

Cost of Liability Capital under Shareholders' Monitoring

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Abstract

This paper discusses empirical research examining the impact of shareholders' monitoring in term of concentrated ownership and majority ownership on cost of liability capital. Using a sample of 184 observations of publicly listed companies on the Indonesian Stock Exchange for the fiscal year that ends on December 31, 2010 through 2013, we find that concentrated ownership, family ownership, internal ownership, and institutional ownership negatively affect cost of liability capital, whereas government ownership has no effect on cost of liability capital. The findings suggest that concentrated ownership, family ownership, internal ownership, and institutional ownership are able to enhance monitoring role which in turn decrease investment risk and credit risk, and finally decrease cost of liability capital. This study provides further evidence on the role of shareholders' monitoring on cost of liability capital using data from emerging market with low-level coercion which is Indonesian Capital Market.

Keywords: cost of liability capital, concentrated ownership, leverage, majority ownership, size.

1. Introduction

This research investigates the effect of corporate governance on cost of liability capital of Indonesian Publicly-owned companies for the year of 2010 to 2013. Corporate governance is the ways through which suppliers of capital to corporations assure themselves of getting return on their investment [1]. Therefore, ownership structure represents an important aspect of shareholder monitoring mechanisms that could potentially complement of a corporate governance framework. Previous research shows that ownership structure is an important determinant of firm performance [2]. Basically, corporate ownership structure is seen either as a potent governance mechanism or the source of corporate governance problems [3]. Prior research does not find an unequivocal support that ownership structure is a significant determinant of firm outcomes, which provide an opportunity for further empirical research.

Our research is based on both the theoretical perspectives of debt agency costs and the traditional manager-shareholder agency costs. There is little, if any, literature on the effect of corporate governance and shareholder monitoring mechanisms on agency cost of liability capital. There is scarce empirical work on this issue, especially in Indonesia. Theoretically, the value of corporate governance in public corporations is widely acknowledged. However, its contribution to value creation for the suppliers of finance remains a subject of an open empirical question. Based on the traditional manager-shareholder agency theory debt issuers suffer from the adverse effects of managerial opportunism and asymmetric information due to the separation of ownership and control

[4]. This, in turn, will increase the likelihood of default in debt commitment. As debt issuers do not have effective control on the use of funds they provide, they are exposed to the risk that opportunistic managers may possibly divert these funds from the initial objective. Corporate governance mechanism such as effective board monitoring, may limit managerial tendency to pursue personal agendas such as wasting firm resources for personal benefits [5]. Creditors depend on financial reports to assess the extent of default risk. In this situation, corporate governance serves as an oversight mechanism in financial reporting process, which assures the integrity of financial reports.

The link between ownership structure and creditors' welfare from the perspective of debt agency cost is unclear [5]. Dominant shareholders may strive to maintain the benefits accruing from their control of the firm by reducing the agency cost of risk against debt issuers so that they can continuously enjoy lower cost of liability capital. Controlling owners may closely align their interest to wealth maximization and have incentive to preserve their reputation in the debt market [6]. On the other hand, creditors may be adversely affected by entrenched controlling shareholders who spoil in risky investment to pursue empire building [7], engage in tunneling activities [8], dilute debt issuers' claim by issuing debt of higher priority [9], and undertake acquisitions that increase leverage and affect debt seniority [10].

We collect a total of 184 firm-year observations and find that concentrated ownership, family ownership, internal ownership, and institutional ownership negatively affect cost of liability capital, whereas government ownership has no effect on cost of liability capital after controlling for firm size and leverage. Our research contributes to both theory and practice in several ways. First, we provide systematic preliminary evidence linking shareholder monitoring mechanisms to cost of liability capital in an emerging market. Second, our study contributes to the emerging literature that investigates the relationship between shareholder's monitoring mechanisms and cost of liability from the theoretical perspectives of both debt agency costs and the traditional shareholder-manager agency conflicts.

2. Literature Review and Hypotheses Development

2.1. Literature Review

This study uses agency theory which predicts and explains states the behavior involving parties and states that agency conflict between principal and agent can be created [4]. The conflict was happened because both principal and agent want to maximize their own utility and interest [4]. The agency conflict can be reduced by implementing corporate governance, because the corporate governance philosophy is to balance between principal and agent interest through a governance mechanism [11]. The agency conflict was not only between agent and principal but also between one principal (investors) and other principals (creditors).

Theoretically, creditors may be adversely affected by the agency conflicts between shareholders and managers. When managers are left to their own devices they tend to resort to opportunistic behavior to pursue personal agendas at the expense of debt issuers. They may also withhold value relevance information from the creditors and manipulate financial reports in order to enjoy higher compensation [5]. Creditors are very concerned about the extent of default risk and rely on financial reports to assess it. Managerial opportunism, asymmetric information and questionable accounting practices increase the default risk. This impose higher risk premium to compensate them for the potentially risky investment. Effective corporate governance can reduce default risk by enhancing monitoring of managerial opportunistic behavior, influencing the integrity of financial accounting reports and alleviating the extent of information asymmetry between firms and debt issuers.

Previous literature examines the implications of bondholder-shareholder conflicts for the agency cost of debt. Agency costs of debt arise because bondholders can be hurt by excessive payouts to shareholders, by claim dilution due to subsequent issuance of debt of higher priority, by asset substitution involving a shift toward high risk projects that benefit shareholders [4], by under-investment when firms forego positive NPV projects if they principally benefit the bondholders [12] and by acquisitions that increase leverage and affect debt seniority [10]. However, in practice, managers have major influence on the operational, investment, and financial decisions of the firm because of the separation between corporate ownership and control. Managerial agency risk arises for outside investors because managers are self-interested and there is asymmetric information between insiders and outsiders [4]. Moreover, shareholders cannot cheaply separate corporate managers involuntarily from control. Such separation typically requires a successful proxy motion by shareholders [13], a takeover [14], or bankruptcy [15]. Therefore, managers can entrench themselves because of transactions costs in shareholder activism, in the market for corporate control, and in the bankruptcy process¹.

Entrenchment allows self-interested managers significant flexibility to pursue their own agenda, and they can threaten bondholder interests in a variety of ways [9]. In particular, risky investment choice by entrenched managers to increase the size of assets under their control [7; 16] can increase the default risk. Furthermore, existing bondholders will be hurt if the management issues senior debt to finance these risky investments. Finally, entrenched managers may exploit their control over financial and investment policy to indulge in self-dealing that reduces liquid assets and endangers debtors. However, entrenched management can help bondholder interests by ameliorating the risk (for bondholders) of opportunistic shareholder behavior [9]. An example is the dilution of bondholder risk from takeovers. Heavily debt-financed takeovers are often inimical to the interests of the current

¹ Corporations can avoid bankruptcy through renegotiation with debt-holders [17]. Managers may also effectively entrench themselves by making manager-specific investments [18] and by strategically enhancing their voting rights [16].

bondholders because they substantially increase leverage and hence the default risk and can subvert the existing seniority of claims. But while a change of control may be in shareholders' interests, it will be resisted by an entrenched management. Therefore, bondholder and entrenched management interests are aligned against the shareholders in the face of unfriendly takeover attempts. To address agency risk from shareholders and managers, bondholders use covenants that restrict investment policy, subsequent financing policy, payout policy, and the firm's behavior during takeover bids and financial distress [9]. However, including an ever-greater variety of restrictions is not always in bondholder interest [19]. This is because covenants constrain management's ability to implement policies that improve the firm's operational position and reduce default risk [9]. Thus, in the efficient contracting outcome, covenants will not generally eliminate the agency cost of debt.

Dominant shareholders can hold control (voting) rights significantly in excess of cash flow rights through a variety of channels. These channels include multiple classes of shares with unequal endowment of control rights [20; 21], voting pyramids [22], and cross-holdings across firms [23; 24]. Moreover [23] finds that more than two-thirds of listed East Asian companies are controlled by a single shareholder. Wresting control from these shareholders is difficult because it requires major changes in the equity structure of the firm and the unraveling of complex cross-holding and voting pyramid structures. The position of the controlling shareholders is similar to highly entrenched managers. Based on the foregoing arguments, controlling shareholders pose agency risk for lenders through risky investments that increase the default risk; through financing arrangements that upset the seniority claims of the current lenders; and through self-dealing [9]. Indeed, because of their significant control and cash flow stakes in a variety of firms, controlling shareholders pose a substantial resource diversion (or tunneling) risk for lenders, and this risk is particularly acute during financial distress. For example, during the emerging markets financial crisis of 1997-1998, assets were transferred and profits tunneled out of companies to escape creditors, who typically received nothing [25]. We note that bank loans can facilitate tunneling by allowing the dominant shareholder to increase the asset base without the dilution of voting rights that may accompany equity financing. However, controlling shareholders can also reduce risks for lenders. To preserve their control of the firm, controlling shareholders interests may be more closely aligned to wealth maximization [26], also they may have an incentive to maintain a good reputation in the debt markets [6], but this effect may be weak if there is access to other forms of external financing. Moreover, if the controlling shareholders are business groups, then their member firms may allocate resources efficiently through internal capital markets developed by pooling cash flows. [27] reports that intra-group equity sales create value for minority shareholders in Belgium. [28] finds that Korean business groups are subject to less financing constraints because of internal capital markets. Examining Indian firms, [29] find that diversified business groups add value. [30] concludes that headquarters can create value by channeling limited resources to deferent uses inside a company by picking winners.

2.2. Hypotheses Development

2.2.1. Concentrated Ownership and Cost of Liability Capital

The active monitoring hypothesis assumes that concentrated owners have mostly undiversified investments and hence they have less incentive to exit the firm and extract benefits from the firm for which it might impair their own wealth [5]. They need to monitor the managers in order to limit managerial opportunism. The shared benefits hypothesis assumes that debt issuers feel secure due to the concentrated owners' active monitoring, and therefore, they are willing to impose lower risk premium effectively reducing cost of liability capital. Concentrated owners may also attempt to reduce the agency risk against lenders so that they can continue to enjoy cheaper cost of liability capital. However, prior studies document inconsistent results. Research done by [31] observes that concentrated ownership is associated with higher (lower) yields if the firm is exposed to (protected from) takeovers. [32] shows that the monitoring power of institutional block-holders have a reducing effect on the cost of liability capital, whereas [33] and [34] observe that an increase in a dedicated group of institutional investors' shareholdings mitigates information asymmetry and lowers cost of liability capital. Thus, we offer the following hypothesis:

H₁: Firms having concentrated ownership have lower cost of liability capital.

2.2.2. Family Ownership and Cost of Liability Capital

Family ownership can be a powerful governance mechanism to curb managerial opportunism and promote long-term survival of the firm. Family owners exert control over the firm's management and they might refrain from undertaking activities that could potentially impair their wealth; thus, alleviating agency conflicts between managers and debt issuers; thus, reducing the cost of liability capital [5]. [35] investigates the effect of founding family ownership on the cost of debt and finds that it reduces cost of liability capital. Debt issuers are willing to demand low risk premium because they view founding family ownership as a potent monitoring mechanism to protect their interest. However, this finding may be unique to the U.S. market because it has a strong investor protection law [20; 1]. Debt issuers may be comfortable with family ownership because they can get effective legal recourse or protection against any form of wealth expropriation by the family owners [5]. Thus, we offer the following hypothesis:

H₂: Firms with higher percentage of family ownership have lower cost of liability capital.

2.2.3. Insider Ownership and Cost of Liability Capital

The convergence-of-interest hypothesis posits insider ownership promotes goals congruence and lowers agency cost because insiders are not only managers but also owners of the firm. Owner-managers avoid value destruction activities in order to protect their mainly undiversified shareholdings [5]. [33] find that the insiders' tendency to protect firms' investment reduced the perceived risk of a firm, thereby prompting investors to accept a reduction in the risk premium leading to a lower cost of capital. Thus, we hypothesize:

H₃: Firms with higher percentage of insider ownership have higher cost of liability capital.

2.2.4. Government Ownership and Cost Liability Capital

Theoretically, government owners are likely to perform a stewardship role and prominent monitors of the management behavior [36]. The government represents a wider interest of the society; hence, they need to ensure that their investment in listed entities is profitable. In view of these factors, debt issuers may be willing to impose lower charge on the funds provided. [37] in a study of selected East Asian and Western European countries observed that government ownership does not have any effect on firms' yield spreads. But government ownership is positively related to bond ratings implying that rating agencies do not view government as an additional potential risk factor of expropriation; instead, their presence increases bond ratings. Thus, we offer the following hypothesis:

H₄: Firms with higher percentage of government ownership have lower cost of liability capital.

2.2.5. Institutional Ownership and Cost of Liability Capital

From institution theory perspective, the ownership of some types of institutional investors could add legitimacy to the investees [38; 39]². We therefore argue that legitimacy can be acquired in the form of an increase in institutional ownership in financially constrained investees. In the case of investing in financially constrained firms, the increase in ownership by some institutional investors can be attributed to the investors' expectation about the investee's long-term growth potential. In other words, for long-term institutional investors to increase the stake of ownership in a financially constrained firm is similar to certifying the investee to meet their higher standards for which they are known [40]. Therefore, we expect that an increase in ownership by long-term institutional investors would add legitimacy to the investee such that lenders would view such an ownership as a positive signal about the investee's current governance structure and future cash flows. Thus, we offer the following hypothesis:

H₅: Firms with higher percentage institutional ownership have lower cost of liability capital.

3. Research Design

3.1. Sample Selection

The sample used in this research are firms listed at the Indonesian Stock Exchange (IDX) in the year of 2010 to 2013. The sample was selected using the purposive sampling technique. The first requirement is that it is a public company listed at the, IDX from 2010 to 2013. The second requirement is that those firms should have complete data needed by the research. The third criterion is, that these firms are not part of the financial industry. The last criterion is, that the firms have publicly available information. The data came from three sources, Indonesian Capital Market

² Institutional theory [38] and [39] emphasizes legitimacy, which is defined as "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" [44].

Directory (ICMD), www.idx.co.id, and company's website. The unit analysis used in this research is firm-year.

3.2. Variable Definition and Measurement

Following [41; 42; 32; 43], we use interest rate as proxy for cost of liability capital. We compute interest rate by dividing interest expenses by average short-term and long term debt for a given year. We use one measure of cost of debt only due to the unavailability of data to compute alternative measures such as yield spread and credit ratings. The set of independent variables consists of concentrated ownership, family ownership, insider ownership, and government ownerships, which represents the shareholder monitoring aspect of corporate governance. We rely on prior studies such as [6; 45; 36] for the determination of the types of shareholder monitoring mechanisms in the Indonesian context. Ownership is defined as the amount of equity shares an ultimate owner holds in the sample firms. The Indonesian Companies Act of 1995 requires firms to disclose directors' report and ownership data in their annual reports. Hence, ownership data are readily available from the sections on the analysis of shareholdings and director's reports of firms' annual reports. Concentrated Ownership (CON) is measured by using Herfindahl index. The value of the H is the sum of the squares of the shares ownership of each kind of ownership and the value is between 0 and 1. It is calculated as follows:

$$H = \sum_{i=1}^n (\text{Share Ownership Portion})^2$$

where i refers to an individual firm and n refers to the number of firms. The higher the index, the more concentrated the ownership. Higher ownership concentration lead to the decrease of information disclosure and increase of agency problem [46].

Family ownership is share ownership by a family. The literature does not provide commonly accepted definition, measure or criterion for identifying a family ownership [6]. We identify family relationship based on the information provided in the section on director's profile of firms' annual reports. We measure family ownership as the cumulative percentage of family members' common equity ownership. Consistent to [2], we define insider ownership as the cumulative percentage of executive directors' equity shares. In line with [47], we exclude the shares held by independent nonexecutive directors because they are expected to play a monitoring role and minimize self-interested behavior of the executive management. Similar to [36], we define government ownership as the sum of ownership percentage of government institutions and government-controlled bodies. Indicator used to measure government ownership is cumulative percentage of government's equity shares. Referring to [48], we define institutional ownership is cumulative percentage of financial institutional and other business institution's equity shares. The indicator used to measure is number of shares owned divided by all outstanding's share.

The control variables that we select are standard for the literature that examines the link between shareholder monitoring and cost of liability capital. Control variables consist of firm's size and leverage. Size is a control variable used to control the variability of firm's size. Firm size is a well established determinant for firm's value and has an effect on many aspects of a firm's operation. [49; 50] note that large firms may have more opportunities to overstate earnings because of the complexity of their operations and the difficulty for interested parties to detect overstatement. This variable is measured by log total assets. This measure reflects firm's size. [51; 52; 53; 54; 55] suggest that firm's size decrease cost of capital since investors in large firms require low return which in turn decrease cost of capital. Lev or leverage a control variable whis is used to control the variability of firm's capital structure. [56] argues that the presence of debt-holders offers additional monitoring benefit via external capital providers who have an incentive and the ability to monitor firm activity to protect investments. Therefore we use leverage to capture the effect of debt ratio. This variable is measured by dividing total liabilities with total assets. The low leverage indicates that a company has low cost of capital [54; 55] because the higher the leverage, the higher return required by investors.

3.3. Model Specification

The main statistical method to test the hypotheses is the OLS regression. The OLS regression models are estimated are as follows:

$$\text{COLC}_{it} = \alpha + \beta_1 \text{CON}_{it} + \beta_2 \text{SIZE}_{it} + \beta_3 \text{LEV}_{it} + \varepsilon_{it} \quad (2)$$

$$\text{COLC}_{it} = \alpha + \beta_1 \text{FAM}_{it} + \beta_2 \text{INT}_{it} + \beta_3 \text{GOV}_{it} + \beta_4 \text{INS}_{it} + \beta_5 \text{SIZE}_{it} + \beta_6 \text{LEV}_{it} + \varepsilon_{it} \quad (3)$$

Where:

COLC_{it}	=	Cost of liability capital of firm i in the year t,
CON_{it}	=	Concentrated ownership of firm i in the year t,
FAM_{it}	=	Family ownership of firm i in the year t,
INT_{it}	=	Insider ownership of firm i in the year t,
GOV_{it}	=	Government ownership of firm i in the year t,
INS_{it}	=	Institutional ownership of firm i in the year t,
SIZE_{it}	=	Log total asset, as the proxy for firm's size of firm i in the year t,
LEV_{it}	=	Leverage ratio of firm i in the year t,
ε_{it}	=	error term.

4. Data Analysis and Discussion

Based on the sampling process described, this study used sample of 184 firm from the year of 2010 to 2013. Unbalanced data was used to include all firms listed on the IDX in each year that met the data requirements. In order to mitigate the survivorship bias, to increase the sample size, and to improve the generalizability of the results this approach was followed even if the firm met the data requirements for a single year.

Table 1 shows the descriptive statistics for the sample data. From Table 1, it can be seen that the mean of the COLC shows a value of 0.066 with a median of 0.052 and a standard deviation of 0.077. The mean of CON shows the number of 0.569 with a median of 0.520 and a standard deviation of 0.185. This means that share pownership of publicly traded companies in Indonesia quite concentrated in certain owner's group. FAM has a mean value of 0.027 whereas INT has a mean value of 0.024. This show a quite moderate numbers in connection with the minimum value of 0.000 for both variables and the median numbers of 0.000 for both variables. Yet, from stand point of maximum value of 0.672 for FAM and 0.721 for INT, this indicates that family ownership and insider ownership dominate the ownership of Indonesian listed firm's shares. The mean of INS shows the number of 0.612 with a median of 0.386 and a standard deviation of 0.325. This means that institutional ownership of publicly traded companies in Indonesia quite moderate, whereas GOV has mean value of 0.103 with a median of 0.000 and a standard deviation of 0.253. This means that in average government ownership in Indonesian listed companies is small compare to that of other group of ownership.

Table 1. Descriptive Statistics

	Mean	Median	Min	Max	St.Dev.
COLC	0.059	0.052	0.018	0.152	0.026
CON	0.569	0.520	0.305	1.000	0.185
FAM	0.028	0.000	0.000	0.672	0.122
INT	0.024	0.000	0.000	0.721	0.102
INS	0.612	0.386	0.000	0.999	0.325
GOV	0.103	0.000	0.000	1.000	0.253
Lev	0.831	0.876	0.393	0.940	0.118
Size	4.167	3.977	2.418	5.865	0.826

To test the hypotheses, this study uses ordinary least square (OLS). The classic assumptions of the regression model were tested before the regression analysis was done. The assessment shows that the data are normally distributed and there is no problem with multicollinearity, heteroscedasticity, autocorrelation and the existence of outliers in the data. Before testing the hypotheses, we also perform bivariate analysis and the correlation among variables is presented in Table 2 in the form of Pearson correlation. The table shows that the correlation between COLC and CON is equal to -0.042. This means that concentrated ownership negatively correlated to cost of liability capital. This result provides initial support for research hypotheses. The similar results are also get for GOV and FAM with the correlation coefficient of -0.110 and -0.031 respectively. The two other variables which are INS and INT have positive correlation to COLC. This will be further examined in regression analysis by involving two control variables namely size and lev. Table 2 also shows that there are no collinearity between variables of interest.

Table 2. Pearson Correlation

	COLC	CON	INS	GOV	FAM	INT	LEV
CON	-.042						
INS	.291 **	.035					
GOV	-.110	.185* *	-.449 **				
FAM	-.031	-.135	-.133	-.089			
INT	.004	-.132	-.077	-.096	-.026		
LEV	-.577 **	.054	-.322 **	.193 **	.116	.007	
Size	-.314 **	.131	-.321 **	.407 **	-.089	-.248 **	.449 **

*, **. Correlation is significant at the 0.05 level and 0.01 respectively (2-tailed).

The regression analysis results to test the hypotheses are presented in Table 3. Panel A in Table 3 shows that F-statistic is significant at the level of 1%. This means that research model (2) meets requirement to test hypotheses. Adjusted R-squared has value of 0.491. This means that all independent variables and all control variables affect dependent variables (CON) by 49.1% and the rest is affected by other variables (residuals) do not involved in this analysis. Panel B in Table 4 shows that F-statistic is significant at the level of 1%. This means that research model (3) meets requirement to test hypotheses. Adjusted R-squared has value of 0.621. This means that all independent variables and all control variables affect dependent variables (CON) by 62.1% and the rest is affected by other variables (residuals) do not involved in this analysis. Hypotheses 1 is tested by using regression model (2) and the result is presented at Panel A in Table 3. The variable of interest is CON. Panel A shows that CON has coefficient value of -0.019 and significant at the level of 5%. This result indicates that concentrated ownership has a significant reducing effect on the cost of liability capital; thus supporting our hypothesis 1 which stated that firms having concentrated ownership have lower cost of liability capital. This means that the more concentrated ownership, the less credit risk and the lower cost of liability capital. Debt issuers seem to regard that concentrated ownership as an organizational attribute that better protects their interest. This results consistent with previous research done in different environments, such as research conducted by [32] which find that the monitoring power of block holders have impact on reducing cost of liability capital, [32; 33; 34] who observe that dedicated of concentrated investors group mitigate information asymmetry and decrease cost of liability capital.

Panel B in Table 3 presents regression results to test hypotheses 2; hypotheses 3, hypotheses 4, and hypotheses 5. To test hypotheses 2, the variable of interest is FAM. The regression result shows that FAM has coefficient of -0.045 and significant at the level of 1%. Statistically this result indicates that FAM variable negatively affect cost of liability capital. This result indicates that family ownership has a significant reducing effect on the cost of liability capital; thus supporting our hypothesis 2 which stated that firms with higher percentage of family ownership enjoy lower cost of

liability capital. This means that the more family ownership, the less credit risk and the lower cost of liability capital. Debt issuers seem to regard that family ownership better protects their interest. This is happened because the greater family ownership, the bigger the effort to perform monitoring. Consequently credit risk become lessens and cost of liability capital become lower. This result is consistent with previous research done in different environments, such as research conducted by [5] which finds that family ownership in certain condition will improve or reduce agency conflict between manager and creditor, and this in turn will decrease cost of liability capital. The result is also consistent to prior result found by [35] who reports that family ownership decrease cost of liability capital. This decrease is because creditors available to receive low risk premium because they assumed that family ownership as a strong monitoring mechanism to protect their interests. Moreover, creditors also feel comfortable with the existence of family ownership because they have effective legal warranty or protection to various expropriation.

To test hypotheses 3, the variable of interest is INT. The regression result shows that INT has coefficient of -0.049 and significant at the level of 1%. Statistically this result indicates that INT variable negatively affect cost of liability capital. This result indicates that insider ownership has a significant reducing effect on the cost of liability capital; thus supporting our hypothesis 3 which stated that firms with higher percentage of insider ownership enjoy lower cost of liability capital. This means that the more insider ownership, the less credit risk and the lower cost of liability capital. Debt issuers seem to regard that insider ownership better protects their interest. This is happened because the greater insider ownership, the bigger the effort to perform monitoring. Consequently credit risk become lessens and cost of liability capital become lower. This result is consistent with previous research done in different environments, such as research conducted by [33] who find that the likelihood of insider owners to protect company's investment reducing the perceived risk of the firm, thereby leading investors to demand lower rates of return on capital provided. This highlights the important role that corporate governance plays in creating value for shareholders by reducing the cost of external financing. This is also in line with the convergence-of-interest hypothesis which posits that insider ownership safeguards the goals congruence and reduces agency cost since the insider are not only managers but also owners of the firm. Owner-managers avoid value destruction activities in order to protect their mainly undiversified shareholdings.

To test hypotheses 4, the variable of interest is GOV. The regression result shows that GOV has coefficient of -0.017 and insignificant. Statistically this result indicates that GOV variable does not affect cost of liability capital. This result indicates that government ownership has not effect on the cost of liability capital; thus it does not support our hypothesis 4 which stated that firms with higher percentage of government ownership enjoy lower cost of liability capital. This result is not consistent with previous research done in different environments, such as research conducted by [33] which find that government share ownership would reduce perceived risk of the firm thereby leading investors to

demand lower rates of return on capital provided. We suspect that in Indonesia, monitoring activities performed by government on state-owned companies is not as effective as it performed by other ownership groups. Yet, this claims should be further proven by empirical research which specifically focus on state-owned companies.

Table 3. Regression Analysis

Panel A: $COLC_{it} = \alpha + \beta_1 CON_{it} + \beta_2 SIZE_{it} + \beta_3 LEV_{it} + \varepsilon_{it}$ (2)			
Variable	Coefficient	t-Statistic	Sig
Intercept	0.176 ***	15.999	0.000
CON	-0.019 **	-2.390	0.018
SIZE	-0.031 ***	-10.122	0.000
LEV	-0.019 **	-2.289	0.023
Adjusted R-squared	0.491		
F-statistic	57.220 ***		
Panel B: $COLC_{it} = \alpha + \beta_1 FAM_{it} + \beta_2 INT_{it} + \beta_3 GOV_{it} + \beta_4 INS_{it} + \beta_5 SIZE_{it} + \beta_6 LEV + \varepsilon_{it}$ (3)			
Variable	Coefficient	t-Statistic	Sig
Intercept	0.193 ***	14.829	0.000
INS	-0.023 **	-2.311	0.022
GOV	-0.017	-1.473	0.143
FAM	-0.045 ***	-2.832	0.005
INT	-0.049 ***	-2.758	0.006
SIZE	-0.024 ***	-10.889	0.000
LEV	-0.019	-1.360	0.176
Adjusted R-squared	0.521		
F-statistic	32.602 ***		

***, **, * show that coefficient is significant at 0.01, 0.05, and 0.1 respectively

To test hypotheses 5, the variable of interest is INS. The regression result shows that INS has coefficient of -0.023 and significant at the level of 5%. Statistically this result indicates that INS variable negatively affect cost of liability capital. This result indicates that institutional ownership has a significant reducing effect on the cost of liability capital; thus supporting our hypothesis 5 which stated that firms with higher percentage of institutional ownership enjoy lower cost of liability capital. This means that the more institutional ownership, the less credit risk and the lower cost of liability capital. Debt issuers seem to regard that institutional ownership better protects their interest. This is happened because the greater institutional ownership, the bigger the effort to perform monitoring. Consequently credit risk become lessens and cost of liability capital become lower. This result is consistent with institutional theory [38;39] which stated that institutional ownership would increase

legitimation of a company because it is assumed that institutional ownership lead to cheaper monitoring cost.

5. Conclusion

This paper investigates the impact of share ownership on the cost of liability capital. The results indicate that concentrated ownership, negatively associated with cost of liability capital. This means that firms having concentrated ownership have lower cost of liability capital. Other type of ownership such as family ownership, insider ownership, and institutional ownership are also negatively associated with cost of liability capital. These mean that firms having family ownership, insider ownership, and institutional ownership have lower cost of liability capital. The only type of ownership which does not impact on cost of liability capital is government ownership.

This research has implication both on theory and literature. Theory and literature expect that concentrated ownership and controlling shareholders, i.e. family ownership, insider ownership, government ownership, institutional ownership increase monitoring activities hence reduce perceived risk of the firm thereby leading investors to demand lower rates of return on capital provided. These results are not fully confirm the expectation and prior research. Therefore, future research are needed to reconfirm the existing theory and previous research. This research has limitation. The main limitation is the small number of available data about cost of liability capital. This lead to the total sample used in this research small and in turn limit the generalization of result. Therefore future research can be conducted by broaden sample, not only sample from Indonesian stock exchange but also involve other stock exchange in ASEAN regional.

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