

Mitigate Type II Agency Conflict Through Good Corporate Governance and Disclosure Quality



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ABSTRACT

Empirical evidence on type II conflicts between controlling shareholders versus minority shareholders has not been extensively explored. This study gives new evidence on the agency conflict in a scenario of highly concentrated ownership. This study aims to examine the effect of Good Corporate Governance mechanism with quality of disclosure on concentrated ownership context. The sample were drawn from companies listed on the Indonesia Stock Exchange (IDX). The data were analyzed with panel data regression. The results shows that CG mechanisms negatively effects with DQ. However, looking at each individual variable, the study reveals that the audit committee and independence of audit committee are not significant. A possible reason is that companies' audit committee members have lack of accounting expertise and independence. These findings shed light on the concept of good CG enhances incentives for good DQ under highly concentrated ownership. It the effectiveness of CG mechanisms is likely to supplement regulation to protect investor rights and may prove to be useful for standard-setters as an important way to reduce agency conflicts.

1. INTRODUCTION

According to the traditional finance paradigm of agency theory, the ownership of public corporations is widely dispersed leading to agency conflict arising between shareholders and manager. This conflict of interests was described as the agency problem by Jensen and Meckling (1976). Jensen and Meckling (1976) argued that with lesser managers ownership of common stock of the firm, they will be more likely to engage in activities that maximize their personal wealth even when those activities reduce the value attributed to owners. Recently, this agency theory paradigm seems not applicable in many countries, especially in Asia's emerging market in which families, business groups or governments own and control most publicly traded firms (Faccio & Lang, 2002; Claessens & Fan, 2002).

Not with standing, the prominence of this agency paradigm has increased considerably in the past two decades. Ownership structure is an important factor in shaping the corporate governance which consists of a set of rules that define the relationship between shareholders, managers, creditors, governments and stakeholders and a set of mechanisms that assist directly or indirectly the implementation of these rules. These rules and the effectiveness of corporate governance mechanisms vary among countries in consonance with the political, economic, legal, and cultural setting (Zhuang et al., 2000). A Concentration of ownership structure relates to the distribution of power between managers and shareholders (Zhuang et al., 2000). When firm ownership spreads, the power of controlling owners tend to be weak due to a lack of oversight (monitoring) on the actions of managers. However, if ownership is concentrated, investors with high ownership (large shareholders) may play a significant role in the control of management. They can also conduct surveillance to obtain information needed to monitor management and have voting rights to press management in some cases. In particular, a shareholder that owned more than 51%, have the right to direct control over the management of the company (Shleifer & Vishny, 1997).

Better governance is supposed to lead to the better corporate performance by preventing the expropriation by controlling shareholders and ensuring better decision-making in concentrated ownership context. This expropriation may be due to smoothening of earning intention which is known as earnings management. Corporate governance is not just about the process by which elected representatives such as directors to make decisions.

It is also about the way organizations are held accountable. Corporate governance has been characterized as asset of mechanisms that effectively protect investors from opportunistic behaviour (Shleifer & Vishny, 1997; Dennis & Mc Connell, 2003; Gillan, 2006).

Shleifer and Vishny (1997) conducted a survey of corporate governance in Asia, literature documented on the importance of characteristics of firms for the better understanding of the economic efficiency of different corporate governance mechanisms. Their finding raises interesting issues about their corporate disclosure practices with the significant difference between diffusely held firms (type I agency conflict) which dominates the sample studied and firms with concentrated ownership (type II agency conflict). In addition, the system of corporate governance in diffuse ownership is more better than in concentrated ownership. This consistent with the claim of Raffournier (1995) that disclosure will be greater for companies with diffuse ownership because it helps owners to monitor the behaviour of management as predicted by agency theory. The unfolding of this issue can be examined through four primary components. This research gives evidence implementation the corporate governance mechanisms for enhancing disclosure quality and determine the effect of corporate governance mechanisms on the disclosure quality in the context ownership concentrated companies.

From the above discussion, it can be concluded that with concentrated ownership structure, agency conflict has shifted to that between controlling shareholders—who have the majority of ownership—and the minority shareholders (type II agency conflict). There are several evidences in accounting literature in relation to disclosure quality to support strengthening of corporate governance in Asia's emerging markets (Ben Ali, 2007; Amoozesh et al., 2013; Soheilyfar et al., 2014, Jatiningrum & Marantika, 2021) yet there is lack of empirical studies to the best knowledge of the researcher.

This study aims to investigate the effects of Good Corporate Governance with disclosure quality in Asia Context. Moreover, research on the links between corporate governance mechanisms and disclosure quality is scarce, with major drawback is neglecting concentrated ownership context on previous research and inconclusive findings with regard to the research on corporate governance and disclosure quality. Therefore, this study is needed due to inconsistencies of available studies.

2. LITERATURE REVIEW AND HYPOTHESIS

Agency theory considers corporate governance mechanisms as one of the classical antidotes of minimizing agency conflicts. The ability of corporate governance mechanisms to reduce conflict of interest and information asymmetry has been emphasized by Shleifer and Vishny (1997). Thus, to reduce information asymmetry associated with conflict of interest, there is a need for more studies to explore the potential impacts of several corporate governance mechanisms on disclosure quality within the context of type II agency conflict. There are several evidences in accounting literature in relation to disclosure quality to support the strengthening of corporate governance in Asia's emerging markets (Ben Ali, 2007; Amoozesh et al., 2013; Soheilyfar et al., 2014), yet there is lack of empirical studies to the best knowledge of the researcher. Moreover, research on the links between corporate governance mechanisms and disclosure quality is scarce, with major drawback is neglecting concentrated ownership context on previous research and inconclusive findings with regard to the research on corporate governance and disclosure quality. Therefore, this study is needed due to inconsistencies in available studies. Another important issue worth mentioning is with regard to the proxies for disclosure quality. Most prior literature on 'disclosure quality' adopt different proxies for examining the disclosure quality such as with voluntary disclosure index (e.g. Hossain et al., 1994; Hossain et al., 1995; Chau & Gray, 2002; Barako et al., 2006), analysts' evaluations of disclosure compiled by the Association for Investment Management and Research (AIMR) (Zhou & Lobo, 2001; Nuryaman, 2009, Soheilyfar et al., 2014), and press releases by the firms (Riahi & Arab, 2011; Jo & Kim, 2007) as proxies of disclosure quality.

Past study did not consider the use of Standard & Poor's Transparency and Disclosure index (S&P T&D index) which is a more comprehensive set of disclosure variables as a proxy for *disclosure Index to measure* disclosure quality proxy. The Standard & Poor's Transparency and Disclosure index (S&P T&D) which consists of the mandatory disclosure (e.g. Arnold & Matthews, 2002) and/or voluntary disclosure (e.g. Botosan, 1997; Botosan & Plumlee, 2002 and Lang & Lundholm, 1996) depends on the requirements in the country where the firms operate, the types of additional voluntary information, as well as the motives of the study conducted by the researcher. It covers information reported in one or more disclosure vehicles such as corporate annual reports, interim reports etc. It also covers the information reported by the company itself and/or others such as financial

analysts report. However, this method is not commonly used by past researchers. There is a need to study using Standard & Poor's Transparency and Disclosure index for disclosure quality measurement as suggested by Patel and Dallas (2002). This will be in line with the measurement of disclosure quality from other Emerging Market in Latin America and Asia.

Kaihatu (2006), while documenting the Asian Development Bank (ADB) study's indicates several factors that contributed to the crisis in Indonesia is due to her high concentration of corporate ownership ranked top with the ineffectiveness of the supervisory function of the board commissioner, and inefficiency and lack of transparency. In a similar way, Soeilyfar et al. (2014) claimed that the relationship between *disclosure quality* and corporate governance mechanisms is significant. Moreover, Jatiningrum et al. (2016) emphasized that companies on the Indonesia Stock Exchange (IDX) have a concentrated ownership structure and less investor protection. This condition could lead to lower level of disclosure quality and ineffectiveness of corporate governance. Therefore, based on the above discussion, there is an importance to provide the evidence that better corporate governance mechanisms effectively lead to higher level of disclosure quality, which is helpful in monitoring corporate insiders in Asia's emerging markets Corporate governance mechanisms have effects on disclosure of information by company to the shareholders with the possibility of incomplete unsuitable disclosure of information the credibility of the information disclosed will be reduced (Kanagartnam & Whalendennisj, 2007). Low levels of corporate disclosures have been recognized not only as one of the factors that caused the Asian financial crisis but also a stumbling block in the regional economic recovery (Berardino, 2001). Prior studies that examined the relation between corporate governance and disclosure have been carried out largely in the UK and in the US (Gelb 2000; Dalton & Dalton, 2008; Forker 1992; Abraham & Cox 2007; Jing, Pike, & Haniffa 2008) where the firms' ownership is dispersed and investors are highly protected (La Porta, et.al, 1999). Gelb (2000) finds that ownership diffusion enhances outsiders' information demand and thus firm disclosure.

While most of previous studies focus on the conflict between managers and shareholders, Ali (2007); Jatiningrum et al (2021) focuses on new agency conflict paradigm: controlling versus minority shareholders. Ali (2007) examines a combined set of corporate governance characteristics that affect disclosure quality in the context of expropriation minority due to ownership concentration. Based on sample of 86 French firms in the 2004

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period, it was found that market is characterized by high ownership concentration and weak investor protection. Also, a negative association was reported between disclosure quality on one hand and family control, double voting shares, concentrated ownership. However, the results show a positive association between disclosure quality and the existence of executive share options plans and proportion of independent directors in the board as well.

3. RESEARCH METHOD

The data used in this study is secondary. The data was obtained from the *financial reports* and *annual reports* of Indonesia's listed companies on Indonesia Stock Exchange (IDX). The population of this study is all listed companies on the Indonesian Stock Exchange (IDX) during 2014 up to 2021, except for financial institution. The sample is expected to be "representative" in the sense that each sampled unit will represent the characteristics of a known number of units in the population. To ensure representativeness of the sample companies of this study, the sampled companies are drawn from all sectors, except for financial institution. The Year of 2007 is for calculating earnings management variable. It is to calculate the delta or difference with the previous year ($t - t-1$). Sampled companies selected were selected from the population of the study using *purposive judgment sampling*.

Variables and The Measurements

1. Independent Variables

The independent variable is a variable that causes the changes occurring on the dependent variable (Ghozali, 2013). The independent variables included some of the corporate governance mechanisms. The Corporate Governance variables and their measurement as stated below:

1. *The Board of Director's size* (BOD) is the number of directors on the board of directors
2. *The Board of Commissioners size* (BCOM) is the number of commissioners on the board members
3. *Independence of the Board Commissioners* (INCOM) is the percentage of independent commissioner over the total number of a board member
4. *Institutional ownership* (INST) is the percentage of shares held by institutional investors

5. *Ownership Concentration (OWNC)* is the percentage of shares held by majority ownership
6. *Audit committee (AC)* is the number of audit committee member
7. *Independence of Audit Committee (INDAC)* is the percentage of independent audit committee members.

2. Dependent Variable

Disclosure Quality proxy used in this study is the Standard & Poor's Disclosure Quality Index (S & P T&D index). Research on disclosure quality from emerging market in Latin America and Asia have used S & P T &D index. S & P T&D Index examines company annual reports for 98 possible information items ("attributes") broadly divided into three sub-categories: (see Appendix 1 and 2).

- Ownership structure and investor rights (28 attributes)
- Financial transparency and information disclosure (35 attributes)
- Board and management structure and process (35 attributes)

The study used the same scoring methodology adopted in S & P T&D index by Patel and Dallas (2002) to measure the transparency and disclosure quality of the sample firm on item disclosed in company annual report and website. Basically, we count the "Yes", "No", N/A answer (yes=1) as a % of the maximum possible 'yes' answer in each category of TD, following Aksu and Kosedag (2006). The formula is as follow:

$$\text{TDS} = \sum_j \sum_k S_{jk} / \text{TOTS}$$

Where:

j = the attribute category subscript

k = the info item (attribute) subscript and

TOTS = the total maximum possible "yes" answers for each firm

S_{jk} = the number of info items disclosed (answer as "yes") by the firm in each category

In this study, data analysis is conducted using panel data regression model. Panel data regression was introduced by Howles in the 1950s. Panel regression method is used in the study to jointly test the model consisting of the independent, moderating variable and the dependent variables. Panel Data or *pooled data* is a combination of time series and cross-sectional data. Panel regression can accommodate information associated with variable both on cross-section and time series basis and substantially decreases the problem of committed-variables, the model ignores the not relevant variables (Frankl, 2005). panel regression method is more appropriate to overcome intercorrelation among independent

variables which can ultimately lead to inaccurate assessments of the regression model (Griffiths, 2001).

Testing of Hypothesis Relationship between Corporate Governance and Disclosure Quality Models for the analysis (Hypothesis a, b, c, d, e, f, g)

$$LN_DQ_{i,t} = \alpha_0 + \alpha_1 BOD + \alpha_2 BCOM + \alpha_3 INCOM + \alpha_4 INST + \alpha_5 OWNCC + \alpha_6 AC + \alpha_7 INDAC + \alpha_8 GROWTH + \alpha_9 FSIZE + \alpha_{10} LEV + \alpha_{11} + \epsilon$$

4. RESULTS AND DISCUSSIONS

This section discusses testing of the goodness of fit model of the model focusing on the coefficient of determination (R²), the significance of F, and statistical t-test (p-value)

Table 1 R square The Relationship between Corporate Governance and Disclosure Quality

Model Summary

Model	R	R Square	Adjusted R Square	Std. error of the Estimate
1.	0.480 ^a	0.331	0.314	0.05180

a. Predictors: (Constant): BOD, BCOM, INCOM, INST, OWNC, AC, INDAC, D1, D2, D3, D4, D5, D6, D7

b. Dependent variable: Ln_DQ

Table 1 displays *adjusted R Square* of 0.314 or 31.4 % of the model linking corporate governance with disclosure quality. This result indicates that the level of variations in *disclosure quality that is accounted by the Corporate Governance* mechanisms (Board of directors’ size, Board size of Commissioners, Independent of Commissioners, Institutional Ownership, Ownership Concentration, Audit Committee, and Independent of Audit Committee) is 31.4%. While the remaining 68.6% of the variations were caused by other variables outside our model.

Table 2 showed that the F value of 13.851 of regression model on the relationship between corporate governance and disclosure quality. Meanwhile, the F table value at df 1= 16 and df 2 = 739 is 1.660. Based on the results, it can be concluded that the F calculated is greater than F table (13.851 ≥ 1.660). Thus, there is no rejected hypothesis or accepted hypothesis. Thus, Panel B regression equation on a relationship between *Corporate*

Governance Mechanisms and Discretionary Accrual have a high goodness of fit, so the regression equation can be used for further testing. Results of model regression between corporate governance and disclosure quality using Fixed Effect method on SPSS. The results in Table 4.32 are used to test hypotheses 2 (hypotheses 2a, 2b, 2c, 2d, 2e, 2f, 2g).

Table 2 The Relationship between Corporate Governance and Disclosure Quality

ANOVA ^b						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	0.595	16	0.037	13.851	0.000^a
	Residual	1.983	739	0.003		
	Total	2.578	755			

a. Predictors: (Constant): BOD, BCOM, INCOM, INST, OWNC, AC, INDAC, D1, D2, D3, D4, D5, D6, D7

b. Dependent Variable: Ln_DQ

Table 3 The Relationship between Corporate Governance and Disclosure Quality

<i>Independent Variable</i>	Expected Sign	Beta	t- value	Sig (p-value)
<i>PANEL B Dependent Variable : LN_DQ (Disclosure Quality)</i>				
<i>Constant</i>	+	0.356	10.553	0.000
<i>Board of Director size (BOD)</i>	+	0.111	8.680	0.000
<i>Board of Commisioner size (BCOM)</i>	+	0.065	3.840	0.000
<i>Independence of Commisioner (INCOM)</i>	+	0.029	2.458	0.047
<i>Institutional Ownership (INST)</i>	+	0.031	4.270	0.000
<i>Ownership Concentration (OWNC)</i>	-	-0.140	-2.925	0.004
<i>Audit Committee (AC)</i>	+	-0.204	-0.635	0.525
<i>Independence of Audit Committee(INDAC)</i>	+	-0.085	-0.489	0.625
<i>Leverage (LEV)</i>	-/+	-0.230	-0.286	0.931
<i>Firm Size (FSIZE)</i>	-/+	0.125	1.862	0003
<i>Growth (GROWTH)</i>	-/+	0.025	1.802	0.047
<i>Adjusted R²</i>		31.4		
<i>F statistic</i>		13.851		
<i>P Value (F Statistic)</i>		0.000		
<i>N</i>		756		

DISCUSSION

Board of directors' Size and Disclosure Quality

Hypothesis a tested if there is positive effects between the board of director size and disclosure quality. Results from Table 4.32 supported the hypothesis. Board of directors' size positively effect on disclosure quality has given the model t value (8.680) which is greater than table value (1.646). Also, significance level (0.000) is greater than the alpha value (0.05). This shows, Therefore, the value of t count \geq t table ($8.680 \geq 1.646$) and has a positive sign. This result indicated that the more of the number BOD member will be increased the level of disclosure and quality of information. Thus, for the board of directors to disclose more information, therefore board may need to consist of members who are skilled managers with different experience that can be improved the efficiency of information disclosure. This finding is in accordance with Alshimmiri (2004) and Akhtaruddin, Hossain, Hossain, and Yao (2009). Therefore, there is a positive relationship between the board of directors' and disclosing. In the other words, the number of board members of the company can affect the information disclosure.

Board of Commissioners size and Disclosure Quality

In table 4.32, the results of **hypothesis b** testing the positive effect of the board of commissioner size on disclosure quality is presented. Regression model shows significance value of 0.000 which are less than the alpha of 0.05. The t- statistics of BCOM is 3.840 which is greater than table value of 1.646 (df =754; alpha 0.05). That result supported the study hypothesis which means that the greater the size of commissioners, the greater possibility of disclosing more information leading to high level of disclosure quality. This result also indicates that a higher board size of Commissioners will increase the quality of financial information issued by the firm. The finding is consistent with Sembiring (2003) and Sulastini (2007) states that the greater the size of the board of commissioners the larger the disclosure level. Similarly, the finding is line with Khodadadi, Khazami, and Aflatooni (2010) and Jatiningrum et.al (2016). The result argued that increasing the level of board size of Commissioners could increasing value of disclosure.

Independence of Commissioners and Disclosure Quality

Table 4.32 contains the result of **hypothesis c** testing. Based on the results, the regression level significance is 0.04 for *Independence of Commissioners compared to p*-value (0.05). Also, the *t-value* statistics of INCOM showed a *t* count value of 2.458 which is greater than *t* table is 1.646 ($df = 754$; $alpha = 0.05$). From these result, it can be concluded. It means that *Independent of Commissioners* has a positive effect on *disclosure quality*. Thus, with increasing independence of commissioners it possible to improve firm disclosure of their financial information and therefore show the greater level of transparency in their reports. This finding is consistent with Katmun (2012) that there is a significant positive relationship between board independence and disclosure quality as well as the finding of Soheilyfar et al., (2014) which also reveals the significant and positive relationship between disclosure quality and chairman independence.

Institutional Ownership and Disclosure Quality

In table 4.32, the results therein showed **hypothesis d** testing. Consistent with the hypothesis the result is not rejected or accepted hypothesis. From Table 4.32, the model significance value for *Institutional Ownership (INST)* is 0.000 which is less than *the alpha* value (0.05). The *t count* statistics of INST showed a value of 4.270 compare to *t* table value of 1.646 ($df = 754$; $alpha = 0.05$). From these result, it can be concluded that institutional ownership has a significant positive effect on disclosure quality. The hypothesis of the study is therefore supported. This, suggests that *Institutional Ownership* have a positive impact on *disclosure quality*. Therefore, the institutional ownership may effectively monitor management to engage in better disclosure information. This finding is consistent with Eldomiaty & Choi (2006), Bushee and Noe (2001), and Khoshbakht and Salteh (2011) which document that large institutional ownership may induce a higher level of disclosure. The further stated that significant relationship existbetween the corporate governance mechanisms and the discretionary disclosure of information. The empirical evidence showed that institutional ownership affects the level of the discretionary disclosure of information by the firms significantly.

Ownership Concentration and Disclosure Quality

Table 4.32 presents result on **hypothesis e** in relation to the negative effect of ownership concentration (OWNC) on *Disclosure Quality*. The significance value of OWNC is 0.004 compared with the *p-value* (0.05). The t count statistics of OWNC showed is -2.925 compared to the t-table statistic of 1.646 (df = 754; *alpha* 0.05). The result confirms the study hypothesis of the negative effect of ONWC with disclosure quality. From these result, it can be concluded that the value of t count \geq t table (-2.925 \geq 1.646). This result indicates that Which indicates that *ownership concentration* has a significant and negative effect on *disclosure quality*. It means that the more the proportion of ownership concentration, the lesser the quality of information disclosure with less of investor protection and weak of system corporate governance., This result is consistent with findings of Ali (2007) and Jatiningrum et.al (2016) that firms with poor disclosure quality have higher in ownership concentration which indicates a significant and negative relationship between disclosure quality and ownership concentration.

Audit Committe (AC) and Disclosure Quality

The result of hypothesis f testing effect od audit committee on disclosure quality. The hypothesis was not supported based on the result in Table 4.32 above. The regression model shows a significance value of 0.525 which is greater than *p-value* (0.05). The t count statistics of AC shows a value of -0.635, while the table t value is 1.646 (df = 754; *alpha* = 0.05). The results indicate that the study hypothesis needs to be rejected. This means that Audit Committee (AC) has an insignificant effect on disclosure quality. This finding is consistent with that of Jatiningrum, Abdul-Halim and Popoola (2016) which found that audit committee effect on disclosure quality is not significant. The result reveals that audit committee is insignificantly associated with disclosure quality. Thus, the quantity of AC members does not effectively impact on disclosure of relevant information.

Independence of Audit Committe (IAC) and Disclosure Quality

Table 4.28 shows the hypothesis g testing on the effect of independence of audit committee (INDAC) on disclosure quality. The level of significance (0.625) is greater than the *alpha* value (0.05). The t count statistics of INDAC showed a value of 0.489. While t table value is 1.646 (df = 754; *alpha* = 0.05). Based on these results, it can be concluding that the value of t count \leq t table (0.489 \leq 1.646). The results reject the hypothesis of the

study which is not supported. This indicates that independent of the audit committee (INDAC) has an insignificant effect on disclosure quality. Thus, the existence Independent of Audit Committee does not have an effect on disclosure quality. It can be inferred that independence of audit committee does not effectively influence management behaviour on disclosure of information. This finding is consistent with Jatiningrum, et al (2016) and Kent and Steward (2008) which both provide evidence that audit committee independence does not have a significant effect on the level of disclosure by firms.

5. CONCLUSIONS AND SUGGESTIONS

The result of the study suggests that the high level of Board of Directors size would be effective in increasing the disclosure under ownership concentration, which to reduce agency problem to type II agency conflict. According the descriptive statistics, some companies in Indonesia have up to 11 directors in the firm. This study provide evidence that the board of directors have an important role in the corporate governance mechanisms. Aji (2012) revealed that the board of directors is to determine policies for the running of the company and the protection of investors in the short term and long term. Therefore, for Indonesian companies to achieve good corporate governance (GCG), the board of directors is expected to balance the decision-making process, especially in relation to the integrity of information disclosed in the financial statements.

Therefore, this finding will assist policymakers and regulators in Indonesia with regard to ownership concentration context as well as for other East Asian countries. This will lead to improved disclosure adequacy that presents adequate financial reporting as an important way to reduce agency conflict. In other words, the stronger the corporate governance system and appropriate monitoring, the more the ability to impact on the firm management to disclose more and give better financial information in the future.

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