

# **CHAPTER I**

## **INTRODUCTION**

### **1.1 General Description of Research Object**

#### **1.1.1 PT. Krakatau Steel Profile**

PT. Krakatau Steel (Persero) Tbk is an State-Owned Enterprises which is engaged in the largest steel production in Indonesia to be awarded the ISO 9001 and ISO 14001. Apart from producing integrated steel, which produces Sponge Iron, Slab, Billets, Hot Rolled Coil, Cold Rolled Coil and Wire Ros, the Company also provide services such as designing, machine maintenance, engineering and construction, and technical consultancy, as well as trading activities such as sales, distribution and agency work, both domestic and international markets. Currently, PT. Krakatau Steel produces CRC and Wire Rods, and HRC of 3.15 million tonnes per year including producing Spiral Pipes, Reinforcing Bars, Electrical Resistance Welding Pipes, and Section Steel. Producing such specialized steel, the Company is able to strengthen its position as one of the nation's strategic industries.

#### **1.1.2 Company History**

PT. Krakatau Steel (Persero) Tbk was established in 1970 under the name of PT Krakatau Steel as the continuation of Trikora Iron Steel Project by President Soekarno. In 1973, the Company began to produce spiral pipes with the specifications of ASTM A252 and AWWA C200. In less than ten years, the Company has added production facilities, such as the Wire Rod Plant, Steel Billet Plant, Sponge Iron Plant, as well as electricity power and a water treatment plant, a telecommunication system, and the Port of Cigading, these as infrastructure facilities. Since 1977, the Company has had the APL 5L Certification, and BCI Certification since 2009.

In addition, since 1991, the Company also has obtained JIS Marketing Approval for HRC products, and for CRC and WR products since 1993. In 2011, the Company applied the Indonesian Product National Standards for HRC through

Obligatory SNI, meanwhile for CRC product is in 2012, which has updated in 2018 for JIS and in 2015 for SNI. The ISO 9001 Certificate which was obtained in 1973 has been updated into the 2015 Version in 2017 by Sucrofindo. In 1997, SGS International awarded the Company with ISO 14001 of the commitment of the Company to OHS aspect and the Environment, which was then updated in 2017 into 2015 Version by Sucrofindo as well. In the defense field through the implementation of PERKAP 24/2007, in 2012, the Company has obtained the SMP (Defense Management System) Certificate issued by the Police Chief of Republic of Indonesia.

### **1.1.3 Vision and Mission**

Vision:

“An integrated steel company with competitive edges to grow continuously toward a leading global enterprise”.

Mission:

“Providing best quality steel products and related services for the prosperity of the nation”.

1. As a National Steel Company, the company tasked with the objective to contribute in increasing the prosperity of Indonesians;
2. To achieve this goal, the Company is committed to produce steel products and other steel-related services with a level of quality to be proud of.

## **1.2 Research Background**

The first concept of Good Corporate Governance (GCG) known in the early 1990s. The concept found by a series of company failures. It can be seen from the Maxwell Group capture the pension fund of the Mirror Group of newspapers and witnessed the failure of Barings Bank. The other failures of a company come from Enron in the US., which has a spectacular collapse, the bankruptcy of Vivendi Universal in France, the scandal at Parmalat in Italy, the trading fraud of *Societe Generale* and Madoff multi-billion dollars Ponzi scheme (International Finance Corporation (IFC), 2014).

In Indonesia, according to Budiati on the article conducted by Hamdani, the concepts of GCG comes from the economic conditions in Indonesia in 1997 that is experiencing a prolonged crisis which is judged due to the absence of responsibility of company management, as well as ignoring the regulations and practices of corruption, collusion, and nepotism (Hamdani, 2016). Those economic crises impact the amount of the company that is not capable of surviving since the poor management. Realized this, on 1 August 2002, the government started implementing GCG principles as an operational foundation. In the same year, Bursa Efek Jakarta that Bursa Efek Indonesia currently knows (BEI), issues regulations for companies listed on the IDX that require companies to have Independent Commissioner and Audit Committee. Afterward, GCG was introduced to all companies in Indonesia. In November 2004, the Indonesian government renews the premier institutions, Komite Nasional Kebijakan Corporate Governance (KNKCG) in 1999 changed to be Komite Nasional Kebijakan Governance (KNKG) based on the decision of the Minister of Economy in Economic Sector Number: KEP/49/M.ELON/11/2004. Besides that, a lot of organizations and institutions that formed to support the GCG implementation, including the Forum for Corporate Governance in Indonesia (FCGI), the Indonesian Institute for Corporate Directorship (IICD), the Indonesian Institute for Corporate Governance (IICG), the Indonesian Corporate Secretary Association (ICSA), the Ikatan Komite Audit Indonesia (IKAI), the Asosiasi Auditor Internal (AAI), the Klinik GCG Kadin, and the Lembaga Komisararis dan Direksi Indonesia (LKDI).

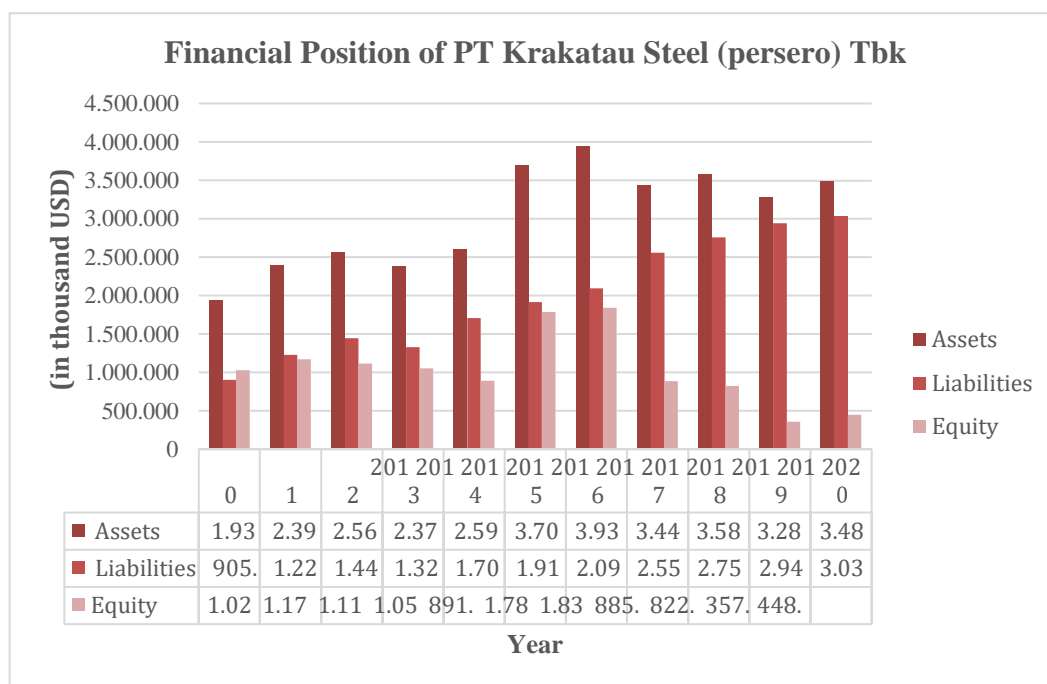
In implementing the concept of GCG in Indonesia, there are GCG general guidelines set by Komite Nasional Kebijakan Governance (KNKG) with five principles to provide maximum benefits to shareholders. Those principles, such as Transparency, refer to the information disclosure in conveying information regarding the company. Accountability explains related to the system, structure, function, and company's responsibility in order to achieve the corporate government implementation effectively. Responsibility is related to compliance and conformity in company management with applicable laws. Independency is a principle that refers to professionally managing the company without any management influence that is not under applicable law, and Fairness refers to the

fair treatment of stakeholders based on applicable regulations. These five principles are also applied in SOE companies as a GCG implementation foundation to build corporate sustainability and capable of building a company internal control system which means a company's responsibility to the stakeholders with management actions to benefit the company through GCG. A Good Corporate Governance ensures to treated all stakeholders equally, give protection for the shareholders, and ensure to manage resource efficiently and effectively.

The role of state-owned companies (SOE) itself is expected to improve the Indonesian economy's quality since the majority of ownership of shares by the government. There is still a multi-level conflict of interest in SOE, which indicates that GCG is not running well. One of the issues is corruption, which often varies from bribery cases to fictitious budgets to project gratuities. A recorded case of bribery occurred in SOE company, namely PT. Krakatau Steel (persero) Tbk, in 2019, which caused a decline in share prices. The decline in share prices indicates that shareholders lack the confidence to invest. This case is related to how PT. Krakatau Steel (persero) Tbk implements the GCG practices on the company. PT. Krakatau Steel (persero) Tbk has implemented several programs to support GCG implementation, such as Whistleblowing System and Gratification Management & Control. Nevertheless, refers to the case of bribery for the procurement of goods and services conducted by individuals at the company that the implementation of the Whistleblowing system to eradicate corruption, collusion, nepotism has not yet been implemented well, as well as not yet fully implemented GCG principles. Refers to the corruption cases, the author chose PT. Krakatau Steel (persero) Tbk as a research sample among the 14 SOE companies. There are three go-public companies in the manufacturing industry listed in IDX; only P.T. Krakatau Steel (persero) Tbk has a bribery issue. The author chose a bribery issue because KKN (Corruption, Collusion, Nepotism) cases are the cases that often occur in SOEs. Even though the Ministry Regulation Number Per-01/MBU/2011 concerning the implementation of Good Corporate Governance in SOEs, but in practice, these regulations have not been fully implemented. Therefore, the author is interested in conducting this research based on a case study at PT. Krakatau Steel (persero) Tbk.

The design of this research has differences in the development of indicators of the Good Corporate Governance research model, such as institutional ownership, audit committee, independent commissioner, and managerial ownership were related to the bribery cases of PT. Krakatau Steel (persero) Tbk. Managerial ownership means that the manager has the rights to share ownership in a company to improve the manager's performance. Alongside the manager's role, the institutional ownership as the external ownership agency has a role in monitoring the manager's performance to prevent an opportunistic action that can damage the company. The amounts of shares in the company can improve the financial performance that managers manage. The existence of an independent commissioner and audit committee in a company can also improve management performance. The independent commissioner act as an internal control to maintain the company's performance. Meanwhile, the audit committee has a role in maintaining the financial performance of a company.

All the activities of GCG conducted by PT. Krakatau Steel (persero) Tbk reflected in the financial performance measuring instrument that shows the level of bad and good company. These, namely financial statements, shows the company's financial performance each year. As shown in Figure 1.1 financial position of PT. Krakatau Steel (persero) Tbk, calculated by total assets, total equity, dan total liabilities from 2010 to 2020, shows that the level of capital has decreased. Meanwhile, PT. Krakatau Steel (persero) Tbk's level of income and profit, which shows in Figure 1.2, shows a fluctuating chart measured by Return on Asset (ROA) and Return on Equity (ROE).



**Figure 1. 1 Financial Position of PT Krakatau Steel (persero) Tbk**  
 Source: PT Krakatau Steel Annual Report year 2010-2020, Data Processed (2021)

Figure 1.1 shows the financial position of PT. Krakatau Steel (persero) Tbk from 2010-2020. The value of assets experienced fluctuations in 2010 has 1,935,004 USD and 2,398,079 USD in 2011, which means it is increasing until in 2012 that has 2,561,947 USD, but decreasing in 2013 has 2,379,504 USD. It was caused by the fact that wages for labor increased by 48% during 2013. Then, it experiences increase from 2014 to 2016 with the value in 2014 is 2,598,423 USD, in 2015 is 3,702,144 USD, and in 2016 is 3,936,713 USD. The increase occurred due to the global steel prices (Hot Roll Steel, CFR East Asia) increasing significantly from USD2715 per ton to reach USD528 per ton by 2016. This increase in steel prices was influenced by several positive factors, such as the planned cuts in steel production capacity and an increase in infrastructure development in China, which boosted steel demand. However, in 2017, it experienced a decrease of 3,441,670 USD. It was caused by a decline in the number of sales of hot rolled steel and reinforcing steel. This drop in the sales quantity was due to unfair trade and HSM plant problems.

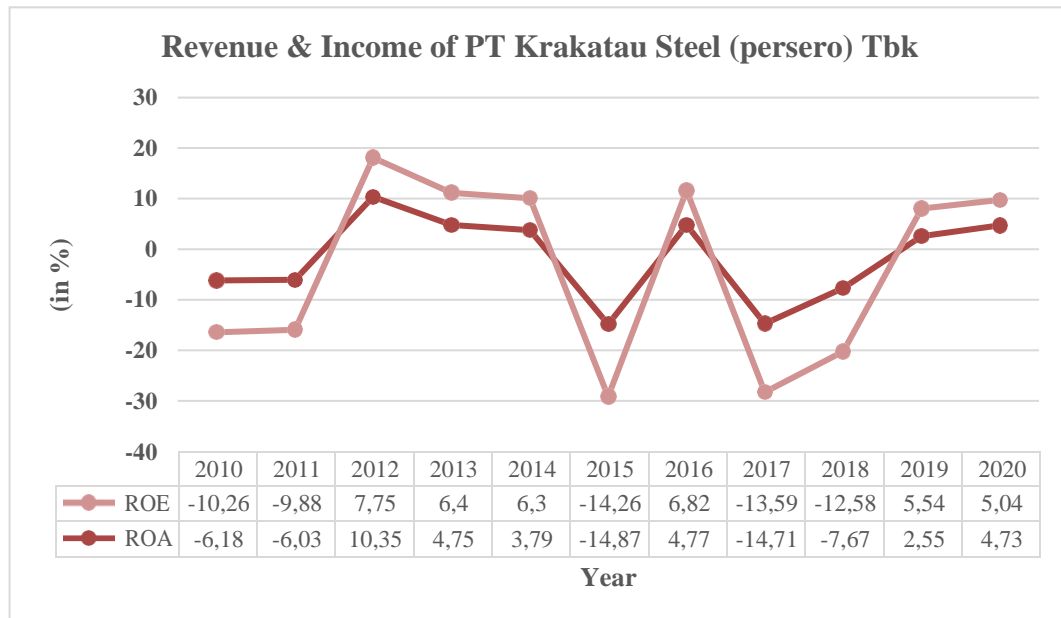
In 2018, the conditions of assets were better, which is increased by 3,582,502. This condition was due to the company achieved the highest production and sales.

At the same time, the company also succeeded in reducing lead times and shortening the cash conversion cycle from 99 days to 64 days in the same period, and generating working capital worth USD100 million from trade receivables that are past due and liquidation of finished goods inventory. Moreover, the company was also able to reduce operating expenses in 2018 significantly. The assets decline again in 2019 by 3,288,037 USD that occurred by the dynamics of the global economy, especially the adverse impact arising from the trade war between the U.S. and China. It has become one of the factors hampering the flow of global trade so far this year, and the fluctuations in the world steel market and raw materials prices.

In 2020 has increased by 3,486,349 USD, caused by the company's success in optimizing aging inventories by accelerating sales of more than six months old. Meanwhile, value of liabilities rising slowly from 2010 to 2012 with the value in 2010 is 1,935,004 USD, in 2011 by 2,398,078 USD, and in 2012 by 1,445,961 USD. This condition was occurred by the post of debt L/C and working capital loans used to finance the purchase of raw materials and semi-finished. The increase in accounts payable was related to the procurement of raw materials and semi-finished products still in transit. Meanwhile, it decreased in 2013 by 1,327,451 USD. The long-term liabilities decreased by 5.1%, all items in this group decreased except for long-term employee benefit liabilities and bank loans.

From 2014 to 2020 was rose slightly by 1,706,555 USD in 2014, 1,914,040 USD in 2015, 2,097,036 USD in 2016, 2,555,757 USD in 2017, 2,758,419 USD in 2018, 2,940,797 USD in 2019, and 3,037,636 USD in 2020. The increase of the liabilities occurred due to an increase in long-term employee benefits liabilities, the income paid in advance, and non-current liabilities due to an increase in long-term bank debt caused by financial restructuring. A portion of short-term debt shifted to long-term debt. Meanwhile, the value of equity is increased from 2010 by 1,029,775 USD to 2011 by 1,170,596 USD that was occurred by land development contract implementation with PT. Krakatau Posco with valued at Rp 30,331.8 million by reporting a net profit of Rp 5,812 million. From 2012 to 2014 was declined by 1,115,986 USD in 2012, 1,052,053 USD in 2013, and 891,868 USD in 2014. The Blast Furnace plant caused it, and the Combined Cycle Power plant finished in 2015.

Roses from 2015 by 1,788,104 USD to 2016 by 1,839,677 USD that occurred by the company's option is by offering its shares through a State Capital Investment (PMN) and a rights issue in November 2016, these have increased equity. Meanwhile, from 2017 to 2019, the value for each year has decreased: 885,913 USD, 822,769 USD, and 357,240 that occurred due to the increasingly sluggish conditions in the domestic, Asian, and regional steel markets, which marked by the lack of trading activity. Nevertheless, it is a slight increase in 2020 by 448,723 USD due to the increase in the value of land assets, which is the value of land assets recorded in other comprehensive income, which directly adds to the value of the company's equity.



**Figure 1. 2 Revenue and Income of PT Krakatau Steel (persero) Tbk**

Source: PT Krakatau Steel Annual Report year 2017-2019, Data Processed (2021)

PT. Krakatau Steel (persero) Tbk's revenue and income. Both Return on Assets (ROA) and Return on Equity (ROE) are fluctuations in each year from 2010 to 2020. The value of Return on Assets (ROA) from 2010 to 2011 has lost by -6.18% in 2010 and -6.03% in 2011. Same conditions in Return on Equity (ROE) have -10.26% in 2010, and -9.88% in 2011. These are occurred due to the external and internal causes, steel import from China as an external cause of the company suffer a loss, from the internal causes, some of the unit production stops operate, and some of the investment is not on target.



Meanwhile, the next three years from 2012 to 2014 have a profit. Although it is decreasing in each year which is in 2012 has a value of ROA is 10.35%. 4.75% in 2013, and 3.79% in 2014, and the value of ROE in 2012, is 7.75%, in 2013 is 6.4%, and in 2014 is 6.3%. This decrease occurred due to the increase in depreciation expenses and the addition of fixed assets and professionals service costs of experts to support the company's restricting program and the provision of impairment losses of receivables. Meanwhile, in 2015 experienced a loss of -14.87% in ROA and -14.26% in ROE caused by the company has debts to several creditors. In 2016 the company experienced a profit which is 4.77% in ROA and 6.82% in ROE. From 2017 to 2018, the company experienced a loss. The value of ROA is -14.71% in 2017 and -7.67% in 2018. The value of ROE in 2017 is -13.59%, and -12.58% in 2018 occurred due to the investment that is not on target. From 2019 to 2020, the company experienced a profit and increases from 2019 by the value of ROA of 2.55% to 2020 by 4.73%. The value of ROE in 2019 is 5.54% and 5.04% in 2020; these are caused by efficiency initiatives that can reduce operational costs; this decrease occurred in energy costs and utility costs.

Financial performance is a description that consists of company achievements during one year, as seen in the financial statement. The financial performance also can predict the profit of the future investments, which will generate the income of people. The indicators that are used in this research to assess company performance are measured by financial ratio. The financial ratio used in this research is Return on Asset (ROA) and Return on Equity (ROE). Return on Asset (ROA) represents the profitability ratios calculated by net income and total assets. The higher the value of Return on Asset, the better the financial performance of a company. A company is at a loss if the value of Return on Asset has decreased; therefore, it can affect its growth.

Meanwhile, Return on Equity (ROE) represents the profitability to measure the company's ability to generate profits and gain the shareholders' investment in a company. Return on Equity (ROE) is the ratio between net income and total equity. The greater the ratio value, the greater the net profit from own capital. The writer chose two variables for financial performance: Return on Assets (ROA) and Return on Equity (ROE) because both ratios represent the returns on company

performance. ROA could be a benchmark for the effectiveness of management in managing the investment to generate a net profit.

Meanwhile, ROE represents the company's ability to use capital and generate equity. In GCG by institutional ownership could increase the control action over the business since those parties are concerned about their investment. Thus, it could improve the control action over management policies to improve company performance. Those are the impact of GCG on ROA. Meanwhile, the impact of GCG on ROE, if a company that applies GCG well, would give an excellent image to investors. It could facilitate a company to increase the stock price; hence, those would improve financial performance.

Several previous types of research have been conducted the research related to the relationship of Good Corporate Governance (GCG) on financial performance. Research conducted by Agustini *et al.* (2016) shows that GCG significantly influences financial performance measured by ROE. Other research conducted by Sarafina & Saifi (2017) found a significant influence of the Independent Commissioner and Audit Committee on ROA. Prasojo (2015) research found that GCG has a significant positive effect on financial performance measured by ROA and ROE. Meanwhile, it is not in line with research conduct by Deswara *et al.* (2021), which defines that GCG measured by institutional ownership does not significantly influence financial performance measured by ROA.

Refers to the results of the previous research, GCG implementation is essential to support the company's achievement and the foundation to run the business to provide benefits to stakeholders and shareholders. Based on the research background description above, the author is interested in taking the title "The Impact of Good Corporate Governance on Financial Performance in State-Owned Enterprise (SOE): Case of PT. Krakatau Steel (Persero) Tbk.". This research aims to determine the influence of Good Corporate Governance on financial performance in SOE, that is, PT. Krakatau Steel (persero) Tbk.

### **1.3 Problem Statement**

Good Corporate Governance is the most critical aspect in the companies to improve company performance, minimize the cost, and increase the investors' trust

to invest their money. A company with Good Corporate Governance be able to compete with its competitors. Therefore, without good corporate governance, the company cannot get a good reputation for the shareholders and the stakeholders since Good Corporate Governance can affect the company's performance. Good corporate governance can be assessed from the financial performance of the companies. A primary source of information on financial performance is financial statements. Therefore, it is defined the question from that problem above are as follows:

1. Is there any significant influence of Institutional Ownership on Financial Performance (ROA) at PT Krakatau Steel (persero) Tbk?
2. Is there any significant influence of Institutional Ownership on Financial Performance (ROE) at PT Krakatau Steel (persero) Tbk?
3. Is there any significant influence of the Audit Committee on Financial Performance (ROA) at PT Krakatau Steel (persero) Tbk?
4. Is there any significant influence of the Audit Committee on Financial Performance (ROE) at PT Krakatau Steel (persero) Tbk?
5. Is there any significant influence of Independent Commissioner on Financial Performance (ROA) at PT Krakatau Steel (persero) Tbk?
6. Is there any significant influence of Independent Commissioner on Financial Performance (ROE) at PT Krakatau Steel (persero) Tbk?
7. Is there any significant influence of Managerial Ownership on Financial Performance (ROA) at PT Krakatau Steel (persero) Tbk?
8. Is there any significant influence of Managerial Ownership on Financial Performance (ROE) at PT Krakatau Steel (persero) Tbk?
9. Is there any significant influence of Institutional Ownership, Audit Committee, Independent Commissioner, and Managerial Ownership simultaneously on Financial Performance (ROA) at PT Krakatau Steel (persero) Tbk?
10. Is there any significant influence of Institutional Ownership, Audit Committee, Independent Commissioner, and Managerial Ownership simultaneously on Financial Performance (ROE) at PT Krakatau Steel (persero) Tbk?

#### **1.4 Research Objective**

Based on the problem formulation, the objective of this research are as follows:

1. To find out the significant influence of Institutional Ownership on Financial Performance (ROA) at PT Krakatau Steel (persero) Tbk.
2. To find out the significant influence of Institutional Ownership on Financial Performance (ROE) at PT Krakatau Steel (persero) Tbk.
3. To find out the significant influence of Audit Committee on Financial Performance (ROA) at PT Krakatau Steel (persero) Tbk.
4. To find out the significant influence of Audit Committee on Financial Performance (ROE) at PT Krakatau Steel (persero) Tbk.
5. To find out the significant influence of Independent Commissioner on Financial Performance (ROA) at PT Krakatau Steel (persero) Tbk.
6. To find out the significant influence of Independent Commissioner on Financial Performance (ROE) at PT Krakatau Steel (persero) Tbk.
7. To find out the significant influence of Managerial Ownership on Financial Performance (ROA) at PT Krakatau Steel (persero) Tbk.
8. To find out the significant influence of Managerial Ownership on Financial Performance (ROE) at PT Krakatau Steel (persero) Tbk.
9. To find out the significant influence of Institutional Ownership, Audit Committee, Independent Commissioner, and Managerial Ownership simultaneously on Financial Performance (ROA) at PT Krakatau Steel (persero) Tbk.
10. To find out the significant influence of Institutional Ownership, Audit Committee, Independent Commissioner, and Managerial Ownership simultaneously on Financial Performance (ROE) at PT Krakatau Steel (persero) Tbk.

#### **1.5 Research Benefits**

1. Theoretical Aspects

This research is expected to provide knowledge regarding the impact of Good Corporate Governance on financial performance. It is capable of being used as a

reference for researchers who are or will conduct research related to the impact of Good Corporate Governance on a company's financial performance.

## 2. Practical Aspects

This research is expected to provide the information and as a consideration for the company in measuring the success of Good Corporate Governance in companies that impact financial performance.

### **1.6 Systematic of Writing**

The writings in this research consists of 5 chapters contain several sub-chapters. The systematic research writing outline is as follow:

#### **CHAPTER I INTRODUCTION**

This chapter explains the general description of the object of research. This research background contains the phenomenon that becomes the issue. Therefore, it is worth researching the problem statement based on the background, the problem questions in the form of questions discussed further in the study. This research objective explains the desired results, the research benefits, the scope of research, and the systematic research in general.

#### **CHAPTER II LITERATURE REVIEW**

This chapter discusses the theoretical basis of good corporate governance and its indicator and financial performance with its indicators. This chapter also describes the previous research used as a reference in this research, a framework that addresses a series of thought patterns to describe a research problem, research hypothesis as a guideline in data testing, and the scope of research that describes.

#### **CHAPTER III RESEARCH METHOD**

This chapter describes aspects regarding the type of research, the research approach used, the identification of the dependent and independent variables, the stages of the research, the determination of the population and sample, the types and sources of data, and the analysis techniques.

#### **CHAPTER IV RESEARCH RESULTS AND DISCUSSION**

This chapter discusses the description of research results and discussion of research results from the data that has been collected and conducts discussion of research analysis to test the hypothesis analysis.

## CHAPTER V CONCLUSIONS AND RECOMMENDATIONS

This chapter describes the conclusions of the research that has been done to answer the problem that has been formulated and the suggestions that can be used as a reference or recommendations for actions that related parties can use.