

# Weak Institutional Embeddedness: The State and Textile Business in Bali, Indonesia

Rochman Achwan

Department of Sociology, Faculty of Social and Political Sciences, University of Indonesia, Depok 16424, Indonesia

## Abstract

Social scientists have developed four theoretical frameworks for analysing Indonesia regional political economy. These prominent frameworks are the state, the market, the culture, and the politico-business oligarchy. By using the different framework of embeddedness of state, economy, and society, this paper argues that healthy institutional embeddedness is a pre-requisite for vibrant textile development. By situating Bali as a case study, this paper shows processes of business inclusion and exclusion from international and domestic markets as consequences of weak institutional embeddedness. It is suggested that the state should institutionally innovate itself and provide ample spaces for regional textile industries to cooperate, not compete, with national and new foreign textile actors. Such innovation will bring the former back into the mainstream of textile business.

**Keywords:** Textile Industry, Embeddedness, Institutional Innovation, Social Network, Indonesia

## 1. Introduction

Social scientists developed four theoretical frameworks for analysing Indonesia regional political economy since the last half century. These frameworks emphasis on the different role of macro institutions namely, the state (Schiller, 1997), the market (Papanek, 2006), the culture (Geertz, 1963) and the politico-business oligarchy (Robison, 1986). Each proponent believes that this single and dominant role is an appropriate tool of analysis to explain the success and failure of textile industrial development in Indonesian regions.

In contrast to the above-mentioned frameworks, this present study employs different perspective of embedding state, economy, and society. It is argued that the three institutional arrangements cannot be viewed as autonomous entities as they are advocated by the proponents of the previous works. The three macro institutional arrangements are embedding each other and they affect textile industrial development. It is also argued that embeddedness embodies an element of dynamism and it promotes and hurdles the development of textile industry.

The central questions that are raised in this article are: What are the patterns of business network formation of textile businesses in Bali? How do they adapt, resist, and re-adapt to the current state policies and market development? How are the embedding state and industry response to international pressures that currently penetrate domestic textile market?

## 2. Site of Research

Bali is chosen as a site of research for a number of reasons. While it is known as one of world tourist destinations, Bali is considered as one of textile producing areas in Indonesia. Large enterprises dominate the textile industry. More importantly, Bali was dubbed as a success story of the deregulation of the clothing industry in the 1980s. The data are collected from primary statistics, the existing literature on Indonesia's political economy and from in-depth interviews with 15 key informants in Bali who have direct and indirect knowledge of, and experience with, the textile industry both during and after the Suharto eras. Observation and in-depth interviews were conducted in Bali in March 2011.

According to Cole (Papanek, 2006), Bali saw dramatic growth in textile exports, from zero in 1974, rising to about USD 11 million in 1980 and reaching USD 160-185 million in 1994. Textile entrepreneurs in Bali emerged from the massive affirmative programme launched by the Sukarno administration in 1950s and 1960s. The 1970s deregulation marked a policy U-turn, abolishing special credit, import licensing, and rationing of imported cloth (Achwan, 2011). This made imported cloth and other inputs more freely available on the market. The textile cooperatives that had previously had a monopoly on the distribution of imported cloth and other inputs lost their power, and closed down the following decade.

The 1980s deregulation fostered a positive business environment and paved the way for entrepreneurs in Bali to rapidly expand their textile businesses. These were the "golden years" for the Balinese entrepreneurs. Although the government offered no special subsidy, the deregulation encouraged textile entrepreneurs to engage in international trade by relaxing regulations on foreign 'tourist' involvement in business activity, and reducing protection of the national airline (Papanek, 2006).

## 3. The Frameworks

Richard Robison, the proponent of the politico-business oligarchy, in his book *The Rise of Capital* (1986),

recognises the specific historical relationships of the state and market and that this becomes the key to the market revolution in modern Indonesia. By focusing on the role of big structures and broad processes associated with national-level power and capital, Robison reveals the emergence of a highly autonomous state and its officials and their specific relationships with corporate capital. This relationship has contributed to the constitution and reconstitution of politico-business oligarchy during the Suharto era and beyond. Indeed, Robison's thesis of politico-business oligarchy is a new departure in understanding Indonesian economy because he emphasises on the importance of power and history. This institution has been neglected by most economic sociologists.

In her recent survey, Fourcade (2007) criticises the overemphasis on social relations, the neglect of power relations, and the a-historical methodology of economic sociology in explaining the economy. She proposes a new perspective to theorise the economy by shifting attention to the importance of power relations among economic actors. Influenced by Bourdieu, she perceives the economy essentially as the social production and reproduction of power relations among actors who have varying access to, and endowments in, various forms of capital. The connections among actors are understood as a product of the operations of "habitus" or matrix of perception, appreciation and action, by which actors unconsciously develop their tastes, which are adjusted to their particular positions in that society. It is the forms of capital and the habitus of the various actors that give them access to certain business networks. Each network of actors strives to influence the state to take action and create social structures that directly and indirectly modify the prevailing rules of the economic game to their advantage.

In the light of Bourdieu's theory, the thesis of politico-business oligarchy helps to concretely and empirically explain historical power struggles over the economy and between economic and state actors. The state and its officials are highly embedded in an economy through alliances with large corporate capital and play a crucial role in shaping the contemporary Indonesian trajectory (Robison, 1986). Both big structures – the state and the economy - undermine regional bourgeoisie, mainly the Muslim petty textile bourgeoisie, who were previously playing a role in the economy and polity in the 1950s (Robison, 1986). However Bourdieu's theory can enrich the oligarchy thesis by presenting the textile industry as an economic field in which different networks of industrial actors have different positions in relation to habitus and a variety of capital endowments. It is in these different positions of actors within the field that the different responses to the domination of the politico-business oligarchy can be discerned.

Recently, economic sociologists have paid attention to the importance of embeddedness of macro institutions – in contrast to a single role of the state or market – in contributing to a country's economic and political performance. Block and Evans (2005) view that the state, the economy, and the society are mutually embedded. They consider embeddedness to be dynamic and changing over time through institutional innovation that may be led by the state, the industry or the society. Moreover, the embedding of these three institutions may bring about positive and negative consequences for economic performance. The success story of economic development in East Asia, according to them, is the result of mutual complementarity between state policy and industry.

#### **4. The Textile Industry in Bali**

The textile industry in Bali tends to function in a distinct institutional domain. It is a competitive market characterised by highly competitive players who have no significant political capital. They do not engage in any type of political networking because government cannot provide significant regulatory support, tax breaks, and public contracts. This is in contrast to other industries such as mining, palm oil, public infrastructure, where the players see the importance of developing political capital with politicians and bureaucrats to support their firm's performance and survival chances. Political capital is a form of capital accumulated through relational ties and is rooted in the institutional structures of the political order (Nee and Opper, 2010).

Visiting a number of large, well-known local clothing shops in Bali, the author was struck by the absence of customers browsing or buying clothing. A key respondent had this to say about the current state of the textile industry in Bali (interview with large textile entrepreneurs). It is commonly understood by the textile industry in Bali that these are difficult times for the industry. Dwindling textile exports resulting from the continuing impact of the 2009 global financial crisis, the Indonesian government's 'defeat' in the China-ASEAN free trade negotiations, and the rising price of raw materials have had a devastating effect on the development of textile industry in Bali. The large industrialists who have managed to keep their textile businesses running have very low profit margins and have developed survival strategies in the hope of a revival of the textile industry in the future.

Art shops and souvenir malls which respectively sell customised and raw textile attract domestic tourists though the numbers do not significantly high. While art shops seem to occupy positions within status market considering their customers come from high social status (Aspers, 2006), Souvenir malls can be categorised as occupying positions within conventional market in which their customers come from different social backgrounds.

The gloomy atmosphere of the textile market in Bali seems to be linked to the reduction in the number of textile enterprises in the last five years, which provincial figures put at 33% over 2006 to 2010 (Statistics Office, Bali Province). The industry is export-oriented, with large production and distribution enterprises playing a dominant role. This export-oriented nature of the textile industry in Bali was fostered by a series of export and banking deregulation policies, along with a relaxation of the residency rules for foreigners, in the 1970s and 1980s.

### **5. The Social organisation of Textile Industry**

The clothing industry in Bali is characterised by a long-established organisation of assembly enterprises. A detail of patterns of power relations among actors involve in the industry can be seen on figure 1.

Large and medium assemblers develop octopus-like networks that connect home industries and subcontractors to modern factories. On the plus side, this type of industrial organisation reduces transaction costs because relations between the assemblers and subcontractors is based on social trust, the assembler placing orders with the subcontractor to carry out a particular job based on piece rate. These relations are typically long-standing, eliminating the need for close and costly production monitoring.

The textile industry is perceived as a site for the social production and reproduction of power relations among actors who have varying access to, and endowments in, various forms of capital (Fourcade, 2007). This perception allows one to identify not only the social positions of the various actors but also the structure of business networks within the textile community.

The pattern of power relations in the industry in Bali is centralised. As a world-renowned tourist destination, Bali has developed market-friendly institutions. Foreign enterprises and individuals can run businesses and, working with domestic entrepreneurs, are able to export and import their products. It is not surprising, therefore, that large and medium assemblers, together with their foreign partners, play a dominant role in the production and distribution of textile in Bali.

The octopus-like networks that characterise the industry in Bali centre around two groups. First are the large and medium assemblers who control subcontractors, who in turn control home workers. In such an industrial arrangement, a large textile assembler might control tens of subcontractors, who in turn control hundreds of home workers. This arrangement has been the general pattern of the organisation of the industry in Bali since the “golden years” of the 1980s.

Market-friendly state policy, coupled with a thriving international market, has lured foreign companies and individuals to Bali to establish business cooperation with local textile entrepreneurs. A Balinese woman entrepreneur shares the following experience. I have been developing business relationships with Japanese traders since 1995. I remember when we met for the first time, they asked me to make women’s textile of specific Balinese designs to send to Japan. Since then once or twice in a year, they come to Bali with requests for new designs. We’ve managed to maintain our business relations, even in spite of the tsunami disaster in Japan (interview with a Balinese woman medium assembler).

Such long and deep personal business relationships simplify the complexity of business transactions. Another type of business relation found in Bali is informal groupings of Balinese businesses and foreign enterprises. They are informal in the sense that none of the assemblers has shares in the other assemblers. One of the striking features of membership of business groupings in Bali is that ethnicity is a factor. Balinese-Chinese assemblers cooperate with each other in production and distribution, for example: To begin with, I received work orders from fellow assemblers. As time passed and my business started to grow, I stopped being a subcontractor and I began to develop my own business relationships with foreign buyers. However, I keep in contact my fellow assemblers to share business information. In so doing, together we develop mutual cooperation and expand our market (interview with a Balinese-Chinese large assembler).

Informal business group have several advantages. Internally, they facilitate the development of group cohesiveness, which functions to reduce transaction costs and foster innovation in technology and textile designs. Cohesiveness, therefore, helps group members adjust to fast-changing tastes in the textile market. Externally, they simplify the complexity of economic transactions and facilitate the engagement of group members in the wider community of the international market. Moreover, they enable access to develop business relationships with established international textile actors, including international branded textile enterprises.

Large textile assemblers that do not have this pattern of business relations also prospered during the golden years, but are currently paying dearly for the global financial crisis and inhospitable domestic business environment. Large, export-oriented textile enterprises in Bali face serious challenges on various fronts. The 2009 global financial crisis, the strong exchange rate of the Indonesian rupiah against the US dollar, and the entry of China into the domestic textile market, have all negatively affected, and in some cases proved fatal to, textile enterprises (interview with a large assembler).

Another alarming development in Bali is that since 2005, most large textile assemblers have diversified and shifted their businesses into banking, resorts, and information technology. This may be seen as a

direct response to the effects of the ACFT.

Unique among the large and medium assemblers in Bali are the owners of art shops. They give orders to highly-skilled handloom weavers in Balinese villages for the production of designer clothing for men and women. Their customers are mostly high and middle income earners from big cities in Java who visit their art shops, which are located in prestigious locations in Bali.

While art shops continue to sell this fine clothing, there has been a downward trend in demand for these products, as poorer quality imitation products have begun to take over the market in Bali. The decline in the number of Balinese weavers is an additional threat: I've been running an art shop for more than forty years. I sent one of my daughters to study textile design in Australia and she's already working in the creative division in the art shop. The problem she has is finding subcontractors to take on orders, due to a shortage of weavers (interview with owner of art shop).

Balinese fine clothing is unique and, bearing in mind its aesthetic qualities, may be one of the clothing products that determines the fate of the industry in Bali. Bali is haven of artistic creativity: Balinese clothing, painting, sculpture, and dance artists interact and motivate each other to generate and give life to new ideas. This is the strength of the Balinese fine clothing industry. However, current production and distribution mechanisms need to be reformed in order to secure strategic positions in national and international markets. Handlooms should have been replaced with power-looms and the target market should have been greatly expanded.

This sort of industrial transformation has been achieved by one clothing multinational in Bali. This is the International brand "Animale", which established a modern textile factory in Bali several years ago. Led by a French art patron, the factory produces exotic women's clothing featuring a mix of Balinese art and modern designs. Animale has fashion outlets in thirty countries. As powerful competitors from China begin to enter Indonesia's textile market as a consequence of the ACFT treaty, the Animale model of industrial transformation might be considered an option for salvaging the clothing trade of the Balinese art shops.

Small textile assemblers in Bali give work orders to small subcontractors and they then assemble all the product components. Their main challenge lies in the domestic market. At the core of the textile market in Bali is the so-called souvenir malls, which sell common clothing, textile and handicrafts. One of the big souvenir malls is *Erlangga*, owned by a man who has been in business for decades. Beginning as a street vendor, he did the rounds of the hotels in Denpasar, the capital city of Bali, offering a variety of clothing to hotel guests. Years later, he opened clothing outlets in the city, selling products made by small assemblers. This experience in trading allowed him to organise small assemblers to supply clothing for his mall. He explains, currently I organise approximately five hundred small assemblers across Bali to supply clothing and handicraft products to the mall. We cooperate with micro-finance institutions and the corporate social responsibility divisions of state-owned enterprises, which, on my recommendation, provide credit to the assemblers (interview with the owner of Erlangga souvenir mall).

## 6.State Policy and Large Textile Firms

The economic policy of the current post-Soeharto era does not appear to prioritise growth of the textile industry. The assumption that textile is a sunset industry has been the foundation of state policy in this sector. In this section, I will discuss the response of large textile entrepreneurs to state policy.

The enactment of the ACFT agreement in January 2010 changed the national landscape of the political economy of the textile industry. The leaders of textile associations in Indonesia have begun to fear the flood of imported China textile on the Indonesian market. In contrast to other non-oil commodities such as oil palm, rubber, and cocoa, manufacturing goods including textile have been severely hit by the influx of Chinese goods. It is very hard for Indonesian textile to compete with imported Chinese textile, both in terms of price and quality (Zein, 2011).

This flood of imported Chinese textile, coupled with limited state intervention, has triggered mounting discontent among large textile entrepreneurs. The Bali chapter of the Indonesian Textile Association (API) which represents them blames the state for its failure to protect the domestic textile industry: Domestic textile products fail to compete with the imported Chinese textile. If this situation continues, domestic textile enterprises will go bankrupt. Currently imported Chinese textile accounts for just 5 % of the market in Bali, but this is expected to rise to 10%-15% in the years to come (interview with the chair of the Bali chapter of the Indonesian Textile Association). Criticising the state's disregard for development of textile industry for almost a decade, the chair of the Indonesian Textile Association says, the state just assumes that textile and textile industries are sunset industries. This assumption has influenced the way the state treats the industry.

Recently, there have been attempts from the state to boost the competitiveness of the domestic textile industry. A number of policies have been introduced by several government ministries. For example, the ministry of finance introduced tax incentives by lifting import duties on 182 raw materials and other capital goods (The Jakarta Post, April 26, 2011). The ministry also cut import duties on weaving and sewing machines. In an attempt to protect the domestic industry, the ministry of industry has also drafted policy proposing

renegotiation with the ACFT countries to postpone inclusion of a number of products including textile and clothing in the free trade zone. This attempt has been criticised by the Indonesian media as a defeatist reaction by the state to the free trade of textile products.

Another state policy concerns the modernisation of production machinery. This ministry of industry scheme offers textile entrepreneurs a 25%-30% discount on new machinery. However, the scheme has not had a welcome reception. A large Balinese entrepreneur gives explanation that there are a number of issues with the modernisation scheme. For one thing, the bureaucratic procedure for receiving the subsidy is very complicated. For another, given the high price of imported inputs and the volatility of the international market, the macro circumstances of the textile industry are not conducive (interview with large Balinese textile assembler).

In sum, textile entrepreneurs in Bali occupied peripheral positions, which meant that they were unable to influence state policies to their benefit. The fate of textile industry was determined by state policies during the Suharto era and after; policies that were both advantageous and disadvantageous to the industry. That said, it is unlikely that state policy makers consciously took into account the interests of provincial textile businesses in the formulation of state policy on the textile industry. For example, the 1980s national economic deregulation, unintendedly, boosted the textile industry and allowed the entrepreneurs to become part of mainstream textile economy. However, such policies were not sufficient to enable the textile industry to become a large and powerful economic force.

### **7.Theoretical Reflections**

This study has shed light on the dependency of regional textile entrepreneurs on the pendulum movement of state policy and its effects on their business organisations and performance during the current post-Suharto era. The author argues that this 'weak embeddedness' of the state and regional textile industry has prevented textile entrepreneurs from influencing the direction of state policy.

Before explaining problems of embeddedness, I shall return for a moment to the recent theoretical developments in economic sociology.

Recent sociological attempts to study the economy have focussed on the structural contexts in which economic actors behave. They view the economy as a field consisting of all actors who have interests in similar economic activities. The field is considered as an arena of power relations among actors who have varying access to, and endowments in, various forms of capital. It is the forms of capital owned by actors which determine their positions and their access to certain networks in the field of industrial organisation.

Earlier, it was mentioned that Block and Evans (2005) view the economy as mutually embedded in the state, economy, and society. According to them, the concept of embeddedness is dynamic and it changes over time through institutional innovation that may be led by the state, the industry or the society. Moreover, they mention that the embedding three institutions may bring about positive and negative consequences for economic development. The positive embeddedness is signified by synergy relations where different macro institutions complement each other to promote economic performance. The success story of bicycle industry in Taiwan is worth mentioning. The Taiwanese state promotes export oriented policy of bicycle by developing research and development agency as one of its programmes. Such programmes have boosted the export of Taiwanese bicycles and made Taiwan become the largest exporting bicycle in the world (Hsieh, 2011). In contrast, the negative embeddedness is indicated by the exclusion of some parts of business society in making policy decision.

Using those perspectives as a theoretical guideline, I try to develop a pattern of embedding state, economy (textile industry), and society (business networks) in the region. A core issue is the recurrence of two phenomena that continue to define the development of the Bali textile industry. The first is the weak institutional embeddedness of the state, textile industry and textile industry associations and, second, is a lack of institutional innovation on the part of the state.

Weak institutional embeddedness is indicated by the lack of interest of state officials in local businesses and their associations as a source of input in the formulation of policy in the textile industry. Such a form of embeddedness makes textile associations dysfunctional and contributes to an industry characterised by very unstable business networks. State policy in Indonesia is thus clearly driven by a logic that does not take into account the interests of textile entrepreneurs. This was the reason why the deregulations of 1980s brought advantages, while policy of no policy in 2000s brought disadvantages to Balinese businesses. The everlasting vulnerability of textile entrepreneurs to unpredictable state policy further contributes to the pervasiveness of unstable and narrow business networks.

Moreover, poor state responses to changing macro circumstances, i.e. the 2008 global financial crisis and the 2010 enactment of the ACFT treaty, indicate a lack of capacity for institutional innovation. The state was unable to create the conditions that might enable provincial textile entrepreneurs to maintain and expand their businesses in domestic and international markets. The occurrence of both weak institutional embeddedness and lack of institutional innovation significantly hinders the future development of the regional textile industry. Such hurdles have induced a substantial number of large Balinese entrepreneurs to close down their textile businesses

and shift to new areas, such as banking, hotels, resorts and information technology.

### 8. Concluding Remarks

The thesis of embeddedness is important in identifying not only the dominant role of a certain macro institution but also the prevailing power and network relations in an Indonesia region. This thesis offers a deep understanding of how intricate the relationships among state, market and, society affect the economy. Such understanding will be encouraging to economic sociologists who are currently advocating a return to social theory.

The textile industry is the oldest manufacturing industry in Indonesia and it absorbs a larger workforce than any other. With its long history – characterised by inclusion in the Soekarno era and exclusion in the Soeharto era and thereafter – the survival of the textile industry seems assured. Nevertheless, it is unlikely that regional textile entrepreneurs will regain significant influence in the formulation of state industrial policy given their exclusion from the state.

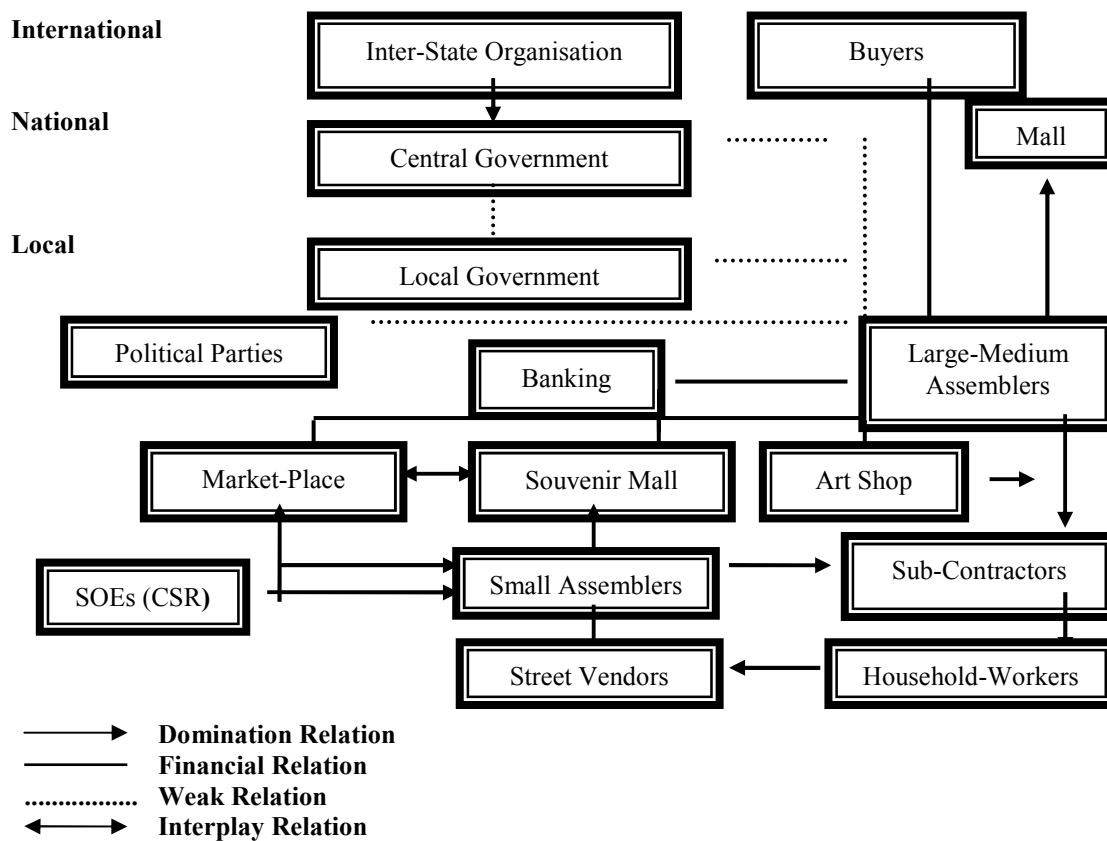
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**Figure 1. General Pattern of Power Relations of Textile Industry in Bali**



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