The Influence of Corporate Governance and MD&A on Agency Costs

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Abstract. Agency cost is an economic concept that refers to the costs associated with the relationship between the "principal", and the "agent". There are many things that can affect agency cost. This article aims to discuss several corporate governance factors that can affect agency costs, these factors include: managerial ownership, institutional ownership, independent commissioners, female directors and Management discussion and analysis as moderating variables that aim to strengthen the positive influence on the variables. Corporate governance. This article is a qualitative research in the form of a literature review. The result of this literature review article is that theoretically managerial ownership, institutional ownership, independent commissioners, female directors, and MD&A has a negative effect on agency cost.

Keywords: agency cost · corporate governance,MD&A

1 Introduction

Agency conflicts arise because of differences in interests between the principal and the agent. Eisenhardt (1989) found the assumption of different interests between principals and agents, causing agency conflicts. Agency conflict arises when the principal does not know any activities carried out by the agent. Agency problems are divided into two categories, namely the first, adverse selection (an adverse decision), occurs when an agent fails to provide his ability. The second, moral hazard, occurs when the agent has failed to take responsibility, or acts according to his own interests so that it is not in harmony with the interests of the principal.

Agency conflict can occur because of differences in decisions between shareholders and managers regarding investment [1]. Agency costs can occur due to agency conflicts within a company. The misalignment of principals and agents will affect the performance and decisions of managers based on personal interests and the decisions of some groups (entrenchment) thereby reducing the welfare of the principal in [2, 3]. According to in Agency conflict occurs if the proportion of managerial ownership of company shares is small so that managers tend to act in their own interests and not based on maximizing the value of the company in making other fund decisions [1].

© The Author(s) 2023
Nairobi et al. (Eds.): ICEBE 2022, AEBMR 241, pp. 42–49, 2023.
https://doi.org/10.2991/978-2-38476-064-0_7

There are many ways that shareholders can do to resolve agency conflicts and minimize agency costs. The main way is through corporate governance mechanisms (Fama and Jensen, 1983) and Information MD&A with the second highest ranking at 22% after Good Corporate Governance (GCG) which was ranked first at 35%. Disclosure of Management Discussion and Analysis (hereinafter briefly MD&A) in presenting information for stakeholders, especially investors is very important in [2].

Information about management may also be published to investors, such as the company's financial performance, corporate governance, corporate social activities, and MD&A.

In this study, the examiners will discuss theoretically the effect of managerial ownership, institutional ownership, independent commissioners, female directors and MD & A on agency costs.

2 Literature Review

2.1 Agency Theory

Agency theory according to explains that the agency relationship is a contract between managers and investors [4]. A conflict is caused by a manager or agent acting inconsistently with the interests of investors so that agency costs will arise. This agency theory there is an agency conflict that is assumed by each individual motivated by self-interest so that The common agency conflict is the of interest between management and directors (agent) and shareholders (principals).

2.2 Agency Costs

According to Agency costis the cost incurred by the owner of the company to regulate and supervise the actions of managers so that they do not act according to their own will. According to the Keaganen theory of [3] agency costs are the provision of appropriate incentives to managers and supervision costs to prevent moral hazard, which are then identified into two types of agency costs, namely those that occur due to conflicts between investors and managers, and those that occur due to conflict between investors and managers. Conflict between investors and debtholders.

2.3 Corporate Governance

Corporate Governance is a system used to regulate the rights and obligations of shareholders, board of directors, managers, directing and controlling the activities of the company. According to the Forum for Corporate Governance In Indonesia (2001) the purpose of corporate governance is to create added value for all interested parties (stakeholders). Good corporate governance implementation is expected to increase public trust, especially investors and creditors, to the company [4].

2.4 Management Discussion and Analysis(MD&A)

MD&A is a narrative explanation of financial statements to make it easier for users of financial statements to understand the contents of the report. MD&A is able to provide an additional point of view about the company, namely the point of view of the company's management.

3 Methodology and Data Analysis

This study is qualitative in nature which is a literature review on the factors that affect agency costs which in this study uses good corporate governance and management discuss and analysis. The data collection technique used in writing this study is documentation. The data is secondary data that comes from various sources, both books and articles.

4 Research Result and Discussion

The purpose of agency theory is toanalyze the relationship between the owner of capital (principal) and manager (agent) in the company. The Principal Appoints Management to manage the company. Basically the principal and agent are based on a contract that regulates the rights and obligations of the agent. The elements in the contract to run efficiently are the existence of symmetrical information between the agent and the principal so that information is transparent, accountable so that it does not benefit either party, and the risk received by the agent regarding the fee is small. Agents have high certainty about the rewards they receive device [5].

The emergence of agency costs due to the supervisory mechanism in an effort to balance the interests of the principal and the agent. Agency costs as costs borne by shareholders for managers to maximize long-term stock prices.

According there are three kinds of agency costs, namely:

4.1 Monitoring Fee

Monitoring costs are costs incurred by the principal to limit the activities of agents that are different from the interests of the principal, supervised by outside investors.

4.2 Bonding Fee

Bonding costs are costs incurred to provide certainty or guarantee to the principal that the agent will not do anything that will harm investors.

4.3 Residual Loss

*Residual Loss*is prosperity that comes from the value of money falling as a result of different interests.

1. Effect of Good Corporate Governance on Agency Cost

. Indonesia adheres to a two-tier system or Two Tiers System, meaning that the company has two separate boards, namely the board of commissioners and the management board and the board of directors (FCGI, 2001). Furthermore, explains that the corporate governance structure in Indonesia consists of the board of directors, board of commissioners, shareholders and other stakeholders.

Components of Corporate Governance.

The components of corporate governance in the NCGP (2006) include:

4.4 Shareholders

Shareholders are corporate organs that hold the highest power and have the right to obtain all information from the board of directors and board of commissioners relating to the interests of the company.

4.5 Board of Commissioners

The board of commissioners functions as a representative of the principal, both the majority board of commissioners and the minority board of commissioners. to protect the interests of minority shares, the independent board of commissioners must own at least 30% of the total number of shares (Bapepam-LK).

4.6 Board of Directors

The board of directors is the management of the company who is obliged to manage the company properly so that the company's goal to increase shareholder wealth or increase company value can be achieved.

4.7 Audit Committee

Based on Bapepam with Circular No. SE03/PM/2000 the company establishes an audit committee of at least 3 members. One independent commissioner as chairman, two independent external company persons have adequate accounting and finance understanding.

4.8 Company Secretary

The corporate secretary serves as a liaison between the company and investors. So that the company secretary must have access to relevant information related to the company and master the laws and regulations in the capital market sector.

4.9 Other Stakeholders

Stakeholders that have a direct impact on the company's strategic and operational decisions are the government, creditors, employees, business partners and other interested parties.

The principles of good corporate governance include [6]:

1. Transparency
2. Independence
3. Accountability
4. Accountability
5. Fairness

Based on the Code of GCG issued by the National Committee for Corporate Governance Policy (KNKCG), the Company's Management Functions carried out by the board have 5 main tasks, namely:

a. Management
b. Risk management
c. Internal control
d. Communication
e. Social responsibility

The existence of good corporate governance is able to influence agency costs through the following mechanisms:

4.10 Managerial Ownership

The large number of shares owned by management from the total outstanding shares is managerial ownership. Large share ownership in terms of economic value has an incentive to align interests with principals. The behavior of opportunity managers (earnings management) will decrease if managerial share ownership increases. Managerial ownership is the shareholder of the management who actively participates in making company decisions, namely directors and commissioners. Managerial ownership in a company can prevent opportunistic actions from management because its position as a shareholder certainly does not want to harm himself.

In this study the managerial ownership structure is defined as the company's share ownership by the company's board of directors and commissioners. The greater the managerial share ownership, the greater the efforts of managers to be responsible for the interests of shareholders, because the manager himself is a shareholder. Share ownership on the management side can reduce agency problems that arise so that agency costs are reduced. Schäuble (2019) in [5]states that managerial ownership is effective in reducing agency costs.

4.11 Institutional Ownership

Institutional ownership can professionally monitor the development of its investment, so that a high level of management control, the potential for fraud can be suppressed. Bushe

(1998) in [6] explains that institutional ownership can reduce the level of managers' incentives to act according to their own interests through intense supervision so as to suppress inappropriate behavior by managers. [7] ownership structure is proxied by ownership concentration This is because a lower ownership structure provides lower incentives to disclose information in order to meet the needs of different groups of shareholders. The number of shareholdings held by institutions is institutional ownership. According to [8] in [9] Institutional ownership is share ownership where the shareholders are institutional or passive in the company's operational activities optimal supervision in a company.

4.12 Independent Commissioner

An Independent Commissioner who has at least thirty percent of the total number of commissioners, means that he has met the guidelines for good corporate governance in order to maintain independence, making effective, precise and fast decisions based on the Independent Commissioner.

POJK No.33/POJK.04/2014, dated 8 December 2014 concerning the Board of Directors and Board of Commissioners of Issuers or Public Companies. The creation of GCG, namely with the existence of a Board of Commissioners whose main purpose is to overcome the possibility of information asymmetry, the board of commissioners functions as a representative of the principal, both the majority and the minority formed by the Principal himself. Must be owned as a basis of competence and experience to be appropriate and in accordance with the company, thus bringing the board of commissioners to be more effective in carrying out their duties [9]. If the proportion of independent commissioners increases, the agency costs will decrease. On the other hand, finding the number of independent commissioners and board meetings actually increases the agency costs of overview [10]. is measured by the number of independent commissioners divided by the total number of commissioners.

4.13 Female Directors

An important mechanism in the implementation of GCG is the formation of a board of directors because it explains transparency (accountability) about an effective on internal control system based on the balance of power sharing between the board of directors, board of commissioners, shareholders and auditors. Another important mechanism to reduce agency costs is the Board of Directors. One of the diversity that occurs within the company is the existence of gender. Where in essence humans are divided into two genders, namely male and female. So that with the presence of the Board of Directors and especially female directors who are more precise and faster on duty and are collegially responsible in managing the company, it will further suppress the information asymmetry that will arise between the principal and the Manager, means of monitoring actions and ensuring that the executive director makes policies that are in line with the interests of shareholders in order to create good corporate governance. Female directors have a better understanding of the company's market segment than men and this can develop quality in the company's decision-making process. So that with especially female directors who are more precise and faster on duty and are collegially responsible in managing the company, it will further suppress the information asymmetry that will arise between the principal and the Manager, means of monitoring actions and ensuring that the executive director makes policies that are in line with the interests of shareholders in order to create good corporate governance.

2. Effect of Management Discuss and Analysis on Agency Cost

MD&A is a narrative explanation of financial statements to make it easier for users of financial statements to understand the contents of the report. MD&A is able to provide an additional point of view about the company, namely the point of view of the company's management.

In the annual report, MD&A can provide investor considerations to evaluate the company's stock price which is presented in a complete and transparent manner. The goal is to lower investor expectations bias, management information is more accurate, open, clear, and complete so that it can reduce the risk of making decisions on its shares. Investors will respond positively MD&A.

5 Summary

Agency cost is a cost-related economic concept, related between "principal", and "agent". There are many things that can affect agency costs. This article aims to theoretically discuss several corporate governance factors that can affect agency costs, these factors include: managerial ownership, institutional ownership, independent commissioners, female directors, and MD&A. This article is a qualitative research in the form of a literature review. This literature review theoretically states that managerial ownership, institutional ownership, independent commissioners have a negative effect on agency costs.

6 Implications/Limitations and Suggestions for Further Research

This research is a qualitative research with a literature review method that seeks to discuss the factors that affect agency costs theoretically, namely through the GCG and MD&A mechanisms and based on the results of previous studies. The variables used to measure GCG are managerial ownership, institutional ownership, independent commissioners, female directors. Further research is expected to add other variables to measure GCG or conduct empirical testing.

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