



**ECONOMICS FACULTY
ANDALAS UNIVERSITY**

THESIS

**INTERNAL GOVERNANCE MECHANISMS AND
AGENCY COST OF INDONESIAN NON-
FINANCIAL COMPANIES**

By:

**TRIZA NOVIASARI
04 153 080**

Undergraduate Student of Accounting Department

**Submitted in Partial Fulfilment for the Undergraduate
Degree in Accounting**

**PADANG
2008**

ABSTRACT

This study examines the influence of two internal governance mechanisms; independent commissioner and concentrated ownership on the agency cost of Indonesian non-financial listed companies in 2002-2006 that measured by Asset Turnover (ATO) and Operating Expense Ratio (OPEX). Result shows that internal governance mechanisms measured by the proportions of independent commissioner and concentrated ownership have a significant influence on agency cost measured by ATO. But for the second measurement of agency cost, OPEX, result shows otherwise, internal governance mechanisms measured by the proportions of independent commissioner and concentrated ownership have not significantly influence agency cost. This seems to suggest that independent commissioner and concentrated ownership is an effective mechanism in mitigating the agency cost as measured by asset turnover (ATO) although the operating expense ratio (OPEX) indicator perceives otherwise.

Keyword: Agency Cost, Governance Mechanism, Board Composition, Ownership Concentration

CHAPTER I

INTRODUCTION

1.1 Background

Over the past two decades, particular attention of both the academic and professional literature has been directed towards the role of corporate governance in company administration (see: Jensen, 1993; Beasley, 1996; Gregory and Simms, 1999; ICAEW, 2001). On last decade, the issue has escalated following corporate scandals in most of the developed world. Indeed, a number of recommendations into the administration of publicly quoted companies in different countries have focused attention on the importance of corporate governance in protecting the interests of shareholders. Such recommendations include Treadway Commission (1987) and the Blue Ribbon Committee (1999) in the US, the Cadbury Committee (1992) and Higgs Committee (2003) in the UK, the Vienot Report (1995) in France, and the Peters Report (1997) in the Netherlands, and these culminated into corporate governance codes in the different countries.

Perceived importance of corporate governance derives from the fact that where there is widely dispersed ownership, shareholders designate managers to administer the operations of company in line with the goal of maximizing shareholder wealth (Jensen and Meckling, 1976; Ajinkya et al., 2005). In this context, the agency theory (Jensen and Meckling, 1976) suggests that because shareholders are not involved in the daily company activities, corporate governance mechanisms are

important in monitoring managers thereby aligning their interests with those of shareholders. Effective corporate governance mechanisms promote efficient allocation of resources, not only within the firm, but also the larger economy, and thus improving the long-term performance of companies (Gregory and Simms, 1999 c.f Mangena and Taurigana, 2006). These corporate governance mechanisms include among other, board structure, ownership structure, debt financing and the market for control.

There is a growing body of empirical research which examines the effectiveness of corporate governance mechanisms on the firm performance. However, the findings presented by the literature have generally been mixed (Baysinger and Butler (1985); Vafeas and Theodorou (1998); Denis and Sarin (1999); Coles, McWilliams and Sen (2001); Weir, Laing and McKnight (2002); Lamber et al (1993); Boyd (1994); Brickley, Lease and Smith (1988); McConnel and Sevaes (1990); Vafeas (2000) c.f Mangena and Taurigana, 2006).

Although, research which examines the effectiveness of corporate governance systems on firm performance is extensive, there is limited research which examines how certain board and ownership structure characteristics influence agency costs. Jensen and Meckling (1976) argue that effective monitoring helps reduce agency costs associated with the separation of ownership and control by restricting the non-value maximizing behavior of managers. This is potentially an interesting issue given that the magnitude of these agency costs can be unlimited unless the actions of managers are properly scrutinized. Such costs include most notably job perks,

CHAPTER V

CONCLUSION

The preceding chapter has presented the empirical results and this chapter provides conclusions drawn from the findings and discussions presented in the previous chapter, followed by an assessment of the potential limitations present in this study and possible future directions for research.

5.1 Conclusion

The purpose of this research is to get the statistical data that shows the influence of internal governance mechanisms; independent commissioner and concentrated ownership toward the agency cost that measured by asset turnover and operating expense ratio.

In this research, the significant influence of internal governance mechanisms on agency cost analyzed by using doubled regression model. According to the result of data analysis, internal governance mechanisms measured by the proportions of independent commissioner and concentrated ownership have influence on agency cost for ATO (Asset Turnover) indicator and for the second indicator OPEX (Operating Expense Ratio) internal governance mechanisms have not influence agency cost.

REFERENCES

- Ang, J., Cole, R., and Lin, J. 2000. Agency costs and ownership structure. *The Journal of Finance*, Vol. 55, Is. 1, pp: 81-106
- Berle, A., and Means, G. C. 1932. *The modern corporation and private property*. New York: MacMillan
- Financial Management Association (FMA).
www.fma.org/SLC/Papers/Boardnagencycosts.pdf
- Florackis, Chrisostomos and Ozkan, Aydin. 2004. Agency Costs and Corporate Governance Mechanisms: Evidence for UK firms. <http://www.ssrn.com>
- Forum for Corporate Governance in Indonesia, 2006, <http://www.fcgi.or.id>
- Helwina, S. 2007. Internal Governance Mechanisms and Performance of Indonesian Non-Financial Companies Listed in Jakarta Stock Exchange. *Undergraduate Degree Thesis*. Andalas University of Indonesia
- Indonesian Code for corporate Governance (ICCG), 2001. Indonesia
- Indonesian Company Law, 2007. UU RI No. 40 *Tentang Perseroan Terbatas*
- Indonesian Stock Exchange Website. <http://www.idx.co.id>
- Jensen, M.C., and Meckling, W.H. 1976. Theory of a Firm: Managerial Behaviour, Agency Costs and Ownership Structure. <http://www.ssrn.com>
- Karina, Ani. 2006. Pengaruh *Corporate Governance* dan Struktur Kepemilikan Terhadap *Agency Costs* (Studi kasus Pada Perusahaan Manufaktur yang *listing* di Bursa Efek Jakarta). *Undergraduate Degree Thesis*. Brawijaya University of Indonesia
- Lasfer, M. Ameziane. 2002. Board Structure and Agency Costs. <http://www.ssrn.com>
- Lukviarman, N. 2004. Ownership Structure and Firm Performance: The Case of Indonesia, *DBA Thesis*, Graduate School of Business. Curtin University of Technology. Perth