



Ownership Concentration and Firm Performance in Indonesia

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Abstract

Objective – The study aim to investigate the effect of ownership concentration on the financial performance of firms listed in the Indonesian Stock Exchange from 2008 to 2012.

Design/methodology – Data for the study were collected from the Indonesia Stock Exchange on or prior to 2 January 2008 and remain listed until 31 December 2012. The population is 140 industrial and manufacturing companies listed on the Indonesia Stock Exchange. But, there are only 43 companies meet the sampling criteria. To investigate the influence of ownership concentration on firm performance in Indonesia, multiple linear regression method was performed.

Results – The results of this study is the ownership concentration positively and significantly influences firm performance in Indonesia and it acts as a substitute for shareholder protection.

Research limitations/implications – The samples are only collected from manufacturing industry and does not take into account the shareholder identity. It is quite possible that shareholder identity influences the relationship between ownership concentration and firm performance. Therefore, future researchers are advised to take into account the shareholder identity so that it becomes clear whether shareholder identity indeed has an effect on such relationship.

Keywords ROA, ownership concentration, large shareholders, firm performance.

1. Introduction

The corporate ownership in Indonesia, like in most Asian countries, is highly concentrated. According to Asian Development Bank (2000), five largest shareholders of public listed firms in Indonesia own 68% of shares on average. More specifically, the ownership of companies in Indonesia is concentrated in the hands of family groups (Carney & Gedajlovic, 2002; Lukviarman, 2004). In terms of ownership structure, most of the shares of top 100 listed companies are held by institutional investors (62.39% on average) (Wulandari & Rahman, 2004). These institutional investors are principally owned and managed by founding family members, and this in turn leads to little separation between ownership and control (Lukviarman, 2004). Claessens et al. (2000) found that families controlled 72% of public listed firms in Indonesia who also usually have their representatives in the leadership structure (Asian Development Bank, 2000).

Due to the concentrated ownership, firms in Indonesia are relatively safe from hostile takeover. In addition, they are also “sterile” from bank ownership because Indonesian laws prohibit banks to hold shares in a company. Nevertheless, firms in Indonesia heavily rely on bank loans as external sources of financing (Lukviarman, 2004). Despite such heavy reliance on bank loans, banks as creditors do not have strong monitoring capacity because of the fact that they are controlled by families who also control the firms which borrows from the banks (Wulandari & Rahman, 2004).

In addition to concentrated ownership, other typical features of corporate ownership in Indonesia are reciprocal ownership arrangement (Wulandari & Rahman,

2004), pyramid structure and cross-holding among firms (Claessens et al. 2000). Reciprocal ownership arrangement is defined as the arranged share ownership where two companies own shares of each other. Such ownership occurs usually on companies which are members of the same group (Wulandari & Rahman, 2004), and through pyramid structure and cross-holding among firms, many controlling owners enjoy higher level of control relative to their actual equity ownership (Fan & Wong, 2002).

The influence of ownership concentration on firm performance of listed firms in Indonesia stock exchange 2008 to 2012 is investigated in this study. It is expected that this study promotes better understanding on how ownership concentration influences firm performance in Indonesian context. The remainder of this paper is structured as follows. Section 2 presents the literature review on ownership concentration. Section 3 describes the research methodology. Section 4 presents the summary of the empirical results, and Section 5 concludes.

2. Literature Review, Theoretical Framework and Hypothesis Development

The nature of concentrated ownership in Indonesia might be influenced by its financial system as argued by Berglöf (1988). In countries where banks play a pivotal role, debt and equity are more concentrated whereas the opposite occurs in countries with market-oriented financial system. Other scholars (e.g., La Porta et al., 2002) propounded that it is the poor shareholder protection which causes the highly concentrated ownership of firms because such ownership is needed to limit expropriation on shareholders. In similar vein, La Porta et al. (1999) reported that the ownership of large firms in the richest common law countries such as the United States is usually widely-dispersed, whereas the existence of controlling shareholders is more common in countries with poor shareholder protection.

Lemmon and Lins (2003) believed that agency problem (caused by conflict of interest) in firms with highly-concentrated ownership occurs between corporate insiders (controlling shareholders and managers) and outside investors. Corporate insiders who have control over firm assets can potentially expropriate outside investors through resources diversion for their private use or by commitment of fund to unprofitable projects that give private benefits.

Demsetz and Lehn (1985) argued that economic incentives to monitor managers and decrease agency costs are stronger in concentrated shareholders. According to Klein et al. (2005), agency theory suggests that more effective monitoring is achieved through concentrated ownership. Demsetz and Lehn (1985) claimed that ownership concentration is positively correlated to the degree to which benefits and costs are borne by the same owner.

Ownership concentration has both benefits and costs. Gul et al. (2010) argued that due to entrenchment effect, controlling shareholders have an incentive to cover up their self-serving behaviours or to limit the leakage of related information. Consequently, the informativeness of stock prices of firms is reduced and the stock prices become more synchronous.

On the other hand, Shleifer and Vishny (1986) believed that the alignment of interests between controlling and minority shareholders can be achieved through ownership concentration. Contrarily to Gul et al. (2010), Gomes (2000) argued that controlling shareholders may be encouraged by ownership concentration to voluntarily disclose more and better firm-specific information for the benefit of minority shareholders.

According to Shleifer and Vishny (1986), concentrated shareholdings raise firm value. Large and concentrated investors have substantial economic incentives, influence and power to maximise firm performance (Anderson & Reeb, 2003). Claessens and Djankov (1999) found that more concentrated ownership is associated with higher

profitability for Czech firms. Xu and Wang (1999) found that ownership concentration is positively and significantly correlated with profitability for Chinese public companies. Thomsen and Pedersen (2000) found that ownership concentration positively affects shareholder value (measured with market-to-book value of equity) and profitability (measured with asset returns) for the largest European companies. Zeckhauser and Pound (1990) found that the presence of large shareholders significantly improves corporate performance. According to Claessens et al. (2000), firm value increases with the cash-flow ownership of the largest shareholder in East Asian countries. These findings support agency theory which suggests that agency cost is lower when ownership is concentrated.

On the contrary, Lehmann and Weigand (2000) found that ownership concentration has a negative impact on profitability on German firms as measured by the return on total assets. Prowse (1992) found that ownership concentration and profitability are unrelated in both firms that are members of corporate groups (keiretsu) and independent firms in Japan. Demsetz and Lehn (1985) found no significant relationship between ownership concentration and accounting profit rates. Demsetz and Villalonga (2001) found no statistically significant relation between ownership structure and firm performance. Cho (1998) found that ownership structure does not affect corporate value. Leech and Leahy (1991) concluded that greater ownership dispersion implies a higher value, profit margin and growth rate of net assets for large British companies.

On the other hand, acknowledging the positive and negative impact of concentrated ownership on firm value, Denis and McConnell (2003) argued that the ultimate effect of blockholder ownership on measured firm value is dependent on the tradeoff between two things; namely the shared benefits of blockholder control and any private extraction of firm value by blockholders. Claessens et al. (2001) found that block ownership by corporations is negatively related to firm performance, while the positive relationship occurred on firms predominantly owned by the government in nine East Asian countries.

After investigating the ownership concentration in Asia, Heugens et al. (2009) concluded that ownership concentration can positively affect corporate performance in countries lacking legal protection of shareholders. However, this positive relationship does not appear in countries where legal protection is well-developed, where shareholders can rely on mostly external corporate governance mechanisms to protect their investments and assure a reasonable return on investments. According to La Porta et al. (1998), Indonesia is included in one of countries which adopt French civil law, and this particular legal system is regarded to have the weakest protection of shareholders. In similar vein, La Porta et al. (2000) regarded Indonesia along with Korea, Taiwan and Thailand as countries with low legal investor protection.

3. Research Method

3.1. Data, variable and sample characteristics

The data population is 140 industrial and manufacturing companies listed on the Indonesia Stock Exchange. The population comes from an independent website about listed firms on the Indonesia Stock Exchange, of the population, 43 companies meet the sampling criteria. The sampling criteria are as follows:

- 1) Listed on the Indonesia Stock Exchange on or prior to 2 January 2008 and remain listed until 31 December 2012.
- 2) Have complete information required in this research.
- 3) Fiscal year end at 31 December from 2008 to 2012.

The sample size is considerably small if compared to the population. The smallness of the sample size is largely a result of the incompleteness of information required from the firms. Hence, firms with incomplete required information have to be removed from the samples.

In this study, firm performance is measured with return on assets (ROA). Ownership concentration is measured by the total percentage of the largest five shareholders of a firm (Demsetz & Lehn, 1985). Firm size (measured with total assets) and sales growth serve as control variables. The research method used in this study involves the collation of data of 43 manufacturing companies available from online financial databases (secondary data), i.e. Thomson One and Orbis.

3.2. Regression Model

To investigate the influence of ownership concentration on firm performance in Indonesia, the following multiple linear regression model is used:

$$ROA = \beta_0 + \beta_1 OC + \beta_2 TA + \beta_3 SG + u$$

ROA = return on assets

OC = ownership concentration

TA = total assets

SG = sales growth

4. Result and Discussion

In this section, the empirical results of this research are presented. Before going further, the table of average values of ROA and ownership concentration Indonesia is presented as follows.

Table 1
Average values of ROA and ownership concentration in Indonesia 2008-2012

No.	Variables	Average Values
1.	Return on Assets	6.61%
2.	Ownership Concentration	71.07%

4.1 Return on Assets(ROA)

The sampled firms listed on the Indonesia Stock Exchange have an average ROA of 6.61% during the period of 2008 to 2012. The average ROA reached the lowest level in 2008 (3.64%) and it reached its highest level in 2011 (7.58%).

4.2 Ownership Concentration

Ownership concentration in this research is measured in the sum of shares ownership of five largest shareholders in percentage. The sampled firms listed on the Indonesia Stock Exchange have an average ownership concentration of 71.07% during the period of 2008 to 2012. The lowest average of ownership concentration occurred in 2008 (69.86%) and the highest occurred in 2011 (72.19%).

4.3 Relationship between Ownership Concentration and ROA

The relationship between ownership concentration and firm performance in Indonesia will be investigated below.

Table 2
Regression results of the relationship between ownership concentration and ROA in Indonesia

Model	Coefficients ^a					
	Unstandardized Coefficients		Standardized Coefficients	T	Sig.	
	B	Std. Error	Beta			
1	(Constant)	-,758	2,447		-,310	,757
	Ownership Concentration	,080	,032	,164	2,493	,013
	Total Assets	,004	,003	,096	1,443	,150
	Sales Growth	,080	,022	,240	3,630	,000

a. Dependent Variable: Return On Assets (SPSS output)

On Table 2, we can see that the p value of ownership concentration (0.013) is smaller than α value (0.05). Therefore, ownership concentration significantly and positively influences ROA of firms in Indonesia. Table 1 in Appendix shows that the value of R square is 0.094, meaning that 9.4% of the variation of ROA can be explained by independent variables in the model and 90.6% of it is explained by other variables not included in the model.

Table 2 also shows that sales growth significantly and positively influences ROA (p value = 0). To further investigate such influence, the samples of firms are divided according to their sales growth and then the regression using samples of growing and non-growing firms is conducted. Firms with sales growth above average fall into growing firms category, and those with sales growth below average fall into non-growing firms category. The average sales growth of firms in Indonesia in this research is 12.65%. Below are the tables of the regression analysis for both firm groups.

		Coefficients ^a				
		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
Model		B	Std. Error	Beta		
1	(Constant)	4,391	2,916		1,506	,135
	Ownership Concentration	,063	,037	,167	1,703	,092
	Total Assets	,007	,003	,212	2,159	,033
	Sales Growth	-,044	,034	-,126	-1,280	,204

a. Dependent Variable: Return On Assets (SPSS output)

Table 3 Regression results of the relationship between ownership concentration and ROA of growing firms in Indonesia (101 observations)

		Coefficients ^a				
		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
Model		B	Std. Error	Beta		
1	(Constant)	-1,331	3,815		-,349	,728
	Ownership Concentration	,105	,049	,187	2,147	,034
	Total Assets	,000	,005	,002	,024	,981
	Sales Growth	,244	,059	,361	4,124	,000

a. Dependent Variable: Return On Assets (SPSS output)

Table 4 Regression results of the relationship between ownership concentration and ROA in non-growing firms in Indonesia (114 observations)

It appears on Tables 3 that ownership concentration only has a marginally, positive and significant effect on ROA of growing firms in Indonesia (p value = 0.092). Conversely for non-growing firms as shown in Table 4, ownership concentration significantly and positively influences ROA (p value = 0.034). In addition, sales growth only significantly and positively influences ROA of non-growing firms (p value = 0).

The results above show that in general, the ROA of firms in Indonesia is significantly and positively influenced by ownership concentration. This is in line with the findings of Shleifer and Vishny (1986), Anderson and Reeb (2003), Claessens and Djankov (1999), Xu and Wang (1999), Thomsen and Pedersen (2000), Zeckhauser and Pound (1990), and Claessens et al. (2000). The results also imply that the shared benefits of blockholder control outweigh any private extraction of firm value by blockholders as argued by Denis and McConnell (2003). Furthermore, the finding of Heugens et al. (2009) which concluded that firms in countries with poor legal protection of shareholders enjoy positive effect of ownership concentration on corporate performance is also supported by the results. In terms of the relationship between ownership concentration and firm performance in growing and non-growing firms, Tables 3 and 4 show that the influence of ownership concentration on firm performance is stronger in non-growing firms.

4.4 Multicollinearity and Autocorrelation Test

In order to check whether the regression models are free from multicollinearity and autocorrelation, collinearity statistics and Durbin-Watson values are used.

Multicollinearity does not occur when tolerance value is equal to or above 0.1 (Field, 2013) and variance inflation factor (VIF) is below 5 or 10 (O'Brien, 2007). On the other hand, positive autocorrelation occurs when d is less than d_l (lower bound) and negative autocorrelation occurs when $(4 - d)$ is less than d_u . The multicollinearity and autocorrelation tests show that the regression models are free from these two statistical problems. More details on these tests can be seen in the Appendix.

5. Conclusion

This study addresses the question whether ownership concentration influences firm performance in Indonesia. The results in this study conclude that in general, ownership concentration positively and significantly influences firm performance in Indonesia and it acts as a substitute for shareholder protection. Shareholder protection is weak in Indonesia, and this is reflected in the Corruption Perception Index published by Transparency International (2015) which ranked Indonesia in 88th of 168 countries and territories (higher rank means lesser corrupt). The relatively low rank of Indonesia in the index reflects the low quality of law enforcement in this country which is also manifested in the weak shareholder protection.

It is assumed that a large amount of shareholding on the hand of large shareholders in Indonesia induces the large shareholders to monitor the management of the firm closely. Close monitoring on the management appears to enhance firm performance in Indonesia. Such monitoring is difficult to take place in a firm with widely-dispersed ownership since the cost of monitoring is high and the benefit of it is enjoyed by both active and passive shareholders (free-rider problem).

This study has some limitations that need to be addressed by future researchers:

- 1) The samples are only collected from manufacturing industry. Future researchers are advised to incorporate samples from all industries to facilitate better and more comprehensive investigation of ownership concentration-firm performance relationship.
- 2) The relatively small sample size might weaken the validity and reliability of the research in this study. Future researchers are advised to increase the sample size that can be achieved through incorporation of samples from other industries and/or primary data collection on the firms.
- 3) This study did not take into account the shareholder identity (institutional, individual, family investors; state, etc). It is quite possible that shareholder identity influences the relationship between ownership concentration and firm performance. Therefore, future researchers are advised to take into account the shareholder identity so that it becomes clear whether shareholder identity indeed has an effect on such relationship.

Last but not least, based on the findings, it is recommended that the large shareholders (or group of large shareholders) in Indonesia to increase or at least maintain their shareholding level. By so doing, it is expected that the close monitoring on the management achieved through ownership concentration will preclude the managers from self-serving behaviour and induce them to prioritise shareholders' interests.

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Appendix

Table 5
R-Square and Durbin-Watson values of regression model of all firms

Model Summary ^b					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	,307 ^a	,094	,081	8,55324	2,056

a. Predictors: (Constant), Sales Growth, Ownership Concentration, Total Assets
b. Dependent Variable: Return On Assets

Table 6
R-Square and Durbin-Watson values of regression model of growing firms

Model Summary ^b					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	,277 ^a	,077	,048	7,04494	2,032

a. Predictors: (Constant), Sales Growth, Total Assets, Ownership Concentration
b. Dependent Variable: Return On Assets

Table 7
R-Square and Durbin-Watson values of regression model of non-growing firms

Model Summary ^b					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	,412 ^a	,170	,147	9,14180	2,049

a. Predictors: (Constant), Sales Growth, Ownership Concentration, Total Assets
b. Dependent Variable: Return On Assets

Table 8
Collinearity statistics for regression model of all firms

Coefficients ^a			
Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	Ownership Concentration	,991	1,009
	Total Assets	,973	1,027
	Sales Growth	,979	1,021

a. Dependent Variable: Return On Assets

		Coefficients ^a	
		Collinearity Statistics	
Model		Tolerance	VIF
1	(Constant)		
	Ownership Concentration	,988	1,012
	Total Assets	,989	1,011
	Sales Growth	,989	1,011

a. Dependent Variable: Return On Assets

Ownership Concentration

Table 9
Collinearity statistics of regression model of growing firms

		Coefficients ^a	
		Collinearity Statistics	
Model		Tolerance	VIF
1	(Constant)		
	Ownership Concentration	,992	1,008
	Total Assets	,982	1,019
	Sales Growth	,987	1,013

a. Dependent Variable: Return On Assets

Table 10
Collinearity statistics of regression model of non-growing firms