CHAPTER I

INTRODUCTION

1.1 Background

Good Corporate Governance, hereinafter GCG, defines as the code of conduct in which companies are directed and controlled to reach the balance between power and authority of the companies in giving accountability to shareholders particularly and stakeholders generally. The goal of GCG is to create added value for all interested party. GCG is one of important aspect of the company which is expected to create a fair competition and conducive business situation that has long-term impact.

GCG is strongly associated with agency theory which describes the relationship between agent (managers) and principal (shareholders) in running the business operation. The agency relationship is a contract in which principal engages another person (agent) to perform some services on their behalf which involved delegating some decision making and authority to the agent.

Agency theory explains the conflict of interest between agent and principal in the business operation that called as agency problem. It is assumed that they have different goals and version level to risk. Conflict of interest is caused by human nature which tends to be opportunistic by maximizing their own interest from the given opportunities and that will be harmful to other party's interest and also company performance. In order to solve the agency problem, the implementation of GCG is required in the company.

The emerging of GCG became popular in Indonesia in the mid-1997 when the financial crisis occurred in Asian countries. World Bank and ADB (Asian

Development Bank) revealed that Asian Financial Crisis was not only caused by macroeconomic factors but also by poor corporate governance practice as the core problem of that crisis. It was followed by the collapse of World's largest business such as Enron and Worldcom in US as well as HIH and One-tel in Australia which got involved in accounting scandals at the beginning of 21st century (Lukviarman, 2004).

According to Iskander and Chamlao (2000), the financial crisis in Indonesia occurred due to weak of legality and regulatory, inadequate and inconsistent practice of accounting and auditing standards, lack of protection of minority shareholder rights, poor oversight instead Board of Directors, and the limited role of Board of Commissioners. This crisis indicates that corporate governance implementation in Indonesia is still weak. After the financial crisis and massive accounting scandals occurred, the corporate governance implementation has become a crucial issue which has been discussed by many countries including Indonesia. It is supported by IMF (International Monetary Fund) which stressed on the implementation of GCG in Indonesia for improving governance practices.

Moreover, the world views GCG implementation in Indonesia is still consider as bad practice until right now. Based on a survey conducted by Political and Economic Risk Consultancy (PERC) in 2000, Indonesia is in the top three worst Asian countries in implementing corporate governance. Asian Corporate Governance Association (ACGA) in 2007 explained that Indonesia position was the lowest among 11 Asian countries based on some assessment categories. The ACGA survey stated that Indonesia has bad scores in every category with the lowest scores in "Enforcement Categories" and "CG Culture Categories". This survey revealed that some points factors of the bad CG implementation in Indonesia are corruption which continues to plague the economy, the company which focuses on maximizing their majority shareholders only, weak regulatory system, questionable commissioners independence, and etc.

Stated-Owned Enterprises or locally known as *Badan Usaha Milik Negara* (BUMN) plays a vital role in establishing the national economy to create public welfare. In fact, the role of Stated-Owned Enterprises, hereinafter called SOEs, has not been optimal causes of many politicization (Abubakar and Ukassa, 2010). The Ministerial Decree of SOEs No.Reg-117/M-MBU/2002 concerning on implementation of GCG practice on SOEs was established as a response to the financial crisis in Asia. It was also supported by the awareness of Indonesian government that SOEs gave significant contribution to financial crisis at that time. Moreover, the increasing business activity in Indonesia nowadays and the importance of SOEs role to the state, it makes the government must reform and improve SOEs performance through GCG implementation. The obligation of GCG implementation on SOEs is expected to increase the value of the company also enhance the contribution to the national economy accordance with the goals of SOEs (Pahlevi, et al., 2016).

Even though the obligation of GCG practices on SOEs has been applied in 2002, it has not been well implemented until right now. For Example, the scandal of Waskita Karya in which three directors were suspected of performing financial manipulation in 2004-2007 of the fiscal year (Tempo.com). Then, there were some of SOEs which did not implement GCG practices in 2013 such as PT Bank Mega Tbk, PT Bank Panin Tbk, PT Bank Jabar Banten Tbk, and PT Bank Mestika

Dharma (Hukumonline.com). Meanwhile, in the second semester of 2014, BPK conducted an investigation with SOEs and other bodies as the object inspection and found the problems for 251 weaknesses of the internal control system and 451 non-compliance with statutory provisions of Rp 8.66 trillion. Then, 14 BPR (Bank Perkreditan Rakyat) were liquidated by OJK (Otoritas Jasa Keuangan) which assessed almost 70% of BPR loss due to poor service and corporate governance (keuangan.kontan.co.id). In other cases, ex-President Director of PT Garuda Indonesia Tbk was suspected in bribery case (Liputan6.com). There was some case of corruption occurred on SOEs such as 7 cases in 2010, 5 cases in 2015 and then increase drastically in 2016 with 16 cases which gave impact to the decreasing of company's performance. Those all cases on SOEs above show the agency problems on SOEs that reflect how poor CG quality on SOEs in Indonesia (Kompas.com).

The poor of GCG practice in companies affect to the financial performance which is reflected by declining in company's profit and shares price. Based on data from the Ministry of SOE, There were 30 SOEs that suffered losses in 2013 such as PT Indofarma Tbk with loss of Rp 54 billion, PT Krakatau Steel Tbk with loss of Rp 194 billion, PT PLN with loss of Rp 29.56 trillion and others. Meanwhile, in 2014 about 26 companies suffered loss such as PT Krakatau Steel Tbk with loss of Rp 2.59 trillion, PT Antam Tbk with loss of Rp 775 billion, PT Garuda Indonesia Tbk with loss of Rp 4.62 trillion, PT Industri Sandang Nusantara with loss of Rp 68 billion and others. Even though the number of companies that suffered losses has been decreased, but the total loss of SOEs was still very high, for instance, the total losses of SOEs were Rp 32 trillion in 2013, Rp 10.2 trillion in 2014, Rp 5.9 trillion in 2015, and Rp 5.6 trillion in 2016 (Detik.com).

According to the survey conducted by McKinsey and Company (2000), the Corporate Governance is the major concern for the investor in assessing the performance of the company. Investors tend to avoid poor-governed companies and attract more to well-governed companies. Meanwhile, based on Indonesia Corporate Governance Manual (2014), the implementation of GCG practice is assumed as the factor to increase the value and performance of the company that will enhance financial stability and profitability. It is reflected by better oversight, better decision making and compliance as well as the improvement of company's operational efficiency. Companies which implemented GCG properly, tend to be more healthy and able to add more value to shareholders, workers, communities, and countries. Some specific benefits of GCG practices are the improvement in operational efficiency, access to capital markets, lower cost to capital,and better reputation for the company.

This research uses the company's structure to meansure GCG implementation i.e Board of Directors, Board of Commissioners, Independent Commissioners and Audit Committee. According to Rossi et al. (2015) company's structures are the main role of performing and controlling the activities of companies. The structures is considered to be a mechanism for Corporate Governance since the obligation of those structures to protect and increase assets and maximizing the return on corporate investment.

Rely on the importance of SOE role to the state and all the cases related to the poor GCG implementation above, the researcher try to analyze the effect of Good Corporate Governance (GCG) implementation which is proxied by some indicators (the size of Board of Directors, Board of Commissioners, Independent

Commissioners, and Audit Committee) on financial performance which proxied by ROA and ROE in Stated-Owned Eterprises (SOEs).

1.2 Problem Statements

Based on the description above, the problems to be studied in this research are:

1. Does the size of Board of Directors has negative significant effect on ROA (Return on Assets) on State-Owned Enterprises (SOEs) listed in Indonesia Stock Exchange (IDX) for period 2013-2016?
2. Does the size of Board of Commissioners has positive significant effect on ROA (Return on Assets) on State-Owned Enterprises (SOEs) listed in Indonesia Stock Exchange (IDX) for period 2013-2016?
3. Does the size of Independent Commissioners has positive significant effect on ROA (Return on Assets) on State-Owned Enterprises (SOEs) listed in Indonesia Stock Exchange (IDX) for period 2013-2016?
4. Does the size of Audit Committee has positive significant effect on ROA (Return on Assets) on State-Owned Enterprises (SOEs) listed in Indonesia Stock Exchange (IDX) for period 2013-2016 ?
5. Does the size of Board of Directors has negative significant effect on ROE (Return on Equity) on State-Owned Enterprises (SOEs) listed in Indonesia Stock Exchange (IDX) for period 2013-2016 ?
6. Does the size of Board of Commissioners has positive significant effect on ROE (Return on Equity) in State-Owned Enterprises (SOEs) listed in Indonesia Stock Exchange (IDX) for period 2013-2016?

7. Does the size of Independent Commissioners has positive significant effect on ROE (Return on Eqity) in State-Owned Enterprises (SOEs) listed in Indonesia Stock Exchange for period 2013-2016?
8. Does the size of Audit Committee has positive significant effect on ROE (Return on Equity) on State-Owned Enterprises (SOEs) listed in Indonesia Stock Exchange (IDX) for period 2013-2016?

1.3 Research Objectives

This study is designed to:

1. To determine whether the size of Board of Directors has negative significant effect on ROA (Return on Assets).
2. To determine whether the size of Board of Commissioners has positive significant effect on ROA (Return on Assets).
3. To determine whether the size of Independent Commissioners has positive significant effect on ROA (return on Assets).
4. To determine whether the size of Audit Committee has positive significant effect on ROA (Return on Assets).
5. To determine whether the size of Board of Directors has negative significant effect on ROE (Return on Assets).
6. To determine whether the size of Board of Commissioners has positive significant effect on ROE (Return on Assets).
7. To determine whether the size of Independent Commissioners has positive significant effect on ROE (return on Assets).
8. To determine whether the size of Audit Committe has positive significant effect on ROE (Return on Assets).

1.4 Research Benefits

From this research, researcher expects to give the valuable insights:

1. For Investor

   This research will give a consideration for the investor in determining and deciding on their investment decision-making since every investor want a better prospect of the company in the future.

2. For government

   This research can be used by the government and other parties in deciding the policy-making through GCG implementation for the better financial performance of SOEs

3. For State-owned Enterprises (SOEs)

   This research will give a proof to SOEs party about the importance of GCG practice on financial performance. It will encourage them to implement GCG practice effectively.

1.5 Writing Systematic

This research consists of five chapters which are as follow:

Chapter I Introduction

This chapter consists of background, problem formulation, research purposes and benefits, and writing systematic.

Chapter II Literature Review

This chapter tries to explain basic theories and knowledge regarding to research from various research such as articles and previous journals.

Chapter III: Research Methodology

This chapter explains about research design, population, sampling methods, final samples, data collection methods, variables used in research, and methods used to analyze data and hypothesis test.

Chapter IV: Result and Discussion

This chapter explains analysis of result in research and discussion regarding to the result.

Chapter V: Conclusion

This chapter describes conclusion of data analysis, research limitation, and research suggestion.