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# Impact of Holding on Financial Performance and Governance: Evidence From Indonesia's State-Owned Enterprise

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**ABSTRACT**

This research examines the influence of holding on the financial performance and governance of State-Owned Enterprise (SOE) carrying out holding companies. Paired t-test is used to examine the influence of holding on the financial performance and governance of State-Owned Enterprise (SOE) carrying out holding companies. This research reveals that the holding has a positive effect on the current ratio, but has no effect on ROA and ROE. Furthermore, this research reveals that holding companies have a negative effect on DER and BOPO. Apart from that, this research has a positive effect on the composition of independent commissioners but has no impact on the size of commissioners. This research confirms that holding contribute in the short term on financial performance and governance. The findings this study plays an important role in optimizing financial performance and strengthening SOE governance. This research also provides suggestion for SOE Management to prepare long term strategies, so that the holding company's business objectives can be achieved. This research contributes to existing literature, by highlighting the financial performance, governance and SOE in Indonesia.



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## INTRODUCTION

Company growth is often accompanied by the need to manage an increasingly complex business portfolio. One strategy commonly used in managing this portfolio is the formation of a holding company (Raykov & Silva-Buston, 2020). A holding company is an entity that has majority shares or complete control over one or more subsidiary companies, which can operate independently under the overall control of the parent company. This practice is usually adopted to optimize company structure, coordinate business strategies, and improve operational efficiency (Handoyo, Suharman, Ghani, & Soedarsono, 2023). The influence of holding companies on financial performance has become an interesting research subject for academics and business practitioners. This is because the formation of a holding company can have a significant impact on the financial performance of the parent company and the subsidiary companies under its auspices (Boliari & Topyan, 2022).

One possible impact of a holding company is efficiency in managing financial resources. By combining financial functions between the parent company and its subsidiaries, holding companies can optimize the use of capital, reduce financial costs, and increase access to cheaper financial resources (Ahn, Oh, & Park, 2020). The benefits of a holding company will be more optimal compared to other competitors, if a diversification effect is formed from the holding (Bressan, Rammerstorfert, & Weinmayer, 2021). Apart from that, holding companies can also influence financial performance through their influence on capital structure and dividend policy. By having greater access to capital markets, holding companies can use leverage to increase profits or reduce financial risk (Ernawati, Suhariningsih, Kusumadara, & Santoso, 2023). Apart from that, a holding company's dividend policy can also affect subsidiary companies' cash flows and long-term investment funding.

The holding's important contribution to the company is improving corporate governance, so that the decision-making process in the company will be easier, relevant and timely. This argument is reinforced by a study by (Yoon, Nam, Kim, & Kim, 2014) which suggests that a holding company strengthens corporate governance, especially if the merger model creates a diversification effect. The holding company provides obligations for the parent company and subsidiaries to comply with regulations to ensure transparency, accountability and good business practices. The company will also implement strong internal controls and conduct regular audits to ensure compliance with corporate governance and statutory regulations.

However, other literatures also reveal that parent and subsidiary companies experience inefficiency after holding a holding company, even though previously each company had better efficiency (Chiou, 2009). On the other hand, the formation of a holding company may also introduce additional costs in the form of bureaucracy and complex management, which may burden financial performance and worsen corporate governance. This argument is confirmed by Tektona and Wahjuni (2023) who reveal that state-owned holding companies cause the governance of subsidiary companies to not run well, especially if there is a mismatch in the core business between the parent company and the subsidiary.

In Indonesia, holding policy are not only carried out by private companies, but also state-owned companies. As Agents of Development or at the forefront of government initiatives, State-Owned Enterprises (*SOE)* are present in society with a significant role, both for the development of the national economy and state revenues (K. Kim, 2018). Apart from being an Agent of Development which is an extension of the government, *SOE* also has a responsibility to the state to ensure that the company is still able to increase or maintain market share and a positive financial position (profitable business/value creator) as well as having sustainable long-term planning to respond to the world increasingly competitive business (sustainable business).

The importance of understanding the influence of holding companies on financial performance and governance is not only relevant for internal stakeholders, such as company management and shareholders, but also for external stakeholders, including regulators, investors and creditors. The discussion of State-Owned Enterprises as the object of this research is also interesting, because their operations are vulnerable to government intervention, including the determination of the Board of Commissioners and Directors (Fu, Xu, Wang, Sun, & Chen, 2023). Thus, it is hoped that this research can provide better insight into business dynamics in the context of the formation and operation of holding companies and their implications for overall financial performance and governance. In this context, further research is needed to explore a deeper relationship between holding companies and the financial performance and governance of State-Owned Enterprises, so that this research is different from previous research which tends to only examine the impact of holding companies on the financial performance of private companies.

## METHOD

The research aims to investigate the impact of holding companies on the financial performance and governance of State-Owned Enterprises that merge holding companies. The research was carried out at State-Owned Enterprises because of their important role in State finances and the policies made cannot be separated from the Government, making political intervention possible. The population of this study was 93 (ninety-three) State-Owned Enterprises that held holding companies. Sampling uses a purposive sampling method with the criteria (1) the company presents an annual report or audited financial report on the Indonesia Stock Exchange or each company's website for the period before and after the holding company, and (2) the company does not carry out merger or split off activities after holding company.

Before testing the hypothesis, outlier and normality checks need to be carried out in this research. The univariate outlier test uses a box plot and skewness and kurtosis tests for normality. If the data is declared an outlier and does not meet normality, then the general procedure carried out is data transformation. After the data is declared to meet the assumptions of normality and is free of outliers, hypothesis testing can be carried out to answer the objectives of this research. Hypothesis testing in this research uses a paired t test, so that the influence of holding companies on financial performance and corporate governance is known before and after holding activities.

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To support the data analysis, it is necessary to measure the variables or indicators used in this research, the financial performance and corporate governance. Financial performance consists of current ratio, debt to equity ratio, return on assets, and return on equity and operation expense to revenue. These financial ratios are considered to be able to accommodate all sectors of State-Owned Enterprises, as well as representing liquidity, solvency, profitability and efficiency. Corporate governance is represented by the number of independent commissioners and the size of the commissioners. The measurements of these variables are described in table 1 as follows.

**Table 1.** Measurement of Variable

| Variable | Indicator | Code | Measurement |
|---|---|---|---|
| **Financial Performance** | Current Ratio | CR | Current Assets/ Current Liabilities |
| | Return on Asset | ROA | Net Profit/Assets |
| | Return on Equity | ROE | Net Profit/Equity |
| | Debt to Equity Ratio | DER | Liabilities/Equity |
| | Efficiency Ratio | BOPO | Operation Expenses/Sales |
| **Governance** | Independent Commissioner | KI | Number of Independent Commissioners |
| | Commissioner Size | UK | Number of Commissioners |

## RESULTS AND DISCUSSION

After the data collection based on the variables and indicators in this research, the number of samples that can be used for data analysis is described in table 2 below. Based on this table, it is explained that the State-owned enterprises managing holding companies are 93, while the number of State-owned enterprises whose annual reports or financial reports are not available on the Indonesian Stock Exchange and each company's website is 41 companies. So the number of BUMN that can be used for further analysis is 52 companies.

**Table 2.** Data Collection

| Description | Total |
|---|---|
| Number of State-owned Enterprises managing holding companies | 93 |
| Number of State-owned Enterprises that do not present annual reports or financial reports on the Indonesian Stock Exchange and the websites of each State-owned Enterprise during the observation period | 41 |

| | |
|---|---|
| Number of State-owned Enterprises for data analysis | 52 |

After the data are collected according to the research variables, assumptions are then tested to ensure that the data can be used for hypothesis testing, the outlier assumptions and data normality. Based on univariate outlier testing using a box plot, several outlier indicators were obtained. Apart from that, some indicators are also not normally distributed. Therefore, the next procedure is to carry out data transformation and obtain the best transformation method for each indicator according to what is presented in table 3.

**Table 3.** Transformed Data

| **Variable** | **Original Data** | | **Best Transformation Method** | **Transformed Data** | |
|---|---|---|---|---|---|
| | Skewness | Kurtosis | | Skewness | Kurtosis |
| **CR before Holding** | 0.000 | 0.000 | log | 0.015 | 0.987 |
| **CR after Holding** | 0.002 | 0.596 | Square Root | 0.615 | 0.066 |
| **DER before Holding** | 0.000 | 0.033 | Square Root | 0.057 | 0.239 |
| **DER after Holding** | 0.000 | 0.000 | log | 0.569 | 0.015 |
| **BOPO before Holding** | 0.000 | 0.002 | Inverse Square root | 0.454 | 0.070 |
| **BOPO after Holding** | 0.000 | 0.086 | Inverse | 0.029 | 0.507 |

After transformation, the research data were concluded to have met the outlier and normality assumptions. Therefore, hypothesis testing can be carried out using paired ttest. Based on hypothesis testing, it was found that the holding company had a positive effect on the current ratio, because the probability value was significant (p 0.000 <005). However, the holding company has no effect on ROA and ROE because it has an insignificant probability ($p = 0.815 > 0.05$) and ($p = 0.560 > 0.05$). The analysis shows that the holding company has a negative effect on DER and BOPO, because the coefficients have negative and significant values ($p = 0.00<0.05$) and ($p = 0.00<0.05$). The results of this research illustrate that holding companies have a positive effect on independent commissioners as a representation of governance ($p = 0.00 < 0.05$). Meanwhile, other governance indicators, the size of the commissioners, are not influenced by the holding company ($p = 0.50 > 0.05$). Details of the results of the analysis are described in table 4 as follows.

**Table 4.** Analysis of Data

| No | Variable | Indicator | t | Prob |
|---|---|---|---|---|
| 1 | Holding Company --Financial Performance | CR | 8.92 | 0.00 |

| | | | | |
|---|---|---|---|---|
| | | ROA | 0.40 | 0.81 |
| | | ROE | -0.58 | 0.56 |
| | | DER | -6.61 | 0.00 |
| | | BOPO | -16.38 | 0.00 |
| 2 | Holding Company -- Governance | KI | 2.54 | 0.01 |
| | | UK | -0.67 | 0.50 |

The test results using the paired t test show that the holding company has a positive and significant effect on the current ratio. A holding company strategy has the ability to manage the allocation of resources and liquidity among its subsidiaries (Suk, Haryanto, & Purba, 2019). With a holding company, subsidiaries can provide financial support to each other in the event of a lack of liquidity, thereby helping to keep the current ratio balanced (Fiechter et al., 2011). In addition, holding companies usually have easier access to external financial resources, such as loans, which can be used to increase the liquidity of the companies under them (Zhang, 2019). All of this can have a positive impact on the current ratio in the short term.

The holding company has no effect on ROA and ROE. Even though the holding company creates asset synergies and a larger capital scale for the parent company and subsidiaries, in the short term the holding company has not been able to increase its profits significantly. Holding companies generally focus on creating synergies and long-term value between subsidiaries (Hariyanti & Hendranastiti, 2023). This synergy takes time to materialize, such as through integration of operations, optimization of resources, or development of joint strategies. So in the short term, these benefits are not yet visible enough in return on assets and return on equity. The formation of a holding company also often involves restructuring the organization and business processes of subsidiaries, where this restructuring can cause inefficiency and disruption in the short term and cause a decrease in profits before synergies are realized.

The results of this research state that holding companies have a negative and significant effect on DER. This condition illustrates that the holding company strategy can reduce DER, thus affecting the company's solvency for the better (Ficbauer & Režnáková, 2014). Financial consolidation in a holding company has the ability to transfer debt between subsidiaries and increase total equity significantly without the need to add new capital (Luciano & Nicodano, 2011). A holding company can acquire another company using its own shares, not debt. So, this strategy does not increase the amount of debt, but increases assets and equity. The holding company can also sell its non-strategic assets to generate cash and can use it to pay off part of the debt, thereby reducing the amount of outstanding debt.

Similar findings for company efficiency reveal that holding companies have a negative and

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significant effect on BOPO. Holding companies can create scale savings, asset optimization, standardization, centralized risk management, and better access to capital. With the right strategy and effective implementation, holding companies can increase profitability, reduce costs and increase value for all stakeholders (Yoon et al., 2014) . A holding company can combine the resources and operational functions of its subsidiaries to achieve economies of scale (Zhang, 2019). For example, a holding company can centralize purchasing raw materials, negotiating with vendors, and managing information technology infrastructure, thereby achieving lower prices and higher efficiency (Ficbauer & Režňáková, 2014).

The holding company can analyze and optimize overall asset use across the company group. Assets that are unused or underutilized by one subsidiary can be reallocated to other subsidiaries that need them. This can increase asset utilization and produce greater added value for the holding company as a whole. A holding company can standardize processes, procedures and systems across its subsidiaries, so that centralizing functions such as accounting, finance and human resources can increase efficiency, reduce duplication and save costs. Standardization can also improve the quality of products and services, as well as strengthen the branding and reputation of the holding company as a whole. Holding companies can centralize risk management at the parent level, so they can identify, evaluate and manage risks more effectively (Raykov & Silva-Buston, 2020). This strategy can help reduce the risk of financial and operational losses for the holding company and its subsidiaries. A holding company can also leverage its expertise and financial resources to help its subsidiaries manage risk and improve their credit profiles (Zhang, 2019).

Apart from that, the holding company will also influence corporate governance positively and significantly, namely the ratio of independent commissioners. This means that the effect of the holding company strategy through adding independent commissioners to the holding company can bring many benefits in terms of corporate governance, supervision and expertise (Kalsum, Fuadah, & Safitri, 2021). Independent commissioners are commissioners who are not affiliated with other interested parties, such as major shareholders, members of the board of directors and/or other members of the board of directors. Independent commissioners act as independent mediators and supervisors who have no personal interest in the holding company. They can help ensure that holding company decisions are made with the interests of all stakeholders, including minority shareholders and the public, in mind (OECD, 2022). This can increase transparency, accountability and trust in the holding company, which in the end can increase company value (Nugraheni, Alhabshi, & Rosman, 2022).

Independent commissioners also have an important role in overseeing holding company management and ensuring that they comply with applicable laws, regulations and corporate governance standards (Rahma & Firmansyah, 2022). They can review the holding company's financial reports, material transactions, and operational risks to identify and prevent potential violations or abuse of authority (Abbas, Ismail, Taqi, & Yazid, 2021). This increase in supervision and internal control can help protect the interests of shareholders and increase the financial stability of the holding company (Ramadhan & Firmansyah, 2022).

Another thing with the number of the board of commissioners, this research reveals that the holding company has no effect on the size of the board of commissioners. Many shareholders state that the size of the board of commissioners is not important in increasing company value, especially if the commissioners actually take policies that are not in line with improving company value (Pangaribuan, Yoewono, Winarno, 2023). A large board of commissioners will actually create inefficiencies, due to the additional allocation of company operational expenses (Khaoula & Moez, 2019). Therefore, many companies will not increase the size of their commissioners even though the company is carrying out a business combination.

## CONCLUSION

This research aims to determine the impact of holding companies on the financial performance and governance of State-owned Enterprises that carry out holding companies. Holding companies are a business strategy to create synergy and increase company value, but many companies also show the opposite condition, namely decreasing financial performance and weakening governance. This research reveals that the holding company has a positive effect on the current ratio, but has no effect on ROA and ROE. The research reveals that holding companies have a negative effect on DER and BOPO. Apart from that, the research has a positive effect on the composition of independent commissioners but has no impact on the size of commissioners.

Apart from achieving improvements in financial performance and governance, State-owned Enterprises must prepare long-term steps to ensure they are in line with the holding company's overall financial strategy and business objectives. Achieving holding company business goals is not always easy and requires careful planning, implementation and coordination. Its success depends on factors such as synergy between companies, a conducive corporate culture, and effective control and measurement systems. Holding companies also need to ensure that centralization does not trigger new bureaucracy and inefficiencies.

The research has limitations, because the period observed is short term and the number of variables in the model is still limited. Future researchers can expand this research by extending the data period to the medium or long term. Therefore, it is hoped that future researchers will be able to overcome these factors, thus providing confirmation of the results of this research and providing a more comprehensive basis for policy makers in making decisions on optimizing State-owned

Enterprises' performance. This emphasis needs to be made, because State-owned Enterprises play an important role in economic development in Indonesia and as a source of income in the State budget.

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