

Management Restructuring on Distress Firm in Indonesia

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Abstract

Companies experiencing financial distress will try to solve these problems with various improvement efforts. One of the efforts that can be done is to carry out management restructuring, namely management changes. This study focuses on the management restructuring strategy on manufacturing companies that experience a decrease in performance, with the proportion of Earning Before Interest and Tax which decreased for two or more consecutive years period 2010 to 2020. The reason for taking this period is to capture the period after the 1997 crisis until the occurrence of global crisis in 2008. This study aims to examine the effect of ownership structure in choosing management turnover restructuring. The data used is cross-section data and processed using logistic regression with Stata. The results of this research simultaneously show that insider ownership, institutional ownership, family ownership, and corporate characteristic variables have an impact on the management restructuring decision. This study proves that the ownership structure mechanism affects the choice of management restructuring in distressed companies in Indonesia.

Keywords: *management restructuring, financial distress, agency theory, ownership structure*



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INTRODUCTION

Corporate restructuring is a strategy that is still relevant to be implemented in today's business world. The company evaluates its performance every period to find out if the company is experiencing growth in profitability or experiencing a decline. Continuous performance degradation conditions may cause the company to experience financial difficulties or financial distress, which is marked by a decrease in operating profit, Return On Assets, Z-Score, or negative earnings. The condition of distress in economic terms is the failure of the company's management to manage the debt contract (the proportion of debt and the total of improper assets) and the negative profit (Weston, 1992, Pourali, 2013).

The decline in corporate performance was also affected by the domestic crisis in Indonesia and the continued global crisis in 2008, which paralyzed some corporate sectors. These conditions can be seen from the policy of the Indonesia Stock Exchange, which delisted against several companies from 2004-2014 (sahamoke.com). Meanwhile, if viewed from the financial performance, in this case, Earnings Before Interest and Tax (EBIT) manufacturing companies also experienced a downturn during the period 2003-2009 before and after the global crisis occurred. The decline in financial performance is indicated as a decrease in performance (financial distress).

This study focuses on management restructuring because distressed firms in Indonesia are mostly due to bad performance from board directors (Ofek, 1993; Lai & Sudarsanam, 1997). Management restructuring plays an important role in efforts to improve the company's performance because one of the

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influential factors in improving company performance is the company's directors and staff. The results of this study still produce mixed findings related to the effect of management restructuring on increasing firm value. Therefore, in this study, the determinant variables that influence the choice of management restructuring will be examined, which are related to the role of managers in making decisions so that they are right. (Pandey, 2015; Koh et al. 2015)

The main purpose of this study is to examine the effect of governance variables such as insider ownership, institutional ownership, and family ownership on the tendency to choose or avoid a management restructuring strategy that is management turnover on manufacturing firms. A change at the level of top management (Chairman) and Chief Executives Officer (CEO) is believed to be the first step in improving performance. Changes in management can improve performance (Gilson, 1990: Murphy and Zimerman (1993), but other researchers state that it has no significant effect (Warner et al., 1988: Lai and Sudarsanam, 2001)

In this study, the variables that are thought to influence the company's choice of management restructuring in Indonesia to adjust to the existing conditions of the board of directors, ownership structure, and control variables such as firm size, liquidity, and inflation (Pandey, 2015) Differences with research Koh et al. (2015) is a variable of ownership structure, in this case, insider ownership, and capital intensity. The proxy of management restructuring is a turnover in the management ranks such as the president director and his staff (Lai & Sudarsanam, 2001)

The results of this study suggest that ownership structure simultaneously affects the choice of a management restructuring. These findings support previous research (Pandey et al., 2015: Koh et al., 2015: Lai & Sudarsanam, 2001). Insider ownership, family ownership, and institutional ownership variables have an impact on the option of a management restructuring. This empirical finding supports Pandey et al. (2015); Lai & Sudarsanam (2001).

LITERATURE REVIEW

Financial Distress

A distressed company is a company that has difficulties in fulfilling its obligations, has a poor track record of bad loans, has a net worth less than real assets, has failures in sales, and decreases in profitability (Kuo et al., 2003, Astha, 2004). Anything that defines financial distress as a condition or problem of the company's economy is the beginning of bankruptcy or can be considered as a decline in the financial condition of the company before finally going bankrupt (Platt and Platt, 2002; Wruck, 1990)

Corporate Restructuring

The company will make various efforts if the company experiences a decrease in performance by performing various restructuring strategies such as restructuring of asset reduction, asset addition, managerial with the replacement of CEO or with employee disposal (Lai & Sudarsanam, 2001: Yawson, 2009: Kang & Shivdasani, 1997 Koh, et al., 2015: Pandey, 2015) and with the dividend policy of reducing dividend payout or even elimination of dividends paid (Koh et al., 2015: Pandey, 2015; John and Netter, 1992))

The company is able to improve its performance by adding assets through acquisitions, joint ventures, or buying property and equipment (Kang & Shivdhasani, 1997). Other measures such as employee reductions have been shown to improve performance, as it is assumed that the restructuring can reduce the company's operational costs by reducing employee productivity (Hillier & McColgan, 2005; Yawson, 2009)

Management Restructuring

Management restructuring is a change in the corporate governance structure, which is generally characterized as a change at the top three levels of management, namely the chairman, CEO, and the Board of Directors. (Astha, 2004). Changes in top management are referred to as the initial conditions for the success of the distress recovery process. Changes in top management can be evidence for banks as lenders, investors, and employees as a positive action to improve the company's performance even though the cause of the decline in performance is beyond management's control (Lai and Sudarsanam, 2001).

Agency Conflict and Corporate Governance

An agency perspective is a foundation used to understand corporate governance. The essence of the agency relationship is the separation of status between the owner and the manager of the company raises a problem commonly called agency problem, which occurs between the owner of the company or shareholders on the one hand with management as the manager on the other.

Development of Hypothesis

Research by Iwasaki et al. (2020) states that management ownership has a negative effect on the choice of restructuring CEO turnover in China. Owners of management tend not to recommend that companies choose CEO turnover restructuring. Research by Demsetz and Lehn (1985), Crutchley and Hansen (1989) concluded that higher levels of management ownership could be used to reduce agency problems.

According to Jun Zhao (2009), owners tend to have a strong influence on the type of diversification/restructuring strategy and relate to the application of organizational structure of an enterprise, and different ownership structures can affect the nature of restructuring activities taken by certain businesses groups. Institutional ownership will have an effect on agency costs and consequently impact on dividend payout policy. If dividends serve as a way for managers to assign markers of management commitments to future value creation, there is no need to pay large dividends, where commitment to shareholder value will be realized through institutional ownership (Pandey et al., 2015)

The hypothesis of this research is:

H1: insider ownership, institutional ownership, and family ownership influence on the choice of management restructuring strategy at distress firms in Indonesia.

RESEARCH METHOD

Research design

This study uses the Asquit et al. (1994) model performance decline proxies by applying earning before interest and tax (EBIT) as a profitability performance variable because EBIT can explain how the company's management is able to generate gross profit before tax. In this study, the proxy for declining performance by looking at the decreasing EBIT for two or more consecutive years is assumed to be able to represent the company period in responding to distress conditions. EBIT is calculated as earnings before the interest expense of debt and tax at the end of the year.

Population and Sample

The company population is all listed companies except the banking sector and reports its annual finance during the period 2010-2020 with a total of 535 firms. Sampling procedure in this research by using purposive sampling method with some sample criterion (Sekaran, 2010, pp 276-278) as follows:

company that experienced performance degradation for two consecutive year period 2010-2020. Based on the above criteria, the sample obtained as many as 373 companies that experienced a decrease in performance or tendency to experience financial distress.

Types and Data Sources

The data used in this study were taken from Indonesian Capital Market Directory Reports and Annual Report in 2010 until 2020 that has been published. Because the data taken comes from the documentation of this research, data is secondary data. Period 2010 to 2020 was taken to capture the phenomenon of post-crisis global crisis 2008.

Variable Operational Definitions

Variable Independent / independent variable used is agency monitoring variables include:

1. Insider Ownership is a shareholder of management (directors and commissioners) who actively participate in the decision making as measured by the percentage of share ownership by directors, commissioners, and managers (Marcus, Kane, and Bodie, 2006)
2. Institutional ownership is a share owned by a corporate entity, institutional ownership within the company acts as a tool to monitor the company used to prevent management from wasting or enriching themselves. measured by percentage share ownership by foreign and domestic entities (Marcus, Kane and Bodie, 2006)
3. Family Ownership is the proportion of family ownership is measured by the percentage of shares owned by the controlling family of the founders of the company. In addition, there are those who say family ownership if the founder or family member owns a greater than 25% share either individually or in a group (Andres, 2008).

The dependent variable is the dummy variable is assessed one if the company gets a management restructuring; otherwise, it is assessed 0 if the company does not perform management restructuring. The dependent variable used is management turnover (MT), which is rated one if there is a management turnover during t-1 to t during the study period. Control variables are firm characteristics such as size, liquidity, inflation.

Analysis Technique

Data analysis technique using logistic regression using Stata. After the prediction variables are identified, then test the Regression binary logistic by gradually entering the variables that exist in the model.

Research model

$$L_i = \ln (P_i / 1 - P_i) = \beta_1 + \beta_2 \text{INSID}_t + \beta_3 \text{INST}_t + \beta_4 \text{KELG}_t + \beta_5 \text{SIZE}_t + \beta_6 \text{LIQ}_t + \beta_7 \text{INF}_t + \mu_i$$

FINDINGS AND DISCUSSION

Descriptive Statistics

Table 1 presents the statistical descriptive of the variables in this study. INSID is the percentage of ownership by managers or directors (dummy), INST is the percentage of ownership of shares by entities or institutions (dummy). Firm family is the proportion of family ownership is measured by the percentage of shares owned by the controlling family of the founders of the company (dummy). SIZE is measured by

the total natural logarithm of the asset. LIQ is measured by the current asset ratio and current liabilities. INF is measured by the level of inflation per year.

Goodness of Fit

The goodness of fit can be seen based on the value of Hosmer-Lomesow. Based on the results of data Stata obtained the result that the model management turnover has a Hosmer-Lomesow value of 12.8556 with probability Chi-Square 0.1169 bigger than alpha tolerated 5% so accept H1 0, which states the model is appropriate or no significant difference between observation with model prediction. Strength can be seen from the explanatory variables pseudo-R 2 value of 4.6 percent.

Table 1. Descriptive Statistics

	Average	Mode	SD	Min	Maks
YMT	0,36	215	0,48	0	1
IOWNt1	2,33		6,60	0	46,05
DIOWNt1	0,35		0,48	0	1
INSTt1	32,49		31,53	0	100
DINSTt1	0,73		0,44	0	1
KELGt1	34,14		30,81	0	99,94
DKELGt1	0,59		0,49	0	1
LIQt1	2,15		2,33	0,030	26,11
SIZEt1	12,45		2,80	4,384	21,09
INF	0,08		0,03	0,043	0,13
Number of Observations	373				

This table presents the statistical descriptive of the variables in this study. INSID is the percentage of ownership by managers or directors (%), INST is the percentage of ownership of shares by entities or institutions (%). KELG is the number of family-owned by the company. SIZE is measured by the total natural logarithm of the asset. LIQ is measured by the current asset ratio and current liabilities. INF is measured by inflation rate based on SBI

Table 2. Summary of Logistic Regression

Dependent	Management Turnover	
	Z statistics	Odd ratio
C	-1.50 (p 0.133)	0.147
Insid	-1.94 ** (p 0.052)	0.575
Inst	0.67 ** (p. 0.042)	1.024
Kelg	-1.95* (p 0.056)	0.785
Size	0.97 ** (0.054)	1.055
Liquidity	1.02 (p 0.309)	1.146
Inflation	-1.34 (p 0.179)	0.021
λ^2		17.49
p value		0.0376**
Pseudo R ²		0.0465

Logistic Regression

Test the Overall Hypothesis

Based on the results of the data, if it can be tested the hypothesis on several variables that predicted influence the decision of election strategy of financial restructuring. The empirical findings state that ownership structure, log Size, liquidity, and inflation have a simultaneous influence on the options strategy of a management restructuring. It is shown in table 2 with the probability value of chi-square of 17.49 with probability $0.0376 < p \text{ value } 5\%$. Thus the regression model is able to be analyzed further.

Discussion

In table 2, it appears that the managerial / insider ownership variable has a significant influence by influencing the company in choosing a management restructuring strategy, i.e., management turnover so that the hypothesis is supported. When viewed from the value of the odd ratio of 0.575 for management turnover column whose value is less than one indicates that companies with high managerial / insider ownership tend to avoid choosing management restructuring/management turnover compared to other distressed companies. This finding is consistent with the results of Iwasaki (2020), Lai & Sudarsanam (1997), and De Angelo (1990). Managerial ownership affects the choice of managerial restructuring in harmony with the agency theory whereby the ownership structure is able to reduce the organizational strains occurring through monitoring mechanisms, i.e., dividend payouts.

The institutional ownership variable has a positive influence on the choice of corporate restructuring. If we have seen from the value of the odds ratio of management turnover of 1.024 worth more than one, which means that companies with increasing institutional ownership then companies tend to choose management restructuring by switch the management or board director. This finding is in line with agency theory, where institutional ownership would prefer to replace the president's director and his staff to solve the crisis. This finding is in harmony with Pandey (2015) and Koh et al. (2015).

The results of this study indicate that family ownership has a negative effect on the probability of the company choosing management turnover restructuring. This indicates that companies with high family ownership tend not to choose management turnover restructuring. The reason may be because the position of some family owners also mostly occupies managerial positions such as MT, so that it will threaten the position of family ownership in the management structure.

The impact of the variable characteristics of the company control over the restructuring decision financially in column 2 of Table 2, Firm size (Size) is the natural logarithm of total assets has a significant influence in the decision to choose management turnover. The odd ratio of 1.055 is more than one, which means that the firm with increasing size has the tendency to choose the management restructuring of management turnover bigger when there is a decrease in performance within the company. This finding is supported by Koh et al. (2015); Pandey et al. (2015) research. Liquidity and inflation have no impact on the decision to choose a management restructuring strategy that is management turnover.

CONCLUSION AND FURTHER RESEARCH

Companies that experience performance decline will try to improve conditions for the better, managers as managers of the company will choose a restructuring strategy that involves the stakeholders with the aim of maximizing shareholder value. This study examines the effect of ownership structure and firm characteristics on the choice of management restructuring strategy as measured by management turnover.

Based on our analysis, we find empirical evidence that both simultaneously and partially, ownership structure and corporate characteristics influence management restructuring decisions in Indonesia. These findings are consistent with previous researchers, which can be seen that ownership structure variables have a good effect on the choice of management turnover strategies. Insider and family ownership have an impact on the probability of choosing management turnover restructuring.

In addition, this research only highlights one restructuring strategy that is management restructuring, so that its findings have not been able to provide an alternative choice of a restructuring strategy for decision-makers so that further research can examine: other strategies, namely business restructuring and financial; using different firm determination proxy using negative Retained Earnings; test the impact of the interaction between independent variables.

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