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Foreign Ownership and Financial Firms Performance: Empirical Evidence Indonesia Financial Services Industry

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Abstract

The aim of the paper is to study the value created by foreign firms in Indonesia finance company industry over the period 2001-2011. We analysed the value creation of foreign firms by comparing the key financial performance to local shareholders. Foreign firms are the major players in banking industry and automotive industry with market share more than 90% in both two wheeler and four wheeler. Meanwhile, the automotive manufacturers and dealers are the one who provide the products of financing for finance company. We analysed seven micro key financial variables (profitability, efficiency, growth, firm size, liquidity, solvency and asset quality). We use parametric panel data dummy regression. The empirical results show that finance companies owned by foreign firms are more efficient, lower in profitability, bigger in size, higher in growth capability, lower in liquidity and higher in solvency.

Keywords : financial performance, foreign ownership, finance company, panel data, financial ratio

Abstrak

Penelitian ini bertujuan untuk mengetahui nilai tambah yang dihasilkan oleh perusahaan asing pada industri perusahaan pembiayaan di Indonesia pada periode 2001-2011. Penelitian ini membandingkan kinerja keuangan antara perusahaan pembiayaan asing dengan perusahaan pembiayaan lokal. Perusahaan asing merupakan pemain utama pada industri perbankan dan industri otomotif dengan menguasai lebih dari 90% pangsa pasar kendaraan roda dua dan roda empat. Manufaktur dan dealer otomotif merupakan penyedia produk pembiayaan. Penelitian ini menganalisis tujuh variabel keuangan yakni profitabilitas, efisiensi, pertumbuhan, ukuran perusahaan, likuiditas, solvabilitas dan

kualitas aset. Penelitian ini mempergunakan data panel regresi dummy. Hasil penelitian menunjukkan bahwa perusahaan pembiayaan yang dimiliki oleh pemegang saham asing lebih efisien, lebih besar untuk ukuran dan pertumbuhan aset. Perusahaan pembiayaan asing memiliki profitabilitas yang lebih rendah, tingkat likuiditas yang lebih rendah dan solvabilitas yang lebih tinggi dibandingkan dengan perusahaan pembiayaan lokal.

Kata Kunci: data panel, kepemilikan asing, kinerja keuangan, perusahaan pembiayaan, rasio keuangan.

JEL Classification Code : C33, F23, G21, G32, G34

1. Introduction

Indonesia finance company industry has evolved from Rp37 trillion in 2001 to Rp221 trillion in 2010 with compounded annual growth rate (CAGR) of 122%. The financing contribution to Indonesia's gross domestic product has reached a value of 3.59% (Nuryartono, 2012). The financing contribution to the total national credit Indonesia reached 12.5% in 2011.

The finance company industry is highly dependent on two other industries, the banking industry and the automotive industry. Banking industry serves as the major funding source for finance companies, ranging from 78% to 91% in the last eight years. Finance company industry is also an industry where demand is a derived demand (Hutabarat, 2012). Financing must involve underlying transaction or product and it may not provide financing or loans without any solid occurrence of transaction of goods or services.

Are there differences in the character of a cross border finance company owned by a foreign investor compared to the ones with local ownership? Given that with the foreign ownership, funding sources of finance companies become more competitive as compared to being entirely dependent on domestic funding sources. The second consideration is that the products financed by finance companies are products of foreign production. The foreign products financed by finance company such as 4 wheeler, 2 wheeler, heavy equipment, and other white goods. Finance companies are categorised based on ownership in accordance with the Decree of the Minister of Finance which is joint venture or foreign owned finance companies which the foreign ownership up to 85% and a local finance company is owned by an Indonesian citizen.

This study becomes unique by examining the value brought by the foreign shareholders to Indonesia finance company industry. Research on the financial performance difference between foreign and local ownership is still uncommon. Among some examples are Vander Venet (2002), Montreevat and Rajan (2003), Wu (2008), Correa (2008), Becalli (2008), Kalluru and Bhat (2009), Tahir et al. (2010), and Wanniarachchige and Suzuki (2011).

Vander Venet (2002) stated that European banks gain increased profits resulting from the influence of parent companies. This study found no change in the efficiency ratio. This study was done on sixty-two samples that did mergers and acquisitions between the years 1990 - 2001 in thirty-four European Union state members.

Montreevat and Rajan (2003) conducted a research on the implications of foreign bank penetration in Thailand banks after two crisis in the 1980's and 1990's. This study found that the penetration of foreign banks in Thailand banks have lowered its cost structure, increased efficiency and improved corporate governance system. Foreign banks have also introduced new products, new technologies and management expertise to the domestic banking system.

Wu (2008) found that foreign banks participated in building the country's economy with the ability to choose productive industrial sectors. The study was conducted from 1996-2003 with a sample of thirty-five emerging market countries.

Kalluru and Bhat (2009) found that the penetration of foreign banks in the banking industry in India, has increased the profitability of the banking industry, overhead costs and non-performing loans increase. Tahir et al. (2010) researched about differences between the performance of domestic banks and foreign banks in Malaysia between 2000 and 2006. Domestic banks have higher margin and operating costs compared to foreign banks. Foreign banks also have a better profitability ratio compared to domestic banks. Domestic banks also have a better efficiency ratio compared to foreign banks.

Wanniarachchige and Suzuki (2011) found that domestic banks and the government have worse performance than the foreign banks in India. Foreign banks have better performance in both aspects of cost efficiency and revenue efficiency. Largest banks in Asia countries, such as China, Indonesia, Singapore, Malaysia, and Thailand, are still owned by governments or private companies of each country. Largest bank in Indonesia Bank Mandiri is owned by the government. Maybank is Malaysia's largest bank, Development Bank of Singapore is Singapore's largest bank, Bangkok Bank is Thailand's largest bank, Bank of Tokyo Mitsubishi UFJ is Japan's largest bank, and Hana Financial Group is South Korea's.

Kim and Lee (2004) observed the banking industry in South Korea from 1999 to 2001. This study found that there were no significant differences between corporate governance and profitability improvement of foreign banks and domestic banks. This study found that the penetration of foreign banks in Korea only results in better banking system.

Correa (2008) conducted a study of two hundred twenty transactions of cross border mergers and acquisitions between the years 1994 to 2003. This study found that banking performance targets did not experience any increase in the first two years compared to companies that did not do mergers and acquisitions. Banks in developed countries experienced decreased net interest margin while banks in developing countries experienced increased overhead costs.

Hagendorfl (2009) found that cross-border acquisitions by parent companies from the United States were focused on increasing revenue while parent companies from Europe were focused on improving efficiency. The acquisition by parent companies from the United States did not show changes in performance on the target company, while acquisitions made by parent companies from Europe improved the performance of the target company. Although there are already numerous researches concerning the financial performance of an acquisition by a foreign investor, there is no conclusive result yet. Therefore, it is important to conduct a research on this topic, especially in a specific industry with acquirers from related industry.

This paper will study the financial performance of finance company industry in Indonesia during 2001-2011. The performance measurement comparison will be based on two categories, which are between foreign and local ownership. The financial measurement are grouped into 7 dimensions, which are profitability, efficiency, solvency, liquidity, size, growth and asset quality. The rest of the paper will be organized as follows, after the introduction, we describe the data and methodology in Section 2, followed by the result and discussion in Section 3. Finally, Section 4 gives summary and conclusion remarks.

2. Methodology, Variable and Data

2.1. Methodology

2.1.1. Dummy Variable Regression

Parametric test model in this study is developed from the dummy regression model by Vander-Vennet (2002). The variables in this study refer to seven measurements on profitability, size, efficiency, liquidity, solvency, growth and asset quality. The five ratios were developed by Healey et al. (1992), Cornet and Tehranian (1992, 2006) and Cheng (2006). This study adds in the variable of growth developed by Mandelker (1972) and a variable of size developed by Vander-Vennet (2002).

These variables are adapted and developed into seven measurement ratio groups with nineteen research variables. Foreign owned companies are coded differently from local owned finance companies (DK = dummy). DK code for foreign owned = 1, code for local owned company = 0. Financial performances are studied based on the ratio of growth, efficiency ratio, solvency ratio, liquidity ratio, size ratio, profitability ratios, and asset quality ratio. Each of the financial indicators is tested parametrically. Parametric tests are conducted by dummy regression towards each variable by the equation as follow :

Model 1a :

$$Y_{it} = a + b_1 DK_{it} + \varepsilon \quad (1)$$

Model 1b :

$$Y_{it} = a + b_1 DK_{it} + b_2 FSI_{it-1} + b_3 TAGR_{it-1} + \varepsilon \quad (2)$$

Where

Y_{it} = EXIR, ROA, ROE, NPM, PROV, LEV, PATA, LIQ, EXPA, REPA, LITA, FSI, TAGR, PAGR, NIGR, REGR, EXGR

DK = dummy ownership, 1 for foreign ownership and 0 for local ownership

FSI = Firm Size

TAGR = Total Asset Growth

The hypothesis of the research are as follow :

H1 : There were differences in growth between the finance companies foreign owned and local owned.

H2 : There were differences in efficiency between the finance companies foreign owned and local owned.

H3 : There were differences in solvency between the finance companies foreign owned and local owned.

H4 : There were differences in asset quality policy between the finance companies foreign owned and local owned.

H5 : There were differences in firm size between the finance companies foreign owned and local owned.

H6 : There were differences in liquidity between the finance companies foreign owned and local owned.

H7 : There were differences in profitability between the finance companies foreign owned and local owned.

2.2. Variable and Measurement

The five ratios were developed by Healey et al. (1992), Cornet and Tehranian (1992, 2006) and Cheng (2006). This study adds in the variable of growth developed by Mandelker (1972) and a variable of size developed by Vander-Vennet (2002). These variables are adapted and developed into seven measurement ratio groups with 17 research variables. This development is adjusted to finance industry ratio (table 1).

Table 1. Financial Ratios

Ratio	Formulation
Growth Ratio	
Revenue Growth	$REGR = \frac{Revenue(t) - Revenue(t-1)}{Revenue(t-1)}$
Total Asset Growth	$TAGR = \frac{Total Asset(t) - Total Asset(t-1)}{Total Asset(t-1)}$
Net Income Growth	$NIGR = \frac{Net Income(t) - Net Income(t-1)}{Net Income(t-1)}$
Productive Asset Growth	$PAGR = \frac{Productive Asset(t) - Productive Asset(t-1)}{Productive Asset(t-1)}$
Productive Assets To Total Assets	$PATA = \frac{Productive Asset}{Total Asset}$
Efficiency Ratio	
Expense Income Ratio	$EXIR = \frac{Expense}{Income}$
Expense to Productive Assets	$EXPA = \frac{Expense}{Productive Asset}$
Expenses Growth	$EXGR = \frac{Expense(t) - Expense(t-1)}{Expense(t-1)}$
Solvency Ratio	
Liabilities Total Assets	$LITA = \frac{Total Liabilities}{Total Asset}$
Leverage Ratio	$LEV = \frac{Total Liabilities}{Total Equity}$
Asset Quality	
Provisioning Policy	$PROV = \frac{Total Provisioning}{Total Productive Asset}$
Size Ratio	
Firm Size	$FSI_t = \ln Total Asset(t)$ $FSI_{t-1} = \ln Total Asset(t-1)$

(continue) Table.1 Financial Ratios

Liquidity Ratio	
Liquidity Ratio	$LIQ = \frac{\text{Total Productive Asset}}{\text{Total Liabilities}}$
Profitability Ratio	
Return on Assets	$ROA = \frac{\text{Net Income}}{\text{Total Asset}}$
Return on Equity	$ROE = \frac{\text{Net Income}}{\text{Total Equity}}$
Net Profit Margin	$NPM = \frac{\text{Interest Income} - \text{Cost of Fund} - \text{Expenses}}{\text{Interest Income}}$
Revenue to Productive Assets Ratio	$REPA = \frac{\text{Revenue}}{\text{Total Productive Asset}}$

2.3. Data

This study uses secondary data collected from various institutes and official literature which include published financial data of each company on various mass media, annual reports for public companies, research reports from various securities, research reports from magazines and Bloomberg database particularly regarding mergers and acquisition transactions.

The data are panel data consisting of cross section data from an observed period of the year 2001-2011. Some of the above data are obtained by using a calculation. Formulation of these variables is presented in table 1. The data used in this study is panel data. Panel data are two-dimensional data and the combination of time dimension (time series) and individual company dimension (cross section).

All finance companies in Indonesia that published the financial statements in 2001 to 2011 are the objects of the research. The number of companies registered with Bapepam LK is one hundred and ninety-three companies. The sampling criteria are as follows:

1. Finance companies listed on the Capital Market and Financial Institution Supervisory Agency (Bapepam-LK) in 2011.
2. Finance companies that actively published financial statements during the period of 2001 to 2011.
3. Finance companies that announced the actions of corporate acquisitions during the period 2001 - 2011 in various mass media channels or annual report.

The sampling unit is finance companies. The sampling frame is the list of companies listed on the Bapepam-LK and those that published financial statements for the period of 2001-2011. The sampling size is the total of all finance companies listed at the Bapepam-LK and met the specified criteria. This study uses purposive sampling with judgment sampling. Samples must meet certain criteria established in this study.

3. Analysis and Discussion

3.1. Performance between Foreign and Local Ownership

The purpose of this study is to assess the differences in financial performance of finance companies owned by foreign firms and those owned by local shareholders. Total financial data of finance companies owned by foreign shareholders amounts to 322 samples. The results of data processing on several ratio measurements show significant differences between finance companies owned by foreign shareholders and those by local shareholders. Data processing uses parametric (Pooled Least Squared).

Tabel 2: The Testing Result on Differences in Financial Performance between Foreign Owned and Local Owned Finance Companies

No.	Variable	Parametric (Pooled Least Squared)	
		Model 1a	Model 1b
1	EXIR	-1.046 (0.786)	-0.586 (0.841)
2	ROA	-0.025 (0.060)	-0.021 (0.068)
3	ROE	-0.316 ** (0.150)	-0.384 ** (0.170)
4	NPM	-0.002 (0.046)	-0.376 (0.051)
5	PROV	0.002 (0.015)	0.008 (0.017)
6	LEV	-7.912 (6.563)	-9.897 (7.564)
7	PATA	0.065 *** (0.015)	-0.011 (0.014)
8	LIQ	-0.994 (2.823)	3.377 (3.135)
9	EXPA	-0.332 (0.407)	-0.167 (0.469)
10	REPA	-0.113 ** (0.053)	-0.059 (0.059)
11	LITA	-0.069 (0.320)	-0.015 (0.368)
12	FSI	1.310 *** (0.132)	0.166 *** (0.056)
13	TAGR	0.838 * (0.436)	1.008 ** (0.502)
14	PAGR	0.339 (1.826)	1.688 (2.100)
15	NIGR	-0.042 (1.214)	0.103 (1.397)
16	REGR	0.500 (0.831)	0.874 (0.957)
17	EXGR	1.127	1.351

Note:

- 1) Dummy estimation coefficient (1 for finance companies owned by foreign shareholders (cross border) and 0 for finance companies owned by local shareholders (non cross border))
- 2) Numbers in () states the estimated standard error
- 3) *) Significant at 10% level
**) Significant at 5% level
***) Significant at 1% level

The significant results of Pooled Least Squared (PLS) will be re-tested using Fixed Effect Model (FEM) dan Random Effect Model (REM) test. Afterwards, The Chow test, Hausman test and LM test will be used to compare the results between PLS and FEM, between REM and FEM and between PLS and REM respectively.

Table 3. Panel Data Test Result

Variable	Model 1 a			Test			Valid Model
	PLS	FEM	REM	Chow	Hausman	LM	
PATA	0.065 ***	0.066	0.065 **	5.53 ***	-	460.37 ***	REM
ROE	-0.316 **	-0.010	-0.316	0.96 **	0.20	0.13	PLS
REPA	-0.113 **	0.592 **	-0.058	2.93 ***	9.24 ***	107.00 ***	FEM
FSI	1.310 ***	0.549	1.006 ***	15.25 ***	2.22	1,727.42 ***	REM
TAGR	0.837 *	-1.478	0.837	0.91	1.36	0.56	PLS

Variable	Model 1 b			Test			Valid Model
	PLS	FEM	REM	Chow	Hausman	LM	
ROE	-0.384 **	0.017	-0.383 **	0.96	2.12	0.16	PLS
FSI	0.166 ***	-0.614	0.203	5.03 ***	-286.42 ***	81.53 ***	PLS
TAGR	1.008 **	-1.712	1.008 **	1.10	120.93 ***	0.15	PLS

Note: 1*) Significant at $\alpha = 10\%$

**) Significant at $\alpha = 5\%$

***) Significant at $\alpha = 1\%$

2) PLS : Pooled Least Squared; FEM : Fixed Effect Model; REM : Random Effect Model

3.1.1. Testing of Growth Ratio Differences (H1)

For total asset growth (TAGR), the test results using the parametric test (least square pool) where the dummy variable (integrated-independent) has a value 0.84 and is significant at $\alpha = 10\%$. By adding a variable lag (1) on firm size and asset growth in parametric testing (pooled least square), firm size aspect obtains a statistical value of 1.008 with $\alpha = 5\%$. These results show there are real differences between TAGR ratio of foreign and local owned finance companies. TAGR ratio of finance companies with foreign alliance is greater than those owned by local shareholders. Foreign finance companies have a greater total asset growth than the local finance companies. This is in line with findings by Hagendorfl(2009).

3.1.2. Testing of Efficiency Ratio Differences (H2)

Productive asset structure aspect towards total assets (productive assets to total assets / PATA) is represented by parametric test (pool least square) where the dummy variable (alliance-non alliance) has a value of 0.065 and is significant at $\alpha = 1\%$. These results show there are real differences in PATA ratio between the foreign and local owned finance companies. PATA ratio of finance companies with foreign alliance is higher than those owned by local shareholders. Foreign finance companies become more efficient compared to local finance companies.

3.1.3. Testing of Solvency Ratio Differences (H3)

There were no significant differences found in the solvency ratio for finance companies owned by foreign and local firms. Both firm types have similar policy on solvency.

3.1.4. Testing of Asset Quality Ratio Differences (H4)

There were no significant differences found in the risk ratio for finance companies owned by foreign and local firms. Both firm types have similar policy on asset quality management.

3.1.5. Testing of Firm Size Differences (H5)

FSI obtains from parametric test statistical value (pool least square) where the dummy variable (integrated-independent) has a value of 1.310 and is significant at $\alpha = 1\%$. By adding a variable lag (1) on firm size and asset growth in parametric testing (pooled least square), firm size aspect obtains statistical value of 0.166 with $\alpha = 1\%$. These results show there are real differences between FSI ratio of foreign and local owned finance companies. FSI ratio of finance companies with foreign alliance is higher than those owned by local shareholders. Foreign finance companies become larger in total assets compared to local finance companies.

3.1.6. Testing of Liquidity Ratio Differences (H6)

There were no significant differences found in the liquidity ratio for finance companies owned by foreign and local firms. Both firm types have similar policy on liquidity management.

3.1.7. Testing of Profitability Ratio Differences (H7)

In terms of profitability aspect, Return On Equity is indicated by a parametric test with value of -0.316 with a dummy variable and -0.384 with a dummy variable, lag (1) for firm size and lag (1) for asset growth with significant at $\alpha = 5\%$.

These results show there are real differences between ROA and ROE ratios of the foreign and local owned finance companies. ROA ratio of companies with foreign alliance is lower than those owned by local shareholders while ROE of foreign finance companies have a greater return than the local finance companies. With panel data testing, for ROE, local finance companies have higher profitability than foreign finance companies. These results are the same with the results of research by Soussa and Wheeler (2006). Soussa and Wheeler found that acquisitions in developing countries are not profitable on average.

On the ratio of operating income to productive assets (REPA), the parametric testing (pool least square) with the dummy variable (integrated-independent), a statistical value of 0.59 is obtained and is significant at $\alpha = 5\%$. These results show there are real differences between REPA ratio of the foreign and local owned finance companies. REPA ratio of finance companies with foreign alliance is lower than those owned by local shareholders. Foreign financing companies offer more competitive rates to customers compared to local finance companies.

4. Conclusion

This paper investigates whether foreign firms influence the performance of finance company. Using a sample of 100 finance companies that published their financial statement over the period 2001-2011, we analyse whether foreign parent company's value are reflected in improved performance of the finance company subsidiary (measured using standard accounting ratios). Our study produced several interesting findings. First, the foreign ownership and acquisition will have better in asset allocation, higher profitability, bigger firm size, higher asset growth, and higher efficiency. On the contrary, the foreign ownership and acquisition has lower return on asset, and lower gross yield. Overall, the result of the study indicate that the foreign acquisition and ownership add value in the firm size, profitability, and efficiency of target companies.

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