UNIVERSITI TEKNOLOGI MARA

THE EFFECT OF BOARD EFFECTIVENESS, GOVERNMENT OWNERSHIP, AND AUDIT RECOMMENDATIONS ON THE FINANCIAL RESILIENCE OF STATE-OWNED ENTERPRISES IN INDONESIA

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Thesis submitted in fulfilment
of the requirements for the degree of
Master of Science
(Financial Criminology)

Accounting Research Institute

April 2024

ABSTRACT

Underperforming State-Owned Enterprises (SOEs) in Indonesia have been a persistent challenge to the government, with a significant number reporting financial losses annually. It was highlighted that 33% of state-owned enterprises do not have financial resilience. Financial resilience is of the utmost significance for businesses as it allows them to endure economic challenges, adapt to new conditions, and quickly bounce back from financial difficulties. Financial resilience is crucial for business stability and attractiveness for investments. Based on the Agency and Stakeholder Theory, this study examines the impact of corporate governance (board characteristics as represent by board number and government ownership) and audit recommendations on financial resilience among Indonesian state-owned enterprises and their subsidiaries that operate in the mining and energy sectors. The mining and energy sectors were chosen because of their vital role in the economy and environment and their uncertain and high-risk nature. SOEs play a significant role in modern economies, including in Indonesia, and may be seen as a vehicle for accelerating economic growth and providing public services and values. This vital role of SOEs makes auditing SOEs an essential task for Supreme Audit Institutions (SAIs). SAIs assist in establishing whether SOEs are operating in the public interest, ensuring that the products and services provided by SOEs are efficient and effective, and ensuring that their operation is fully transparent, accountable, and compliant with laws and regulations. It is crucial to complete this stage of SOEs audit to ensure the effective implementation of the auditor's recommendations by the auditees. Governance is of significance to both the public and private sectors. Boards of directors are responsible for the oversight of managerial information. Thus, it can improve financial reporting and performance, leading to resilience. The study examined 20 SOEs for five years, 2018 – 2022. The period was chosen to reflect before, the pandemic period, and after. Data was processed using OLS by SPSS. The findings confirm that board effectiveness and audit recommendations positively and significantly influenced financial resilience. However, the hypothesis that government ownership influences financial resilience is not supported. This is is probably due to the challenges in making swift and agile decisions due to cumbersome bureaucratic processes and political agendas prioritizing short-term political objectives over long-term financial sustainability. This interference can lead to inefficiencies, misallocation of resources, and hindered adaptability to market changes, ultimately negatively impacting financial resilience. The findings contribute to the enrichment of the growing literature on monitoring mechanisms in agency theory and the role of government as owner and stakeholder, especially in SOEs operating in emerging countries such as Indonesia. The findings also found SAI activities that resulted in audit recommendations improved SOEs in the mining and energy sectors' financial resilience. This study could provide evidence to the regulators such as Ministry of SOEs and Ministry of Finance that performance audits done by Indonesia SAI are beneficial to improve SOEs financial resilience that could lead to organization resilience and sustainability. The regulators could also use the findings to develop the blueprint to create world-class Indonesia SOEs.

ACKNOWLEDGEMENT

I extend my deepest gratitude to everyone who contributed to the completion of this thesis. This work would not have been possible without the invaluable insights, support, and guidance from various individuals and organizations.

First and foremost, I would like to express my profound gratitude to my Main Supervisor, Prof. Zuraidah Binti Mohd Sanusi, and my Co-Supervisor, Prof. Jamaliah Bte Said, whose dedication to academic excellence profoundly influenced this research. The hours they dedicated to discussing concepts, reviewing drafts, and providing feedback have significantly completing this work. I am truly grateful for the freedom they granted me in exploring my research interests, alongside the insightful perspectives and constructive criticisms that have enhanced the depth and quality of this study.

I would also like to express my sincere appreciation to my advisor, Dr. Purwatiningsih Lisdiono, whose expertise, understanding, and patience added considerably to my research experience. Her willingness to give time and effort to guide my work has been a source of inspiration and motivation. Her constructive criticism, patience, and unwavering belief in my abilities have been instrumental in my growth as a researcher and as a person.

Special thanks go to my colleagues at Badan Pemeriksa Keuangan Republik Indonesia for stimulating discussions and the supportive environment they fostered. Their perspectives and critiques were helpful in refining my thesis.

On a personal note, I am forever indebted to my family for their understanding, patience, and unconditional love. My family has been my constant source of encouragement and support during both the highs and lows of this academic endeavor.

This thesis represents not just an academic achievement but a profound personal journey. I am grateful for the guidance, support, and encouragement I have received from everyone who has been part of this process. Thank you.

TABLE OF CONTENTS

CHAPTER ONE
INTRODUCTION

1.1 Background of The Study

Over the past few years, there have been regular unanticipated and highly impactful occurrences, such as the global spread of COVID-19 from 2020 to 2022. These incidents have caused significant disruptions to global economic operations. The growing uncertainty of the business landscape has heightened the significance of organizational resilience in times of crisis, making it a crucial subject in business management practice (Wang et al., 2023).

Like all other categories of organizations, enterprises (including state-owned enterprises) face rapid, frequently disruptive changes and profound unpredictability. Many organizations prioritize resilience in response to various challenges, such as natural disasters, political unrest, financial instability, technological advancements and disruptions, and a dynamic international business landscape (Ishak and Williams, 2018). In these circumstances, nations worldwide are endeavoring to revive their economies and devise remedies for a pandemic that appears far from its conclusion. Public management, especially the management of state-owned firms, is crucial in guaranteeing economic stability and recovery in many countries (Pleșa et al., 2022).

From the above explanation, it is said that organizations are doomed to obsolescence unless they undergo adaptation or adjustment in their lifecycle. Adverse events have substantial consequences and can potentially exacerbate if not addressed expeditiously (Pettit et al., 2013). For organizations to prosper amidst difficult circumstances, they must fortify their resilience (Heredia et al., 2022). Many scholarly investigations have examined the importance of organizational resilience and adaptability in sudden transformations and disruption (Baharin et al., 2021; Huang and Farboudi Jahromi, 2021). The adversities and uncertainties have heightened organizations' need for agility, foresight, and organizational resilience attributes. Resilience can be defined as the ability to anticipate and absorb threats or shocks – i.e., large-scale adverse events – and recover from them. This definition entails internal resilience, or the ability to perform work as planned when faced with disruption, and external resilience, the ability to remain relevant during crises by addressing and