

The Effect of Pyramidal Ownership Structure to the Financing Policies and Firm Value in Indonesia: Cronyman as Moderating Variable

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Abstract

The research to examine the effects of ownership structures on financing policies and firm valuation. The populations are all listed companies in Indonesia Stock Exchange for period of 2013 and 2015. The sample selection technique used purposive sampling and resulting in a final sample of 72 listed firms. Empirical tests are conducted using multiple regressions and two stages least squares regression to test the simultaneous relationship between ownership structure, financing policies and firm value. The estimated results provide support for the hypotheses proposed that the separation of cash flow rights and control rights have led the use of excess leverage among pyramidal companies to preserve ultimate owner's control. However, we failed to find a significant relationship between firm's leverage and firm's value. The conclusion is the simultaneounity relation between ownership structure, leverage and firm value appear that only the ownership structure significantly related with leverage and firm value. Also firm value and leverage ownership impact the ownership structure. Meanwhile, leverage does not appear to have a significant relation with the firm value, or the other way around.

Keywords: ownership structure; ultimate ownership; financing policies; firm values jel classification

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INTRODUCTION

The literature of corporate governance and agency problem had been discussed around the conflict of interest between owners and managers (Boshkoska, 2014). Faccio, Lang, & Young (2001) find evidence that the ownership of corporations in the United States has been not so widely dispersed and more concentrated which dominated by family companies, other studies later had confirmed this evidence such as the study from Tan (2012) found evidence that corporations on such countries have been more concentrated with just a few family companies dominated the whole economy.

The controlling shareholders often use the pyramidal structure, cross-holding structures and dual-class shares to enhance control of the firm. Therefore the centre of agency problem has shifted from owner manager problem to the majority owners and minority owners (Porta & Lopez-de-silanes (1999). Pioneer to the work of Porta & Lopez-de-silanes (1999) there has not been found systematical evidence displaying pattern of ownership structure on public company

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because they used the concept of immediate ownership instead of ultimate ownership.

Another concept of ownership suitable for firms with concentrated ownership is ultimate ownership which is direct and indirect ownership on public corporation. Indirect ownership is ownership on public corporations through chain of ownership. Ultimate ownership has the ability to solve the problem of immediate ownership. Therefore, it can be used to identify chain of ownership, ultimate owner, separation of cash flow rights and control rights, also the mechanism of enhancing voting rights. Ultimate owner of a company can be individuals, family, institution or government. Through ultimate ownership, ultimate owner can achieve superior control on a company despite his low or insignificance cash flow rights (Claessens et al., 2000; Claessens & Yurtoglu, 2012; Porta & Lopez-de-silanes, 1999).

A large body of literature does confirm the evidence that corporate governance, particularly the role of ownership structure, is crucial in determining the incentive of insiders to expropriate minority shareholder. The impact of corporate governance on the firm value has been extensively carried out in recent years. Bistrova & Lace (2011); Michelberger (2016); Mohamed & Elewa (2016); dan Owala (2010) finds that the corporate governance has a strong impact on firm stock performance. The better performance is associated with firms that have higher disclosure quality, higher outside ownership concentration, and lower diversified operations.

While there is substantial empirical evidence regarding the relation between ownership structure and firm value, it has nevertheless been difficult to conduct irrefutable tests of this hypothesis. A primary problem has been disentangling the endogeneity issues that arise because ownership structure, investment opportunities, financing decisions, dividend decision and firm value may all be jointly determined (Yang, 2012).

Bae, Baek, Kang, & Liu (2012) report that minority shareholders have been expropriated extensively in the late 1990s through below-market share issues to insiders. The decline of the value of firms would be enhanced by the existence of cronyman inside the firms who supported the control of the controlling shareholders. We also test the endogeneity issue by jointly determine the financing decision, existency of cronyman and firm value. Faccio, Lang, & Young (2010) supporting the view that debt facilitates expropriation when the capital market institutions appear to be ineffective. Bunkanwanicha, Gupta, & Rokhim (2008) find evidence of expropriation to minority shareholders though debt. Bany-Ariffin, Mat Nor, & McGowan (2010) who find evidence on expropriation of controlling shareholders in Malaysian firms. However, our results supplement their evidence, particularly because adding of cronyman variable with the power to enhance the expropriation behavior of the controlling shareholders and the impact to the firm value as an end result. Moreover we also address the disentangling of endogeneity issue of financing decision, cronyman and firm values by investigating the simultaneous effects of each variable.

Our results also support the predictions of theoretical studies that investigate the effects on firm value of the separation of cash flow rights and control rights. Harris & Raviv (1988) show that separating ownership and control can lower shareholders' value and may not be socially optimal. Shleifer & Vishny (1997) argue that as ownership gets beyond a certain point, large owners gain nearly full control of the company and are wealthy enough to prefer to use firms to generate private benefits of control that are not shared by minority shareholders.

Finance literature has acknowledged the role of debt as an important mechanism to reduce the agency problem between owner and manager resulted from separation of ownership and control (Boshkoska, 2014). M. Jensen (1986) referred to the strategic used of debt as a mechanism to reduce the agency cost as a "Control hypothesis" from debt creation. According to control hypotheses, shareholders are able to use debt to limit potentially expropriation by managers of the firms in situation where firm has more internally generated funds compare to investment opportunities with positive NPV.

The role of debt as potentially disciplining mechanism has been limited in firms where ownership structure is concentrated and where it's management come from controlling owner (Peng & Sauerwald, 2012). In such company which is commonly found in Asia and European countries, debt can be use as a tool to expropriate minority shareholders and creditors. This view

is called “expropriation hypotheses” from debt creation. In a weak institutional environment, minority shareholders are subject of expropriation behavior by controlling shareholders using unfair transaction to tunnel resources from affiliated company located at the bottom of a pyramidal structure, where the difference between voting rights and cash flow rights are largest, to companies located at the top of the pyramidal structure. In typical environment, debt has the ability to facilitate expropriation because by raising their debt proportion in the firm’s capital structure, controlling shareholders are able to achieve higher control on the resource of affiliated company without spending extra capital (Byun, Choi, Hwang, & Kim, 2013). Moreover, by creating more debt in affiliated company where they have lower cash flow right and higher voting right, controlling shareholders could use the extra debt for the other affiliated companies through debt creation within companies in the same group or transfer pricing mechanism to affiliated companies where they have higher cash flow rights (Chen, Kao, & Lu, 2014).

The study of the relation between debt structure and corporate governance is advantageous, not only to better understand whether or not firms that are vulnerable to expropriation issue more debt to have more resources to use for private interests, but also to shed lights on the other possible agency problems. These agency problems may arise between the firms’ controlling shareholder of a firm and the firm’s debt providers belong to the same business groups controlled by the same family. Bunkanwanicha, Gupta, & Rokhim (2008) results showed that firms with lower ownership of the largest controlling shareholders tend to have a higher leverage. Furthermore, Bany-Arifin, Mat Nor, & McGowan (2010) find evidence that the separation of cash flow rights and control rights, allow the ultimate owner to control the company’s recourses for the creation of private benefit and to avoid punishment from such conduct.

In regards to the existence of controlling shareholders on the board of directors which we term as cronyman following Adams, Hermalin, & Weisbach (2010). Studies such as, Jameson, Prevost, & Puthenpurackal (2014) find that controlling shareholder board membership in Indian firms has a statistically significant negative association with Tobin’s Q. Higher proportion of independent directors, higher institutional ownership or larger firm size does not appear to mitigate this relationship. In line with this study, Kuo & Hung (2012) find evidence that family control lessens investment-cash flow sensitivity by mitigating the problem of asymmetric information. Investment-cash flow sensitivity will be higher in family-controlled firms with excess control rights when firms lack independent directors.

According to the literature discussed above, we concluded that higher debt ratio in firms with weak corporate governance practice would facilitate expropriation especially in countries with weak institutional environment where protection to the investors and creditors is weak (Bunkanwanicha et al., 2008).

- H_{1a}: Cash flow right of the largest shareholder will have a negative relation with the debt level of the firm**
- H_{1b}: control right of the largest shareholder will have a positive relation with the debt level of the firm**
- H_{1c}: Higher control right compared to cash flow right of the largest shareholder will have a positive relation with the debt level of the firm**
- H_{1d}: Positive relation from higher control right over cash flow right will be magnified when cronyman existed in the firm.**

Theoretically, the impact of ownership structure on firm value could be explained in at least two ways. On one hand, the more concentrated cash-flow ownership of the largest shareholder are, the stronger is that shareholder’s incentive to have the firm run properly. In other words, the high ownership could also reduce the incentive for the largest shareholder to expropriation. These effects are often called “incentive alignment effects”. On the other hand, Shleifer & Vishny (1997) argue that as ownership gets beyond a certain point, large owners gain nearly full control of the company and are wealthy enough to prefer to use firms to generate private benefits of control

that are not shared by minority shareholders. The pyramid and cross-holding structure which is common in Asia would allow the largest control shareholder to expropriate firm resources in ways that serve its own private interest at the expense of other shareholders. These effects are often called “entrenchment effects”.

Jiraporn, Kim, Kim, & Kitsabunnarat (2012) separate these two effects by providing evidence on the positive incentive effects and the negative entrenchment effects of large ownership: Increases in control rights by the largest shareholder are accompanied by declines in firm values. Azofra & Santamaría (2011) found evidence that 96% banks have ultimate owners. They also found that the bigger the gap between the cash flow right and control right, the poorer the bank will perform.

Ownership structures exhibit relatively little concentration in the United States. Elsewhere, most firms are predominantly controlled by a single large shareholders (Villalonga, Amit, Trujillo, & Guzman, 2014). Thus, studying non-U.S. firms can provide evidence about the effects of large shareholders that is difficult to detect in U.S. data. Moreover, the literature indicates that the positive incentive effect relates to the share of cash flow rights held by large shareholders and that negative entrenchment effect relates to the share of control rights held by large shareholders. Non-U.S. firms exhibit far more divergence between cash flow rights and control rights than do U.S. firms, because in most countries, the largest shareholder often establishes control over a firm despite little cash flow rights.

Bae, Baek, Kang, & Liu (2012) find that controlling shareholders’ expropriation incentives imply a link between corporate governance and firm value. Especially when the boards of directors are less independence by controlling shareholders and their related parties’ existence on the boards. Furthermore, Jameson, Prevost, & Puthenpurackal (2014) find evidence that controlling shareholders’ board membership has a negative impact to tobins’s q. Kim, Kitsabunnarat-Chatjuthamard, & Nofsinger (2007) find evidence, when a country’s minority shareholder rights are strong, then minority shareholders should have the legal power to affect board composition. They also find that countries with stronger shareholder protection rights have firms with lower ownership concentrations and with more independent directors.

H_{2a}: Cash flow right of the largest shareholder will have a negative relation with the debt level of the firm

H_{2b}: Control right of the largest shareholder will have a positive relation with the debt level of the firm

H_{2c}: Higher control right compared to cash flow right of the largest shareholder will have a positive relation with the debt level of the firm

H_{2d}: the negative relation of the higher controlling rights of the largest shareholder will be magnified when cronyman existed in the firm.

While there is substantial empirical evidence regarding the relation between ownership structure and firm value (e.g., McConnell & Servaes, 1995), it has nevertheless been difficult to conduct irrefutable tests of this hypothesis. A primary problem has been disentangling the endogeneity issues that arise because ownership structure, investment opportunity, financing decision, and firm value may all be jointly determined (Demsetz & Villalonga, 2001; Kole, 1997). Setia-Atmaja, Tanewski, & Skully (2009) argue that a complex relation between corporate governance mechanism variable and corporate governance decision is simultaneously made as a response to the agency problem. In other words, separate research on each variable of corporate governance is not suggested to overcome the issue of endogeneity and simultaneous relationship between variable. For example, firm performance is a result of corporate governance decision along with other factors that influence corporate governance decision (Bistrova & Lace, 2011; Michelberger, 2016; Mohamed & Elewa, 2016; Owala, 2010).

Nyonna (2012) suggested an endogeneity issue arises in ownership structure where they fail to prove the existence of significant relationship between firm’s profit and concentrated

ownership structure after they treat ownership structure as an endogenous variable. Abosedo Adebisi & Kajola Sunday, n.d.; Fauzi & Locke (2012); Manawaduge & De Zoysa (2013); Zakaria, Purhanudin, & Palanimally (2014) study the relation between ownership structure and firm's performance and Demsetz and Villalonga (2001) failed to find a significant relationship between the two variable when they treat ownership structure as an endogenous variable.

Separating interpretation between complex relations of ownership structure, debt financing decision and firm value is an urgent task; yet, it has not been thoroughly discussed in the literature of finance. In reality, the firms made decision of corporate governance including financing decision would affect the firm value as a proxy of agency cost. Those variables in reality would also affect each other and therefore could not be properly studied as an independent variable.

H_{3a}: There is a simultaneous relation between pyramidal structure, financing decision and firm value

H_{3b}: There is a simultaneous relation between pyramidal structure, financing decision, and firm value with different effect when cronyman existed in the firm

METHODS

The sample use in this study is all listed companies in Indonesia Stock Exchange for period of 2013 and 2015. The listed company as research object because easy to trace the ultimate owner of the company. Based on collecting data from Osiris and Bloomberg financial database, it is resulting 72 firms as samples. Ownership of listed companies will be classified into two categories which is dispersed ownership and concentrated ownership. Classification of dispersed or concentrated ownership will be based on three cut-off of voting rights which are 10%, 25% and 50%. Using the lowest cut off is similar with some researchers such as (Claessens et al., 2000; Porta & Lopez-de-silanes, 1999) state that 10% voting rights is effective enough to control the company in the middle or end of the chain of ownership. Using 25% cut off is in accordance with the rule of Bapepam no. 3. While the use of 50% cut-off is in accordance with PSAK 4, PSAK 7, PSAK 22 and PSAK 38.

Controlling shareholders are shareholders with the highest voting right in a given cut-off. Someone is classified as a controlling shareholder when he or she has the highest voting right compare to the other shareholders with voting rights in accordance with a given cut-off. Basically, the highest (lowest) cut-off use, the less (more) controlling shareholders will be found. The controlling shareholder could be a family, government, financial institution, firms with widely dispersed ownership, other controlling shareholders. The operation of variable can be seen at table 1.

Table 1. Operation of Variables

Measurement Variables	Empirical Model
Debt (Lev) proxied with the ratio of debt to assets (Total debt/Total assets).	Testing hypothesis on the effect of cash flow rights and control rights to debt using Equation 1 below: $Lev_{i,t} = \alpha_{10} + \alpha_{11} OWN + \alpha_{12} CONT + \alpha_{13} SZ + \alpha_{14} PR + \alpha_{15} G + \alpha_{16} TAN + \alpha_{17} DI + \epsilon_{02}$ (1)
Firm Value, Q is measure with Tobins' Q which is the sum of market value of equity and book value of debt divided by the book value of assets.	Testing hypothesis on the effect of separation of cash flow rights and control rights to debt using equation 2: $Q_{i,t} = \partial_{20} + \partial_{21} CEC + \partial_{22} CECHIGH + \partial_{23} CR + \partial_{24} CEC * CR + \partial_{25} SZ + \partial_{26} PR + \partial_{27} G + \partial_{28} TAN + \partial_{29} DI + \epsilon_{02}$ (2)
Cash Flow Right (OWN), Cash flow right is shareholders' claim to receive profit distribution from the firm in form of dividend (Claessens et al., 2000; Porta & Lopez-de-silanes, 1999).	Testing Hypothesis on the effect of cash flow right and control right to the value of the firm, using equation 3: $Q_{i,t} = \alpha_{30} + \alpha_{31} OWN + \alpha_{32} CONT + \alpha_{33} SZ + \alpha_{34} PR + \alpha_{35} G + \alpha_{36} TAN + \alpha_{37} DI + \epsilon_{03}$ (3)

Control in excess of cash flow rights (CEC), CEC is a ratio of control rights to cash flow rights owned by the largest shareholder. Control right is calculated based on one-share-one-vote basis. If firm has pyramidal structure or cross-holding structure, we use the control rights of the weakest link in the chain. We then sum all the control rights of each chain held by the same ultimate owner.

CECHIGH, Dummy variable that takes a value of 1 if control rights of the largest owner are higher than cash flow rights and if this separation is higher than the median separation in corporations where control rights and cash flow rights differ.

Cronyman (CR), Cronyman variable is a dummy variable that takes the value of 1 when controlling shareholder is actively involved in the management of the firm including the involvement of family member, relatives or identifying by the same family name or related by marriage.

Size of the firm (SZ), Size is measure by the log of total asset of the firm.

Profitability (PR) is measure Return on Asset.

Growth (G) is measure by the change in sales from the prior year.

Asset Tangibility (TAN) is measure by the ratio of total fixed assets to total assets.

Dummy Industry (DI)

Testing Hypothesis on the effect of separation of control right and cash flow right on the value of the firm, using equation 4:

$$Q_{it} = \partial_{40} + \partial_{41} CEC + \partial_{42} CECHIGH + \partial_{43} CR + \partial_{44} CEC * CR + \partial_{45} SZ + \partial_{46} PR + \partial_{47} G + \partial_{48} DI + \epsilon_{04} \quad (4)$$

In order to test simultaneous Relation Between Ownership Structure, Financing Decision and Firm Value, we need to use two stages least square (2 sls) equation.

$$LEV_{it} = \alpha_{10} + \alpha_{11} OWN_{it} + \alpha_{12} CONT + \alpha_{13} Q_{it} + \alpha_{14} X_{it} + \epsilon_{1it} \quad (5)$$

$$Q_{it} = \gamma_{10} + \gamma_{11} OWN_{it} + \gamma_{12} CONT + \gamma_{13} Lev_{it} + \gamma_{14} X_{it} + \epsilon_{1it} \quad (6)$$

$$LEV_{it} = \alpha_{20} + \alpha_{21} CEC_{it} + \alpha_{22} CECHIGH_{it} + \alpha_{23} CR_{it} + \alpha_{24} CEC_{it} * CR_{it} + \alpha_{25} Q_{it} + \alpha_{26} X_{it} + \epsilon_{2it} \quad (7)$$

$$Q_{it} = \gamma_{20} + \gamma_{21} CEC_{it} + \gamma_{22} CECHIGH_{it} + \gamma_{23} CR_{it} + \gamma_{24} CEC_{it} * C$$

$$R_{it} + \gamma_{25} LEV_{it} + \gamma_{26} X_{it} + \epsilon_{2it} \quad (8)$$

RESULT AND DISCUSSION

Based on Table 2, we can conclude that on average the debt of the firms in this sample is 32.7% and firm value 1.365.

Table 2. Descriptive Variables

VARIABLE	LEV	Q	OWN	CONT	CEC	CEC HIGH	CR	CEC *CR	SZ	PR	G	TAN
Mean	0.327	1.365	0.302	0.399	3.901	0.4242	0.893	1.7802	9.5409	0.0579	0.3525	0.631
Median	0.285	1.018	0.226	0.3795	1.420	0.0000	1	1.225	9.5462	0.0419	0.1547	0.548
Maximum	1.010	5.718	0.9350	0.9600	44.62	1.0000	1.000	11.299	11.104	0.7052	25.940	11.07
Minimum	0.001	0.053	0.0011	0.0530	0.000	0.00	0.000	0.0000	6.5285	-0.346	-2.478	0.005
Std. Dev.	0.235	1.022	0.2353	0.2040	8.968	0.4954	0.308	1.9663	0.8133	0.0981	1.9305	1.182
Observation	206	206	198	198	206	206	206	206	206	206	206	206

Testing Hypothesis

Table 3 shows that cash flow right of the largest shareholder has a negative relation with leverage, while controlling rights of the largest shareholder has a positive relation with leverage, in support of Hypothesis 1_a, 1_b, 2_a, 2_b, and 3_a.

Table 3 has indicated that coefficient a_{32} is negative but not statistically significant. It means that the data from the research can not be use to support hypothesis 2b, although the sign of coefficient is in line with the prediction of the hypothesis. We could also concluded from the table 3 that this research has failed to provide evidence supporting the NEE (*Negative Entrenchment Effect*) argument.

Table 3. Result of Hypothesis 1_a, 1_b, 2_a, 2_b, and 3_a

Model	Result of the estimation of Hypothesis 2a and Hypothesis 2b Equation 3						Result from testing hypothesis 3a Equation 5			Result from Testing Hypothesis 3b Equation 6				
	Result of the estimation of Hypothesis 1a and 1b Equation 1			Standardized Coefficients Beta			Hypothesis	Sig.	Standardized Coefficients Beta	Hypothesis	Sig.	Standardized Coefficients Beta	Hypothesis	
	Standardized Coefficients Beta	Hypothesis	Sig.	Standardized Coefficients Beta	Hypothesis	Sig.								Standardized Coefficients Beta
(Constant)	-0.7267	0.000	0.018	2.2396	0.018	0.8282	0.000	0.021	2.1491	0.021	0.021	0.018**	0.021	0.018**
OWN	-0.3483	0.052*	0.031**	2.4946	0.031**	-0.3753	0.005**	2.6746	0.018**	0.018**	0.018**	0.018**	0.018**	0.018**
CONT	0.0433	0.071*	0.147	-1.925	0.147	0.4224	0.009**	-1.8419	0.155	0.155	0.155	0.155	0.155	0.155
Q						0.026	0.052*							
LEVERAGE	0.0966	0.000***	0.262	-0.1092	0.262	0.1051	0.000***	-0.5606	0.084	0.084	0.084	0.084	0.084	0.084
PR	-0.2298	0.013*	0.000***	2.0901	0.000***	-0.249	0.010*	-0.0802	0.405	0.405	0.405	0.405	0.405	0.405
G	-0.0052	0.171	0.492	-0.0143	0.492	-0.0074	0.044**	2.0134	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***
TAN	0.043	0.007***	0.187	0.1026	0.187	0.0375	0.015**	-0.0123	0.555	0.555	0.555	0.555	0.555	0.555
DI	0.3546	0.000***	8.50***		8.50***	0.3664	0.000***	0.1742	0.050**	0.050**	0.050**	0.050**	0.050**	0.050**
F stat	14.16***		0.25		0.25		14.96***		7.94***	7.94***	7.94***	7.94***	7.94***	7.94***
Adj. R2	0.5558		0.25		0.25		0.57		0.365	0.365	0.365	0.365	0.365	0.365

***Support statistically on alpha 1%; ** support statistically on alpha 5%; *support statistically on alpha 10%.

Table 4. Result of Hypothesis 1_c, 1_d, 2_c, 2_d, and 3_b

Model	Result of testing hypothesis 2c and hypothesis 2d Equation 4						Result from Testing Hypothesis 3b Equation 7			Result of Testing Hypothesis 3b Equation 8				
	Result of Testing Hypothesis 1c and Hypothesis 1d Equation 2			Standardized Coefficients Beta			Hypothesis	Sig.	Standardized Coefficients Beta	Hypothesis	Sig.	Standardized Coefficients Beta	Hypothesis	
	Standardized Coefficients Beta	Hypothesis	Sig.	Standardized Coefficients Beta	Hypothesis	Sig.								Standardized Coefficients Beta
(Constant)	-0.7808	0.000	0.071	1.9262	0.071	-0.7934	0.000	2.2976	0.035**	0.035**	0.035**	0.035**	0.035**	0.035**
CEC	0.1006	0.027**	0.020**	-0.2003	0.020**	0.1007	0.012**	-0.1015	0.017**	0.017**	0.017**	0.017**	0.017**	0.017**
CECHIGH	0.1308	0.002***	0.035**	-0.257	0.035**	0.1395	0.001***	-0.4132	0.071*	0.071*	0.071*	0.071*	0.071*	0.071*
CR	0.0114	0.889	0.110	0.7036	0.110	0.0127	0.879	-0.7901	0.070*	0.070*	0.070*	0.070*	0.070*	0.070*
CEC*CR	0.019	0.071*	0.002***	-0.1938	0.002***	0.1155	0.007***	-0.1818	0.007***	0.007***	0.007***	0.007***	0.007***	0.007***
Q						0.0258	0.050**							
LEVERAGE	0.1062	0.000***	0.225	-0.1131	0.225	0.1054	0.000***	0.773	0.053*	0.053*	0.053*	0.053*	0.053*	0.053*
PR	-0.1954	0.039**	0.000***	1.9674	0.000***	-0.2466	0.011**	-0.1707	0.108	0.108	0.108	0.108	0.108	0.108
G	-0.0077	0.038**	0.473	-0.0148	0.473	-0.0072	0.048**	2.183	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***
TAN	0.035	0.017**	0.053*	0.1926	0.053*	-0.0324	0.029**	0.0487	0.695	0.695	0.695	0.695	0.695	0.695
DI	0.3732	0.000***	8.43***		8.43***	0.388	0.000***	-0.8275	0.540	0.540	0.540	0.540	0.540	0.540
Fstat	14.41***		0.295		0.295		15.02***		40.42***	40.42***	40.42***	40.42***	40.42***	40.42***
Adj. R2	0.5348		0.295		0.295		0.625		0.334	0.334	0.334	0.334	0.334	0.334

***Support statistically on alpha 1%; ** support statistically on alpha 5%; *support statistically on alpha 10%.

Table 4 present coefficients that significantly affect the dependent variable are coefficients α_{21} , until α_{25} from equation 7; and coefficients γ_{11} , until γ_{15} from equation 8. The empirical model has a better goodness of fit with higher R^2 compared to the previous similar model use in this research which is equation 2 and equation 4. The empirical evidence suggests that the simultaneous model is better in explaining dependent variable than the previous model. The simultaneity between financing decision and firm value is as predicted by the hypothesis. We could find a significant relationship and a simultaneous relationship between financing decision and firm value. Table 4 show the result of hypothesis 1_c, 1_d, 2_c, 2_d, and 3_b.

Based on table 3, give empirical support to hypothesis 1a is in accordance with LIE (Leverage Increasing Effect) argument or incentive alignment effects. According to this argument, concentration of cash flow right of the largest shareholder is the factor that limit the controlling shareholder from not positioned himself on the condition that vulnerable to the risk of potential bankruptcy which will happen when the firm fail to fulfil its financial obligation. The higher the concentration of cash flow right the higher the risk from the event of bankruptcy that has to be bear by the largest shareholder. Therefore, the high cash flow ownership by the largest shareholder will increase his incentive to be more risk averse. This positive effect of cash flow right to leverage is similar with findings from Bunkanwanicha, Gupta, & Rokhim (2008); and Jiraporn, Kim, Kim, & Kitsabunnarat, 2012).

These findings also suggest that firms with weaker corporate governance (lower OWN), explained by the incentive alignment effects, tend to have higher debt level as compared to stronger corporate governance firms. Despite debt constraints expropriation, as suggested by the classical agency theory, debt can facilitate expropriation. It is possible to interpret that the good corporate governance firms are reluctant to increase the firm's default risk. The support for hypothesis 1b where the positive relation of control rights of the largest shareholder with leverage is in accordance with the argument of Incentive alignment effects. These findings suggest that firm with weaker corporate governance (higher CONT and Lower OWN), explained by the incentive alignment effects, tend to have a higher debt level as compared to stronger corporate governance firms. Despite debt constraints expropriation, as suggested by the classical agency theory, debt can facilitate expropriation in emerging markets especially in Indonesia where institutions appear to be weak. It is also possible to interpret that good corporate governance firms are reluctant to increase the firm's default risk.

Given that pyramidal structure of groups naturally facilitates expropriation, combined with the generally perceived notion that groups have access to internal capital markets to raise funds for investment, the compulsion of firms with higher vulnerability to expropriation to signal the market through lower debt level will be weaker.

Our estimates with respects to the sample of firms of group affiliates do show that firms more vulnerable to expropriation do indeed have a higher level of debt.

From table 4, show empirical testing find evidence that the higher control rights owned by the largest shareholder compared to its cash flow rights, the higher the debt level of that particular firm. Similar evidence also found when the difference of control right and cash flow right is above the median from all listed firms used in the research sample, will have a higher debt level. This result is in line with hypothesis 1c and hypothesis 1d.

The variable of CEC and CEHIGH is a proxy of entrenchment effects. We expect that firms that are more vulnerable to entrenchment (Higher CEC and CEHIGH) exhibit a higher debt level. Our results are strongly in line with this prediction. These results support our hypothesis that corporate governance is linked to the firm's financing policies. The weaker corporate governance firms tend to have a higher debt level as compared to the stronger corporate governance firms. The evidence supports the view that debt can facilitate entrenchment. With the active involvement in the management of the firm, the controlling shareholder could enhance their control on the firms. The active involvement in the management of the firm has raised the agency problem between controlling shareholder and minority shareholders also with creditors

of the firms.

Table 3 indicates that the data is supporting the hypothesis 2a which stated that cash flow right of the largest shareholder has a positive relation with the value of the firm. Positive relation of cash flow right of the largest shareholder with firm's value is in line with PIE (Positive incentive effect) argument. This argument stated that controlling shareholder will not have the incentive to expropriate minority shareholder because they will be negatively affected from the consequences of the expropriation in form of lower firm value. This argument is also supported by Chen, Kao, & Lu (2014); Claessens, Djankov, Fan, & Lang (2002); Mitton (2002); and Yeh & Woitke (2005).

Based on table 4 shows that the high value of CEC and CEHIGH variables indicate how highly potential is the private benefit from controlling a firm. By gaining private benefit on the resources of the firm, the controlling shareholder has an opportunity to increase his/her wealth without concerning the consequences of his/her action. Opportunity to gain the private benefit will also increase when the largest shareholder involves actively in the management of the firm by gaining office in the board of commissioners or board of directors. This situation refers to a higher agency problem between majority shareholder and minority shareholder. The market which realised this agency problem will lower the value of the firm when there is a large separation between control rights and cash flow rights of the largest shareholder and when the largest shareholder is actively involved in the management of the firm.

Empirical results of testing hypothesis 3a are shown in table 3. Those table indicated that coefficients which significantly affect the independent variable as predicted by coefficients α_{11} , α_{12} , α_{13} from equation 5; and also coefficients γ_{11} until γ_{13} from equation 6. The empirical model has proven to be a better model than empirical model identify in equation 1 and equation 3 because of the higher goodness of fit and resulted in higher R^2 value. Equation 1 and 3 is quite similar with equation 5 and 6, the only difference is that the dependent variable in equation 1 and 3 became the explanatory variable in equation 5 and 6. This effort is made to test the potential simultaneous relationship between the dependent variable in equation 1 and 3 which is firm value and financing policies (McConnell and Sarvaes, 1995 as well as Berger and diPatti, 2003). Equation 5 has a value of R^2 of 0.567 compare with equation 1 that has a value of R^2 only of 0.529. Equation 6 has a value of R^2 of 0.475 compare with equation 3 that has a value of R^2 only as much as 0.295. The F value for the whole model is also highly significant at alpha 1%. We also found evidence that OWN variable is positively related to firm value and it is statistically significant on the alpha level of 1%. Meanwhile, variables of CONT and leverage are not related to firm value. We concluded that the market has not considered leverage as an important variable in determining the value of the firm.

The empirical evidence for testing hypothesis 3b is shown in table 11 and 12. These table present coefficients that significantly affect the dependent variable are coefficients α_{21} until α_{25} from equation 7; and coefficients γ_{11} until γ_{15} from equation 8. The empirical model has a better goodness of fit with higher R^2 compared to the previous similar model use in this research which is equation 2 and equation 4. Equation 7 has R^2 value of 0.625 compare to R^2 value of 0.538 in equation 3. While equation 8 has an R^2 of 0.334 compared to R^2 in equation 4 only 0.295. The F value is also significantly high at alpha level of 1%. Thus, the empirical evidence suggests that the simultaneous model is better in explaining dependent variable than the previous model. The simultaneity between financing decision and firm value is as predicted by the hypothesis. We could find a significant relationship and a simultaneous relationship between financing decision and firm value.

CONCLUSION

We find evidence that the firm level corporate governance is linked to the firm's financing decision. The percentage of cash flow rights of the largest shareholder (a proxy of incentive alignment effects) is negatively associated with the debt ratio. The indicator based on the control rights in excess of cash flow rights (CEC) and CEHIGH (a proxy for entrenchment effects)

provide more evidence that firms that are more vulnerable to entrenchment appear to have a higher leverage. The higher debt ratio of the weaker corporate governance suggests that debt can facilitate expropriation.

The incentive effect and entrenchment effect of the ownership structure to the firm's capital structure appear to be larger when the largest shareholder is actively involved in the management of the firm which proxied by cronyman variable. Therefore, the hypotheses in this article concerning the magnifying effect of cronyman existence were supported by the empirical evidence.

This research documents the relationships between ownership and control stakes held by the largest shareholder on the one hand, and the market valuation on the other hand, for a large of publicly traded corporations in Indonesia. We show that firms' valuation increases in the hands of the largest shareholder. This result is consistent with a large literature on the positive incentive effects associated with increased cash flow rights in the hands of a single or few shareholders. We also find a negative entrenchment effects with large controlling shareholders: Increases in control rights by the largest shareholder are accompanied by declines in firm values. This negative effect is particularly severe for large deviations between control and cash flow rights.

The simultaneity relation between ownership structure, leverage and firm value appear that only the ownership structure significantly related with leverage and firm value. Also firm value and leverage ownership impact the ownership structure. Meanwhile, leverage does not appear to have a significant relation with the firm value, or the other way around.

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