic competencies and urging greater performance.

Despite being Indonesia's largest employer, the civil service finds itself competing directly with a growing number of multinational and reputable local corporations for the nation's limited talents. The Ministry of Finance, Bank of Indonesia, KPK

and BPKP are some of the government agencies seeking high-caliber talents in finance and auditing from the same pool of talent as the private sector.

Sheltered from the pressures of high attrition, the government has had no compelling reason to focus on employer branding. However, with shifting values and public expectations, the civil service is losing its luster as employer of choice. Today, Indonesia's best and brightest are not interested in government scholarships or the prospects of working for seniority-based organizations. Instead, they prefer a competitive and merit-based compensation scheme, and are inspired to work for capable leaders in an environment that offers good prospects, fair career advancement and development opportunities.

For these reasons, good leaders at the ministries will help the government attract Indonesia's top talents to work in the civil service.

Empowering change

With the changing profile and aspiration of Indonesia's new breed of talents, the nation's paternalistic culture no longer has a stranglehold over change management. Today, the civil service is beginning to differentiate high performers, retain top contributors and reward high achievers with real incentives for good performance.

While status quo was important in the past, the paradigm shift has resulted in ministries that are keen to work with the public. This can be seen from the reduction of red tape, an increasingly customer-focused culture, efforts to make public service more accessible, and greater transparency in government initiatives. There has been a significant increase in the use of e-government platforms; and in the case of e-procurement, a transparent online system has reduced opportunities for unethical working processes and manipulation.

On the threshold of a new era

The government has made clear its commitment towards strong governance and good public service. Today, political stability and robust economic growth has set the stage for bureaucratic reform and provided the impetus for a people-friendly government.

Although Indonesia has achieved so much within such a short time, good public service will ultimately depend on the competency of each organization and the systems in place to shape and drive performance. Through willingness to professionalize the civil service and adopt global benchmarks in the management of the public sector, we believe the government will be able to draw the right talent and unleash its full potential in strengthening and supporting the nation's economic objectives.

Helping Indonesia work

To improve the performance of the public sector, Hay Group has identified some critical success factors, which include:

- **Quality of leadership at the top**

Today's leaders are expected to play multifaceted roles. Their ability to switch from visionary chiefs and team captains to astute decision-makers to inspire change and motivate performance is critical.

- **Implementation is key**

The roadmap to bureaucratic reform is fraught with complexities. The challenge for leaders is to reinforce change and bring about an actionable plan within the capability of an organization.

- **Identify champion teams**

Change management is a collective process. The appointment of champion teams strengthens employee participation, enabling reform processes to be more closely supervised and effectively implemented. It also encourages employee commitment and the willingness to make discretionary effort.

- **Give reward and consequences**

In high-performing and high-accountability organizations, employees are clear about larger goals and expected outcomes. They are motivated by the right reward and accept consequences for non-performance.

- **No one-size-fits-all solution**

Every government agency has its own culture, system and process. As such, there are no short cuts to change management and the right solution is one that is fit for purpose.





The *keris* is a traditional ceremonial sword prized for its mythical powers. As a symbol of strength and heroism, it is believed to bestow its wielder with triumph in the face of adversity.



By **NUGROHO IRAWAN** – Director
nugroho.irawan@haygroup.com

Based in Jakarta, Nugroho helps senior executives achieve higher business performance through effective organizational development and reward management practices. These range from organization restructuring, accountability distribution mapping and work culture formation, to executive compensation, performance management and leadership development.

Sharpening the sword: Igniting Indonesia's growth drivers

Rise of state-owned enterprises

Over the last decade, state-owned enterprises (SOEs) have become a major force in Indonesia – the largest economy in Southeast Asia. In 2009, total revenue contribution from its 142 SOEs was Rp. 986 trillion or 18 per cent of Indonesia's GDP (Figure 1).

By 2011, total SOE capital expenditure outpaced the government's capex spending by 73 per cent while operating expenses were seven times higher (Figure 2). Indonesian SOEs have consistently shown stable and significant growth, as seen by 14.97 per cent increase in revenues and 19.61 per cent increase in net profit (Figure 3).

Figure 1. Assets, revenues, net profit of Indonesian state-owned enterprises (2004 – 2009)
 Source: *Towards World Class Corporations*, Dr. Ir. Mustafa Abubakar M.Si., 29 September 2010



Figure 2. Capital expenditure & operating expenditure of SOEs in Indonesia (2010 - 2011)

Source: *Good Corporate Governance Implementation In Indonesia's State-owned Enterprises*, Gatot Trihargo, Deputy Assistant for Strategic Industry & Manufacturing SOEs II, 18 May 2011

	Capital expenditure (Rp trillion)		Operating expenditure (Rp trillion)	
	2010	2011F	2010	2011F
State expenditure budget in APBN P 2010 & APBN 2011	95.0	121.7	112.8	131.5
SOEs*	196.9	210.1	932.2	1,020.9
Percentage of SOEs to State	207.3%	172.6%	827.9%	776.3%
GDP	6,253.8**	7019.9***	6,253.8**	7,019.9***
Percentage of SOEs spending to GDP	3.1%	3.0%	14.9%	14.5%

*Excluding the subsidiaries of SOEs **Source : APBN-P 2010 *** Source : APBN 2011

Figure 3: Financial summary 2009 – 2011 of Indonesian SOEs (in Rp trillion)

Source: *Towards World Class Corporations*, Dr. Ir. Mustafa Abubakar M.Si., 29 September 2010

Items	2009 (Audited)	2010 (Audited, Tbk)	2011 (RKAP)	Growth	
				10/09	11/10
Revenue	987,37	1.135.16	1.294.37	14.97%	14.03%
Net profit	86.90	103.94	113.72	19.61%	9.41%

Affirming their meteoric growth, the number of Indonesian SOEs on Forbes's Global 2000 had risen from four in 2009, to seven in 2010, and 10 in 2011 – the biggest ranking jumps coming from those in the banking sector. More SOEs are expected to join the list as Indonesia's rightsizing policy progresses.

Leveling the playing field

While the significance of SOEs as revenue center and economic growth driver cannot be denied, their contributions however are not evenly distributed. In 2010, over 90 per cent of total SOE revenues were contributed by just 26 government corporations – with Pertamina, PLN and Telkom leading the pack (Figure 4). And despite their impressive financials, it appears that progress rate among Indonesia's top SOEs is still lagging behind other nations.

To maximize SOE contribution to the national budget, the government has been actively consolidating the number of SOEs. In late 2011, State Enterprises Minister Dahlan Iskan announced a move to cut the number of SOEs by 12 per cent, citing poor governance and inefficient services as roadblocks to profitability and performance.

This is not surprising, given the strong correlation between a firm's financial performance and the abilities, motivation and competencies of its people

as seen in global research – a signal to SOE CEOs that it is time to focus on HR and talent management. Studies by Hay Group have also established the positive relationship between leadership styles and organizational climate, a factor that accounts for nearly 30 per cent of the variations in bottom-line performance.

Sharpening reward practices

Today, one of the factors impeding SOE performance is an uncompetitive reward structure. Because of this, SOEs have relied on their internal talent pool, as they are unable to afford the best people in the market. High turnovers and shortage of professional bankers, geologists and engineers in booming sectors like banking, mining and oil & gas have resulted in the escalation of fixed costs without corresponding increase in productivity or performance.

In Indonesia, implementing a performance-linked pay structure has been especially difficult. To begin with, there is usually insufficient clarity in organizational goals – and not many SOEs translate their objectives into achievement targets. Line managers are not used to setting KPI targets together with their team members, and bonus payouts are viewed as year-end windfalls rather than rewards for the achievement of specific performance parameters.

Unless properly managed, the fact that SOEs are now pegging salaries to meritocracy and job size rather than seniority could lead to disenchantment – for example, when a senior manager realizes that he draws less than a younger colleague with a larger job responsibility, conflict or dissonance might ensue.

Hay Group's total reward framework has provided the basis for better performance management and measurable results at the 26 high-performing SOEs in Indonesia. With a customized remuneration program that takes into account unique business strategies, companies like Pertamina, Bank Mandiri and Telkom have been consistently standing out as industry frontrunners.

With a varied strategy for incentivizing performance, these SOEs achieve a more balanced approach to employee engagement and motivation. For example, both financial and non-financial rewards, including variable pay schemes, training and development opportunities and welfare benefits, can be used as productivity levers with less pressure on employment costs.

Our work with Fortune magazine has proven, time and again, how the World's Most Admired Companies drive better performance – not through bigger paychecks, but through the effective use of intangible rewards. The bottom-line: SOEs should reserve the best pay increases only to those who are truly deserving.

The art of effective engagement

The aggressive pace of consolidation among Indonesian SOEs means that differences in culture, work ethics and leadership must be promptly addressed. It can be intimidating trying to achieve candid and frequent dialogues in Indonesia's traditional and conservative culture; and corporate policies, once established, are rarely challenged.

Furthermore, a paternalistic outlook sets the stage for directive leadership – a style that is highly effective in crisis situations, but not the best approach when bosses are required to coach employees and motivate performance. Over time, directive leaders are unable to foster the right culture, or encourage initiative and job ownership.

Hay Group's competency profiling tool has enabled SOEs to have clear selection criteria when it comes to recruiting leaders. We tap into global expertise and research-based interventions in order to identify the best and most effective leadership talents.

Different strokes for different folks

From a business standpoint, the government's aggressive consolidation and rightsizing program (with current emphasis on the construction, agricultural, mining and pharmaceutical sectors) is more likely to achieve its full potential if incumbent SOEs are leveraging the right HR tools to deliver calculated results.



“ By focusing on strong corporate governance and improving HR management, the government aims to make its SOEs more transparent and accountable. ”

Findings from Hay Group’s employee engagement surveys have enabled some of our SOE clients to gain insights on performance triggers, and why it has become essential to deploy differentiated strategies when it comes to managing different generations and strata of management. For example, young executives are more likely to be retained by job exposure and career advancement compared to monetary incentives, while long-serving employees prefer the recognition that comes from their experience.

Simply put, there are no short cuts and SOEs must find the right organizational structure, deliver the right rewards, empower the right leaders, incorporate the right performance measures and create the right environments in order to turn their business strategies into revenue growth.

Promoting professionalism

Recognizing that some organizations are more advanced in their HR development, the government encourages the sharing of best practices so that SOEs can learn from each other’s professionalization efforts. The Association of HR Directors is a professional platform for HR practitioners in state-owned enterprises. Through this forum, Hay Group has been invited to facilitate numerous useful discussions, including a session on competency modeling for HR professionals.

Delivering calculated growth

Among other initiatives, the Ministry of State-Owned Enterprises has welcomed private sector collaboration in strengthening the succession and selection process of top executives and to introduce competitive compensation structures.

It has also acknowledged the urgency for stricter performance management and evaluation processes in order to accelerate the nation’s development. By focusing on strong corporate governance and improving HR management, the government aims to make its SOEs more transparent and accountable.

As state instruments for national welfare, SOEs are constantly being challenged to improve public service obligation and create better jobs to drive the economy. As such, cautious step-by-step HR management is the best way to realize the true potential of human capital. Then only can SOEs sustain Indonesia’s economic growth momentum and deliver on the government’s long-term expectations.







By LUSI LUBIS – Managing Consultant
lusi.lubis@haygroup.com

As practice leader for Leadership and Talent Management and member of Hay Group Indonesia's Country Management Team, Lusi advises senior executives on aligning business strategies to organizational goals. She specializes in organization effectiveness, top team alignment, talent management, competency assessment, executive coaching and leadership programs for transformation and organizational change.

Retuning business traditions: Building a family legacy that lasts

Family businesses: Building blocks

Much has been written about family enterprises – their relative tenacity over non-family businesses and their potential contribution to the country's economic landscape.

Hay Group's definition of a family-owned business (FOB) is a company where the family has a controlling interest and expects to continue exercising a meaningful influence over the business into the next generation(s).

According to S&P 500's report in 2011, 37 per cent of Fortune 500 companies are family owned, so family companies are not just mom-and-pop establishments – they are a force to be reckoned. The report also states that family businesses outperform non-family businesses.

Family businesses contribute 80 to 90 per cent of all businesses in the world's free economies and employ more than 75 per cent of the working population around the world.

Likewise in Asia, family businesses form the backbone of economies here where they represent about 50 per cent of all listed companies.

In particular, 70 per cent of the top 100 corporations in Indonesia are family businesses. The 3 per cent of ethnic Chinese in Indonesia own approximately 70 per cent of the country's businesses, controlling around 80 per cent of the biggest companies in Indonesia.

Even though Asian family businesses are mainly at an early stage of their life-cycle (most are second- or third-generation firms), family businesses continue to be a crucial source of wealth creation in Asia. They are key players in strategic industries, financial markets and commercial activities in Asia.

In general, Asian family businesses share a number of fundamental strengths, including long-term commitment, consistency in decision-making and better alignment of owner and management interests. Their performance is underpinned by Asian values – whereby family businesses are viewed as an inheritance, providing an important source of continuity in the transfer of wisdom, businesses and wealth.

with Dr. ANDREAS RAHARSO – Director
andreas.raharso@haygroup.com

Andreas is the director of research for Hay Group's global research centre for strategy execution, headquartered in Singapore. He leads Hay Group's global research programmes, using the insights to develop and improve solutions in strategy execution for clients. Prior to joining Hay Group, Andreas was the dean of a business school and had also worked as the finance director of a sugar refinery.



Sustainability concerns

There are several examples of successful family businesses which are among the top 100 Indonesia corporations based on revenue: Salim Group, Sinar Mas Group, Djarum Group, Bakrie Group, Lippo Group, Gudang Garam Group, Radja Garuda Mas, and Sampoerna Strategic. Some of these FOBs are not only operating locally but also have expanded their business internationally. Their business spans across a wide range of sectors.

Indonesian family businesses, currently managed by its second and third generations, have their fair share of sustainability issues.

The Chinese have a saying about family businesses: *the first generation builds, the second generation grows, and the third generation destroys*. This adage about rags to rags in three generations, otherwise termed as the third-generation jinx, has an unfortunate ring of truth.

While most family business owners would like to transfer their business to the next generation, it is estimated that 70 per cent will not survive into the second generation and 90 per cent will not make it to the third generation, according to the Family Firm Institute.

Several global FOBs operating beyond the third generation are:

- **Cargill Incorporated** (founded in 1865): The Cargill family owns 90 per cent of the Cargill enterprise, which is still privately owned up to today.

- **Faber-Castell** (1761): One of the world's largest manufacturers of pens, pencils, office and art supplies remains a Faber-Castell family legacy.
- **Ayala Corporation** (1834): The Philippines' oldest conglomerate, overseeing the Bank of the Philippine Islands, Ayala Land Inc., the Manila Water Company and Globe Telecom (one of the Philippines' largest mobile phone networks), is owned by the Ayala family.
- **Takenaka Corporation** (1610): The Takenaka family owns the biggest architecture, engineering, and construction firm in Japan.
- **Hermes International** (1837): The high fashion house, specializing in leather, lifestyle accessories, perfumery and luxury goods belongs to the Hermes family.

What can Indonesian FOBs learn from them about sustainability? To understand this, we first have to grasp the notion of "family capital".



Key to successful transition

Akin to physical, financial and human capital, *family capital* is a unique form of social capital that serves as an asset to family enterprises. It is acquired through the building of strong, gratifying and supportive relationships among family members.

The ability of a family business to transcend across generations, especially the third and subsequent generations, is highly reliant on the intentions or perspectives of the next generation, the quality of interpersonal relationships inside the family, the ability to acquire the predecessor's key knowledge and skills, and personal commitment to the family firm.

Family capital is a reflection and accumulation of an FOB's *heritage*, *kin interaction* and *civic structure*.

Heritage consists of the relationship networks and family identity, how family members see themselves as one. Accusations that we often hear in FOB disputes like “you are departing from our founding principles”, or “that is not who we are” stem from unclear or different understanding of family values.

Hence it will be helpful for family members to go back to the family values that brought them success. These values should then be formalized and communicated to all employees and family members

alike so that they become corporate values, thus decreasing the brand dissonance for everyone.

Kin interaction includes the family's obligations, rights and social norms. In business, rights and obligations come from position of power within the firm. In FOB, rights refer to the power to make business decisions, while obligation involves ensuring the financial and emotional well-being of other family members.

Civic structure is the family's moral infrastructure. It encourages trustworthiness among family members and in family governance, and refers to the processes, policies, laws, customs and institutions affecting the way a FOB is managed.

A high level of family capital not only maintains the fabric of familial relations in the family business, but also guides the subsequent generations in making decisions in the best interest of the family corporation.

As the company is under less pressure to deliver quarterly results and dividends to shareholders, family members tend to be more careful about overstretching business resources, and they are often underpinned by the values of the founding family, as opposed to being managed as purely commercial concerns.

Figure 1: Best practices for family capital investments

Heritage	Kin-interaction	Civic structure
<ul style="list-style-type: none"> Train family members to be effective in FOB management. 	<ul style="list-style-type: none"> Hold regular family meetings to share views and perspectives on non-FOB issues. 	<ul style="list-style-type: none"> Develop strict ethical standards for FOB processes.
<ul style="list-style-type: none"> Mentor family members who are potential successors before they take over management roles. 	<ul style="list-style-type: none"> Engage family members in FOB-related conversations. 	<ul style="list-style-type: none"> Establish mutually agreeable processes that maintain the family's continued ownership and control.
<ul style="list-style-type: none"> Establish business processes to induct family members into their FOB networks. 	<ul style="list-style-type: none"> Align the behaviors of the younger generation with expectations of the older generations in the family. 	<ul style="list-style-type: none"> Set-up regulations to strengthen interpersonal relationships among family members.
<ul style="list-style-type: none"> Identify clear values to be perpetuated in the family and business. 		

The Hay Group advantage

At Hay Group, we have analyzed the drivers of outstanding FOB performance. We understand that the practice and philosophy of running a FOB is different from running a purely commercial enterprise.

As the FOB develops through different stages of evolution, we work closely with both family *and* business to establish or renew a compelling FOB aspiration, develop distinctive and sustainable family capital, align key stakeholders to preserve control and ownership and build business value. Through the transition and consolidation phases, we help FOB owners to:

- Confirm family members' vision and their vision for the business so that everyone agrees on what the business looks like and achieve in the future; and make sure the business strategy is aligned to family aspirations.
- Develop a family office and council that is responsible for managing the implementation of the family vision.
- Transfer the goodwill from the founder/family to the business through a professionalized operating model and management.
- Develop a family plan and protocols that provide governance structures as well as balance family and business control with decision-making freedom by non-family managers.
- Develop a leadership team that not only focuses on delivering business goals, but one that is also sensitive to family values and create succession plans that meet the aspirations of both family and organization.
- Set up the right reward strategy and structure that allows retention and development of both family and non-family managers.
- Identify and establish a culture in the business that values growth and meet aspirations of the family as well as attract and retain talent, both from the family and outside.

Besides, healthy relationships among family business members bond the family together in tumultuous times and are a good form of defense in warding off hostile takeovers, thereby ensuring business continuity in the long term. Figure 1 summarizes some of the best practices in keeping family capital healthy.

On the other hand, a professionalization strategy or process that neglects the family will lead to deteriorating circumstances for the business. Even though the business might thrive initially, the family, which forms the basis of the business, will start to fall apart, ultimately causing the business to fail.

We are not saying that family harmony must always take precedence over profitability. In order for FOBs to operate and achieve success in the long run, FOB members must recognize that having a high level of family capital is fundamental before the firm is able to achieve financial capital.

Essentially, blood is thicker than water – it is important to maintain high levels of family capital to encourage further accumulation of financial capital. Without accounting for family capital, professionalizing the FOB would be like a game of Russian roulette.







The theatrical art of *wayang kulit* is a beloved pastime in Indonesia. The puppets are manipulated behind a white screen, bringing mystical tales to life through light and shadow.



By **NIDTHIA CHELVAM** – Managing Consultant
nldthia.chelvam@haygroup.com

Nidhia helps MNCS and international organizations in the areas of leadership management, organizational transformation and business integration. His line and operational management experience with global companies across three continents, and his unique blend of cross-functional insights and multi-cultural exposure, have helped clients to turn strategy into results.

Harnessing hidden strengths: Touching the intangibles

Open for business

If surging foreign direct investments are a signal of the growing global interest in Indonesia, the pace of its economic expansion affirms its seriousness as a competitor in Asia. In 2010, UNCTAD listed Indonesia – Southeast Asia’s largest economy – as a top-10 FDI destination in the world. The archipelago also climbed 10 rungs to 44th position out of 139 countries ranked in the World Economic Forum’s Global Competitiveness report in 2011.

Rich with natural reserves, Indonesia is a commodities powerhouse and a leading exporter of coal, crude oil, palm oil, cocoa, tin and rubber. As a market for mineral extraction, prospects for Indonesia have been excellent – perhaps, even more so than South Africa, Australia and Canada.

It helps that a large consumer market supports Indonesia’s promising business outlook. The country is, after all, the world’s fourth most populous nation. Over half of its 240 million people are under 29 years old, while 60 per cent are under 39 years of age. Coupled with a rapid urbanization rate, multinational companies (MNCs) in Indonesia gain instant access to a dynamic workforce, growing at 2.3 million per year.

Seeking opportunities through M&As

Political stability, backed by the government’s achievements in fiscal and bureaucratic reforms, has provided impetus for higher productivity as well as merger and acquisition (M&A) activities. No wonder the value of M&A deals in Indonesia has risen exponentially over the last 20 years, and in tandem with the number of transactions (Figure 1).

Despite successive falls in global stock markets, growth through acquisition is an achievable option for MNCs seeking opportunities in Asia. Globally, M&A deal values grew by 22 per cent in 1H2011 compared to the same period in the previous year – an indication that corporate takeovers remain highly active.

Yet, M&As are inherently risky – and flawed by evaluation methodologies that ignore the intrinsic value of intangible capital, i.e. the non-monetary assets that drive deal profitability. The strong link between intangible capital and the future business performance of the merged entity is something that academic research, and our work with clients, repeatedly demonstrates.

Figure 1: Announced mergers and acquisitions for Indonesia (1990-2011)

Source: Institute of Mergers, Acquisitions and Alliances



Decoding M&A success

To determine the elements of intangible capital that deliver greater impact on post-merger integration, Hay Group conducted a worldwide survey of 220 top executives involved in major M&A activities across various business sectors.

This is what we found:

- Companies do not adequately assess the value and ‘fit’ of a target’s intangible capital in the early stages of a transaction. Most M&A activities fail because of this.
- Typical M&A evaluation strategies neglect the risks attached to intangible capital. Consequently, mitigating such risks during post-merger becomes difficult.
- The value of intangible capital is not fixed but fluctuates throughout the deal process.
- Companies that have not identified the risks or planned to manage them pro-actively often see a corresponding fall in shareholder value.
- Intangible capital can be optimized through leadership and cultural alignment. These drivers improve integration success, simplify the process of identifying potential targets and increase the effectiveness of due diligence activities.

Grappling with intangibles

Research shows that intangible capital could account for up to 75 per cent of the value of any organization. Figure 2 delineates the core constituents of intangible capital – and as our CEO interviews reveal, the earlier companies address the

underlying issues of intangible capital, the easier it becomes to identify and mitigate post-merger integration risks.

In fact, more than half of our respondents agree that failing to audit non-financial assets such as governance, brand image and client relationships increases the danger of making the wrong acquisition.

Nothing is constant

The common mistake is assuming that intangible capital retains its value throughout the course of M&A integration. In reality, it fluctuates with internal and external changes – typically decreasing over the course of a transaction (Figure 3).

A target firm’s intangible capital is usually at its strongest at the start of a transaction. However, as rumors about potential buy-outs circulate, intangible capital such as client loyalty, brand image and employee commitment begins to destabilize, decreasing with each step of the pre-deal process. By the time the deal is completed, intangible capital is at its most volatile and shareholder value risk is at its greatest.

Despite the value it brings, the management of intangible capital remains secondary to tangible assets. Even leaders – themselves a key driver of intangible capital – are not always willing to be persuaded.

Figure 2: Hay Group model of intangible capital

Organizational capital	Relational capital	Human capital
Culture and market convergence <ul style="list-style-type: none"> Shared values, attitudes, beliefs and customs 	Brand <ul style="list-style-type: none"> External and internal image and reputation 	Leadership <ul style="list-style-type: none"> Clear vision established and communicated
Governance <ul style="list-style-type: none"> Aligned business processes Clear and effective governance 	<ul style="list-style-type: none"> All that touches the customer experience 	<ul style="list-style-type: none"> Conflicts of interests coordinated and balanced for all stakeholders
Agility <ul style="list-style-type: none"> Capacity to manage internal business transformation React quickly to new market demands 	Client intimacy <ul style="list-style-type: none"> Knowledge of the client 	<ul style="list-style-type: none"> Team commitment and employee recognition
Communication and teaming <ul style="list-style-type: none"> Willing to share information Simple channels/information flow 	Client loyalty <ul style="list-style-type: none"> Client satisfaction Low turnover and high rate of referrals 	Employees <ul style="list-style-type: none"> High potentials identified, developed and rewarded Demonstrate strong commitment and loyalty and valued by the organization
Energy and clarity <ul style="list-style-type: none"> Communicated and understood business strategy Clear direction for people to mobilize their energy 	External networks <ul style="list-style-type: none"> Strong relationships with suppliers, distributors and other partners or centers of influence 	Development and management <ul style="list-style-type: none"> New skills, knowledge and leadership styles acquired with training and coaching
Organizational structure <ul style="list-style-type: none"> Effectiveness of the organization to deliver the strategy 	Internal networks <ul style="list-style-type: none"> Effective internal communication High impact cross functional teams 	Engagement <ul style="list-style-type: none"> Employee empowerment and degree of attachment to the company
Tacit 'know-how' and information <ul style="list-style-type: none"> Willingness to innovate Unpatented intellectual property 	<ul style="list-style-type: none"> Enabling relationships across organizational and geographic boundaries 	Productivity <ul style="list-style-type: none"> Efficient management of costs, resources and time

Leadership alignment

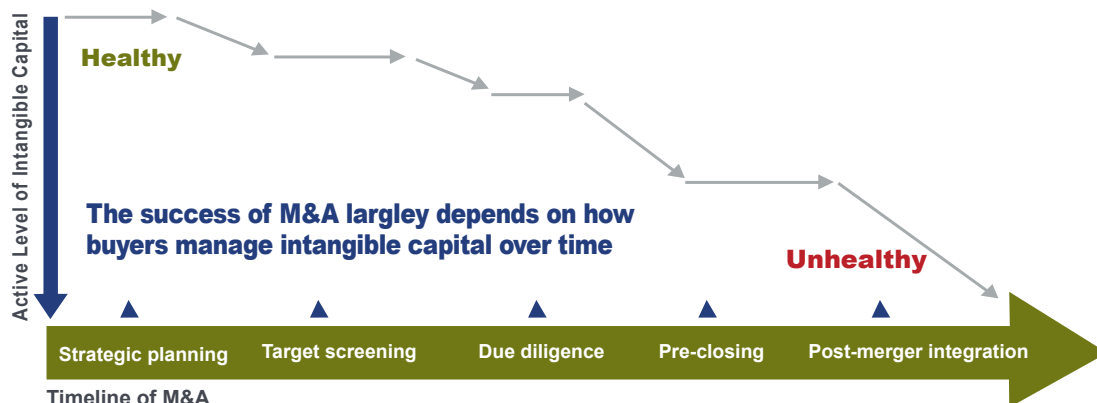
When there is consensus between the leaders of two merging firms, the chances of cost and growth synergies are heightened.

In Indonesia, where cross-cultural mergers have become increasingly common, it is imperative for management to set aside differences in individual and collective expectations early in the M&A timeline, and to foster leadership alignment in

areas such as brand positioning, client relationships, employee productivity, engagement and governance styles etc.

In our global survey, organizations that reviewed their leadership capabilities were 50 per cent more likely to unlock significant post-merger value, and four times more successful in achieving their merger objectives. Equally important is leadership decision-

Figure 3: Intangible capital varies over time



making behavior. Two-thirds of respondents to our M&A pulse surveys said that slow decision-making was a key barrier to effective integration.

Finally, post-merger integration creates uncertainty for customers and employees. Open, honest and timely communication by leaders at every level can alleviate this – despite natural tendencies to protect staff morale, productivity and customer service by delaying communication or glossing over difficult issues. In conservative and paternalistic Asian societies like Indonesia, this becomes the Achilles' heel.

Cultural alignment

Likewise, merging firms with comparable organizational cultures are more likely to understand and support each other's actions and decisions. Leaders who create a single, unified corporate culture also reap higher tangible benefits – including stronger earnings, sales and market share. Sadly, research evidence proves otherwise, with only 38 per cent of our respondents having any form of cultural analysis during due diligence. Not surprisingly, 60 per cent had difficulties obtaining information about the target company's culture, while 54 per cent admitted that this increased the danger of M&A failure.

There are two underlying factors to cultural alignment: attitudes towards risk-taking and organizational agility. Firstly, firms with the same relative tolerance to risk-taking are better able to deliver merger objectives. Operationally, the achievement of cost and growth synergies requires bold decisions, and leaders cannot afford a risk-averse culture.

Agility refers to the timeliness of decisions. Clearly, indecision and the failure to respond quickly based on sound information, judgment and experience will jeopardize chances of M&A success.

Lessons for MNCs in Indonesia

There is no doubt that Indonesia has much to offer in terms of opportunities and resources, and MNCs are increasingly cautious about their aggressive growth plans. Nonetheless, we believe there is room for greater prudence on M&A strategies.

Paying close attention to intangible capital throughout an M&A transaction brings critical insights and value to the deal, maximizing chances of success at every stage.

Reviewing intangible capital and risk factors during the initial phase, for example, will result in clearer information about the 'best buys' available. During due diligence, a careful assessment of the elements of intangible capital will highlight potential gains and risks. Finally, these efforts will pave the way for effective intangible capital management in the months following the deal.

By creating the right conditions for deal success, MNCs can deliver greater shareholder value from their acquisitions. And this has become especially relevant for businesses operating in today's uncertain economic environment.



Indonesia's megalithic stone sculptures are world famous. They represent sharp attention to detail and high levels of craftsmanship – a labor of artistic dexterity and patient resolve by their creators.







By **NIDTHIA CHELVAM** – Managing Consultant
nldthia.chelvam@haygroup.com

Nidhia helps MNCS and international organizations in the areas of leadership management, organizational transformation and business integration. His line and operational management experience with global companies across three continents, and his unique blend of cross-functional insights and multi-cultural exposure, have helped clients to turn strategy into results.

East meets West leadership: Carving the new face of capitalism in Indonesia

Priming for success

Indonesia, Asia's less talked-about jewel, is a significant market for any organization with global aspirations. Its robust domestic market, fuelled by rising foreign investments and a growing middle-class, presents opportunities for both local and multinational companies alike.

Yet, CEOs are finding it hard to translate this optimism into business. It seems that an extraordinary amount of effort needs to be put just to increase output, revenues or even to decrease the cost of sales. And worse, in some cases, the effort seems to be inversely proportionate to results.

The government's "MP3EI" economic master plan aims to move Indonesia from an efficiency-driven economy to an innovation-driven economy by 2025. Key success factors will include the development of knowledge workers, management of knowledge and enabling technology, fostering of entrepreneurship, as well as innovation and research & development. Besides infrastructural changes needed to support this breakthrough, the mindset and skills of Indonesian workforce and management will need to shift. The question is: how can this be achieved?

Decoding Indonesia's Most Admired Companies

For the first time in 2012, Hay Group partnered with Fortune magazine in Indonesia to study the country's Most Admired Companies with the aim of understanding what sets successful Indonesian companies apart from their peers. In the study, local luminaries PT Astra International, PT Unilever Indonesia, PT Bank Central Asia, PT Bank Mandiri and PT Garuda Indonesia have emerged as Indonesia's top five Most Admired Companies.

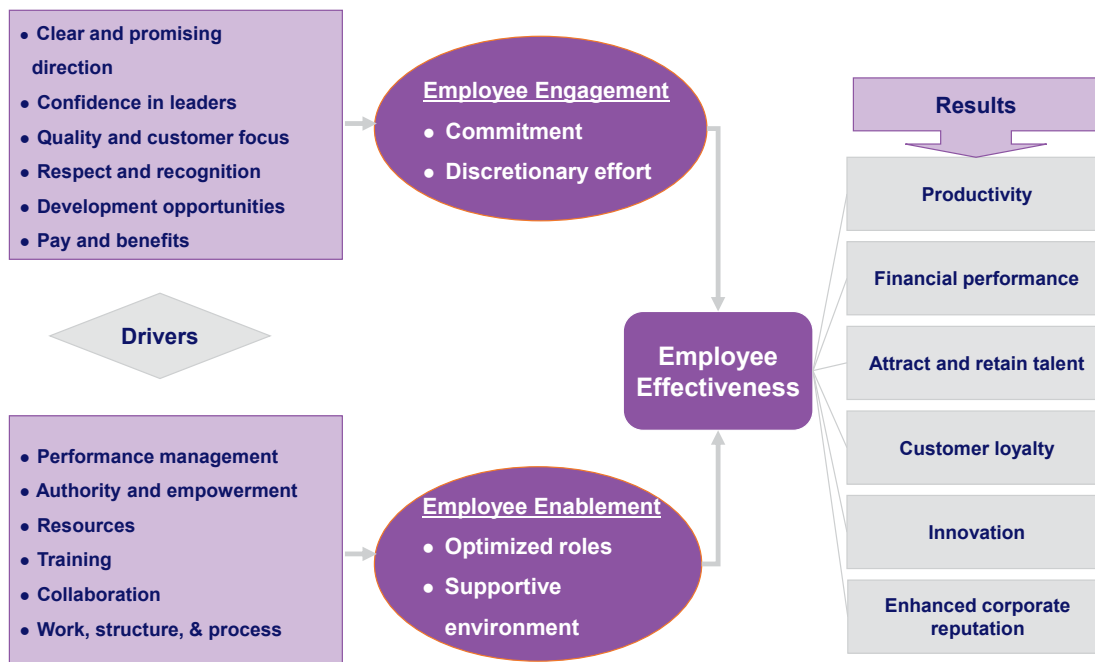
At the same time, Hay Group Indonesia hosted a Leadership Forum in Jakarta, where Indonesian CEOs were invited to share their views on leadership practices. Not surprisingly, their observations dovetailed with the findings from our Fortune study. We sum-up the common trends below:

- **Dealing with the frustration factor**

In terms of motivating performance, CEOs believe in tapping into the discretionary effort of employees.

With various innovative HR tools, including incentive pay, perks and career advancement prospects to engage today's employees, why is employee frustration continuing to impede performance in the workplace?

Figure 1: Hay Group's employee effectiveness framework



According to Hay Group Insight (Figure 1), workplace frustration stems from the lack of employee empowerment and enablement. While work remains challenging, the lack of empowerment to make decisions and the lack of enablement to perform effectively is causing significant numbers of employees in Asia to feel frustrated.

Our research shows that companies that engage and enable their employees outperformed their industry peers on revenue growth by 4.5 times. In terms of profitability, such companies exceeded industry averages in terms of five-year Return on Assets, Return on Investment and Return on Equity by 40 to 60 per cent. This level of performance is not to be sneered at, in any sort of economic climate.

Or look at it another way. While CEOs make promises about what their organization can deliver to customers, shareholders and other stakeholders, it is the employees who keep these promises on their behalf. Do we really want to put detached or ineffective employees in front of our clients and investors?

▪ Money can't buy love

Knowing what drives employee effectiveness, let us now look at what makes employees tick. Figure 2 shows the top five reasons why employees in Asia are jumping ship. Quite clearly, the conclusion is this: people join companies, but leave their bosses.

Figure 2: Why employees leave

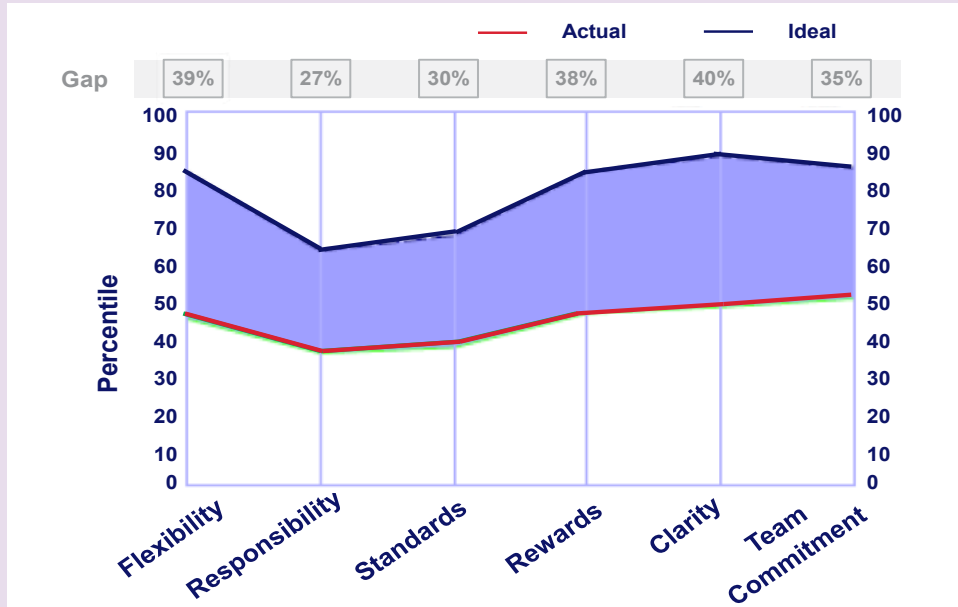
Source: Hay Group Indonesia survey

Baby Boomers	Generation X	Generation Y
Lack of recognition	External inequity of compensation	Limited growth opportunities in organization
Direct supervisor's management style	Limited growth opportunities in organization	External inequity of compensation
Performance assessments	Lack of recognition	Lack of career development program
Business instability	Lack of career development program	Lack of recognition
External & internal inequity of compensation	Direct supervisor's management style	Direct supervisor's management style

Baby Boomer : 1940s – 1959 (age 50 ~ 69 years) | Generation X : 1960s – 1979 (age 30 ~ 49 years) | Generation Y : after 1980s (under 30 years)

Figure 3: Organizational climate of Indonesian companies

Source: Hay Group's *Styles & Climates* database



Of course, specific reasons may vary across different generations (Baby Boomers, Generation X and Generation Y) although these continue to involve the following common factors:

- Lack of recognition
- Ineffectual direct manager/supervisor
- Uncompetitive pay

Out of the top five reasons for leaving, only one had to do with money itself. The rest are about how the employees are managed by their direct supervisor, how valued they feel and whether they think that their career is going somewhere within the organization.

It appears, therefore, that both the Baby Boomers and Generation-X employees want to work in organizations where their contribution is valued and recognized by top management. Hence, in motivating and retaining your best employees, it really boils down the leadership and the organizational climate that they experience.

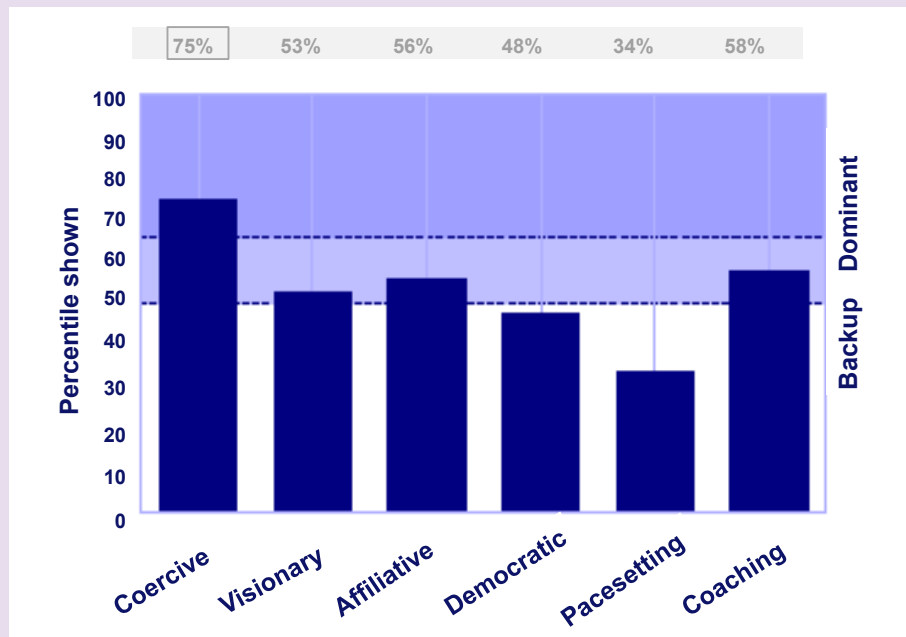
▪ Why climate change matters

Let us now turn to the kind of organizational climate that leaders are creating in Indonesia. Figure 3 shows the gaps between ideal and reality through six factors governing organizational climate.

Figure 4: Hay Group's six leadership styles

Coercive	Coercive leaders expect immediate compliance. They rely on negative corrective feedback and focus on negative consequences.
Visionary	Such leaders set the big picture and move their teams towards a shared vision. They sell "visions" as the keys to long-term success by explaining the "whys".
Affiliative	Affiliative leaders are concerned with creating harmony and promoting friendly relations. They are likely to avoid performance-related confrontations.
Democratic	Such leaders are democratic individuals who believe in building commitment through consensus. They invite employees to generate new ideas and develop directions for themselves and the company.
Pacesetting	Pacesetting leaders have high expectations and are apprehensive about work delegation. They have no sympathy for poor performance, and are likely to do a job themselves if high performance is not forthcoming.
Coaching	Coaching leaders focus on the professional development of employees. They help employees identify their strengths and weaknesses, and encourage the achievement of long-term goals through instruction and feedback.

Figure 4: Leadership styles of leaders in Indonesia
Source: Hay Group's *Styles & Climates* database



The biggest gaps in organizational climate have to do with clarity and flexibility. Employees want to know how their responsibilities, functions and/or projects are connected to the company's objectives – and they want the flexibility to determine how their work is to be carried out.

This brings us back to our earlier discussion on employee enablement. In other words, what they are saying is “tell me what needs to be done and how it is connected to our goals. Then give me the tools to get it done. Oh and please get out of my way.”

Affirming our findings, Mr Joseph Bataona, Director of Bank Danamon said, “We need to be clear about our expectations; and the entire leadership team must be sending the same message.”

▪ Right situation, right style

Next, we look at the leadership styles of Indonesian bosses. Hay Group has identified six leadership styles that apply around the world – affiliative, coaching, coercive, democratic, pacesetting and visionary (Figure 4). The dominant style of Indonesia's leaders is coercive, with coaching and affiliative being secondary approaches (Figure 5).

The good news is that there is no one best style of leadership – each has its strengths and limitations and is appropriate to certain situations. For instance, the coercive approach is useful in getting an organization through the economic crisis, but will stifle initiative and innovation in the good times. The affiliative style is most suitable for dealing with emotional situations, such as breaking bad news to employees.

“ We need to be clear about our expectations; and the entire leadership team must be sending the same message. ”

- Mr Joseph Bataona, Director, Bank Danamon

Effective leaders are adept at all six leadership styles and can switch from one style to another, depending on the circumstances. But, typically, managers will default to the style they are most comfortable with, especially in times of crisis and stress.

As pointed by Mr Jahja Setiaatmadja, President Director & CEO of Bank Central Asia, “We must know many ways to manage people. They are not the same.”

As for what works best in Indonesia, Mr Ketut Budi Wijaya, CEO of Lippo Karawaci commented, “Even when you provide critique, it must be done in a harmonious and non-confrontational manner.”

The challenge for CEOs

Today’s leaders are expected to play multifaceted roles: visionary chief, astute decision-maker, brilliant strategist, team captain and inspirational boss. And they are expected to do all these effortlessly.

While there is much that we can learn from the West in terms of business and talent management, particularly in the areas of leadership and empowerment, it must be tempered by an understanding of how Indonesia works.

“You start with the Western approach because it’s proven. But we have our Indonesian culture to consider too,” advised Mr Emirsyah Satar, CEO of Garuda Indonesia.

Mr Roberto Feliciano, CEO of First Media and Director of Lippo Group added, “We try to balance Western management approach with an Eastern philosophy of building consensus and loyalty.

To stand shoulder-to-shoulder with Indonesia’s Most Admired Companies, Indonesia’s top executives need to increase their repertoire of leadership styles. They must provide clarity, create the right organizational climate for greater delegation of authority and power, and invest in the right processes for accelerated leadership selection and development – all within Indonesia’s cultural context of harmony, loyalty and consensus.

A vast amount of latent potential lies waiting to be unleashed in Indonesia. While companies like Astra International and Garuda have taken bold strides towards breakthrough change, it is time for others to bridge the gap by helping their leaders to behave in ways that encourage, rather than drive people to sustainable performance.



“ Even when you provide critique, it must be done in a harmonious and non-confrontational manner.”

- Mr Ketut Budi Wijaya, CEO of Lippo Karawaci

This paper was first presented at Hay Group's CEO exclusive roundtable on 25th January 2012. We have included their comments and observations in this paper. We would like to thank the following executives for their insightful, lively and robust participation.



Mr. Emirsyah Satar
CEO
PT. Garuda Indonesia Tbk



Mr. Hendrik Weiler
President-Director,
PT. ABB Sakti Industri



Mr. Hiramshyah S. Thaib
President-Director & CEO
PT. Bakrieland Development Tbk



Mr. Jahja Setiaatmadja
President-Director & CEO
PT. Bank Central Asia, Tbk



Mr. Kartika Wirjoatmodjo
President-Director
PT. Indonesia Infrastructure Finance



Mr. Ketut Budi Wijaya
CEO
PT. Lippo Karawaci Tbk



Mr. Prijono Sugiarto
President Director & CEO
PT. Astra International Tbk



Mr. Rinaldi Firmansyah
President-Director
PT. Telekomunikasi Indonesia, Tbk



Mr. Roberto Feliciano
CEO / Director
PT. First Media / Lippo Group



Mr. Sachin Gopalan
COO
Berita Satu Media Holdings



Mr. Susanto Djaja
CEO
PT. Metrodata Electronics, Tbk



Mr. Stuart L Dean
President & CEO
GE ASEAN





The *ketupat* is a rice cake wrapped in woven palm leaves. Traditionally served during festive occasions, these iconic “rice packages” are a popular staple in local Indonesian cuisines.



By **NUGROHO IRAWAN** – Director
nugroho.irawan@haygroup.com

Based in Jakarta, Nugroho helps senior executives achieve higher business performance through effective organizational development and reward management practices. These range from organization restructuring, accountability distribution mapping and work culture formation, to executive compensation, performance management and leadership development.

Rewarding Indonesia: Packaging rewards that balance performance with growth

Remuneration exceeds performance

While Europe and North America underwent one of the worst economic downturns, Indonesia's economy continued to grow at an annual compounded rate of 5.33 per cent between 2008 and 2010 (Figure 1).

A Hay Group survey of LQ45 most liquid companies listed on the Indonesia Stock Exchange and other selected companies over the three-year period revealed that the median executive pay during the same period has increased at more than double the GDP growth rate at 13 per cent.

The companies surveyed have linked organizational performance to executive remuneration in the following order of priority (Figure 2):

- **Profits**

There is clear alignment between pay and annual targets and budgets, ensuring affordable pay although the pay structure is oriented towards short-term behaviors and thinking.

- **Shareholder returns**

Even though the tax on shares is very low at 0.1 per cent, it is still not a popular investment instrument in Indonesia, hence it is less commonly used as an

incentive, and when it is used, the grant sizes tend to be insufficient to motivate the executives.

- **Growth indicators**

There is an apparent lack of multi-year key performance indicators in executive incentive schemes. In fact, in the infrastructure and consumer product sectors, we found a negative correlation indicating that the executives in these two sectors continued to be rewarded based on profitability while the revenue growth has contracted.

In 2010, the Indonesia Stock Exchange had over 340 listed companies with a combined market capitalization of US\$270 billion. Two-thirds of the market capitalization was in the form of foreign funds and only around one per cent of the Indonesian population invested in company shares.

Foresight for growth

These findings show that organizations can structure their executive reward with a more balanced approach by factoring in long-term incentives to communicate the importance of creating shareholder value and revenue growth for the company, even as the executives deliver on short-term profits and results (Figure 3).

Figure 1: Productivity gap: Executive pay jumping ahead of economic growth (2008 - 2010)

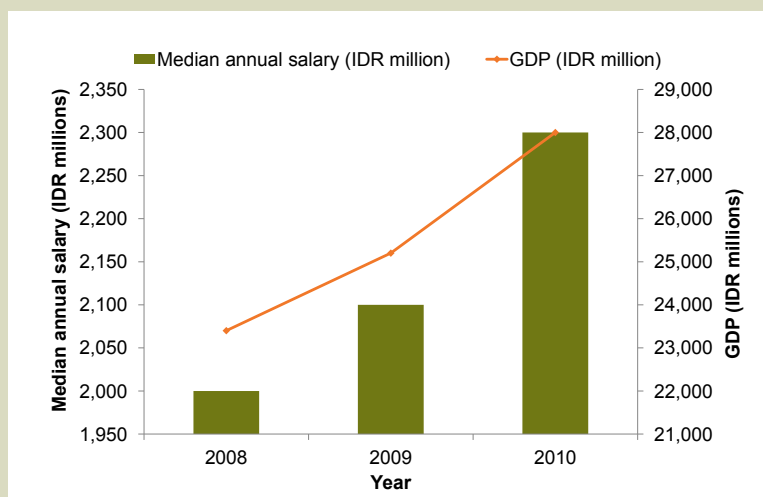


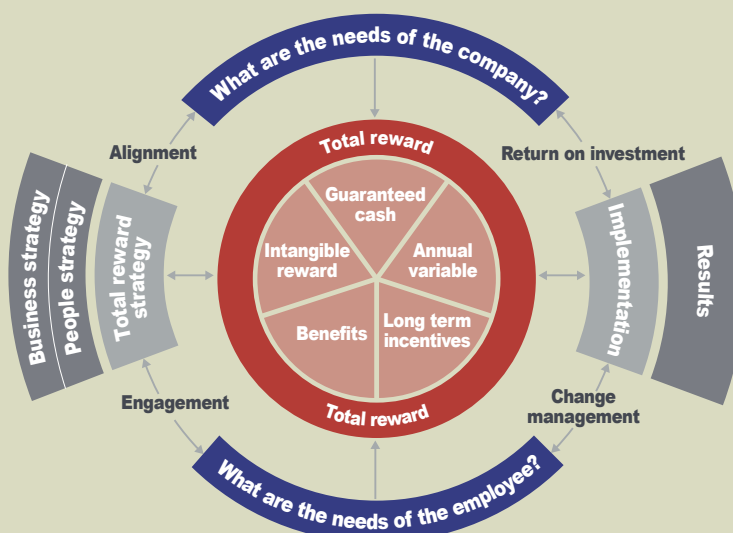
Figure 2: Co-relation of executive pay with short and long-term goals

Source: Hay Group Board Compensation report, 2011

Industrial sectors	Shareholder return	Profitability	Growth
General	No correlation	+ 83%	No correlation
Mining	- 67%	No correlation	No correlation
Infrastructure	- 61%	+ 77%	- 50%
Consumer product	+ 25%	+ 81%	- 49%
Banking	+ 30%	+ 84%	No correlation
SOE	No correlation	+ 92%	No correlation
Non-SOE	No correlation	+ 86%	No correlation

Figure 3: Hay Group total reward framework

Source: Hay Group total remuneration report, 2011



The following elements are used when considering the right remuneration mix:

- **Fixed pay** (including the base salary and fixed payments)
Rewarding the ongoing value to the organization as well as the job's inherent market value.
- **Short-term incentives** (or *tantiem*)
Rewarding the achievement of short-term goals and objectives.
- **Long-term incentives** (including Management Stock Option Plan, shares etc)
Rewarding the achievement of multi-year business and financial objectives and promoting shareholder value creation.
- **Benefits and perquisites**
Rewarding membership to the organization, and promoting the welfare and wellbeing of executives and their immediate family.

Fixing the fixed pay differential

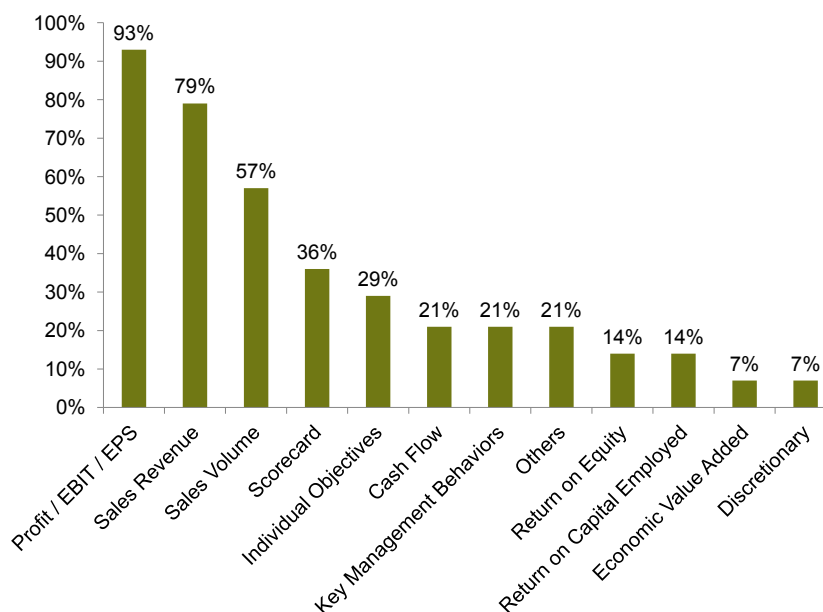
The survey finds that fixed pay varies widely according to industry clusters. Publicly-listed companies generally pay 16 per cent more than other companies, while local Indonesian firms (including state-owned enterprises) lag by nine per cent behind their foreign counterparts. Executives with privately owned Indonesian companies are paid 23 per cent more than their counterparts in state-owned enterprises.

The variation in remuneration practice creates an unlevelled playing field driving local talents towards foreign companies and non state-owned enterprises with better pay prospects and implied prestige. This poses a serious challenge for small local companies and state-owned enterprises that are less competitive in its reward packages to attract top talents into their teams.

The following factors will have to be carefully considered to structure an attractive executive remuneration package:

- **Define and set the correct benchmark for executive remuneration.**
- **Consider using a similar organization for comparison** as the scope and responsibilities will vary according to company size.
- **Review and apply the correct financial indicators to motivate and promote the right behaviors from the executives.**
- **Factor in the advantages and impediments to doing business at different locations across Indonesia.**

Figure 4: Profit metrics as performance management
Source: Hay Group Board Compensation report, 2011





Achieving alignment

Ninety-five per cent of Indonesian companies have some form of short-term incentives in place and will continue the practice with more than half intending to increase the payouts in 2012. Bonus payouts are generally on target with half of the organizations surveyed paying more bonus than the target by as much as 50 per cent in some cases.

Increasingly all the companies surveyed are reviewing the performance targets, such as increasing the stretch targets and the number and weightage of non-financial metrics. Overall, financial metrics such as profit margin, EBIT, sales revenue and volume are still widely used as performance measures (Figure 4).

However, the survey also revealed that the targets are not set at the beginning of the year together with the employees. The bonuses are typically perceived as a year-end windfall when they are not directly associated with performance and results.

It is therefore imperative for the companies to consider the following elements in designing the short-term incentive program:

- Is the size of the proposed award enough to motivate the executives?
- Are the key performance indicators adequate to capture the desired performance?
- Are the set targets and expectations realistic and attainable?
- Should the bonus payouts be deferred as a means to retain talents?
- Do the payouts provide sufficient upside to stretch performance?

Creating long-term growth

Long-term incentive plans are relatively new in Indonesia but the landscape looks to be changing soon as more than 85 per cent of the companies surveyed by Hay Group either have existing long-term incentive plans or intend to implement one in 2012.

The two key motivations for implementing long-term incentives are to align pay and rewards by linking them to long-term strategy and performance, and pay market competitive rates to attract and retain talents. Cash-based payouts are generally preferred for its simplicity, tax implications and easier accountability.

In designing a long-term incentive program, organizations will have to be mindful in structuring the payouts to motivate the executives while inculcating an ownership culture. The dilution of rewards due to deferred payouts and the upside of incentive programs are also key factors for consideration.

Motivating holistically

Besides the local business environment and expectations revealed in our survey, it is essential to consider the following factors when designing the total remuneration package to attract, motivate and retain top executives:

- The long-term and short-term implications of the incentive programs on talent attraction and retention.
- The size of the company with the commensurate responsibilities and challenges.
- The stage of growth of the company where a new start-up will have greater risks and operational duties than a matured and established company.







By Dewi Tobing- Consultant, Leadership & Talent
dewi.tobing@haygroup.com

Based in Hay Group's Jakarta office, Dewi is an experienced facilitator, specializing in leadership, team commitment and performance management. She helps organizations by defining and implementing human resource programs in order to support business strategy and objectives.

Growth Factor Inventory: Identifying the hidden potential of your people

State, not trait

Two key challenges facing Indonesian organizations today are the urgent need to develop more local business leaders who can become able captains of the industries, and to identify hidden talents among existing employees who possess the qualities to become great leaders if given the appropriate training, guidance and opportunities for performance.

The further up the organizational structure, the fewer top-level positions are available for aspiring managers. This reflects the importance of selecting and developing the right talents to fill these crucial leadership positions because capable managers who are bypassed for promotion become potential targets for poaching.

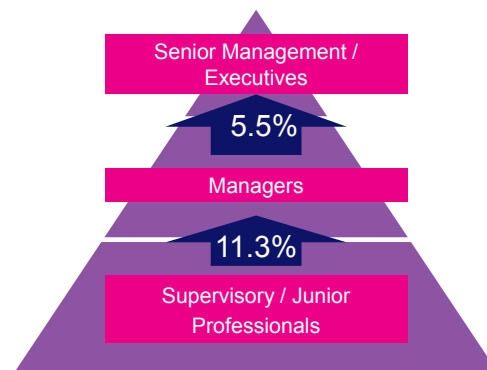
As Figure 1 illustrates, just 5.5 per cent of all managers are eventually promoted into senior management/executive positions, while only 11.3 per cent of all supervisory/junior professionals would make it into managerial positions. There should be a more reliable way for organizations to pick the right talents, and more importantly, to predict high-potential performance within a given pool.

Top performance is a temporary state, not an enduring trait. Most existing tools assume historical results as absolute predictors for future performance, ignoring the underlying potential of employees required to form the solid foundation for taking on greater responsibilities of organizational leadership.

In fact, traditional promotion and hiring of talent have always been based on past performance records and recommendations. This has often proved to be unreliable, as a top performer in a certain role may not have the requisite skills, aptitude or experience to excel in a different position. The company risks losing a top performer when it promotes an unsuitable person to a new position, and at the same time, depriving someone who is more suitable.

A Hay Group research with 20 companies excelling in talent management showed that they consistently outperformed their peers in terms of return on share price. A similar research by the Corporate Leadership Council affirmed the finding that strategic focus on employee potential was deemed the most effective strategy in building a reserve of high quality leaders. Eighty per cent of the employers saw high potential employees as 50 per cent more productive than the average employees.

Figure 1: Talent progression between management levels
Source: Hay Group Indonesia PayNet, September 2011



Defining potential

“Potential” refers the fit between a person’s current capabilities and possible future roles, taking into account the person’s longer-term capacity for personal growth and possible derailers (Figure 2).

At the same time, “growth factors” are deep-seated traits affecting a person’s ability to develop over time. On the other hand, “derailers” are aspects of the person or the organization interfering with growth and performance, and hence, detracting from potential. In most cases, career derailment involves both individual factors and organizational complicity.

In essence, organizations must be clear and objective about “potential” – the true measure of current abilities vis-à-vis intended or future requirements, be it a promotion or a longer-term “leadership” role. At the same time, “growth factors” and “derailers” address a third (and crucial) question: Does a candidate have what it takes to grow and develop?

Finding the needle in the haystack

It can be difficult to identify the high potential employee without a systematic approach. To address the organizational need to assess and identify the right leaders for both short and long-term deployment, Hay Group has developed two revolutionary systems comprising a guide on assessing growth factors that promote long-term potential, and a selection roadmap to identify talents at different levels of an organization. Five key steps are recommended to identify and manage potential within the organization:

- **Step 1: Identify the roles and characteristics needed to support business strategy**

Begin with the business strategy and use it to define what type of behaviors and qualities the organization needs from the employees, and identify the roles that are most crucial in executing the business strategy. Focus talent selection and development efforts on those roles, behaviors and qualities.

Figure 2 - Definition of Potential
Source: Hay Group research



▪ **Step 2: Assess the long-term potential using the growth factors**

Go beyond job-specific abilities and past performance of individual employees. There are deep-seated character traits that affect a person's ability to learn and develop over time to effectively meet the demands and changes of new role requirements. We call them *growth factors* (Figure 3).

These factors are most useful for identifying high potential individuals in management positions who warrant extra investment in their development, or for choosing employees to promote into management. Organizations that take the growth factors into consideration when assessing the long-term potential of the employees are likely to improve their investment in leadership development.

▪ **Step 3: Distinguish between long-term leadership potential and short-term job-specific potential**

Differentiate between performance and potential, as well as between potential and readiness for promotion. Top performance is a transient state, usually the result of a good job and skill fit; it is not an enduring trait. It is paramount for organizations to understand the importance of separating potential from performance in order to identify and build internal capacity for growth.

Generally, the growth factors are more important for selecting future leaders (investment on human capital) while job-specific factors for immediate performance (suitability), as shown in Figure 4.

▪ **Step 4: Invest in the training and development of high potential employees**

Organizations need to take risks to help people grow, promoting development through stretching career moves, coaching and training. This implies reducing the factors that can cause career derailment, and should be part of the responsibility of line managers – not just HR.

Derailers in a person could include short sightedness and focus on short-term results and technical expertise, arrogance and bigotry, inability to listen and comprehend what others are saying, lack of self control, depression, sulkiness and self-centeredness. A person's learning and growth potential has peaked when he is unable to shift from old habits or familiar approaches even when circumstances have changed.

The organization is often an involuntary participant in the derailment of careers by forgiving such flaws and shortcomings as long as the employees are meeting their targets rather than dealing with issues. Other organizational derailers include assuming that the best employees will automatically rise to the top, a good manager can manage anything and moving high potential employees too quickly from one role to another before they could learn from their experience and mistakes.

Figure 3: Growth factors

Source: Hay Group research

Thinking beyond the boundaries

This is a broad application of conceptual ability and an early manifestation of strategic thinking. High intelligence alone is often not enough if the individual is unable to look beyond their roles and make connections with other functions and areas to create new opportunities and value for the organization.

Curiosity and eagerness to learn

This quality prepares an individual to take on broader and more challenging roles outside their normal work scope. It supports thinking beyond the boundaries by providing the motivation to discover new information.

Social understanding and empathy

The genuine desire and ability to understand others in their explicit arguments and tacit perspectives is an innate and essential executive skill for influencing people, which is difficult to acquire.

Emotional balance

This quality embraces emotional resilience and realistic optimism. It is a measure of the maturity and strength of character in a person to bounce back from adversity and lead under stressful circumstances, keeping the team motivated and inspired.

Figure 4: Typical and best practices for assessing potential

Source: Hay Group research

Higher in the organization			
	potential for the future	suitability for now	
Bench strength for the future	<p>3 Selecting for leadership potential at executive group level</p> <ul style="list-style-type: none"> ▪ Growth factors / Derailers ▪ The organizations's general leadership competencies ▪ Appropriate range of prior experience and skills (readiness) 	<p>4 Selecting for immediate performance in mission-critical leadership roles</p> <ul style="list-style-type: none"> ▪ Unique leadership competencies (fit to organization AND specific leadership role-profile requirements) ▪ Growth factors / Derailers 	suitable for an urgent need
	<p>2 Selecting for broad managerial potential and for graduate entry to middle manager</p> <ul style="list-style-type: none"> ▪ Growth factors / Derailers ▪ Core, general or threshold competencies for the whole organization (often based on organization's beliefs) 	<p>1 Assessing immediate performance in key entry or low-level roles</p> <ul style="list-style-type: none"> ▪ Job-specific skills, knowledge and experience (i.e. "resume readiness") ▪ Specific competencies suitable for the job at hand (i.e. being "able") ▪ Growth factors / Derailers if intent is longer-term career growth as well as immediate performance 	
	potential for the future	suitability for now	
Lower in the organization			

Hay Group's *Growth Factor Inventory* measures four qualities that define an individual's readiness to stretch beyond their current role, making the distinction between current performance and future potential. It focuses specifically on those qualities and capabilities that can contribute to their leadership development:

- Eagerness to learn
- Breadth of perspective
- Understanding others
- Personal maturity

▪ Step 5: Create enabling systems for effective talent management

Develop processes to help find and promote hidden diamonds, and mechanisms to inject objective data into the decision-making processes around best deployment of talent.

Ready, set, grow!

Current many managers struggle with trying to separate their subordinates' current performance from future potential. However, as we have seen, it is not impossible to disentangle strong results from strong capability to develop the skills required for senior leadership.

This hinders organizations from fully exploiting developmental opportunities – from mentoring to stretch assignments, to formal executive development programs.

Furthermore, our employees' qualities and perspectives do not remain static; instead it evolves over time with the changing circumstances.

Hence, having a Growth Factor Inventory will enable management to monitor the state of their current talent pool while obtaining a reality check on their investments in key human capital assets and leadership.



World-class organizations require World-class execution

Turning strategy into results

Your course is set - you know where you are heading. Now, getting there is the challenge. You know from experience that having a clear business strategy is just the first step in the race for competitive advantage.

Setting your direction for success takes drive, a clear vision, a well-structured organization and the right people to get you there. World-class organizations know how to stay the course by turning strategy into results.

Let Hay Group help you sharpen your ability to execute strategy - just as we have helped countless organizations of all shapes and sizes around the world over the past 60 years.

For more information on how Hay Group Indonesia can help transform your organization into a world-class one, please contact Rainer Michael at e|rainer.michael@haygroup.com.

HayGroup®



Master the matrix

Why does the matrix frustrate high-achievers?

The matrix structure is a common one in large companies. On paper, it makes sense - unite multiple business units and functions to gain efficiencies and enable cooperation across silos.

And yet we are surprised that even seasoned managers produce uneven results in such a set-up. It's no accident - a matrix blurs the clear lines of authority that many are accustomed to. A single, solid-line supervisor is replaced by many dotted-line stakeholders, and team members may work under a manager they don't report to, and barely even know.

Managing in such a muddled environment requires different leadership competencies than in a traditional organization. Leaders must manage their teams by *influence*, instead of direct authority.

To find out how to make your leaders succeed in a matrix, please contact Rainer Michael at e| rainer.michael@haygroup.com.

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Hay Group Indonesia

Midplaza2 18th floor J. Jend. Sudirman 10-11 Jakarta 10220

T| +62 21 574 7222 F| +62 21 573 9795 W| www.haygroup.com/id