4. Institutional Role and Foreign Ownership in Capital Structure Decisions in Managerial Ownership Companies

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Submission date: 23-Dec-2020 09:47PM (UTC+0700)

Submission ID: 1480877981

File name: apital_Structure_Decisions_in_Managerial_Ownership_Companies.pdf (407.3K)

Word count: 3117

Character count: 16090

International Journal of Advanced Science and Technology
Vol. 29, No. 8, (2020), pp. 24-31

Institutional Role and Foreign Ownership in Capital Structure Decisions in Managerial Ownership Companies

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Abstract

The manager will conduct power voting by more preferring the use of equity rather than debt. Therefore, the purposes of this research are (a) is there any capital structure decision differences in managerial ownership companies after the presence of institutional ownership (b) is there any capital structure decision differences in managerial ownership companies after the presence of foreign ownership. The research data were from the recorded companies in the Indonesian Stock Exchange 2009-2018. The data of 22 companies with managerial ownership, the data of 198 managerial ownership companies after the presence of institutional ownership, the data of 86 companies with managerial ownership with the presence of foreign ownership were collected. The result of the research showed that there were no significant differences in capital structure decisions of managerial ownership companies after the presence of institutional and foreign ownership. The role of monitoring towards managerial ownership companies was not effective, because of the asymmetry information and family ownership structure affiliated direction.

Keywords: *Voting Power of managerial ownership, Monitoring from Institutional and Foreign Ownership.*

1. Introduction

The manager as a shareholder of the company (managerial ownership), will make the decisions to maintain the voting power. The voting power of the manager can be used as a mechanism of decision making according to personal interests. The existence of equity financing will reduce (dilution) the power of manager control over the company so that it will prefer debt financing. The manager's action in maintaining voting power can be reduced with effective monitoring by institutional ownership and foreign ownership.

Sun et al. (2015) showed that companies with institutional ownership have resources to monitor the manager's performance. This impacts the needs of external monitoring from the debtholders. The presence of institutional ownership is a substitution from debt. Otherwise, Short et al (2002) explained that if institutional ownership has a diversified stock portfolio, then direct monitoring will be ineffective. So, institutional shareholders will be more prefer the use of debt as a complementary mechanism.

Not just institutional ownership, foreign ownership also has resources and monitoring managerial decision ability, especially in developing countries (Douma et al, 2006; Rahim et al, 2020). When faced with information asymmetry problems, then the monitoring by foreign ownership will be ineffective and will increase the debtholder's role in the monitoring.

This research provides literature contributions towards institutional and foreign ownership roles on monitoring manager actions in maintaining voting power. This research highlighted the effective monitoring role differences in institutional and foreign ownership.

2. Literature Review

Managerial Ownership and Capital Structure

The capital structure decisions not only influenced by the characteristic of the company, like the previous researches. But also the harmony between monitoring factors and the desire of the manager as a manager and shareholder at the same time. Harris and Raviv (1998) found that there are positive relationships between managerial ownership and capital structure.

The manager will prefer the use of debt in the capital structure so that it will preserve or increase the control towards the decisions of the company. Those control will be convenient for decision making and access to the company resources for personal interests.

The Presence of Institutional and Foreign Ownership towards Capital Structure on Companies with Managerial Ownership

Institutional ownership can do effective monitoring to monitor management performance. Shleifer and Vishny (1986) showed that institutional ownership successfully monitoring management performance. Institutional ownership will ensure that the management performance always acting in line with the interest of the shareholders.

The previous researches showed the positive and negative relationship between foreign ownership and capital structure. In the research by Zou and Xiao (2006), Gurunlu and Gursoy (2010) and Islam et al, (2018) showed the positive relationship between capital structure and foreign ownership. The presence of the information asymmetry in the developing countries is bigger so that extra monitoring from the debtholder is needed. Moreover, foreign ownership has a large portfolio diversification, so that the stock ownership is low and causing ineffective monitoring. However, Jeon and Ryoo (2013) explained that foreign ownership can monitor the better one so that they decrease the monitoring role of the debtholders. In Indonesian company organs, the role of monitoring from the domestic institutional ownership and the independent director is not effective. It is because there are often links between independent directors and domestic institutional ownership.

Foreign ownership has effective resources and the ability to do monitoring towards managerial decisions in developing countries. Douma et al (2006) showed that domestic institutional in developing countries cannot do effective monitoring because of the lack of investor specialization and incentives. Otherwise, the role of monitoring from foreign ownership is not effective when faced with information asymmetry problems and affiliated ownership.

Therefore, foreign ownership has an important role in monitoring manager decisions in the capital structure. The manager's decisions to keep maintaining control through the use of equity can be decreased with effective monitoring from institutional and foreign ownership. Otherwise, when it faced with information asymmetry problems and affiliated ownership, it makes the monitoring role not effective and will be impacting the DER as an external monitoring mechanism.

This research hypothesizes that companies with managerial ownership try to maintain control through equity. Effective monitoring from institutional and foreign ownership will push the debt reduction but if it is not effective, it will increase the debt. Hypothesis: there are differences in company capital structure managerial ownership with the presence of institutional and foreign ownership.

ISSN: 2005-4238 IJAST

3. Research Method

We discussed the literature concerning the relation towards ownership structures and capital structures. The capital structure approximately in this research was using DER which was a debt and equity ratio. By comparing, the impact toward voting power was obtained. The equity addition impacted the additional number of outstanding share and voting power was reduced, conversely, the debt additional did not reduce the voting power. Our ownership structure proxied with managerial ownership company, managerial with the presence of institutional ownership, also managerial with the presence of foreign ownership. The use of these proxies was to support the prior hypothesis, which was there were differences in DER on the ownership structure. The presence of institutional and foreign ownership should be made a difference in the use of debt than only with managerial ownership. The DER ratio could be different because of the managerial ownership wanted a small DER, and managerial ownership companies with the presence of MI and MF want more debt. Limited resources and the presence of information asymmetry resulted in the need to increase the role of debtholders in monitoring.

They could also want the same DER because companies with managerial ownership reduced the debt as an anticipation voting power dilution, as well as MI and MF who want the small one. After all, they had the capability and resources to do the monitoring.

The data of this research were from companies that registered in the Indonesian Stock Exchange 2009-2018. The descriptions of 306 companies were 22 with managerial ownership, 198 with managerial and institutional ownership and 86 with managerial and foreign ownership.

		Ownership Structure		
		M	MI	MF
Obs	Total	22	198	86
	%	7.19%	64.71%	28.10%
DER	Mean	1.78	1.17	1.15
	Std Sev	2.45	1.32	5.62
	Min	-1.94	-1.92	0.04
	Q1	0.13	0.50	0.27
	Median	1.01	0.93	0.55
	Q3	2.88	1.64	0.92
	Max	7.78	4.14	2.25
% Ownership	Min	0.00002	0.04451	0.22068
	Q1	0.13121	0.53913	0.50054
	Median	0.32629	0.61364	0.57698
	Q3	0.73917	0.77478	0.85946
	Max	0.83956	0.95654	0.99477
	Mean	0.40153	0.62706	0.62735
	Std Sev	0.31291	0.20253	0.21656
% Managerial Ownership	Min	0.00002	0.00001	0.00001
	Q1	0.13121	0.00124	0.00040
	Median	0.32629	0.01845	0.00249
	Q3	0.73917	0.09030	0.09560
	Max	0.83956	0.28243	0.25710
	Std Sev	0.31291	0.13840	0.12305
	Mean	0.40153	0.08352	0.06815

TABLE 1. Data Description

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Based on the description of data above describes that M were companies with managerial ownership; MI were managerial companies with the presence of institutional ownership; MF were managerial companies with the presence of foreign ownership. The average of companies DER with M was 1.78, MI was 1.17 and MF was 1.15. As much as 50% of companies of M sample had the DER average between 0.13 and 2.88, MI between 0.50 and 1.64 and MF between 0.27 and 0.92. Companies with MI and MF had DER that tend to be homogeneous and smaller DER average compared with M. The average use of debt compared with the equity on the M company was bigger than the MI and MF.

4. Result of the Study

Managerial ownership companies (M) with potential agency problems in the form of maintaining voting rights, trying to use equity. If in the managerial ownership companies they had the Institutional and Foreign ownership, then the monitoring could be done without the debtholder. Institutional and Foreign ownership had the resources and competencies for the managerial monitoring so that it reduced the role of the debtholders. If you want to find out more about the model of the monitoring, you can read the article Almazan et al. (2005)

The existence of Institutional ownership with an average of 62.72% on the managerial ownership companies, caused the average of managerial ownership from 40.15% to 8.3%. The existence of foreign ownership with an average of 62.73% on a managerial ownership company, caused the managerial ownership average from 40.15% to 6.81%.

The reduction of managerial ownership with the presence of institutional and foreign ownership caused voting power reduction. So that the managerial desire to use equity was not realized. Companies with institutional and foreign ownership tend to prefer for the increase of the debt in DER as a monitoring substitution.

Data Assumptions Test

The data assumptions that had been fulfilled were (1) normality (2) outliner and (3) variance homogeneity. According to the plot box that the not symmetry data and Q-Q plot could be known that the data was spreading not around the prediction line so that the data was not normal and there was still an outlier.

The group samples were much deviated from normal; this was very relevant when the sample size was small and not the same and the data was not symmetry. The group variance was very different because of the presence of outliers, then the Kruskal Wallis test (non-parametric test) was carried out.

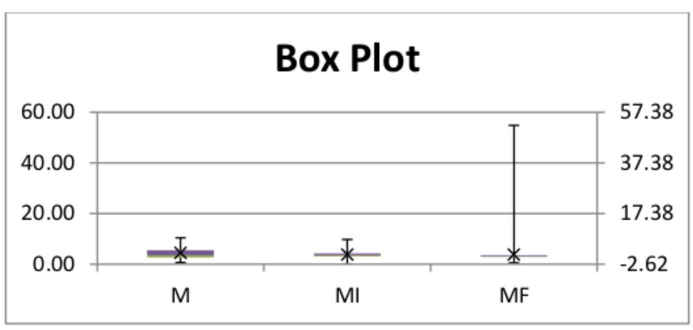

FIGURE 1. Box Plot

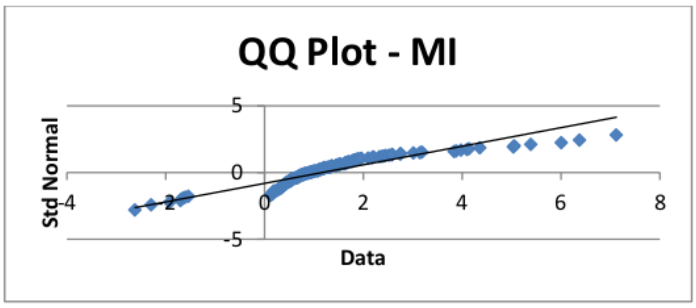

FIGURE 2. QQ Plot-MI

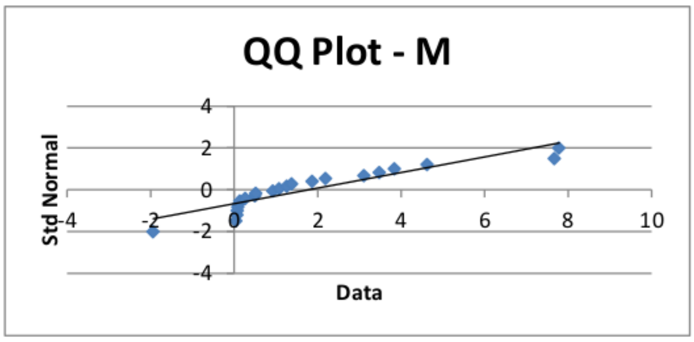

FIGURE 3. QQ Plot-M

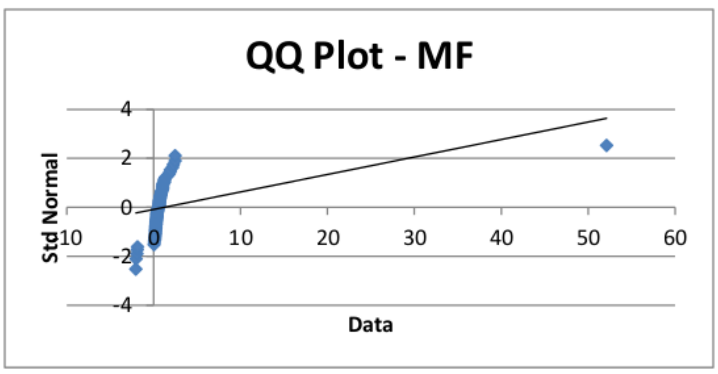

FIGURE 4. Box-Plot dan QQ Plot: Outlier Test

Next, on the normal testing with d'Agustino-Pearson test, the resulting that the data was not normal

d'Agostino-Pearson			
DA-stat	8.666829	65.80439	182.7292
p-value	0.013123	5.11E-15	0
Alpha	0.05	0.05	0.05
Normal	no	No	No

TABLE 1. d'Agustino-Pearson Test

Then, the Levene test showed that the data have a homogeneous variance

DESCRIPTION					Alpha	0.05
Group	*Count*	*Sum*	*Mean*	*Variance*	*SS*	*Std Err*
Man	22	40.68	1.85	2.42	50.73	0.64
Man-Inst	198	171.78	0.87	0.99	194.14	0.21
Man-Forei	86	117.44	1.37	29.72	2526.42	0.33
ANOVA						
Sources	*SS*	*df*	*MS*	*F*	*P value*	*F crit*
Between Groups	28.97	2	14.48	1.58	0.21	3.03
Within Groups	2771.30	303	9.15			
Total	2800.27	305	9.18			

TABLE 2. Levene Test

Data Analysis

The data prerequisites test showed that the data was not normal, there are homogeneous outliers and variance, then using the non-parametric statistic. The test results with Kruskal Wallis were as follows:

DESCRIPTION					Alpha	0.05
Group	*Count*	*Sum*	*Mean*	*Variance*	*SS*	*Std Err*
Man	22	39.1	1.78	6.00	125.97	0.69
Man-Inst	198	232.63	1.17	1.74	343.17	0.23
Man-Forei	86	99.14	1.15	31.61	2686.80	0.35
ANOVA						
Sources	*SS*	*df*	*MS*	*F*	*P value*	*F crit*
Between Groups	7.60	2	3.80	0.37	0.69	3.03
Within Groups	3155.93	303	10.42			
Total	3163.54	305	10.37			

TABLE 4. Kruskal Wallis Test

	Managerial Ownership			**Managerial and Institutional Ownership**			**Managerial and Foreign Ownership**		
	Basic Industry and Chemicals	Miscellaneous Industry	Consumer Goods Industry	Basic Industry and Chemicals	Miscellaneous Industry	Consumer Goods Industry	Basic Industry and Chemicals	Miscellaneous Industry	Consumer Goods Industry
2009	0	0	0	6	5	3	6	3	0
2010	0	0	0	8	4	3	5	4	1
2011	1	0	0	9	0	4	4	2	1
2012	2	1	0	4	5	6	4	2	2
2013	1	0	0	8	4	8	3	2	4

2014	2	0	2	8	5	6	5	4	3
2015	1	0	1	13	3	9	5	4	2
2016	2	0	1	11	8	8	4	3	1
2017	2	0	2	11	7	8	4	3	0
2018	1	1	2	9	7	8	3	1	1
	12	2	8	87	48	63	43	28	15

TABLE 5. Closing and Discussion Table

Because the p-value was bigger than the significance level, then Ho was accepted, that was there were no DER differences on the managerial ownership companies with institutional ownership and foreign ownership. This showed the indication that the monitoring role from institutional and foreign ownership was ineffective. So there was no DER difference as a capital structure proxy. Managerial ownership companies with the presence of institutional and foreign had no average difference in DER. This result was in line with Gursoy's (2010) research that there were still information asymmetry problems in the developing countries that were bigger so that there were no DER differences.

The research results did not show the DER difference as a proxy from the debtholder monitoring. Companies with the presence of institutional and foreign ownership, there were no capital structure decision differences on the managerial ownership companies. These results were not in line with the initial expectation monitoring that conducted institutional and foreign towards effective managerial ownership so that it increased the debt on the DER.

For further discussion, what if the institutional and foreign ownership monitoring had the resources and capability but proven ineffective, will the non-affiliated appointment of independent directors be more effective?

5. Conclusion

Managerial Ownership = M, Institutional Ownership = MI, Foreign Ownership. Manufactures Sectors = *Basic Industry and Chemical* (sub-sectors: (1) Cement; (2) Ceramics, Glass and Porcelain; (3) Metal and Allied Products; (4) Chemicals (5) Plastics and Packaging (6) Animal Feed; (7) Wood Industries; (8) Pulp and Paper (9) Others); *Miscellaneous Industry* (sub-sectors (1) Machinery and Heavy Equipment (2) Automotive and Components (3) Textile and Garment (4) Footwear (5) Cable (6) Electronics); *Consumer Goods Industry* (sub-sectors (1) Food and Beverages (2) Tobacco Manufacturers (3) Pharmaceuticals (4) Cosmetics and Household (5) Houseware (6) others)

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