II. LITERATURE REVIEW

2.1 Theoretical Basis

A. *Agency Theory*

Agency theory as a basic in understanding corporate governance. Agency theory is a contract between the owner (principal) and managers as agents (Jensen and Meckling, 1976). The core issue of agency theory that a proper planning contracts between owners and managers to align interests.

According to the agency theory Jensen and Meckling (1976), principal is the shareholder and the managing agent is the management of the firm. The shareholders hope that the agent will act in the interests of the shareholders, so that they can delegate authority to the agent. But mostly there is a difference of interests between shareholders and agents, as well as the asymmetry of information, resulting in frequent conflict.

Based on the assumption of selfish is a human nature, resulting a difference between the interests of managers and the interests of the owner. The owner is motivated to prosper himself with increasing profitability, while the manager is motivated to maximize the fulfillment of economic, among others, in terms of acquiring the investment and loan.

Thus there are two different interests in the company in which each party seeks to achieve the desired prosperity (Nugroho and Syafrudin, 2012).

A lot of managers seek to increase the scale of the firm by expansion than the prosperity of the shareholders. Dissimilarity goals between shareholders and company's managers are often called agency problem (Arifin and Ratnawati, 2012). The existence of agency problems would caused costs for companies to overcome the problems, these costs are called agency cost.

There are several ways to reduce the agency cost, one is to increase the shareholding to the management (Jensen and Meckling 1976). The greater ownership by the management will reduce the potential for conflict between management and shareholders. Moh'd et al (1998) stated that the distribution of shares between shareholders from outside (institutional investors) and dispersion of ownership can reduce agency cost. Institutional Ownership such as banks, insurance companies or investment companies will increase control that come from external management.

B. Good Corporate Governance Theory

According to Barnhart and Rosenstein (1998) in Siallagan and Machfoedz (2006) agency problem can be solved by good corporate governance (GCG), which are the internal mechanism and external mechanisms.

Kaen (2003) stated corporate governance is basically a matter of "who" should control the course of corporate activities and "why" it must be

controlled on the course of corporate activities. What is meant by who are the shareholders, while the why is because of the relationship between the shareholders of the various parties interested in the company.

Good corporate governance (GCG) definitively a system to regulate and control the firm that create value added for all stakeholders (Monks, 2003). There are two things that are emphasized in this concept. First, the importance of the right of shareholders to obtain information correctly and on time. Second, the company's obligation to make an accurate, timely, and transparent disclosure about information of corporate performance, ownership, and stakeholders.

According Kaihatu (2006) in general, there are five basic principles of good corporate governance:

1. *Transparency* (information disclosure), the transparency in decision making process and openness in expressing material and relevant information about the company.
2. *Accountability*, namely clarity of function, structure, systems, and accountability of corporate divisions, so that the management system of company is effectively implemented.
3. *Responsibility* is suitability in the management of the company to the principle of healthy corporate and applicable legislation.
4. *Independency* is a condition in which a company is managed professionally with no conflict of interest or influence/pressure from

management that is not in accordance with the regulations and legislation and also the principles of healthy corporate.

5. *Fairness* is fair and equitable in fulfilling the stakeholder rights which comes under the agreement and applicable laws and regulations.

Corporate governance mechanism can be divided into internal mechanism and external mechanisms. Internal mechanism came from the board of directors, internal control and internal audit functions. The quality of the internal mechanism is widely associated with better corporate performance (Dharmastuti, 2013). Supervision by the board of commissioners is a mechanism that is essential in aligning the interests of shareholders and management. External mechanism derived from the capital market, the firm control market, the labor market, the status of the state, the court's decision, the shareholders and the practice of investor activity.

External mechanisms of corporate governance will be examined through the role of institutional shareholders. Institutions as the owner of the company has a strategic role in giving effect to the company.

C. Institutional Ownership

According Siallagan and Machfoedz (2006) the company's ownership structure has an influence on the value of the company. In this case the ownership structure is divided into two; managerial ownership and institutional ownership. The ownership of the company may consist of

institutional ownership and individual ownership or a mixture of both with a certain proportion.

Husnan (2001) reveal that there are two types of ownership in a company in Indonesia which are companies with very spread ownership and company with concentrated ownership. More spread corporate ownership gives greater rewards to the management (Goldberg and Idson, 1995 in Husnan, 2001). In the concentrated type of ownership, there are two group of shareholders, that are controlling and minority shareholders (Asian Development Bank, 2000 cited in Husnan, 2001). The controlling shareholders can act together with the interests of shareholders or againts the interests of shareholders, as it also has more information than the minority shareholders, it will affect the behavior of company (The Bussiness Roundtable, 1997). In the case of the concentration of ownership, the possibility of agency problem that arises is the majority owner and minority owner. The majority owner participated in controlling company that tend to act in their own interests although at the expense of minority owners.

The characteristics of concentrated ownership in the company are very common in the companies listed in Indonesia Stock Exchange (Husnan, 2001). An institution that is meant is the owner of a public company in the form of institutions, not the owner of individuals or private. A concentrated ownership by Prowsen (1998) in Wulandari (2006), is more powerful because the owner have more control in the company. The

disadvantage of concentrated ownership presented by Shleifer and Vishny (1997) in Wulandari (2006) is in the possession of large amounts of shares can put the interests of their own which might be contradict with other owners.

Institutional ownership has the ability to control the management through effective monitoring process, thereby reducing management actions that perform earnings management. A certain percentage of shares owned by the institution can affect the financial statements preparation process that do not rule out the possibility of the interests Accrued management (Boediono, 2005).

Allegedly institutional investors are able to prevent the occurrence of profit management than individual investors. Institutional investors considered more professional in control of its investment portfolio, so it is less likely to get distorted financial information.

D. Value of The Company

The company's main purpose according to theory of the firm is to maximize wealth or company’s value (Salvatore cited in Apriada, 2013). The high value of the company is the desire of the owners of the company, because with a high value indicates that prosperity of the shareholders is also high.

Silveira and Barros in Nuraina (2012) defines the value of company as an appreciation of investors on a company. This value is reflected in the

company's stock price. Investors whose are assessing the company that has good prospects in the future will tend to buy shares of the company. As a result of high demand for stocks caused the stock price to rise. It can be concluded, when the stock price is high, it is indicates that investors give high value to the company. The value of company can also provide maximum shareholder wealth when the company's stock price is rising. The higher the stock price, the higher the wealth of shareholders.

2.2 Previous Research

In this research, the researchers tried to examine the effect of of institutional ownership structure on firm value. This research is conducted because based on previous studies, they showed inconsistent results about the effect of institutional ownership, as presented in the following table:

Table 1. Summary of Previous Research

	Author	Title	Variable		Sample	Result
			Dependent	Independent		
1	Haruman (2008)	Effect of Ownership Structure and Financial Decision Through Corporate Value	Value of the company Financial decisions	Institutional ownership	94 manufactures companies listed on Indonesia stock exchange	Institutional ownership has a positive effect on firm value
	Sukirni (2012)	Managerial Ownership, Institutional Ownership, Dividend Policy and Debt Policy Analysis of the Value of the Company (the study of companies listed on the Indonesia Stock Exchange years 2008-2010)	Value of the company	Institutional ownership Dividend Policy Debt Policy	companies listed on the Stock Exchange the period 2008-2010	Institutional ownership has a significant positive effect on the value of the company.

	Author	Title	Variable		Sample	Result
			Dependent	**Independent**		
3	Nuraina (2012)	Effect of Institutional Ownership and Firm Size Policy on Debt and Corporate Values	Value of the Coompany	Institutional Ownership	Companies listed on Indonesia Stock Exchange (IDX) for the period 2006-2008	Institutional ownership has a significant effect on the value of the company.
4	Senda (2013)	Effect of Managerial Ownership, Institutional Ownership, Dividend Policy, Profitability, Leverage Financial and Investment Opportunity Set To Value Company	Value of the company	Managerial ownership Institutional ownership Dividend Policy	142 companies were taken in the study are manufactur-ing companies listed in Indonesia Stock Exchange	Institutional ownership has negative unsignificant relation to firm value
5	Andantara (2013)	Effect of Share Ownership Structure and Corporate Social Responsibility to Corporate Value	Value of the company	Institutional ownership	Samples used are 47 companies listed in Indonesia Stock Exchange 2008-2010 period	Institutional ownership has no effect on the value of the company
6	Wongso (2013)	Effect of Dividend Policy, Ownership Structure and Debt Policy on Corporate Values in the Perspective of Agency Theory and Theory Signaling	Value of the company	Debt Policy Institutional ownership dividend policy	33 companies LQ45 2009-2011	Institutional ownership significantly influence the value of the company
7	Nurfitri *et al.* (2014)	Effect of Ownership Structure and Financial Decision Against Corporate Value In LQ-45 Company Listed in Indonesia Stock Exchange	Value of the company	Instititional ownership	22 Companies listed in LQ45	Institutional ownership affect the value of the company at LQ45 companies listed on the Indonesia Stock Exchange.

	Author	Title	Variable		Sample	Result
			Dependent	Independent		
8	Dian and Lidyah (2014)	Influence of Corporate Social Responsibility, Managerial Ownership, Institutional Ownership and Corporate Value Against Coal Mine Listed in Indonesia Stock Exchange	Value of the company	Institutional ownership	11 coal mining company listed on the Indonesia Stock Exchange in 2010 to 2012	Institutional ownership significantly influence the value of the company

Nuraina (2012) and Haruman (2008) examined the effect of institutional ownership on firm value on companies listed in the Indonesia Stock Exchange. Their study found that isntitusional ownership has significant positive effect on the value of company.

The research was supported by research from Nurfitri et al., (2014), which examined the the influence of institutional ownership on firm value on companies listed in LQ45, as well as research Sukirni (2012) on companies listed in the Indonesia Stock Exchange. Research conducted Dian and Lidyah (2014) on the coal company, also found that institutional ownership has an effect on firm value.

Negative influence of institutional ownership on firm value found by Wongso (2013), which examines LQ45 company. While, research conducted by Adnantara (2013) on manufacturing companies listed in Indonesia Stock Exchange 2008-2010 period, found that institutional ownership has no significant effect on firm value. Similar results were found in studies conducted by Senda (2013) of all companies listed on the Indonesian Stock Exchange (IDX) during 2009 to 2011.