

VALUE CREATION MODEL IN INDONESIA

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ABSTRACT

Value creation is the most important objective of a listed company, because by creating value, corporate could obtain the sustainable profit and provide high and consistent return for all stockholders. There are many internal and external factors that determine the value creation process. The purpose of this research is examine empirically: (1) the value creation process in Indonesian listed companies; (2) the influence of the corporate complexity, financial structure, growth opportunities, operational excellence, level of disclosure and good corporate governance mechanism on value creation of Indonesian listed companies; and (3) the proposed model of value creation in Indonesian listed companies. The population used in this research are Indonesian Stock Exchange's LQ 45 companies. This research using two models of empirical research. The first model examine the effect of independent variables to dependent variables, Value Creation, reflected on the Economic Value Added (EVA), and in the second model, Value Creation is reflected on the Market Value Added (MVA). To strengthen the results of quantitative analysis, qualitative test by using content analysis is applied to identify the description of value creation process and the key factors of value creation. The results of this research provide empirical evidence about the description of the value creation process in Indonesian Listed Companies, This research also find the influence of corporate complexity, operational excellence, financial structure, growth opportunities, level of disclosure and good corporate governance mechanism on value creation, measured by Economic Value Added (EVA) and Market Value Added (MVA). This research also proposed a model of value creation that reflects how the general strategy undertaken by Indonesian Listed Companies in creating value for its shareholders.

Keywords : Value Creation, Good Corporate Governance Mechanism, Indonesia Listed Companies.

INTRODUCTION

In 2008, the world faces a global economic crisis that started from the bankruptcy of several major financial institutions in the United States with the root causes of US Subprime Mortgage Crisis. The crisis has an impact on almost all sectors of finance, such as capital markets, insurance, banking and financial institutions in both the United States and around the world. Stock price index in almost all major world markets are declining, especially after the United States House of Representatives rejected the bailout package intended to rescue Wall Street.

The Wall Street Composite Index has down almost 778 points on Monday, September 29, 2008, or the biggest declining since the terrorist attacks in the United States on September 11, 2001. Nikkei index at the Tokyo Stock Exchange shed 4.12 per cent in the transaction closing date of 30 September 2008 after the United States financial markets rescue package was rejected. Hong Kong's stock index was also fell 1.40 percent, and South Korea's stock index fell 0.72 percent. In London, the FTSE 100 index was down 2.30 percent to 4705.5, its lowest point since December 2004, before it fell and closed at 4765 points (Kompas, 30 September 2008)

In Indonesia, on October 8, 2008, Indonesia Stock Exchange (IDX) was forced to suspend the trading of shares due to dramatic decreasing in IDX index, reaching 10.38 percent. IDX trading suspension due at 11:06 pm Jakarta. Composite Index (JCI) fell sharply by 168.052 points to 1451.669 and LQ 45 index was corrected 38.261 point or 11.86 percent to 284.236. This condition was the impact of the global and regional markets bearish caused by US financial crisis, especially after US Federal Reserve, also can not assure investors that the United States market with the Dow Jones dropped his 5.11 percent, or 508.38 points, to 9447.11. The 2008 crisis has pushed down stock prices some Indonesian listed companies significantly compared to the price at the beginning of 2008.

On June 2010, 18 months after the crisis peak, share prices movement of some companies in IDX still did not recover. The stock prices on June 2010 was only 8 to 38 percent comparing to the price before the crisis, although IDX Composite Index has increased more than 100 percent., reached 2925 point at the end of June 2010, comparing with the lowest IDX Composite Index 1335 point on November 25, 2008. This condition reflects that although the economic crisis has been recovered, but some companies are not able to increase value for its shareholders. Rather than creating value, that companies has just destroyed shareholder value, and that's we named them as the value destroyer companies.

Table 1 gives a brief overview of stock price movement and comparisons of some Bakrie group companies before and after the crisis, or the first quarter of 1998 (Q1) compared with the third quarter of 1998 (Q3) and 18 months after crisis (June 2010).

Table 1 Stock Price Movement of Value Destroyer Company

No	Listed Company	Stock Price Q1 2008	Stock Price Q3 2008	Stock Price 23 Juni 2010	Q1 –Q3 2008 %
1.	PT Energi Mega Persada Tbk	Rp 1.530,-	Rp 84,-	Rp 133,-	94,53 %
2.	PT Bakrie Brothers Tbk	Rp 650,-	Rp 50,-	Rp 54,-	92.33 %
3.	PT Bumi Resources Tbk	Rp 8.750,-	Rp 910,-	Rp 1.910,-	89.6 %
4.	PT Bakrie Telecom Tbk	Rp 425,-	Rp 51,-	Rp 165,-	84 %

Note : All prices in Indonesian Rupiahs (IDR)

Sources : IDX Statistic 2008 and www.kontan-online.com

The table show that there are significant decreasing of 4 companies under Bakrie Group after the crisis period (from 84% to 94.53%) and still do not recover 18 months after crisis

Nevertheless there are still some Indonesian listed companies' stock price movements are relatively stable and did not decline extremely in times of crisis. An example is the stock price of PT Unilever Indonesia Tbk, PT Telekomunikasi Indonesia Tbk and PT Bank Rakyat Indonesia Tbk during the global economic crisis took place at the end of 2008 is higher than the stock price at the time of IPO (Initial Public Offering-IPO). This condition reflects that in the conditions of global economic crisis, the Indonesian Stock Exchange there are still some companies that are able to create value for its shareholders, which is reflected in the magnitude of the resulting company returns to shareholders. These companies are known as the creator of enterprise value or value creator. The movement of the stock value creator can be seen in Table 2 below:

Table 2. Stock Price Movement of Value Creator Company

No	Listed Company	IPO Price	Price 30 Dec 2008	Price 23 Juni 2010	% IPO - 23 Jun 2010
1	PT Unilever Indonesia Tbk	3.175,-	7.800,-	17.800,-	460 %
2	PT Bank Rakyat Indonesia Tbk	2.000,-	4.575,-	9.200,-	360 %
3	PT Astra International Tbk	14.850,-	10.550,-	47.600,-	220 %
4.	PT Telekomunikasi Indonesia Tbk	2.800,-	6.900,-	8.000,-	185 %

Note : All prices in Indonesian Rupiahs (IDR)

Sources : IDX Monthly Statistic May 2010 dan www.kontan-online.com

Table 2 show that there are significant increasing on share prices Value Creator Company, from 185% to 460% from their IPO, 2 months after crisis and 18 month after crisis. This condition reflects four companies could create significant value for shareholders.

Shareholder Value Creation is the main objective that should be achieved by the company. The achievement of value creation will indicate the extent to which the company can provide a satisfactory return to shareholders over the long term. Value creation occurs in a company, if the company is able to generate returns above the demands of investors, or the return of capital invested should be more than the cost of capital of the company. Dalborg (1999) states that the value will be created in a business, if the return on the shareholders, either dividends and stock price increases exceed the risk-adjusted rate in the capital market or the cost of capital.

Although research and publications on value creation have been developed by some researchers in Europe and the United States, but the implementation of the concept of value creation in Indonesia is still relatively limited. One of the significant publications and comprehensive information on the application of the concept of value creation is done by SWA magazine in cooperation with Stern Stewart & Co., with the publication of 100 ranks public companies in Indonesia are able to create value for our shareholders.

In addition to the publication of the survey results, the support of empirical research related to how the company's value creation process carried out along with the factors that influence in Indonesia is still relatively limited. Research conducted by SWA Magazine and Stern Stewart & Co creator of enterprise value in the period 2001 - 2009 is still limited to the calculation and ranking company in Indonesia with a value creator using indicators Economic Value Added (EVA) and Market Value Added (MVA) and yet tested empirically the key factors triggering the creation of value in Indonesia. The results of research and publications indicating that at least six key factors affecting value creation process, which is focused on core competence, operational excellence, financial structure, business growth, good corporate governance and information disclosure level.

Based on the phenomenon of previous studies, it can be formulated central theme of this research is the development of Value Creation Model Company in Indonesia which is based the premise of a "Presumably the company will be able to create value for shareholders if the company focus on its core competencies, have operational excellence, has a strong financial structure, has good growth opportunities, implementing good corporate governance mechanism and has a reliable level of disclosure of information to stakeholders ". This research consists of three parts, first to determine value creation process in

some listed companies on the Indonesian Stock Exchange, second to determine the influence of some key factors to the company's value creation process and third to formulate a model of value creation in the Indonesia Stock Exchange.

Value Creation Concept And Research

Value creation can be measured by several approaches, including commonly used is the Economic Value Added (EVA) and Market Value Added (MVA). EVA approach is a method for measuring the value creation throughout the enterprise by calculating the cost of capital, either capital contributions or loans from shareholders or the risks that companies face in making investments (Rappaport, 1998). EVA is the net asset value of the dollars, multiplied by the difference between the percentage of return on net assets and the percentage of capital costs. EVA will be able to describe the efficiency of the company within a certain period and can be used to measure the economic value derived from company operations.

While the MVA approach would be to measure the accumulated wealth of the company from time to time for shareholders. MVA values will be able to describe how wealth can be created or eliminated by the company to the current period (Wiessenrieder, 1997). MVA is a cumulative measure of financial performance that shows how much added value to the invested capital investors during the company's standing. EVA and MVA values were positive indicating that the company managed to create value for the market and the owners of capital because the company can produce a rate of return that exceeds the cost of capital rate. This is consistent with the company's goals is to maximize the value of the company.

The framework in this study is based on Grand Theory of Entity proposed by Paton (1922). This theory states that the company is a separate entity and has its own identity, different from shareholders. While Middle Range Theory in this study were taken from the Agency Theory (Jensen and Meckling, 1976) which states that the agreement between the shareholders and the management need to be made to reduce agency costs and will be able to offset losses in the value of the company as a consequence of the separation of ownership and management. Application Theory in this study using the theory of Shareholder Value Creation proposed by Rappaport (1986).

Nyiramahoro and Soshina (2001) identified several ways to create value for shareholders : (1) operational excellence in the possession of the company, (2) the management of optimal financial structure, (3) focusing on core competencies., (4) have good earnings growth, (5) timely and accurate information disclosure to all stakeholders, as well as share repurchase. In the context of companies located in Indonesia, several studies and other publications such as Surya (2003), Hong (2005) and SWA (2007) have identified several key factors that are thought to affect the value creation process. Some of the key factors are: operational excellence, focus on core competencies, optimal financial structuring, efforts towards growth opportunities, disclosure of accounting information and also the implementation of good corporate governance within the company.

In the process of value creation, focus on one area of core competence is necessary because the company will not be able to optimally concentrate on a variety of different business lines, so in order to maximize value, the company is expected to focus more on its core competencies. (Berger and Ofek (1995), Stein (1997), Bodnar et al (1998), Lins and Servaes (1999), Chen and Ho (2000), Lins and Servaes (2001), Gibson et al (2001), Nirahamahoro et al (2001) Lamont and Polk (2002), Denis et al (2002), Bushman et al (2004), Boubaker et al, (2008))

The company must also maintain its financial structure in such a way so as to provide maximum benefit for the shareholder. Through the selection of appropriate financial structure, management can also ensure that the policy taken in accordance with the interests of the shareholders (Modigliani and Miller (1958, 1963), Miller (1977), Zenovia and Anca (2009), Grossman and Hart (1980), Ross (1977), Hirigoyen and Jobard (1989)). Growth can provide additional assets for achieving future earnings, growth prospects for the company that has an important role in the value creation process. New product innovation, not only perfecting products is also one of the explanations for why the company can create spectacular results in the creation of value. The market will reward investment for growth if it is able to create value for shareholders (Myers (1977), Smith and Watts (1992), Gaver and Gaver (1993, 1995) Kallapur and Trombley (1999) Doorley and Donovan (1999) , Zook and Allen (2000) Nyimarahoro et al, (2001))

Excellence in operations means the company's ability to run existing businesses to generate sustainable profits by using existing assets. Operating efficiency plays an important role in the value creation process as it can support the overall profitability and also a major requirement in the company's growth Bacidore et al (1997), Chen and Dodd (2001) Stern Stewart (2001), Nyimarahoro et al, 2001; Ramezani et al (2002), Fuller and Jensen (2002), Nainggolan et al (2008)

Increased disclosure is expected to reduce information asymmetry (Verrechia, 2001; Jensen and Meckling, 1976). Information plays a major role in determining the value of a company, so the way companies present information or the level of disclosure can also create corporate value (Nyimarahoro Soshina, 2001; Van and Linde, 1998; Team SWA, 2007). Disclosure of confidential information to the public will only be able to reduce the competitiveness and growth potential of the company and this condition would interfere with the process of value creation in the company (Barone, 2001; Holland, 2001; 2005; 2006).

Good corporate governance mechanisms that will either avoid the potential. conflict of interest between management and the stakeholders in the company. Companies with good corporate governance can to obtain a high appraisal of shareholders because of the low risk investment in the company, which is consequential on the decline in the cost of capital in the company. The fall in the cost of capital the company will automatically support the process of value creation for the shareholders

(Holderness (2002), Black, Jang and Kim (2003), Duwelics and Herbert (2004), Bellalah (2004), Page, 2005; Hong, 2005 , Main and Afriani 2005, Koh, Laplante and Tong (2006), Shen, Hsu and Chen (2006)).

Research Method

This study uses data before and after the global economic crisis of 2008 to determine the impact of the global crisis on the value creation process in Indonesia Stock Exchange. The population in this study are 45 companies listed in Indonesia Stock Exchange that enter into the calculation of LQ 45 period February 2, 2009 until July 31, 2009 Consideration used is a company on the list LQ 45 index IDX is a company whose shares are actively traded on exchanges and is an appreciation of the market activity of the company is reflected in the high frequency trading.

The first part of this research is to conduct a qualitative analysis by using a content analysis of value creation practices of companies that become population. This stage is done by identifying the various descriptions contained in the annual reports of each company and then grouping description of value creation, focus on core competencies, operational excellence, growth opportunities, financial structure, disclosure of information, and a good corporate governance mechanisms.

In detail, Content Analysis carried out in two ways, first by classifying position descriptions at the company's annual report to determine the urgency of the company's value creation process (Holsti, 1969). If the description of the creation of value is reflected in the annual report as an important part of the vision, mission, objectives and strategy of the company, it means that the company has a great urgency to the process of value creation and value creation strategies. Second, content analysis is done by knowing the power of description and value creation strategies that reflected the creation of value creation in the form of descriptions or indigo creation strategy in the company's annual report (Krippendorff, 1980).

The second part of this research will be the analysis of quantitative analysis using Partial Least Square (PLS) to determine the effect of several key factors: focus on core competence, financial structure, operational excellence, the level of disclosure, growth opportunities and good corporate governance mechanisms on firm value creation process . Based on this analysis is expected to note the strength of the key factors to influence the entire value creation process. In this study, also used two controlled variables, company size and the company listing period listed in the Exchange.

The third part of this study will attempt to formulate a model of value creation companies listed in Indonesia Stock Exchange by using basic quantitative and qualitative analysis in the previous section. The value creation model then examined in several value creator companies in the Indonesia Stock Exchange to determine the strength of this model as a reference in the process of value creation companies listed in Indonesia Stock Exchange.

Research Result

The first step of this research is to conduct content analysis of company’s annual report to find companies strategy on creating value. The result of Content Analysis indicate that the value creation has become an important concern for Indonesian listed companies. The result show that 80% listed companies have described the value creation process in its annual report. Specifically, 11.4% of the sample has been described the value creation in the company vision, 37.14 % describe in the mission of the company and 8.5% in the Boards Report. This content analysis also give description of value creation statement in annual report.

Table 3. Value Creation Statement

Description	Value Creation Statement
Value Creation Statement	1. Maximizing value for shareholders 2. Maximizing shareholder value by calculating the change in stock price 3. Creating value for shareholders, with the application of the calculation of the indicator value creation (EVA / TSR) 4. Creating value for shareholders with the strategy / steps to create value

Sources : Secondary Data Analysis

From table 3, we could understand that the sample companies has described value creation statement clearly on vision statement and mission statement, so we could learn that the value creation process was the main priority of corporate objectives. This content analysis also give explanation about company’s strategy to create value. Table 4 describe summary of the value creation process and the main strategies to create value for shareholders categorized by six factors determining value creation process.

Table 4. Value Creation Strategy in Annual Report

Factors Determining Value Creation	Main Strategy
Focused on Core Competency	<ol style="list-style-type: none"> 1.Focus on core business 2. Horizontal diversification while focusing on that segment of the controlled 3.Development of a subsidiary with a focus on its core competencies and excellence
Optimal Financial Structure	<ol style="list-style-type: none"> 1.Availability of internal funds 2. Solid debt management 3. Financial management structure composition 4. Support long-term funding 5. Financial risk management 6. Increase Composition in equity
Operational Excellence	<ol style="list-style-type: none"> 1. Rely on market forces, through long-term purchase contracts 2. Mix between increasing revenue and controlling costs 3. Rely on the strength of the company's resources
Growth Opportunity	<ol style="list-style-type: none"> 1. Ability of firms produce high value added products 2. Business infrastructure and the physical strength of the company. 3. Growth industry group continues to increase expansion of the company, either horizontally or vertically
Good corporate governance Mechanism	<ol style="list-style-type: none"> 1.Statement that the company has implemented GCG effectively 2. Implementation of GCG to support the company's goals 3. The existence of a formal commitment to the implementation of GCG 4. The presence of GCG implementation evaluation 5. GCG implementation comply the international standards
Information Disclosure	<ol style="list-style-type: none"> 1.Company has made a timely disclosure and as required by applicable regulations through several media disclosures. 2. Company states that the disclosure of information is part of the corporate culture 3. Company stated that the disclosure of information will increase the company's goals. 4. Disclosure comply with international disclosure standards

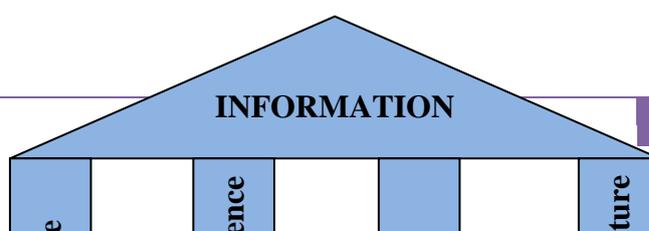
Sources : Secondary Data Analysis

The Second Stage is to conduct quantitative analysis using Partial Least Square (PLS) to determine the effect of several value creation determinants by using EVA and MVA as the value creation indicators. The first result shows that there are significant simultaneous effect of value creation determinants (complexity of the company, operational excellence, financial structure, growth opportunities, good corporate governance mechanism and the level of disclosure of information) on value creation measured by Economic Value Added (EVA). Changes in the value creation process arising as a result of changes in the determinant factors, complexity of enterprise variable, operational excellence, financial structure, growth opportunities, good corporate governance mechanisms and levels of information disclosure is at 54.80 percent, remainder, 45.20 percent variable changes value creation is influenced by variables others are not identified in this research.

When Market Value Added (MVA) was used to measure value creation process, the statistical test results also indicate that the empirical model that there are two simultaneous influence of the complexity of the company, operational excellence, financial structure, growth opportunities, good corporate governance mechanisms, disclosure of information on value creation. While the magnitude of the estimated effect of its complexity, operational excellence, financial structure, growth opportunities, good corporate governance mechanism, and the level of disclosure of information, the creation of value is equal to 54 percent. The rest, 46 percent from other variables variables beyond the variables examined in this study.

Based on analysis of the value creation process and hypothesis testing that has been done in this study, we can formulate a model of value creation that reflects how the general strategy undertaken by public companies in Indonesia in value creation. Model of value creation in Indonesian public firms depicted standing on a foundation which provides the foundation of value creation, which is good corporate governance mechanism and is supported by several pillars: operational excellence, growth opportunities, focus on core competencies and optimal financial structure. Furthermore, mix of value creation strategies that need to be packaged in a model of communication to stakeholders through a strategy of accurate accounting information disclosure. Figure 1 shows the Proposed Value Creation Model in Indonesia.

Figure 1 : Value Creation Model in Indonesia



Value creation Model in Figure 1 shows that in order to create value for its shareholders, the company must have a sustainable and strong financial operational condition. These can be reflected in the ability of the company to focus on its core competencies, and could concentrate all its resources to create value.

The model shows that the company needs to have operational excellence in order to operate efficiently and have strong competitiveness, which is very useful in the process of value creation in the long term. In addition, the company's ability to properly manage the financial structure, in order to produce a low capital cost, so as to support the value creation process. The company should also have sustainable growth through the ability to detect the needs of the market and technological developments, so as to ensure the sustainability of growth in the long term. In addition to the financial condition and operating strong as pillars of value creation, then, the process of value creation should also be guided by the mechanisms of good corporate governance within the company as corporate governance mechanism is a requirement for companies to gain confidence for investors.

Implementation of good corporate governance mechanisms that will either avoid potential conflicts of interest between management and the stakeholders in the company. Value creation model also requires that companies need to consider the appropriate level of disclosure of information such that disclosure of such information can contribute to value creation. The company's ability to conduct financial communication to stakeholders is one of the keys to success for the company enterprise value creator.

Conclusion

This study provides empirical evidence that value creation statement and strategy has been explicitly disclosed in annual report of sample companies in Indonesia Stock Exchange. It has been considered that value creation strategy is an important point that must be communicated to all stakeholders through the annual report. Most of the company to emphasize the creation of value in the statement of vision, mission and directors as well as reports various strategies implemented to create value through its annual report.

The results of quantitative analysis showed that there are significant influence of some independent variables : the complexity of corporate, operational excellence, financial structure, growth opportunities, mechanisms of good corporate governance, level disclosure of information to value creation as indicated by Economic Value Added (EVA) and Market Value Added (MVA). This result was consistent with some previous research that give empirical evidence that six variable above were the important determinants of value creation process.

Based on the quantitative and qualitative analysis, we can formulate a model of value creation that reflects how the general strategies undertaken by companies listed in Indonesia Stock Exchange in conducting value creation. Value creation model is depicted standing on a foundation which provides the foundation for value creation process, the mechanisms of good corporate governance and is supported by some of the main pillars of value creation, namely operational excellence, growth opportunities, focus on core competencies and capabilities to manage corporate financial structure. Variety of value creation strategies that need to be packaged in a model of communication to stakeholders through a strategy of accurate accounting information disclosure.

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