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THE IMPACT OF INSTITUTIONAL OWNERSHIP AND MANAGERIAL OWNERSHIP ON LOAN LOSS PROVISION

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ABSTRACT

The objective of this study is to ascertain the impact that managerial and institutional ownership have on provisions for loan losses. For the period 2018-2022, the data utilized in this study comprises all banking companies that are publicly traded on the Indonesia Stock Exchange. Even though the banking industry has stricter regulations compared to other industries, earnings management is an action that is often carried out by company managers aimed at the manager's personal interests and the interests of the company.The research data underwent analysis using Eviews. The findings of the study indicated that managerial ownership did not have a statistically significant impact on loan loss provisions, while institutional ownership did have a significant negative effect. Institutional investors have been demonstrated to be effective monitoring proxies in the implementation of company policies; therefore, the findings of this study may serve as a benchmark when contemplating banking company policymaking, specifically in the investor selection process.

Keyword : Asia, Bank, Institutional Ownership, Managerial Ownership, Loan Loss Provisions.

INTRODUCTION

In Indonesia, the provision for loan loss was formerly referred to as Allowance for Productive Asset Losses (PPAP). However, as a result of the revision of PSAK 55 in 2006, the name was subsequently modified to Allowance for Impairment Losses (CKPN). Banks are required to establish a provision known as the Reserve for Impairment Losses in order to account for provision for asset losses. An expansion or enlargement of the loan loss provision at a financial institution confers advantages upon the institution, as it furnishes reserves in anticipation of credit risk. An Indonesian phenomenon that transpired between 2018 and 2022 was the volatility of economic investment loans. The data pertaining to the valuation of commercial bank investment loans in rupiah by economic sector is presented in Table 1. The data comprises both conventional and sharia commercial banks, as sourced from the Central Statistics Agency.

Table 1 Position of Commercial Bank Investment Loans (Billions of Rupiah)

Economic Sector	Investment Credit Ceiling		
	2019	**2020**	**2021**
Loans Based on Business Field	1.476.768	1.408.367	1.431.068
Agriculture, Hunting and Forestry	243.096	228.332	240.615
Fishery	4.946	5.773	5.730
Mining and excavation	10.369	11.062	14.907
Processing industry	176.529	176.818	195.055
Electricity, gas and water	114.588	91.515	62.894
Construction	175.116	183.454	189.989
Wholesale and Retail Trade	171.615	159.978	165.513
Provision of accommodation and food and drink	84.750	81.713	79.944
Transportation, warehousing and communications	214.484	200.211	223.600
Financial Intermediaries	17.819	14.512	14.711
Real Estate, Rental Business, and Corporate Services	162.538	150.774	150.492
Government Administration, Defense and Mandatory Social Security	7.433	4.414	1.734
Education Services	16.436	15.158	15.151
Health Services and Social Activities	24.787	24.723	24.483
Community, Social, Cultural, Entertainment and other Personal Services	49.673	56.793	44.343
Individual Services Serving Households	1.452	1.742	1.655
International Agencies and Other Extra International Agencies	3	0	2
Activities with unclear boundaries	1.133	1.395	251
Loans to Other Non-Business Fields	0	0	6

Source : www.bps.go.id

Table 1 shows the fluctuations in lending by banks in the period 2019 – 2021. Across several economic sectors, investment lending has either increased or decreased, as is evident. Additionally, this affects the provision for loan loss incurred by the financial institution. The loan loss provision of a company can be influenced by a variety of factors, including institutional ownership. According to AlQudah et al., (2020) iinstitutional ownership can be a supervisory function for companies to implement loan loss provisions so that they are not used to manipulate company income figures. In order to analyze this matter in isolation, the majority of research on earnings management employs loan loss provisions as a metric to assess earnings management within companies (Grassa & Chakroun, 2016; Lassoued et al., 2018; Teoh et al., 1998).

Revenue figures are undeniably significant indicators for both internal and external stakeholders, whereas ensuring the sustainability of a company necessitates its stability, dependability, and profitability (Alhadab & Al-Own, 2017; Ciftci et al., 2019). Aside from that, the matter of earnings management pertains to the pursuit of maintaining a consistent profit level in order to secure the managerial position against potential acquisition by an alternative manager (Alves, 2012). Earnings management is defined as a deliberate act of manipulation in financial reports with the aim of realizing personal interests (Schipper, 1989). In other words, managers exploit their controlling position for their personal gain through several maneuvers around earnings (Saftiana et al., 2019).

An additional determinant believed to impact loan loss provisions is managerial ownership. Managerial ownership promotes earnings manipulation as an additional characteristic. As previously stated, a positive and negative relationship between managerial ownership and earnings management is supported by two arguments. One potential consequence of increased insider ownership is a reduced capacity for managerial discretionary behaviour (Jensen dan Murphy, 1990), and as a result accrual-based

earnings manipulation decreases. This is the interest convergence hypothesis, which suggests that the interests of managers and insiders converge with the interests of owners (Bennedsen dan Nielsen, 2010). The effects of entrenchment are further intensified by managerial ownership. This imbalanced control, in conjunction with the absence of activist intervention beyond shareholders or efficient corporate control markets in Asia, grants insiders' considerable autonomy in making corporate decisions. Within this domain, it is argued that management presents accounting values for personal gain, thereby exacerbating the erosion of accounting profits' credibility.

The primary objective of this study is to analyze the impact that managerial and institutional ownership have on provisions for loan losses. From 2018 to 2022, all banking institutions listed on the Indonesia Stock Exchange comprise the data for this study. This research aims to make a scholarly contribution to the study of corporate governance mechanisms and earnings management as they pertain to the survival of companies, with a particular focus on banking institutions.

LITERATURE REVIEW

Corporate governance, in accordance with stewardship theory, ensures the effective allocation of resources and harmonizes the objectives of the organization, individuals, and society about social obligations (Donaldson dan Davis, 1991). Thus, corporate governance is defined as a structure of rights and responsibilities between stakeholders (Tan, 2014). Effective corporate governance functions like a mechanism that ensures that stakeholder interests are well served by executives. Companies with poor corporate governance often adopt suboptimal strategies and manipulate actual performance to avoid takeover (Dalton et al., 2007; Shleifer and Vishny, 1997). Managers employ the technique of earnings management to justify suboptimal decision-making (Claessens and Yurtoglu, 2013). Earnings management is defined by Beneish (2001) as a circumstance in which managers accurately portray the financial position of the organization. This definition inherently demonstrates the presence of information asymmetry between shareholders and managers, in which both parties seek to artificially increase the company's performance and income at the shareholders' detriment.

Another component of corporate governance is institutional ownership, which pertains to the ability, capability, and resources of institutions to oversee and penalize managers to increase their emphasis on company value. In addition to this, institutional ownership can reduce agency conflicts between investors and managers, per Jensen M. C. (1976). The potential impact of an institution's ownership percentage of shares on the financial report preparation process should not be overlooked, as actualization in accordance with management's objectives remains a possibility. According to research Tehranian et al., (2011) and Cahyani & Hendra (2020), managerial conduct can be constrained by the actions of institutional investors and company supervisors. Thus, actions taken by institutional ownership to monitor a company can incentivize managers to place greater emphasis on the company's performance, thereby limiting earnings management by managers. H1: Institutional ownership has a significant negative effect on loan loss provisions.

Managerial ownership signifies the fact that management serves as both shareholders and managers. If the manager possesses a significant amount of company shares, they will serve as a decision-maker within the organization and their every action will be motivated by the desire to enhance the company's performance. When management concurrently serves as the owner or shareholder of the company it oversees, it is conceivable that the implementation of earnings management practices could be reduced (Cahyani & Suryono, 2020).

As a result of the fact that management will be held accountable for the outcomes of each decision they make, a greater proportion of managers' ownership in the company will generate optimal company performance and encourage management to exercise greater caution. (Suseno, Fitriah, & Rosdiana, 2019). If they have a significant amount of company stock ownership, management will act as the party with an interest in the organization, and every action they take will be motivated by the desire to improve the company (Cahyani & Suryono, 2020). By increasing managerial ownership of shares, the value of discretionary accruals can be diminished in order to discourage earnings management actions, thereby enhancing the quality of financial reports, and in this case, earnings reporting. The ability of managerial ownership to oversee the operations of the company can mitigate conflicts of interest that may arise between management and owners or shareholders (Pramesti & Budiasih, 2017). H2: Managerial ownership has a significant negative effect on loan loss provisions.

RESEARCH METHODS

This research used secondary data. This research data collected from annual financial

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reports that are publicly available on the Indonesia Stock Exchange website for the period 2018 - 2022, with a total sample of 145 companies. Eviews 12 was used to analyze the collected data. In this research, the regression equation model is:

$LLP = \beta_0 + \beta_1 IO_{it} + \beta_2 MO_{it} + e$

where LLP - *Loan Loss Provisions;* IO – *Institutional Ownership;* MO – *Managerial Ownership.*

LLP is measured using a formula:

$$LLP_{it} = a + \beta_1 BEGLLR_{it} + \beta_2\, LASSET_{it} + \beta_3\, LCO_{it} + \beta_4\, CHLOAN_{it} + \beta_5\, NPL_{\,it} + \beta_{6-11}\, L_CATEGORE_{it} + \varepsilon_{it}$$

where $\mathbf{LLP_{it}}$ - Loan Loss Provisions; $\mathbf{BEGLLR_{it}}$- Beginning Loan Loss Reserves; $\mathbf{LASSET_{it}}$- Natural Log Of Total Assets; $\mathbf{LCO_{it}}$ - net loans which was written-off after deducting any recoveries as a percentage of total loans; $\mathbf{CHLOAN_{it}}$ - The Change In Total Outstanding Loans (change in total outstanding loans) in the end of the year t; $\mathbf{NPL_{\,it}}$ - Loans that are more than 90 days past due and are still subject to interest; $\mathbf{L_CATEGORE_{it}}$ - different loan categories such as individual, corporate, other bank, and government loans; **ε_it : ** The error term of model 1

$$RSLG_{it} = a + \beta_1\, LASSET_{it} + \beta_2\, URSGL_{it} + \varepsilon_{it}$$

where $\boldsymbol{RSLG_{it}}$ - *Realized Securities Gains And Losses* (realized securities gains and losses from held-to-maturity (HTM) and available-for-sale (AFS) securities as a percentage of total assets; $\boldsymbol{LASSET_{it}}$ - *Natural Log Of Total Assets*; $\boldsymbol{URSGL_{it}}$ - Unrealized securities gains and losses from AFS as a percentage of total assets. So, the earnings management model is as follows:

$$EM_a = DRSGL_a + DLLP_a$$

Abu-Dawleh et al., (2021)

Institutional ownership is calculated using a formula:

$$\frac{\sum \text{shares owned by institutions}}{\sum \text{outstanding shares}} \times 100\%$$

Managerial ownership is calculated using a formula:

$$\frac{\sum \text{shares owned by the CEO}}{\sum \text{outstanding shares}} \times 100\%$$

RESULT AND DISCUSSION

The aim of the research was to empirically test the influence of institutional ownership and managerial ownership on loan loss provisions. Table 2 is the regression results from the research model.

Table 2 Regression Test Results

Variabel	Prediction	Coefficient	Probability
IO	-	- 0.006248	0.0046***
MO	-	-0.102204	0.1731
Adj R-squared		0.041068	
F-statistic		4.083507	
Prob (F-statistic)		0.018866	

Note:
IO= *Institutional Ownership*; MO= *Managerial Ownership*

Significance at level *10%, **5%, ***1%

Based on the findings of this study, it is evident that loan loss provisions are significantly impacted negatively by institutional ownership. Specifically, as the percentage of institutional ownership increases, loan loss provisions for the company decrease. This means that the more company shares owned by institutions, the lower the level of loan loss provisions in the company. This is in accordance with Jensen M. C. (1976) statement that institutional ownership can reduce agency conflicts between investors and managers. The results of this study are in line with research by Tehranian et al. (2011) and Cahyani & Hendra (2020) that supervisory actions carried out by a company and institutional investors can reduce loan loss provisions. Thus, company monitoring actions carried out by Institutional Ownership can encourage managers to focus more attention on company performance so that it will limit the existence of loan loss provisions.

The relationship between managerial ownership and loan loss provisions, however, has not been conclusively demonstrated by research. This means that increases or decreases in the value

of managerial ownership do not affect changes in loan loss provision. The results of this research are not in line with research by Cahyani & Suryono (2020) which states that managerial ownership can reduce loan loss provisions. The failure of management, which is also the owner of the company's capital, to improve the quality and process of financial reporting is caused by the relatively small percentage of managers who own shares compared to the total capital owned by general investors.

CONCLUSION

The findings of this study indicate that loan loss provisions decrease as institutional ownership of the company increases in the regression analysis. In addition to the demonstrated benefit of institutional investors as monitoring proxies in the implementation of company policies, the findings of this study may serve as a reference for banking institutions when formulating policy, specifically about the selection of investors.

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