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An Expropriation Practice through Related Party Transactions in Indonesia

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ABSTRACT

The purpose of this study to examine the influence of governance toward an expropriation practice in Indonesia and to examine the institutional ownership that acts as a moderator in strengthening the effect of corporate governance toward an expropriation practices as measured by related party transactions. This study uses panel data regression analysis. The results showed that corporate governance negatively affects the practice of expropriation and institutional ownership cannot strengthen the influence of corporate governance toward an expropriation practice. This research contributes to the type II agency theory (conflicts between controlling and non-controlling shareholders), which can be minimized by implementing corporate governance.

KEYWORDS: Corporate Governance; Expropriation; Institutional Ownership; Related Party Transaction's

INTRODUCTION

Agency conflicts that usually occur in Indonesia and countries in Asia, where ownership of the companies tend to be concentrated, occur between controlling shareholders and non-controlling shareholders, indicating a Type II agency conflict (Villalonga and Amit, 2006). This is different from the conflicts that occur in developed countries such as America and Europe, which are conflicts between management and shareholders (Type I agency conflict) due to the spread of ownership structures. Concentrated ownership gives rise to control rights and cash flow rights on the part of controlling shareholders, for example the family and the government.

This increases the potential for controlling shareholders to be deeply involved in the management of the company (Shleifer and Vishny, 1986; La-Porta, Lopez-de-Silanes, and Shleifer, 1999) and enables them to transfer funds out of the company to other companies with the aim of profitable the controlling shareholder (Friedman, Johnson, and Mitton, 2003). This condition can open opportunities for controlling shareholders to take over assets from non-controlling shareholders in the form of tunneling through related party transactions.

In Indonesia, the phenomenon of cases related to an expropriation that is detrimental to non-controlling shareholders is the transfer pricing case which indicates a tunneling between PT Adaro and its affiliated company, Coaltrade Service International, Pte Ltd. PT. Adaro Indonesia sells coal below market price to its Singapore affiliate, Coaltrade Service International Pte. Ltd. Coaltrade buys coal from PT. Adaro for $ 32 per tonne and resold the coal at the then market price of $ 95 per ton. The transaction caused a decrease in PT. Adaro. In 2005, Adaro's profit was recorded at US $ 697.1 million. If calculated at market price, the profit earned was US $ 1.287 billion (Gatra, 2007). Coaltrade was able to record a net profit in 2005 of US $ 42.4 million even though it was only managed by five people. This transaction led to a transfer of profits from PT. Adaro to Coaltrade which indicated there was a practice of an expropriation. As a result of this transaction, minority shareholders in PT. Adaro (39%) suffered losses, while the welfare of Adaro and Coaltrade's controlling shareholder, namely PT. Padang Karunia increased due to losses at PT. Adaro was covered by the profits in Coaltrade. This phenomenon shows that the protection of the rights of non-controlling shareholders in Indonesia is still low.

The majority of previous studies examined what factors can influence an expropriation, for example the effect of ownership structure on expropriation (Shleifer and Vishny, 1986; La-Porta et al., 1999; Lemmon and Lins, 2003; and Utama and Utama, 2014), the effect of control rights and the difference in cash flow rights that maximize an expropriation (Johnson, La-Porta, Lopez-de-silanes, and Shleifer, 2000; Claessens, Djankov, and Lang, 2002; and Baek, Kang, and Park, 2004), so there are rarely studies that examine what factors can minimize an expropriation practice.

According to agency theory, good corporate governance can minimize the tendency for anexpropriation practices. The results of previous studies examining the effectiveness of corporate governance still show inconsistencies. Yeh, Shu, and Su (2012) and Hamid, Ting, and Kweh (2016) state that an expropriation practice in the form of tunneling can be minimized with good corporate governance. In addition, Lo, Wong, and Firth (2010) state that good corporate governance can prevent manipulation of transfer prices in related party sales transactions.

Based on agency theory, the problem of an expropriation can be overcome with a good corporate governance mechanism. Research on the effectiveness of corporate governance towards an expropriation is limited and the results are inconsistent. Lo et al., (2010) found that governance mechanisms in the form of a high percentage of independent directors, the presence of different people in the CEO and president director (chairman) positions, and the presence of financial experts on the audit committee will reduce an expropriation in the form of manipulating transfer prices on RPT. Hamid et al., (2016) also show that the corporate governance mechanism in the form of the number of independent directors on the audit committee and the separation of CEO and chairman (President Director) positions will reduce the level of an expropriation in Malaysia. Yeh, et al., (2012) also support previous research by showing that corporate governance practices using corporate governance index can limit tunneling.

However, a different result is shown by Sari and Taman (2011), namely that the governance mechanism is not able to reduce the tendency of tunneling risk. The research results by Sari, Djajadikarta, and Baridwan's (2014) also state that corporate governance is not the only effective factor to prevent tunneling. In addition, Juliarto, Tower, and Rusmin (2013) stated that corporate governance mechanisms in the form of national governance (business environment), foreign ownership structures, and independent directors are not effective corporate governance mechanisms in preventing tunneling but managerial ownership actually has a positive effect on tunneling.

Thus, research on the effect of corporate governance towards an expropriation practices still give the inconsistent results. Research that does not support the role of corporate governance in reducing an expropriation argues that the corporate governance used is still in the form of ownership structure, so it is necessary to use corporate governance effectiveness. In addition, there are also allegations of ineffective corporate governance mechanisms in Indonesia. The difference between this study and previous research is that the majority of previous studies tested the effect of individual corporate governance components towards an expropriation so that this study wanted to examine the overall effect of corporate governance mechanisms as a whole on an expropriation using corporate governance scores in order to have the validity of results that are more appropriate to the conditions currently. To bridge the inconsistencies in the results of previous studies, this study adds a moderating variable, namely Institutional Ownership which is the percentage of shares owned by institutional investors. Institutional ownership is chosen to be moderator because it can play a role in controlling or monitoring the actions of management or controlling shareholders to minimize the risk of an expropriation (Nielsen, 2007).

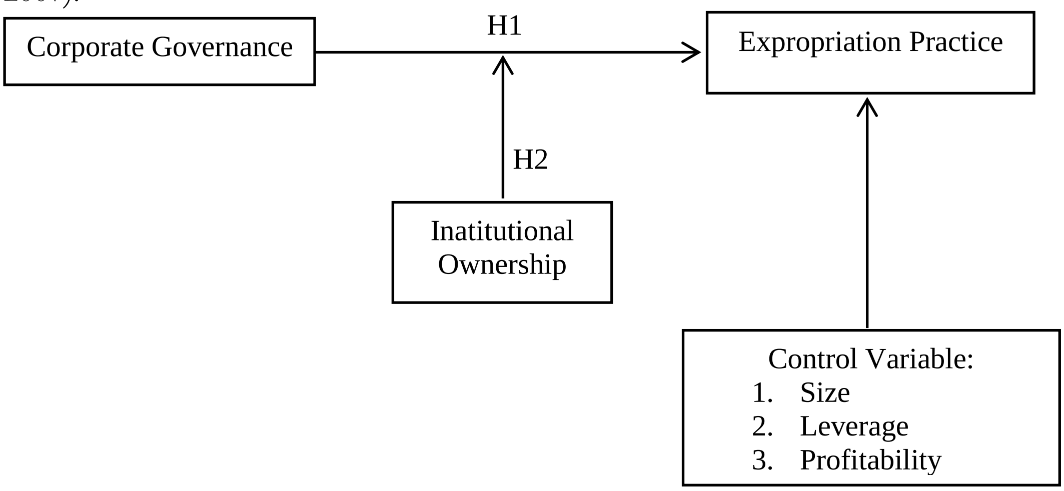

Figure 1. Theoretical Framework and Hypothesis Development

The problem of this research is whether corporate governance can affect an expropriation and whether institutional ownership can strengthen the affect of corporate governance toward an expropriation practices. The purpose of this study is to empirically examine the effect of corporate governance toward an expropriation and to examine whether institutional ownership can moderate the effect of corporate governance toward an expropriation.

The Effect of Corporate Governance toward An Expropriation Practices

When the ownership structure is concentrated, the amount of control in the company is indicated by the amount of control rights held by controlling shareholders (Claessens, Djankov, Fan, and Lang, 2002 and La-Porta, et al., 1999). Higher control rights than cash flow rights lead to higher probability of an expropriation practices (Johnson, et al., 2000; Claessens, et al., 2002; and Baek et al., 2004). The controlling shareholder can make operational or strategic decisions that benefit the controlling shareholder. This action can be detrimental to minority shareholders because controlling shareholders can get private benefits compared to non-controlling shareholders with weak control rights they have, so it is necessary to find solutions to overcome these problems.

With the agency theory approach, corporate governance mechanisms are used to protect the interests of minority or non-controlling shareholders by preventing opportunistic actions by controlling shareholders, including acts of an expropriation (Jensen and Meckling 1976). A strong corporate governance mechanism is expected to provide protection to investors and ensure a fair level of treatment for all shareholders so that a good corporate governance mechanism will prevent expropriation by controlling shareholders.

Several previous studies have found that corporate governance mechanisms have a negative effect toward an expropriation practice. For example, Lo, et al. (2010) found that the corporate governance mechanism in the form of a high percentage of independent directors, the presence of different people in the position of CEO and president director (chairman), and the presence of financial experts on the audit committee will reduce an expropriation in the form of manipulating transfer prices on RPT. Hamid, et al. (2016) also show that the corporate governance mechanism in the form of the number of independent directors on the audit committee and the separation of CEO and chairman (President Director) positions will reduce the level of an expropriation in Malaysia. Yeh, et al. (2012) also support previous research by showing that corporate governance practices using a corporate governance index can limit tunneling.

However, different results are shown by Sari and Taman (2011) who conducted research on the effect of implementing corporate governance mechanisms on tunneling risk for merger and acquisition activities carried out in acquirer and target companies. The results show that the corporate governance mechanism is not able to reduce the tendency of tunneling risk in merger and acquisition activities. Researchers indicate the cause of the hypothesis is not supported because the measurement of corporate governance using ownership structures has not shown the effectiveness of corporate governance. The results of this study are in line with the research of Sari, Djajadikerta, and Baridwan (2014) who also state that corporate governance is not the only factor that is effective in preventing tunneling.

In addition, Juliarto, et al. (2013) conducted a research on tunneling determinants in five ASEAN countries. The results show that the corporate governance mechanisms in the form of national corporate governance (business environment), foreign ownership structures, and independent directors are not effective corporate governance mechanisms in preventing tunneling but managerial ownership has a positive effect on tunneling. Thus, research on the effect of corporate governance toward an expropriation practices still experiences inconsistent results. Research that does not support the role of corporate governance in reducing an expropriation argues that the corporate governance used is still in the form of ownership structure, so it is necessary to use corporate governance effectiveness. In addition, there are also allegations of ineffective corporate governance mechanisms in Indonesia.

Gao and Kling (2008) conducted a study on tunneling in China which concluded that the corporate governance mechanism in the form of outsiders on the board of directors, unqualified audit opinion, share ownership by senior managers, and distributed ownership structures can prevent tunneling. However, this study does not support the results of previous studies which suggest that institutional ownership can prevent tunneling. Based on this description, the research hypothesis formulated is:

H_1: Corporate governance has a negative effect toward an expropriation practices

The Effect of Corporate Governance toward an Expropriation Practices Moderated by Institutional Ownership

The use of institutional ownership variables in this study is based on agency theory, namely the free cash flow hypothesis which states that institutional ownership will reduce agency conflicts between principals and agents (Jensen and Meckling, 1976). When a company has a greater amount of free cash flow, the controlling shareholder will have greater flexibility in making policies to utilize free cash flow. As a result of this condition, the principal (non-controlling shareholder) will bear the agency costs. Therefore, institutional investors appear to be able to influence firms not only on passive monitoring, but also by actively participating in firm control and decision-making processes (Pound, 1988; Smith 1996).

The research results of Balsam, Baltov, and Matrtquardt (2002) found that the existence of institutional investors has a negative effect toward an expropriation. Midiastuty and Machfoedz (2003) also found that the presence of high institutional ownership restricts each party from committing acts of an expropriation. The results of the research by Pound and Shiller (1964) concluded that institutional investors spend more time doing investment analysis and have access to information that is too expensive to obtain for other investors. Institutional investors will monitor effectively and will not be easily deceived by the actions of the agent (majority shareholder).

In addition, The Federal Reserve Financial Economists Roundtable (1988) also states that the existence of high institutional ownership is a positive phenomenon that can increase the effectiveness of corporate governance and can reduce the problems created by separating ownership from control, and considers supervisory activities by institutional investors as effective cost for the company. Institutional investors have a real interest and ability to influence corporate decisions that are much different from the small independent board representatives of investors (Chen, 2008). In addition, Cheung (2006) concluded that institutional ownership has a negative effect toward an expropriation practice. This supports Nielsen (2008) statement which concludes that institutional investors tend to reduce agency costs and the risk of an expropriation of minority (non-controlling) shareholders.

The basis for determining institutional ownership as a moderating variable in this study is that institutional ownership can be a substitute for corporate governance mechanisms in overcoming agency problems (Jensen and Meckling, 1976), and can reduce agency costs (The Financial Economists, 1988). With institutional ownership, it will be able to reduce the company's free cash flow which is potentially expropriated by controlling shareholders and institutional ownership can complement the implementation of corporate governance mechanisms in reducing an expropriation practices that are more effective as an effort to protect shareholders. This can also support the argument that institutional ownership can strengthen the negative effect of corporate governance toward an expropriation practices. Based on this description, the research hypothesis formulated is:

H_2: Institutional ownership strengthens the negative effect of corporate governance toward an expropriation practice

METHOD

This research is an explanatory research which tries to explain the existing phenomena with the object of public companies listed on the Indonesia Stock Exchange for the period 2014-2018. The sample in this study was taken by purposive sampling technique using the following criteria:

1. Public companies listed on the IDX and publishing annual reports for the period of 2014-2018 sequentially.
2. The reporting currency is stated in Rupiah's.
3. Companies that make sales with related parties.
4. Companies that do not experience losses during the observation period.

The method of collecting data is by means of documentation from the company's annual report which is taken through the official IDX website (www.idx.co.id). There are 50 companies that meet the criteria from 2014-2018.

Data analysis was used with the following stages:

1. Descriptive Analysis

Descriptive statistical analysis is used in this study to provide an overview of each research variable, namely corporate governance, an expropriation practices, and institutional ownership. Mean, standard deviation, mean, maximum, and minimum values were used as components of descriptive statistics.

2. Panel Data Regression Estimation Testing

Based on the collected data, the data in this study is panel data which is a combination of data that is time series and cross section data. To determine the appropriate technique for panel data regression, the following three tests are used:

a. *F Test* (*Chow Test*), conducted to compare or choose which model is better between CE and FE, that is, if the p value> 0.05, the selected model is CE, whereas if the p value <0.05, the model chosen is FE.

b. *Hausman Test*, conducted to compare or choose which model is the best between FE and RE, that is, if the p value is> 0.05, the model to be used is RE, while if the p value is <0.05, the model chosen is FE.

c. *Breusch and Pagan Langrange Multiplier* (LM) *Test*, used if the results of FE and RE tests are inconsistent, for example FE is a suitable model according to the Chow test but RE is a suitable model according to the Hausman test. To choose which model to use, this LM test was carried out, that is, if the p value> 0.05, the model selected was CE, whereas if the p value was <0.05, the model chosen was RE. In addition, Gujarati and Porter (2009: 605) state that the LM test is also carried out to ascertain whether there is a random effect or not in hypothesis testing. If the p value is> 0.05, the model chosen is FE, whereas if the p value is <0.05, the model chosen is RE.

3. Classic Assumption Testing

The hypothesis in this study was tested using regression testing with panel data processed by the Eviews program. Gauss-Markov in Winarno (2015: 4.2) states that a good linear estimator has the properties of Best Linear Unentif Estimator (BLUE) so that this test requires the fulfillment of four classical assumptions, namely the assumption of normality, heteroscedasticity, multicollinearity, and autocorrelation.

4. Hypothesis Testing

This study uses panel data regression analysis technique which consists of several regression equations in accordance with the research hypothesis. The form of statistical equation moderation testing for this study based on Ghozali (2011: 228), Hair, Black, Babin, and Anderson (2014: 177) is as follows:

$$EP_{it} = \alpha_1 + \beta_1\,CG_{it} + \beta_2\,SIZE_{it} + \beta_3\,LEV_{it} + \beta_4\,ROE_{it} + \varepsilon_{it} \quad \text{.....................(1)}$$

$$EP_{it} = \alpha_2 + \beta_1{'}CG_{it} + \beta_2{'}INS_{it} + \beta_3{'}SIZE_{it} + \beta_4{'}LEV_{it} + \beta_5{'}ROE_{it} + \varepsilon_{it} \quad \text{.....(2)}$$

$$EP_{it} = \alpha_3 + \beta_1\,CG_{it} + \beta_2\,INS_{it} + \beta_3\,CG_{it} * IO_{it} + \beta_4\,SIZE_{it} + \beta_5\,LEV_{it} + \beta_6\,ROE_{it} + \varepsilon_{it} \quad \text{..............................(3)}$$

Note:

EP : Expropriation Practice
CG : Corporate Governance
SIZE : Firm Size
LEV : Leverage
INS : Institutional Ownership
ROE : Profitability
i : entity to i
t : period to t
α : Constanta
β : Regression Coefficient
ε : Error

Hypothesis testing includes testing equation 1, testing classical assumptions and estimating panel data regression. Meanwhile equations 2 and 3 are used to test the regression equation with moderation so that the classical assumption and panel data regression estimates are no longer carried out. The regression equation with moderation is a development of the regression equation without moderation, which only adds the interaction variable between the independent and moderated variables so that the classical assumption testing and panel data regression estimates have been carried out when testing the regression equation without moderation.

RESULTS AND DISCUSSION

From the 250 observations used during the 2014-2018 period, descriptive analysis was carried out with the following test results.

Table 1. Descriptive Statistics

Variable	Mean	Maximum Value	Minimum Value	Deviation Standard
EP (VD)	8,02	12,50	3,26	2,32
CG (VI)	0,82	1,00	0,36	0,13
INS (VM)	0,65	0,98	0,07	0,17
SIZE (VK^1)	9,44	12,97	5,11	2,03
LEV (VK^2)	0,43	0,88	0,00	0,20
ROE (VK^3)	0,15	1,86	0,00	0,21

The results of the descriptive statistics above indicate that the standard deviation value of all variables is lower than the average value which indicates that the data is homogeneous and has low variability. Furthermore, the panel data regression model was selected using the Chow test, Hausman test, and Lagrange Multiplier with the following results:

Table 2. Estimation Results of the Chow Test, Hausman Test, and Lagrange Multiplier Test Regression Model

Chow Test (Cross section Chi-Square)	Hausman Test (Cross section random)	Lagrange Multiplier Test (Breusch-Pagan, both)	Conclusion The right model
19,105968*	23,149761*	248,7219*	*Fixed Effect Model*

Note : *) Significant at the 5% significance level

Based on the test results determining the panel data regression model estimation technique using the Chow test, Hausman test, and the Breusch-Pagan Lagrange Multiplier (LM) test, it shows that the Fixed Effect Model (FE) is the right panel data regression model estimation technique for all hypothesis testing research. Furthermore, the results of the classical assumption test, namely normality test, heteroscedasticity test, multicollinearity test, and autocorrelation test are fulfilled with the following results:

Table 3. Classical Assumption Test Results

Normality Test (prob. Jarque Bera)	Heteroskedasticity Test (parameter coefficients for each independent variable)	Multikolinearity Test (correlation value between variables >0,8	Autocorrelation (Durbin-Watson stat/ *d*)
0,228828	2,790100	Tidak ada	175,2682

Note : *) Significant at the 5% significance level

Furthermore, the elaboration of the test results is divided into two parts, namely (1) testing the first equation regarding the effect of corporate governance toward an expropriation practices and (2) testing the second and third equations related to the effect of corporate governance toward an expropriation practices moderated by institutional ownership.

1. Hypothesis Testing 1 (without modetaion)

$$EP_{it} = 6{,}365 - 1{,}584CG + 0{,}371SIZE - 1{,}126LEV - 0{,}352\ ROE$$

2. Hypotehsis Testing 2 (with moderation)

$$EP_{it} = 6{,}338 - 1{,}588CG + 0{,}048INS + 0{,}371SIZE - 1{,}128LEV - 0{,}351ROE$$

$$EP_{it} = 5{,}155 - 0{,}116CG + 2{,}231INS - 2{,}761CG * INS + 0{,}374SIZE - 1{,}133LEV - 0{,}355ROE$$

The first hypothesis (H1) states that corporate governance has a negative effect toward an expropriation practices accepted so that it can support the research results of Lo et al., (2010), Yeh et al., (2012), and Hamid et al., (2016) which state that implementation of corporate governance can reduce the practice of an expropriation. This study explains the type II agency conflict that occurs between controlling and non-controlling shareholders, which is described through related party sales transactions which have the opportunity to cause transfer pricing manipulation that can be carried out by related parties as a form of an expropriation practice. To overcome this problem, every company tries to implement good corporate governance that can minimize the appearance of an expropriation practices. To minimize opportunities for an expropriation practices, the application of corporate governance is expected to pay attention to the rights and interests of stakeholders and with good corporate governance, it is hoped that it can ensure a balanced treatment for stakeholders, so that the risk of agency conflicts can be minimized.

The research regression equation obtained by the estimator is as follows:

Table 4. Summary of Panel Data Regression Results

Explanation	Variable	Regression Coefficient	*p-value*	R^2	Sig. F *Change*
Equation 1 (Hypothesis 1)	Constanta	6,365	0,000	0,930	0,000
	CG	-1,584	0,022		
	SIZE	0,371	0,000		
	LEV	-1,126	0,043		
	ROE	-0,352	0,282		
Equation2 (Hypothesis 2)	Constanta	6,338	0,000	0,930	0,000
	CG	-1,588	0,023		
	SIZE	0,371	0,000		
	LEV	-1,128	0,043		
	ROE	-0,351	0,283		
	INS	0,048	0,936		
Equation 3 (Hypothesis 2)	Constanta	5,155	0,006	0,930	0,000
	CG	-0,116	0,956		
	SIZE	0,374	0,000		
	LEV	-1,133	0,043		
	ROE	-0,355	0,279		
	INS	2,231	0,467		
	INS*CG	-2,761	0,468		

The test results for each hypothesis formulated in this study are as follows:

Table 5. Hypothesis Testing Results

Hypothesis	***p-value***	**Decision**
H1	0,022	Accepted
H2	0,468	Rejected

Therefore, the results of this study can confirm the application of agency theory, particularly the type II agency theory (between controlling and non-controlling shareholders) which usually appears in companies with concentrated ownership. In addition, the results of this study have also answered Claessens and Fan's (2003) research which states that conventional corporate governance mechanisms are considered insufficiently relevant to dealing with agency problems in Asia so that another mechanism is needed to improve them, namely the existence of a corporate governance index score that is has been used in this research. The use of corporate governance scores in this study can also be a relevant reference for assessing how the implementation of corporate governance that has been implemented in the company can balance the rights and interests of stakeholders.

The second hypothesis (H2) in this study states that institutional ownership can moderate the negative effect of corporate governance toward an expropriation practices. The results of the second hypothesis testing (H2) is rejected, so the results of this study cannot support the results of Nielsen's (2007) study which states that institutional investors in the company can monitor the existence of an expropriation practices by controlling shareholders.

According to agency theory related to the free cash flow hypothesis, institutional ownership can minimize conflicts of interest within the company, but it still shows inconsistent research results. Researchers suspect that institutional ownership cannot moderate the negative effect of governance toward an expropriation practices because the amount of institutional ownership in public companies listed on the Indonesia Stock Exchange tends to be constant every year and most of them are a group of companies themselves that become the majority shareholder. This is supported by the statements of La Porta et al., (1999), Claessens, Djankov, and Lang (2000), and Faccio and Lang (2002) which state that various companies tend to be controlled by controlling shareholders which looks very real and clear. This occurs because there are various pyramid ownership mechanisms and cross-ownership are commonly found in many developing countries, including Indonesia. Therefore, institutional ownership has no effects on related party sales transactions which are used as a measure of the company's tendency to an expropriation practice and moderate the influence of corporate governance in minimizing an expropriation practices.

The results of this study do not support the results of previous studies, namely research by Cheung, Rau, and Stouraitis (2006) and Chen (2008) which state that institutional ownership can minimize the risk of an expropriation practices. However, the results of this study support the results of Lemmon and Lins (2003), which states that institutional ownership cannot minimize an expropriation practices.

CONCLUSION

The results of this study have proven the agency theory approach that with the implementation of good corporate governance, the company is able to provide protection to stakeholders by paying attention to each stakeholder's rights and interests so as to minimize an expropriation practices that can harm non-controlling shareholders. In addition, institutional ownership cannot strengthen the influence of corporate governance in an effort to minimize an expropriation practices that are proxied by related party sales transactions, so this research cannot prove the agency theory related to the free cash flow hypothesis which is one of the causes of agency conflicts when the company does not use cash accordingly.

The measurement of corporate governance variables uses a corporate governance score index adopted from OJK Circular No. 32 of 2015 concerning Guidelines for the Implementation of Public Company Corporate Governance is proven to be able to improve conventional corporate governance mechanisms in reducing the practice of an expropriation in Indonesia which tends to concentrate companies.

Furthermore, the results of this study explain that the agency theory of free cash flow is less relevant in Indonesia because from their ownership structure, public companies in Indonesia adhere to a pyramid ownership structure, which has ownership of a company through another company (Claessens, et al., 2000). This shows that there is a high disclosure of institutional ownership in public companies in Indonesia, only to comply with applicable regulations.

The limitation of this study is that some companies only disclose general corporate governance practices which make it difficult for researchers to assess whether the company is not implementing certain corporate governance practices or whether the company has done so but is not described in detail in the company's annual report. Therefore, further research is recommended to consider the addition of other data sources related to corporate governance, for example using company information contained on the website of each company.

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