The Mediating Impact of Value Chain in The Link Between Corporate Governance and SOE's Performance

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Abstract

State-owned enterprises (SOEs) continue to improve their performance. One of the efforts taken by the Ministry of SOEs is to restructure the SOEs into holding companies based on clusters. The formation of each company cluster is carried out in stages. This study examines the effect of corporate governance, on the performance of SOEs with the mediating role of value chain. Corporate governance refers to the results of the corporate governance self-assessment, which is the uniqueness of the CG assessment for SOEs. Value chain analyzes all activities carried out by SOEs. Performance is measured comprehensively by combining financial and non-financial perspectives. Participants were general managers of the accounting and business process division in each state-owned enterprise. There are 138 participants.

The results showed that corporate governance directly influenced value chain and SOE's performance, value chain affected SOE's performance. Value chain mediates the effect of corporate governance on SOE's performance.

Keywords: corporate governance, value chain, SOE's performance

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1. Introduction

State-owned enterprises (SOEs) are a significant component of the economy in emerging countries. SOEs are businesses in which the government holds at least 51% of the equity. SOE, like any other business, must have sound governance in its operations. Corporate governance includes institutional shareholders, boards of directors and commissioners, performance-based management, the capital market as controlling shareholder, ownership structure, financial structure, connected investors, and product rivalry. State-owned enterprises are established to meet social needs, not to increase profit. However, when the number of stakeholders increased, some governments modified the governance system for state-owned enterprises to improve performance. (2000) (Parker et al.) State-owned enterprises in Indonesia are expected to play a role in bringing the country's economic development in line with global economic trends. Citizens profit from state-owned enterprises since they enhance infrastructure and transportation, in particular. The government controls enterprises in the oil, gas, mining, and coal industries as a significant source of revenue. SOE contributed IDR 415 trillion to the Indonesian government in 2019, which equates to IDR 23 trillion in tax revenue, IDR 50 trillion in dividends, and IDR 135 trillion in other non-tax state revenues (NTSR). SOE's earnings contribution to PNBP increased from 10% to 19% between 2010 and 2019.

In Indonesia, state-owned businesses (SOEs) continue to play a significant role, and government share ownership has not decreased, as it has in other emerging countries. As a result, there has been and continues to be collusion among power holders in the business environment of state-owned enterprises. In order to communicate information in business entities, SOE must be transparent as a firm. In response, the Indonesian government created legislation governing state-owned firms engaged in commercial and economic activity. It is connected to agency theory, in which the company's corporate governance plays a role in minimizing conflicts of interest. When the manager, as an agent, operates the company, his or her interests differ from those of the owner, conflict ensues. Because of the agency perspective, Jensen and Meckling (1976) argue that state ownership and management of government-appointed managers are distinct. When the manager, a paid agent charged with representing the owners' best interests, pursues self-interest rather than the owners' best interests, the agency encounters issues.

According to SOE Minister Regulation No, companies as SOEs are required to measure GCG implementation by conducting assessments. PER-09/ MBU/2012 dated July 6, 2012, on Amendment to SOE State Minister Regulation No. PER-01/MBU/2011 dated August 1, 2011, on the Implementation of Good Corporate Governance in SOE Article 44. Every year, the company assesses its GCG implementation to establish its level of appropriateness. An external assessor conducts a Good Corporate Governance (GCG) assessment every 2 (two) years, interspersed with self-assessments completed by the company's internal assessors every succeeding year. An external assessor conducts the assessment on behalf of a third party outside of the company.

Bai and Xue (2005) argue that state-owned enterprises would also pursue objectives other than profitability and efficiency to improve their performance. Lu (2009) argues that a good governance system at SOE does not only make the company's performance healthy, but it can make the company survive despite the economic crisis. The study results (Khongmalai, Tang, & Siengthai, 2010), who conducted SOE research in Thailand, stated that the corporate governance model shows that strategic human resources are the most strategic factor followed by information technology and risk management internal control, and internal audit in sequence. In the future, state-owned enterprises will have to face rapidly changing economic conditions, rapid technological developments, and government conditions for the next few years. Facing this change requires a change in corporate governance (Huang & Jing, 2019)

Furthermore (Adel, 2021) argues that an application of GCG is also considered to reduce the risk of corporate business failure.

According to research conducted by (Chung & Zhang, 2011) on applying corporate governance in Indonesia, the Indonesian government can see a big committed institutional investor's ownership of state-owned firms. According to Murni and Nengzih (2018), effective corporate governance is predicted to increase firm performance in Indonesian state-owned firms. (Musallam 2020) claims that the larger the shareholders, particularly the state shareholders, the better the company's performance in Indonesia. However, the size of the government's shareholders has no bearing on the investors.

The performance of a company is strongly supported by business processes consisting of two activities, namely the primary activities and supporting activities called the value chain (Porter, 1991). (Barton, 2017) stated that every employee in each division has a very significant role in implementing business processes. Good cooperation between divisions will provide added value in meeting the needs of the community so that the company is able to compete or have a competitive advantage.

Value chains can be affected by the implementation of corporate governance. *Corporate governance* is a mechanism used by companies to see the work of shareholders, directors and managers. Empirical studies on the impact of *corporate governance* on the company's value chain conducted by (Gellynck & Molnár, 2009), (Gereffi & Lee, 2014), (Kano, 2018), (Uddin, Goswami, Rahman, & Dhar, 2019) revealed that *Value Chain governance* has an impact on improving quality control, reducing opportunistic behavior of agents and improving performance. (Fischer, Gonzalez, Henchion, & Leat, 2006) stated that *good corporate governance* increases the interdependence between functions within the company and provides an additional dimension of business failure risk.

Given the relevance of SOE corporate governance in supporting state development, this study will focus on three objectives :

(1) To examine the effect of Corporate Governance on SOE's Performance
(2) To examine the effect of Value Chain on SOE's Performance
(3) To examine the effect of corporate governance on value chain towards SOE's Performance

2. Literature Review

2.1. *Agency Theory*

According to Jensen and Meckling (1976), agency theory is a contract between the manager (agent) and the owner (principal). For this contractual relationship to run smoothly, the owner will delegate decision-making authority to the manager. An agency relationship is a contract in which one or more people (employer or principal) employ another person (agent) to perform several services and delegate decision-making authority to the agent (Jensen and Meckling, 1976). The ownership of BUMN (government) shows the amount of government ownership in a company. Government ownership is more aimed at business units or agencies that affect the interests of many people or business units that serve the public at large. Government ownership is generally fully controlled by the state and only a small portion of other ownership structures. According to the Decree of the Minister of SOE in Indonesia Number Kep-117/M-MBU/2002, Corporate Governance is a process of structure used by BUMN organs to improve business success and corporate accountability to realize shareholder value in the long term while taking into account the interests of other stakeholders. Based on law, regulations, and ethical values.

2.2. *Self-Assessment Corporate Governance*

Corporate governance is a process and structure used by company organs (shareholders, board of commissioners, and board of directors) to improve business success and corporate accountability in order to realize long-term shareholder value while taking into account the interests of other stakeholders, all while adhering to laws and ethical values. Business leaders, researchers, policymakers, and others are always interested in learning more about corporate governance. From time to time, our understanding of Corporate Governance practices evolves. GCG (good corporate governance) is a framework for regulating and controlling a company to add value to all stakeholders. This concept emphasizes two points: first, the importance of shareholders' right to receive accurate and timely information, and second, the company's commitment to providing accurate, timely, and transparent disclosures of all information on company performance, ownership, and ownership stakeholders. SOEs are required to implement good corporate governance under Law No.19 of 2003 concerning BUMN and the Decree of the Minister of State-Owned Enterprises of the Republic of Indonesia Number: KEP-117IMBU/2002 concerning the Implementation of Good Corporate Governance Practices in State-Owned Enterprises.

The company seeks to optimize the application of good corporate governance principles, namely transparency, accountability, responsibility, independence, and fairness in every operational activity. The implementation of good corporate governance will strengthen trust and increase value for shareholders and stakeholders.

Figure 1. The good corporate governance principle

Transparency is shown by the company ensuring access to pertinent information in a timely and accurate manner to Shareholders and other stakeholders. This always gets the attention of the company in order to ensure the fulfillment of the rights of the Shareholders and other stakeholders. Accountability is seen as how the company has regulated the function clarity, structures, systems, and responsibilities of each of the company's organs so that all business and operational activities of the company can run effectively and efficiently and can be accounted for transparently and fairly in order to realize sustainable performance. Responsibility means when the firm is always according to the applicable laws and regulations in carrying out every business activity and its daily operations to create a healthy and conducive business climate. In addition, as part of the community, the company also always does its social responsibilities towards society and the environment. Independency can be explained by the company ensuring that responsibilities are carried out, obligations and authorities of each organ of the company always run well without any intervention from other company organs or other parties who do not adhere to the regulation and policies of the government. Fairness is where the company does not take discriminatory actions and guarantees the protection of the rights of shareholders and stakeholders following the regulation and policies of the government.

SOE is a company that must have good performance to carry out the policies issued by the government. Therefore, on the one hand, SOE must meet its performance targets; on the other hand, as a public sector company, it must provide services to the community according to the needs of the government. To achieve this goal, the Ministry of SOE, as the majority shareholder, made a self-assessment regulation in 2012. The goal is for SOE to more freely assess and integrate governance principles which are the key management processes to ensure performance achievement.

The assessment method uses a measuring instrument with six aspects and a specific weight as outlined in the above copy of the Ministry of SOE Secretary's Decision No. SK-16/S.MBU/2012 as follows:

1. Commitment aspects to the implementation of Good Corporate Governance Continuously: The first aspect assesses six indicators related to corporate governance guidelines (GCG code), and code of conduct, gratification control, and alleged corporate irregularities (whistleblowing system). The maximum score of the first aspect is 7.
2. Shareholders and GMS/Capital Owners: This aspect consists of 6 aspects related to the General Meeting Shareholders (GMSS) for the appointment or dismissal of the Board of Commissioners and the Board of Directors, ratification of the annual report, and the responsibility of shareholders in implementing corporate governance. The maximum score of the second aspect is 9.
3. Board of Commissioners/Supervisory aspects: All duties and responsibilities of the board of commissioners are regulated in 12 indicators with a maximum score is 35. The Board of Commissioners has the function of supervising the board of directors in implementing plans and policies. As a commissioner, he participated in training to improve his abilities.
4. Board of Directors: All duties and responsibilities of the board of commissioners are regulated in 13 indicators with a maximum score is 35. In addition, SOE Directors must attend ongoing training, develop work programs, implement them to achieve performance targets, maintain good relations with commissioners and stakeholders, ensure information disclosure, and hold annual GMS and others.
5. Information Disclosure and Transparency: Companies must provide information, access stakeholders, submit information on annual reports and financial reports, and participate in ARA. The maximum score is 9.
6. Other aspects: This aspect related to the company has become a benchmark for other companies in Indonesia. The maximum score is 5

These six parameters are based on corporate governance principles (transparency, accountability, responsibility, independence, fairness) adapted to Indonesian SOE. The core element of these five principles is the company's performance improvement through monitoring of management performance and management accountability to the stakeholders, according to the applicable rules and regulations.
Based on the overall score, can be made the predicate of self-assessment. A summary of the score and their predicate are presented in Figure 2.

Figure 2. Range of self-assessment score

2.3. *Value Chain*

Companies in running their business must be able to prepare goods or services of high quality and have competitive prices. This can be achieved if the company is able to analyze the cost structure and identify strategies for long-term company development. Porter (1991) states that the value chain is how companies are able to combine managing costs and monitoring effectiveness required abroad focus.

Value chain describes the linked set of value-creating functions required by companies to provide products or services to consumers. The value chain concept begins with the provision of basic raw materials from suppliers, moving them to a set of value added activities to the production and marketing department of products or services to the distribution of goods or services to end users, namely consumers. Hoque (2004) said Value chain is a method for decomposing the firms into strategically important activities and understanding their impact on cost behavior and differentitation the generic strategies.

2.4. *SOE's Performance and Balanced Scorecard measure*

The performance of SOE can be measured in a variety of ways. A balance of financial and non-financial metrics is required for effective performance management. The balanced scorecard is a model that may assess both financial and non-financial performance. When short-term and long-term goals are considered, four views emerge. Four points of view can be examined in-depth:

(1) From a financial perspective, profitability is frequently associated with financial metrics such as Return on Assets (ROA), Return on Equity (ROE), and Return on Investment (ROI). Financial performance measures organizational learning and growth, internal business processes, and customer perspective to provide a final result or bottom-line organizational improvement.
(2) This area focuses on what must be done and what is most important to accomplish the mission from the customer's perspective.
(3) Internal business processes: this perspective focuses on the activities that an organization must perform effectively to satisfy customer requirements.
(4) Learning and growth perspective: this component focuses on how an organization can improve employee performance (through training), improve, and learn to support critical operations success.

2.5. *Corporate governance, value chain and SOE's Performance*

The implementation of *corporate governance* will support the company's activities. Gereffi & Lee (2014); Knoll & Jastram (2019) revealed that *corporate governance* would be implemented successfully, if the individuals in it (directors, commissioners, shareholders and audit committees) carried out their duties well so that the firm performance will increase. Good firm performance will be achieved if it is supported by company activities which include *primary* and *supporting activities* called the *value chain* (Porter, 1991). Frederick & Gereffi's (2009) stated that corporate governance in every company's business activities can improve coordination, especially the *value chain*. Corporate governance and *value chain* are a series that can provide benefits for companies in competing.

3. Methodology

The sample includes 69 non-financial state-owned enterprises in Indonesia. Self-assessment score is secondary data from the year 2020. Value chain and firm performance uses primary data. The data was collected through questionnaires. Participants were general manager of the accounting and business process department in each SOEs.

The data were analyzed using partial least square structural equation modelling approach (PLS-SEM). This study reports the measurement model and the structural model. The measurement model reports as validity and reliability measured according to the indicator model. Because the model, the two stage approach was applied. In the first stage is to perform a confirmatory factor analysis (CFA). It reports convergent validity by value of loading factor and AVE. For discriminant validity, this study uses HTMT for the model construct (Henseler et all., 2015). Realibility reports value of composite reliability (CR) and Cronbach Alpha (CA). The second stage has just tested full model.

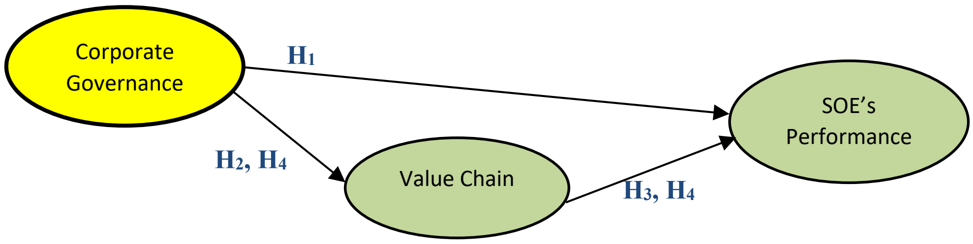

Figure 3 Research Model

H_1 : There is a significant effect corporate governance on SOE's performance
H_2 : There is a significant effect corporate governance on value chain
H_3 : There is a significant effect value chain on SOE's performance
H_4 : Value chain has a mediating role in the relationship between corporate governance and SOE's performance

4. Result and Findings

4.1. *Analysis results*

This research focuses on the mediating effects of value chain in the relationship between corporate governance and SOE's performance. Data were analyzed using structural equation modeling (SEM) and processed using Partial Least Square (PLS) to test the hypotheses. Two procedures were performed to test the hypotheses. First, we examined the direct effect of corporate governance on SOE's performance, corporate governance on value chain and value chain on SOE's performance. Second, if the direct effect was significant, we continued with a second test to prove the mediating effect of value chain in the relationship between corporate governance and SOE's performance.

Before hypothesis testing on structural equations, it was necessary to test the validity and reliability of the instrument. Table 1 shows the results of the instrument validity and reliability test.

Table 1 Validity and Reliability

Construct/Items	Loading Factor	CA	CR	AVE	Result
Value Chain		0.910	0.927	0.586	Valid & Reliable
VC1	0.947				
VC2	0.968				
SOE's Performance		0.873	0.900	0.531	Valid & Reliable
FP1	0.766				
FP2	0.813				
FP3	0.765				
FP4	0.809				

Table 1 shows that all latent variables have fulfilled the validity requirements because the loading factor of each indicators is above 0.70. Composite reliability and Cronbach's Alpha values also show that the research instruments in each variable are proven to be reliable with value above 0.5.

The direct effect test was conducted to test hypothesis 1, hypothesis 2 and hypthoses 3. The fourth hypothesis states that value chain mediates the relationship between corporate governance and SOE's performance. Statistical result results from the complete mode are presented in Table 2.

Table 2 Hypothesis Test

No	Hypothesis	Beta Coefficient	t-count (≥1,96)	P value	Remark
Direct Effect					
1	*Corporate Governance* has a significant effect on SOE's performance	0.339	3.780	0.000	Support
2	*Corporate Governance* has a significant effect on SOE's performance	0.254	3.469	0.001	Support
3	*Corporate Governance* has a significant effect on SOE's performance	0.360	2.710	0.007	Support
Indirect Effect					
4	*Value chain mediates the relationship between corporate governance and SOE's performance*	0.122	2.204	0.028	Support

4.2. *Discussion*

4.2.1. The relationship between corporate governance and SOE's performance

SOEs can be said to be non-profit organizations because the majority of their shares are owned by the Government, and they move to serve the community. But on the other hand, SOEs must generate profits for the sustainability of their business. Thus, SOEs must always pay attention to how to retain customers, which are expected to increase company revenues. The implementation of *corporate governance* plays a role in improving the company's performance.

The findings in this study support and prove the results of research by (Aboagye & Otieku, 2010), which stated that there is a positive relationship between corporate governance and company performance. Jian, Tingting, & Shengchao (2011) showed that *corporate governance* by measuring the characteristics of directors has a positive influence on company performance so that it can increase *competitive advantage*.

4.2.2. The relationship between corporate governance and value chain

Corporate governance has a significant positive effect on the value chain. The governance structure in the self-assessment has represented the rights and responsibilities of each party involved in the business, including the Board of Commissioners and the Board of Directors, Managers, Shareholders, and other relevant parties as *stakeholders*. Based on the indicators measured, it can be seen that SOEs are committed to implementing sustainable governance by having corporate governance guidelines (*GCG Code*) and a *code of conduct* which are reviewed regularly. The implementation of general meeting of shareholders (GMS) confirms that SOEs have implemented one of the indicators of *corporate governance*, which of course, will affect the course of the company's business processes. The Board of Commissioners supervises the management and provides direction if necessary. The Board of Directors as management determines the organizational structure, establishes policies and standard operating procedures (SOP), prepares work plans and budgets (WP&B) and sets performance targets. Management also prepares and submits annual reports and financial reports. These results indicate that SOEs have implemented the indicators stipulated in the Decree of the Ministry of SOEs, in which the synergy between Management, the Board of Commissioners and *stakeholders* that support business processes both from *primary activities* and *supporting activities*, is implemented. Good cooperation between the Board of Directors and the Board of Commissioners will support the company's business processes, in which the directors who represent the company's management will work in accordance with existing policies and the board of commissioners as supervisors will supervise the work to meet the targets set in the planning process. The results of the study are in line with others (Gellynck & Molnár, 2009), (Gereffi & Lee, 2014), (Uddin et al., 2019), who stated that the implementation of *corporate governance* could affect the entire *value chain*.

4.2.3. The relationship between value chain and SOE's performance

Haque stated that the company's main activities will run well if it is supported by supporting activities. The main activity starting from *inbound logistics* is the process of procuring materials, processing materials into finished products (*operations*), how the company stores the finished products until they are transferred to consumers and when the company does marketing and makes sales (*sales and marketing*). To support all main activities, it is necessary to maintain equipment in good condition, determine competent suppliers according to procurement procedures, have information technology capable of supporting all activities, and hire employees who have the appropriate expertise. This business series is able to improve the company's internal business processes. The results of the research related to the influence of the *value chain* on firm performance are in accordance with the research findings of Ferrari & Parker, 2006), which show that the application of the *value chain* is a key factor in the company's competitive advantage seen from the *balanced scorecard*. Helm & Jones (2010) Helm & Jones (2010) explained that primary activities starting from the procurement process, the manufacturing process, and storage to sales, will improve the company's performance. Cinquini & Tenucci (2010) corroborated the results of previous research stating that the successful implementation of corporate strategic management is supported by the *value chain*.

4.2.4. Value chain has a mediating role in the relationship between corporate governance and SOE's performance

SOEs regularly conduct a self-assessment every year, which is reviewed by competent external parties in the field of governance. The results of the self-assessment always have a Follow-up Recommendation (RTL) that must be considered; management should be improved if the score obtained is below average, and governance should be improved if the score obtained is above average. The average *self-assessment* score in the Very Good category indicates that SOEs have implemented good governance. Good *corporate governance* shows the synergy between the Board of Directors as management, the Board of Commissioners as supervisors and *stakeholders* in carrying out business processes. Thus, all activities in *primary* and *supporting activities* run in accordance with established procedures. The implementation of a *good value* chain will improve firm performance as indicated by the company's ability to retain customers so that it is able to maintain income which will improve company performance. In line with research conducted by (Murni & Nengzih, 2018), that corporate *value chain* can mediate *corporate governance* relationships as measured by using indicators of *transparency, accountability, responsibility, independence* and *fairness*; so as to improve the performance of Indonesian SOEs.

5. Conclusion

The findings of this study are useful for SOEs management. The follow-up recommendations from the self-assessment report must really be a concern; the RTL does not only contain deficiencies that must be corrected but also things that the company must improve. The self-assessment value shows the compliance of the company's management in implementing good governance. The integration of the board of directors, board of commissioners, shareholders and stakeholders greatly affects the value of corporate governance. Good governance can certainly improve the company's business activities.

In the midst of the rapid development of the business world, only companies that run fast can achieve performance. Performance can be achieved by fulfilling the company's activities, both from primary activities and supporting activities.

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