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# Board Structure in State-Owned Enterprises (SOEs): Two-tier Model Analysis on the Implementation of Corporate Governance in Indonesia

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**Abstract.** The discussion on corporate governance is focused on the duties of the board of commissioners (BOC). This is important, especially for countries that use the two-tier board model, such as Indonesia. This qualitative study aims to analyze the fulfillment of the number and composition of commissioners as well as the process of appointment and dismissal of commissioners in state-owned enterprises (BUMN) listed on the Indonesia Stock Exchange. The results showed that BUMN had fulfilled the number and composition of commissioners. In addition, the existence of an audit committee and board of commissioner meetings is a component that plays an important role in assisting the commissioners in carrying out their supervisory functions. In the end, the process of succession of commissioners becomes an important part that affects the fulfillment of the number and composition.

**Keywords:** corporate governance, board structure, board supervisory/board of commissioners, state-owned enterprises, board size, board independent

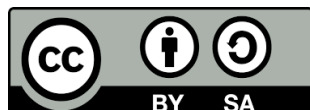
## INTRODUCTION

Law Number 19 year 2003 divides SOEs in Indonesia into three categories, namely Public Company (Perusahaan Umum), Persero Company (Perusahaan Perseroan), and Public Persero Company (Persero Terbuka). At the end of 2021, there were 95 SOEs, in which 14 companies were Public Persero, 69 companies were Persero, and 12 companies were Public-Benefit Corporation/Public Company (the Central Statistics Agency Republic Indonesia, 2022). From the data, it can be interpreted that only about 14.74% of SOEs in Indonesia have the status of a Public Persero Company. Examined further, this condition becomes a challenge for the Ministry of SOEs to encourage more SOEs in the form of Public Persero Company. This is important because companies must meet the information disclosure requirement to stakeholders by being registered on the capital market. In addition, there are other aspects related to the existence of public companies listed on the capital market. Apart from raising capital, other important matters relate to better and more transparent governance, increasing corporate value, and public supervision that can impact management. This also aligns with Geddes (2003), who states that there are

five benefits for companies conducting public offerings in the capital market: (1) it can increase the value of the company; (2) it can build stable ownership and broadly; (3) it can improve the companies image; (4) the companies have the opportunity to get better funding in the future, and (5) they get convenience in maintaining liquidity mainly in the secondary market.

In addition to the above conditions, SOEs in almost all countries also face problems in terms of corporate governance. Wong (2004) has identified three problems in implementing corporate governance (CG) in SOEs: lack of transparency, excessive political interference, and multiple and conflicting objectives. Vagliasindi (2008) also identified multiple principal problems in the management of SOEs, which resulted in the difficulty of SOEs in clearly defining their goals. In line with the opinion of Wong (2004) and Vagliasindi (2008), Dragomir, Dumitru, and Feleaga (2021) state that failure to implement CG in SOEs is caused by political intervention, the emergence of conflicts of interest, agency relationships, and lack of trust between interested parties.

SOEs in Indonesia also face problems related to the implementation of CG. Wicaksono (2008) identified political intervention in the management of SOEs in Indonesia. Meanwhile, Kamal (2011) revealed that the



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problem of SOEs governance stems from problems related to conflicting goals, political interference, lack of transparency, and the unprofessionalism of the board of commissioners (BOC). Apriliyanti and Randøy (2019) revealed that the decision-making process in the board meeting rooms of most SOEs in Indonesia is influenced by the government and politicians.

In the implementation of CG, one of the important elements is the governance structure. The effectiveness of the governance structure as part of a comprehensive CG system is largely determined by the factors of people, selection, and motive (Lukviarman, 2016).

Regarding the governance structure, previous research has focused on the discussion on the fulfillment of corporate organs that carry out supervisory and advisory functions using the terminology of the board structure done by Garcia-Ramos and Diaz (2021); Tabassum and Singh (2020); Lahlou (2018); Jameson, Prevost, and Puthenpurackal (2014); Chen (2014); Monem (2013), Adams and Mehran (2012); Linck, Netter, and Yang (2008); Boone, et al. (2007), Coles, Daniel, and Naveen (2007), Raheja (2005), and Baker and Gompers (2003). In this case, the board structure can be used as an important indicator of corporate governance (Baker and Gompers, 2003).

Therefore, this paper aims to analyze the board structure of SOEs (BUMN) in Indonesia. The discussion is focused on two aspects. The first is the fulfillment of commissioners in terms of size, composition, and supervisory function. The second is the process of appointing and dismissing SOEs commissioners. The uniqueness of the discussion lies in the two-tier board structure model applied in Indonesia. The model basically establishes a separation between the executive (management) board and the supervisory board. This is certainly in line with the position and function of the two organs of the company, as stated in Law No. 19 of 2003 and Law No. 40 of 2007. However, unlike other countries that adhere to this system, in Indonesia, the two organs have an equal position with different functions. Therefore, structurally the board of directors (BOD) is not under the BOC, so that is not authorized to dismiss the BOD; it only temporarily suspends from office (Lukviarman, 2016).

The discussion on CG cannot be separated from agency problems. Jensen and Meckling (1976) stated that the agency problem arose after the separation between ownership and control. Eisenhardt (1989) revealed that agency theory is basically a response to problems in agency relationships involving principals and agents. Meanwhile, Crutchley and Hansen (1989) revealed that agency theory emerged as a result of conflicts of interest between corporate managers, outside stockholders, and bondholders.

The various conditions above arise as a result of information asymmetry, where information is centered on company managers. Shleifer and Vishny (1997) focused on the separation between management and finance to suppress or reduce agency problems. In the

end, corporate governance can be used as a control mechanism for how companies must be managed and controlled to achieve company goals (Lukviarman, 2004).

In general, there are two models in the implementation of the governance system in a country. Anglo-Saxon countries that adhere to the common law tradition use a single-tier board or single board system or unitary boards. Tricker (2014) uses the term "a single governing body" to describe this system. On the other hand, continental European countries use the dual board system. In this model, Banks (2004) divides it into the supervisory board and the management board (Banks, 2004) or the supervisory board and the executive board (Weimer and Pape, 1998; Huse, 2007; Prasetyantoko, 2008; Tricker, 2020). They also have the task of monitoring the performance of the management board (Weimer and Pape, 1998). In addition, they also represent shareholders and are tasked with appointing, supervising, providing advice to the management board, and developing corporate strategy (Banks, 2004).

As already explained, previous studies used the term board structure to describe the compliance of company instruments that carry out the supervisory function and provide advice to management. Previous studies have generally used two proxies to describe the board structure, namely board size and board composition or board independence, such as Chen (2014); Adams and Mehran (2012); Boone, et al. (2007); Coles, Daniel, and Naveen (2007); Raheja (2005); Baker and Gompers (2003). Meanwhile, other researchers such as Monem (2013) and Linck, Netter, and Yang (2008) use three proxies in the form of board size, board independence, and board size.

In addition to board size and board composition/board independence, other factors that need to be considered in the supervisory and advisory duties carried out by the BOD are the implementation of board meetings and support from committees under the coordination of the board (Brick and Chidambaran, 2010). Board meetings are an important mechanism for carrying out board duties (Vafeas, 1999; Brick and Chidambaran, 2010).

The commissioner or supervisory board is also assisted by several committees as part of an important development in CG (Tricker, 2014). The existence of this committee ultimately becomes important, considering that most of the work of the BOD or supervisory board is carried out through the committee (Adams, Hermalin, and Weisbach, 2010). The existence of a committee is also important as an aspect of internal governance (Banks, 2004). This committee ultimately carries out very specific functions or responsibilities in the form of remuneration, nomination, and audit committee (Tricker, 2014). Klein (1998) divided this committee into five the form audit, compensation, nominating, investment, and finance committee. In the end, Klein (1998) placed importance of the role of the audit and the remuneration committee in monitoring independently. This is also reinforced by several

follow-up studies which ultimately show the importance of the audit committee (Klein, 2002; Adams, Hermalin, and Weisbach, 2010).

**RESEARCH METHOD**

This study employed a qualitative method. Qualitative research is an approach to exploring and understanding the meaning individual or group ascribes to social or human problems (Creswell, 2014, p.4). This selection is based on the view that the study was conducted to describe the two-tier model in the implementation of corporate governance in Indonesia. Data collection was carried out in two stages.

In the initial stage, this research used quantitative data collection instruments with descriptive analysis. The sample in the study included 16 SOEs listed on the Indonesia Stock Exchange in accordance with the data released by the Central Statistics Agency. The data processed and analyzed was obtained from the 2015-2020 annual report and reported on the implementation of CG.

Furthermore, this study used the qualitative method in the stage of data collection. This was done to triangulate the results of processing and analyzing the quantitative data. Data collection was carried out through document studies from various regulations and provisions from the government, ministry of state-owned enterprises, and financial services authorities; news published in the mass media; and interviews with several informants, including one expert on Indonesian SOEs, two academics, two commissioners of BUMN subsidiaries, and one former president commissioner of an SOE.

**RESULT AND DISCUSSION**

**Overview of the Governance Structure in SOEs**

As explained in the previous section, the governance structure is basically related to important structures or organs in a company. The Table 1 is a descriptive statistic on the governance structure of public SOEs for the 2015-2020 period.

In relation to the data presented in Table 1, there are several important points that serve as benchmarks

for compliance with the governance structure of SOEs in Indonesia with the status of a public company that has conducted an initial public offering in the capital market.

The first is BOC size. The average number of commissioners is 6.32 people or six people, with the most being ten people and the minimum being three people. This number has met the requirements in Law no. 40 of 2007, where every publicly listed company must have at least one commissioner or POJK (Financial Services Authority Regulation), and no 33/POJK.04/2014, where every public company in Indonesia is required to have at least two commissioners.

The second is the number of independent commissioners. The average number of independent commissioners is 2.78 people or three people, with the highest number being six people and the minimum being one person. This number has met the requirements in Law no. 40 of 2007 and POJK no 33/POJK.04/2014, where each public company is required to have at least one independent commissioner with a composition of 30 percent of the total commissioners. Viewed from the composition, the average is 42.65%. 42.65% of commissioners in public state-owned enterprises have the status of independent commissioners. Hermalin and Weisbach (2003) and Adams and Mehran (2012) positioned the importance of the role of independent commissioners in supervising the actions taken by directors or management.

The third is the number of audit committees. The average number of audit committees is 4.19 people or four people, with the most being eight people and the minimum being two people. This audit committee has an important role in supervising the company's financial statements (Klein, 2002). Furthermore, Klein (2002) stated that the audit committee also plays a role in reviewing the company's financial statements and the audit process and exercising control over the company's accounting system so that, in the end, it requires regular meetings with external auditors and company financial managers. In line with the opinion of Klein (2002), Monolescu, Geta Roman, and Mihaela Mocanu (2011) position the important

Table 1. Descriptive Statistics: Governance Structure of Public SOEs

	<b>BOC size</b>	<b>IndepBOC size</b>	<b>AuditComm size</b>	<b>BOC meetfreq</b>
<b>Mean</b>	6.32	2.78	4.19	19.46
<b>Mode</b>	6	2	4	12
<b>Minimum</b>	3	1	2	4
<b>Maximum</b>	10	6	8	57
<i>BOC_size</i>	: number of commissioners			
<i>IndepBOC_size</i>	: number of independent commissioners			
<i>AuditComm_size</i>	: number of meetings held by commissioners in one year			
<i>BOC_meetfreq</i>	: number of meetings held by commissioners in one year			

role of the audit committee in supervising financial statements, financial audit activities, internal control, internal audit, and risk management. This condition ultimately places the importance of an audit committee primarily related to its composition (Klein, 2002).

The fourth is the frequency of commissioner meetings in one year. The average number of meetings is 19.46 times or 19 times a year, with the minimum number of meetings being 57 times a year and at least four times a year. Although specifically the number of commissioners' meetings is not regulated in Law 40 of 2007 or Law 19 of 2003, it is important to do this as part of a mechanism that can be carried out by commissioners to perform their duties in supervising and providing advice to directors. In the view of Brick and Chidambaran (2010), the BOC meeting is a form of monitoring that will affect the improvement of the company's operational performance. This certainly confirms the argument that positions the frequency of board meetings as one of the important dimensions in evaluating the implementation of the company's operational activities (Vafeas, 1999). This is also in line with the argument of one of the informants, who said that: "the joint meeting can be used to supervise the performance of the directors and as a medium to solve the company's operational problems to improve the company's performance."

In the context of the relationship between directors and commissioners, Indonesia, which adheres to dual board systems or two-tier boards, places a clear separation between the executive function (board of management or directors) and supervisory function (board of supervisors or commissioner) as seen in Figure 1.

Regarding the figure, Husnan (2001) said that the BOD has the main function of running the company and making strategic and operational decisions, while the BOC represents the owner in supervising the performance of the BOD. In practice, one of the informants said that: "the commissioners can evaluate the performance of the directors, which is submitted to the shareholders." Another informant mentioned that: "The commissioners can also evaluate the performance achievements of the directors, which are

then submitted through the shareholder meeting mechanism. This is done because commissioners are appointed by the government through the ministry of SOEs so that they will act on behalf of the government in supervising the company's functions".

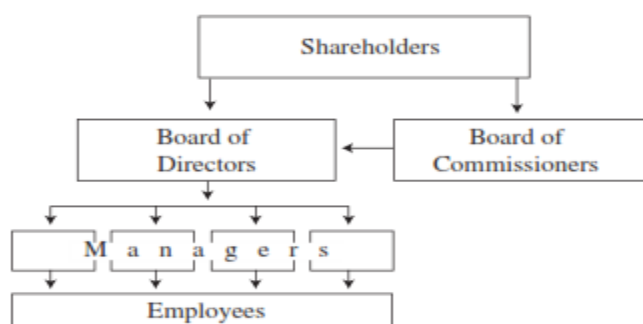
This evaluation is ultimately a consideration for retaining or even dismissing the BOD. In this context, another informant expressed that: "The commissioner may propose the dismissal of the directors to the Minister of BUMN who has the right to dismiss the directors. It is conducted when the BOD is deemed to have committed fraud or default, and the performance of SOEs has not been achieved. Although eventually, it often cannot be done because the bargaining position is unlike. One of them relates to the assumption that it is the directors who provide salaries to the commissioners. Thus, the commissioners do not use their authority".

### Mechanism of appointment and dismissal of director and commissioners

In the context of SOEs in Indonesia, the mechanism for the appointment and dismissal of directors and commissioners is regulated in the provisions of Law No. 19 of 2003 and regulations of the Ministry of SOEs (PER-11/MBU/07/2021 as an improvement from PER-03/MBU/02/2015 for the provisions of directors and PER-10/MBU/10/2020 as an improvement from PER-02/MBU/02/2015 for commissioners). The provisions in the two regulations are used as the basis for selecting reliable, accountable, and free directors, commissioners, and supervisory boards that are free from intervention by parties. In addition, Kamal (2010) argues that the dominance of state ownership in SOEs can lead to situations where bureaucrats/politicians occupy important positions in the SOE organs, primarily as commissioners or supervisory boards. In our view, there are several interesting things from the implementation of the two regulations.

First, in the process of selecting directors, the Ministry of SOEs has a talent management system, one of which is related to the talent pool as a forum containing potential directors who have met the

Figure 1: Organizational structure of a publicly listed company in Indonesia



qualifications and assessments carried out by professional institutions. This is a good effort in preparing for every succession of leadership of the directors in SOEs. Unfortunately, this has not been established for the election of commissioners or supervisory boards. One of our informants mentioned that: "this talent pool system should also exist for the election of commissioners and supervisory boards as an effort by the Ministry of SOEs to get candidates for commissioners who are capable, professional, and dedicated."

The second is talent sources for candidates of directors, commissioners, and supervisory boards. The sources of talent in the selection of directors and commissioners/supervisory boards basically consist of two sources, namely internal sources from the Ministry of SOEs as well as from SOEs and external sources. For directors, the candidates can come from talents of the SOE ministry consisting of echelon I, echelon II, and echelon III officials as well as functional officials at least equivalent to echelon III, SOE talents consisting of SOE directors, officials one level below the BOD, and Directors in the subsidiary. SOE companies/SOE joint ventures that contribute significantly and/or have strategic value to SOEs, as well as external talents. Meanwhile, for commissioners, candidates can come from former directors of SOEs, the BOC of SOEs, structural and functional government officials, and other sources. The interesting thing, of course, relates to external talent sources, which are professionals who come from the private sector. The concern is related to the selection of commissioners and supervisory boards because of the inclusion of elements of Structural Officials and Government Functional Officers. One of the interviewees stated: "that this condition, in the end, opened up opportunities for concurrent positions to be held by government officials. This will of course have for them in carrying out their duties in supervising the BOD".

The third is the dismissal of the BOD, commissioners, or supervisory board. This relates to sudden termination or termination at any time that can be carried out by the ministry of state-owned enterprises as an extension of the government, although they can also be dismissed based on a Ministerial Decree by stating the reasons. Another interesting issue is related to the magnitude of the power of the Minister of SOEs who can dismiss directors, commissioners, and supervisory boards at any time. One of the informants said: "Often the dismissal of commissioners was not based on performance considerations. This is, of course a major concern related to the succession of candidates for commissioners".

## CONCLUSION

The fulfillment of the number and the composition of independent commissioners is important in the implementation of corporate governance. The existence of an independent commissioner provides an opportunity for the creation of supervision in the company's operations or strategy, one of which is

reflected in the existence of the audit committee as one of the committees under the coordination of the BOC. The BOC meeting can serve as a mechanism for creating supervision for management. In the end, the board structure with an emphasis on the number of commissioners and the composition is strongly influenced by the appointment and dismissal of commissioners. In this case, the succession of commissioners becomes an important part that will affect the fulfillment of the number of commissioners and their composition.

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