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THE INFLUENCE OF OWNERSHIP, TOTAL ASSET AND COMPETITION ON FINANCIAL DISCLOSURE OF MANUFACTURING COMPANIES LISTED IN INDONESIA STOCK EXCHANGE

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Abstract

The purpose of this study is to investigate whether the extent of company disclosure in Indonesia are affected by the internal factors and external factor. Many previous studies related to disclosure conducted in Indonesia only focused to the internal factors, e.g. total asset and ownership structure (blockholder). Unlike previous studies, we address the impact of competition as an external factor to company disclosure level. Furthermore, this study uses Botosan Index and Herfindahl Index (HI) as a proxy for the extent of disclosure and competition. The result shows that total asset, blockholder and competition has a positive influence on company disclosure level

Keywords: Competition, Herfindahl Index, Disclosure, Ownership structure

BACKGROUND

The Agency Theory implies there is asymmetric information¹ between management as the agent and the principal (owner). According to Jensen and Meckling (1976), agency problem occurred when the manager hide some information to the principal and divert the company asset to maximize their utility. As consequences, the agency problem can have a detrimental effect on shareholder value. Lang and Lundholm (1996) state a company can minimize asymmetric information between manager and shareholder by increasing a company disclosure. The company disclosure can be improved by providing not simply mandatory information (mandate disclosure) but additional information (voluntary disclosure) as well.

The advantages of higher disclosure are : 1) Higher disclosure reduced the cost of equity (Botosan (1997); Tjakrajinata (2000); Sitanggang (2002); Adhariani(2004); and Budiarti (2007)); 2) Sengupta (1998) found that higher disclosure reduced the cost of debt. Higher disclosure improves the lender perception related to default risk of the company. Furthermore, the credit analysts will have more informed company strategy and their ability to repay debt.

¹ According to Scott (2000), there are two types of asymmetric information: adverse selection and moral hazard. The adverse selection refers to the willingness of the investor who has less information to buy the company stock merely with the lower price to compensate the agency problem caused by the manager in the future. Moral hazard problem occurred when the manager act inappropriately to the principal whom has less information and cannot perfectly monitor the manager.

Some studies show that large shareholder (blockholders) has a positive relationship with company disclosure (Healy, Hutton and Palepu (1999); Jiambalvo, Rajgopal and Mitchell, Chia and Loh (1995); Aitken, Hooper and Pickering (1997)). The blockholder² control the company decision making included the decision related to the company disclosure. The blockholders have a greater willingness to discipline poorly performing management and more incentive to intervene and exercise 'voice' (Mayer (1997), Schmalensee and Willig (1989); and Tirole (1990)).

The other studies find that value of total asset has a positive relationship with the extent of company disclosure. Chow and Wong-Boren (1987); King, Pownal and Waymire (1990); Bradbury (1991); Bradburyy (1992); McKinnon and Dalimunthe (1993); and Berger and Hann (2002)). Bradbury (1991) state the bigger value of total asset but not followed proportionally by a higher disclosure will suffer a greater potential loss relatively than a small asset. Consequently, the shareholders tend to increase monitoring and implementation of high disclosure policy. Furthermore, Singhvi (1971) state that the company which has a bigger value of asset necessarily implement a high disclosure policy because the easier access flexibility to the financing and to increasing the stock liquidity.

The previous study shows the influence of blokholders and total asset to the extent of company disclosure. On the other hand, Bilson, Smith and Whaley (2006) stress the influence of competition as an external factor to the extent of company disclosure. There is a trade-off to implement a higher disclosure. In the industry with highly competitive environment, providing more voluntary disclosure on company annual report would have more advantage. Its voluntary disclosure should give more information about business strategy and their competitive advantage to the investor. Investor's positive perception on company stock would be beneficial to the existing stockholder. Verrecchia (2001) explain that in the industry with highly competitive environment, the potential loss caused by the new entrants and existing competitor relatively lower than the industry with low competitive environment. For a company that operated in low competitive environment, a voluntary disclosure on annual report result more disadvantage than a potential loss caused by the increasing competition from new entrants and existing competitors (Darrough and Stoughton (1990); Dye (2001); and Verrecchia (2001)). Furthermore, Dye (2001) state that in the industry with low competitive environment, increasing level of company disclosure would cause a potential loss of company cash flow because the competitor reduced the company market share. Therefore, the empirical study shows that competition as an external factor affects a company disclosure level.

Based on previous studies, we can summarize that both of total asset and ownership structure as internal factors and competition as external factor has a positive influence on company disclosure level. Eventhough, many previous studies related to disclosure conducted in Indonesia only focused to the internal factors, e.g. total asset and ownership structure like blokholders (Tjakradinata, 2000; Sitanggang, 2002; Adhariani, 2004; dan Budiarti, 2007). Unlike previous studies, we address the impact of competition as an external factor to company disclosure level. Therefore, the objective of this study is to investigate the influence of large

2 Beside percentage of ownership large (block) holder, Singhvi (1971) uses the other proxy for ownership by using the number of shareholder

shareholder, total asset and competition to disclosure level on publicly listed company on Indonesia Stock Exchange. We include sample simply manufacture due to these companies tend to disclose more items compared to non-manufacture companies (Lincoln and Kalleberg (1990); Cooke (1989); Choi and Hiramatsu (1987); and Stanga (1976)).

The remainder of this paper is organized as follows. The second section provides literature review and hypothesis development. The third section describes research methodology meanwhile the fourth section explains results. The final section provides conclusion and implication.

HYPOTHESIS DEVELOPMENT

Healy, Hutton and Palepu (1999); Jiambalvo, Rajgopal and Mitchell, Chia and Loh (1995); Aitken, Hooper and Pickering (1997) show that institutional ownership is positively correlated with company disclosure level. Their studies find that institutional ownership plays an active role in the monitoring and control of the firm. As a result, they assure that management action align with the shareholders' objective.

Mayer (1997), Schmalensee and Willig (1989); and Tirole (1990) state that institutional ownership is able to enforce management to increase the voluntary disclosure and finally reduce the information asymmetry between management and shareholders. The institutional ownership with a greater ownership concentration and higher voting right exert their control over management by using as an example: reward decision (i.e., giving more incentive or bonus to management) or punishment (i.e., to fire and replace the management or no-bonus to management). This finding is affirmed by Michell, Chia dan Loh (1995) dan Aitken, Hooper dan Pickering (1997) as well. They contend that higher dispersed ownership structure is associated with lower level of company disclosure.

Birt, Bilson, Smith and Whaley (2006) conclude that large shareholder (e.g. blockholder) exert a control to company decision including disclosure policy. Birt, Bilson, Smith and Whaley (2006) also argue that blockholder would motivate company to increase disclosure in order to mitigate not only interest between shareholder and management but also among shareholder. This study finds a positive relationship between ownership concentration and disclosure level. Therefore, the first hypothesis is:

H1: Ownership by large shareholder is positively correlated with company disclosure level

Beside ownership structure, company with larger of total asset tends to increase their disclosure level. A company with a large of total asset will maintain their asset in order to not to decrease or even loss due to improper policy or management frauds. Bradbury (1991) argues that a company with large of total asset but does not implement high disclosure level will suffer more potential loss than a company with small of total asset. Furthermore, Foster (1986); McKinnon and Dalimunthe (1993); Bradbury (1992); and Berger and Hann (2002) explain that company with larger of total asset will implement high disclosure policy to mitigate the agency problem between management and shareholders.

Singvi (1971) argues that company with larger of total asset will implement high disclosure policy because the advantage of easier access to get external financing and increasing the stock liquidity. Meanwhile, Sengupta (1998) explain that a company with larger

of total asset tend to disclose more because the information about company asset is a 'good news' to investor. A larger of total asset will show that a company has a good reputation and ability to repay their loan or credit. As a result, the creditor will charge a lower cost of debt.

The positive impact of total asset to company disclosure is supported by Birt, Bilson, Smith dan Whaley (2006) as well. Buzby (1975) also assert that a company with larger of total asset will has sufficient resources and an information system to help company in collecting and providing information. Based on previous study, the second hypothesis is:

H2: Total value of asset has a positive relationship with company disclosure level

Dye (2001) argues that if the company disclosure is not mandatory, company only provide favorable information to the stakeholders. Company will not disclose unfavorable information that seems disadvantage to the company. The cost occurred due to disclose unfavorable information is called a proprietary cost (Verrecchia (2001)). A proprietary cost is a trade-off between incentive and disincentive in consequence of the company implements high disclosure policy. The incentive is to increase the stock price meanwhile the disincentive is a loss of market share (Verrecchia (2001)).

Verrecchia (2001) investigates the role of proprietary cost in order to explain why company act reluctantly to disclose additional information (voluntary disclosure). Verrecchia (2001) argues that companies operate in a low-competitive environment has disincentive to reveal voluntary disclosure. They assume that the voluntary disclosure will disclose too much information to their competitor and reduce their market share. Conversely, companies that operate in a highly competitive environment will have a greater incentive to disclose because the potential loss of market share is relatively lower than low competitive environment. By releasing additional information could be beneficial to the company because it could reduce asymmetric information between management and the shareholders (Hayes & Lundholm (1996); Harris (1998); Botosan and Stanford (2005), Harris (1998)). Therefore, we state the third hypothesis is:

H3: The competition is positively correlated with company disclosure level

RESEARCH METHOD

Variable Measurement

In measuring a company disclosure level, it is commonly used a scoring or index that can be calculated based on disclosure items on a company annual report. In US and European countries there is a rating for disclosure level which is published by Association for Investment Management and Research (AIMR). This rating can be a reference to investor to measure a disclosure level of listed companies.

In addition to rating released by AIMR, a several studies like Cerf (1961); Mautz and May (1978); Fith (1979); Nair and Frank (1980); Lee and Twedie (1981); Gray, Sweeney and Shaw (1984); Gray and Robertson (1989); and Cooke (1988, 1992) introduce several index as an alternative of company disclosure measurement. A disclosure index can be used to measure how compliance (obedient) a company to government or stock exchange regulation. This index should be as an indicator of mandatory disclosure and/or voluntary disclosure. It is counted based on the explanations on company annual report regarding company financial

status and its performance. All of information must be revealed, in qualitative or quantitative, in order to help stakeholders in a decision making (Siegel and Shim (1994)).

Cerf (1961) uses a disclosure index that consist several disclosure items. These items are constructed after studying on investment decision-making process, by exploring how the decisions are made by conducting some interview with security analysts and doing some tests on reports produced by analysts. Another study, Cooke (1992) uses 165 disclosure items included mandatory and voluntary disclosure items. His research constitutes further evidence on Shingvi and Desai (1971) empirical research.

Botosan (1997) use disclosure quality by using an index that is calculated based on information provided in annual report³. Botosan (1997) explains that annual report can be used to measure quality of disclosure. Lang and Lundholm (1993) in Botosan (1997) state there is a positive relationship between annual report and other company publications (a coefficient is 0.62) and between annual report and investor relation disclosure rating (a coefficient is 0.41). Botosan (1997) mentions that disclosure on company annual report could be a good proxy of company disclosure.

Botosan (1997) state that disclosure index are classified into the following five categories : background information, summary of historical, key non-financial statistics, projected information and management discussion and analysis. Each main segment has total score that is measured by using several disclosure items. Each disclosure item has maximum score. The score depends on variant information provided in annual report. In measuring each item, Botosan (1997) provides the list of disclosure items with explanation and guidance (anchor) to define the score. It is useful to minimize subjectivity in defining the score.

In contrast to US and Europe, Indonesian has no institution that provides disclosure index such as Association for Investment Management and Research (AIMR). Furthermore, most of studies related to measure disclosure level in Indonesia use Botosan Index (Tjakradinata (2000); Adhariani (2004); and Budiarti (2007)). As mentioned above, Botosan index could minimize subjectivity in measuring company disclosure.

In measuring disclosure level, it is required to understand the style and format of annual report of listed companies. In Indonesia, Badan Pengawas Pasar Modal (Bapepam) and Lembaga Keuangan as a regulator to monitor stock exchange in Indonesia has released a decree No: KEP-134/BL/2006 Regulation No X.K.6 that state there is obligation for publicly listed companies to publish an annual report. The decree also provides a guidance of the style and content of annual report that is mandatory to be informed to the public. According to that decree, companies have to verify significant changes compared to the last annual report (called as a management discussion and analysis).

The decree also provides the style and format of annual report in general which is consist of important financial summary, commissioner's report,⁴ Board of Director (BOD) report, company profile, management discussion and analysis, good corporate governance, responsibility of BOD on annual report, and audited report. Specifically on management dis-

3 The company can also provide a quarter and semester report, corporate actions, and another published information directly to the mass media.

4 Indonesian companies generally apply a two-tier approach of corporate governance which is the control of managing directors lies in the hand of a separate supervisory board.

discussion and analysis, a company has to explain the following information, i.e : operational review on each segment of business, financial performance analysis, management discussion and analysis on business condition, significant changes, impact to the company, prospect and achievement and also explanation about accounting policy that is used. The company can give additional information (voluntary disclosure) as well such as information about company strength (or other 'good news') which can be beneficial to the company. Measuring of a company disclosure level can be performed by determining and evaluating the disclosure items that are given in annual report (which has to comply with the regulation standard).

In this study, the value of disclosure is calculated based on the list of disclosure items and weighted according to weighted item based on study by Botosan (1997). The formula of total disclosure value is given below:

$$TSCORE_i = \sum_{i=1}^5 SCORE_{ij}$$

Disclosure total (TSCORE) is total score for company j in category i to all category (category 1 to 5). This score then will be divided by maximum score of disclosure level:

$$DISC_j = \frac{\sum_{i=1}^5 TSCORE_{ij}}{\max(TSCORE_i)}$$

Ownership structure is proxied by average percentage of large shareholder (block holder). Large shareholder is defined as shareholder who own more than 5% of outstanding shares. The higher percentage of large shareholders shows more concentrated ownership.

The competition level reflects the competition among companies which belong in the same industry classification (SIC). To measure the competition level, we use Herfindahl Index (HI)⁵. The value of competition is 1 minus Herfindahl Index (1-HI) and has a range between 0 until 1. If the value close to zero, it means that the competition is low meanwhile the value close to one means the competition is high. To calculate HI for each industry based on SIC, the study used the formula:

$$HI_j = \sum_{i=1}^{n_j} \left(\frac{R_{ij}}{R_j} \right)^2$$

R_{ij} is a revenue of company i in industry j , n_j is a number of companies in industry j .

5 The other proxy for competition is Concentration Ratio (CR). It is called CR-4 or CR-8 which reflect the number of four or eight mean the number of biggest companies (Leuz (1999) and Harris (1998). This proxy is not used in this study due to not all industries have at least four public listed companies. This study uses Herfindahl Index because this index is commonly used in other research and also by US Department of Justice to investigate fraud of antitrust (Birt, Bilson, Smith and Walley (2006)). Besides Helfindahl Index is also well known Herfindahl-Hirschman Index (HHI) that has the same value with Herfindahl Index (HI) multiply by 10000. HHI has value 0 to 10000. If the value closes to 0, it shown perfect competition meanwhile if the value closes to 10000 means the market or industry is monopoly.

$$R_j = \sum_{i=1}^{n_j} Rij$$

R_j is the revenue total of all companies in industry j .

Sample

To be included in the final sample, the observation has to meet the following criteria: 1) The companies are manufacturing companies that publicly listed in Indonesia Stock Exchange; and 2) The company has an annual report in 2006. Furthermore, this study uses Standard Industry Code (SIC) to determine industry classification. This information is obtained from OSIRIS data base per April 1, 2008. On the other hand, we use one year annual report to measure company disclosure with the assumption that the format of annual report is constant over time and hence the annual report is a good proxy of overall company disclosure as well (Botosan, 1997).

Empirical Model

We employs Ordinary Least Squares Regression as shown below to investigate the influence of large shareholder, competition and total asset to disclosure level.

$$DSCORE = \beta_0 + \beta_1 * O + \beta_2 * C + 3 * TA + \varepsilon \quad \dots \dots \dots (1)$$

where

- o = Intercept
- O = Large shareholder is defined as shareholder who own more than 5% of outstanding shares
- C = Competition
- TA = log(Total Aset)
- ε = error

EMPIRICAL RESULT

The Result of Sample Selection

The result of sample selection is shown in table below:

Table 1
Summary of Sample Selection Procedure

Sample Data	Total	
	Company	SIC
Number of companies in manufacturing industries based on SIC (from OSIRIS)	107	24
Number of companies that is not reported 2006 annual report or the data is not available	6	1
Number of selected samples	101	23

Descriptive Statistic

The descriptive statistic on Table 2 shows that the distribution of average company disclosure level is 0.562408, meaning that companies disclose 56% disclosure items of Botosan Index. Based on average disclosure level result, 46 out of 101 companies have above average value. This result shows that the transparency level of manufacturing companies on Indonesia Stock Exchange is relatively lower. Furthermore, there is wide variation of disclosure level among manufacturing companies, i.e. between 0.228 and 0.9764. The relatively same result is shown by industry disclosure level as well on Table 3. The average value of industry disclosure level on Table 3 is 54.6. %, meaning that 12 out of 23 industries has below average value.

The competition level in the industries (denoted by C and measured by using Herfindahl Index (1-H)) shows the average of competition in industry is 0.582. There are 12 industries with value below mean HI industries. The lowest value is industry with SIC 262 (paper mills) with HI value 0.0043. Meanwhile the maximum HI value is industry with SIC 335 (rolling, drawing and extruding of nonferrous metals) with value 0.08316.

As shown in Table 4, the industry with SIC 324 (Cement, Hydraulic) has the highest disclosure level (0.7614). This industry has the average of large shareholder ownership (56.07 %) and the average of total asset (9.9021) which is higher compared to value of average large shareholder ownership (38.24%) and average of total asset (8.655) of all industries. Furthermore, the average value of competition for this industry (0.6155) is higher compared to average value of competition for all the industries (0.5196).

Table 2
Descriptive Statistic of Data Distribution for the Companies in 2006

	N	Range	Minimum	Maximum	Mean	Std. Deviation	Variance
Disc	101	.7481	.2283	.9764	.562408	.1478891	.022
TA	101	5.0937	5.2434	10.3371	8.651523	.8986841	.808
C	101	.8273	.0043	.8316	.582347	.2096920	.044
G	101	.91	.09	1.00	.3791	.25260	.064

Table 3
Descriptive Statistic on Distribution Data for Industries in 2006

	N	Range	Minimum	Maximum	Mean	Std. Deviation	Variance
DISC	23	.4307	.3307	.7614	.546826	.0985750	.010
O	23	.65	.18	.83	.3824	.18259	.033
TA	23	2.8500	7.0521	9.9021	8.655248	.6369608	.406
C	23	.8273	.0043	.8316	.519600	.2176460	.047

On the other hand, the industry with SIC 313 (steel works, blast furnaces and rolling and finishing) has the lowest disclosure level. This industry has the average ownership of large shareholder (25.9%) which is relatively lower than the average ownership of large shareholder in all industries (38.24%). The total asset of this industry is 7.9741 and the competition is 0.4297 that are relatively lower than the average of total asset (8.655) and competition (0.5196) of all industries.

Table 4
Data Distribution of the Industries in 2006

SIC	Average of Disc	Average of O (%)	Average of TA	Average of C	Companies Total
204	0.6689	42.30	9.0911	0.6036	4
208	0.6315	69.11	8.7039	0.6071	4
209	0.4472	27.66	8.7748	0.1306	5
211	0.5433	64.22	9.7421	0.5072	3
228	0.6066	35.93	7.8931	0.5749	6
229	0.5870	26.86	8.8506	0.7832	7
232	0.6378	18.16	8.9626	0.4305	3
243	0.6000	30.30	8.8146	0.6773	4
262	0.4725	61.04	7.8343	0.0043	2
267	0.5514	18.57	9.2034	0.6489	3
283	0.6424	60.09	8.7140	0.7165	9
284	0.4843	40.77	8.1103	0.1735	4
289	0.5121	30.32	8.5609	0.6971	9
301	0.4882	30.13	9.2254	0.3667	3
308	0.5173	30.38	8.3347	0.7712	9
314	0.4370	32.48	8.2989	0.5489	2
324	0.7614	56.07	9.9021	0.6155	3
325	0.5459	20.24	9.0305	0.3269	3
331	0.3307	25.99	7.9741	0.4297	2
335	0.6308	20.81	8.7574	0.8316	7
341	0.4016	33.75	8.2897	0.3578	2
349	0.4751	21.73	7.0521	0.4579	3
371	0.6040	82.68	8.9501	0.6899	4

Based on result of descriptive statistics above, we conclude that disclosure level tend to increase along with ownership of large shareholder, total asset and competition level.

Analysis of Correlation among Variables

The result of correlation test shows that consistent with expectation, coefficient of total asset and competition correlate positively with disclosure level at significant level 1 % meanwhile coefficient of large shareholders ownership correlate positively with disclosure level at significant level 5 %.

Table 5
The Pearson Correlation Test among Variables
Correlations

		Disc	O	TA	C
Pearson Correlatic	Disc	1.000	.200	.260	.292
	O	.200	1.000	.044	.007
	TA	.260	.044	1.000	.101
	C	.292	.007	.101	1.000
Sig (1-tailed)	Disc		.023	.004	.002
	O	.023		.331	.471
	TA	.004	.331		.471
	C	.002	.471	.158	
N	Disc	101	101	101	101
	O	101	101	101	101
	TA	101	101	101	101
	C	101	101	101	101

Regression Analysis

Analysis of regressions conducted after validity check that assumption of OLS regression is fulfilled. As shown table 6 this model has R^2 30%, meaning that the internal factors (ownership of large shareholder and total asset) and the external factor (competition) can explain 30 % variation of company disclosure level.

Table 6
Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.549a	.302	.280	.1154597

a. Predistors : (Constant), TA, O, C

b. Dependent Variable : Disc

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	.090	.135		.670	.505	-.178	.359
	O	.110	.054	.188	2.033	.045	.003	.217
	TA	.037	.015	.225	2.422	.017	.007	.067
	C	.189	.065	.268	2.891	.005	.059	.319

a. Dependent Variable: Disc

The coefficient of ownership structure is 0.110 and significant level at 5 %. So, this study finds that there is positive relationship between ownership of large shareholder and company disclosure. This finding support that the large shareholder with a greater ownership concentration will enforce management to implement high disclosure policy in order to assured management act in the best interest of shareholder.

This study finds the coefficient value of total asset is positive (2.422) and significant at the 5 % level (p-value = 0.017). Therefore, it proves that the larger total asset will enforce the company to increase their disclosure level. This finding supports the argument that: 1) potential loss caused by agency problem is higher for company with larger total asset (Foster (1986); McKinnon and Dalimunthe (1993); Bradbury (1992); and Berger and Hann (2002)); 2) increasing transparency of larger total asset will show company's good reputation. Furthermore, company will get easier access to external financing (Sengupta, 1998).

The coefficient of competition is positive (2.891) and significant at the 1 % level (0.005). It shows higher competition encourages the company to increase their disclosure. This finding supports the argument that companies in a highly competitive environment will have a greater incentive to disclose because the potential loss of market share is relatively lower than low competitive environment. By releasing additional information could be beneficial to the company because it could reduce asymmetric information between management and the shareholders (Hayes and Lundholm (1996); Harris (1998); Botosan and Stanford (2005), Harris (1998); Botosan and Stanford (2005)).

CONCLUSION AND IMPLICATION

This study shows that disclosure level of public listed companies on Indonesia Stock Exchange are affected by: 1) internal factors: i.e., ownership of large shareholder and total asset; 2) external factor, i.e. competition. Using Botosan Index as a proxy of company disclosure and Herfindahl Index as a proxy of competition, the result shows that ownership of large shareholders, total asset, and competition has a positive influence on company disclosure.⁶ The implication of this study is the government should play an active role to encourage favorable business competition so the high competition can motivate companies

6 However, the ownership of large shareholders could raise agency problem between large shareholders (majority shareholders) versus minority shareholders.

to implement high disclosure. Furthermore, regulator on stock exchange (Bapepam & LK) and Indonesia Stock Exchange should improve the mechanism to increase disclosure level of public listed companies in Indonesia in order to create better fairness business environment and risk-protection for investors.

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