Research Journal of Finance and Accounting
ISSN 2222-1697 (Paper) ISSN 2222-2847 (Online)
Vol.6, No.12, 2015

Capital Structure and Agency Cost: Study of Conglomerate Companies Listed on the Indonesian Stock Exchange

Makhdalena
Faculty of Teaching and Education, University of Riau, Pekanbaru, Indonesian.

Abstract

This study examined the effect of capital structure on agency cost. Population of this research is conglomerate companies listed on the Indonesian Stock Exchange, amounting to 29 companies. The study period is 2007-2012. Agency cost is measured using the ratio of operating expenses to sales and capital structure measured by the ratio of liabilities and equity. Analysis of the data used in this study is multiple regression. Institutional ownership, size and return on assets (ROA) is a variable control. The results showed that, capital structure, institutional ownership, size and ROA simultaneously positive and significant impact on the agency cost. Partial capital structure and significant positive effect on agency cost. Instititional ownership but not significant positive effect on agency cost. Size positive but not significant effect on agency cost. ROA and significant negative effect on agency cost.

Keywords: Agency Problem, Agency Cost, Capital Structure

Introduction

So that the company can be more effective and efficient in operation, the company should perform the separation of functions between the owners and managers (Berle and Means, 1932). Separation of functions between the owner and the manager will give rise to agency problems (Jensen and Meckling, 1976). According to Jensen and Meckling (1976) the emergence of agency problems within the company because of a conflict of interest between shareholders and management. Natural conflict of interest between shareholders from outside the company managers arising from the possibility manager took the decision to increase the personal wealth at the expense of the interests of shareholders (Jensen and Meckling, 1976). According to Jensen and Meckling (1976), misalignment between the objectives of shareholders from outside the company with the manager will cause the cost of agency (agency cost) for the owner.

Results of research conducted by many researchers there are inconsistencies, such as Jensen (1986), Agrawal and knoeber (1996), Florackis and Ozkan (2004), Zhang and LI (2008), Knight and Weir (2009), Xiao (2009) , Gul et al (2012), Zheng (2013), Lakshmi (2013), Mohammed (2013), shows that the capital Structure can reduce agency cost, while the results of research conducted by Li and Cui (2003), Pratheepkanth (2011), Siddiqui et al (2013) and Chechet and Olayiwola (2014), capital structure can not dampen the agency cost. So with the inconsistency of the results of the study, researchers wanted to examine the effect on the capital structure of the agency cost for the case in Indonesia.

Research Question

Based on the background research, the formulation of the problem of this research is: What effect on the capital structure on agency cost conglomerate companies listed on the Indonesian Stock Exchange.

Research Objective

The purpose of this study was to see whether the effect on the capital structure on agency cost conglomerate companies listed on the Indonesian Stock Exchange.

Relationship Between Capital Structure and Agency Cost

Jensen (1986) provides a solution to reduce agency cost is by way of the use of debt in the capital structure of the company. With the use of debt in the capital structure of the company, the company's managers have to make savings on expenses that are not important on free cast flows. The savings on free cast flows should be done by the manager because the manager had to pay principal and interest on the debt.

Agrawal and Knoeber (1996) conducted research on firm performance and mechanisms to control agency problems between managers and shareholders in the company in the US by using regression. Control mechanisms are tested in these studies is shareholdings of insiders, institutions, and large blockholders, outside directors, debt policy, size (log assets), labor market and market manager or corporate control. Results of

research and Knoeber Agrawal (1996) found a relationship between firm performance with insider shareholdings, outside directors, and corporate debt control is active. Overall found for every optimal control as a surveillance mechanism except outside directors.

Li and Cui (2003) conducted a study on the capital structure on agency cost study on Chinese Listed Firms to 211 non-financial companies 1999-2001. The dependent variable is the agency cost is measured using return on equity (ROE). The independent variable is capital structure (debt to assets), ownership concentration. Variable control is the board size, firm size (log-sales) and industry (dummy). The results showed that the leverage associated positive and significant impact on agency cost. Ownership concentration (the Reviews largest shareholder) are positively related to agency cost but not significantly. Ownership concentration the five Reviews largest shareholders positively and significantly related to the agency cost. Board size associated negative and significant impact on agency cost. Firm size is positively related but not significant to the agency cost.

Research conducted by Florackis and Ozkan (2004) on the companies in the UK regarding the Agency cost and corporate governance mechanisms with the data from 1999 to 2003 using regression. Florackis and Ozkan (2004) measured the agency cost using the ratio of the total sales by total assets (asset turnover) and the ratio of selling, general and administrative expenses (SG & A) to total sales as the dependent variable. And for the independent variable using the firm's ownership, board, compensation and capital structure. While controlnya variable is size (log assets), growth opportunity (market to book value). The results showed that the univariate analysis indicated Overall mekanaisme corporate governance such as managerial ownership, ownership concentration, salary, bank debt and short-term debt can help overcome the agency problem between managers and shareholders. And the relationship between governance and agency cost variable is very strong for the asset turnover ratio and SG & A expense ratio.

Zhang and LI (2008) conducted a study on the UK Public Companies regarding the impact of capital structure on agency cost to the data in 2004 and 2005 by using multiple regression. Zhang and Li (2008) measured the agency cost using the ratio of operating expenses to sales. Research conducted by Zhang and Li (2008) produce that leverage (debt to assets) and significant negative effect on agency cost, and so does the size (log sales) and a significant negative effect on agency cost while return on assets a negative effect but not significantly.

Knight and Weir (2009) conducted research on public companies in the UK with the regression of the agency cost and corporate governance mechanisms and ownership structure. Knight and Weir (2009) found results that the agency cost associated with the governance mechanisms and ownership as well as the boards can reduce agency cost and debt was found to lower the agency cost. In this study, Knight and Weir (2009) measured the agency cost using 1) the ratio of sales to total assets; 2) free cash flows and growth prospects and a number of acquisitions. While the indicator for debt measured by the percentage of total debt to total assets. Board ownership is measured by the percentage of ownership by the board of total shares outstanding. Institutional ownership is measured by stock ownership by the board with a percentage of the total shares owned by institutional more than 3%.

Xiao (2009) conducted a study on Chinese publicly listed companies with the ultimate ownership of the agency cost of individual and firm value for the period 2002 to 2007 the data using regression. Agency cost measured by the divergence between the ultimate owner's control rights and a low cash rights. Results of research conducted by Xiao (2009) illustrates that the agency cost and significant negative effect on firm value. Return on assets negatively related to the agency cost but not significantly.

Pratheepkanth (2011) conducted research on capital structure, as measured by debt to equity and financial performance as measured by gross profi, net profit, ROI, ROE and ROA in the industry the company listed in the Colombo Stock Exchange in Sri Lanka to data for 2005-2009. Results showed that the capital structure is negatively related to financial performance.

Gul et al (2012) conducted a study on the Karachi Stock Exchange for the period covering 2003 to 2006 on the agency cost, corporate governance and ownership structure by using a fixed effect regression as multivariate data analysis. To measure the agency cost, Gul et al (2012) using the asset utilization ratio. Research stiffened Gul et al (2012) suggest that the directors ownership and high institutional ownership can reduce agency cost. And a small number of councils also can reduce agency cost and independent directors have a positive relationship with the agency cost.

Zheng (2013) conducted a study on listed companies in Chinese with 775 perusahaani and Shenzhen stock markets for the three years 2010-2012. The study looked at the relationship between the agency cost and capital structure by using OLS. Capital structure is measured by debt to assets ratio and long-time liabilities rate, and

agency cost rate is measured by the overhead expenses and asset turnover rate. Results showed that the agency cost has a negative relationship with the debt to assets ratio and the long time-related liabilities rate is positive but not significant with the agency cost.

Lakshmi (2013) conducted a study on the capital structure on agency cost in Indian public companies to the data of 2002 to 2012 by using regression. The study found that the leverage (debt to assets) high can reduce agency costs and firm size (log of sales) and a significant negative associated with the agency cost agency cost while negative relates to firm performance but not significantly.

Mohammed (2013) conducted research on agency cost and capital structure to the company listing on the Nigerian stock exchange as many as 94 companies for the period 2000-2006 using dynamic panel models. Agency cost as an independent variable that is measured by using a ratio of total sales and total assets. Capital structure as the dependent variable is measured by leverage (ratio of total liabilities and total assets). And as the control variable is the business risk (standard deviation of EBIT), profitabily (EBIT percentage of total assets), assets tangibility (percentage of total fixed assets total assets ratios), company size (log of sale) and growth prospects (total annual assets percentage change). The results showed that the capital structure on average negative associated with agency cost.

Siddiqui et al (2013) conducted a study on the internal corporate governance mechanisms and agency cost for the period 2003-2010 at companies listed on the Karachi Stock Exchange. They use the agency cost for the dependent variable with two proxies, namely asset utilization ratio and liquidity assets ratio. While the independent variable is the CEO tenure, board meetings, audit committee meetings, board size, duality, debt financing, ownership block. The results showed that the variable active board and audit committee and related assets utilization ratio of positive and strong. Blockholders ownership, board size, duality and asset utilization ratio has a negative relationship. When they use the liquidity assets ratio as a proxy for agency cost can be reduced with the frequency of meetings boards. Variable size boards and CEO tenure has a positive correlation with asset liquidity ratio. Variable duality, debt financing and investors who are not siqnifikan related to assets ratio liquidity.

Chechet and Olayiwola (2014) conducted a study on company listing on the Nigerian Stock Exchange (NSE) for the 2000-2009 period using the fixed-effect analysis, random-effects and Hausman Chi Square estimations. Chechet and Olayiwola (2014) used two independent variables for the capital structure, the debt ratio and the equity ratio and profitability as the dependent variable. Their results showed that the debt ratio and significant negative associated with profitability (hipotasis I) and for the second hypothesis, debt ratio and significant negative associated with profitability, while equity was positively related to profitability, but not significant.

Hypothesis

Based on the theoretical overview, the research hypothesis is: capital structure affect the agency cost.

Research Methods

This study of the capital structure as measured by the ratio of debt to equity (Pratheepkanth, 2011) and agency cost, as measured by operating expenses to sales (Florackis and Ozkan, 2004). And as a control variable is return on assets (ROA), size as measured by log of sales (Li and Cui, 2003; Zhang and Li, 2008) and institutional ownership. Population of this research is conglomerate company listed on the Indonesian Stock Exchange, amounting to 29 companies with years of observation as much as 174. The data used in this research is secondary data obtained from the Indonesian Capital Market Directory (ICMD) for the period 2007 to 2012. For analyze the data in this study using multiple regression.

Results and Discussion

The results showed that, capital structure, return on assets, size and institutional ownership simultaneous and significant effect on agency cost, amounting to 0.233. While the rest of 0.77 (1 to 0.23) influenced by other factors not examined in this study such as the characteristics of the board, compensation, ownership structure (Florackis and and Ozkan, 2004). While the partial results of the study are: capital structure and significant positive effect on agency cost. Istitutional ownership a positive effect on agency cost but not significantly. Size positive effect on agency cost but not significantly. Return on assets and a significant negative effect on agency cost. The results are consistent with the results of research conducted by the Li and Cui (2003), Pratheepkanth (2011), Siddiqui et al (2013) and Chechet and Olayiwola (2014) which states that the capital structure has positive influence on agency cost, but not in line with research conducted by Jensen (1986), Agrawal and knoeber (1996), Florackis and Ozkan (2004), Zhang and LI (2008), Knight and Weir (2009), Xiao (2009), Gul et al (2012), Zheng (2013), Lakshmi (2013) and Mohammed (2013) which showed that capital structure can reduce

agency cost. Capital structure possible causes are positively related to agency cost is because most conglomerate company listed on the Indonesian Stock Exchange is due to agency cost-owned by conglomerate company listed on the Indonesian Stock Exchange was above average (0.3988), as many as 60 %. Means that many companies are inefficient because 60% of companies have agency cost is above average (0.3988). And for the capital structure, the conglomerate companies listed on the Indonesian Stock Exchange had an average of 1.79 and has a capital structure that is below the average is as much as 77.6%. Means most conglomerate company listed on the Indonesian Stock Exchange are many sources of funds originating from own capital. This happens probably because most conglomerate company listed on the Indonesian Stock Exchange has size (log sales) than average (14.534) is as many as 57.5% and ROA above average (5.9318), as many as 55, 4%. So most conglomerate companies listed on the Indonesian Stock Exchange is not efficient and the funds originate from its own capital obtained from the ROA results of sales.

Conclusion

Based on the analysis of research data, it can be concluded this research is capital structure and significant positive effect on agency cost. This happens because most of the conglomerate companies listed on the Indonesian Stock Exchange are inefficient and use their own capital as a source of funds derived from the profit from the sale.

References

Agrawal, A and C. R. Knoeber. (1996). Firm Performance and Mechanism to Control Agency Problem Between Managers and Shareholders. *Journal of Financial and Quantitative Analysis*. Vol 34. No.3. September.p. 377-397.

Berle, JR, A.A. dan G.c. Means. (1932). *The Moddern Corporation and Private Property*. Macmillan, New York.

Florackis, Chrisostomos dan Ozkan, Aydin. (2004). Agency Costs and Corporate Governance Mechanisms: Evidence for UK Firms. *Seminar of University of York, European Finance Association Meetings*.

Gul, *et al*. (2012). Agency Cost, Corporate Governance and Ownership Structure. *International Journal of Business and Social Science*, 3, 9.

H M, Rakesh dan P, Lakshmi. (2013). Capital Structure on Agency Costs: Evidence from Indian Public Companies. *IOSR Journal of Business and Management*, 15, 50-53.

Jensen, M dan W. Meckling. (1976). Theory of the Firm: Managerial behavior, Agency cost, and Ownership structure. *Journal of Finance Economic*. 3, 305-360.

Jensen, Michael C. (1986). Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers. *American Economic Review*, May 1986, 76, 2, 323-329.

Li, Hongxia dan Cui, Liming. (2003). Empirical Study of Capital Structure on Agency Costs in Chinese Listed Firms. *Nature and Science*, 1.

McKnight, Phillip J dan Weir, Charlie. (2009). Agency Costs, Corporate Governance Mechanisms and Ownership Structure in Large UK Publicly Quoted Companies: A Panel Data Analysis. *The Quarterly Review of Economics and Finance*, 139-158.

Mohammed, Dauds.(2013). A dynamic Panel Model of Capital Structure And Agency Cost in Nigerian Listed Companies. *Accounting & Taxation*, 5, 2, 33-44.

Pratheepkanth, Puwanenthiren. (2011). Capital Strusture And Financial Performance: Evidence From Selected Business Companies In Colombo Stock Exchange Sri Lanka. *International Refereed Reasearch Jounal*, II, 171-183.

Siddiqui, Muhammad Faisal. (2013). Internal Corporate Governace Mechanismes and Agency Cost: Evidence from Large KSE Listed Firms. *European Journal of Business and Management,* 5, 23, 103-109.

Xiao, Sheng. (2009). How Do Agency Costs Affects Firm Value? Evidence from China. *Journal of Economic Literature*

Zhang, HE dan Li, Steven. (2008). The Impact of Capital Structure on Agency Costs: Evidence from UK Public Companies. *Journal of Economic Literatur*,

Zheng, Mengmeng. (2013). Empirical Research of the Impact of Capital Structure on Agency Cost of Chinese Listed Companies. *International Journal of Economics and Finance*, 5. 10.

Frequencies

Statistics

		AGENCYCOST	CAPITALSTRUSTURE	INST	SIZE	ROA
N	Valid	174	174	174	174	174
	Missing	0	0	0	0	0
Mean		.398842	1.794253	.525603	14.534289	5.931782
Median		.268060	.900000	.580600	15.034498	5.290000
Mode		.0870	.0800	.7687[a]	16.9717	-11.4400[a]
Std. Deviation		.3719179	5.2939077	.2913240	1.8693900	10.5445693
Variance		.138	28.025	.085	3.495	111.188
Range		2.7391	68.5900	.9547	7.9244	107.3600
Minimum		.0119	-4.1200	.0062	10.7724	-67.0100
Maximum		2.7510	64.4700	.9609	18.6968	40.3500
Sum		69.3985	312.2000	91.4550	2528.9663	1032.1300

a. Multiple modes exist. The smallest value is shown

Regression

Descriptive Statistics

	Mean	Std. Deviation	N
AGENCYCOST	.398842	.3719179	174
CAPITAL STRUSTURE	1.794253	5.2939077	174
INST	.525603	.2913240	174
SIZE	14.534289	1.8693900	174
ROA	5.931782	10.5445693	174

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.483[a]	.233	.215	.3294454	1.630

a. Predictors: (Constant), ROA, CAPITAL STRUSTURE, SIZE, INST

b. Dependent Variable: AGENCYCOST

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	5.588	4	1.397	12.871	.000[a]
	Residual	18.342	169	.109		
	Total	23.930	173			

a. Predictors: (Constant), ROA, CAPITALSTRUSTURE, SIZE, INST

b. Dependent Variable: AGENCYCOST

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	.303	.199		1.523	.130		
	CAPITALSTRUSTURE	.010	.005	.148	2.176	.031	.974	1.027
	INST	.071	.094	.056	.764	.446	.845	1.184
	SIZE	.009	.014	.047	.669	.504	.903	1.107
	ROA	-.016	.002	-.466	-6.610	.000	.912	1.097

a. Dependent Variable: AGENCYCOST

The IISTE is a pioneer in the Open-Access hosting service and academic event management. The aim of the firm is Accelerating Global Knowledge Sharing.

More information about the firm can be found on the homepage:
http://www.iiste.org

CALL FOR JOURNAL PAPERS

There are more than 30 peer-reviewed academic journals hosted under the hosting platform.

Prospective authors of journals can find the submission instruction on the following page: http://www.iiste.org/journals/ All the journals articles are available online to the readers all over the world without financial, legal, or technical barriers other than those inseparable from gaining access to the internet itself. Paper version of the journals is also available upon request of readers and authors.

MORE RESOURCES

Book publication information: http://www.iiste.org/book/

Academic conference: http://www.iiste.org/conference/upcoming-conferences-call-for-paper/

IISTE Knowledge Sharing Partners

EBSCO, Index Copernicus, Ulrich's Periodicals Directory, JournalTOCS, PKP Open Archives Harvester, Bielefeld Academic Search Engine, Elektronische Zeitschriftenbibliothek EZB, Open J-Gate, OCLC WorldCat, Universe Digtial Library , NewJour, Google Scholar