Partial Privatization and Performance of Privatized Soes: The Evidence from Indonesia

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Abstract

Using 214 observations from data collected on 15 State Owned Enterprises (SOEs) in Indonesian that have been partially privatized from year 1991 to 2007, the research employs Wilcoxon signed-rank test to assess the impact of partial privatization on the performance of these firms. It uses panel regression to investigate the factors affecting the success or failure of privatization.

Unlike what mainstream theories propose and what most empirical studies report, given Indonesian context, this paper finds that privatization positively affect the performance of partial privatized SOEs in almost all of the performance measures employed, both in the short term and long term period. Further investigation also reveals that residual state ownership has negative effect all the time, while the positive impact of the number of government commissioners tend to decrease; on the other hand the favorable impact of independent commissioner has a tendency to be greater in the long term. Externally, although the magnitude of the contribution is very marginal in comparison with other predictors, the positive impact of the size of stock market also continues to grow along time.

The government commitment to improve the performance of privatized SOEs through better monitoring and adequate incentive plan and the development of capital market appear to be key success of privatization case in Indonesia. This paper suggests that, the gradual and partial Indonesian privatization can be an alternative model for other developing countries across the world.

Keywords: Partial Privatization, Performance, Indonesia, State-Owned Enterprises

1. Introduction

The most fundamental question having ever addressed after implementation of privatization policy is whether ongoing privatization would be really effective for improving the performance of privatized enterprises as aimed at by the policy makers or not. Such question is undeniably important for SOEs stakeholders in order to evaluate the existing practice of privatization, then to formulate more precise implementation strategy for the future. Given Indonesian context, the issue becomes more relevant because privatization has unique characteristics in the sense that it has been gradually and partially pursued. Many studies, both theoretically and empirically, report that partial privatization is likely to be less effective in boosting performance in comparison with full privatization.

Privatization is a multifaceted program with multiple objectives. However, from a micro perspective, the main and most fundamental objective of privatization is to increase the performance of the divested firms (Vickers and Yarrow 1991). This paper is aimed to assess the impact of partial privatization on the performance of privatized SOEs, and then to investigate the determining factors of the success or failure of privatization in Indonesia.

The remainder of the paper is organized as follows: Section 2 summarizes the result of our literature survey on this issue. Data and methodology are explained in section 3. Empirical result

is presented in section 4, then, our analysis and discussion is described in section 5. Section 6 concludes.

2. Literature Review

Public firms are perceived to be ill-governed, less efficient, lacking transparency and underperforming compared to their counterpart in the private sector. Many studies have been undertaken to identify the causes of poor performance associated with public ownership of enterprises compared to their private counterparts. According to its source, the problem plaguing SOEs can be categorized into two groups, namely: internal governance problem and external governance problem (Hit, et.al, 2005). Internal governance problem incorporates several problems undelying companies such as ill-defined and poorly-monitored objectives due to the presence of complex agency problem (agency problem theory by Arrow, 1986), overwhelming political interference and futile rent seeking activities due to the presence of conflicting interests among several involving parties (public choice theory by Buchanan, 1972 and Tullock, 1965), managers' moral hazard as an impact of soft budget constraint effect (soft budget constraint theory by Kornai, 1980), and lack of incentive to control due to the presence of dispersed/diffused ownership (property right theory by Jensen & Meckling, 1976). On the other hand, external governance problem refers to the absence of constructive pressure from stock market expected to discipline inefficient manager's behavior through stock price signaling mechanism (Shleifer and Vishny, 1997).

Theoretically, there is no other way but full privatization, which is selling state stock with control relinquishment from the state to private owners, through stock market, to be considered as the most effective way of curing the existing problem in the public enterprises. It is basically a transfer of control from multi-agents with multifaceted goals to private owners with single concern of profit maximization. It is obviously able to eliminate all potential problems triggered by political interference. On the other hand, partial privatization which is defined as selling of state ownership without transfer of control from the state to private owners has been perceived to have a little impact on the performance of newly divested SOEs. Besides, it doesn't get rid of the main problem of political engagement; the success of partial privatizations relies considerably on the level of market discipline provided by the stock market (Gupta, 2005).

Empirically, there have been numerous studies revealing the superiority of full privatization over the partial one. D'Souza, et al (2005) found in their study over a sample of 129 share-issue privatizations from 23 developed (OECD) countries. The same conclusion is also reported by Boubakri et.al (2005) in their research toward a sample of 230 firms from 32 developing countries. The same finding was also reported by country specific studies, such as in Malaysia (Sun and Tong, 2002). In contrast, very few studies report the success story of partial privatization. Given very well established capital market, Gupta (2005) found the favorable impact of the partial privatization in India.

Given the special context of Indonesia in which institutional development, specifically capital market, has been less developed in comparison with developed countries, is it possible for partial privatization to work satisfactorily? If it is possible, what is the secret behind such success that other developing countries intending to adopt partial privatization could learn from favorably? Since there are very few studies that show how partial privatization may still work successfully in developing country, this study would contribute significantly to the body of knowledge.

3. Data and Methodology

We confine our analysis to partial privatization in which the state still holds more than 50% of remaining shares after privatization. The government of Indonesia basically has been adopting this type of privatization because out of 16 divested SOEs from 1991 to 2007 only PT Indosat divested more than 50%. In this study we include all of those 15 partially divested SOEs. To get a clear-cut understanding of privatization impact, we include only original SOEs which are initially fully owned by the state, excluding privatization of the former bailed-out private firms. The list of privatized SOEs is as shown in the following Table 1.

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Table 1. List of Partially Privatized SOEs taken in the analysis

No	SOE	Sectors	Year of Privatization and Share Sold	Residual State Shares	First Time Privatization Method
1	**PT Semen Gresik**	**Cement**	**1991 (25%), 1998 (14%)**	**51.0%**	**IPO**
2	**PT Tambang Timah**	**Mining**	**1995 (35%)**	**65.0%**	**IPO**
3	**PT Telkom**	**Telecommunication**	**1995 (23%), 1999 (9.62%), 2001 (11.9%), 2002 (3.1%)**	**51.2%**	**IPO**
4	**PT BNI**	**Banking**	**1996 (25%), 2007 (26.3%), 2010 (3.1%)**	**60.0%**	**IPO**
5	**PT Aneka Tambang**	**Mining**	**1997 (35%)**	**65.0%**	**IPO**
6	**PT Kimia Farma**	**Pharmacy**	**2001 (9.2%)**	**90.8%**	**IPO**
7	**PT Indofarma Tbk**	**Pharmacy**	**2001 (19.8%)**	**80.2%**	**IPO**
8	**PT TABA**	**Mining**	**2002 (16.26%), 2004 (12.5%)**	**65.0%**	**IPO**
9	**PT Bank Mandiri**	**Banking**	**2003 (20%), 2004 (10%), 2011(10%)**	**60.0%**	**IPO**
10	**PT BRI**	**Banking**	**2003 (45%)**	**55.0%**	**IPO**
11	**PT PGN**	**Mining**	**2003 (39%), 2006 (5.31%)**	**55.3%**	**IPO**
12	**PT PP**	**Construction**	**2004 (49%), 2010 (21.46%)**	**51.0%**	**EMBO**
13	**PT Adhi Karya**	**Construction**	**2004 (49%)**	**51.0%**	**EMBO & IPO**
14	**PT Jasa Marga**	**Service**	**2007 (30%)**	**70.0%**	**IPO**
15	**PT Wijaya Karya**	**Construction**	**2007 (31.7%)**	**68.3%**	**IPO**

Note: IPO: Initial Public Offering, EMBO: Employee Management Buy Out

Basically we employ similar method of analysis to what has been employed by some previous researches such as Boubakri et al (2005) and D'Souza et al (2005). To assess whether partial privatization brings significant impact on the performance of divested SOEs we employ univariate non parametric test called Wilcoxon Signed-rank test. It is principally done by comparing the mean value of each performance measure in pre and post privatization. Meanwhile, to investigate the determining factors of performance changes found in the first test, we employ panel regression. Following Megginson and Netter (2001), we include firm specific as well as environment specific factors as predictors of the success or failure of partial privatization. We classify the performance measures into 3 categories: profitability (ROS), efficiency (EFFICIENCY), and productivity (EMPROD). Furthermore, we use the remaining state ownership (OWNERSHIP), number of government commissioner (GOVCMSNR), number of independent commissioner (INDPCOMSNR), composite stock index (STOCKINDX), stock turnover (STOCKTURNV) as predictors (independent variables) in the second stage of the analysis, where the log of GDP (LogGDP) is used as control variable for the effect of general macroeconomic policy. List of variables used are as described in Table 2. In more detail the panel estimation is expressed as follows:

Performance = α + β1 (residual state share) + β2 (number of government commissioners) + β3 (number of independent commissioners) + β4 (Size of capital stock) + β5 (intensity of capital stock transaction) + β6 (Size of economy) +μit

We divide the analysis into two time frames; short term and extended term. Short term analysis, done by comparing 3 years before and 4 years after privatization, is aimed at assessing the immediate impact of privatization, while extended period analysis which is to examine the impact of privatization in the long term period is done on the entire sample data--data available on pre and post privatization. In the latter analysis we use 214 observations in the unbalanced panel regression.

Table 2. Definitions of explanatory variables used in regressions

Variable	Proxy for	Empirical Definition
Return on Sales (ROS)	**Performance of SOE--Profitability**	**Operating Income divided by Total Sales**
Efficiency[5] (EFFICIENCY)	**Performance of SOE--Efficiency**	**Value Added/Capital Employed** **Value Added = Operating Income + non Cash Expensed; Capital Employed = Working Capital + Fixed Assets; Working Capital = Current Assets – Current Assets**
Employee Productivity (EMPROD)	**Performance of SOE--Productivity**	**Inflation-Adjusted Operating Income divided by Number Employee**
Residual State Share (OWNERSHIP)	**Internal firm factor to represent newly capital structure**	**The percentage of residual state share (0-100%)**
Government Commissioner (GOVCMSNR)	**Internal firm factor to represent shareholder's supervision**	**Number of government commissioners on BOC**
Independent Commissioner (INDPCMSNR)	**Internal firm factor to represent size of the SOEs**	**Natural logarithm of total assets in every year of observation period**
Stock Index (STOCKINDEX)	**External firm factor to represent size of capital market as one indicator of the capital market efficiency**	**An indicator of price stock movement of all stock listed in Indonesia Stock Exchange.**
Stock Turnover (STOCKTURNV)	**External firm factor to represent intensity of capital market as one indicator of the capital market efficiency**	**Stock turnover is the total value of shares traded during the period divided by the average market capitalization for the period.**
Gross Domestic Product (logGDP)	**Size and level activity of economy**	**Natural logarithm of total GDP data taken from world data site measured in constant local currency (trillion IDR)**

4. Empirical Result

4.1 The Impact of Privatization on Performance of Divested SOEs

Table 3 shows the result of short term analysis. Generally speaking, the table reveals that there are statistically significant positive changes in performance of partially privatized SOEs in the *post* privatization in comparison with the performance in the *pre* privatization. In the short term the divested SOEs experienced improved efficiency and productivity at 5% and 1% significance level respectively. Out of 14, there are 10 and 13 divested SOEs that demonstrate increased efficiency and productivity respectively. Profitability goes up by 0.063 on average, while productivity improves by IDR 133 million per employee on average. With regard to profitability, out of 14[6] there are 9 SOEs experiencing increased profitability. However, it is considered

[5] For banking industry, efficiency is calculated by using income-based approach (Leightner and Lovell, 1998) which is total interest + non-interest income divided by total interest + non-interest expenses.

[6] One SOE is dropped from analysis due to outlier problem which the dropped SOE significantly deviates from general trend

statistically insignificant.

Analysis result of extended period is shown in Table 4. It is revealed that most divested SOEs perform better after privatization. The impact of privatization is even more noticeable. Even after including the outlier dropped in the short term analysis, all of three performance indicators, including profitability, increase at statistically significant level. In comparison with the impact of privatization in the short term, there is significant improvement. The mean change of profitability goes up from 0.0248 in the short term to 0.04722 in the extended period, while efficiency rises from 0.0626 to 0.0836. Lastly productivity also grows from IDR 134 million to IDR 332 million. The efficient divested firms also underline the fact. All in all, the result shows that the effect of privatization is likely to be positively larger in the long term period.

4.2 The Determining Factor of The Privatization Success

As exhibited in Table 5 and Table 6, the panel estimations identify several factors affecting the performance enhancement of privatized SOEs. Most of firm specific predictors play significant role in affecting the performance of the firm. The difference tends to be more on the level and the trend of the importance. The percentage of residual state shares in the divested firms seems to have negative impact on the performance of divested firms, especially in the long term period. While in the long term it affects efficiency and profitability at 5% and 1% significance level respectively, in the short term it significantly affects only the efficiency level at 5%, but not significant for the profitability and productivity. The favorable influence of the number of government commissioners appears to become less critical in the long term since it favorably affects the profitability at 1% only but not significant for the efficiency and productivity compared to the impact in the short term which affects profitability and productivity positively. In contrast, the role of independent commissioners gets stronger in the long term period. Although it affects the same indicators of performance in both period of analysis, which are efficiency and profitability, the significance level is stronger in the long period. It rises from 5% to 1% for efficiency and from 10% to 5% for profitability.

With respect to the external specific factor, our result demonstrates that the size of transaction in the capital stock, which is represented by stock index, also presents positive contribution to the performance improvement after privatization particularly in the long term. While in the short term it affects significantly only the productivity at 1% significance level, the important role of capital stock is even more visible in the long term when profitability as well as efficiency is favorably affected by it at 5% and 10% correspondingly. Nevertheless, compared to other variables, the magnitude of stock market importance is very marginal. It is shown by its very small coefficient (0.0001) for both efficiency and profitability. Lastly, it seems to us that no single variable affects significantly the productivity of the firm in the long term.

5. Analysis and Discussion

5.1 Partial Privatization and Performance of Divested SOEs

Considering the mainstream theoretical arguments supported by finding from numerous studies which neglects the possible success of partial privatization, the finding of this study is very interesting. It is rather contrasted with what is reported by several studies on the same issue. Many works such as done by Boubakri et. al, (2005) and D'Souza et.al. (2005) conclude that privatization would be effective in bringing performance enhancement if it is only done fully by relinquishing control from the state to the private sector. Partial privatization is considered unable to eradicate the main problem of political interference. The only possible source of performance improvement in the case of partial privatization is the presence of capital market that can bring incentive to the manager in the form of takeover threat.

Apparently, partial privatization in Indonesia is successful in forcing the firms to enhance their efficiency shortly after privatization. Of the consequences is some firms are compelled to cut their normal profit. Hence, some divested SOEs experience declined profitability shortly after privatization. However, it looks just a matter of time for partial privatization to show its favorable impact. In the long term, most divested SOEs demonstrate their superiority in all aspects of performance indicators. Unlike the Indian case reported by Gupta (2005), Indonesia has not had stock market as well established as India. Theoretically, it would be less likely for privatization to be successful. In fact, the privatization is surprisingly successful in Indonesia. There must be very interesting reason behind this success.

5.2 Government Commitment through Effective Monitoring and Proper Incentive

so that it affects considerably the aggregate result.

Under partial privatization, the government as both a majority shareholder and a regulator is the key player in making the program successful. In the case of Indonesia, the government of Indonesia seems to use privatization as a momentum to show its commitment to improve the performance of divested SOEs. In Indonesia, privatization is not a popular policy. The government often gets strong oppositions from the stakeholders especially public, politicians, employees, as well as managers. Politically, privatization was considered as selling the sovereignty especially during economic crisis when domestic investors had weak purchasing power to buy the shares offered. The involvement of IMF and World Bank also caused some people considered privatization as a new form of colonization. Nevertheless, the government seemed to have no choices to solve the severe and emergent economic problem. Eventually, the government had to take bitter and unpopular decision of privatization on the premise that that privatization would bring benefit to stakeholders in general, and enhance the performance of the enterprises in particular. Thus, once the decision of privatization has been taken, the government has moral obligation and promise to meet. The government pursues its commitment and promise through at least two ways:

5.2.1 Effective Monitoring Mechanism

The effort of the government to set forth well-established monitoring mechanism can be seen from the following actions. Firstly, the government establishes better monitoring institution. Before 1998, supervision and monitoring of SOEs were done dispersedly under several Technical Ministries according to their respective sectors. One of the IMF conditions in helping Indonesia out of the 1997 crisis was to ask the government to restructure and privatize all SOEs in the medium term. To fasten and ease the process of fast-track and full privatization as required by IMF, oversight of public enterprise was transferred firstly from the Technical Ministries to the Ministry of Finance as stipulated in Government Regulation (PP) No 12 and 13. Later, the government decided to transfer oversight task to new ministry called Ministry of SOEs which was responsible for restructuring, privatizing as well as monitoring public enterprises after privatization. Centralized oversight is deemed to be better in minimizing political interference from bureaucrats and politicians of related ministries. In addition, the policy formulating process can be streamlined under separate new ministry.

Secondly, the government delegates more authorities and power to the Board of Commissioners (BOC). Shortly after privatization, the privatized SOEs are obliged by Liability Limited Law to make some adjustments in their Article of Association in respond to change in their status. New proposal of Article of Association has to be approved by General Shareholder Meeting (GSM), which is the state itself as majority stakeholder. Of main changes is about the new role of the Board of Commissioner (BOC). Previously, the role of BOC is just as an extended hand of GSM in overseeing operational decision made by Board of Directors (BODs). Almost all strategic policies in association with the companies are taken by GSM, and then it would be BOC's responsibility to ensure those decisions to be implemented properly. Through new Article of Association, the state usually delegates more authorities to BOC, meanwhile GSM deals with more strategic decisions which usually related to the issue of state finance. All of those efforts can prevent political noise caused by politicians and bureaucrats so that it could give managers more independence in operating their enterprises while minimizing potential rent seeking activities from bad politicians or bureaucrats.

Thirdly, government enhances the intensity and quality of monitoring by reducing the number of government commissioners and allowing independent commissioners in the BOC. Since the government decided to give more autonomy by implementing "control by objective", the government has refrained from intervening in SOEs directly at the operational level. As substitute, the government has optimized supervision and monitoring function through BOC. Before privatization when SOEs were fully owned by the state, the BOC consisted of only government commissioners which were usually appointed from top-ranked bureaucrats or retired officers from related ministries. It is also a common practice that some members of the BOC are politicians belong to government parties. This highlights the facts that political interference is adversely rampant in the context of Indonesian SOEs.

As regulated in Company Law No. 40, listed firms (including privatized SOEs) may have two categories of commissioners in their BOC, namely: delegated commissioners, and independent commissioners. A delegated commissioner is usually appointed from parties affiliating to the shareholders. Their presence is to represent the shareholders' interest. Including in this category are government commissioners who represent the state as majority shareholders. Meanwhile, an independent commissioner shall be neither appointed from parties associating with the main shareholders nor the members of the BOC. As depicted in Table 7, there is an increase in the average number of total BOC members of most privatized SOEs in post privatization compared to pre privatization. Nonetheless, increasing the number of BOC members can lead to worsening political intervention if the new composition of the BOC is dominated by politicians. With its commitment to improve the performance of divested SOEs, government trims down the number of government commissioners in listing SOEs as shown by the same table. Theoretically, declined number of government commissioners could lessen of the amount of information available to politicians and bureaucrats (Schmidt, 1990), which is in turn would lead to less political interference in SOEs. As a result, privatized SOEs would become relatively more independent from rent-seeking activities so that it could lead to better performance as advocated by public choice theorists. As shown by the result of the regression, the positive contribution of government commissioners which is initially noticeable becomes less contributive in the long term.

The same table reveals that the cause of increased average number of BOC members is the presence of independent commissioners. Although it is not obligatory, to enhance credibility and objectivity in the monitoring of privatized SOEs, the government through GSM agrees to have independent commissioners in the BOC. Independent commissioners are typically persons with expertise in fields related to the SOEs' business. Most of them are economic observers, practitioners, academicians, and so on. With their skills, experience, as well as professionalism, and with no vested interest from any political group, their presence is considered important to maintain public trust in the governance of SOEs. The number of independent commissioners on the BOC is not determined strictly; rather the government matches with the need in the industry. Another factor taken into consideration is the number of shares owned by non-state shareholders, larger number of shares owned by private owners, more independent commissioners in BOD will be. To some extent, it can be considered as minority interest representatives.

5.2.2 Performance-Aligned Incentive System

Besides monitoring, incentive is also said by Megginson (2005) as another factor which is absent from public enterprises. With multi-layer and complex agency problem, the impact of the absence of adequate incentive system is much more severe in public enterprises. It is further argued that the cause of the absence of incentive for managers to efficiently utilize all resources available is rivalry among associated ministries/departments in defining the objective to be accomplished by managers. What the government did by establishing one-roof monitoring ministry is likely to reduce the possibility of ill-defined objectives. In addition, in connection with advocates of the principal-agent problem, management and employees may have conflicting objectives deviating from the objective set by the state as majority shareholders. Of solutions suggested by some scholars (Zahra and Pearce, 1989) to tackle this problem is by setting proper incentive linked to the performance of the firms. As a result, the principal and the agent are likely to have an aligned goal and interest.

Apparently, the government of Indonesia has realized the problem, even long time before privatization is carried out to certain enterprises. It has been common practice that government usually grants bonus to management and employees as a form of appreciation for their performance. The amount of bonus has been usually linked to the performance of firms in related years. By doing so, it is expected that the employee would have an incentive to perform excellently in order to obtain larger annual bonus. Unfortunately, the bonus has not been always granted every year. In practice, it is subject to many factors such as need over investment fund in the next year and dividend policy imposed by the government to satisfy state budget need. All of those conditions, in turn, would diminish the incentive power of annual bonus. Therefore, more definite incentive system is required.

Alternatively, along with or following privatization the government proposes new incentive system. The system is basically stock-based incentive. After going public, stock price is considered as the most representative and the most objective performance indicator. Stock price represents all information related to the firm, including current and prospective performance, future investment plans, dividend policy, and some other issues related to ethics and corporate governance. By relating the incentive to the performance of the stocks it can align the objective of both the state as the owner and employees as well as managers as the controller.

In general, stock-based incentive plan offered by the government of Indonesia to managers and employees of privatized SOEs can be classified into two categories, namely: Employee Stock Allocation (ESA) and Management Stock Option Plan (MSOP).

Under ESA plan, the government allocates certain portion of shares issued at Initial Public Offering (IPO) to be granted to or purchased by employees and managers under certain condition and certain term of payment. Including in this category are Bonus Share Grants and Share Purchase at Discount plan. Under Bonus Grants, the government provides annual bonus to the employees and managers as appreciation of their performance not in the form of money, rather, in the form of shares. In this case, the employees and managers get shares for free according to their take home pay because all cost would be taken from retained earnings or be expended in the firm financial report. To prevent the employees from realizing capital gain shortly after purchasing the stock, the government sets a lock-up period varying from 6 months to 3 years. Meanwhile, under Share Purchase Discount plan, the employees and managers are allowed to purchase certain number of shares at discounted price or subsidized price. In most cases, main part of stock price is paid by using bonus of the employees, while the rest is either being shouldered by the firm or paid with employees' cash. To help and encourage the employees, in some cases the firms also give a loan at subsidized interest rate to be used to purchase the stock offered. Similar to Bonus Shares Grant, the government also determines certain lock-up period for this plan.

Another stock-based incentive plan is MSOP which is usually for the managers with certain conditions and requirements. Under this scheme of incentive, eligible managers would be allowed to have option to purchase stock in the future at predetermined or discounted price.

5.2.3 Remaining Government Ownership and Performance

The new capital structure of privatized SOEs *post* privatization is characterized with dispersed ownership among individual shareholders. The presence of institutional shareholders in the new shareholder composition of divested SOEs is extremely rare. Furthermore, the main objective of individual private investor in purchasing stocks is to earn capital gain in the short term rather than to get dividend yield realized in the long term. In this respect, it is more likely for the individual shareholders to buy and sell their stock in any time considered more advantageous. To make situation worse, the Indonesian capital market, especially in the early stage of privatization of being implemented, was less developed in which minority interest right might not be well-protected. As a consequence, silent individual shareholders in the sense that each individual shareholder might not pay enough attention to what the management does in directing the firm is likely to exist. Hence, external governance expected to arise from privatization may have never been realized under these situations as reported several studies in other regions (Omran, 2002).

It is observed that the percentage of residual ownership held by government negatively affect the performance of newly privatized SOEs at significant level. One may say that no matter how large the size of share sold through privatization as long as it is not followed by transfer of control from the government to private owner it would not cause essential change in the way of the firm being managed. Apparently, this is not the case of Indonesia. As explained above, the commitment of the government to improve the performance of privatized SOEs through delegating more power of GSM to BOC and allowing public monitoring appear to be the rationale of this funding. It seems that the government delegates bigger authorities to BOC when the residual state ownership is lower, and vice versa.

At the same time, to represent larger private ownership in the enterprises, the government allows more independent commissioners seating in BOC. Those policies show positive impact because political interference is likely to be much lower. In addition, the presence of more public monitoring also play role in preventing rent seeking activities from bad politicians as well as abuse of power of bureaucrats. As a result, the privatized enterprises become more sterilized from any political engagement so that they can operate more as business entity rather than as political vehicles. This finding is rather different from what is reported by Boubakri, et al (2005) that documents that privatization without control relinquishment by the government may have little impact on the SOEs' performance after privatization in developing countries. In another case as reported by D'Souza, et al (2005), residual government ownership is also considered as insignificant factor in determining ROS in the study which use privatized firms in developed countries as a sample.

5.2.4 Role of Capital Market

The finding in this issue supports the theory of privatization, specifically in the case of share issue privatization (SIP) that argues that the capital market as external governance can trigger the performance listed firms. Capital market is said to have capability in compelling the managers to perform well by posing hostile takeover threat. Price stock in the efficient capital market reflects adequately the performance of the managers. Looking at the trend of price stock, investors may deem that managers do not perform the job well. Consequently, they might sell the shares held to avoid bigger investment loss. In this regard, it is arguable that capital market development is one of critical issues in the context of partial privatization in Indonesia. This is because most privatizations in Indonesia have been carried out through capital market (only one of 16 cases in this study used method other than SIP). This finding also supports the conclusion of several recent studies (Levine and Zervos, 1998; Subrahmanyam and Titman, 1998; La Porta et al., 1997) that document that the intensity of share market, which means also the level of market efficiency, could be judged from size and or the liquidity of capital market.

As discussed above, the role of stock market in affecting the performance of privatized SOEs is more observable in the long term. It might show the pace of development of Indonesian capital market. Since it was liberalized in 1989 (Boubakri et. al. 2005), Indonesian stock market has greatly developed year by year. In addition to the increased number of listed firms, it has also been indicated by larger size of transaction as well as by the level of stock market activity. During 1990-1997 the Jakarta Composite Index had always been on the bottom among other four neighboring countries: Thailand, Malaysia, Philippine, and Singapore. In year 2010 when the index reached 3,703, and took over Singapore's position, Indonesian Stock Market had ranked second in the region, just below Philippine Stock Market on the top. According to Arianto (1996), Indonesian stock exchange (before year 2000) could be classified into the category of weak form efficiency since there was strong indication that the price of stock was influenced by the information of the price and its movement in the preceding periods. It seems to be true that stock index is one of the indicators of capital market efficiency. Consequently, the more efficient the stock market, the more pressure posed to discipline the managers. As a result, the listing SOEs become more profitable and more efficient in the long term along with the increased efficiency of the capital market.

Despite its significance in affecting the performance of SOEs, especially in the long term, the size of capital market impact is considerably marginal in comparison with other variables such as number of independent commissioners. For example, for every 1 point increase in stock index it would contribute to an increase in profitability and productivity only by 0.0001. In broader sense, it can be said that to enhance the performance of the firms, betterment of internal factors should be first priority.

6. Conclusion

Mainstream existing theoretical and empirical studies reveal that partial privatization is less likely to bring about significant impact on the performance of privatized SOEs. Theoretically, with the control still in the hands of the government, partial privatization would lead to an unresolved problem of political interference. The only potential source for privatized SOEs to improve is market discipline from the stock market. Is not it possible for partial privatization, even with less developed capital market, to produce significant positive impact on the performance of privatized SOEs? Using 214 sample observation from all Indonesian SOEs (15 firms) that have been partially privatized from year 1991 to 2007, the research employs Wilcoxon signed-rank test to assess the impact of partial privatization on the performance and uses panel regression to investigate the factors affecting the success or failure of privatization.

Interestingly, the results of Wilcoxon Signed-rank test reveal that partial privatization brings about significantly positive impact on all performance measures both in the short term and long term. Partial privatization appears to compel the firms to cut their normal profit. Hence, some divested SOEs experienced declined profitability shortly after privatization. However, in the long term most of them are able to regain their economic profit. Further analysis by using panel regression shows that some factors play very critical role in making privatization successful. From the internal firms, the remaining state share negatively affects the performance. Moreover, while the positive impact of government commissioners tends to decrease, in contrast the positive effect of independent commissioner tends to rise. From outside the firm, although the contribution is relatively marginal compared to the contribution of other factors, size of transaction in capital seems to provide favorable impact on performance in the long term. The magnitude of the impact seems to be in line with the stage of capital stock development.

Uneasy process of privatization in which there is so much resistance from stakeholders, politically and socially, forces the government to implement privatization with more commitment and moral obligation to prove that partial privatization can produce positive impact to the stakeholders. To improve the performance of privatized SOEs, the government takes two main actions: establishing better and proper monitoring, and launching adequate incentive plan. Proper monitoring is carried out through establishing centralized and independent monitoring ministry, reducing the number of government commissioners, delegating more authorities to the BOC, and allowing public monitoring to take place. Meanwhile, adequate performance-aligned incentive system can be mainly pursued through Employee Stock Option and Management Stock Option Plan.

Table 3: The Result of Privatization Impact Analysis in the Short Term

Independent Variable	N	Mean Pre	Mean Post	Mean Change	Z statistic for difference in means (post – pre)	Ratio of firms with positive change over the firm with negative change
Profitability *Return on Sales*	**14**	**0.2139**	**0.2387**	**0.0248**	**1.099**	**9 : 5**
Efficiency *Value added/Capital Employed*	**14**	**0.4608**	**0.5234**	**0.0626**	**1.601****	**10 : 4**
Productivity *Real Operating Income/Employee*	**14**	**86.9222**	**220.8816**	**133.9593**	**3.233***	**13 : 1**

Note: Significant at the 1% (*), 5% (**) and 10% (***) levels

Table 4: The Result of Privatization Impact Analysis in the Long Term

Independent Variable	N	Mean Pre	Mean Post	Mean Change	Z statistic for difference in means (post – pre)	Ratio of firms with positive change over the firm with negative change
Profitability *Return on Sales*	**15**	**0.1562**	**0.2035**	**0.04722**	**2.158****	**13 : 2**
Efficiency *Value added/Capital Employed*	**15**	**0.4620**	**0.5456**	**0.0836**	**1.931****	**12 : 3**
Productivity *Real Operating Income/Employee*	**15**	**81.6575**	**413.7529**	**332.0954**	**3.233***	**13 : 2**

Note: Significant at the 1% (*), 5% (**) and 10% (***) levels

Table 5: The Result of Determining Factor of Privatization Success in The Short Term

Independent Variable	Dependent Variable		
	Efficiency	Profitability	Productivity
OWNERSHIP	**-0.2679 (-1.78)****	**-0.0693 (-0.46)**	**-152.7677 (-1.22)**
GOVCMSNR	**0.0139 (0.43)**	**0.0660 (2.39)***	**44.6243 (1.67)*****
INDPCOMSNR	**0.0558 (2.22)****	**0.0456 (1.72)*****	**0.6950 (0.03)**
STOCKINDX	**0.0001 (0.16)**	**0.0001 (1.45)**	**0.1118 (3.81)***
STOCKTURNV	**-0.0207 (-0.26)**	**0.2746 (2.81)***	**-12.7326 (-0.19)**
LOGGDP	**-0.0987 (-2.01)****	**-0.5788 (-3.12)***	**156.0913 (0.84)**
CONS	**0.8082 (3.45)**	**0.0447 (0.20)**	**-58.0169 (-0.25)**
R-sq	**0.095**	**0.312**	**0.272**
No. Obs	**98**	**98**	**98**
No. of Group	**14**	**14**	**14**
F (Prob > F)	**24.82 / 0.004**	**23.74/0.000**	**68.57/0.000**

Note: Significant at the 1% (*), 5% (**) and 10% (***) levels

Table 6: The Result of Determining Factor of Privatization Success in The Long Term

Independent Variable	Dependent Variable: Efficiency	Dependent Variable: Profitability	Dependent Variable: Productivity
OWNERSHIP	**-0.2255 (-2.02)****	**-0.2239 (-4.06)***	**-7.8910 (-0.30)**
GOVCMSNR	**0.0183 (1.10)**	**0.0272 (3.28)***	**2.1616 (0.50)**
INDPCOMSNR	**0.0445 (2.68)***	**0.0155 (1.89)****	**-6.5037 (-1.58)**
STOCKINDX	**0.0001 (2.14)****	**0.0001 (1.79)*****	**0.0045 (0.74)**
STOCKTURNV	**-0.0632 (1.07)**	**0.0588 (2.81)****	**3.9985 (0.22)**
LOGGDP	**-0.1926 (-1.42)**	**-0.1318 (-1.95)****	**28.9851 (0.80)**
CONS	**1.9024 (1.86)**	**1.1680 (2.30)**	**-128.5371 (-0.48)**
R-sq	**0.095**	**0.241**	**0.029**
No. Obs	**98**	**214**	**214**
No. of Group	**14**	**15**	**15**
F (Prob > F)	**24.82 / 0.004**	**47.42/0.000**	**7.34/0.2904**

Note: Significant at the 1% (*), 5% (**) and 10% (***) levels

Table 7 Composition of Commissioner

NO	SOEs	Government Mean Pre	Post	Change	Independent Mean Pre	Post	Change	Total Mean Pre	Post	Change
1	PT Adhi Karya	4.00	3.14	-0.86	0.00	1.71	1.71	4.00	4.86	0.86
2	PT ANTAM	4.00	3.57	-0.43	0.00	1.21	1.21	4.00	4.79	0.79
3	PT Bank Mandiri	4.00	2.75	-1.25	0.00	4.00	4.00	4.00	6.75	2.75
4	PT BNI	3.00	3.08	0.08	0.00	3.00	3.00	3.00	6.08	3.08
5	PT BRI	4.00	2.75	-1.25	0.00	3.75	3.75	4.00	6.50	2.50
6	PT Indo Farma	5.00	3.10	-1.90	0.00	0.50	0.50	5.00	3.60	-1.40
7	PT Jasa Marga	5.00	4.00	-1.00	0.00	2.50	2.50	5.00	6.50	1.50
8	PT Kimia Farma	4.00	2.10	-1.90	0.00	1.90	1.90	4.00	4.00	0.00
9	PT PP	4.00	3.14	-0.86	0.00	0.43	0.43	4.00	3.57	-0.43
10	PT PGN	5.00	3.63	-1.38	0.00	2.00	2.00	5.00	5.63	0.63
11	PT PTBA	5.00	3.78	-1.22	0.00	1.78	1.78	5.00	5.56	0.56
12	PT TELKOM	5.00	3.50	-1.50	0.00	1.50	1.50	5.00	5.00	0.00
13	PT Timah	3.00	2.25	-0.75	0.00	1.38	1.38	3.00	3.63	0.63
14	PT WIKA	4.00	3.00	-1.00	0.00	2.00	2.00	4.00	5.00	1.00
15	PT Semen Gresik	5.00	3.50	-1.50	0.00	1.75	1.75	5.00	5.25	0.25
	TOTAL	4.27	3.15	-1.11	0.00	1.96	1.96	4.27	5.11	0.85

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