Capital Structure, Ownership Structure, and Firm Size: It's Implication on Agency Cost (A Study in Indonesia Manufacturing Company)

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Abstract

This research examined the influence of capital structure, ownership structure, and firm size on agency costs in manufacturing companies listed on the Indonesia Stock Exchange. The capital structure is measured using Debt to Equity Ratio (DER) and Long Term Debt Equity Ratio (LTDER). The ownership structure is measured by institutional ownership and foreign ownership while company size is measured using Ln total assets. The population in this study are all manufacturing companies listed on the Indonesia Stock Exchange (IDX) from 2013-2018. The sampling technique used purposive sampling so that the number of samples in this study was 478. The method of data analysis used multiple linear regression. The results showed that DER had a positive and significant effect and LTDER had a negative and significant effect. Institutional ownership has positive and significant influence and foreign ownership has a positive and not significant effect. Firm size has a positive and significant effect

Keyword: capital structure, ownership structure, firm size, agency cost

Introduction

Agency theory is a theory that explains relationship principals-agents and resolving the problems that can occur in a principal-agent relationship (M. Jensen & Meckling, 2012). The principal here is the shareholders or owners of the company and the agent is the person appointed by the company to manage the company. Shareholders who are the delegating principal business decisions making to managers who are representatives or agent of the shareholders. With the separation of ownership and management functions there will be a conflict of interest or also called agency conflict (Panda & Leepsa, 2017). The problems arise when the two parties (principal-agent) have conflicting objectives and it is difficult or expensive for the principal to verify what the agent is doing and whether the agent has behaved appropriately. Other than that the relationship between principals and agents can lead to conditions asymmetrical information because the agent has more information about the company compared to the principal. Assuming that the individuals act to maximize one's interest then with information the asymmetry it possesses will encourage agents to hide some information that is not known to the principal (Panda & Leepsa, 2017).

Furthermore, agency conflicts can lead to agency costs, namely in the form of providing appropriate incentives to managers and monitoring costs to prevent hazards. Agency cost is measured by the asset utilization ratio (Ang, Cole, & Lin, 2007). Asset Utilization Ratio is a ratio used to find out how well the total use of company assets in the company's operational activities. The higher this ratio, the more productive the assets used, the better the business climate created will foster an investment climate to create value for shareholder. The following data is on the agency costs as measured by asset utilization ratio:

Table 1. Level of Asset Utilization Ratio of Several Manufacturing Companies Listed on the IDX

Company Name	2013	2014	2015	2016	2017	2018
PT. Akasha Wia International Tbk	1.14	1.15	1.03	1.16	0.97	0.91
PT. Budi Starch & Sweetener Tbk	1.08	0.92	0.73	0.84	0.85	0.78
PT. Delta Djakarta Tbk	1.00	0.89	0.67	0.65	0.58	0.45

Table Cont…

PT. Gudang Garam Tbk	1.09	1.12	1.11	1.21	1.25	1.39
PT. Ultrajaya Milk Tbk	1.23	1.34	1.24	1.11	0.94	0.99

Source: Processing Result

The table above presents the development of agency costs proxied by the asset utilization of several manufacturing companies listed on the Indonesia Stock Exchange in the 2013-2018 period. The average asset utilization ratio increases and decreases every year. PT. Delta Djakarta from 2013 -2018 asset utilization ratio has decreased. In 2013 the value of asset utilization ratio was 1.00 and in 2018 it dropped to 0.45. In contrast to PT. Gudang Garam value of asset utilization has increased, only in 2015 decreased from 1.12 in 2014 to 1.11 in 2015.In theory, the decrease in asset utilization ratio indicates an increase in agency costs. This increase in costs can be caused by poor investment decision making by managers, lack of effort from managers to getting profits, managers take advantage of executive income (executive perquisites) such as buying unproductive assets, office space, cars and office properties that are too luxurious (Ang, Cole , & Lin, 2007).

(Lin, Ma, Malatesta, & Xuan, 2011) provide solutions to reduce agency costs by using debt in the company's capital structure. By using debt in the capital structure will make the company's managers will save costs that are not important so that it can increase free cash flow (free cash flow). In this study capital structure was measured using the DER and LTDER proxied. DER indicates the level of company risk, where the higher the DER ratio, the higher the company's risk. This is caused by funding from external companies is greater than equity. Companies that have a large external source of funds in their capital structure put a heavy burden on the company. In addition to the DER ratio in this study also uses the Long Term Debt to Equity Ratio (LTDER) as a proxy for the capital structure which is a comparison between long-term debt and shareholder equity. The results of the study (Zheng, 2013) state that there is no significant effect between capital structure and agency costs. This is different from research conducted by (Ellul, Guntay, & Lel, 2007) and (Lin et al., 2011) found a positive and significant relationship between capital structure and agency cost (agency cost)

Furthermore, to reduce agency costs by aligning the interests of principals and agents so that conflicts between principals and agents can be reduced (Masdupi, 2005). The characteristics of the ownership structure in this study were measured using the proxy for institutional ownership and foreign ownership.(Sajid, Muhammad, Nasir, & Farman, 2012) found a positive and significant relationship between institutional ownership and asset utilization ratio. In contrast to research conducted by (McKnight & Weir, 2009) which shows agency cost is not influenced by institutional ownership. According to companies with a high amount of foreign ownership will voluntarily and disclose or report information to reduce agency costs (Agency Cost). In addition to institutional ownership, foreign ownership also affects agency costs. Foreign ownership is ownership of shares by foreign individuals or institutions of the company's shares in Indonesia. Foreign investors face greater risks such as political and legal risks in Indonesia because they invest across countries. According to Xiao et al (2014) companies with a high amount of foreign ownership will disclose or report their information voluntarily and clearly to reduce agency costs.

The size of the company has an influence on agency costs, where the size of the company will create a moral hazard problem when managers usually utilize incentives that are by their interests that are not included in the employment contract agreed upon by the principal and agent. According to (Sajid et al., 2012) an increase in the number of company assets, one of which is caused by the effectiveness of the utilization of assets is relatively small, this condition causes many assets to accumulate. This can encourage or be used by managers to commit fraud that will increase agency costs.

Review of Literature
Agency Theory

According to (Jensen & Meckling, 2012) the concept of agency theory is a relationship or contract between a shareholder (principal) and one or several people who manage a company/management (agent). The shareholders (principal) who employ and delegate agents (parties appointed by the principal) whose duty is to manage the company for the benefit of the shareholders (principal). (Chrisman, Chua, & Litz, 2004) the shareholders (principals) and agents as the appointed party are in the position of mastery of uneven information (asymmetric information) where the agent as the party managing the company has more information about the company compared to principal. This asymmetric condition will lead to moral hazard which allows agents to do everything that will benefit them personally and provide burdens borne by shareholders.

The condition of the imbalance of information between the principal and agent will cause agency problems. According to (Fachrudin, 2011) agency problems occur when managers tend to make decisions that will benefit themselves rather than the interests of shareholders (principal). Agency problems occur usually in two forms, (1) agency problems between shareholders and managers, where conflicts occur when making decisions related to fundraising and how the funds will be used, (2) agency problems between principals and creditors (Jensen & Meckling, 2012). To overcome and reduce agency problems, companies incur costs called agency costs.

Agency Cost

Agency costs are costs incurred to control and supervise all the activities of managers so that managers or agents can carry out their obligations to improve the welfare of shareholders. caused by the separation between the owner (shareholder) and the company manager (agent) or management. (Jensen & Meckling, 2012) states that agency costs are the sum of monitoring costs (principal costs incurred to oversee agent behavior such as determining the amount of compensation to be given to managers), bonding costs (agent costs to ensure that the mechanism is in accordance with interests from shareholders (principals) for example costs incurred by managers to provide financial statements for shareholders) and residual losses (costs arising from the fact that due to manager's actions that are not in accordance with the aim to maximize shareholder value.

To measure agency costs, you can use several proxies. According to (Wang, 2010) agency cost can be calculated using total asset turnover and operating expense ratio where these two variables are significant as a measurement of agency cost. According to (Ang et al., 2007) to measure agency costs (agency cost) can use two efficiency ratios namely asset utilization ratio which is the level of asset turnover and expense ratio which is the ratio of operating expenses to sales.

Capital Structure
Definition of Capital Structure

Capital structure is a combination of each account that is on the right-hand side in the statement of financial position (balance sheet). The capital structure or financial leverage decision is a composite composition of debt and equity that impacts the firm's value and the cost of capital. In maximizing the value of shareholders of companies that use debt in their capital structure will cause the value of the company to increase due to a tax reduction due to interest payments from debt. But the higher the debt will increase the risk of the company because it increases capital costs.

Components of Capital Structure

Capital structure in the company is broadly divided into two components, namely, equity capital (Shareholder Equity) which is capital that comes from within the company such as from the owner of the company and capital that is in the company for an indefinite period of time and foreign capital / debt long term (long term debt) which is a debt whose time period is more than ten years. Long-term debt is generally used to finance the expansion of the company (expansion) or modernization of the company because the

capital needs for these needs require large funds. The types of long-term debt are bond loans and mortgage loans.

Capital Structure Theory

In 1958 Modigliani and Miller issued a financial theory about capital structure and considered the beginning of capital structure theory. The theory issued by them is known as the modern capital structure theory (Modigliani-Miller Proportion). MM theory was made assumed to be in an economic condition that is almost impossible to exist at this time in the condition that there are no taxes imposed by the government on companies, there are no transaction costs and all companies and individuals have the same interest rates, especially interest rates on debt that is it has. But with the existence of this MM theory that underlies the founding of theories about the next capital structure.

Theory of Modigliani and Miller

The theory issued by Modigliani and Miller (1958) is a theory based on a perfect market that is that the capital structure imposed by any company will not affect the value of the company. But if there is a tax, the company will have more debt, because this will increase the value of the company.

Pecking Order Theory

Myers and Majluf (1984) introduced a theory based on research previously carried out by Donaldson (1961) which is a theory that discusses the company's capital structure funding decisions known as pecking order theory. This pecking order theory is one theory that bases on the asymmetric occurrence of information. Information asymmetry is a condition in which a company's internal parties are considered to be more aware of information about the company's condition compared to external parties who have an interest in the company (investors).

Trade-Off Theory

The theory that is no less important, which is the basis of decisions on funding for corporate capital structures, is the theory created by Myers (1984), namely the trade-off theory. This theory is based on conditions where companies will be more inclined to use funding from outside, namely by using debt. The company will borrow to the extent that the profits from the tax shield it gets are as large as the costs incurred due to the possibility of bankruptcy (Setyabudhi, 2008).

Ownership Structure

There are various forms of ownership structure in companies, such as managerial ownership, institutional ownership, individual ownership, public ownership, and government ownership. Managerial ownership is ownership that is obtained by managerial companies, such as commissioners or directors in the company. Institutional ownership is ownership owned by institutions such as banking, insurance, pension funds, and other institutions. Individual ownership is ownership obtained by individual individuals. Public ownership is ownership acquired by the community and government ownership is ownership of companies controlled by the government.

Company Size

The size of the company is a picture of the size of the company that is seen in the total value of assets on the balance sheet at the end of the year. In terms of obtaining funds, large companies have the flexibility and ability to get funds because of easier access to the capital market. According to Titman and Wessels (1998), relatively large companies are generally more diversified because they can optimize the use of the target debt ratio, so it is not easy to go bankrupt. Therefore large companies tend to use higher debt. This is consistent with the trade-off theory, namely the higher the level of profits, the company will increase the amount of debt to obtain greater profits due to tax reductions and if the debt level is too high, it will be reduced to the optimal target.

Methods

The research method used is descriptive verification. The object of this research is manufacturing companies listed on the Indonesia Stock Exchange (IDX) in the analysis period, namely 2013-2018.In this

study, the population is all manufacturing companies listed on the Indonesia Stock Exchange in 2013-2018. The sampling method in this study uses a purposive sampling method which is a sampling-based on criteria set by the researcher. Judging from the source, this research data is secondary data. Researchers used data sources originating from the company's prospectus during the study period. The source of data used in this study is data derived from data on the financial statements originating from the official site of the Indonesia Stock Exchange (www.idx.co.id) and other sites needed from 2013 to 2018. To obtain data in his research the writer uses secondary data. This secondary data was collected using the documentation method, namely by recording or documenting data related to the research, namely the company's prospectus, annual reports, during the 2013-2018 research period.

Results and Discussion

Descriptive Statistics

Before the research variables are tested using statistical data, the data of each variable must be described. This is intended to see an overview of each variable studied. In this study, there are five independent variables and are factors that influence the agency cost of manufacturing companies listed on the Indonesia Stock Exchange (2013-2018). These variables are a debt to equity ratio, long debt to equity ratio, institutional ownership, foreign ownership, and Firm Size. While agency cost is measured by Asset utilization as the dependent variable.

Table 2. Descriptive Statistics of Variable

	Agency Cost	DER	LTDER	Institutional Ownership	Foreign Ownership	Firm Size
Mean	1.0219	0.7766	0.2904	0.2871	0.2871	28.3808
Maximum	3.1048	4.0100	1.9100	1.0000	0.9600	32.0000
Minimum	0.0027	0.0040	0.0090	0.0110	0.0000	25.0000
Std Dev.	0.5345	0.7416	0.3410	0.1951	0.3286	1.5464

Data processing result with spss

Overall, the Agency costratio obtained a minimum value of0.0027, with a maximum value of 3.1048 and an average value of 1.0219, and a standard deviation of 0.5345, indicating that the average deviation of each coefficient value agency cost is 0.5345 from the average value of the agency cost coefficient. DER obtained a minimum value of 0.0040 with a maximum value of 4.0100and an average value of 0.7766 and a standard deviation value of 0.7416, this indicates that the average deviation of each DER value was 0.7416 from the average DER value. LTDER obtained a minimum value of 0.0090 with a maximum value of 1.9100 and an average value of 0.2904 and a standard deviation value of 0.3410, this indicates that the average deviation of each LTDER value was 0.3410 from the average the value of LTDER. Institutional ownership obtains a minimum value of 0.0110 with a maximum value of 1.0000, and an average value of 0.2871 and a standard deviation value of 0.1951, this indicates that the average deviation of each institutional ownership value is 0.1951from average institutional ownership. Foreign ownership obtained a minimum value of 0.0000 with a maximum value of 0.9600, and an average value of 0.2871 and a standard deviation value of 0.3286, this indicates that the average deviation of each foreign ownership value was 0.3286 from average foreign ownership. Firm Size obtains a minimum value of 25.0000 with a maximum value of 32.0000, and an average value of 28.3808 and a standard deviation value of 1.5464, this indicates that the average deviation of each Firm Size value is 1.5464 from Average Firm Size.

Data Analysis

Before carrying out multiple linear regression analysis, it must be done a classic test so that in advance the results of the processed data can be assessed what is the purpose of the study. A normality test is done to

prove whether in the regression model the confounding or residual variable has a normal distribution or not. From the results of the normality test, it is seen that the significance is greater than α, which is 0.067> 0.05, which means that the distribution of normal residuals is carried out after the transformation of the dependent variable and independent variables into logarithmic form. Then multicollinearity was tested. All variables have a Tolerance value of more than 0.10 and a Variance inflation factor (VIF) of less than 10, to distinguish multicollinearity from all the independent variables needed in the study. The heteroscedasticity test is used to answer whether in the regression model there is an unequal variance in the residue from one observation to another. A good model is one that does not occur heterokedastisitas. The results of the calculation of each independent variable showed a level of sig> α 0.05, namely 0.913 for DER, LTDER of 0.840, Institutional ownership of 0.393, Ownership of 0.299, and Company size of 0.907. Undeniably this research is free from heteroscedasticity variations and is worthy of discussion. Finally, the autocorrelation test involves testing in regression while the requested variable does not correlate with itself. Based on the autocorrelation test, it was found that the Durbin-Watson value was 0.594> -2 and more <2, which means that the variable was free from autocorrelation.

Multiple Regression Model

The multiple regression analysis in this study was used to express the functional relationship between the independent variable and the dependent variable. Multiple regression analysis was performed using the SPSS program. Following are the results of the regression process obtained:

$$Y = -0{,}408 + 0{,}171X_1 - 0{,}557\ X_2 + 0{,}557\ X_3 + 0{,}013\ X_4 + 0{,}037X_5$$

A constant value of -0,408indicates that if the free variable is zero then Agency Cost is -0,408, this means that if the manufacturing company does not have DER, LTDER, institutional ownership, foreign ownership, and or the company does not have a firm size but Asset utilization at several fixed manufacturing companies -0,408. For the DER value of 0,171with a significance of 0.000< 0.05. This shows that DER has a significant positive effect on Agency costs. For LTDER value of – 0,557with a significance of 0.000<0.05. This shows that LTDER has a significant negative effect on Agency costs. Institutional ownership is 0,557with a significance of 0.000<0.05. This shows that institutional ownership has a significant positive effect on Agency costs. Foreign ownership of 0,013with a significance of 0.8596 >0.05. This shows that foreign ownership has no a significant positive effect on Agency cost. The size of the company is 0,037 with a significance of 0.014<0.05. This shows that company size has a significant positive effect on Agency cost

Discussion
Effect of Capital Structures on Agency Cost
Effect of DER on Agency Cost

According to Gibson (2008), DER is a proxy to see the structure of the company's capital, where the high DER according to (Ang et al., 2007) signifies the structure of the business capitalization more utilizing the debt relative to the equity. The higher the DER's eating value the higher the company also risks because there is an obligation to pay debt interest. From the results of DER studies positive and significant impact on agency costs with the significance of 0.000 < 0.05. This is following previous research (Fachrudin, 2011) which finds the positive and significant relationship of corporate capital structure to agency cost. In agency theory, it is stated that in determining the capital structure needs to be considered the costs incurred by the difference in the interest between shareholders and managers. Besides, the cost of a large debt becomes a bounding cost to the manager, as it encourages managers to use the company's funds to invest properly. The study was inconsistent with research (M. C. Jensen & Meckling, 1976) stating that debt use in capital structures can encourage managers to work more efficiently and prevent unimportant expenditures and by Using debt managers are more cautious in cash spending at the time the company has a lot of debt.

Effect of LTDER on Agency Cost

Meanwhile, LTDER as a proxy for capital structure has a negative and significant effect on Agency Cost with a significance of 0.000<0.05. This is consistent with research (Burhanudin & Handayani, 2018), (Septiawan & Wirawati, 2016) leverage has a negative and significant effect on Agency Cost, which indicates that the higher the debt policy, the agency costs will decrease.The company's capital structure is the proportion of the use of external funds or debt both long-term and short-term. The consequence of using debt incurs interest expense for the company. According to (Berger & Bonaccorsi in Patti, 2006) the selection of capital structure using debt can reduce agency costs. The use of debt as a source of corporate funding can prevent corporate expenses that are not important and encourage managers as agents to run the company more efficiently, not to deviate from the company's goals and act more to shareholders. Also, according to Zheng (2013) repurchase of outstanding shares will be carried out if the company obtains sufficient funds from debt. If a stock purchase occurs, the total outstanding shares will decrease, which means the value of earnings per share will increase. This condition is an advantage for managers in the form of incentives, especially when managers own shares in the company.

In addition, from the initial literature on agency costs (MC Jensen & Meckling, 1976) later developed by (Harris & Raviv, 1991) and (Myers, 2001) which explains the relationship between agency costs and capital structure, high levels of leverage can reduce costs malignancy through the threat of liquidation or the inability of the company to pay off its obligations which will cause personal losses to managers and through pressure to generate cash flow to pay interest expenses (M. Jensen & Meckling, 2012). This is the following research Zheng (2013) payments of principal and interest on the debt will prevent management from overinvestment in using free cash flow. A high degree of leverage will reduce conflicts between shareholders and managers regarding investment choice issues, the amount of risk borne, the conditions under which the company will be liquidated and the dividend policy (Berger & Bonaccorsi in Patti, 2006). But the results of this study are different from the research conducted by (Sadewa & Yasa, 2016), (Hamidah, Wicaksono, & Ahmad, 2017), leverage has a positive and significant effect on agency costs. According to the results of his research, the high level of debt was caused by the ineffectiveness of the company in managing its expenses until it was converted to sales.

Influence of Ownership Structure Against Agency Cost
Effect of Institutional Ownership on Agency Cost

The value of the institutional ownership regression coefficient is 0.577 with a significance level of 0.000<0.005. A positive coefficient value means the relationship between institutional ownership variables and agency cost is unidirectional, where each 1% increase in institutional ownership will increase Agency Cost by 0.577%. This is caused by the average institutional ownership of manufacturing companies 0 in other words institutional ownership does not exist so that it increases agency costs According to (Masdupi, 2005) one way to reduce agency problems is that companies increase institutional ownership as a monitoring agent. Outside shareholders can reduce agency costs, this is due to the presence of ownership from outside the company so that the concentration of ownership occurs because the owner is a source of power that can support or oppose the existence of management.

Institutional ownership is ownership of company shares by institutions or institutions such as insurance companies, banks, investment companies. Institutional ownership will encourage increased oversight of decision making and company performance so that it can align the interests of shareholders with company owners (Sajid, Muhammad, Nasir, & Farman, 2012). Supervision of institutional ownership is emphasized through their sizable investment in the capital market. If institutional investors are not satisfied with the agent's performance, investors can sell their shares back and this will reduce managers' opportunistic behavior that can reduce agency costs (Wahyudi, U., 2006).

Effect of Foreign Ownership on Agency Cost

The value of the regression coefficient of foreign ownership is -0.013 with a significance level of 0.859>0.005. According to (La Porta, Lopez-de-Silanes, & Shleifer, 1999) and (Xiao, Jones, & Lymer, 2005) monitoring of foreign shareholders is relatively higher because it faces a great risk in investing across countries, especially in developing countries. Companies with large foreign ownership will be compelled to report or disclose information voluntarily and widely. The disclosure of information can reduce agency costs incurred in the company so that it puts pressure on the company to more efficiently utilize resources to reduce agency costs. This is different from research conducted by (Nelson & Mohamed-Rusdi, 2015)showing a positive relationship between foreign ownership of agency fees from audit fees included in agency costs and foreign ownership of audit fees is greater.

According to (La Porta, Lopez-de-Silanes, & Shleifer, 1999) foreign investors face more risks when they invest in other countries with the country's economic conditions, especially in developing countries. (Wright & Madura, 1995) state that agency costs at multinational companies are greater than national companies. This is due to other countries where the head office opens its subsidiary has different characteristics from the central company making it difficult to oversee the performance of managers. According to (Xiao et al, 2004) companies whose shares are mostly owned by foreigners usually, face the problem of information asymmetry due to geographical and language barriers. Therefore companies with foreign ownership will increase agency costs

Effect of Company Size on Agency Cost

Firm size regression coefficient value is 0,037 with a significance level of 0.014<0.005. A positive coefficient value means the relationship between firm size variables and Agency Cost is unidirectional, where every 1% increase in company size will increase Agency Cost by 3.068%. This is consistent with the research (Sajid et al., 2012) that found a positive relationship between company size and Agency Cost. An increase in the number of company assets occurs as a result of the effectiveness of the use of assets carried out by a relatively small amount that causes several assets to accumulate, the situation will be used by managers to commit fraud to gain personal benefits and cause agency costs to increase. According to research (Hamidah et al., 2017) the greater the size of a company, the higher the interests of shareholders and managers. This causes a gap between shareholders and managers so that agency costs will increase.

Conclusions

Based on the data analysis and discussion that has been done, the following conclusions can be drawn: a) DER has a positive and significant effect on agency costs, b) LTDER has anegative and significant effect on agency costs, c) Institutional ownership has a positive and significant effect on agency costs, d) Foreign ownership has a negative and not significant effect on agency costs, and e) Firm size has a positive and significant effect on agency costs

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