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The effect of managerial and institutional ownership on corporate social responsibility disclosure

Abstract:

Purpose - This study aimed to analyze the effect of ownership structure that consists of managerial ownership and institutional ownership of the extensive of corporate social responsibility (CSR) disclosure.

Design/methodology/approach - The population in this study is manufacturing companies listed in Indonesia Stock Exchange (BEI) since the manufacturing companies are considered to have great potential on environmental damage (Mathews, 2000). The selected sample were the companies which meet certain criteria (*purposive sampling*) which published the complete annual financial statements from 2011 to 2015. This study used an analysis method using Partial Least Square (WarpPLS) to assess the effect of the structure of ownership consists of managerial ownership and institutional ownership on the extent of the corporate social responsibility disclosure (CSR).

Findings - The results showed that there is a direct effect of a negative and significant correlation between Managerial Ownership on Corporate Social Responsibility Disclosure and there is a direct effect of the positive and significant correlation between Institutional Ownership on Corporate Social Responsibility Disclosure.

Originality/value - Originality of this paper shows (1) Partial Least Square (WarpPLS) that applied to determine the effect between variables managerial and Institutional Ownership on Corporate social responsibility disclosure, (2) This research is collected data financial statements and annual reports of manufacturing companies obtained from the Indonesia Capital Market Reference Center (PRPM), which is located in the Indonesia Stock Exchange (IDX), which there hasn't been research by the methods and the same location.

Keywords: Corporate social responsibility disclosure, Managerial Ownership, Institutional Ownership

1. Introduction

In recent few decades, one of the fundamental changes in the business sector is the growing awareness of Corporate Social Responsibility. The corporates which were only profit-oriented in the past, now have also concerned to the welfare of society and the environmental preservation, since in running their businesses, in addition to rely on the capital of stockholders, they also rely on other stakeholders, such as employees, customers, suppliers, surrounding community, and others for the continuity of their businesses (Freeman et al., 1983).

In Indonesia, the implementation of CSR is regulated in Law Number 25 of 2007 concerning Investment and Law Number 40 of 2007 concerning Limited Liability Company as the amendment of Law Number 1 of 1995. This law regulates the Social and Environmental Responsibility which is aimed at realizing sustainable economic development to improve the quality of life and the environment which provide benefits to the Company itself, the local community and society in general. This provision is intended to support the company's relations to be harmonious, balanced, and in accordance with the environment, local values, norms, and cultures.

The company which has its business activities in the field of and/or related to the natural resources is obliged to implement the Social and Environmental Responsibility. In order to carry out the obligations of the Company, the Social and the Environmental Responsibility is should be budgeted and accounted as an expense of the Company by

considering appropriateness and fairness. The activity is contained in the Company's annual report. In case the Company does not carry out the Social and Environmental Responsibility, the Company will be penalized in accordance with the legislation.

In order to implement the provision of Article 74 paragraph (4) of Law Number 40 of 2007 concerning Limited Liability Company, the government issued a Government Regulation Number 47 of 2012 on Limited Liability Company Social and Environmental Responsibility. The Corporate Social Responsibility is a corporate responsibility to its stakeholders (Vos, 2003). The purpose is to create a value and build a relationship with the stakeholders (Freeman, 2008), thus, it can increase the social capital. The term social capital in sociology is the expected benefits of special treatment or cooperation between individuals and groups. The point is that social relationship has a value. Similarly, the physical capital and human capital can increase productivity, as well as the social capital which can affect the productivity (Putnam, 2000).

According to Sembiring (2005), there are 78 items of corporate social responsibility disclosure which are expected to be disclosed and there are only a few of which are required by law and regulation. Therefore, there must be awareness and initiative from the actor, in this case the owner of the company/corporation. The ownership of a company is determined by the number of stocks owned of the total outstanding stocks. Stocks can be owned by the manager of the company, other institutions, and the wider community individually. There were several previous studies which examined the effect of managerial and institutional ownership on the corporate social responsibility disclosure in Indonesia which showed inconsistent results.

Managerial ownership is ownership by the management of the company, as measured by the percentage of the number of stocks owned by the management, whereas the institutional ownership is the ownership by the government, financial institutions, legal entities, foreign institutions, and other trusteeships (*perwalian*) and institutions (Jensen et al., 1976). Furthermore, Jensen and Meckling state that managerial ownership is the ownership by the management of company, as measured by the percentage of the number of stocks held by the management.

Another ownership structure is the institutional ownership, which generally acts as parties to monitor the company. A company which have a large institutional ownership (more than 5%) indicates its ability to monitor management. The higher the institutional ownership, the more efficient the utilization of assets of the company and it is also expected to act as a deterrent against the extravagance conducted by the management (Faizal 2004 in Arif, 2006). It means that institutional ownership can be a driving force for the company to perform corporate social responsibility disclosure.

There are many reasons from the companies in disclosing the CSR which have been examined in some previous studies, among others, to obey the existing regulations, to obtain competitive advantages from the implementation of CSR, to meet the requirement in loan contract and the expectations of the community, to legitimate the companies' activities, and to attract investors (Deegan and Blomquist, 2001; Hasnas, 1998; Ullman, 1985; Patten, 1992; in Basamalah et al., 2005). This study will analyze the effect of the structures of stock ownership consists of managerial ownership, institutional ownership, and foreign ownership on the disclosure of CSR. The sample used in this study is the manufacturing companies since they are considered to have a great potential towards the environmental damage (Mathews, 2000). Based on the background above, this study will assess the effect of the structure of ownership consists of managerial and institutional ownership on the extent of corporate social responsibility disclosure (CSR).

2. Literature Review

Managerial ownership is one of the items contained in the good corporate governance. Jensen and Meckling (1976) found that managerial ownership succeeds to be a mechanism in reducing agency problems of the managers to align the interests of managers and stockholders. The centralization of interests can be achieved by giving the ownership to the manager. If the manager has more stocks of the company, he/she will strive to meet the interests of stockholders who is also him/herself. By increasing the number of managerial ownership, then the management will perceive the direct impact on any decisions they make and try to reduce the risk of losing their assets. However, the high level of managerial ownership may cause the entrenchment effect. It means that if there is a high managerial ownership, there is a strong position to control the company and the external parties will find it difficult to control the actions of the manager (Febrianto and Suwardjono, 2004). This is because the manager has a considerable vote on a high managerial ownership. Based on this view, the management can make any action and policy oriented to the individual interests.

Institutional ownership is an ownership by the parties in the form of institutions such as foundations, banks, insurance companies, investment companies, pension funds, limited liability companies (PT), and other institutions. An institution is usually able to control the majority of stocks because it has greater resources than the other stockholders. Since it controls the majority of stocks, then the institutional party can monitor the management policy more restrictively than other stockholders.

Tan and Keeper (2008) state that institutional investors play an important role in corporate governance by actively supervising their investment and provide protection against management plans to reduce the value of the stockholders.

According to Jensen and Meckling (1976), one of the ways to reduce the agency cost is by increasing the institutional ownership in order to supervise the managers. In other words, it would encourage the optimal supervision on management performance. It shows that the increase in the percentage of institutional ownership can decrease the percentage of managerial ownership because the managerial and institutional ownership are interchangeable in a monitoring function (Suranta and Machfoedz, 2003).

Gray et al. (1987) in Belal (2001) defines Corporate Social Responsibility as a process of social and environmental communication from the economic organizations towards certain groups in society, involving the responsibility of the organization (especially for company) outside the financial responsibility to the capital owners, particularly the stockholders. The company has a greater responsibility than just to make a profit for its stockholders.

The companies increasingly realize that their survival depends on their relationships with society and environment in which they operate. It is in line with the legitimacy theory which states that a company has a contract with the society to carry out its activities based on the values of justice, and how it responds to various groups of interest to legitimize its activities (Tilt, 1994). If there is disharmony between the system of values of the company and of society, the company will lose its legitimacy, which will further threaten the survival of the company (Lindblom, 1994 in Haniffa and Cooke, 2005). CSR information disclosure in the annual report is one of the ways by which the company build, maintain and legitimize its contribution in terms of economy and politics (Guthrie and Parker, 1990; Suwaldiman 2005 in Rahman and Widayarsi, 2008).

Corporate social responsibility can not be separated from the interests of the stockholders and stakeholders of the company. This concept is then translated as the triple bottom line, namely: Profit, People and Planet. It means that the purpose of CSR should

be able to increase the profit of company, to improve the welfare of the employees and the community, as well as to improve the quality of the environment at the same time.

3. Methodology

The population in this study is manufacturing companies listed in Indonesia Stock Exchange (BEI) since the manufacturing companies are considered to have great potential on environmental damage (Mathews, 2000). The selected sample were the companies which meet certain criteria (*purposive sampling*) which published the complete annual financial statements from 2011 to 2015.

The data collected in this study were the secondary data, financial statements and annual reports of manufacturing companies obtained from the Indonesia Capital Market Reference Center (PRPM), which is located in the Indonesia Stock Exchange (IDX). This study used three variables consist of managerial ownership, institutional ownership and corporate social responsibility disclosure. This study used an analysis method using Partial Least Square (WarpPLS) to assess the effect of the structure of ownership consists of managerial ownership and institutional ownership on the extent of the corporate social responsibility disclosure (CSR).

4. Result and Discussion

4.1. Goodness of Fit dalam WarpPLS

Testing Goodness of Fit using predictive value-relevance (Q^2). The value of R^2 endogenous variables in the study of 0.293. Predictive value-relevance is obtained by the formula. The calculation result shows the value of predictive-relevance of 0.293 or 29.3%, so the model was said to have predictive value for decent relevant. Predictive value of relevance of 29.3% indicated that the diversity of data that can be explained by the model was of 29.3% or in other words the information contained in the data of 29.3% can be explained by the model. While the remaining 48.9% explained by other variables (which are not yet contained in the model) and error.

4.2. Hypothesis Testing

Hypothesis testing is performed on each line partially direct effect. A complete analysis of the results, is contained in the results of the analysis of PLS, can be seen on the chart. The following table presents the results of hypothesis testing using Partial Least Square (PLS).

Table 1: Hypothesis Testing PLS Model

Relationship	Path Coefficient	<i>p-value</i>	Information
Managerial Ownership → The Corporate social responsibility disclosure	-0.374	0.006	Significant
Institutional Ownership → The Corporate social responsibility disclosure	0.522	< 0.001	Significant

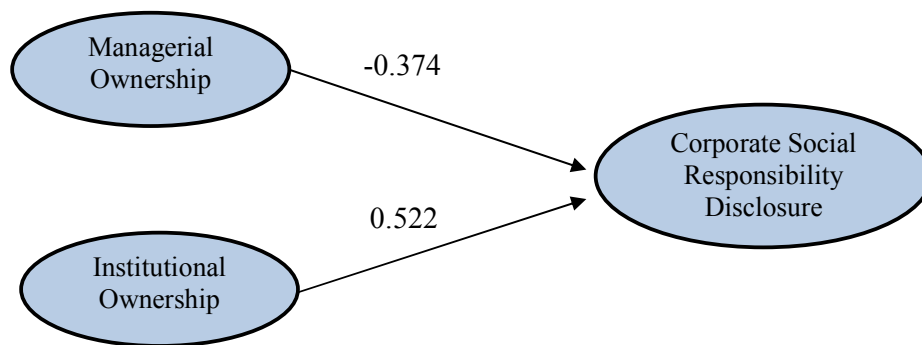


Figure 1 : The results of PLS Analysis Institutional and Managerial Ownership Effect on Corporate Social Responsibility Disclosure

Testing the direct effect between the Managerial Ownership towards corporate social responsibility Disclosure, coefficients of inner weight is equal -0.374 , with a p -value of $0.006 < 0.05$, it indicate direct effect is significant between the Managerial Ownership against the corporate social responsibility disclosure. Considering the inner weight is negative, indicating that relations are both negative. That is, the higher Managerial Ownership, will result in the lower corporate social responsibility disclosure.

Testing the direct effect between the Institutional Ownership towards corporate social responsibility Disclosure, obtained coefficients inner weight of 0.522 , with a p -value of $0.001, < 0.05$, it indicate direct effect is significant between Institutional Ownership against the corporate social responsibility disclosure. Given the inner weight is positive, indicating that relations are both positive. That is, the higher the Institutional Ownership, will result in the higher corporate social responsibility disclosure.

5. Discussion

5.1 The Effect of Managerial Ownership on the Corporate social responsibility disclosure

Jansen and Meckling (1976) states that the conflict between the *principal* and *agent* can be reduced by aligning the interests between the *principal* and *agent*. *Principal* may limit the deviation of its interest by establishing appropriate incentives for the *agent* and by incurring monitoring costs designed to restrict the deviate activities of the *agent*. Thus, the *agent* will act in accordance with the command that has been mandated by the *principle*, so that the interests of the *principle* will be met by the *agent*. The existence of this agency conflict will result in *agency cost*. Agency theory explains that the increased ownership by the manager (*insider ownership*) can be a control for *agency cost* resulted from the mechanism to minimize the *agency conflict* that occurs between the owners and managers.

Managerial ownership is one of the items contained in the good corporate governance. Jensen and Meckling (1976) found that managerial ownership succeeds to be a mechanism in reducing agency problems of the managers to align the interests of managers and stockholders. The centralization of interests can be achieved by giving the ownership to the manager. If the manager has more stocks of the company, he/she will strive to meet the interests of stockholders who is also him/herself. By increasing the number of managerial ownership, then the management will perceive the direct impact on any decisions they make and try to reduce the risk of losing their assets.

Insider ownership is the owner of the company that serves also as the manager of the company. The greater the *insider ownership*, the lower the conflict of interest between the stockholders (owners) and the management of the company since they will act together more cautiously in making any decision as a result of the decision will not only have impact on the owner, but the manager also take the consequence of the decision that have been made. If the decision made by the management is wrong, they will take the consequence to burden the losses due to the decision and vice versa, if the decision made by the management is right, they will take the result according to what was expected earlier, that is receiving the benefits of the decision have been made.

Managerial stock ownership structure is the proportion of general stocks held by the management. The conflict of interests between the manager and the owner becomes greater when the managerial ownership of the company becomes lower (Jensen and Meckling, 1976). In this case, the managers will try to maximize their own interests than the interests of the company. Therefore, the greater the managerial ownership in the company, the more productive the managers in maximizing the value of the company, in other words, the contract and supervision costs will be lower. The managers of the company will disclose social information in order to improve the image of the company, although they have to sacrifice their resources for this activity (Gray et al (1988) in Murwaningsari 2009]. The result of this study is in contrast to the result of the study conducted by Anggraini (2006), which indicated that there is a significant-positive relationship between managerial ownership and CSR. It proves that the high managerial ownership can result in *entrenchment effect*. It means that if there is a high managerial ownership, there is a strong position to control the company and the external parties will find it difficult to control the actions of the manager (Febrianto and Suwardjono, 2004). This is because the manager has a considerable vote on a high managerial ownership. Based on this view, the management can make any action and policy oriented to the individual interests.

5.2. The Effect of Institutional Ownership on the Corporate social responsibility disclosure

The result of this study indicates that institutional ownership variable has a positive and significant effect on the corporate social responsibility disclosure. A company which has more dominant stockholding by other institutions or is usually called as institutional ownership will have higher supervision and control on the management.

Institutional ownership is an ownership of company stocks by financial institutions such as insurance companies, banks, pension funds, and asset management (Koh, 2003; Veronica and Bachtiar, 2005). A high institutional ownership will result in greater monitoring efforts by the institutional investors that can deter opportunistic behavior of the managers. A company which have a large institutional ownership (more than 5%) indicates its ability to monitor management (Arif, 2006).

This result is in line with the result of the study conducted by Murwaningsari (2009) which shows that institutional ownership structure has a significant effect on the corporate social responsibility disclosure. However, it is in contrast to the study conducted by Barnae and Rubin (2005), a study to see CSR as a conflict of various shareholders, which showed that institutional ownership does not have any relationship to CSR. Furthermore, Mani (2004) in Kasmadi and Susanto (2006), who examined the determining factors of the extent of voluntary disclosure in the annual reports of the companies in India, found that financial institution has no significant relationship to the voluntary disclosure in the annual reports of the companies in India.

An example of the institution requires disclosure of CSR is in European banking, in which the banks in Europe implement a policy in providing loans only to the companies which implement CSR well. Barnea and Rubin (2005) conducted a study to see CSR as a conflict of various *shareholders*, which showed that *institutional ownership* does not have any relationship to CSR. Furthermore, Mani (2004) in Kasmadi and Susanto (2006), who examined the determining factors of the extent of voluntary disclosure in the annual reports of the companies in India, found that *financial institution investment* has no significant relationship to the voluntary disclosure in the annual reports of the companies in India.

6. Conclusions and Suggestions

Based on the results of the study, the conclusions are as follows:

1. There is a significant direct effect of the Managerial Ownership on the Corporate social responsibility disclosure. Given that the coefficient of *inner weight* has a negative mark, it indicates that the relationship between them is negative. It means that, the higher the Managerial Ownership, the lower the Corporate social responsibility disclosure.
2. There is a significant direct effect of the Institutional Ownership on the Corporate social responsibility disclosure. Given that the coefficient of *inner weight* has a positive mark, it indicates that the relationship between them is positive. It means that, the higher the Institutional Ownership, the higher the Corporate social responsibility disclosure.

There are some suggestions based on this study, as follows:

- a. For companies, it is expected to always concern and improve the financial performance of the company through the optimization of the relationship between the institutional and managerial ownership, so that the disclosure of CSR will be improved.
- b. For investors, it is expected to be more careful in making any investment, especially by considering the disclosure of CSR of the company in the financial statement, so that they will not experience any losses in their investments.
- c. For further research, it is expected to improve the study by adding some companies as the sample of study as well as increasing the time period in conducting the study.

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