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Privatization and Firm Performance: a Study of Indonesia's State-owned Enterprises

Fransiska Soejono[1✉], **Heriyanto**[2]

Faculty of Business and Accounting, Musi Charitas Catholic University, Palembang, Indonesia[1,2]

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Abstract

This study aimed to examine the differences in the company's performance before and after privatization. This study also examined the differences in performance before and after privatization on specific sub-samples of the data which is based on privatization method. Government policy of carrying out the privatization toward SOEs is still pro and contra. Various Privatization methods offer its weaknesses and strengths. There are different opinions on the best method for SOE privatization in Indonesia. The population is all companies which execute the privatization method. Secondary data were used namely financial statement which was taken from the Indonesia Stock Exchange, and the company's website. Data were analyzed using normality test data. In addition, the paired t-test by using normally distributed data assumption was used to test the hypothesis. The results showed that Direct method privatization positive and significant changes in measuring Total Asset Turnover. Performance conducted Privatization through the capital markets showed different results. Test on the capital market method of data showed a similar effect with an analysis on the entire data (without separating the privatization method used) that occur significant performance degradation, especially in measuring Total Asset Turnover, Debt Ratio and Return On Equity. Conducted Management/Employee Buy-Out (MBO) privatization implied a substantial reduction in measuring Debt Ratio and Return on Equity Performance.

Privatisasi dan Kinerja Perusahaan: Studi pada Badan Usaha Milik Negara Indonesia

Abstrak

Penelitian ini bertujuan untuk menguji perbedaan kinerja perusahaan sebelum dan setelah melakukan privatisasi. Penelitian ini juga menguji perbedaan kinerja perusahaan sebelum dan sesudah privatisasi sesuai dengan metode privatisasi yang dilakukan oleh perusahaan. Keputusan pemerintah untuk melakukan kegiatan privatisasi Badan Usaha Milik Negara masih sering menerima pro dan kontra. Kegiatan privatisasi memiliki berbagai macam kelemahan dan kekuatan yang menimbulkan perdebatan, metode privatasi yang paling tepat diterapkan di Indonesia. Populasi dari penelitian ini adalah semua perusahaan yang pernah melakukan privatisasi. Data sekunder yang digunakan di penelitian ini berupa laporan keuangan yang diperoleh dari Bursa Efek Indonesia. Data juga diuji menggunakan pengujian normalitas. Sebagai tambahan, uji t juga digunakan untuk menguji hipotesis yang ada di penelitian ini. Hasil pengujian menunjukkan bahwa privatisasi langsung berpengaruh positif dan signifikan terhadap perputaran total asset. Pengujian kinerja perusahaan yang melakukan privatisasi di pasar modal juga menunjukkan hasil signifikan, terutama pada pengujian perputaran total asset, rasio hutang dan rasio laba terhadap ekuitas. Employee Buy-Out (MBO) *privatisasi menunjukkan pengurangan yang substantial pada pengukuran rasio hutang dan rasio laba terhadap ekuitas.*

JEL Classification: G11, G12, G13

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✉Correspondence Address
Jl. Bangau No. 60, 9 Ilir, Ilir Tim. II, Kota Palembang, Sumatera Selatan 30144
Email: fransisca@ukmc.ac.id

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INTRODUCTION

State-owned Enterprise (SOE) is worked as a profit generator for the state and providing economic stimuli and also any other aspects (Law No. 19 of 2003). The ownership of SOE is predominantly controlled by the government and until now it's expected to drive the national economy. SOEs is an integral part of the national economy since SOEs in various sectors is a source of the country's income. The amount of dividend and taxes deposited by SOEs to the government from 2004 to 2008 had increased. The dividend transfer increased by over 2,9 times in 2008 compared with 2004, so the tax payment from SOEs increased by 3,5 times. The contribution of SOEs to Gross Domestic Product (PDB) as 21.92% to 23.47% in 2004-2008.

The issue today is not all SOEs are profitable for the state. The overall net profit of SOEs was 78 trillion IDR, compared with the asset of SOEs which amounted to 1,978 trillion IDR. So, the profit ratio wasn't outstanding, only 3.9%, far below the 1-year interest rate on deposit which could reach to up to 6% in 2008. The number of healthy SOEs declined from 2004 to 2008. Indonesia had 141 SOEs in 2009, but SOE performance wasn't so good. Healthy SOEs from 1997 to 2009 was only 16 to 46%.

The government expects SOEs to drive economic growth, but other conditions show that the government must subsidize any SOE which has a loss. This shows the dependency of SOEs to the government and eventually becomes a burden for the government. Government subsidy also makes it more difficult for SOEs to be efficient. The role of government in SOEs becomes unclear because the result of subsidy policy makes it difficult to compare SOEs with private companies. Several studies even show that SOE performance is relatively lower than private companies (Berger et al., 2005; Bonin et al., 2005; Fries & Taci, 2005; Soejono, 2010). Hapsari and Rokhim (2017) state that the government should continue to open the banking market up to foreign investor if they are proven taking a positive impact.

One government action to solve this is privatization. Privatization policy in SOE was first performed in 1991 on PT Semen Gresik, Tbk. Several studies state that the financial performance of government companies increases after privatization (Dharwadkar et al., 2000; Gupta, 2005; Urga et al., 2007; Ochieng & Anwar, 2014). A study on the difference of performance before and after privatization in Indonesia has been performed but the result is limited to significant performance improvement in real sales (Juoro, 2002).

The selection of the best privatization method is an essential first step in privatization (Bachiller, 2017). The simplified method in SOE privatization is the capital market. Privatization through the capital market is often performed by the government. Data from the ministry of SOE shows that there are 20 of 24 SOEs which are privatized through the capital market from 1991 to 2013. Privatization through the capital market is considered transparent because society can directly appraise company performance through a published financial statement.

The community also has an opportunity to control and owns stocks of government companies. Local government also can buy company stocks, so local government is more focused on developing business in their region. Another privatization method is selling shares to management or employees (MBO method) and the direct method. MBO method can be the right and strategic step because it's considered able to change and improve cultural attitudes and behaviors in the company. This method also can reduce labor issues because employees are directly involved in the corporate operation, management and control. Direct methods, such as strategic sale, make external parties' strategic partners, because they have better access to the global market, thus driving SOE to reach the international market.

Jelic et al. (2003) and Boubakri et al. (2005) find empirical evidence that privatization method influences company long-term performance. There are different opinions on the best method for SOE privatization in Indonesia. Alipour (2013) argues that there should be accountability in privatization. Go public mechanism is more transparent and fairer than a strategic sale, which is full of negotiation. Yonnedi (2010) states that Initial Public Offering (IPO) can improve the quality of Good Corporate Governance (GCG) but the implementation should still involve political decision of the House of Representative (DPR,) as long as time lack problem of political decision can be solved and IPO of SOEs hark back to the spirit of the Constitution of 1945, so that SOE privatization isn't always controversial and considered selling state assets to foreign parties.

Korteweg and Sorensen (2017) also states that regarding the implementation of GCG in SOE management, SOE privatization can be performed through the capital market. Buchner et al. (2016) states that if the method taken in SOE privatization isn't followed by GCG enforcement, it's not optimally successful. Purwoko (2002) finds something else. His study shows that SOE privatization with direct method (Private Placement) by foreign investors with over 50% inclusion with giving the most optimal benefit. Buchner et al. (2016) states that there is no single model for successful privatization. It can be anything from sales to the private sector to transfer of ownership to employees. Studies on research method and company performance in Indonesia are limited.

The purpose of the current study was first, to analyze different company financial performance before and after privatization. Second, to test the significant difference of company financial performance before and after privatization in the implementation of varying privatization methods (Capital Market, Direct and Employee/ Management).

Hypothesis Development

Well implemented privatization method will support improved company performance. IPO method will enable increased capital in the company. Increased wealth can be used to develop business and eventually improve people welfare. Moreover, when more investors are interested in buying SOE stocks, the value of the company also increases. Jelic et al. (2003) and Boubakrie et al. (2017) find empirical evidence that privatization method influences long-term company performance. There are differing opinions on the best method for SOE privatization in Indonesia. Alipour (2013) argues that the most effective mechanism is handing it to the capital market, not bidding system, to be transparent. Ho et al. (2016) and Ghulam (2017) states that go public mechanism is more transparent and fairer than a strategic sale, which is full of negotiation.

Yonnedi (2010) states that Initial Public Offering (IPO) can improve the quality of Good Corporate Governance (GCG). Korteweg and Sorensen (2017) also indicates that regarding the implementation of GCG in SOE management, SOE privatization can be performed through the capital market. Research Staff of the Center of Financial Statistic and Research, Department of Finances of the Republic of Indonesia (Purwoko, 2002) states that the ideal privatization model is private placement by a foreign investor with over 50% inclusion. The study by Purwoko (2002) shows that the issue of privatization by IPO method is reducing the chance to close State Budget deficit. The survey by Jelic et al. (2003) finds empirical evidence that privatization method influences long-term company performance. Therefore, the research hypotheses were:

H1a: There is a significant difference in financial performance before and after privatization using direct method implementation.

H1b: There is a significant difference in financial performance before and after privatization in capital market implementation.

H1c: There is a significant difference in financial performance before and after privatization in MBO method implementation.

METHOD

This study covered privatized government companies or State-owned Enterprises (SOEs) in Indonesia. The study was aimed to determine how the privatization method policy by the government impacted the performance of State-owned Enterprise. The population in this study was all privatized companies in 1989 to 2017. The sampling technique was purposive sampling (judgment sampling) with the following criteria (1) privatized SOE and the privatization method was known; (2) company listed in Indonesian Stock Exchange (BEI); (3) available financial statement data two years before and after privatization.

The data used was secondary data, which is data of the privatization method and company financial statement. The data collection technique was documentation technique with sources of data and year of privatization data from the ministry of SOE, data of company financial performance from Financial Statements downloaded from various websites (Ministry of SOE, Indonesian Stock Exchange, sahamok.com and company website).

There were five variables of company financial performance used in this study, which are Total Asset Turnover Ratio (TAT) which is one of efficiency ratio, showing how well company asset is used (Brown at al., 2016). The ratio is a part of activity ratio (Chang & Boontham, 2017) which measures the effectiveness of the usage of all assets in producing sales. The bigger the ratio, the more effective the management of all company assets. Formula: Sales Ratio/Average Total Asset (Jiang at al., 2013). Debt Ratio (DR) is a part of the leverage ratio. It is a ratio which measures the proportion of fund from debt to finance company assets. The bigger the ration, the bigger the usage of debt in financing investment in assets, meaning the financial risk of company increases and vice versa. Formula: Total Debt/Total Assets (Chang & Boontham, 2017).

Operating Profit Margin Ratio (OPM) is a ratio measuring a company's ability to produce profit before interest and tax with sales achieved by the company. This ratio shows the efficiency of the departments of production, personnel and marketing in generating a profit. Formula: EBIT/Sales (Mardjana, 2000; Chang & Boontham, 2017). Return on Asset (ROA) is a part of profitability ratio. It shows a company's ability to use all of its assets to produce a profit after tax. The ratio is essential for management to evaluate the effectiveness and efficiency of company management in managing all the company's assets. The bigger the ROA, the more efficient the use of company assets, or in other words the same total assets can produce more significant profit and vice versa. Return on Equity (ROE) is a part of profitability ratio, which shows the company's ability to produce a profit after tax using its capital.

The ratio is important for shareholders to determine the effectiveness and efficiency of capital management by company management. The higher the ratio, the more efficient the use of own capital by the company management. EAT/Total Equity (Brown at al., 2016). Privatization methods used in this study were: a) through the capital market (IPO/right issue/SPO); b) direct (Strategic Sales/Private Placement); c) to management and employees (Management/Employee Buy Out).

RESULT AND DISCUSSION

The population in this study was all privatized companies in 1989-2017. During 1989-2017 period, there were 31 privatized companies (with 47 cases of privatization). Privatization carried out after 2013 was not the sale of shares, but the addition of government capital through State Capital Participation. This number covered all privatization cases in SOEs and non-SOEs and also go public (open) and closed companies. But, because seven from 11 cases didn't leave any government stocks after privatization, they're not included in the research samples. One company was privatized in 2013 and couldn't be used because the data of two years after privatization couldn't be known. Therefore, the privatization period was from 1989 to 2012.

After sample selection, 60 observation data were collected (including 30 privatization cases and data of two years before and two years

Table 1. Descriptive Statistic of Financial Performance of SOE Pre and Post Privatization in 1989-2012

Financial Performance Variable	Minimum	Maximum	Mean	Std. Deviation
TAT_pre	.0327	1.6637	.642697	.5124427
TAT_post	.0425	1.5083	.569087	.4324439
DR_pre	.1022	.9450	.659308	.2306165
DR_post	.0962	.9234	.605538	.2351357
OPM_pre	-.0030	.5772	.239688	.1531125
OPM_post	-.0940	.5766	.248530	.1723866
ROA_pre	.0061	.4337	.081923	.0894457
ROA_post	-.2030	.2294	.058997	.0698026
ROE_pre	.0792	.5510	.225468	.1181920
ROE_post	-.4960	.5249	.153818	.1409410

after privatization) with 20 companies in total. Further, regarding the purpose of this study, which was testing the impact of privatization of SOE performance, this study used financial performance data of SOE two years before and two years after privatization policy.

Table 1 shows the descriptive statistic of SOE financial performance variables before and after privatization. On average, SOE performance after privatization declined than before, except for Operating Profit Margin (OPM). This might be because two years before and after privatization aren't enough to see any change/improvement of company performance.

Before privatization, the government was the majority shareholder of SOEs (government's shareholding was over 50%). After privatization, the government was still the majority shareholder in most SOEs (96.7%). Only one SOE (3.3%) had government's shareholding becoming a minority (less than 50%) after privatization, i.e., PT Indosat Tbk. It happened in the second privatization of PT Indosat Tbk in 2002.

Regarding the privatization method used by SOEs, 64% of 30 cases (observation) of SOE privatization used the capital market method. 23% used the direct method and only 3% of all cases (observation) of SOE privatization in this study used MBO method. Privatization through the capital market was more population and was the method preferred by the government. In reality, there were three privatization cases which used two methods simultaneously (mix method), i.e., two examples used Direct and Capital Market methods and one exam le used Management/ Employee Buy-Out (MBO) and Capital Market method. The data showed that 60% or 12 of 20 SOEs performed privatization only once. Other SOEs performed privatization twice (5 companies), three times (2 companies) and four times (1 company). PT Telekomunikasi Indonesia Tbk, PT Bank Negara Indonesia Tbk and PT Bank Mandiri Tbk were the SOEs which performed privatization more than twice.

Data Analysis, Hypothesis Testing and Discussion

Normality test showed that all performance variable data were normally distributed. To fulfill the normality test, data transformation was performed only on variable ROA. The conversion was performed using square root (sqrt) because the histogram data of variable ROA was moderate positive skewness. Then, outlier test was performed, discovering four observations which exceeded extreme value limit (with standard deviation ≥ 2.5). Hypothesis test used parametric difference test (paired t-test).

Table 2. The Difference of Financial Performance Before and After Privatization by Privatization Method

	Financial Performance (pre-post)				
	TAT	DR	OPM	ROA	ROE
Capital Market:					
mean	.106	.103	-.042	.002	.067
t	3.343	4.848	-1.616	.105	2.496
Sig.	.002	.000	.116	.917	.018
Direct:					
mean	-.101	-0.035	.047	.003	.010
t	-.825	-1.710	1.163	.119	.173
Sig.	.002	.111	.266	.907	.865
MBO:					
mean	.326	.057	-.015	.016	.114
t	1.531	14.392	-1.355	2.222	33.618
Sig.	.368	.044	.405	.269	.019

Table 2 shows the test result related to the difference of SOE financial performance before and after privatization using capital market, direct and MBO methods.

First, in privatization by the capital market method, the test result is only TAT, DR and ROE ratios were significantly different, while OPM and ROA weren't significantly different before and after privatization. Second, in privatization by the direct method, only TAT ratio showed a significant difference of financial performance, while DR, OPM, ROA and ROE ratios didn't show any difference in financial performance before and after privatization. A significant difference of financial performance of TAT ratio in the direct method was consistent with the study by Purwoko (2002) which showed that SOE privatization by the direct method (Private Placement) would give more benefit than capital market method. Third, privatization by MBO method produced statistically significant DR and ROE ratios. It indicated declined proportion of debt use by SOEs to fund their assets and decreased ability of SOE managements in managing equities to produce company profitability. However, TAT, OPM and ROA ratios didn't show any significant difference.

Table 3 shows the result of the test of difference of SOE financial performance before

Table 3. The Difference of Financial Performance Before and After Privatization in Mixed Privatization Method (Mix Method)

Note	**Mean**	**T**	**Sig.**
TAT post- TAT pre	.052	1.445	.208
DR post – DR pre	.005	.348	.742
OPM post – OPM pre	-.040	-.864	.427
ROA post –ROA pre	-.011	-.780	.471
ROE post – ROE pre	-.015	-.971	.376

and after privatization using mix method (using two privatization methods at the same time in one privatization). In mix method, no financial performance (TAT, DR, OPM, ROA and ROE) showed significant difference before and after privatization.

The result of the hypothesis test showed that using observation, overall there was a significant difference in financial performance in SOEs before and after privatization. The financial performance variables which were significantly different were TAT, DR and ROE ratios. Significant (positive) variable TAT indicated that there was reduced efficiency in SOE managements in company assets to produce sales (revenue) after privatization. Significant (positive) variable ROE stated that there was the reduced ability of SOE managements in managing company equities to generate a profit after privatization.

Meanwhile, significant (positive) variable DR meant reduced debt use by SOE managements to fund company assets after privatization. Significant reduction of debt ratio showed that privatization could reduce company debt burden. Variables OPM and ROA didn't significantly show change related to the improved operational performance of SOEs after privatization. Specifically, the result indicated that there was no significant difference compared to the ability of SOE managements in producing operational profit and managing company assets to generate a net profit after privatization.

Furthermore, based on the test on privatization cases using the capital market method, variables TAT, DR and ROE had positive and significant differences. The test result of privatization cases with direct method showed that only variable TAT was significantly (negative) different. It indicated that after privatization, there was the improved efficiency of SOE managements in managing their assets to produce sales (revenue).

The test result is consistent with the argument of the Research Staff of the Center of Financial Statistic and Research, Department of Finances of the Republic of Indonesia (Purwoko, 2002; Marciano, 2008) who states that the ideal privatization model is private placement by a foreign investor with over 50% inclusion. The study by Purwoko (2002) shows that the problem of privatization by IPO method is reducing the possibility of closing the State Budget deficit.

Meanwhile, the test of SOE privatization cases using MBO method found that variables DR and ROE were positive and significant. In MBO method, SOE management and employees are given the opportunity to buy company stocks. In this mechanism, the company should be able to reduce monitoring cost (agency cost) because employees will monitor business decisions (policies) taken by company management. Moreover, employees also tend to perform better to improve company financial performance.

Methods considered excellent and able to give an optimal result for company performance but, produced loss/ reduced performance might not be supported by the correct implementation. Failure of privatization might also be due to lack of support from management and labor. Bachiller (2017) states that there are some things which differentiate the success/ failure of privatizations in developed countries and developing countries. First, in developed countries, privatization was directed to find more dynamic management, while most developing countries direct privatization to "remove" losing SOEs. Second, privatization in developed countries are easy to perform through the capital market and political issues can be minimized. Third, legal conditions in developed countries are clearer and stricter, while in developing countries the legal circumstances are unclear.

Marcelin and Mathur (2015) underlined the importance to affirm the politic of the implementation of SOE restructuration. Another possibility is privatization is half-hearted because most stocks (96.67%) of SOEs were dominated by the government. Buchner et al.

(2016) states that if the methods of SOE privatization aren't followed by GCG reinforcement, it's not successful. Lack of a dominant individual because the majority shareholder is the government makes the agency cost higher and it harms the government as the recipient of dividend and companies.

This study contributed to several parties. First, for academicians, this study showed reduced TAT and ROE performances after privatization. Further investigation can use the result of this study to find the cause of the reduced company performance. Second, the government can evaluate the implementation of privatization to find factors causing the decline of company performance after privatization. The evaluation result can be used to consider future privatization decisions.

Moreover, the direct method can be selected by the government as one of the privatization methods. Third, this study provides information to investors on the impacts of privatization on company financial performance. Investors should be more careful in their decision to invest in privatized SOEs.

CONCLUSION AND RECOMMENDATION

The study on the difference of SOE performance before and after privatization produced the following findings: First, in overall data and Capital Market method data, there were significant differences of SOE financial performance before and after privation in financial variables TAT, DR and ROE. Meanwhile, variables OPM and ROA didn't show any significant difference. Second, the test on the difference of SOE financial performance before and after privatization using direct method gave the opposite result from the capital market method. The result of the analysis on direct method showed that only variable TAT was significantly different, while variables DR, OPM, ROA and ROE weren't significantly different. Third, the test of the difference of SOE financial performance before and after privatization using MBO method showed a significant difference in financial variables DR and ROE while variables TAT, OPM and ROA weren't significantly different. This study had limitations of only using samples of privatized SOE and go public companies (open companies).

Future studies can include other company samples which aren't SOEs and companies which haven't been going public (open companies) but have been privatized. This study didn't separate the results of the test of difference of SOE performance after privatization for banking and non-banking sectors. This separation is considered necessary considering the chance of different privatization mechanisms between banking and nonbanking companies. Different privatization mechanisms might be because business decisions of banking companies have more regulations and law from relevant authorities.

Furthermore, measurement of financial performance (related to the financial ratio used) of banking companies was relatively different due to different financial characteristics. Future studies should include control variables such as total company assets, company age, economic situation (before and after the crisis), government regime and other variables considered influential to company performance after privatization policy. This study only used financial performance (financial ratio) as an observed variable. Future studies should use other variables which measure company non-financial performance after privatization, such as the effectiveness of company management, company restructuration, development of organizational culture and other variables considered to measure company non-financial performance after privatization.

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