

OWNERSHIP STRUCTURE AND AGENCY COST CASE STUDY ON MANUFACTURING COMPANY IN INDONESIA STOCK EXCHANGE

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ABSTRACT

The frequent occurrence of conflicts of interest between shareholders and management, causing agency problems. One way to overcome this issue is to include managerial ownership (Jensen & Meckling, 1976). The purpose of this research is to examine the effect of ownership structure on agency costs. The structure of ownership consists of managerial ownership that measured by the portion of share owned by management, institutional ownership measured by the portion of share owned by financial institution, government ownership measured by the portion of share owned by government, and foreign ownership that measured by the portion of share owned by foreign investors. The population in this research is manufacturers listed on the Indonesia Stock Exchange (IDX) with a sample of 102 companies taken by purposive sampling method. To test the hypothesis, the research uses multiple regression analysis with a significance level of 0.05. The results show that managerial ownership and institutional ownership have no significant effect on agency costs. Likewise, government ownership and foreign ownership also have no significant effect on agency costs. This indicates that in manufacturing companies in Indonesia ownership structure cannot be used to control agency cost.

Contribution/Originality: This study contributes to existing literature by examining the effect of ownership structure on agency costs.

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1. BACKGROUND

Agency conflicts often occur in a company. Conflicts of interest between shareholders and the management have triggered the occurrence of the malignant conflict. Jensen and Meckling (1976) state that agency problems arise because of differences in interests between principals and agents. This relationship raises the tendency of differences in interests because in principle humans will try to maximize the utility for their own interests. This difference brings the potential for agency problems between principals and agents that can cause or trigger costs that should not have been incurred in the company's operations when managed by the owners themselves, or commonly referred to as agency costs.

There are several ways to overcome agency conflicts. According to Jensen and Meckling (1976) the first way is to increase the company's share ownership by the management. The manager will immediately feel the benefits of the decisions taken and also if there are losses that arise as a consequence of wrong decisions. This ownership will align management interests with the interests of shareholders. The second way is to increase the ratio of dividends to net income or dividend payout ratio so that there is not enough free cash flow available. In addition, Wahidahwati (2002)

adds several ways that can be used to reduce agency costs by increasing funding through debt and using institutional investors as monitoring agents that would cause managers to feel overseen in determining financial policies.

The separation of ownership and the management of the company can make agency costs inevitable. Agency costs must be kept to a minimum. This can be reduced through the company's ownership structure. Large companies currently have a very diverse shareholding. The diversity of ownership in a company can affect the number of agency costs in the company and is considered to be able to minimize the impact of agency costs on the company. The various ownership includes managerial ownership, institutional ownership, government ownership, foreign ownership, and family ownership.

Managerial ownership is ownership of shares by the company management. [Mustapha and Ahmad \(2011\)](#) state that share ownership by managers will motivate managers to increase the value of the company. The lower the stock owned by the manager, the lower the manager also to find profitable investments. The manager will position himself as the owner of the company if it can increase managerial share ownership so as to reduce opportunistic behavior. Thus, the higher managerial ownership will reduce conflicts between managers and shareholders so that agency problems decrease and agency costs also decrease. Whereas in the research of [Wijayati \(2015\)](#) it is found that the different result namely managerial ownership does not have a significant effect on reducing agency costs.

Institutional ownership is the ownership of investors who come from the financial sector. High institutional ownership can allow the manager to control his behavior so as not to try to maximize himself because this ownership represents a source of power used to support/prohibit management decisions so as to reduce the agency cost of the company. [Gul, Sajid, Razzaq, and Afzal \(2012\)](#) find that higher institutional ownership can reduce agency costs because institutional parties can oversee company performance and manager behavior that will influence decision making. While the results of research conducted by [McKnight and Weir \(2009\)](#) found that institutional ownership does not affect agency costs because institutional shareholders cannot always monitor effectively.

Government ownership is a situation where the government has a stake in a company. Government ownership can be used to resolve conflicts of interest between management and shareholders by implementing control mechanisms that limit management's intervention in the management of the company because there is potential for management to maximize its interests that are not in line with company objectives and can mean reducing agency costs. Research conducted by [Nelson and Mohamed-Rusdi \(2015\)](#) shows a significant positive relationship between audit fees and government ownership. Whereas [Raisya, Fauziati, and Herawati \(2014\)](#) found that government ownership has no significant effect on agency costs. These results indicate that the size of the ownership structure owned by the government cannot be used as a tool to determine the increase or decrease in agency costs within the company.

Foreign ownership is the ownership of company shares owned by foreign investors. On the one hand, foreign investors can pressure the company to be efficient and can reduce the cost of violence, but on the other hand, due to geographical distance, language and ignorance of local conditions can make foreign shareholders less influential in monitoring and management which results in not being able to reduce agency costs. [Firth, Yung, and Rui \(2008\)](#) found that foreign ownership had a higher effect on reducing agency costs. Whereas research conducted by [Saputro and Syafruddin \(2012\)](#) found that foreign ownership had no significant effect on agency costs as measured by OGA (operating general and administration).

2. DEVELOPMENT OF HYPOTHESES

2.1. Managerial Ownership of Agency Costs

[Jensen and Meckling \(1976\)](#) state that managerial stock ownership is a solution in the agency problem that can help the unification of interests between shareholders and managers, the higher the proportion of managerial stock ownership, the better the company's performance. Companies with a large amount of managerial shareholding should have low agency conflict and low agency costs. [Florackis \(2008\)](#) found that managerial ownership had a positive effect on agency costs. [Dewi and Ardiana \(2014\)](#) found that there is a positive relationship between managerial ownership and agency costs and found that companies managed by owner-managers are significantly higher than non-owner owner companies. From this description, the authors propose the following hypothesis:

H₁: Managerial ownership has a positive effect on Agency Costs.

2.2. Institutional Ownership of Agency Costs

Companies with large institutional ownership can indicate their ability to monitor management because the greater the institutional ownership, the more efficient the use of company assets and is expected to act as a prevention against waste by management ([Faisal, 2005](#)). Research conducted by [Gul et al. \(2012\)](#) concludes that institutional ownership has a positive effect on agency costs, which indicates that higher institutional ownership can reduce agency costs. Then research conducted by [Henry \(2010\)](#) found that institutional ownership can significantly reduce agency costs. From this description, the authors propose the following hypothesis:

H₂: Institutional ownership has a positive effect on Agency Costs.

2.3. Government Ownership of Agency Costs

Government ownership can be seen through the percentage of the number of shares owned by the government. Research conducted by [Hadiprajitno \(2013\)](#) found that majority of government ownership affects agency costs. This is because the government has longer interests so that short-term conflicts between management and the government are smaller and more efficient and because the political content that can cause inefficiencies in company operations is not a problem. Then research conducted by [Nelson and Mohamed-Rusdi \(2015\)](#) shows a significant

positive relationship between audit fees and government ownership. In this case, the audit fee is included in the agency cost. From this description, the authors propose the following hypothesis:

H_s: Government ownership has a positive effect on Agency Costs.

2.4. Foreign Ownership of Agency Costs

Foreign ownership has a relatively low portion of ownership and has a less powerful role in an organization. Foreign ownership will make the company's performance better and will cause agency costs to decrease because managers will be monitored by foreign ownership. Research conducted by Nelson and Mohamed-Rusdi (2015) shows a significant positive relationship between audit fees and foreign ownership. In this case, the audit fee is included in the agency costs. Then Hadiprajitno (2013) concludes that majority of foreign ownership has a positive effect on agency costs. From this description, the authors propose the following hypothesis:

H_s: Foreign ownership has a positive effect on Agency Costs.

3. RESEARCH METHOD

3.1. Population and Sample

The population in this research is all companies engaged in the manufacturing industry which are listed on the Indonesia Stock Exchange in 2017. The sampling technique is conducted by purposive sampling, namely the selection of samples with certain criteria that have been determined so that the samples are matched with the objectives of the research. The criteria used to determine the sample are:

1. Manufacturers listed on the Indonesia Stock Exchange in 2017.
2. Manufacturers that publish financial statements on the Indonesia Stock Exchange in 2017.
3. Companies that have data related to managerial ownership, institutional ownership, government ownership, foreign ownership, and family ownership.

Based on these criteria, the number of samples obtained for this research are 102 samples of manufacturers listed on the Indonesia Stock Exchange in 2017.

3.2. Research Variable

The research variable consists of one dependent variable, namely agency cost, four independent variables consisting of managerial ownership, institutional ownership, government ownership, and foreign ownership, and firm size as a control variable. The variables and measurements are as follows:

Table-1. Variable and Measurement.

No	Variable	Notation	Measurement
1	Agency Cost	AC	Operating Expenses/Sales
2	Managerial Ownership	MOWN	Number of share owned by management/Number of share
3	Institutional Ownership	IOWN	Number of share owned by institution/Number of share
4	Government Ownership	GOWN	Number of share owned by government/Number of share
5	Foreign Ownership	FOWN	Number of share owned by foreign/Number of share
6	Firm Size	SZ	Ln Total Asset

Source: McKnight and Weir (2009).

3.3. Data Analysis

To test the hypothesis, we will use multiple regression analysis with a significance level of 0.05. The following equation is the regression:

$$AC = \alpha + \beta_1 MOWN + \beta_2 IOWN + \beta_3 GOWN + \beta_4 FOWN + \beta_5 SZ + \varepsilon_i$$

Where:

AC	= agency cost.
MOWN	= managerial ownership.
IOWN	= institutional ownership.
GOWN	= government ownership.
FOWN	= foreign ownership.
SZ	= firm size.

4. RESEARC RESULT

4.1. Descriptive Statistics

Descriptive statistics are employed to determine the description of the data in the research. The descriptive statistical results are presented in the Table 2.

Agency cost has a minimum value of 0.01 and a maximum value of 16.52. Then the average value of the agency cost is 0.37; this means that the average amount of agency costs incurred due to conflict between stakeholders is 0.37. While the standard deviation owned by the agency cost is 1.68. The greater the value of the standard deviation that is owned will indicate that the agency cost is more widespread or varied, but the smaller the value of the standard deviation that is owned will indicate that the agency cost is more evenly distributed in the sample company.

Managerial Ownership has a minimum value of 0.00 and a maximum value of 0.71. Then the average value of managerial ownership is 0.07. Whereas the standard deviation owned by managerial ownership is 0.14. The greater the value of the standard deviation owned will indicate that managerial ownership is increasingly spread or varied,

but the smaller the value of the standard deviation owned, it will show that managerial ownership is more evenly distributed in the sample company.

Table-2. Descriptive statistics.

Variables	N	Minimum	Maximum	Mean	Std. Deviation
AC	102	0.013	16.516	0.37015	1.684239
MOWN	102	0.000	0.712	0.06804	0.144965
IOWN	102	0.000	0.882	0.06367	0.173337
GOWN	102	0.000	0.900	0.03186	0.151301
FOWN	102	0.000	0.963	0.31811	0.335838
SZ	102	12.597	31.077	24.73469	4.799356
Valid N (ListWise)	102				

Institutional ownership has a minimum value of 0.00 and a maximum value of 0.88. Then the average value of institutional ownership is 0.64. While the standard deviation owned by institutional ownership is 0.17. The greater the value of the standard deviation that is owned will indicate that institutional ownership is more widespread or varied, but the smaller the value of the standard deviation that is owned will indicate that institutional ownership is more evenly distributed in the sample company.

Government ownership has a minimum value of 0.00 and a maximum value of 0.90. Then the average value of government ownership is 0.03. While the standard deviation owned by government ownership is 0.15. The greater the value of the standard deviation that is owned will indicate that government ownership is more spread or varied, but the smaller the value of the standard deviation that is owned will indicate that the ownership of the government is more evenly distributed in the sample of companies.

Foreign ownership has a minimum value of 0.00 and a maximum value of 0.96. Then the average value of foreign ownership is 0.32. While the standard deviation owned by foreign ownership is 0.33. The greater the value of the standard deviation owned will indicate that foreign ownership is more spread or varied, but the smaller the value of the standard deviation that is owned, it will show that foreign ownership is more evenly distributed in the sample company.

4.2. Hypothesis Test Results

Multiple linear regression analysis was used in this research to determine the effect of independent variables (managerial ownership, institutional ownership, government ownership, foreign ownership, family ownership) and control variables (company size) on the dependent variable (agency cost). Here is a table of the results of multiple linear regression analysis:

Table-3. Hypothesis test result.

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.873	1.045		0.835	0.406
KM	-0.876	1.322	-0.075	-0.663	0.509
KI	0.507	1.074	0.052	0.472	0.638
KP	-0.317	1.204	-0.028	-0.263	0.793
KA	-0.074	0.662	-0.015	-0.112	0.911
SZ	-0.017	0.038	-0.047	-0.438	0.663

Table 3 above shows that managerial ownership has no significant effect on agency costs because the significance value is greater than the specified 0.05. Likewise with institutional ownership, government ownership and foreign ownership, all of which have a greater significance value than the requirements 0.05, so that statistically it has no effect on agency cost.

5. DISCUSSION

5.1. Managerial and Agency Costs

After testing, it is found that managerial ownership does not significantly influence agency costs so the second hypothesis which reads institutional ownership affects agency costs is not proven.

Managerial ownership does not affect agency costs because managerial ownership in a company has a very small proportion of the total shares of the company in circulation. With this very small ownership, managers tend to act and approve or follow the results of the General Meeting of Shareholders (GMS). The proportion of shares held does not affect the manager's operational decision making and makes other shareholders try to monitor and influence management decision making which results in inflexible and slow decision making.

The results of this research are consistent with the results of research by Faisal (2005) who found that managerial ownership structure did not significantly influence agency costs. Management ownership has not been able to function fully as a mechanism to improve the efficiency of the utilization of company assets and has not been able to suppress managerial discretion. Wijayati (2015) also found that managerial ownership does not have a significant effect on reducing agency costs.

The results of this research contradict the research of Ang, Cole, and Lin (2000) and Rashid (2015) who found that increasing managerial ownership can reduce agency costs, as well as Florackis (2008) found that managerial ownership is strongly associated with agencies.

5.2. Institutional Ownership and Agency Costs

After testing, it is found that institutional ownership does not significantly influence agency costs so the second hypothesis which reads institutional ownership affects agency costs is not proven.

Institutional ownership does not affect the agency cost can occur because institutional ownership in the company does not exercise strict control and supervision of the manager's decision despite having greater power in influencing the manager's decision. Institutional investors also tend not to want stock market prices to fall due to information asymmetry. Therefore institutional owners as shareholders can pressure managers to provide accurate information related to company conditions even though it requires large costs such as higher supervision costs.

The results of this research are consistent with the results of research by McKnight and Weir (2009) and Raisya et al. (2014) who find that institutional ownership has no effect on agency costs. Institutional shareholders may not carry out their role as company supervisors because they have delegated the supervisory function to the company's board of commissioners.

The results of this research contradict the research of Gul et al. (2012) who found that institutional ownership influences agency costs which indicate that higher institutional ownership can reduce agency costs. Then Henry (2010) and Putri (2017) also found that institutional ownership can significantly reduce agency costs.

5.3. Government Ownership and Agency Costs

After testing, it is found that government ownership does not significantly influence agency costs so the third hypothesis which says government ownership affects agency costs is not proven. The non-influence of government ownership of agency costs is because the government often has different goals than those of shareholders other than the government. The government is more inclined to emphasize its objectives or policies on politics and social rather than economic efficiency because the income derived from ownership of shares is not the main objective of the government. This is what is often inconsistent and in line with the company's goals in increasing shareholder value through sustained share price increases.

The results of this research are consistent with research by Raisya et al. (2014) who found that government ownership does not affect agency costs. Ownership owned by the government cannot be used as a tool to find out the increase or decrease in agency costs in the company because there is still a lot of space in an organization that is not overseen by the government, this gap can certainly be used as a tool for certain parties to get personal benefits. Research (Firth et al., 2008) in China also found that government ownership has no influence on agency costs.

The results of this research contradict the research of Nelson and Mohamed-Rusdi (2015) who found a significant positive relationship between audit fees and government ownership. In this case, the audit fee is included in the agency cost, and research by Hadiprajitno (2013) also found that government ownership has an effect to reduce agency costs.

5.4. Foreign Ownership and Agency Costs

After testing, it is found that foreign ownership does not significantly influence agency costs so that the fourth hypothesis which reads foreign ownership affecting agency costs is not proven. No influence of foreign ownership on the increase or decrease in agency costs in companies can occur because in general foreign investors have obstacles in carrying out various supervisory functions. This is because foreign investors have difficulty in communicating, geographical distance constraints, in ignorance of local conditions in carrying out supervision within the company that makes the role of foreign investors invisible and contributes to reducing agency costs, especially those related to administrative costs within the company.

The results of this research are in accordance with research conducted by Saputro and Syafruddin (2012) who found that foreign ownership had no significant effect on agency costs as measured by OGA (operating general and administration) and research by Raisya et al. (2014) also found that foreign ownership did not contribute to an increase or decrease in agency costs.

The results of this research contradict the research of Firth et al. (2008) who found that foreign ownership had a higher effect on reducing agency costs and Nelson and Mohamed-Rusdi (2015) research also showed a significant positive relationship between audit costs included in agency costs and foreign ownership.

6. CONCLUSION

Managerial ownership does not significantly influence agency costs. This is because managerial ownership has a very small proportion of the number of shares of a company in circulation as a result of which managers tend to act and approve the results of the GMS and cannot influence decisions in a company. Institutional ownership does not significantly influence agency costs. This is because institutional ownership in the company does not carry out strict control and supervision of the manager's decision despite having greater strength and tend not to want the stock market price to fall due to information asymmetry, as a shareholder can pressure managers to provide accurate information related to the company's condition even though it requires a large cost.

Government ownership does not significantly influence agency costs. This is because the government often has different goals than the objectives of other shareholders. The government is more inclined to emphasize its objectives or policies on politics and social rather than economic efficiency because the income derived from ownership of shares

is not the government's main objective in increasing shareholder value. Foreign ownership does not significantly influence agency costs. This is because in general, foreign investors have obstacles in carrying out various supervisory functions, namely difficulties in communication, geographical distance constraints, and ignorance of local conditions in carrying out supervision within the company which makes the role of foreign investors invisible and contributes to reducing agency costs.

This research is of course still very perfect but is expected to provide input to the management of manufacturers in the number of fixing agency conflicts and for further researchers can be used as a reference to develop further in order to strengthen existing theories.

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