State-Owned Enterprises, Efficiency and Performance: The Case of Indonesia

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Abstract: Researchers investigate the efficiency and performance of partially privatized Indonesian State-Owned Enterprise (SOEs). Researchers find that partially privatized Indonesian SOEs have higher efficiency and performance than those of their private-owned counterparts. The results might suggest that the SOEs might benefit from better corporate governance, high market power and other privileges and that the benefits are greater than the policy burdens imposed on these firms.

Key words: State-owned enterprises, efficiency, performance, Indonesia, high market power

INTRODUCTION

State-Owned Enterprises (SOEs) play important economic roles of a country. They help maintain social stability and drive economic growth (Bai and Xu, 2005; Huang *et al.*, 2010), especially in the developing countries (Doamekpor, 1998). Due to the roles, State-Owned Enterprises (SOEs) (Researchers use the terminologies state-owned enterprises, state-owned firms, public firms and government firms interchangeably to refer firms that fully or majority owned by government while private-owned enterprises or private-owned firms represent their counterparts) have been studied from several perspectives, such as benefits and costs of privatization (La Porta and Lopez-de-Silanes, 1999; Omran, 2004), political influences (Shleifer and Vishny, 1994; Dinc, 2005), multitasking and policy burdens (Bai and Xu, 2005; Liao *et al.*, 2009), profitability and efficiency (Holz, 2002; Goldeng *et al.*, 2008) and governance (Qiang, 2003).

The development and social views of public firms contend that SOEs are inefficient because of their roles in helping the government to promote economic development and maintaining social stability by providing jobs and unemployment reduction (Huang *et al.*, 2010). Efficiency is usually measured by labor surplus or employee productivity. Similarly, the political perspective of government ownership of firms argues that politicians may take advantage of their positions by forcing SOEs to recruit their supporters which then lead to labor surplus (Shleifer and Vishny, 1994; Buchanan, 1972).

A number of empirical studies find evidence that SOEs bear a policy burden in the form of labor surplus (Wu *et al.*, 2012). Huang and Xiao (2012) contend that

employee productivity is negatively associated with government ownership. They argue that the more the government ownership the more the managers put emphasis on employment than revenue/profit.

The development or social theories of public firms suggest that the performance of SOEs will be lower than that of Private-Owned Enterprise (POEs). Similarly, the political theory of SOEs and agency theory (This theory is also in line with property rights theory (Alchain and Demsetz, 1972) and public choice school (Boycko *et al.*, 1996) are also commonly used to explain the performance difference of SOEs and POEs Jensen and Meckling, 1976). The agency theory assumes that managers are opportunistic and tend to maximize their utilities at the expense of the firm owners. Many studies have used the theory to argue that SOEs are inferior to POEs due to the management incentive problems (Goldeng *et al.*, 2008). For example, Dewenter and Malatesta (2001) find that government-owned firms are less profitable than private firms.

The present study investigates the efficiency and performance of partially-privatized and government-controlled Indonesian SOEs. The Indonesia's institutional reforms were started in 1998, triggered by the harmful 1997/1998 economic crisis brought the country into a political turmoil. The reforms then led the country becomes more democratized and decentralized (Henderson and Kuncoro, 2011; Arifin *et al.*, 2013). Indonesian SOEs play major economic roles (Fitriningrum, 2006). For example, part of the government revenue comes from the dividends of SOEs. However, SOEs could also be financial risks for the government. Some SOEs exist to provide goods and services to serve the public needs (public service obligation) or to conduct businesses in

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industries where are void of private firms. The Indonesian government has the responsibility to bear the loss and inject capital when such SOEs encounter financial problems.

Interestingly, the results of this study are in general, contradictory to the predictions of the development and political theories of government firms and the results of some previous empirical studies that document the inferior performance of government firms compared to private firms (Goldeng *et al.*, 2008; Dewenter and Malatesta, 2001). The results of this study show that employee productivity and accounting performance of SOEs is significantly higher than those of the POEs.

Theories of state-owned enterprises: According to the social or development theory, the main objective of SOEs is to drive the development of a country. Traditional economists argue that SOEs benefit a country because they provide alternatives to market failures and conduct projects which promote economic development but are not profitable for private investments (Atkinson and Stiglitz, 1980; Shleifer and Vishny, 1994; Doamekpor, 1998).

The political theory of government ownership of firms contends that SOEs are less profitable because they serve the interests of politicians (La Porta *et al.*, 2002). The literature on political view of SOEs has been growing since the seminal research of Shleifer and Vishny (1994, 1998). They introduce the concept of grabbing hand where bureaucrats/politicians extract resources from SOEs under their control in order to fulfill their private or parties' objectives which are not consistent with the maximization of the firm value. For instance, politicians and bureaucrats can influence a state-owned bank to provide excessive lending in a general election year (Dinc, 2005; Micco *et al.*, 2007; Claessens *et al.*, 2008). Several studies have supported the prediction of this theory (La Porta *et al.*, 2002; Sapienza, 2004; Dinc, 2005; Micco *et al.*, 2007). This theory has been used to explain several problems in SOEs, such as agency problem (Siqueira *et al.*, 2009; Lu *et al.*, 2010), inefficiency (Wu *et al.*, 2012; Dinc, 2005), excess employment (Wu *et al.*, 2012), poor performance (Holz, 2002). Some empirical studies have also confirmed that the higher the government ownership in SOEs, the higher the inefficiency and the lower the performance of the firms (La Porta and Lopez-de-Silanes, 1999; Omran, 2004, McLeod, 2005). Similarly, some empirical studies also find that employee productivity is lower in SOEs than in POEs (Dewenter and Malatesta, 2001; Rousseau and Xiao, 2008).

Recent discussions on SOEs are dominated by the debate on the impact of privatization of such firms. This issue is interesting as it has been a political and economic phenomenon over the past few decades (Orman, 2004). The proponents of privatization contend that privatization leads to the improvement of firm performance because it helps to achieve efficiency (Shirley, 1999; Omran, 2004; Boubakri *et al.*, 2005). D'Souza and Megginson (1999) argue that by going public, firms would have many entrepreneurial opportunities because they would not be subject to government control. Wu *et al.* (2012) argue that privatized firms should perform better because they are no longer subject of policy burden (surplus labor). In the financial sector, Andrews (2005) argues that privatization of state-owned banks tends to reduce the fragility of country's financial and economics systems because the privatized banks have better corporate governance. One could argue that privatized firms are more profitable because they are not subject to policy burdens, such as employment and wage or compensation control (La Porta and Lopez de Silanes, 1999).

MATERIALS AND METHODS

Data: This study aims to investigate the differences in efficiency and performance between state-owned and privately-owned firms. Data are collected from all non-financial firms listed in the Indonesian stock exchange (IDX) between 2004 and 2009 resulting in 1160 firm-year observations in an unbalanced panel data set. Researchers exclude firms that do not have complete data. The final data set has 226 firms. Researchers do not include banks and other financial firms (finance industry) in the sample because of their specificities. Of the firms including in the sample, 10 firms are state-owned resulting in 49 observations. Financial statements, as well as annual reports of firms come from the IDX.

Variables

Efficiency: Researchers use 2 measures of firm efficiency. They are labor surplus (Wu *et al.*, 2012) and employee productivity (Dewenter and Malatesta, 2001). Researchers measure labor surplus as following (Wu *et al.*, 2012):

$$Surplus = \frac{\left(Employees - Industry\ employees \times \dfrac{Sales}{Industry\ sales} \right)}{Employees} \quad (1)$$

Then, researchers measure employee productivity (productivity) as follows:

$$Productivity = Natural\ logarithm \left(\frac{Sales}{Employees} \right) \quad (2)$$

Performance: Researchers use the 2 common proxies of firm accounting performance which are the ratio of Return On Assets (ROA) and the profit Margin ratio (MARGIN).

State-owned enterprises: A dummy variable (SOE) is used, taking a value of 1 for the state-owned enterprises and 0 for the privately-owned enterprises.

Control variables: Researchers employ a number of control variables. Firm size (SIZE) was measured by the natural logarithm of total assets. Firm leverage (LEVERAGE) was measured as the ratio of total debt to total assets. Firm age (AGE) was calculated as the difference between the year under investigation and the year of incorporation. Researchers take into account the possible differences of labor surplus and employee productivity across industries. Agri, Mining, Basic, Consumer, Property, Infra and Trade are dummy variables for agriculture firms, mining firms, basic industry and chemical firms, consumer goods firms, property, real estate and building construction firms, infrastructure, utilities and transportation firms and trade, services and investment firms, respectively (the industry classification refers to one digit Jakarta Stock Industrial Classification (JASICA). Miscellaneous indusrty is used as a benchmark). Researchers also control for time effect by including a vector of year dummies (YEARS).

Empirical model: Researchers estimate the empirical models using pooled and random effect panel regressions. The equations to be estimated are as follows:

$$
\begin{aligned}
\text{Surplus}_{i,t} = & \ \alpha_0 + \alpha_1 \text{SOE}_i + \alpha_2 \text{SIZE}_{i,t} + \alpha_3 \text{LEVERAGE}_{i,t} + \\
& \alpha_4 \text{AGE}_{i,t} + \alpha_5 \text{AGRI}_i + \alpha_6 \text{MINING}_i + \alpha_7 \text{BASIC}_i + \\
& \alpha_8 \text{CONSUMER}_i + \alpha_9 \text{PROPERTY}_i + \alpha_{10} \text{INFRA}_i + \\
& \alpha_{11} \text{TRADE}_i + \text{YEARS} + \varepsilon_{i,t}
\end{aligned}
$$
(3)

$$
\begin{aligned}
\text{Productivity}_{i,t} = & \ \alpha_0 + \alpha_1 \text{SOE}_i + \alpha_2 \text{SIZE}_{i,t} + \alpha_3 \text{LEVERAGE}_{i,t} + \\
& \alpha_4 \text{AGE}_{i,t} + \alpha_5 \text{AGRI}_i + \alpha_6 \text{MINING}_i + \\
& \alpha_7 \text{BASIC}_i + \alpha_8 \text{CONSUMER}_i + \alpha_9 \text{PROPERTY}_i + \\
& \alpha_{10} \text{INFRA}_i + \alpha_{11} \text{TRADE}_i + \text{YEARS} + \varepsilon_{i,t}
\end{aligned}
$$
(4)

$$
\begin{aligned}
\text{ROA}_{i,t} = & \ \alpha_0 + \alpha_1 \text{SOE}_i + \alpha_2 \text{SIZE}_{i,t} + \alpha_3 \text{LEVERAGE}_{i,t} + \\
& \alpha_4 \text{AGE}_{i,t} + \alpha_5 \text{AGRI}_i + \alpha_6 \text{MINING}_i + \\
& \alpha_7 \text{BASIC}_i + \alpha_8 \text{CONSUMER}_i + \alpha_9 \text{PROPERTY}_i + \\
& \alpha_{10} \text{INFRA}_i + \alpha_{11} \text{TRADE}_i + \text{YEARS} + \varepsilon_{i,t}
\end{aligned}
$$
(5)

$$
\begin{aligned}
\text{Margin}_{i,t} = & \ \alpha_0 + \alpha_1 \text{SOE}_i + \alpha_2 \text{SIZE}_{i,t} + \alpha_3 \text{LEVERAGE}_{i,t} + \\
& \alpha_4 \text{AGE}_{i,t} + \alpha_5 \text{AGRI}_i + \alpha_6 \text{MINING}_i + \\
& \alpha_7 \text{BASIC}_i + \alpha_8 \text{CONSUMER}_i + \alpha_9 \text{PROPERTY}_i + \\
& \alpha_{10} \text{INFRA}_i + \alpha_{11} \text{TADE}_i + \text{YEARS} + \varepsilon_{i,t}
\end{aligned}
$$
(6)

RESULTS AND DISCUSSION

Table 1 presents the descriptive statistics for the variables of the sample while Table 2 shows the correlation matrix of variables. The variable of interest which is the dummy variable for State-Owned firms (SOE) has a positive and significant correlation with the 2 proxies of accounting performance as well as with employee productivity as a measure of efficiency.

Table 3 reports the results of pooled regression and random effect regression where the dependent variables are labor surplus and employee productivity as measures of firm efficiency while Table 4 presents the regression results for firm performance, proxied by return on assets and profit margin. The Wald tests in the random effect estimations meet the requirement.

First, researchers do not find the labor surplus difference between listed Indonesian SOEs and their listed private-owned counterparts both in pooled regression and random effect regression. Second, the finding in the pooled regression shows that contrary to the general presumption and previous studies (Dewenter and Malatesta, 2001; Rousseau and Xiao, 2008; Huang and Xiao, 2012), partially privatized Indonesian state-owned enterprises have higher employee productivity than that of their private counterparts. However, attenuation is found in the coefficient of the dummy for state-owned enterprises when random effect (GLS) regression is employed.

Again in contrast with some previous studies, the empirical results of this study both estimated by using pooled and GLS estimations that are presented in Table 4, clearly show that Indonesian partially privatized SOEs significantly have higher return on assets than that of private-owned firms (Dewenter and Malatesta, 2001; Holz, 2002). The results are robust when researchers employ profit margin ratio as the proxy of firm performance.

Some possible arguments may explain the findings. First, the partially privatized state-owned enterprises may have high degree of monopoly power which leads to higher profitability. As state-owned firms are public enterprises, they might have a high degree of monopoly power to help the government ensures that goods and services are equally distributed to meet the needs of the public. Second, as they have substantial contributions to government budget, they may receive some privileges from the government particularly in the form of access to sources of revenue. These 2 factors imply that even though they may have to conduct some development purposes, such as recruiting more employees or exploited by politicians to hire politicians' supporters, their revenues can still cover the increased labor costs. Third,

Table 1: Descriptive statistics

Statistics	SURPLUS	PROD.	ROA	MARGIN	SOE	LNTA.	LEV.	AGE
Mean	-1.136	13.329	4.228	5.050	0.043	20.413	0.577	24.531
Median	0.233	13.318	3.670	4.720	0.000	20.454	0.542	23.000
Maximum	1.000	19.171	94.020	99.700	1.000	25.304	4.370	98.000
Minimum	-108.899	4.445	-85.020	-97.220	0.000	13.426	0.000	0.000
SD	6.985	1.470	14.097	20.788	0.202	1.744	0.394	13.197
Skewness	-9.496	-0.195	-0.532	-0.965	4.533	-0.191	3.256	1.484
Observations	1195.000	1195.000	1245.000	1196.000	1410.000	1251.000	1251.000	1368.000

Table 2: Correlation matrix

Matrix	SURPLUS	PROD.	ROA	MARGIN	SOE	LNTA.	LEV.	AGE
SURPLUS	1.000							
PROD.	-0.530	1.000						
ROA	-0.024	0.243	1.000					
MARGIN	-0.038	0.200	0.698	1.000				
SOE	-0.006	0.224	0.230	0.183	1.000			
LNTA.	-0.101	0.431	0.252	0.251	0.297	1.000		
LEV.	0.008	-0.073	-0.338	-0.298	-0.027	0.068	1.000	
AGE	0.060	0.012	0.241	0.114	0.097	0.233	0.087	1.000

SURPLUS is the labor surplus calculated as (Employees-Industry employees×Sales/Industry sales); PROD is the employee productivity which is measured as natural logarithm of sales per employee; ROA is return on assets (%); MARGIN is profit margin ratio (%); SOE is the dummy for state-owned enterprises; SIZE is firm size measured by natural log of total assets; LEVERAGE is the ratio of debt to total assets; AGE is the difference between the year under investigation and the firm's year of birth

Table 3: Regression results

Regression	Labor surplus		Labor productivity	
	Pooled	Panel (GLS random effect)	Pooled	Panel (GLS random effect)
SOE	0.68 (0.799)	1.348 (1.557)	0.369* (0.195)	0.261 (0.436)
SIZE	-0.761*** (0.23)	-1.235*** (0.395)	0.423*** (0.035)	0.545*** (0.066)
LEVERAGE	0.116 (0.183)	0.342 (0.431)	-0.349*** (0.08)	-0.226* (0.121)
AGE	0.039*** (0.011)	0.054* (0.028)	-0.004 (0.003)	-0.008 (0.007)
AGRI	0.465 (0.257)	0.483 (0.755)	-0.557*** (0.131)	-0.418 (0.308)
MINING	-1.004 (1.188)	-1.171 (1.869)	1.001*** (0.199)	0.995*** (0.362)
BASIC	0.045 (0.213)	0.01 (0.513)	0.547*** (0.106)	0.616*** (0.236)
CONSUMER	-0.188 (0.256)	-0.256 (0.657)	0.39*** (0.125)	0.455 (0.29)
PROPERTY	0.955*** (0.307)	1.257** (0.583)	-0.276** (0.122)	-0.261 (0.245)
INFRA	1.213*** (0.326)	1.653** (0.783)	0.295** (0.137)	0.283 (0.297)
TRADE	-3.019*** (0.885)	-3.002* (1.757)	0.705*** (0.119)	0.787*** (0.263)
Year dummies	Included	Included	Included	Included
Constant	Included	Included	Included	Included
White robust standard error	Yes	Yes	Yes	Yes
Firms	224	224	224	224
Observations	1160	1160	1160	1160
Overall R^2	0.059	0.055	0.343	0.335
R^2 between		0.063		0.353
R^2 within		0.045		0.333
Wald test		$\chi^2(16) = 36.58 (0.002)^{***}$		$\chi^2 (16) = 221.75 (0.000)^{***}$

This data shows regression results of pooled regression and random effect panel data; The dependent variable in the first 2 columns is (Employees-Industry employees×Sales/Industry sales) while the dependent variable in the last 2 columns is labor productivity measured by natural log of sales per employee; SOE is the dummy for state-owned enterprises; SIZE is firm size measured by natural log of total assets; LEVERAGE is the ratio of debt to total assets; AGE is the difference between the year under investigation and the firm's year of birth; Agri., Mining, Basic, Consumer, Property, Infra and Trade are dummy variables for agriculture firms, mining firms, basic and chemical firms, consumer firms, property firms, infrastructure firms and trade, services and investment firms, respectively; The values in parentheses are standard errors corrected using White robust method; *,**,***Significance at the 10, 5 and 1% levels, respectively

the partial privatization may have resulted in better public and internal monitoring which ultimately have improved the efficiency and performance of these firms (the Indonesian goverment has privatized a number of state firms after the institutional reforms. The newly partial privatized SOEs are the dominant kind of SOEs in the sample) (Cuervo and Villalonga, 2000). Fourth, the superior performance of partially privatized SOEs might come from the fact that agency problem between managers and shareholder is weaker in these firms. As expected, results of the control variables provide evidenceof economies of scale as shown by positive signs of the coefficients of firm size on employee productivity, return on assets and profit margin. Moreover, negative signs of the coefficient of firm size on labor surplus strengthen this evidence. Difference across industry is more pronounced on efficiency than on performance.

Table 4: Regression results

	ROA		Profit margin	
Regression	Pooled	Panel (GLS random effect)	Pooled	Panel (GLS random effect)
SOE	10.93*** (1.861)	9.42*** (2.708)	11.566*** (2.591)	10.193** (4.258)
SIZE	1.903*** (0.28)	2.089*** (0.48)	2.826*** (0.456)	2.716*** (0.809)
LEVERAGE	-11.429*** (1.621)	-13.844*** (1.845)	-16.017*** (2.661)	-19.151*** (3.785)
AGE	0.174*** (0.043)	0.163** (0.079)	0.06 (0.051)	0.062 (0.086)
AGRI.	4.125 (2.811)	4.138 (5.002)	4.747 (3.51)	3.514 (6.636)
MINING	0.957 (1.913)	0.425 (2.971)	-0.407 (2.906)	-0.95 (4.187)
BASIC	2.819*** (1.007)	2.34 (1.783)	3.037* (1.812)	2.214 (2.661)
CONSUMER	7.258*** (1.985)	6.501* (3.58)	6.025*** (2.049)	4.697 (3.84)
PROPERTY	-1.668 (1.164)	-2.296 (1.868)	5.618** (2.7)	4.182 (4.227)
INFRA	-1.275 (1.209)	-1.532 (1.976)	-0.661 (2.953)	-0.257 (4.702)
TRADE	4.014*** (1.104)	3.708* (2.046)	5.038*** (1.655)	4.31 (2.975)
Year dummies	Included	Included	Included	Included
Constant	Included	Included	Included	Included
White robust standard error	Yes	Yes	Yes	Yes
Firms	227	227	227	227
Observations	1198	1198	1198	1198
Overall R^2	0.265	0.261	0.188	0.185
R^2 between		0.347		0.247
R^2 within		0.122		0.09
Wald test		$\chi^2 (16) = 228.44 (0.000)^{***}$		$\chi^2 (16) = 83.03 (0.000)^{***}$

This data shows regression results of pooled regression and random effect panel data; The dependent variable in the first 2 columns is Return On Assets (ROA) in percentage while the dependent variable in the last 2 columns is profit margin (%); SOE is the dummy for state-owned enterprises; SIZE is firm size measured by natural log of total assets; LEVERAGE is the ratio of debt to total assets; AGE is the difference between the year under investigation and the firm's year of birth; Agri., Mining, Basic, Consumer, Property, Infra and Trade are dummy variables for agriculture firms, mining firms, basic and chemical firms, consumer firms, property firms, infrastructure firms and trade, services and investment firms, respectively; The values in parentheses are standard errors corrected using White robust method; *,**,***Significance at the 10, 5 and 1% levels, respectively

Researchers do several robustness checks (table of robustness checks are available upon request). First, researchers change the proxy of firm performance to Return on Equity (ROE) and the results remain the same. Second, researchers exclude the year of 2008 (the global financial crisis) as one might argue that during the crisis state-owned enterprises might have more privileges from the government than non-crisis period. However, the results show that the coefficients of state-owned enterprises remain unchanged.

CONCLUSION

Researchers investigate the impact of government ownership of firms on efficiency and performance in the context of Indonesian firms. Researchers find that partially privatized Indonesian state-owned enterprises have higher employee productivity than that of their private-owned counterparts. No difference of labor surplus is found between state-owned and private-owned firms. Contrary to the general presumption and previous study results, researchers find that Indonesian state-owned enterprises, compared to private-owned enterprises have higher accounting performance, measured by the ratio of return on assets and the profit margin ratio.

The higher employee productivity and accounting performance of state-owned enterprises might result fromhigh market power, special government treatmentsand improved corporate governance. Further, investigation of such possibilities would be an interesting future research.

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