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[Management Research Review, Volume 36, Issue 11 \(2013-11-02\)](#)

[European Research Studies Journal Volume XX, Issue 4A, 2017 pp. 124 - 132](#)
[What Effects Do Privatisation Policies Have on Corporate Governance of State-Owned Enterprises?](#) Munawarah¹, Muhammad Din², Fatlina Zainuddin³, Harjum Muharam⁴ [Abstract: This study](#) attempts [to test the](#) effect [of](#) state ownership [and](#) follow-up of audit findings in state-owned enterprises (SOEs) owned by the government of the Republic of Indonesia, on the good corporate governance of SOEs. By using Ordinary Least Square (OLS) analysis, conducted by observing 98 observations during 2010-2014, the findings show that there are [negative relationship between state ownership and](#) good corporate governance implementation in SOEs in Indonesia. In addition, the results also reveal that the follow-up of audit findings positively affect the implementation of governance. Keywords: Good Corporate Governance, State ownership, privatization, audit findings, State-Owned Enterprises (SOEs) JEL Classification: G31, G34, G38, L33, M42 1Ph.D Student in Management at Faculty of Economics and Business, Diponegoro University, e-mail: munawarah1980@untad.ac.id 2Faculty of Economics and Business, Tadulako University, e-mail: muhammaddin@untad.ac.id 3Ph [.D Student](#) in [the Faculty of Economics and Business](#), Tadulako University, e-mail: fatlina.z@gmail.com 4Faculty of Economics and Business, Diponegoro University, e-mail: hardjum@gmail.com

1. Introduction The performance of state enterprises in Indonesia generally has not provided an optimum contribution to the national economic growth and government annual revenue, primarily caused by the inadequacy of the implementation of Good Corporate Governance (GCG). Basically, Good Corporate Governance (GCG) is considered not only as a formality, but also as a system which is able to influence the value of company. The impetus for good corporate governance is very demanded for many Southeast Asian countries that experience overwhelmingly monetary crisis in the late 1990s, caused mainly by a weak implementation of corporate governance in public sector, monetary institutions and private companies. A research conducted by the Asian Development Bank (ADB) identifies that the lack of corporate governance, particularly in Indonesia, was the main contributors of that crisis (Zhuang, De Dios, and Martin, 2000). Unlike previous studies arguably focusing more on the [implementation of Good Corporate Governance](#) as a means [to](#) improve [the](#) performance [of](#) private business (Chiang He & Lai, 2012; Colarossi et al., 2008) and government-owned enterprises, especially in developing countries (Colley et al. 2003; Zeitun, 2009; Babatunde & Olaniran, 2009), [this study aims to](#) analyze [the effect of](#) state ownership [and](#) the follow-up of the results of financial investigation [on the implementation of GCG](#) of [State-Owned Enterprises](#) in Indonesia. This study basically aims to provide the broader scope of analysis from previous study of Munawarah et al, (2017), by examining the role of follow-up of audit findings on the GCG practice in SOEs. Thus, there are two contributions of this study compared to previous studies, that are the need for privatization in enhancing the credibility of business management of SOEs; and the role of follow-up of audit findings in improving the effectiveness of corporate governance.

2. Literature Review and Hypothesis Development The Organization of Economic Cooperation and Development (2005) states that SOEs are an important part of gross domestic product, employment and market capitalization of a country, especially with the acquisition of such strategic industrial infrastructure as energy, transportation and telecommunications. Moreover, the performance of SOEs has a broader segmentation as they can affect other business sectors. The development of an increasingly competitive global market, a more rapid technological advance and the deregulation of monopolistic markets have by far become the fundamental needs of the adjustments and restructuring of SOEs, including their privatization by stock offerings in the capital markets. Claessens et al. (2002) showed that the state as the controller is very concerned to increase the value of state-owned

companies by exploiting SOEs to generate large dividend to increase the state revenue. On the other hand, a very large controlling right by the state will also be able to lead to further decline in the company value and the potential occurrence of the expropriation of the minority shareholders. Therefore, it is necessary, regarding the existence of GCG as a set of rules, to regulate the activity of SOEs management to ensure the ongoing creation of the general welfare. In addition, GCG is expected to avoid a gap between the principal and the agent of government roles. Therefore, [the implementation of Good Corporate Governance](#) is highly demanded [to limit the](#) government roles and political interference, and to regulate the state ownership to create a common interest as stipulated in the basic guidelines for the implementation of GCG of SOEs (OECD, 2005; Ivanova and Bikeeva, 2016). In addition, as a basic means to protect the right of minority shareholders from mastery or appropriation of rights by managers and government as the controlling shareholder of SOEs, GCG practice is perceived to be able to minimize any opportunistic behaviour (Mitton, 2002; Savina, 2016; Menshchikova and Sayapin, 2016; Baldacchino et al., 2017; Toudas and Bellas, 2014; El-Chaarani, 2017). The application of GCG in SOEs could reduce any behaviour possibly arising from government ownership. This, in turn, can help increase the [company's performance and value](#). Moreover, [the role of the](#) legislative council [as](#) a watchdog over financial management and the performance of SOEs is needed to create an effective implementation of Good Corporate Governance. Kusumawardhani (2012) finds a positive influence of legislative oversight, as measured by the number of parliament members in the Board of Commissioners, on the financial performance of local government. It means that a greater number of legislature will lead to a more effective supervisory function, that eventually results in a higher government financial performance. H1: State ownership has negative effect [on the implementation of Good Corporate Governance](#). Auditing [is](#) one of [the](#) institutional responsibilities [of](#) both public and private businesses concerned mainly for pointing out the errors in financial account. The result of the audit findings will be very helpful in creating accountability in financial management (Setyaningrum [et al.](#), 2014; [Pociovalisteanu and Thalassinou, 2008](#); Giannakopoulou [et al.](#), 2016). For managers of state finances, partially in Indonesia, the obligation to follow up the result of the audit report, as stipulated in Law No. 15/2004, is the responsibility of the entity or auditee. In fact, however, from 2008 until 2012 only few recommendations (55%) of the report were followed up in accordance with the recommendations of the bureau, while the remaining of 45% was followed up not in accordance with the recommendations, that were eventually put in the category of non-actionable (IHPS BPK RI, 2013). Lin and Liu (2012) state that although the detection of irregularities is an important part of auditing, it is just the first step before others which are more important, namely asking responsibility and making corrections. Therefore, high-quality auditors are expected to be able to generate appropriate recommendations which are relatively easily implemented in accordance with the company conditions. This, in turn, leads to a higher and more effective follow-up of audit recommendations. Claessens and Yurtoglu (2012) find that the level of state ownership and the diversity of corporate governance applied in each country are influenced by the economic diversity and financial conditions, institutional environment and structures, and group affiliates and investors. Bhagat and Bolton (2008) find that the SOEs performance is influenced by corporate governance, capital structure and ownership structure. Xu and Wang (1999), Qiang (2003), Ang and Ding (2006) reveal that the SOEs governance structure is strongly influenced by the level of state ownership. Hence, although the ownership structure of a country is perceived to be able to have a direct impact on performance, there is a role of corporate governance in mediating this effect. Nguyen and Van Dijk (2012) demonstrate that the corporate governance of SOEs may reduce the level of corruption and negatively impact on corruption. Hence, the audit findings have

an important role in highlighting the potential [cases of corruption](#) and mismanagement in the [SOEs](#). Thus, the process of auditing is likely [to be able to](#) improve [the good corporate governance](#) of SOEs. This means that the auditing results are an effective means for the implementation of good corporate governance. Efendy (2010) notes that the audit recommendations should be followed by any related institutions to keep auditor motivation in pointing the fraud that occur. Improving the effectiveness of the recommendation is one of the strategic objectives apparently outlined in the business performance indicators. For auditors, audit finding recommendations and implementations determine the effectiveness of their functions and roles to encourage the quality of public sector management and state finance (Setyaningrum et al., 2014). Additionally, Rongbing and Yuetang (2010) argue that the correction or improvement efforts made by the audit institutions and associated parties in China related to the findings are the most important factors in determining the extent to which auditing bodies can perform transparency and promote accountability of the public sector and private company. [H2: There is a positive relationship between the](#) follow-up of auditing findings and implementation of Good Corporate Governance.

3. Methodology

3.1 Sampling Method

This study was conducted by observing the data from the period 2010-2014, by using purposive judgment sampling method. The SOEs were selected as sample based on several requirements. Among them, the companies must have the data on the number of auditing report follow-up during the observation period, and were listed the value of the evaluation assessment on the application of GCG [based on the](#) Decree [of the](#) Ministry [of](#) [State Enterprises No.SK-16/S.MBU/2012](#) or the Circular of the Ministry of State Enterprises No.S-168/MBU/2008. Moreover, the companies must have proprietary data of government and non-government ownership share on enterprises, and have a complete data related to all variables examined during the observation period. After several selection processes, the amount of sample was 98 SOEs, consisted of 28 observations of public companies and 70 observations of unpublic companies. Among them, 17 companies was taken from 2010 data, 23 from 2011, 22 from 2012, 27 from 2013, and 9 from 2014. Majority of sample was from transportation and warehousing industry with 32 observations (32.65%), followed by finance and insurance with 16 observations (16.33%), mining with 16 observations (12.24%), and manufacture with 10 observations (10.20%).

Empirical Model and Measurement of Variables

To assess the proposed model, the following formula of ordinary least-square was used: $GCG_{it} = \beta_0 + \beta_1 GOV_{it} + \beta_2 AUD_{it} + \varepsilon_{it}$ (1) in which the GCG is good corporate governance measured by the scores on the assessment of GCG implementation based on the regulation of the Minister of SOEs, on the assessment conducted by either the state or independent parties. The assessment of the implementation of GCG after 2012 used appropriate parameters as specified [by the](#) Letter [of Secretary of the Ministry of SOEs](#) No [.SK-16/S.MBU/2012 on the indicators](#) and [parameters of Assessment and Evaluation of the Implementation of GCG in SOEs](#). As for the year 2011 and earlier, this study used the Circular [Letter of the Ministry of SOEs No.S- 168 /MBU/ 2008 on the](#) Implementation [of](#) GCG Practices in SOEs (Munawarah et al, 2017: 956); AUD, is the follow-up of the recommendations of the bureau, as measured by the percentage of the number of those having actually been implemented by the particular enterprise in accordance with the recommendation of the bureau compared to the total number of bureau recommendations; GOV [is the government ownership](#) in SOEs, [as](#) measured by [the percentage of](#) government ownership as compared to the total stocks.

4. Results

4.1 Descriptive Statistics

The results of descriptive statistics reveal that privatized SOEs have a higher mean value in all the variables of the audit findings and corporate governance than those in non-privatized ones. This indicates that the bureau recommendation and GCG assessment scores for the publicly listed SOEs are higher. Table 2. Statistic Description of Variables Items

Mean Median Std. Dev Min Max Panel A: Overall Sample = 98 Observations (firm-year) AUD 43.568 41.24 40.602 0 100 GOV 89.688 100 16.174 51 100
 IDX 0.285 0 0.454 0 1 GCG 83.490 83.58 7.167 66.56 96.32 Panel B:
 Privatized SOEs= 28 Observations (firm-year) AUD 56.893 66.186 42.213 0
 100 GOV 65.76 65.01 8.554 51 85.81 GCG 87.169 86.725 5.919 75.68 96.32
 Panel C: Unlisted SOEs = 70 Observations (firm-year) AUD 38.238 25.343
 38.979 0 100 GOV 99.26 100 3.725 73.15 100 GCG 82.018 82.1 7.128 66.559
 94.62 Source: data processed, 2016. Table 3. Test for Equality of means of AUD
 and GCG categorized by values of IDX Variable Df Value Probability AUD test)
 (Anova F- 41.24 40.602 100 GCG test) (Anova F- 100 16.174 100 Source: data
 processed, 2016. 4.2 Hypothesis Testing H1 states that there is the effect of
 state ownership on the SOEs' corporate governance, while H2 states the effect
 of follow-up of audit findings on SOEs' [corporate governance](#). The results show
[the effect of](#) state [ownership](#) (GOV) and the follow-up of auditing reports (AUD)
[on the implementation of Good Corporate Governance \(GCG\)](#). Overall, [the](#)
 independent variable of GCG can explain the variation by 18.53% percent. The
 results also reveal that the state ownership has a significant negative effect on
 the GCG with a negative coefficient of -.0125 at a significance level of 5
 percent. This result indicates that hypothesis 1 is accepted, meaning that an
 increase of state ownership in SOEs can decrease state ownership negatively of
 GCG implementation. The testing also finds that the variable of following up the
 auditing results [has a positive and significant influence on](#) the implementation
[of](#) GCG with a coefficient of 0.049 at a significance level of 5 percent. This
 means that the higher the following up of the auditing results, the higher the
 effectiveness of the implementation of GCG in SOEs. Thus, hypothesis 2 is
 accepted. Table 4. Hypothesis Testing Variable Coefficient Std. Error t-statistic
 Prob. Constant 92.52061 4.001767 23.11994 0.0000 GOV -0.124511 0.041773
 -2.980671 0.0037 AUD 0.049041 0.016640 2.947144 0.0040 R-square
 0.185328 Adjusted square R- 0.168177 F-statistic 10.80564 Prob. (F-statistic)
 0.000059 AUD, is the number of [follow up on the](#) recommendations [of the](#)
[audit findings](#) of the bureau, measured by the percentage of the number of
 follow-up recommendations that has been implemented by the state in
 accordance with the recommendation of the bureau compared to the total
 number of the recommendations. GOV, is the government shareholding in
 SOEs, measured by the percentage of government ownership as compared to
 total stock. GCG, is good corporate governance, measured by scores on the
 assessment of GCG implementation [based on the regulation of Minister of](#)
[SOEs](#), either on its own assessment conducted by state-owned or assessment
 by independent parties. Source: data processed, 2016. The testing results show
 that state ownership influence SOEs' governance. [This result is consistent with](#)
[the](#) studies [of](#) Munawarah [et al.](#) (2017), Xu [and](#) Wang (1999), Qiang (2003),
 Bhagat and Bolton (2008), Nguyen and Van Dijk (2012). Lisic et al. (2014)
 state that Chinese company largely owned by the state negatively affects the
 fraud occur at the company. Moreover, the findings of Wahyuni (2011) show
 that government ownership negatively affects the SOEs performance in
 Indonesia. 5. Conclusion The results show that the [state ownership has](#)
[negative effect on](#) corporate governance in SOEs. This means that a lower level
 of corporate governance is likely to lead to an increased audit findings. The
 result also shows that the follow-up of recommendations of the bureau
 positively affects the [implementation of Good Corporate Governance](#),
 highlighting [the](#) importance [of](#) following up [the](#) recommendations [of the](#)
 bureau to advance the effectiveness of the implementation of GCG. Moreover,
 the findings reveal that publicly listed SOEs have better auditing result and
 higher implementation of GCG, significantly different with the non-listed
 enterprises. The conclusions generally imply to reduce the potential audit
 findings from the bureau and to reduce the level of state ownership by
 privatization strategies. This study also has some limitations. Even though the
 number of sample was achieved in accordance with the criteria proposed, it was

still relatively small as it used only few number of Indonesia's SOEs listed in the IDX. In addition, the model has not considered the opportunistic behaviour describing several characteristics of the company management and other variables that can be considered as control variables. Hence, these two considerations can be examined in further researches. References: Ammann, M., Oesch, D., & Schmid, M.M. 2011. Corporate governance and firm value: International evidence. *Journal of Empirical Finance*, 18(1), 36-55. ok Ang, J.S., & Ding, D.K. 2006. Government ownership and the performance of government-linked companies: The case of Singapore. *Journal of Multinational Financial Management*, 16(1), 64-88. ok Babatunde, M.A., & Olaniran, O. 2009. The effects of internal and external mechanism on governance and performance of corporate firms in Nigeria. *Corporate ownership & control*, 7(2), 330-344. Ok Baldacchino, J.P., Caruana, R., Grima, S., and Bezzina, H.F. 2017. Selected Behavioral Factors in Client-Initiated Auditor Changes: The Client-Auditor Perspectives. *European Research Studies Journal*, 20(2A), 16-47. Bhagat, S., & Bolton, B. 2008. Corporate governance and firm performance. *Journal of corporate finance*, 14(3), 257-273. Borisova, G., Brockman, P., Salas, J.M., & Zagorchev, A. 2012. Government ownership and corporate governance: Evidence from the EU. *Journal of Banking & Finance*, 36(11), 2917-2934. Chiang, H.T., He, L.J., & Lai, C.H. 2012. The Governance Effect of Institutional Stakeholders on Family-Controlled Companies' Earnings Management. *Corporate Ownership & Control*, 9(4), 81-95. Claessens, S., & Yurtoglu, B.B. 2013. Corporate governance in emerging markets: A survey. *Emerging markets review*, 15, 1-33. Claessens, S., Djankov, S., Fan, J.P., & Lang, L.H. 2002. Disentangling the incentive and entrenchment effects of large shareholdings. *The journal of finance*, 57(6), 2741-2771. Colarossi, F., Giorgino, M., Steri, R., & Viviani, D. 2008. A corporate governance study on Italian family firms. *Corporate ownership & control*, 5(4), 93-103. Efendy, M.T. 2010. The effect of competence, motivation and auditor's independence on audit quality (Empirical Study on Government of Gorontalo)). Thesis Master of Science in Accounting, Universitas Diponegoro, Unpublished. El-Chaarani, H. 2017. The Mutual Impacts of Corporate Governance Dimensions and Legal Protection Systems on the Performance of European Banks: A Post-Crisis Study. *European Research Studies Journal*, 20(2A), 538-567. Giannakopoulou, N.E., Stamatopoulos, V.T. and Thalassinou, I.E. 2016. Corporate governance in shipping: An overview. *Maritime Policy and Management*, 43(1), 19-38. Gupta, P.P., Kennedy, D.B., & Weaver, S.C. 2009. Corporate governance and firm value: Evidence from Canadian capital markets. *Corporate Ownership and Control Journal*, 6(3). Ivanova, A.I., Bukeeva, V.M. 2016. Corporate Social Responsibility: Specificity, Formation Mechanism, Estimation of Management Efficiency. *European Research Studies Journal*, 19(3) Part A, 167-184. Kaihatu, T.S. 2006. Good corporate governance and its implementation in Indonesia. *Journal of Management and Entrepreneurship*, 8(1), 1-9. Lisic, L.L., Silveri, S.D., Song, Y., & Wang, K. 2015. Accounting fraud, auditing, and the role of government sanctions in China. *Journal of Business Research*, 68(6), 1186-1195. Menshchikova, V.I. and Sayapin, V.A. 2016. Model of Innovation-Oriented State Economic Policy. *European Research Studies Journal*, 19(1), 189-200. Mitton, T. 2002. A cross-firm analysis of the impact of corporate governance on the East Asian financial crisis. *Journal of financial economics*, 64(2), 215-241. Munawarah, Widowati, C., Muharam, H. and Din, M. 2017. State Ownership and Corporate Governance: An Empirical Study of State Owned Enterprises in Indonesia. *International Journal of Civil Engineering and Technology*, 8(7), 951-960. Nguyen, T.T., & Van Dijk, M.A. 2012. Corruption, growth, and governance: Private vs. state-owned firms in Vietnam. *Journal of Banking & Finance*, 36(11), 2935-2948. OECD, 2005. OECD Guidelines on Corporate Governance of State-Owned Enterprises. OECD Publishing. Pociovalisteanu, M.D., Thalassinou, I.E. 2008. The beginning and some national particularities of liberalism. *Metalurgia International*, 13(2), Special Issue, 172-177. Qiang, Q. 2003. Corporate

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