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Ownership Structure of Sustainable Companies in Indonesia: The Effect on Managers' Behavior

Dianwicaksih Arieftiara*, Shinta Widyastuti, Masripah, Munasiron Miftah

Faculty of Economic and Business, Universitas Pembangunan Nasional Veteran Jakarta, Jakarta, Indonesia

Abstract

This research aims to analyze the ownership structure of sustainable companies and to examine the behavior of managers of each structure, particularly in ESG Reporting and tax-concerned behavior. In addition, this research aims to examine the effect of Ownership Structure on ESG reporting and Tax Avoidance. There are five focus of ownership structures discussed in this research, such as foreign, government, institutional, managerial, and family ownership and this research is the first that examining how the behavior of ownership structure, specifically in sustainable companies. Focuses on all non-financial listed companies in Indonesia from 2012 – 2022 or 11 years of observation which have publish ESG Reporting, it is obtained 244 firm years of final samples. The methodology for examines the hypotheses is panel data regression models, the result is in general nearly all the ownership structures have negative and significant effect on ESG Reporting. Among four out of five structures are significantly have negative effect on ESG Reporting, those are Foreign, Government, Institutional and Family Ownership, meanwhile the Managerial Ownership has no effect on ESG Reporting. In addition, for tax-concerned behavior, the results shown that ESG Reporting, Government, Institutional, and Family Ownership has positive effects on Effective Tax Rate/ETR, meanwhile Managerial Ownership has negative effect on ETR. By examining behavior each of ownership structures based on modern corporate theories, this research is expected to have contribution in providing new empirical evidence of how the behavior of sustainable companies based-on the ownership structures distinction.

Keywords: Ownership Structure; ESG Reporting; Tax Avoidance; Sustainable Companies.

1. INTRODUCTION

This research has necessity in line with the government's commitment to the Sustainability Development Goals, so that even though it is not yet mandatory, companies in Indonesia have made Environmental Social and Governance (ESG) reporting even since 2012. The Financial Services Authority issued a regulation regarding sustainability reporting obligations for companies as of January 2019, but the state has not clearly regulated "Stick and Carrot" or the application of rewards and punishments for these obligations. This reporting behavior cannot be separated from how companies implement good governance so that it has an impact on various decisions including tax avoidance decisions. If it is seen that Indonesia is experiencing a downward trend in tax revenue due to tax avoidance carried out, especially from corporate tax revenue, this decline is one of them caused by tax avoidance behavior by companies that should get supervision from corporate governance mechanisms, besides that this invites debate among academics and practitioners because some believe that it is ethical because the benefits of tax avoidance are used for business expansion and buying more resources (labor and raw materials) from society. In addition, a report from the Organization for Economic Co-operation and Development (OECD) on Revenue Statistics of Asia Pacific country in 2021 states that the tax ratio in Indonesia is in the 5th lowest position, which is higher than Vanuatu, Bhutan, Pakistan and Laos as lowest. This position is better than the previous year (2020) which was in the 3rd lowest position with Bhutan and Laos.

For this reason, this study aims to obtain an overview of the determinants of public corporate governance through ownership structure, map the ownership structure of public companies in Indonesia and further investigate

*Corresponding author. Tel.: +628113427377
E-mail: dianwicaksih@upnvj.ac.id

whether it affects ESG reporting behavior, behavior towards other strategic decision making, namely tax avoidance behavior. This research is the first that focuses on sustainable companies and the first that providing new empirical evidence the effect of ownership structure on ESG Reporting and Tax avoidance behavior in Indonesian context.

2. LITERATURE REVIEW

2.1 Modern Corporation Theory and Behavior of Managers

With recent decades, the modern corporation theory has experienced tremendous growth, notably with regards to the separation of ownership and managerial conduct. An overview of the main ideas and developments in this field of corporate governance is given by this literature review. The 1976 development of agency theory by Jensen and Meckling (1976) had a significant impact on how people talked about separating ownership and management. It asserts that because shareholders (owners) and managers (agents) have different objectives regarding profit maximization and job security, conflicts of interest between them are unavoidable. This theory emphasizes the necessity for methods to match management conduct with shareholder interests, such as executive remuneration and corporate governance systems.

Scholars have investigated the manner in which managers may amass influence and establish themselves inside companies, building on the agency thesis. Their actions, which are frequently motivated by self-interest, may lead to poor choices that are detrimental to shareholders. In order to prevent management entrenchment, research in this field has stressed the value of checks and balances, such as independent boards of directors and involved shareholders (Fama and Jensen, 1983; Bebchuk and Weisbach, 2010).

The difficulty of observing and regulating managers' conduct on behalf of shareholders is highlighted by the principal-agent relationship, a key idea in contemporary company theory. In an effort to establish a balance between offering incentives and preventing excessive risk-taking, researchers have looked at how several mechanisms, including stock options, performance-based pay, and board monitoring, impact managers' behavior (Shleifer and Vishny, 1997; Bainbridge, 2008).

Stakeholder theory has been more popular recently, since the traditional focus of contemporary business theory has been on shareholders' interests. According to this viewpoint, businesses should prioritize community value in addition to shareholder value and take into account the interests of all stakeholders, including employees, customers, and the general public. This change has an impact on how managers act and decide (Brickley, et al., 1997).

Behavioral economics has made significant contributions to our understanding of how managers make decisions. It examines how cognitive biases and restricted rationality might cause management conduct that is less than ideal. According to this research, comprehending these biases can aid in the creation of corporate governance systems that are more efficient.

Corporate governance changes and rules designed to better align executive conduct with shareholder interests have also affected modern company theory. To increase transparency and accountability, for instance, the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 in the United States imposed strict regulations and reporting requirements.

2.2 Hypotheses Development

The literature on modern company theory has developed to include a wide range of viewpoints and elements impacting corporate governance, particularly with regard to the separation of ownership and management conduct. As organizations struggle to balance management conduct with the interests of shareholders and other stakeholders in a constantly shifting global business environment, this field of research is of utmost importance.

2.3 Ownership Structure and ESG Reporting

The ownership structure should principally supervise and encourage agents to mitigate losses and inefficiencies resulting from separation of ownership. Share ownership and control over the company are distributed among the shareholders and other parties who have an interest in the company. The role of ownership structure is very important in regulating relationships between various stakeholders within the company, including shareholders, management, employees, creditors, and other stakeholders. The ownership structure can influence the decision-

making process in the company. Majority shareholding or the owner's family tends to have a greater influence in determining company policies, including financial policies, dividend policies, and other policies. These decisions can affect a company's long-term performance and direction.

Although foreign ownership has merit in encouraging ESG disclosure, Saini & Singhania (2019) argue that there is a potential negative relationship that could hinder efforts for complete and transparent disclosure of information. Companies often establish relationships with various foreign investors who have different cultural, legal, and policy backgrounds. Differences in ESG reporting standards are one of the major hurdles. Different countries or regions may have different guidelines and regulations on how ESG information should be reported.

From the point of view of managerial ownership, this is in line with agency theory, where the higher the owner comes from the manager, the lower the information asymmetry so that the disclosure of non-financial information (including ESG reporting) is not done in detail because managers who also represent owners (shareholders) have believed in the quality of ESG activities so that they do not require more detailed disclosure / more information. Conversely, the lower the composition of managers as owners (shareholders), the higher the information asymmetry, so that non-financial related activities (including ESG) must be informed and disclosed in more detail which ultimately has an impact on higher ESG reporting scores.

The government as the owner or main stakeholder in the company has the responsibility to ensure that the company's operations are not only profitable for shareholders, but also support community welfare, environment and governance (Rudyanto 2017). One of the main ways in which government ownership affects Environmental, Social and Governance (ESG) disclosure is through tougher regulations and policies. The government can impose more comprehensive reporting requirements related to environmental, social and governance aspects.

Family ownership within a company often reflects the family's values, identity, and long-term goals. However, in some situations, the relationship between family ownership and a company's Environmental, Social and Governance (ESG) disclosure could show a negative trend (Liao, E., &; Jesmin, F. H., 2023). This phenomenon illustrates a condition where family-owned companies tend to have lower levels of ESG disclosure than other company ownership structures. Family companies often have ownership structures that are concentrated in the hands of the family.

Although ESG issues are increasingly gaining global attention as part of corporate social responsibility, not all types of institutional owners have the same priorities when it comes to ESG aspects. One reason for this complexity is the wide variety of goals and strategies that institutional owners have. There are various kinds of institutional shareholders, such as pension funds, investment funds, index funds, insurance companies and so on. Each of these types of institutional owners has different preferences and investment goals. For example, pension funds are more focused on growing long-term investments to meet pension payment obligations to employees. Meanwhile, insurance companies will prioritize stability and protection against investment risks. Therefore, ESG issues do not have the same urgency for all these types of institutional owners. Based on the arguments above, the research hypothesis 1 is stated as follow:

H1: Ownership structure has effect (positively or negatively) on ESG Reporting

2.4 Ownership Structure and Tax Avoidance

Research conducted by Cabello and Gaio (2019) revealed that tax avoidance behavior in companies can be influenced by management contracts. The implementation of performance-related pay policies for executives, such as in management contracts, has the potential to influence tax avoidance practices in the corporate environment.

It is possible that foreign investors as major shareholders of companies choose to take advantage of the potential reduction of the tax burden and ignore the interests of minority shareholders, according to the expropriation hypothesis outlined by Jensen and Meckling (1976). Salihu et al. (2015), stated that companies with foreign ownership tend to benefit from tax avoidance practices and waive the risks. Companies with foreign ownership tend to prioritize the benefits of tax avoidance rather than legitimacy issues.

Political relations can be observed from the presence of individuals who serve as government officials or politicians who occupy leadership positions in SOEs/BUMDs. SOEs that have political connections in their leadership structures have a tendency to engage in tax avoidance actions. Fan et al. (2007) noted that government-

owned companies tend to have low levels of profit and efficiency, poor governance, and more serious agent conflicts between majority and minority holders (*principle-to-principle*).

As a major shareholder, the family can choose to maximize profits from tax savings and potentially sacrifice the interests of minority shareholders. Tax avoidance measures can be used by families to cover losses, obscure rent extraction practices and ultimately deceive minority shareholders (Desai and Dharmapala, 2006).

Institutional ownership is expected to be able to oversee all tax planning activities to avoid favorable behavior for management. Thus, conflicts of interest between management and owners can be resolved more effectively, and the steps taken by management in the context of tax planning can be more in line with the overall goals of the company and society (Darsani and Sukartha 2021).

H2: Ownership structure has an effect on tax avoidance.

2.5 ESG Reporting and Tax Avoidance

Carbon emission reduction activities, corporate social responsibility activities, Human Resources development activities, research and development activities related to the search for new environmentally friendly technologies, all of these are activities where the costs incurred from these activities are classified as deductible expenses. Thus, some companies that focus on ESG activities and reporting have high tax avoidance activities as well, but on the other hand the attention to Environmental Social and Governance issues is the company's effort to improve its image and legitimize its position before all stakeholders, so that high tax avoidance activities can have an impact on the potential for fines and bad reputation (Arieftiara et al, 2020).

H3: ESG Reporting has an effect on tax avoidance.

3. METHOD

3.1 Data and Sample

The research conducted on non-financial sectors published companies in Indonesia which have concern in sustainability efforts from 2012 – 2021, which selected based on certain criterias, such as: company has concern on ESG activities, has complete data need for the statistical estimation. Table 1. shows the sampling procedure for the research, which total final sample data is 244 firms years.

Table 1: Sampling Procedures

Description	Total
Indonesian published companies which have concern in ESG activities for 2012-2022 (11 years)	305
Financial Sector Companies	(61)
Indonesia non-financial sector listed companies which have concern in ESG Activities for 2012-2022	244
Final Samples (firm years)	244

Source: Research Data, Arieftiara, et al. (2023)

The research uses unbalanced panel, and from Table 1, the total final samples is 244 firm years, which is consists of 11 years data observations. The main reason of using 2012 Data, because as GRI noticed that since 2012, The United Nations starts to include the Sustainabile Development Goals (SDG) on its annual meeting, and this become one breakthrough moment for business in global to be more serious in shifting from economics/profit oriented to be sustainable. This new focus is captured by more companies are publishing sustainability reports or Environmental, Social and Governance (ESG) Reports starting 2012.

3.2 Research Model

Based on Qasem et al (2022) and Lavin and Pearce (2021), also as objectives of this reseach, the estimation method for hypotheses testing is panel data regression using an empirical model as follows:

$$ESG_{it} = \alpha + \beta_1 FO_{it} + \beta_2 GO_{it} + \beta_3 IO_{it} + \beta_4 MO + \beta_5 FYO_{it} + \beta_6 SIZE_{it} + \beta_7 AGE_{it} + e_{it.} \quad (1)$$

$$ETR_{it} = \gamma + \sigma_1 FO_{it} + \sigma_2 GO_{it} + \sigma_3 IO_{it} + \sigma_4 MO + \sigma_5 FYO_{it} + \sigma_6 \widehat{ESG}_{it} + \sigma_7 SIZE_{it} + \sigma_8 AGE_{it} + e_{it} \quad (2)$$

where:
ESGit = ESG reporting firm i year t
ETRit = Effective Tax Rate (Tax expense divided by Pre-tax Income) firm i year t
FOit = percentage of foreign on ownership structure in firm i year t
GOit = percentage of government on ownership structure in firm i year t
IOit = percentage of institution on ownership structure in firm i year t
MOit = percentage of managerial on ownership structure in firm i year t
FYOit = percentage of family on ownership structure in firm i year t
ETR_{it} = Tax avoidance behavior using ETR
$\widehat{ESG}_{it}$ = *fitted value* of ESG Reporting of firm i year t
SIZEit = firm size (ln total asset)
AGEit = firm age

ESG Reporting represents managers behavior in publishing ESG-activities information to the companies stakeholders. Following Chen et al (2021), ESG reporting is measured with ESG Combine Score published by the Refinitive Eikon. The ownership structure, following this research is focus on the highest percentage of companies shares ownership held by family. Tax avoidance is proxied by Effective Tax Rate (ETR) which is calculated from tax expense divided by Control variables in this research are firm's size, age, and profitability which indicates-respectively by natural logarithm of total assets, length period of firm operation in year, and Return on Assets (ROA).

The expected result from empirical estimation is, for Hypothesis 1, β_1 until β_5 is expected to have non-equal to zero (could be positive or negative sign) with level of significant is 5%. Then, criteria for Hypothesis 2 acceptance is σ_1 until $\sigma_5$expected to have positive or negative value (not-equal to zero) with level of significant is 5%, meanwhile hypothesis 3 is expected the σ_6 expected to be both positive or negative significant with level of significant is 5%, finally, the expected sign for β_5 is to be positive or negative. For control variables, SIZE, AGE and ROA are expected to have positive effect with level of significant 5%.

4. RESULTS AND DISCUSSION

Table 2 below shows descriptive statistics with with Indonesian samples. Table 2 showed that in general, sustainable companies in Indonesia are dominated owned by family for 36.3%; followed foreign for 34.5%; institution for 22.8%; goverment for 10.9% and last by manager for 0.68%.

Table 2: Descriptive Statistics of Main Variables.

Variables	Observations	Mean	Skewness	Maximum	Minimum	Std. Dev.
ESG	244	-0.053	0.000	0.167	-7.709	0.626
FO	244	0.345	0.134	1.656	-2.963	0.811
GO	244	0.109	0.521	0.999	0.103	0.186
IO	244	0.228	22.18	25.52	19.10	1.376
MO	244	0.006	62.00	93.00	33.00	11.816
FYO	244	0.362	0.037	0.474	-0.067	0.068
SIZE	244	0.555	1.000	1.000	0.000	0.497
AGE	244	0.129	0.000	1.000	0.000	0.336
ROA	244	0.089	1.945	0.4741	-0.0667	0.087

Notes: ESG =. ESG Reporting Combined Score; FO = percentage of foreign ownership; GO = percentage of government ownership; IO = percentage of institutional ownership; MO = percentage of managerial ownership; FYO = percentage of family ownership; SIZE = firm size (natural logarithm of total assets); AGE = time periods of firm operated (years); ROA = profitability (ratio of Net Income and Total Assets)

The results of Model 1 and 2 as Table 3. Table 3 showed the result for Model 1, the four ownership structures, consistently have negative and significant coefficients namely FO, GO, IO and FYO. Meanwhile, the MO was not significant but has a negative sign as well. This result is in line with existing practices and rules in Indonesia that obligations to ESG Reporting are not clear rewards and punishments so that companies do not have clear added value when implementing besides the high cost of producing this report makes the majority owner do not want detailed reporting. These results implied that overall, ownership structure has been shown to influence ESG Reporting so that Hypothesis 1 is supported by data.

Table 3: Regression results for Hypotheses 1, 2 and 3

Variable	**Model 1**			**Model 2**		
	Coefficient		Prob.	Coefficient		Prob.
C	-18.061		0.497	0.1203		0.715
ESG	-		-	0.0042	***	0.000
FO	-8.926	**	0.035	0.0324		0.539
GO	-29.800	***	0.000	0.1426	*	0.065
IO	-10.999	**	0.019	0.1633	***	0.006
MO	-38.728		0.287	-1.6065	***	0.000
FYO	-47.053	***	0.000	0.2295	***	0.000
SIZE	3.996	***	0.001	0.0003066		0.984
AGE	-0.033		0.679	-0.0043	***	0.000
ROA	40.801	*** *	0.001	0.1234		0.428
Adjusted R-squared	0.4546			0.1758		
F-statistic	26.31			6.76		
Prob(F-statistic)	0.000			0.000		
N	244			244		

Notes:
FO = percentage of foreign ownership; GO = percentage of government ownership; IO = percentage of institutional ownership; MO = percentage of managerial ownership; FYO = percentage of family ownership; SIZE = firm size (natural logarithm of total assets); AGE = time periods of firm operated (years); ROA = profitability (ratio of Net Income and Total Assets)
***, **,* = significant at level 1%; 5%; and 10%

The results showed that GO, IO, and FYO have a positive and significant coefficient of ETR, this means that the higher the percentage of government, institutional and family ownership, the higher ETR, which means lower tax avoidance behaviour. On the contrary, MO has a negative and significant effect, meaning that the higher the percentage of manager owners, the lower ETR, and the lower tax avoidance behaviour. This led to hypothesis 2 is supported by data.

The results showed that ESG results have a positive and significant coefficient, which means that the higher the ESG reporting activity, the higher the ETR which is an indication of lower tax avoidance. Therfore, this shows that the companies are consistent in maintaining a good image and do not avoid high taxes.

For variable control, Model 1 both SIZE, AGE and ROA are proven to affect ESG Reporting, while in Model 2, only AGE affects tax avoidance negatively, or the more mature companies are high tax avoidance.

5. CONCLUSION

The research aims to provide mapping regarding ownership structure of sustainable companies in Indonesia and to investigate the effect of different ownership structure on managers behaviour. The result showed that in general, sustainable companies in Indonesia is dominated owned by family, followed foreign, institution, goverment and last by manager. Foreign, Government, Institutional, and Family Ownership are the four structures out of the five that notably have a negative impact on ESG Reporting; meanwhile Managerial Ownership has no impact on ESG Reporting. Additionally, the results for tax avoidance behaviour showed that Managerial Ownership had a negative impact on ETR which mean higher tax avoidance behavior. On the contrary, Government, Institutional, and Family Ownership have positive effects on ETR, which means higher ownership structure leads to lower tax avoidance behavior (higher ETR level). This research is anticipated to contribute to the development of recent empirical data on how the behavior of sustainable firms differs depending on ownership arrangements by evaluating the behavior of each ownership structure based on contemporary corporate theories.

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