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Tunneling Control and Good Corporate Governance to Improve State-Owned Enterprises Performance

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Abstract

This research aims to look at the influence of tunneling and GCG variables on the performance of Indonesian State-Owned Enterprises. The data used is secondary data taken from the Annual Report of Indonesian State-Owned Enterprises. The data period is six years, from 2014 to 2019. The population in this study was 44 Indonesian State-Owned Enterprises, and the sample was determined using purposive sampling methods. The data is processed using multiple linear regression analysis. The results of the data analysis showed that tunneling and GCG had a significant effect on the performance of Indonesian State-Owned Enterprises, both simultaneously and partially. This study implies that more technical regulations are needed to regulate the boundaries of related transactions in State-Owned Enterprises so that tunneling actions can be minimized. State-Owned Enterprises must also always improve their performance to be more optimal, at least it can increase of State Owned Enterprises that can deposit dividends into the state treasury. The novelty of this research is the use of SOE objects for tunneling subjects that are generally research in private companies.
Keywords: *tunneling; good corporate governance; performance; soe*

JEL Classification: M40; M41

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INTRODUCTION

State-Owned Enterprises (SOE) is business entities with the majority shareholder being the government. Companies owned by the government as the majority shareholder have the greatest control rights, including its financial performance (Tang & Firth, 2011; K. Wang & Xiao, 2011). SOE in several other countries is formed to carry out activities on behalf of the State and provide profits to the State or in state-owned investments in other companies. As the majority owner, the State is heavily involved in the decision-making process of SOE, especially concerning political interests (Prabowo et al., 2018). The existence of these State-Owned Enterprises has a dual status, namely as a tool for the government and as a public service institution (Balbuena, 2014). State-Owned Enterprises have a goal to increase

income for the State and increase the prosperity of society in general. Found there are pressures that interfere with the independence of SOE businesses (Whelan & Muthuri, 2017). So that there is a policy to privatize SOE (Y. Lin et al., 2010). Basically, SOE have an important role and are a major component in the global economy today (K. J. Lin et al., 2020a).

SOE is obliged to provide goods and services at low prices, serve as producers, hire competent employees, correlate with government-preferred suppliers, and occupy business locations with political considerations (Boko & Qin, 2011). SOE aiming at non-profit is designated by the State as companies that serve the community and this is part of the responsibility of the State, all receipts made by SOE were remitted to the State and expenditure were covered by the State (Christiansen, 2013; K. J. Lin et al., 2020a). The State Owned Enterprises is engaged in various fields such as the manufacturing industry, finance and banking, as well as services. In Indonesia, the latest data in 2021 from the Ministry of State Owned Enterprises website informs that currently there are 128 State Owned Enterprises in several field. Of the total State Owned Enterprises profits of Rp. 189 trillion, only 15 State Owned Enterprises contributed up to 73%.

Empirical studies find that strong investor protection (Kuo et al., 2014), in this case related to tunneling problems, is associated with effective GCG (Kuo et al., 2014). Higher board independence is negatively correlated with related party transactions (C. Chen et al., 2018). GCG can significantly reduce the size of debt-related transactions and slightly reduce the size of asset-related transactions (Utama & Utama, 2014). The existence of GCG is expected to reduce the company's risk arising from related transactions. Corporate governance is a set of relationships between company management, the board of directors, shareholders and other stakeholders (Lehuede, 2013; OECD, 2004; Rediker & Seth, 1995).

The current financial crisis in the United States is also due to the non-compliance with the implementation of GCG principles (Christensen & Lægreid, 2020; Eng et al., 2019; Lins et al., 2017; Probohudono et al., 2013). Several cases of financial scandals (Danielson et al., 2008; Gordon & Henry, 2011; Karim et al., 2016; Pilar & Joaquina, 2017) such as Enron Corp, Worldcom, Xerox, and others involving the company's top executives illustrate that the implementation of governance has not been in accordance with GCG principles (Y. Chen & Chien, 2007).

The performance of the company, which in this study is especially State Owned Enterprises, must be endeavored as much as possible. This is done to provide benefits to the government and provide the best service to the community. Based on the consideration of the importance of the performance of State Owned Enterprises, this study aims to examine the effect of tunneling variables and GCG on the performance of Indonesian State Owned Enterprises.

The concentration of ownership between majority and minority shareholders leads to Type 2 agency conflicts. This is a development of agency theory (Jensen & Meckling, 1976). The existence of a dominant controlling shareholder controlling the running of the company can reduce type 1 agency conflict (Fama & Jensen, 1983), because management is also controlled by the controlling shareholder (Musacchio et al., 2015). However, the existence of this type 2 conflict can be detrimental to the company itself (Y. Chen & Chien, 2007) and its minority shareholders (La Porta et al., 1999), most of whom are the general public. In this

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case the controlling shareholder can have the incentive and ability to control or even take over the interests of the minority shareholder (Sari et al., 2014). Tunneling comes with various conditions, both transactions with external companies and with subsidiaries. Tunneling may arise from the existence of related party transactions (Kang et al., 2014).

Tunneling is the transfer of assets and profits of a company for the benefit of the majority shareholder (Gao & Kling, 2008; Johnson et al., 2000). Tunneling is a form of expropriation (Cho & Lim, 2018; K. J. Lin et al., 2020b; Utama & Utama, 2014; Wan & Wong, 2015). There are two forms of tunneling, namely through self-dealing transactions with asset transfers or by increasing ownership without asset transfers (Y. L. Cheung et al., 2006). The transfer of assets by the majority shareholder can be done by diverting resources from the company for its profit. Tunneling can take the form of illegal transactions that may go undetected (Enriques, 2014)or the sale of assets through contracts such as transfer pricing, loan guarantees (La Porta et al., 1999; Shan, 2013), overcompensation to executives, or expropriation of assets. The increase in majority shareholder ownership can be done through dilutive shares, insider trading, minority freeze, acquisition, or other transactions that result in losses for minority shareholders (Sari et al., 2014; Shan, 2013). Reputation incentives are linked to founder decisions with a high degree of importance. RPT is used as an efficient mechanism. (Bansal & Thenmozhi, 2020).

Evidence of shareholder control through related party transactions is carried out by testing whether related transactions are tunneling by classifying them into 7 categories (Y. L. Cheung et al., 2006): (1) asset acquisition by related parties, (2) asset sales by related parties, (3) asset exchange between the company and shareholders controlling shareholders, (4) trading in goods and services between the company and the controlling shareholders, (5) cash payments, loans or guarantees by the company to the controlling shareholders, (6) cash payments, loans, or loan guarantees provided by related parties to the company , and (7) the transfer of assets to the company from a subsidiary that is majority owned and not publicly listed which may harm the minority shareholders of the subsidiary for the benefit of the company's shareholders. Transactions that occur in category 6 and category 7 will benefit the company or known as propping. Whereas in category 5 there are cash payments by companies to the related parties that have a high possibility of tunneling. While categories 1-4 are transfers of assets or purchases of goods and services, which can be in the form of tunneling or propping.

Tunnelling is an action taken by the majority shareholder to take over the rights that should be obtained by the minority shareholder. Tunnelling is supported by weak laws protecting minority shareholders and non-ideal corporate governance as is often the case in developing countries (Friedman et al., 2003). Tunnelling is a form of expropriation. There are two forms of tunnelling, namely through self-dealing transactions with asset transfers or by increasing ownership without asset transfers. Transfer of assets by majority shareholders can be done by transferring resources from the company for their interests, either in the form of illegal transactions that may not be detected or sale of assets through contracts such as transfer pricing, loan guarantees, excessive compensation to executives, or expropriation on company opportunities. An increase in majority shareholder ownership without asset transfer can be done through dilutive share issues, insider trading, minority freeze-outs, creeping acquisitions or other transactions that may result in losses for minority shareholders. In general, owners and/or managers in business groups have strong incentives to extract

resources from member firms for their personal gain (Bae et al., 2002; Bertrand et al., 2002; Lemmon & Lins, 2003), thereby enabling they use investment and financing decisions as a means of tunnelling.

Tunnelling appears with various conditions as several studies have done (Y.-L. Cheung et al., 2009; Y. L. Cheung et al., 2006; Friedman et al., 2003; Ryngaert & Thomas, 2012). An asset exchange motivated by tunneling incentives is associated with poorer stock performance and post-exchange financial performance, on the other hand, for better propping (Lou et al., 2014). Tunneling may arise from the existence of related party transactions/RPT (Juliarto, 2013). Negative tunneling (or propping) was introduced through research (Bae et al., 2002; Y. L. Cheung et al., 2006; Friedman et al., 2003; Oktavia, 2020). Propping is generally carried out by controlling shareholders to support companies that are in financial difficulty or bankruptcy. So this research formulates the following hypothesis:

H1 : *Tunneling has a negative effect on the performance of Indonesian State Owned Enterprises*

This study uses the performance of SOEs as the dependent variable. Rani et al. (2013) found that companies with higher corporate governance scores have better short-term performance as indicated by positive and higher abnormal returns. Better corporate governance significantly reduces the size of the RP of liabilities and marginally decreases the size of the RP of assets. The size of the RPT has a positive effect on firm value when the transaction involves borrowing from a related party and has no effect on firm value when the transaction involves the placement of assets in a related party. Companies with less full disclosure of RPT, the size of the asset RP has a negative effect on firm value. There are other possible determinants of the type of RPT including expropriation risk as reflected in ownership structure, degree of financial constraint, and degree of dependence on the key institutional environment. The existence of good governance is expected to reduce the company's risk arising from related transactions (Agnihotri & Bhattacharya, 2019; Gao & Kling, 2008). In this study, the authors formulate the following hypotheses:

H2 : *GCG has a positive effect on the performance of Indonesian State Owned Enterprises*

RESEARCH METHOD

This research is quantitative approach. The data used is secondary data taken from the Annual Report of Indonesian State-Owned Enterprises for a period of 6 years, from 2014 - 2019. The unit of data analysis of this research is 24 Indonesian State-Owned Enterprises and the data sample is determined using the purposive sampling method, namely State-Owned Enterprises that have financial statements with complete information related to the variables in this study.

The data was processed using multiple linear regression analysis. The dependent variable is the performance of Indonesian State Owned Enterprises as measured by the Return on Assets (ROA) ratio (H.-D. Wang et al., 2019). The independent variables are tunneling variables and GCG. Tunneling is measured using the TUNTA (the extend of tunneling) number (Gao & Kling, 2008; Johnson et al., 2000; Shan, 2013), which is the total related receivables minus related debts and then divided by total assets (X1). While the GCG

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variable is measured using the GCG score (X2). The control variables used in this study were the company's Age (C1) and Leverage (C2). Based on the hypothesis developed, then the models in this study are as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$$

Where:
Y = State Owned Enterprises performance; α = constant; X1 = tunneling; X2 =GCG; ε = error. With the above model, the contribution of tunneling and GCG to the performance of Indonesian State Owned Enterprises are assessed.

All the data required in this research can be obtained from annual reports that have been presented and have been publiced by SOEs. There is data that can be collected directly such as GCG score and age, or calculated first such as ROA and tunneling. But in general all data can be obtained from the annual report.

RESULTS AND DISCUSSION

From the sample data obtained in this study, the following descriptive statistics of research data are presented:

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Y	241	-12.00	7,400	.54823	.754537
X1	241	-.40	.99	.0659	.22627
X2	241	32.00	99.00	85.0227	12.66802
C1	241	1.00	83.00	23.8548	18.72030
C2	241	12.79	29.99	20.5681	3.69100

Source: data processed by the author (2021)

Table 1 shows the distribution of the data processed in this study. There are 241 State Owned Enterprises annual report data that meet the criteria in the study and are then designated as samples. There is a State Owned Enterprises performance with a minimum ROA point of -12% and the highest point at 7.4%. This shows that there are State Owned Enterprises that are at very low performance. The highest tunneling number is at .99 which means that the ratio between related receivables and related payables is very high. The lowest GCG at number 32 out of a scale of 100 means that there are State Owned Enterprises that are still far from GCG principles. Furthermore, the results of the regression analysis are presented as follows:

Table 2. Multiple regression results

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-11,718	3,549		-3.301	.001
	X1	-9,398	1,946	-.282	-4,830	.000
	X2	.204	.035	.343	5.791	.000
	C1	.037	.023	.092	1,580	.115
	C2	-.021	-121	-.010	-176	.860
R Square		: 0.206				
Adjusted R Square		: 0.193				
F		: 15.352				
Sig		: 0.000				

Source: data processed by the author (2021)

With an R square of .206, it can be said that the tunneling and GCG variables contribute to the influence of the performance of Indonesian State Owned Enterprises by 20.6%, while 79.4% is influenced by factors other than tunneling and governance. Based on the result of the F test which shows a sig value of 0.000, this figure is < from the 0.05 significance level, meaning that tunneling and GCG significantly affect the performance of Indonesian State-Owned Enterprises. Furthermore, the results of the ANOVA test concluded that the tunneling and GCG variables each partially had a significant effect on the performance of Indonesian State-Owned Enterprises. From the ANOVA table above, it can be entered into the research model as follows:

$$Y = -11.718 - 9.398X1 + 204X2 + \varepsilon$$

The model compiled explains that the increase in State Owned Enterprises performance by 1 point is due to a reduction in tunneling activity by 0.9 and an increase in GCG by 204.

Thus, the performance of State-Owned Enterprises is considered not optimal. BPK member Achsanul Qosasi said that in the 2020 State Budget, State Owned Enterprises are targeted to be able to deposit dividends of IDR 45.5 trillion. However, this figure is 95%, the majority is targeted for only 10 State-Owned Enterprises with the target of resolving non-performing loans at state-owned banks. While other State-Owned Enterprises only produce 5% and some are still losing. In addition, there were several cases in State Owned Enterprises including Krakatau Steel which faced financial problems, high debt, and corruption, Garuda Indonesia with its 2018 financial statements deemed not in accordance with PSAK, Harley motorcycle smuggling Davidson and Brompton bicycles, as well as bribes for the procurement of aircraft and aircraft engines, as well as Jiwasraya with a reinsurance scheme that provides false profits, sponsors Manchester City, invests in fried food stocks, and JS Protection products. In its history it has also been told that many Indonesian companies and banks have failed in the Asian Crisis in 1997-1998 (Rusmin & Evans, 2017).

Indonesian State-Owned Enterprises that provide dividends to the State have not met expectations. It can be interpreted that there are still many State-Owned Enterprises that are in an unfavorable condition. Such losses will be borne by both state-owned companies and minority shareholders. An example is that there is a minority shareholder of Garuda Indonesia who has suffered losses of up to Rp. 11.2 trillion as a result of the continued decline in the value of the airline's shares over the last 9 years.

One of the performance problems that arise in State-Owned Enterprises is estimated to arise from tunneling behavior. This is based on the results of several studies that occur quite a lot in developing countries, including Indonesia. Tunneling is supported by weak laws protecting minority shareholders and non-ideal corporate governance as is often the case in developing countries. In addition, the form or structure of corporate ownership in developing countries is not far from a concentrated form. This tunneling behavior is generally detrimental to both minority shareholders and the company.

In State-Owned Enterprises, the performance of government-owned companies has empirically increased due to support from the government. This is based on the view that with related transactions, the assets in one company will be used for financing activities in

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other State-Owned Enterprises. In this case, it is intended to provide covert benefits for the government, both material benefits deposited with the government and immaterial, namely increasing the performance of other companies which causes a decrease in performance in certain State-Owned Enterprises.

Tunneling in this study is measured using related receivable transactions compared to related debt transactions. The more related receivables, the State-Owned Enterprises provide a lot of convenience and relief to other parties. In this case, this results in reducing the profits that should be obtained by State Owned Enterprises. This condition will be detrimental to the company and also minority shareholders because they do not get the profits they should. This must be controlled so that the profits of State-Owned Enterprises are not too much harmed due to too many assets being traded in related receivables. Some studies convey the results that corporate governance in developing countries leads to the possibility of tunneling by linking to the ownership structure of public companies in Indonesia (Usman, 2019).

Tunneling appears with various conditions as several studies have done (Y.-L. Cheung et al., 2009; Friedman et al., 2003; Lou et al., 2014; Ryngaert & Thomas, 2012). An asset exchange motivated by tunneling incentives is associated with poorer stock performance and post-exchange financial performance, on the other hand, for better propping (Lou et al., 2014). Tunneling may arise from the existence of related party transactions/RPT (Juliarto, 2013). Negative tunneling (or propping) was introduced through research (Bai & Lian, 2013; Y. L. Cheung et al., 2006; Friedman et al., 2003).

One of the weaknesses in State-Owned Enterprises is that the quality of corporate governance is not yet optimal. The recent rise of State-Owned Enterprises corruption cases proves this. The quality of integrity of some State-Owned Enterprises leaders and oversight from the board of commissioners looks weak. On the other hand, the Chairperson of the KPK said that the performance of internal supervisors in State Owned Enterprises was still weak. Thus, improvements in governance absolutely must be carried out.

This governance improvement is intended so that in the future the performance of State-Owned Enterprises can be further improved. PT Pertamina in order to improve performance carried out a number of initiatives to make improvements internally, including implementing savings. Thus, Pertamina set the priority scale to realize investments to renegotiate existing contracts. The company earned a profit of US$ 1 billion or Rp. 14 trillion in the end of 2020 where in the first half of last year, Pertamina lost US$ 767.91 million. The existence of good governance is expected to reduce the company's risk arising from related transactions (Agnihotri & Bhattacharya, 2019; Gao & Kling, 2008).

CONCLUSION

The results of data analysis show that the tunneling variables and GCG have a significant effect on the performance variables of Indonesian State-Owned Enterprises, either simultaneously or partially. The limitation of this research is that it does not carry out comparisons of performance measurements using other more complex performance measures, where BUMN is a business entity that does not only pursue profits but also services to the community. This study implies that there are more technical regulations to regulate the boundaries of related transactions in State Owned Enterprises so that tunneling can be minimized. On the other hand, State Owned Enterprises must always be improved so

that their performance becomes more optimal. At least the dividends from SOEs paid to the state have increased from the current conditions.

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AUTHORSHIP CONTRIBUTION STATEMENT

All authors contributed to this article by compiling content, analyzing data, and making conclusions.

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