



**Impact of Corporate Governance Mechanisms
on Firm Performance; Evidence from
Indonesia's State – Owned Enterprises (SOEs)**

THESIS

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Abstract

This study aimed for identifying the effect of corporate governance mechanisms on firm performance in Indonesia's SOE's. Generally, we can conclude that Indonesian BUMN still has to design corporate governance mechanisms on Indonesia's State – Ownership Enterprises' performance, measured by return on assets, return on equity and sales – employee ratio. The units of analysis are 31 Indonesia's State – Ownership Enterprises for period of 2003 – 2006. The study results are as follow: (1) in contrast with previous researches, partially it is found that there is a positive significant influence of board of commissioner's size on firm performance. (2) There is no significant influence of Board of Commissioners' Composition to firm performance. (3) Averagely, government ownership percentage has negative significant impact on more optimal corporate governance mechanisms system that could encourage the company to have efficient governance in order to increase the firm's performance. This is so crucial because board of commissioner and ownership structure are some of primary element in corporate governance, and corporate governance it self, is really needed to maximize firm's value

Keywords: corporate governance, board structure, government ownership, return on assets, return on equity, sales - employee ratio.

CHAPTER 1

INTRODUCTION

1.1 Background

Modern corporate finance literature focuses on two important issues that govern the management activities and their behavior, those are ownership and control mechanism that ensure that the placement good governance mechanism may have positive impact on company value. Therefore, the relation between ownership structure and company performance has been an issue of interest among academics, investors and policy makers alike because of the importance of alternative governance system in which government ownership serve as a control mechanism.

Though modern organization emphasizes the importance of the separation of ownership and control system, but it has been commonly observed among the corporation that there exists agency problem (Jensen and Meckling, 1976). It is because separating entities have their own interest can differ from interests of those that supply external finance and for those who control them. The so-called "principal-agent" problem is reflected in management pursuing activities which may not be at the best interest of the shareholders of the company and other stakeholders.

In a related study, Claessen, Djankov and Lang (1999) investigate the separation of ownership and control in 2980 public companies in 9 East Asian countries. Their findings suggest that corporate control is typically enhanced pyramid structure and cross holding companies in all East Asian countries except

Singapore where about half of the samples companies are controlled by state. Orden and Garmendia (2005) examined the relationship between ownership structure and corporate performance in Spanish companies. Ownership structure has been analyzed in terms of concentration of control and the type of investor exerting control. Company performances which used in research were return on assets (ROA) and return on equity (ROE). One of the findings is companies which under controlled government showed negative impact and have worse performance than other ownership structures.

More recently, Zeitun and Tian (2007) examined the impact of ownership structure mix on company performance and the default risk of a sample of 59 publicly listed companies in Jordan from 1989 to 2002. They documented that the ownership structure has significant impact on performance based on accounting measure however, government involvement are significantly negative related to the company's performance based on ROA and ROE (return on equity) but shows positively related to market performance based on Tobin's Q.

BUMN are defined as companies that have a primary commercial objective and in which the Indonesian Government has a direct controlling stake to appoint Board members, senior management, and/or make major decision (e.g. contract award, strategy, restructuring and financing, acquisition and divestments etc. BUMN and their controlling shareholders constitute a significant part of the economic structure of the nation (Razak, Ahmad and Aliahmed, 2006).

Corporate governance is a concept to increase company performance through supervising or monitoring management performance and guarantee management accountability to stakeholder based on rule's framework. The

CHAPTER V

CONCLUSION

5.1 Conclusion

The purpose of this research is to examine the corporate governance mechanism and firm performance in Indonesian BUMN. The population of this research is Indonesian BUMN listed in Indonesia BUMN Ministry in 2003-2006.

The results of hypothesis test are:

The conclusion based on hypothesis test is:

1. The finding's showed that there is a partial support to the first hypothesis. It is found that there is a positive significant influence of BOC size on ROA and ROE, but negative significant influence to SER in Indonesian BUMN. This implies that BUMN which has more BOC member could increase ROA and ROE, but in other hand decrease SER. Averagely, board size is not the reason of the Board of Commissioners' function ineffectiveness; and contrast with many previous researches, this study also found that there is significant positive relationship between BOC Size and Firm Performance, as long as that increasing still below the critical number (7 or 8 member). This different result might be caused by the different board system that are adopted, different company characteristic, regulation factor, macro economic factor, etc.
2. The regression test result that second hypothesis is rejected. There is a negative significant influence of Board of Commissioners' Composition to Return on Asset and there is no significant influence of Board of

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