

## INSTITUTIONAL OWNERSHIP AND AGENCY CONFLICT CONTROLLING MECHANISM<sup>1</sup>

**Leo Indra Wardhana**

STIE YKPN Yogyakarta.  
(leoindra8@yahoo.com)

**Eduardus Tandelilin**

Universitas Gadjah Mada  
(tandelilin@yahoo.com)

### *Abstract*

*The research investigates ownership structure in Indonesia in context of agency theory for non-financial firms listed on the Indonesian Stock Exchange for 2000-2007 periods. The uniqueness of characteristic of ownership structure in Indonesia, which is dominated by large institutional shareholders motivated researcher to examine the impact and its relationship to agency conflict and balancing off agency theory in Indonesian companies. In this condition, it is certainly indicating that the existing conflict is not between managers and owners but majority and minority.*

*The study argues that in low level ownership, controlling institutional shareholder expropriates the minority shareholders. However, when the ownerships comes to higher level, the controlling shareholder will make agency conflict lower since monitoring hypothesis becoming relevant in such level. In other words, the study argues that nonlinear relation between agency conflict which is proxied by firm's performance ratios and controlling institutional ownership exist. Nevertheless, the study argues that debt and dividend policy can also be used to reduce the conflict. Thus, the study also examines the simultaneous relationships among the mechanisms used to reduce agency conflict.*

*The result indicates that when controlling institutional shareholder has significant amount of shares, they will actively monitor the manager to ensure them making value. However, when the ownership is insignificant, controlling shareholder will harm firm value due to expropriation of controlling shareholder. Therefore, nonlinear relationship exists between controlling institutional shareholder and agency conflict. Second, debt policy and dividend policy can be used to reduce the conflict. The last, it is found that balancing off agency theory is not applied among all policies. The only bidirectional relationship is between institutional ownership and debt policy.*

**Keywords:** *controlling institutional ownership, agency theory, balancing off agency theory, debt policy, dividend policy*

---

<sup>1</sup> This research is funded by P3SWOT of the Beaurau of Foreign Planning and Cooperation of the Republic of Indonesia's Ministry of National Education.

## INTRODUCTION

Agency theory is based on assumption that economic man will choose an action to maximize their personal utility (Jensen and Meckling, 1976). So far, the study of agency theory and its empirical research has given stronger emphasis on conflict between management and owner. Whereas, the other conflict, especially that of the majority against minority, has been rarely observed, especially for cases in Indonesia.

Indonesian companies which are listed at the stock exchange turns out to have the same ownership composition as those in Asian regions, but have different composition from those in America and European countries. Joher (2006) mentioned that developing countries, on the average, the institutional owners have 45% ownership of the total market capitalization. So does what happens in Indonesia. Most of Indonesian companies are stockholders in the form of business institutions, which is called institutional ownership.

The condition in Indonesia shows that institutional ownership belongs to majority owners or controlling owners. The data phenomena after the economic crisis 1998 shows that the biggest institutional ownerships (controlling ownership) have an average proportion of 60%<sup>2</sup> of the ownership.

Indonesia, a country located in Asian regions, has the same character of ownership structure as well described in the study of Joher (2006). Claessens *et al.* (2000) found out that agency conflict that occurs in East Asia regions is the agency conflict among the shareholders, in this case, the majority share holders against the minority share holders. La Porta, *et al.* (1998) in Leemon and Lins (2003) argue that the absence of governance mechanism in most developing countries provokes the agency problems between the majority shareholders (controlling shareholders) and minority.

Knowing the phenomena of a relatively big institutional ownership and the typical difference of conflict from the condition in America and Europe, the researcher is interested to examine agency theory, especially on Indonesian condition in which most companies are owned by institutional investors and on the condition of corporate governance which relatively different from the United States of America and other developed countries. Moreover, some research findings in Indonesia, for example Mahadwartha (2004), shows inconsistency towards the theory of the prevailing convergence hypothesis on the agency conflict between the majority and minority. From the characters of data and the different findings, the existing relationship is presumably non-linear. This research will discuss the behavior of institutional ownership as controlling owners and its impact toward the agency conflict.

Besides ownership structure discussed above, another mechanism can be used to control agency conflict. Such mechanisms are debt policy (Jensen, 1986; Ang *et al.* 2000) and dividend policy (Chrutchley and Hansen, 1989; Gugler and Yurtoglu, 2003).

The presence of different ownership structure in Indonesia, that is, the large institutional ownership, certainly will contribute significantly to the policy taken by the company. Whether this institutional ownership will increase or decrease the agency conflict to have influence on the company's value and its agency conflict is an interesting part to conduct research on. Nevertheless, most studies of agency theory in Indonesia still focus on managerial ownership, which is actually less relevant to the existing conflicts. Hence, this research will discuss whether the controlling institutional ownership, debt policy, and dividend policy can be used to reduce agency conflict in the context of conflict between majority and minority.

## LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### 1. The Influence of Institutional Ownership towards Agency Conflict

Researches on ownership structure that have been done can be categorized into two groups. First, those which argue that the more the ownership is concentrated to one owner, the lower possibility there will be for agency conflict to occur (Jensen MeckKling, 1976; Demsetz and Lehn, 1985; Pound, 1992). Such phenomenon is called convergence hypothesis. Second, those which argue that the higher the institutional ownership, the bigger the agency conflict will be (La Porta *et al.* 1999; Bozec and Bozec, 2007). Such phenomenon is called entrenchment or expropriation hypothesis.

In context of Indonesia, institutional owners are found in most of companies listed in Indonesian Stock Exchange. Therefore, conflicts that take place among the companies in Indonesia tend to be conflict between the majority and minority shareholder. If the conflicts are as such, it is sensible to minimize the majority ownership. If there is not any majority ownership, conflicts between the majority and minority will not arise. Such argument is called entrenchment hypothesis (Pound, 1988); Shleifier and Vishny, 1997, La Porta *et al.* 1999; Pozen, 2004). Somehow, researches on concentrated ownership carried out in Indonesia do not show such result, like the research of Mahadwartha (2003). Such research concludes that convergence argument is tend to be able to explain such phenomena.

The latest research by Siregar (2006), finds out the presence of expropriation from the controlling shareholders, in which the controlling shareholders generally have institutional ownership. Such findings support others' like Pound (1988), Shleifier and Vishny (1997), La Porta *et al.* (1999), and Pozen (2004), saying that institutional owner will utilize their rights to take benefits from

the minority due to the asymmetrical information between the two parties.

Some empirical researches have proven that there is non-linear relationship between concentrated ownership with performance, as proxy of agency conflict. The research of Gedajlovic and Shapiro (1998) found out that non-linear relationship between ownership concentration with profitability is positive but then turns into negative, in the United States of America and Germany. Bukart *et al.* (1997) previously, argues that strict monitoring will constrain the manager's initiative. Hence, those researches were done in developed countries whose character of ownership structure is quite different to that of Indonesia. For example, in the United States of America whose ownership structure is far more spread than Indonesia's, shows that 5% of ownership has been categorized as a high majority ownership and tend to be controlling owner (Mork *et al.* 1988; Ang *et al.* 2003). While in Indonesia 5% of ownership is considered to be small amount of ownership. Besides, the observed case focuses on management and owner, not on majority and minority.

Concerning with Indonesian context, where agency conflict occurs between majority and minority (Claessens *et al.* 2000), expropriation argument remains to prevail because as explained by agency theory on majority-minority conflict, when a controlling shareholders exist, they will predominate the management policy, and these controlling shareholders will most possibly reach their personal expectations. However, such opportunistic behavior occurs on particular prerequisite. When the controlling institutional ownership has relatively low level of ownership, it allows more opportunistic actions rather than when they have much higher level of ownership due to the loss that the controlling owner will suffer. In the other words, when the controlling shareholder has a relatively low ownership, the benefit of opportunistic action will still higher than the

loss from the on-going agency conflict. Some how, when the advantage of the opportunistic action is less than the loss of share's value due to the conflict, the controlling institution will develop a strong sense of belonging and begin actively to control in order to see if the asset value increases. In the other hand, when the ownership of the controlling institutional owners is low, the monitoring on management tends to be looser. Thus, institutional ownership will provoke the agency conflict upon the low condition of ownership, but upon the high condition of ownership, institutional ownership will reduce the agency conflict. The contradictory outcomes and arguments above indicate a non-linear correlation between the majority ownership, which is an institution, with the agency conflict. Based on mentioned theories and arguments, the hypothesis can be stated as follows:

H<sub>1</sub>: The Company's performance is low upon the low condition of the controlling institutional ownership, but the company's performance is high upon the high condition of the controlling institutional ownership.

## 2. The Influence of Debt Policy towards The Agency Conflict

Ang, *et al.* (2000) found out that bank inspection to its debtors will reduce the agency conflict in the debtor's company. The lower the agency conflict is, the more it will spur the company's performance, so that the debtors will be able to meet their obligation to the creditor well and punctually. However, the reduced conflict is between the manager and the owner. In this context, debt serves as a bonding mechanism that will restrain the managers to act for their own goodness, and that way they will make a strategic decision that will boost the company's value (Jensen, 1986). Nevertheless, Jensen (1986) also found out

that debt is able to augment the manager's ability to make decision.

In context of conflict between the majority and minority owners, debt can also be seen as a bonding mechanism that is able to reduce conflict between them. With the presence of debt that is related to the risk of bankruptcy, the majority will not promiscuously spend the company's cashflow and will allow the managers to take benefit of the debt optimally, or will involve in the inspection on how the managers spend the debt optimally. If the company goes bankrupt, the institutional owners will suffer the biggest loss and will not get the expected advantage. Then, the company's debt policy will be used by the minority owners for controlling mechanism toward the majority since they cannot control the majority and the manager.

The presence of creditor ensures the minority owner that the majority will not misuse their authority to spend the company's cashflow promiscuously for their personal interest and to expropriate the minority. The use of debt in this context shifts from manager-bonding mechanism to the biggest-institutional owner (majority)-bonding mechanism.

If the company uses debt as leverage, the cost will be more expensive when the majority owners expropriate the minority since it will increase the cost of capital. (Easterbook, 1984). However, the advantage of debt as the controlling and bonding mechanism will reduce because if they use higher level of debt, agency conflict will occur between the creditor and the owner. Thus, at a certain point, the increase of the debt use will promote the agency conflict. Therefore, the hypothesis goes as follows:

H<sub>2</sub>: Debt has positive influence toward performance upon the low debt rate, but turns into negative upon the high debt rate.

### 3. The Influence of Dividend Policy towards Agency Conflict

Crutchley and Hansen (1989) assert that dividend makes the shareholders have a steady income and it reduces agency conflict of equity since managers cannot do any perquisites action because the cash flow has been distributed to the owners.

In context of majority and minority conflict, the majority shareholders often have facilities and incentives to take benefits out of their rights. According to the free cashflow hypothesis in agency conflict, the source of conflict comes from the cashflow that will be used by the majority for their personal benefit, so to distribute the free cashflow as dividend will reduce such conflict.

The research of Gugler and Yurtoglu (2003), with the Rent extraction Hypothesis, stated that there is abnormal positive return when the company announces increase in dividend, and vice versa. Such positive response is a form of market assumption, implying that the presence of majority shareholders will not harm the minority. It means the majority does not expropriate the minority.

In this argument, it can be concluded that distributing the dividend will ensure the minority that they will not be expropriated by the majority, so the distribution of dividend can reduce the agency conflict between the majority and minority. Therefore, the hypothesis is:

H<sub>3</sub>: The distribution of dividend has positive influence on the performance

### 4. Interdependent Relationship between Institutional Ownership, Debt and Dividend Policy

According to balancing-off agency theory out of the three policies mentioned above, only one is going to be used to reduce agency conflict. It means, when one of them is high, the other is low (interdependent relationship exist).

The research of Cruthley and Hansen (1989) and Jensen *et al.* (1992) shows such an interdependent relationship, that companies with high managerial ownership will distribute low dividend and use debt at a low level. Then, Bathala *et al.* (1994) found out that debt policy and managerial ownership are determined by the exchange of variables, that is, institutional ownership, debt policy and managerial ownership. Tandelilin and Wilberforce (2003), for the case in Indonesia, shows that there is a substitutional relationship between debt policy and managerial ownership but such a relationship is not found between dividend policy and managerial ownership.

Such conclusions are indicators of the interdependency between one policy and another. It means if one of the agency conflict controlling mechanism has been used (at high level), the other policies are not used at all (or used at a low level). and there is a complementary policy toward the others to support the mechanism set. This way, it can be hypothesized as follows:

H<sub>4</sub>: There is interdependent relationship between institutional ownership, debt policy, and dividend policy.

## RESEARCH METHOD

### 1. Data and Sampling

The data used for this research is secondary data, which is audited annual financial report of each company. The sample used for the research were obtained using purposive sampling method, specifically the selection of samples based on certain criteria. In this research, the criteria of the samples selection are:

1. Non-financial public company listed at Indonesian stock exchange.
2. The availability of the financial reports data from 2000 – 2007.

In relevance with the objectives of empirical research that is to generalize the company's behavior, the year 1998 and 2008 are not used. On those periods, Indonesia underwent crisis that was the impact of Asian crisis, to be precise, on June 1<sup>st</sup> 1997 – August 31<sup>st</sup> 1998 (Leuz and Gee, 2006). While in the period of 2008, Indonesia was undergoing crisis, which was the impact of global crisis.

As this research uses performance variable, which in abnormal condition was presumably very different from that in the normal condition, the samples in the crisis year is not included. Moreover, the ownership structure before the crisis and after the crisis is different. Lemmon and Lins (2003) finds out that on the crisis period insiders (controlling institutional owners and managers) have incentive and ability to expropriate the minority. Therefore, because the crisis period did not take place in the mid year of observation, which is 1998 and 2008, this research uses sample year of 2000 – 2007.

## 2. The Definition of Operational Variable

### 2.1. Dependent Variable

The dependent variable in the first to third hypothesis is agency conflict. Agency conflict is a variable that cannot be observed. Hence, in this research, some proxies will be used as agency conflict variables. Such proxies are as the following:

1. Asset utility: Following Ang et al. (2000), this research uses asset utilization as the proxy of agency cost, which is calculated as sale divided by the total total asset. The more efficient the manager uses the assets, the smaller the agency conflict to occur. It means, the managers do maximize the company's value by enhancing the performance well, since the the controlling institutional owner is actively monitor the managers.
2. Q: Following Morck *et al.* (1998), this research uses tobin's q ratio as the proxy of

agency conflict. This ratio measure the market value of the company, based on book value. This ratio is equal with the value of market equity, so it is much influenced by the price in the stock exchange. The higher the value of this share, the higher the q value is. This proxy will represent the minority's behavior toward the majority owner's behavior. If the majority tends to expropriate them, the value of Tobin's q will be small. Where:

$$Q = (MVE + PS + DEBT) / BVTA$$

Where,

Q: Tobin's q; MVE: The amount of outstanding common shares multiplied by the market value; PS: preferred stock; DEBT: book value for long-term debt; BVTA: book value for total asset.

Those performance based proxies used in the research are from two different measurements, which are market and accounting based measurement. The combination of the two different bases of performance measurement is expected to serve complimentary to each other performance measurement.

### 2.2. Independent Variable

Independent variable in the first hypothesis is Institutional Ownership. It is an ownership of a legal institution recorded as the non-public shareholders divided by the amount of the spread shares. In Indonesia, it is possible for more than one institutional owner to own a company. In line with the developing hypothesis, that is, the conflict between the majority and minority, the proxy used in this research is the biggest institutional owner that is called controlling institutional owner. Then, to test the non-linearity of the institutional owner's influence, institutional ownership will be squared and be used as independent variable. This method follows Miguel's (2003).

The second independent variable used in this research is leverage. Leverage or debt

policy is long term debt proportion owned by the company towards its total assets. This variable is measured by comparing the amount of its long-term debt in period  $t$  with total asset owned by the company in period  $t$ . Following the method of Miguel *et al.* (2004) the debt policy will be squared and be used as independent variable to experiment non-linear influence.

The third variable is dividend policy. This variable is the amount of dividend paid to the investor every year.

### 2.3. Control Variable

The following control variable is used for testing model for the first to third hypothesis. The first control variable used in this research is the managerial ownership. Managerial ownership is the ownership of the board of director and management divided by the amount of the outstanding shares. The managerial ownership has negative effect to the agency conflict as in accordance with the convergence hypothesis (Jensen and Meckling, 1976).

The second control variable used in this research is the size of the company. It is commonly used as control in financial field research. Jensen and Meckling (1976) argue that agency conflict is inclined to occur at big companies. It is measured through natural logarithm of the total asset.

### 2.4. Endogenous Variable

In order to test the fourth hypothesis, the simultaneous equation is used (Jensen *et al.* 1992). In line with the theory employed and the model developed in this research, the endogenous variable consists of institutional ownership, dividend policy, and debt policy.

### 2.5. Exogenous Variable

The first exogenous variable is size of the company. The bigger the fixed asset, the bigger asset can be given as collateral to obtain additional debt (Titman and Wessels,

1998). Jensen and Meckling (1976) argue that agency conflict occurs in big companies. Afterwards, the bigger the size of the company, the more managers are needed to manage the company and consequently, the higher the managerial ownership is needed.

The second exogenous variable is the company's growth. Titman and Wessels (1988) argue that companies with rapid growth indicate the flexibility of future investment and the bigger opportunity for management to do expropriation towards the creditors. Hence, the company's growth will have negative influence towards the debt policy. In term of institutional ownership, the company's growth will have positive influence. This is due to the insiders' information about the company's prospect, specifically the company's prospect of growth (Joher, 2006). Managers know better of projects taken by the company. Institutional owners with high proportion of ownership and managers are internal parties (Pound, 1988), who have information about the company's performance and risks. Upon facing the surmounting risk, the internal parties will control the percentage of their share ownership.

The third exogenous variable is company performance, which are Return on Equity (ROE) and Return on Asset (ROA). The higher the company's performance, measured by ROE, the more interested the institutional investors will be to buy the company's shares (Crutley and Hansen, 1989). Myers and Majluf (1984) associated profitability with the debt policy through their *pecking order* hypothesis. It is stated that the larger the profitability is, the more the company will reduce its demand for debt because it has more profit for the capital source. According to Myers and Majluf (1984) and Titman and Wessels (1988), the higher the profitability is, i.e. ROA, the larger internal fund the company will have to invest, therefore the utilization of debt will be smaller.

The fourth exogenous variable is depreciation, which is proxy of tax benefits that does not come from debt. Certainly, the bigger the depreciation is the smaller propensity for the company to use debt (DeAngelo and Masulis, 1980 in Johar, 2006).

The fifth exogenous variable is fixed asset. According to Scott's research (1977) in Jensen *et al.* (1992), the level of fixed asset will have positive influence on the level of debt.

The sixth exogenous variable is the investment opportunity. According to Myers and Maljuf (1984), a company undergoing a rapid growth and having opportunities for big investment will tend to distribute small dividend. The opportunity to invest is proxied by using market value ratio towards the value of book of equity, which is one of mostly used proxies for investment opportunity (Kallapur and Trolley, 1999).

### 3. Hypothesis Testing

In this research, before regression test is conducted, which is later called formal hypothesis test, informal test will be carried out and presented before the formal one. The informal test is the elaboration of descriptive data using ranking method.

#### 3.1. Hypothesis Testing 1, 2, dan 3

The econometric model used to test hypothesis 1,2, and 3 in this research is as the followings:

$$\begin{aligned} \text{AssetUtil} = & \alpha + \beta_1 \text{IO}_{it} + \beta_2 \text{IO}^2_{it} + \\ & \beta_3 \text{LEV}_{it} + \beta_4 \text{Div}_{it} + \\ & \beta_5 \text{MOW}_{it} + \beta_5 \text{Size}_{it} + \varepsilon \quad (1) \end{aligned}$$

$$\begin{aligned} Q = & \alpha + \beta_1 \text{IO}_{it} + \beta_2 \text{IO}^2_{it} + \beta_3 \text{LEV}_{it} + \\ & \beta_4 \text{Div}_{it} + \beta_5 \text{MOW}_{it} + \beta_5 \text{Size}_{it} + \varepsilon \quad (2) \end{aligned}$$

Note:

Q : tobin's q ration

AssetUtil	: asset utility
$\alpha$	: intercept
$\beta_1, \beta_5$	: regression coefficient
IO	: the biggest institutional ownership
IO <sup>2</sup>	: IO Quadrate
MOWN	: Managerial Ownership
LEV	: leverage
Size	: size
$\varepsilon$	: residual error

Himmelberg, *et al.* (1999) argued that the optimal level of monitoring activity by the majority shareholders is different from each other, depending upon each company's characteristic. This argument indicates there is individual difference among the significant samples in cross sectional data. Managerial, cultural and industrial differences rise. To capture the difference, the regression used is panel data regression with Fixed Effect method (Least Square Dummy Variable).

#### 3.2. Hypothesis Testing 4

While to test the fourth hypothesis, it uses Two Stage Panel Data Regression with simultaneous equation model as follows:

$$\begin{aligned} \text{IO} = & b_{11} + b_{12} \text{LEV} + b_{13} \text{Div} + b_{14} \text{Size} + \\ & b_{15} \text{Growth} + b_{16} \text{ROE} + e \quad (3) \end{aligned}$$

$$\begin{aligned} \text{LEV} = & b_{21} + b_{22} \text{IO} + b_{23} \text{Div} + b_{24} \text{Growth} + \\ & b_{25} \text{Q} + b_{26} \text{FA} + b_{27} \text{Depre} + \\ & b_{28} \text{ROA} + e \quad (4) \end{aligned}$$

$$\begin{aligned} \text{Div} = & b_{31} + b_{32} \text{IO} + b_{33} \text{LEV} + b_{34} \text{ROA} + \\ & b_{35} \text{Growth} + b_{36} \text{Investment} + e \quad (5) \end{aligned}$$

Where Institutional Ownership (IO), Debt Policy (LEV), dan Dividend Policy (Div), Size of Company (Size), Depreciation (Depre), Growth of Company (Growth), and profitability, i.e. Return on Asset (ROA) dan Return on Equity (ROE), Investment, Tobin's q (Q), dan Permanent Asset (FA).



## RESULTS

### 1. Descriptive Statistic

The general descriptive statistic of each variable available used in the research will be presented as the following (table 2).

The following will present the data characteristic description that will be examines in

this research. Because this research focuses on the institutional ownership, the first data characteristic that will be elaborated is the characteristic of institutional ownership. The following is the presentation of the characteristic of institutional ownership data.

**Table 1.** Table of The Amount of Sampling Companies by Industry

Industri	n	Industri	N	Industri	n
Adhesive	3	Electronics and Electric	3	Photo	2
Agriculture	4	Fabricated Metal Product	5	Plastic and Product	10
Appreal and Textile	12	Farm	5	Pulp and paper	5
Automotive	17	Food and Beverages	17	Real Estate	29
Cable	6	Holdings	2	Telecommunication	2
Cement	2	Hotel	5	Textile, Garment	9
Ceramic, Glass	4	Metal	15	Tobacco	3
Chemical and Allied	6	Mining	6	Transportation Service	7
Construction	1	Others	11	Wholesale	14
Customer Good	3	Pharmaceutical	8	Wood Industry	4

**Table 2.** Table of Descriptive Statistic each Variables

	ROA	ROE	LEV	DIV	Q	AU
Average	0,017	-0,083	0,467	55.055.256.935	1,442	1,004
SB	0,354	7,527	6,331	336.351.330.222	11,580	1,161
Min.	-43,109	-253,150	0,000	0	0,003	0,000
Max.	5,585	133,410	224,266	6.047.448.000.000	443,120	15,854
	MB	G	IO <sub>total</sub>	TA (size)	MOW	IO
Average	3,995	0,010	0,663	2.559.667.611.363	0,016	0,597
SB	40,184	1,773	0,201	6.943.020.246.370	0,059	0,241
Min.	-190,506	-43,109	0,000	566.667.431.000	0,000	0,000
Max.	1.032,84	57,162	0,990	82.058.760.000.000	0,700	0,900

**Table 3.** Table of The Institutional Ownership Characteristic

	Total Institutional Change	Biggest Institusal (controller) Change	The Interval between the Total And the Biggest
Average	0,051	0,040	0,185
S.B.	0,114	0,111	0,190
Min.	0,000	0,000	0,000
Maks.	0,950	0,916	0,760

This table provides information about the behavior of institutional owners, in relevance with the size of ownership every year. Each company's amount of ownership interval is calculated every year, and then the intervals are made absolute. From the absolute interval value obtained, it is combined for all companies and is calculated its average and standard deviation. For the interval, the total ownership subtracted by the biggest ownership for each company and combined to find the average and the fixed deviation.

Conclusions that can be obtained from those data exploration are:

1. Generally, mostly the company owners that are listed in Indonesian stock exchange from year 2000-2007 are companies with institutional ownership. Most of the owners are non-financial company and in a company ownership, there is more than one institutional owner. In each company, there is the biggest institutional owner, who is later called as the controller.
2. The owner and the amount of ownership in a company remains stable, on the average. It can be seen from the the yearly ownership change at table 3. The average change of ownership every year is 5,1% for the total ownership and 4% for the biggest ownership with standard deviation of 11% each.
3. The interval between the total institutional ownership and the biggest institutional institution at the average is stable and not large, i.e. 18,5% with fixed deviation of 19%. It can be seen from the average interval of the total institutional ownership with the biggest institutional ownership at table.

Before conducting regression analysis, the researcher elaborates the trend of the inter-

variable correlation by sorting the data in an accordance with the order of certain variable (sorting) that the researcher calls as informal test.

Table 4 shows that the pattern of the biggest institutional ownership distribution follows the normal distribution. It shows that the controlling institutional ownership (IO) with Tobin's q (Q) variable and Asset Utility (AU), which are the proxy of agency conflict, show a non-linear pattern with quadratic form, forming U curve. This means, upon the condition of low ownership, the average value of Tobin's q (Q) and asset utility (AU) tend to be low. This shows that upon the condition of low level of controlling (the biggest) institutional ownership, the Company's performance is, but the company's performance is high upon the high condition of the controlling institutional ownership. In the other words, upon the condition of high ownership, the controlling institutional ownership will try to maximize the Tobin's Q (Q) value and asset utility (AU). This shows that upon the condition of high biggest institutional ownership, the additional of ownership will reduce agency conflict.

It can be seen from table 5 that the relationship between debt (LEV) and Tobin's

**Table 4.** The Relationship between the Biggest Institutional Ownership (the Controller) with the Performance

Panel 1				Panel 2			
IO	n	Q	AU	IO	Q	AU	
		Average			Average		
0-19	17	18,428	1,870	1	0,219	107,052	1,327
20-39	65	66,424	0,922	2	0,357	0,693	0,910
40-59	76	1,174	0,977	3	0,464	1,068	1,002
60-79	44	13,875	1,017	4	0,582	1,936	1,031
80-100	11	111,872	28,092	5	0,748	43,876	8,197

Table 4 panel 1 classifies the ownership into 5 with the interval of 20%, i.e. 0-19% up to 80%-100%. The value of each variable is the average calculated from the average of each company in every period of observation, which later is sequenced along with the size of the controlling institutional ownership. Whereas, panel 2 divides the ownership into 5 sections with the same of amount of n value. The sequence of ownership at panel 2 is begun with the lowest ownership (no.1) up to the highest (no.5).

Q (Q) and Asset Utility (AU) also shows non-linear pattern. However, the pattern is not in a quadratic form. While the relationship between dividend (DIV) and performance shows linear and positive trend. This means, upon the condition of high dividend distribution, the company's performance is

higher. In other words, the higher the dividend distribution is the lower the agency conflict will be.

Table 6 shows the relationship among the biggest institutional ownership, debt, and dividend, which indicates interdependent relationship.

**Table 5.** The Relationship between the Debt and Dividend and the Performance

Panel 1				Panel 2			
LEV	Q	AU		DIV	Q	AU	
Average			Average				
1	0,027	1,069	0,989	1	0	0,921	0,764
2	0,097	0,876	1,214	2	14.234.855	1,219	1,007
3	0,194	13,370	0,956	3	1.007.433.078	2,124	1,451
4	0,313	0,933	1,102	4	6.363.836.499	7,095	0,926
5	1,765	38,973	8,218	5	278.271.823.691	110,817	8,337

Table 5 panel 1 divides the level of debt (on average) into 5 equal sections from the lowest (no.1) up to the highest (no.5). The value of each variable is the average calculated from the average of each company in every period of observation, which is later sequenced along the size of debt. While panel is 2 dividend.

**Table 6.** The Relationship between the Controlling Institutional Ownership, the Debt and the Dividend

Panel 1				Panel 2		
IO	LEV	DIV		LEV	IO	DIV
Average						
1	0,219	1,267	3.868.226.325	0,027	0,527	32.623.930.597
2	0,357	0,270	4.517.772.644	0,097	0,488	5.286.369.473
3	0,464	0,301	131.145.863.625	0,194	0,471	76.467.159.824
4	0,582	0,196	62.612.934.611	0,313	0,440	124.286.045.654
5	0,748	0,294	74.013.254.811	0,607	0,440	9.445.187.946

  

Panel 3			
	DIV	IO	LEV
Average			
1	0	0,318	0,308
2	14.234.855	0,569	0,307
3	1.007.433.078	0,451	0,547
4	6.363.836.499	0,452	0,868
5	278.271.823.691	0,577	0,304

Panel 1 divides the average of IO into 5 equal sections, which is begun from the lowest (no.1) up to the highest (no.5). The value of each variable is the average, calculated from the average of each company in the period of observation, which is later sequenced along with the size of IOP. While panel 2 is sequenced along with the debt and panel 3 is sequenced along with the dividend

Table 6 shows that at panel 1 the biggest institutional ownership has negative relationship with debt policy, and on the other hand, at panel 2, along with the addition of debt, the institutional ownership become smaller, and the other way around. While the relationship between ownership and dividend policy does not show a clear-cut relation and tends to show non-linear pattern. Some how, at panel 3, the relationship between dividend and ownership shows trend of positive relationship. Along with the enlargement of institutional ownership, the amount of dividend is higher. For debt and dividend, either at panel 2 or 3, it does not show any linear pattern of relationship.

The result of the data description (the informal test) mentioned above mostly supports the hypothesis proposed in this research. Next, the formal test, which is regression test, will be presented to test the hypothesis proposed.

## 2. The Result of Regression Analysis 1, 2, and 3 and Discussion

This hypothesis test is carried out using Two Stage Panel Data Regression. The model used in this research is Fixed Effect Panel Data Regression with Cross Sectional Weight. While the argument for using such regression model is the presence of individual difference in large cross-section, which arouses the heteroscedasticity.

The outcome of this panel data regression of this research is in table 7. It can be compared that  $R^2$  model with dependent variable Tobin's q (Q) is bigger than model with dependent variable asset utility, i.e. 0,13. Therefore, model with Tobin's q is better than model with asset utility. Besides, only LEV variable at panel 2 does not have influence on AU variable, while IO and DIV variables have the same outcome of regression at panel 1. This way, the researcher will use the best model as discussion.

**Table 7.** The Outcome of Panel Data Regression

$$AssetUtil = \alpha + \beta_1 IO_{it} + \beta_2 IO^2_{it} + \beta_3 LEV_{it} + \beta_4 Div_{it} + \beta_5 MOW_{it} + \beta_5 Size_{it} + \varepsilon...1$$

$$Q = \alpha + \beta_1 IO_{it} + \beta_2 IO^2_{it} + \beta_3 LEV_{it} + \beta_4 Div_{it} + \beta_5 MOW_{it} + \beta_5 Size_{it} + \varepsilon...2$$

	Panel 1 (Q)				Panel 2 (AU)			
	Coef	t	p		Coef	t	p	
C	17,307	4,423	0,000	***	4.639	10.087	0.000	***
IOP	-4,980	-2,093	0,036	**	-0.192	-5.355	0.000	***
IOP2	3,952	2,496	0,012	**	0.003	5.278	0.000	***
LEV	0,888	8,845	0,000	***	0.003	0.152	0.879	
LEV2	0,035	78,232	0,000	***	0.000	-0.355	0.723	
DIV	0,000	2,523	0,011	**	0.000	3.172	0.002	***
MOW	-0,007	-0,050	0,960		-0.626	-3.009	0.003	***
LNSIZE	0,001	0,139	0,888		-0.130	-7.696	0.000	***
R <sup>2</sup>	0,189				0,131			

\*\*\*) 1% \*\*)5% significance level; then applicable to all tables.

Hypothesis 1 states that the controlling institutional ownership will decrease the performance of the condition of low ownership, but upon the condition of high ownership, institutional ownership will promote the performance. From the outcome of regression shown at table 7, it can be seen that coefficient variable of the controlling institutional ownership is marked negative and significant at alpha 1% and its quadrate is marked positive and significant at alpha 5%, meaning that the first alternative hypothesis is accepted.

This research outcome most probably can be the answer why the previous research cannot prove convergence hypothesis or expropriation on the case of Indonesia, which is strongly suspected to have occurred between majority and minority.

It can be concluded that upon the condition of low ownership, the controlling institutional owners will do expropriation toward minority by making use of their votes as majority. While upon the condition of high ownership, the controlling institutional owner will do active inspection toward the management party and even will act straightforwardly to ensure the management carries out their responsibility to promote the company's value as maximally as possible, because his wealth is adhered to their company in significant amount. Like an argument proposed by Pozen (2004) which says that institutional owners will act as activists who advocate the shareholders if the pressuring action they do towards management will be economically valuable or directly influence the shares price. That is why the institutional owner will tend to do active monitoring toward management to promote their performance so that the company's value will rise.

The second hypothesis states that debt has positive influence towards the performance as proxy of agency conflict, but after reaching certain point, it will decrease the performance. The regression outcome shows coefficient variable of LEV is marked positive and sig-

nificant at alpha 1% and its quadrate is marked positive and significant at alpha 1%. It means the influence of debt towards performance is linear. Therefore, such finding is supportive to the research of Ang, *et al.* (2000). In context of conflict between majority and minority, debt is used to monitor toward the majority for the minority who cannot inspect themselves to restrain the majority from any opportunistic action. Besides, debt is also a bonding mechanism to the majority to allow managers to use the debt optimally or will inspect along with the managers to optimally use the debt because if the company goes bankrupt, the institutional owners are the ones who suffer the greatest loss.

The third hypothesis states that the bigger the dividend, the smaller agency conflict between the majority and minority. It means the dividend payment can reduce agency conflict. The outcome of such research supports Gugler and Yurtoglu (2003) that finds out an abnormal positive return for the announcement of dividend rise, and the other way round. Such positive response is a form of market valuation that the majority shareholders do not expropriate the minority. Nevertheless, the dividend payment can guarantee that the cashflow is used to maximize value of the company.

### 3. The Result of Hypothesis 4 Testing and Its Discussion

The fourth hypothesis is the interdependence among the institutional ownership, the debt and dividend policy. The method used to test this hypothesis is two-stage panel data regression with equation of simultaneous model 3, 4, and 5. Table 8 shows the summary of the regression outcome for hypothesis 4.

Table 8 Panel 1, shows that the debt policy (LEV) has negative influence toward the institutional ownership and is significant at alpha 1% while the dividend policy does not have any influence towards the institutional ownership. Then, from panel 2, it can be seen

**Table 8.** The Outcome of Simultaneous Panel Data Regression

$$IO = b_{11} + b_{12}LEV + b_{13}Div + b_{14}Size + b_{15}Growth + b_{16}ROE + e \dots 3$$

$$LEV = b_{21} + b_{22}IO + b_{23}Div + b_{24}Growth + b_{25}Q + b_{26}FA + b_{27}Depre + b_{28}ROA + e \dots 4$$

$$Div = b_{31} + b_{32}IO + b_{33}LEV + b_{34}ROA + b_{35}Growth + b_{36}Investment + e \dots 5$$

Variable	Coefficiency	t	P	
Panel 1: Endogeneous IO				
C	0,879	32,807	0,000	***
DIV	0,000	1,080	0,280	
LEV	-0,001	-9,737	0,000	***
ROE	0,000	1,060	0,289	
G	-0,001	-6,626	0,000	***
LNSIZE	-0,008	-7,978	0,000	***
Panel 2: Endogeneous LEV				
C	0,030	0,614	0,539	
IO	-0,043	-1,935	0,053	**
DIV	0,000	0,121	0,904	
G	-0,001	-11,730	0,000	***
LNFA	0,006	3,242	0,001	***
ROA	-0,010	-0,966	0,334	
Panel 3: Endogeneous DIV				
C	-290.000.000.000	-10,413	0,000	***
IO	5.690.000.000	2,931	0,003	***
LEV	88.353.873	0,564	0,573	
ROA	3.550.000.000	3,290	0,001	***
G	893.000.000	7,146	0,000	***
MB	4.107.387	4,921	0,000	***
LNSIZE	11.000.000.000	10,373	0,000	***

that institutional ownership has positive influence toward the debt policy and is significant at alpha 5%. Anyhow, the dividend policy does not have any influence toward the debt policy. Panel 3 shows that institutional ownership has a positive influence towards the dividend policy and is significant at alpha 1%. While the debt policy turns out to have no influence toward the dividend policy.

It can be concluded from the regression result above that the dividend policy does not have interdependent relationship with other policies. The dividend policy is only determined by the institutional ownership, but not on the contrary. This finding supports the findings of Tandelilin's and Wilberforce

(2002) that does not find any substitutional correlation between the managerial ownership and the dividend, in which in this context managerial ownership represents the majority that is in the form of institution.

The institutional owner, as majority, through management, will makes decision on the high dividend policy. According to signaling theory, if the dividend rises, the investor will consider it as positive signal. An institutional investor likes a high dividend because it is related to the certainty and personal wealth. Besides, the high dividend can lessen the conflict against the minority shareholders so that it can avoid the decrease of share price.

In relevance with the provable hypothesis 1 of this research, the dividend distribution is used by the institutional owner to lessen the conflict against the minority, as described by the finding of La Porta *et al.* (2000). It argues that insiders (the majority owner in the form of institution and management) are interested to pay dividend in the hope of building reputation, which is, behaving decently towards the minority. Such reputation is an important thing to withdraw fund from the capital market. This finding is supportive to Gugler and Yurtoglu (2003) with rent extraction hypothesis and to Crutchley and Hansen (1989) stating that dividend makes the shareholders have certainty of income and lessens agency conflict of equity especially because of perquisites action.

The relationship between the debt policy and the institutional ownership is substitutional. In the condition of high institutional ownership, the level of debt tends to be low. In other words, upon the high debt policy, the institutional ownership will tend to be small. The wealth of the majority with high ownership will be highly adhered to company's stock price. The reduction of debt (leverage) will lessen the risk of the company so by itself, will lessen the risk of the majority's wealth. A low leverage is expected to reduce the risk of bankruptcy and financial distress. Therefore if the leverage is higher, the opportunity for the controlling institutional investor to carry out more ownership will be smaller too.

The next finding is that between the debt policy and the dividend policy. There is no interdependent relationship between debt policy and dividend policy. It doesn't support the theory of cashflow because the high debt will make the dividend distribution high, since the necessity of capital is not taken from the retained earning. Ballancing-off agency theory, which says that one mechanism will be a substitute for the other is not supported either. Some how, this finding is in line with that of Tandelilin and Willberforce (2002). Out of the finding, it indicates that the

dividend policy, which is determined by the majority in RUPS (board of director), is indeed used to reduce agency conflict between the majority and minority and is not related to the debt policy. The other theoretical explanation is clientele effect, so that dividend is distributed in accordance with the preference of the investor.

In conclusion, the interdependent relationship is only proven between the debt policy and the institutional ownership, or the Ballancing-off agency theory, is applicable to the institutional ownership and the debt policy only. While the relationship between the dividend policy and the institutional ownership is not reciprocal and the bidirectional relationship between the dividend policy and the debt policy is not proven.

## CONCLUSIONS

The expropriation argument on the majority ownership in the form of institution in Indonesia is proved to be at the low level of controlling institutional ownership only. Some how, in the higher level of institutional ownership is inclined to lessen the agency conflict upon the condition of high ownership due to the monitoring they do (convergence argument).

The debt policy has positif effect toward the performance as a proxy of agency conflict. This way, the debt policy can be used as an agency conflict controlling and bonding mechanism between the majority and minority so it will lessen the agency conflict between them.

The dividend policy has positive influence toward the performance as a proxy of agency conflict. It means, the higher the dividend payment, the more the conflict between majority and minority will lessen due to the dividend distribution, which the minority regards as not expropriating them. In other words, the dividend payment becomes a con-

trolling and bonding mechanism for the majority owners.

The institutional ownership and the debt policy have substitutional relationship. The majority's wealth is tightly adhered to the wealth of the company. The decrease of debt utilization will lessen the risk of the company so by itself will lessen the risk of the majority owner.

The institutional ownership and the dividend policy have a linear relationship. The dividend policy is influenced by the controlling institutional ownership, but anyhow, the institutional ownership is not influenced by the dividend policy. Then, the interdependent relationship is not found between the debt policy and the dividend policy.

Another conclusion taken from the descriptive statistic analysis is that most big companies in observation are owned by more than one institutional investor, but there is always the biggest owner. The mentioned biggest institutional owner, which is called as the controller, is prone to remain unchanged year by year in the period of observation.

Then, to keep the company performance well, the institutional ownership should be at the high level of ownership because it can lessen the agency conflict. Such a thing is proved through the fact that the presence of institutional ownership can make the asset utilization efficiency and the company's market value higher.

## REFERENCES

- Ang, J.S., R.A. Cole, and J.W. Lin, 2000, "Agency Cost and Ownership Structure". *Journal of Finance*, 55/1, 81-106.
- Baltagi, B. H., 2005. *Econometric Analysis of Panel Data*. 3<sup>rd</sup> ed. New Jersey: John Wiley and Sons, Ltd.
- Bathala, C.T., K.P. Moon, and R.P. Rao, 1994. "Managerial Ownership, Debt Policy and The Impact of Institutional Holdings: An Agency Perspective". *Financial Management*, 23 (3), 38-50.
- Bozec, Y. and R. Bozec, 2007. "Ownership Concentration and Corporate Governance Practice: Substitution or Expropriation Effects?". *Canadian Journal of Administrative Sciences*, 24, 182-185.
- Bukart, M., D. Gromb, and F. Panunzi, 1997. "Large Shareholders, Monitoring, and the Value of the Firm". *Quarterly Journal of Economics*, 112 (3), 693-728
- Chadbury, A., 1992. "Codes of Best Practice", *Report from the Committee on Financial Aspect of Corporate Finance*. London: Gee publishing.
- Claessens, S., S. Djankov, and L.H.P. Lang, 2000. "The Separation of Ownership and Control in East Asian Corporations". *Journal of Financial Economics*, 58, 81-112.
- Demsetz, H. and K. Lehn, 1985. "The Structure of Ownership: Causes and Consequences". *Journal of Political Economy*, 50, 1029-1057.
- Gedajlovic, E. R., and D. M. Saphiro, 1998. "Managerial Ownership Effect: Evidence from Five Countries". *Strategic Management Journal*, 19, 533-553.
- Graves, S.A., and S.A. Waddock, 1990. "Institutional Ownership and Control: Implications from Long-term Corporate Strategy". *Academy of Management Executive*, 4, 75-83.
- Gugler, K and B. B. Yurtoglu. 2003. "Corporate Governance and Dividend Pay-out Policy in Germany". *European Economic Review*, 47, 731-758.
- Han, K.C., S.H. Lee, and D.Y. Suk, 1999. "Institutional Shareholders and Dividends". *Journal of Financial and Strategic*, 12 (1), 53-62.
- Himmelberg, C., R. Hubbard, and D. Palia. 1999. "Understanding Determinan of Managerial Ownership and the Link between Ownership and Performance".



- Journal of Financial Economics* 20, 293-315.
- Holderness C., R. Krozner, and D. Sheehan, 1999. "Were the Good Old Day that Good? Changes in Managerial Stock Ownership Since the Great Depression". *Journal of Finance*, 54, 435-469.
- Jensen, M.C., and W.H. Meckling, 1976. "Theory of the Firm: Managerial Behavior, Agency Cost, and Ownership Structure". *Journal of Financial Economic*, 3, 305-360.
- Jensen, G.R, D.P, Solberg and T. S. Zorn, 1992. "Simultaneous Determination of Insider Ownership, Debt, and Dividend Policies". *Journal of Financial Quantitative Analysis*, 247-263.
- Jensen, M.C, 1986. "Agency cost and Free Cash Flow, Corporate Finance, and Take overs". *American Economics Review*, 323-329.
- Jensen, M.C. and K. J. Murphy, 1990. "Performance Pay and Top Management Incentives". *Journal of Political Economics*, 98, 225-264.
- Joher, H., Mohd A., and Nazrul, 2006. "The Impact of Ownership Structure on Corporate Debt Policy: Two Stage Least Square Simultaneous Model Approach for Post Crisis Period: Evidence from Kuala Lumpur Stock Exchange". *International Business and Economics Research Journal*, 5 (5), 51-64.
- Kochhar, R., 1996. "Explaining Firm Capital Structure: The Role of Agency Theory vs. Transaction Cost Economic". *Strategic Management Journal*, 17, 713-728.
- Kallapur, S., and M.A. Trombley, 1999. "The Association Between Investment Opportunity Set Proxies and Realized Growth," *Journal of Business Finance and Accounting*, 26, 505-519.
- La Porta, R., F. Lopez-De-Salines, and A. Shleifer, 1999. "Corporate Ownership Around the World". *Journal of Finance*, LIV (2), 471-517.
- Leech, D., 1988. "The Relationship between Shareholder Concentration and Shareholder Voting Power in British Companies: A Study of the Application of Power Indices for Simple Games". *Management Science*, 34 (41), 509-527.
- Leuz, C. and F.Oberholzer-Gee, 2006. "Political Relationship, Global Financing, and Corporate Transparency: Evidence from Indonesia". *Journal of Financial Economics*, 81, 411-439.
- Mahadwartha, P. A., 2004. *Pengawasan dan Pengikatan Berbasis Kepemilikan Institutional Internal [Supervision and Fastening Based on Internal Organization Ownership]*. Unpublished Dissertation, Yogyakarta: Universitas Gadjah Mada.
- Miguel, A de, J. Pndando, and C. de La Torre, 2004. "Ownership Structure and Firm Value". *Strategic Management Journal*, 25 (12), 1199-1207
- McConnell, John J., and H. Servaes, 1990. "Additional Evidence on Equity Ownership and Corporate Value". *Journal of Financial Economics*, 27, 595-612.
- McConnell, J. John, and H. Servaes, 1995. "Equity Ownership and The Two Faces of Debt". *Journal of Financial Economics*, 39, 131-157.
- Morck, R, A. Schleifer, and R. Vishny, 1988. "Management Ownership and Market Valuation: An Empirical Analysis". *Journal of Financial Economics*, 20, 293-315.
- Mudambi R., and C. Nicosia., 1998. "Ownership Structure and Firm Performance: Evidence from the U.K. Financial Service Industry". *Applied Financial and Economics*, 8, 175-180.
- Myers, S.C, and N.S, Majluf, 1984. "Corporate Financing and Investment Decisions When Firm have Information Investors Do Not Have". *Journal of Financial Economics*, 13, 187-221.
- Pound, J., 1988. "Proxy Contest and The Efficiency of Shareholder Oversight".

- Journal of Financial Economics*, 20, 237-265.
- Pozen, R.C., 1994. "Institutional Investors: The Reluctant Activist". *Harvard Business Review*, 140-150.
- Shleifer, A., and R.W.Vishny, 1986. "Large Shareholders and Corporate Control". *Journal of Political Economy*, 94, 461-488.
- Siregar, Baldric. 2006. "Determinan Risiko Ekspropriasi [Expropriation Risk Determination]". *Jurnal Akuntansi Manajemen*, XVII, 3, 269-282.
- Tandelilin, E., and T. Wilberforce, 2002. "Can Debt and Dividend Policies Substitute Insider Ownership in Controlling Equity Agency Conflict". *Gadjah Mada International Journal of Business*, 4 (1), 31-44.
- Titman, S. and R. Wessels, 1988. "The Determinants of Capital Structure Choice". *Journal of Finance*, March, 1-19.
- Varma, R., 2001. "The Role of Institutional Investors in Equity Financing and Corporate Monitoring". *Journal of Business and Economic Studies*, 7 (1), 39-53.