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The Influence of Ownership Structure on Leverage, Intellectual Capital Disclosure, and Firm Risk (A Study on Manufacturing Companies listed in Indonesia Stock Exchange, 2013-2018)

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Abstract

This study aims to examine the influence of ownership structure on leverage, intellectual capital disclosure, and firm risk. It was conducted at manufacturing companies listed on the Indonesia Stock Exchange from 2013-2018 with a population of as many as 142 companies. The sample was selected using purposive sampling with a total sample of 21 companies. The analysis was done using SEM analysis with the WarpPLS approach. The results of the study show that ownership structure has a significant effect on leverage and intellectual capital disclosure but not to firm risk. Whereas, it is found that leverage significantly affects intellectual capital disclosure and firm risk. Intellectual capital disclosure is also proven to significantly influence firm risk. It can be said that the results of this study are useful for potential investors to estimate firm risk in making investment decisions. The study results are also significant for company management to manage firm risk.

Keywords: ownership structure, leverage, intellectual capital disclosure, firm risk

INTRODUCTION

Every company expects high performance to provide welfare for the parties concerned. Company performance cannot be separated from company/firm risk. [1] revealed that firm risk has a role to play in firm performance because firms that take more risk generally have higher (although volatile) returns. However, excessive risk-taking can be fatal for the company.

The factors that influence firm risk have become draw the attention of researchers. Researchers have tested the effect of ownership structure on firm risk ([2] [3] [4] [5]. The results show that, in general, the ownership structure is related to firm risk. A conflict of interest between the principal and the agent may arise because of excess cash flow. Shareholders prefer high-risk investments that also generate high returns, while management prefers investments with lower risks. Besides, leverage is also predicted to affect firm risk [6];[7];[8]. According to the signaling theory [9], an increase in the company's leverage level will be accompanied by an increase in the risk of bankruptcy. High leverage is a signal that the company's ability to generate profits is low because it must return the loan principal and interest, causing the firm risk to be high.

The research examining the effect of intellectual capital disclosure on firm risk is still very limited. Not all companies report intellectual capital in their annual financial statements because all of which still voluntary. It is necessary to conduct a study that shows the effect of intellectual capital disclosure on firm risk. Therefore, the novelty of this study is to examine the effect of intellectual capital disclosure on firm risk. The results of this study are important for management in managing firm risk through intellectual capital disclosure. It is expected that this study can be used by potential investors as a consideration in choosing a profitable investment.

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MATERIAL AND METHOD

This study is explanatory research aimed to examine the effect of the research variables. The

measurement of ownership structure variables in this study refers to [3],[10,[4] and [11]. Meanwhile, the leverage measurement accommodates the research of [12] and [7]. On the one hand, intellectual capital disclosure adopted the research indicators from [13]. Last but not least, firm risk looks up to the research of [14] and [15]. This study was conducted at manufacturing companies listed on the Indonesia Stock Exchange in 2013-2018. The samples of this study were 21 companies selected among 142 manufacturing companies based on certain criteria. The analysis technique used is inferential analysis with SEM-WarpPLS.

Data Collection

Ownership Structure

The ownership structure is the holding portions of a company based on the shareholding percentage, namely the ratio between the number of shares owned by insiders (insiders) and the number owned by investors [16]. The percentage of ownership is determined by the percentage of total shares of the company. Ownership structure describes the composition of shareholding in a company whether it is governmental, institutional or public, foreign, family, or managerial. According [17], theoretically and empirically, firm performance is a certain proportion of distribution that the insiders have a greater percentage of ownership than outsiders.

In general, ownership structure can be classified into 3 types: management/managerial ownership, institutional ownership, and public ownership. Management/managerial ownership is the shareholding proportion of the management members to the total number of outstanding shares. According to Agency Theory [17], one way to reduce conflict between principals and agents can be done by increasing the managerial ownership of a company. Managerial ownership in a company encourages the integration of interests between principals and agents so that managers act along with the shareholder's wishes. Managerial ownership is also able to unite the interests of managers and shareholders so that managers will be careful in making decisions because they directly share the benefits and losses of decisions as to its consequence. On the one hand, institutional ownership is shown through the proportion of shares owned by institutional investors and blockholders. The existence of institutional ownership has an important meaning in monitoring company management to reduce agency conflicts. The institutional ownership in insurance companies, banks, investment companies, as well as other institutions will encourage more optimal supervision of the manager’s performance. This type of ownership can be said to play a very important role in reducing the opportunistic behavior of managers and monitoring them to be careful in making decisions [18]. Public ownership is the percentage of share ownership owned by the general public. External ownership has a great power to influence the company through mass media, which is the voice of the public. Public ownership indicates that the public has seen the potential of the company's profitability so that they are willing to invest in the company. It is noted that the company develops its business to increase corporate value as a competitive advantage so that people are willing to continue investing in the company.

Leverage

Leverage is one of the policies that must be taken by a company regarding the composition of a company's funding or capital. Companies that experience a lack of internal funding sources can take leverage as an alternative. Leverage is the use of external funds in a company with the consequence that the company must bear a fixed burden in the form of interest and debt installments [19]. Leverage also shows the company's ability to meet its obligations in covering fixed costs and corporate debts. This ability is shown by the amount of equity used to pay debts; the lower the leverage, the lower the debt proportion used in the capital structure, vice versa.

Intellectual Capital Disclosure

Intellectual Capital refers to non-physical capital and intangible/invisible assets that are related to human knowledge and experience and the technology used [20]. The existence of intellectual capital is often considered quite important and can provide high economic benefits in the future. [21] mentioned that intellectual capital consists of three elements, namely, human capital, internal capital, and external capital. The three elements are interrelated to illustrate the company's ability to manage intellectual capital. It is assumed that the merge of these resources can be used to achieve organizational goals. The character of intellectual capital disclosures in financial reports is voluntary

and such disclosure is important information for potential investors. Human capital disclosure is the disclosure of information that refers to an individual's knowledge such as qualifications, skills, values, and experiences in an organization. This capital is inherent in employees. Whereas, internal capital disclosure is the disclosure of information that refers to the knowledge in the organizational structure, processes, procedures, routines, systems, and culture created or carried by employees. Besides the two capital disclosures mentioned above, there is external capital disclosure that is the disclosure of information that refers to knowledge in an organization's external relationships such as suppliers, customers, and business partners.

Firm Risk

According [22], a risk is defined as a danger, disaster, and the possibility of experiencing loss and damage. By that, risk refers to the likelihood of an unfavorable event to occur. Risk is uncertainty in outcomes or events [23]; [22]; [24] especially concerning the future [14]. Firm Risk is the possibility of getting an unexpected return, making potential investors avoid high firm risk with low returns. The firm risk is measured using the coefficient of variation of return on invested capital (ROIC) and the standard deviation of return on assets [14]. Meanwhile, Ziarko [15] chose to assess firm risk based on the standard deviation of return on equity.

Ownership Structure and Leverage

Looking at the study of [17], the natural tendency of managers is to make decisions in their own best interest which may conflict with the opinions of others. At the risk of non-diversifying personal wealth, managers are encouraged to reduce their corporate debt to levels below the value-maximization level. However, as managerial ownership increases, conflicts between managers and shareholders are likely to be resolved ([17], and consequently, managers' incentives to reduce debt decrease. There is a negative relationship between managerial ownership and debt. The results of research firom [25] pointed out that the ownership structure has a significant impact on the capital structure but not vice versa. In correlation to that, [11] revealed that ownership structure has a significant impact on capital structure. Specifically, managerial ownership has a significant effect on leverage [25]. Based on the theoretical and empirical studies above, the first hypothesis in this study is:

Hypothesis 1. Ownership structure has a significant effect on Leverage

Ownership Structure and Intellectual Capital Disclosure

Based on Agency Theory ([17], companies with greater ownership concentration will disclose more information (intellectual capital disclosure) to reduce agency cost and asymmetric information. [8] Bukh, et al., conducted research with managerial ownership as an exogenous variable and intellectual capital disclosure as an endogenous variable. The results of that study emphasized that managerial ownership has a positive impact on intellectual capital disclosure. Research [11] also agreed that the ownership structure has a significant positive effect on intellectual capital disclosure. Therefore, the second hypothesis can be formulated as follows:

Hypothesis 2. Ownership structure has a significant effect on Intellectual Capital Disclosure

Ownership Structure and Firm Risk

The Agency Theory of [17] said that conflicts of interest between principals and agents, one of which, can arise because of excess cash flow. Excess cash flow tends to be invested in things that have nothing to do with the company's main activities. This causes differences in interests because shareholders prefer high-risk investments that generate high returns while management prefers investments with lower risks. Based on [2], examined the effect of equity ownership structure on firm risk. At a low level of equity insider ownership, their ownership has a positive effect on firm risk. When insiders increase their investment, it will reduce the firm risk significantly. Research [5] found that the ownership structure has a significant negative effect on total risk. This leads to the next hypothesis:

Hypothesis 3. Ownership structure has a significant effect on Firm Risk

Leverage and Intellectual Capital Disclosure

Companies with higher leverage ratios will disclose more information because companies with such capital structures have bigger agency costs ([17]. Additional information is needed to remove doubts from bondholders regarding the fulfillment of their rights as creditors. Companies with high leverage ratios must make broader disclosures than companies with low leverage ratios. Based on this explanation, the next hypothesis is formulated as follows:

Hypothesis 4. Leverage has a significant effect on Intellectual Capital Disclosure

Leverage and Firm Risk

Referring to the Signaling Theory [9], it is explained that an increase in the company's leverage will be accompanied by an increase in the risk of the company's bankruptcy. High leverage indicates that the company is heavily financed with debt, resulted in high fixed costs in the form of interests. High leverage is a signal that the company's ability to generate profits is low, leading to high firm risk. This is supported by research who wrote that high leverage creates a high risk of stock prices on the Karachi stock exchange[6]. According [7] also found that leverage has a significant positive correlation with systematic risk. Henceforth, the fifth hypothesis is:
Hypothesis 5. Leverage has a significant effect on Firm Risk

Intellectual Capital Disclosure and Firm Risk

Intellectual Capital Disclosure shows the seriousness of the company in declaring the condition of the company's Intellectual Capital to the public so that this gives a positive signal. The Signaling Theory [9] described that Intellectual Capital Disclosure provides a foundation of trust to potential investors that the company has higher intellectual capital than other companies that do not disclose intellectual capital. Companies that disclose intellectual capital openly tend to differentiate themselves from other companies so that the capital market provides incentives in the form of increased investor confidence. This ultimately increases the value of shares or decreases the company's cost of capital [26. The increase in share value indicates that the stock has a low level of risk. Based on theoretical studies above, it can be formulated that:
Hypothesis 6. Intellectual Capital Disclosure has a significant effect on Firm Risk

RESULT AND DISCUSSION

Model Testing

The measurement of the fit and quality indices model refers to the WarpPLS analysis technique [27]. The measurement results illustrate that the Average Path Coefficient (APC)=0.128, p=0.035; Average R-squared (ARS)=0.046, p=0.015; Average Adjusted R-squared (AARS)=0.030, p=0.018; Average block VIF (AVIF)=1.007, acceptable if <= 5, ideally <= 3.3; Average full collinearity VIF (AFVIF)=1.014, acceptable if <= 5, ideally <= 3.3; Tenenhaus GoF (GoF)=0.175, small >= 0.1, medium >= 0.25, large >= 0.36; Sympson's paradox ratio (SPR)=1.000, acceptable if >= 0.7, ideally = 1; R-squared contribution ratio (RSCR)=1.000, acceptable if >= 0.9, ideally = 1; and Statistical suppression ratio (SSR)=1.000, acceptable if >= 0.7. These results indicate that the model is supported by good data and has indicators that meet the requirements in WarpPLS.

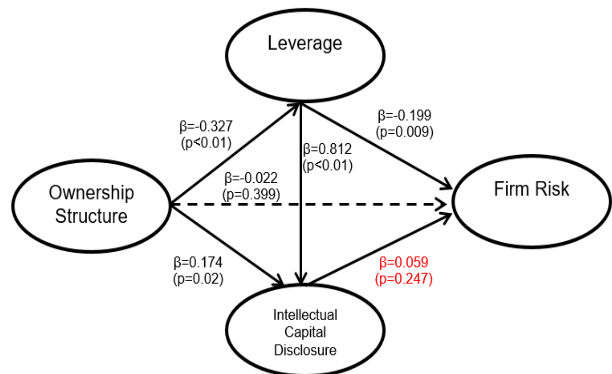

Figure 1 - Final Structural Model

Table 1 – Results of Hypothesis Test

	Path	β	p-Value	Claim
(H1)	Ownership structure → Leverage	-0.327	<0.001	Accepted
(H2)	Ownership structure → Intellectual capital disclosure	0.174	0.020	Accepted
(H3)	Ownership structure → Firm risk	-0.022	0.399	Rejected
(H4)	Leverage → Intellectual capital disclosure	0.812	<0.001	Accepted
(H5)	Leverage→ Firm risk	0.199	0.009	Accepted
(H6)	Intellectual capital disclosure → Firm risk	0.359	<0.001	Accepted

Hypothesis Test

The hypothesis testing in this study was carried out on all 6 hypotheses by comparing the p-value with alpha 5%. If the p-value ≤ 0.05, then the hypothesis is accepted, and if the p-value> 0.05, then the hypothesis is rejected.

1) Hypothesis 1 says that ownership structure has a significant effect on leverage. The results show that the p-value < 0.001 so that hypothesis 1 is accepted. The negative coefficient indicates that the ownership structure has a negative effect on leverage.
2) Hypothesis 2 mentions that the ownership structure has a significant effect on intellectual capital disclosure. The results display that p-value = 0.020 so that hypothesis 2 can be said to be accepted. The positive coefficient means that the ownership structure has a positive effect on intellectual capital disclosure.

3) Hypothesis 3 assumes that ownership structure has a significant effect on firm risk. The results reveal that p-value = 0.399 (> 0.05) so that hypothesis 3 is rejected. A negative coefficient marks that ownership structure harms firm risk.
4) Hypothesis 4 states that leverage has a significant effect on intellectual capital disclosure. The results denote that the p-value <0.001 so that hypothesis 4 is accepted. The coefficient is known to be positive, meaning that leverage has a positive effect on intellectual capital disclosure.
5) Hypothesis 5 illustrates that leverage has a significant effect on firm risk. The results of the test generate a p-value = 0.009 (<0.05) so that hypothesis 5 is accepted. The positive coefficient explains that leverage has a positive effect on firm risk.
6) Hypothesis 6 claims that intellectual capital disclosure has a significant effect on firm risk. The hypothesis test shows that the p-value <0.001, this indicates hypothesis 6 is accepted. The positive coefficient clarifies that intellectual capital disclosure has a positive effect on firm risk.

Discussion

This study reveals 6 important findings. First, the ownership structure has a significant and negative effect on leverage. This is consistent with agency theory [17] that the natural tendency of managers is to make decisions in their own best interest which may conflict with the opinions of others. At the risk of non-diversifying personal wealth, managers are encouraged to reduce their corporate debt to levels below the value-maximization level. However, as managerial ownership increases, conflicts between managers and shareholders are likely to be resolved [17]. The implication in this matter is that the manager's motivation to reduce debt will be decreased. This result is also in line with previous studies ([5]; [11]; [25]) which found that ownership structure has a significant impact on capital structure; specifically, managerial ownership has a significant effect on leverage.

Secondly, it is denoted that the ownership structure has a significant positive effect on intellectual capital disclosure. This provides empirical evidence for Agency Theory [17] that companies with a greater concentration of ownership will disclose more intellectual capital disclosures to reduce agency costs and asymmetric information. This finding supports the research from Bukh, et al [8] that the extent of managerial ownership has a positive impact on intellectual capital disclosure. This also strengthens the opinion of [11] Sadeli, et al., [11] which concluded that ownership structure has a significant and positive effect on intellectual capital disclosure.

Then, the ownership structure is known to have a negative and insignificant effect on firm risk. This is not relevant to Agency Theory [17] which acknowledges that the conflicts of interest between the principal and the agent may arise due to excess cash flow. Management prefers lower-risk investments in the use of excess cash flow. Meanwhile, shareholders prefer high-risk investments that also generate high returns. Previous research has found that when insiders increase their investment, it reduces the firm risk significantly. Ownership structure has a significant negative effect on total risk ([2]; [5]). These findings show different results from previous studies. Increasing ownership structure does not always reduce firm risk. Although shareholders have a lower proportion in the company's ownership structure, principals have the power to choose profitable investments with higher risks. This can cause the ownership structure to have an insignificant negative effect on firm risk.

The next finding points out that leverage has a significant positive effect on intellectual capital disclosure. This confirms Agency Theory that companies with higher leverage ratios disclose more information because companies with such capital structures have higher agency costs [17]. Intellectual capital disclosure is needed when broad information is considered important by a company to reduce investors' doubts on leverage. Thus, it can be said that the higher the leverage, the greater the company's obligation to disclose intellectual capital.

This study also finds that leverage has a significant positive effect on firm risk. This is in accordance with Signaling Theory [9] which discusses the relationship between firm leverage and firm risk. It is explained that companies with high dependence on debt for its operations will have fixed costs in the form of high interest and the potential of bankruptcy. This is consistent with previous research ([6];[10]) that high leverage signifies the low and risky ability of the company to generate profits.

Last but not least, this study declares that intellectual capital disclosure has a significant effect on firm risk. This result is relevant to Signaling Theory [9] which noted that companies who secure investors' interests seriously tend to disclose intellectual capital widely. Intellectual capital disclosure provides important information to investors so that investors feel confident that the firm risk is low. Intellectual capital disclosure provides a trust base for potential investors that the company has high intellectual capital. According [29], that companies who disclose intellectual capital openly tend to differentiate themselves from other companies so that the capital market provides incentives in the form of increased investor confidence which in turn will increase the value of shares or decrease the company's cost of capital.

Implications

By looking at the results above, this study provides both theoretical and practical implications. Agency Theory [17] is still relevant in the context of this research. It is known that the ownership structure has implications for leverage. If managerial ownership increases, conflicts between managers and shareholders are likely to be resolved, reducing the tendency to loan/debt. Ownership structure also has implications for intellectual capital disclosure. Companies with a greater concentration of ownership will disclose more intellectual capital to reduce agency costs and asymmetric information. This study also proves that leverage affects intellectual capital. Companies with high leverage ratios have the obligation to perform greater intellectual capital disclosure. Meanwhile, Agency Theory [17] is failed to support this study regarding the relationship between ownership structure and firm risk. This study does not provide strong evidence that a higher ownership structure produces lower firm risk. Therefore, it can be understood that the proportion of ownership structure does not correlate with firm risk. The attraction of interests between agent and principal is not always won by the agent when the agent has a high proportion of ownership. This means that the principal also has the power to determine the profitable investment even though it has a higher risk.

On the other hand, this study strengthens the Signaling Theory [9] about the effect of leverage on firm risk. High leverage indicates that the company is heavily financed with debt, resulted in high fixed costs in the form of interests. High leverage acts as a signal that the company's ability to generate profits is low, making the firm risk to be high.

This study also reveals new findings in the context of the Signaling Theory [9]. Intellectual capital disclosure is proven to have a significant effect on firm risk. It can be viewed as a potential signal about the attributes of management decisions; investors assume that intellectual capital disclosure reflects information about the characteristics of management decisions. This signal can provide a reliable basis to differentiate (discriminate) a company from other companies in terms of the attributes of the company's decisions. As a result, the capital market will provide incentives in the form of increased investor confidence which in turn will increase the value of shares or reduce the cost of capital for companies that show low risk.

The practical implication of this study is related to the firm risk estimation of investors. When making investment decisions, of course, investors consider the risk factors that can be estimated from the ownership structure, leverage, and intellectual capital disclosure. Based on the results above, potential investors are found to be more focused on leverage and intellectual capital disclosure than on the ownership structure in knowing the size of the firm risk. The ownership structure is not proven to have a significant effect on firm risk, meanwhile, leverage and intellectual capital disclosure have a significant effect on firm risk.

Research Limitations

This study has several limitations on the scope and sample selection. The scope of this research is limited to manufacturing companies listed on the Indonesia Stock Exchange in 2013-2018. There are still several types of companies listed on the Indonesia Stock Exchange but this is not the focus of this research. In addition to that, the sampling technique uses certain criteria so that not all companies can be researched.

Suggestion

Further research is expected to re-examine the conceptual model of this study and develop a new research model by including other relevant variables. It is also suggested to investigate non-manufacturing companies to expand the focus of this research. The scope of the research also

needs to reach other countries so that generalizations become broader.

CONCLUSION

The results of this study strengthen Agency Theory [17] that ownership structure has a significant negative effect on leverage. On the one hand, ownership structure and leverage are found to have a significant positive impact on intellectual capital disclosure. This study also points out that the ownership structure has insignificant negative implications for firm risk. These results reveal the relevance of Signaling Theory [9] concerning the relationship between leverage and firm risk. High leverage signals that the company's ability to generate profits is low so that the firm risk becomes high. To sum up, this study proves that intellectual capital has a significant effect on firm risk.

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