International Business Management 11 (2): 392-396, 2017
ISSN: 1993-5250
© Medwell Journals, 2017

The Effect of Ownership Structure on the Expropriation Risk

Nurul Fitri, Gugus Irianto and Endang Mardiati
University of Brawijaya, Malang, Indonesia

Abstract: This study aims to analyze the impact of ownership structure on the expropriation risk. The risk of expropriation of using transactions related as a proxy in this study. This study was conducted in public companies engaged in non-financial sectors as well as active during the period 2008-2012 in the Indonesia Stock Exchange. This study uses a sample of 227 companies listed in the Indonesia Stock Exchange. The study found that institutional ownership, public ownership and family ownership have a positive effect on the risk of expropriation. This indicates that the agency theory of type 2 applies in Indonesia and the public company in Indonesia with transactions related high can increase the risk of expropriation impact.

Key words: Ownership structure, the risk of expropriation, related transactions, agency theory type 2, found

INTRODUCTION

Expropriation is conducted by the majority shareholders to the minority since the former have more information about the company and higher control right. Expropriation risk can be identified by tracking transactions in relation with special relationships. Subekti explains that the effect of the poor implementation of “civil law” rule on accounting application in Indonesia gives a chance to the expropriation practice. Improvement in law enforcement, the expose range of publication financial report, transparency of special relation transactions, explicit ownership proportion and transparency of activities and decision making can minimize the risk of expropriation. Ownership structure can be observed by looking at the proportion both for the ultimate and immediate. The ultimate ownership refers to the ownership chain which can be traced in detail to find out about the control right, the controlling party and the control system used in the company. Immediate ownership, on the other hand, does not require a detailed investigation because it can be directly seen from stock ownership proportion in the publication financial report. This phenomenon is a direct and indirect control of the company by means of the ownership proportion of other companies. Certain party’s concentrated ownership brings more control right of the policy in a company so that it can make transactions which trigger the expropriation practice. This research is aimed at verifying the effects caused by ownership proportion on expropriation risk by taking into account transactions of special relations.

Theoretical review and hypothesis development: Ownership proportion can influence the behavior of controlling or majority shareholders who possess concentrated ownership and high control right. This theory was developed by Jensen and Meckling (1976). Research by La Porta *et al*. (1999), Claessens *et al*. (2000), Faccio and Lang (2002), Cheung *et al*. (2006), Siregar (2007) and Sari (2010) studies the proportion of ownership structure of some countries in Asia, Europe, America and Australia. Indonesia is one of them. La Porta *et al.* (1999), Claessens *et al*. (2000), Faccio and Lang (2002) conducted a study which explains the concentrated ownership on the controlling shareholders which means that control over the company and decision making are exercised by the majority shareholders. Concentrated ownership in the three studies are above 50% which indicates that the company is controlled by one party, i.e., the majority shareholders in making decisions of the companies and having more information on the companies. Controlling shareholders as the owners of concentrated stock proportion in public corporations can effectively determine or participate in the manager decision making including transactions with related parties. Related party transactions can lead to “agency problem” expropriation exercised by the majority shareholders to the minority. The study by Cheung *et al.* (2006) public companies in China with concentrated proportion ownership have high related party transaction, violation of exchange law and poor disclosure quality.

Siregar (2007) and Sari (2010) investigate companies regarding concentrated ownership in Indonesia and find most of public corporate in Indonesia are controlled by majority shareholders who serve as well as the controlling shareholders. Shareholders of a company are classified into: institutional, public, family, managerial and governmental.

Corresponding Author: Nurul Fitri, University of Brawijaya, Malang, Indonesia

Expropriation of shareholders: Expropriation is a risk resulted from deprivation act of the majority shareholders as the controlling party over the minority. Research conducted by Lemmon and Lins (2003) and Cheung *et al*. (2006) prove that the majority shareholders are involved in the expropriation practice or tunneling towards the minority shareholders especially in the developing country market. Furthermore, expropriation can be manifested in merger and acquisition with affiliated parties. A major control on the majority shareholders results in an increase in incentive finance. The increasing cash flow will motivate controlling shareholders to conform their interest (alignment effect) to the company or non-controlling shareholders. Meanwhile when the controlling shareholders increase their control through the pyramid structure or cross-shareholding by maintaining low ownership, controlling shareholders will be motivated to exercise appropriation to the company (entrenchment effect). According to Dyanti (2013) entrenchment problem might also happen if family, as the company founder (founder's family) has a low stock ownership in the main company but possesses a big controlling right so that they can have control over the branch companies through his stock ownership. Research conducted by Anderson and Reeb (2003) conclude the existence of condition comparison if the biggest shareholder is an institution like a bank or public and family. The rising entrenchment is estimated to be triggered by the domination of family ownership in Indonesia. Stock ownership controlled by family causes higher agency conflict between minority and majority shareholders. This study measures the emergence of expropriation risk effect using a direct method evaluated by ownership proportion of shareholders in public companies at BEI (Indonesian Stock Exchange). Method used in the research by Sari (2010) is looking at transactions made by public companies with parties with special relation. Transactions which enable the emergence of expropriation risk are:

- Asset purchasing, transaction between public companies and related parties whic is controlled by certain parties regarding the purchasing of tangible/intangible assets
- Asset selling, transaction between public companies and related parties whic is controlled by certain parties regarding the selling of tangible/intangible assets
- Equity selling, transaction between public companies and related parties whic is controlled by certain parties including stock selling
- Trading relation, transaction between public companies and related parties which is controlled by certain parties regarding the trading of goods and services
- Cash paymemt, transaction between public companies and related parties whic is controlled by certain parties regarding payment

Hypothesis of institutional ownership to expropriation risk: Institutional ownership can generally acts as the party which monitors the company. The bigger the institutional ownership, the more efficient the utilization of the company asset will be which is expected to function also as prevention to improvidence or expropriation practiced by the majority shareholders. Wicaksono (2002) stated that the bigger the institutional ownership, the more increasing the company performance; this is based on the interest of the shareholders which commonly increases the company value. This increase is realized by suppressing the risk level.

Some studies infer that investors who are financial institutions can play a part in controlling or monitoring management actions to bring a possibility of minimizing expropriation risk (Shleifer and Vishny, 1986, 1997). The higher the institutional ownership, the lower the possibility of expropriation risk is. Institutional ownership variable has a negative influence toward expropriation risk. Chen *et al*. (2008) mentioned that institutional ownership is an important influence on the performance and operational activities of the company. Nielsen (2008) in the study of "investor institusional dan private equity" stated that financial institution ownership is an investment institution which covers pension fund, bank and investment advisor. Ownership of the majority stock and conflict between shareholders and managers which lead to expropriation risk are relatively lower because the institution can monitor the performance of the management as the company organizer. In addition, it can also reduce conflicts between majority and minority shareholders. Based on the literatures and previous research results, the hypothesis that can be formulated is as follows:

- H_{a1}: institutional ownership has a negative influence toward transactions which enable the emergence of expropriation risk

Hypothesis of public ownership to expropriation risk: Public share ownership, although a minority shareholders in a company has an interest to the company. The bigger the ownership of the public share, the more significant the control mechanism over the management behavior which

can minimize the expropriation risk exercised by shareholders with concentrated ownership for the public share ownership will be distributed. The existence of public share ownership will facilitate monitoring, intervention or other disciplinary influences on the managers which will eventually make the managers act as the interest of the shareholders. Public ownership can be utilized as a monitoring device on the management behavior which can minimize the expropriation risk for example related to the dividend policy. Monitoring mechanism is played by dividend in order to control the agency problem as demonstrated by Easterbrook (1984). Easterbrook (1984) stated that dividend payment will encourage the issuing of new securities which can result in the act of monitoring by the market. This will require the company to report clearly and in detail regarding the condition of the company both from the ownership aspect and the operational activities. Therefore, the risk of expropriation can be minimized. The existence of public share ownership will facilitate monitoring, intervention or other disciplinary influences on the managers which will eventually make the managers act as the interest of the shareholders. Research conducted by Faccio and Lang (2002) shows that public ownership can be used as a control over the manager behavior. The stricter the control applied by the public shareholders, the smaller the risk of expropriation will be. The variable of public ownership structure has a negative influence on the expropriation risk. Based on the literature review and results of previous studies, the hypothesis that can be formulated is:

- H_{a2}: public ownership has a negative influence on transactions which enable the appearance of expropriation risk

Hypothesis of family/individual ownership to expropriation: Claessens *et al.* (2000) stated that the biggest expropriation risk appearing due to the special relation occurs if the controlling shareholders are family. The expropriation risk is smaller when the share owned by non-family since a high ownership will lead to a full control right to the family in the organization of company management. There is a tendency to give priority to the family interest compared with other the shareholder's interest whether in the form of decision making policy or the company's operational management which in general to benefit the family. In other words, it can be concluded that the bigger the family ownership, the higher the likelihooh of expropriation risk. The variable of famil ownership has a positive influence on the expropriation risk. A study by Claessens *et al.* (2000) and Sari (2010) conclude that family as the controlling shareholders will increase the control rights in the management of the company. Research finding made by Claessens *et al.* (2000) is in line with the one conducted by Sari (2010). It found evidence that family ownership has a positive influence on expropriation risk. Based on the literature review and the results of previous studies, the hypothesis can be formulated as:

- H_{a3}: family ownership has a positive influence on transactions which enable the appearance of expropriation risk

MATERIALS AND METHODS

Sample and data: This research population is all public companies which continuously active in the Indonesian Stock Exchange, except those from the financial sector for the period of 2008-2012 with a total of 227 corporate. The sampling technique employed in this study is purposive sampling with a condition that the company did not make >45 related transactions. Companies with no ownership percentage data are 27. Companies without complete data at the Indonesian Stock Exchange during the observation period are 98. This research used 57 companies as the samples. The data was analyzed using double regression analysis.

Variable and measurement: Variables of this research include dependent and independent variables. The dependent variable is the expropriation risk whereas the independent variables are institutional ownership proportion, public ownership and family ownership. Table 1 describes the measurement of the research variables.

Empirical model: In a hypothesis test regarding the effect of ownership structure on the expropriation risk, it agrees

Table 1: Variable and Measurement

Variables	Measurement
Kins	Institutional ownership (comparison of institutional ownership percentage to the total ownership percentage) ×100%. This measurement refers to the study by Itturiaga and Ridriguez, Faisal
Kpub	Public ownership (comparison of public ownership percentage to the total ownership percentage) ×100%. This measurement refers to the research by Sari (2010)
Kkel	Family ownership (comparison of family ownership percentage to the total ownership percentage) ×100%. This measurement refers to the research by Sari (2010)
Ekspro	Expropriation (accumulating transactions of special relations, then take the average value of them) ×100%. This measurement refers to the research by Sari (2010)

Kins = Institutional ownership; Kpub = public ownership; Kkel = family ownership, Ekspro = Expropriation

with the hypothesis. The study initially estimated that β1 and β_2 were negative while β_3 was positive. Hypothesis 1-3 used double regression equation. This regression is formulated in this study as follows:

$$Expro(S, P, A, L) = a_0+\beta_1 KIns+\beta_2 KPub+ \beta_3 KKel +e..................(H_a)$$

RESULTS AND DISCUSSION

The test result on the hypothesis of the effect of institutional ownership proportion, public ownership and family ownership on expropriation risk in Indonesia can be seen in Table 2. Institutional ownership (K-Ins) is influential and can explain the effect of Expropriation risk (Ekspro) on the companies which exercise expropriation-related-transactions at BEI. According to the agency theory, institutional ownership has a negative influence on expropriation risk but this study shows thin public companies at BEI.

This condition illustrates that institutional ownership is not quite effective in suppressing the expropriation level in a company by utilizing control, management and control over all operational and non-operational cost well since institutional ownership is part of family ownership so that there is a high control owned by the family on behalf of the institution or company. A high control right provides an opportunity to the institution which becomes part of the family to make transactions with related parties which potentially triggers the expropriation risk. This research finding is inconsistent with the one by Nielsen (2008) but it supports the study by Shleifer and Vishny (1997).

The research result demonstrates that K-pub has a negative influence on expropriation risk at BEI. This result does not agree with the finding by Faccio and Lang (2002). This condition describes that high public ownership cannot suppress or cannot be used as a monitoring over the performance of public company management in Indonesia during the research period. Based on the agency theory, public ownership has a negative influence on expropriation risk but this study shows that public ownership has a positive influence on the expropriation risk. It happens because the high rate of public ownership proportion does not represent the real condition of the public ownership or the society. Stocks sold through the Indonesian Stock Exchange are purchased by the employees or company itself to show that a lot of investors are interested in the company's stocks. Consequently, the stock price will rise due to the high investor's interest in the sold stock sheet.

This condition seems to depict a good performance of the company so that it can attract investors and trigger a rise in the stock price. Employees of a company buy the company shares and it makes them part of the public or society who have ownership proportion of the corporate. A high public ownership with high control right can elevate transactions of special relations in a public company so that it can trigger an increase in the expropriation risk. The result of this research proves that K-kel has a positive influence on expropriation risk in public companies at BEI. This research result is consistent with the studies conducted by Claessens *et al.* (2000) and Sari (2010).

This situation is affected by the family/individual ownership which is concentrated on one family or individual. In condition like this, there is a huge opportunity for the expropriation practice to other shareholders exercised by the family shareholders. The higher the ownership percentage of family/individual, the bigger the potential of expropriation transactions is. In the family/individual ownership, family shareholders who acts as the owner of the company with a control right of the company will make decisions to reach the goals of the company, i.e., increasing profit during the period. Stakeholders are likely to sell their shares if there are poor performance of the company, high risk related to manipulative transactions and lack of information transparency needed by the investors. On the contrary, they will keep their shares if the company makes an improvement in the quality and performance result (increasing profit).

Table 2: Result of hypothesis testing

$Expro(S, P, A, L) = a_0+\beta_1 KIns+\beta_2 KPub+\beta 3KKel +\varepsilon$

Hypothesis	H_a	β1	β2	β3	F-value	R^2	N	Finding
H_1	β_1 -	0.578						Not supported*
H_2	β_2 -		0.149		10.412	0.371	57	Not supported*
H_3	β_3 +			0.106				Supported

*Supported statistically at α 5% but has an opposite direction

CONCLUSION

This study shows that each variable of stock ownership, i.e., institutional ownership, public ownership and family ownership has a positive influence on the expropriation risk. It happens because there is a control right on the family side that has a concentrated ownership proportion, ownership proportion condition which does not represent the real condition (there is a possibility of stock frying) and poor enforcement of law related to shareholders in Indonesia, mainly regarding the rights of the minority as investors with low ownership proportion. High control rights owned by family through distributed stock ownership provide an opportunity for the family to make transactions of special relation with the related parties so that, it can trigger the appearance of expropriation risk.

This research result is affected by the characteristics of the public companies in Indonesia. In general, public companies listed in Indonesian Stoch Exchange (BEI) have concentrated ownership proportion on the family as the shareholders who have control rights on the company's operational activities, policy making and even decision making within certain period of time. This is the thing that creates an opportunity on the practice of expropriation by the majority shareholders to the minority, agency problem type 2 which supports the existence of Agency Theory type 2 in Indonesia.

LIMITATIONS

This study has its limitations since it only used immediate ownership so that the validity of ownership proportion is relatively weak and the researcher did not employ variables of managerial ownership and government ownership.

RECOMMENDATIONS

In the future, to get a better and more accurate result it is important to add more independent variables like the proportion of management ownership and government ownership. Ownership structure in the next research should not only use immediate ownership which can be directly traced in the financial report but add ultimate ownership which requires detailing investigation of ownership in the publication financial report so that the ownership proportion validity is robust.

REFERENCES

Anderson, R.C. and D.M. Reeb, 2003. Founding-family ownership, corporate diversification and firm leverage. J. Law Econ., 46: 653-684.

Chen, J., L. Blenman and D.H. Chen, 2008. Does institutional ownership create values? The New Zealand case. Q. J. Finance Accounting, 47: 109-124.

Cheung, Y.L., P.R. Rau and A. Stouraitis, 2006. Tunneling, propping and expropriation: Evidence from connected party transactions in Hong Kong. J. Fin. Econ., 82: 343-386.

Claessens, S., S. Djankov and L.H.P. Lang, 2000. The separation of ownership and control in East Asian corporations. J. Financial Econ., 58: 81-112.

Dyanti, V., 2013. Effect of controlling interest end of transactions with related parties. Master Thesis, University of Indonesia, Depok, Indonesia. (In: Indonesia).

Easterbrook, F.H., 1984. Two agency-cost explanations of dividends. Am. Econ. Rev., 74: 650-659.

Faccio, M. and L.H. Lang, 2002. The ultimate ownership of Western European corporations. J. Financial Econ., 65: 365-395.

Jensen, M.C. and W.H. Meckling, 1976. Theory of the firm: Managerial behavior, agency costs and ownership structure. J. Financial Econ., 3: 305-360.

La Porta, R., F. Lopez-De-Silanes and A. Shleifer, 1999. Corporate ownership around the world. J. Finance, 54: 471-517.

Lemmon, M.L. and K.V. Lins, 2003. Ownership structure, corporate governance and firm value: Evidence from the East Asian financial crisis. J. Finan., 58: 1445-1468.

Nielsen, K.M., 2008. Institutional investors and private equity. Rev. Finance, 12: 185-10.1093/rof/rfm009.

Sari, R.C., 2010. Tunneling and prediction models: Empirical evidence on transactions with related parties. Ph.D Thesis, Gadjah Mada University, Yogyakarta, Indonesia. (In: Indonesian)

Shleifer, A. and R.W. Vishny, 1986. Large shareholders and corporate control. J. Political Econ., 94: 461-488.

Shleifer, A. and R.W. Vishny, 1997. A survey of corporate governance. J. Finance, 52: 737-783.

Siregar, B., 2007. Separation of cash flow rights and rights in ownership structure ultimate control. Ph.D Thesis, Gadjah Mada University, Yogyakarta, Indonesia. (In: Indonesian)

Wicaksono, A.A., 2002. Effect of managerial ownership structure and the public, company size, EBIT-Sales and total debt-Total assets the company has value go public and listed on the Jakarta Stock Exchange. Master Thesis, Diponegoro University, Semarang, Indonesia (In: Indonesian).