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The Effect of Agency Costs on Firm Value: A Moderating Role of Female Commissioners

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Abtract

The objective of this study is to empirically investigate the influence of agency costs on firm value moderated by female commissioner. Agency costs are proxied by asset turnover ratio, operating expense ratio, and administrative expense ratio, while firm value is proxied by return on assets and return on equity. The sample consists of non-financial companies listed on the Indonesia Stock Exchange during the period 2019-2021. Based on the sampling criteria, the total sample size is 286 firms, with a total of 858 observations. The results reveal that operating expense ratio and administrative expense ratio have a negative effect on firm value, while asset turnover ratio has a positive effect on firm value. Moreover, the findings indicate that female commissioner can positively moderate the linkage between two agency cost proxies (operating expense ratio and asset turnover ratio) and return on assets, as well as the relationship between three proxies of agency cost and return on equity. Incorporating the robustness tests, our results indicate that the presence of a female commissioner remains significant even during the Covid-19 pandemic, further supporting the main findings of the study. This highlights the consistent and significant role of female commissioners in strengthening the relationship between agency costs and firm value. These findings strongly support that the presence of women directors weakens the impact of agency costs and enhances firm value, and provide a suggestion for policymakers to consider implementing regulations regarding proportion of female commissioner in board composition.

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1. Introduction

The value of the firm represents one of the critical concerns for stakeholders, particularly shareholders and management (Harrison & Wicks, 2013; and Baah et al., 2020). The extent to which a company is capable of generating value for its shareholders serves as an essential indicator within the market (Koller et al., 2020). Financial performance is a fundamental element in evaluating a firm's value (Kodongo et al., 2015; Susanti & Restiana, 2018; Haryanto et al., 2018; Banamtuan et al., 2020; and Jihadi et al., 2021). To sustain performance, companies are expected to prioritize and consistently achieve a superior and measurable level of financial performance over time (Jemunu et al., 2021; and Mai, 2021).

The Economist Intelligence Unit (2019) states that there are two ratios that can be used to measure a company's financial performance, namely Return on Assets (ROA) and Return on Equity (ROE). As stated by Brigham & Houston (2019), ROA is the comparison of net income to total assets, measuring the return on total assets. On the other hand, ROE is the comparison of net income to equity, measuring the return on investment for common shareholders. These measurements reflect the future sustainability of the company.

As a company operates over time, there is an interesting phenomenon related to the issue of fulfilling the value of the firm that needs to be reexamined. In the context of corporate resources, opportunistic managers tend to prioritize their personal needs over the interests of shareholders as important parties. The agency theory by Jensen & Meckling (1976) asserts that management, as agents, should be accountable to shareholders, as principals, as stated in the contract. Within this agency relationship, conflicts often arise due to the asymmetry of information between the two parties. Consequently, management, possessing superior information within the company, will strive to prioritize their personal objectives. Therefore, in the process of value creation for the firm, it is necessary to mitigate such conflicts, and one approach is through comprehensive monitoring mechanisms.

The role of agency costs is believed to be vital in minimizing agency conflicts (Savitri, 2018). As a positive contribution, agency costs emerge as a much-needed monitoring mechanism to align the interests between two parties, namely principals and agents (Muchlas, 2018). On the other hand, the occurrence of agency costs can lead to a decline in the financial performance of the company, thereby affecting shareholders' wealth (Baykara & Baykara, 2021; and Andreas et al., 2023). This is due to the emergence of agency costs, which can reduce the company's profitability (Nugraheni & Wiratno, 2022).

To measure the agency costs within a company, some prior studies have employed various proxy of measurements. The diversity of these proxies indicates the absence of a universal measurement proxy. Previous studies, such as Hoang et al. (2019), Komarudin & Affandi (2020), and Sapuan et al. (2021), have utilized the expense ratio and asset utilization ratio as proxies for agency costs incurred by the company. Meanwhile, Khan et al. (2020) employed the comparison of administrative expenses to income to determine the magnitude of agency costs.

In minimizing the impact of agency costs on firm value, companies should design and implement an effective corporate governance system. One component that plays a crucial role in the implementation of corporate governance is the board of commissioners. The board of commissioners in a company is responsible for general and independent oversight and ensuring the effectiveness of decision-making processes (KNKG, 2021). Through the presence of the board of commissioners, agency costs will be reduced due to the supervisory mechanisms exerted by the board over company managers (Serly & Zulvia, 2019).

One aspect that needs to be highlighted regarding the role of the board of commissioners is the participation of women. Although Indonesia does not have specific regulations specifically governing minimum quotas for women in board positions, public companies have provided opportunities for women to be in charge (Deloitte, 2018). In 2019, the percentage of women holding positions on the Board of Commissioners in Indonesia was 14.9%, second best-rank in gender diversity among ASEAN countries (The Economist Intelligence Unit, 2019). However, according to the Indonesia Financial Services Authority (OJK), the contribution of women in the board of commissioners still needs to be enhanced (Ramadhani, 2021). Moreover, when compared to non-Asian countries, the representation of women in board positions in Indonesia is significantly lower. In 2018, the percentage of women holding board positions in Canada was 21.4%, in the USA it was 17.6%, in Austria it was 19.7%, in Belgium it was 30.5%, in Denmark it was 25.4%, and in France, it was 37.2%. Several countries have implemented minimum quotas for the representation of women on boards, resulting in a higher percentage of women involved in board positions.

Based on prior empirical studies, there is still a research gap concerning the relationship between agency costs and firm value considering the presence of women in the board of commissioners. Evidence from the Economist Intelligence Unit (2019) on 1,836 companies in Southeast Asia (Indonesia, Malaysia, Philippines, Thailand, and Vietnam) indicates that, on average, companies involving women in their board composition produce higher Return on Assets (ROA) and Return on Equity (ROE) compared to companies without female board members. The research finding of Ain et al. (2020) suggests that the presence of women on the board can reduce agency costs by reducing information asymmetry and opportunistic behavior of managers through improved monitoring functions. Anas et al. (2022) revealed that women on the board can enhance the effectiveness of board meetings, leading to an increase in firm value. Wijaya (2021) also found that female commissioners can positively moderate the relationship between agency costs and firm value. Similar results were found in the studies by Duppati et al. (2020), Brahma et al. (2020), and Zakaria et al. (2021), which confirmed that the presence of women on the board has a positive impact on firm value. These findings indicate the positive contribution of women on the board of commissioners in enhancing firm value. However, on the other hand, Khairani & Harahap (2017) found that female commissioners tend to avoid risks, leading to a decline in firm performance due to slow reactions to market changes. Furthermore, the research by Riyanti et al. (2023) also demonstrated that gender diversity on the board has a negative impact on firm value. In addition, the study by Satria et al. (2020) found insignificant roles of women commissioners in improving ROA and ROE as proxies for firm value.

Taken as a whole, based on the research background mentioned, this study aims to empirically investigate the relationship between agency costs and firm value, considering the role of female board of commissioners as a moderating variable. Operational expenses, administrative expenses, and asset turno-ver ratios are employed as metrics to gauge agency costs. The findings of this research are anticipated to serve as empirical evidence of the role played by female commissioners in the relationship between agency costs and corporate value

2. Hyphotesis Development

Agency costs occur when manager, as an agent, make decisions that benefit themselves while neglecting the interests of the company owner (principal). According to Ain et al. (2020), agency costs refer to financial incentives such as stock options, performance bonuses, and other incentives that enable agents to fulfill their tasks correctly. Some decisions made by managers involve various combinations of salaries, commissions, and other operational expenses (Jensen & Meckling, 1976). High operating expenses ratios indicate high agency costs (Hoang et al., 2019). According to Liang et al. (2020), management obtains welfare and benefits by using administrative costs to cover excessive expenditures. The research findings of Hoang et al. (2019) and Khan et al. (2020) show that companies with lower agency costs (indicated by lower expense ratios) have higher financial performance or firm value. In addition, Khuyen (2021) and April & Handayani (2018) found the inverse relationship between operating expense ratio and ROA and ROE.

Furthermore, agency costs also arise due to the inefficiency of management in asset management, resulting in a decrease in revenue (Houqe et al., 2022). A high asset turnover ratio indicates the effectiveness of utilizing company assets, which contributes to increased profitability (Nasution et al., 2019). Conversely, a low asset turnover ratio indicates high agency costs due to ineffective asset utilization, resulting in a reduced contribution to profit. The presence of excessively high agency costs can reduce company performance. The greater company performance will maximize profits from assets and shareholder wealth (Nuhu, et al., 2020) and enhance firm value (Oktarina, 2018). Sapuan et al. (2021) verified a positive impact of the asset turnover ratio on ROA. Similarly, Nasution et al. (2019) identified a comparable association between the asset turnover ratio and ROE. Hence, the hypotheses formed areas follows:

H_1 : The expense ratio has a negative effect on firm value.

H_2 : The administrative expense ratio has a negative effect on firm value.

H_3 : The asset turnover ratio has a positive effect on firm value.

The board of commissioners plays a crucial role, as a controller, responsible for overseeing and providing suggestions to the board of directors, ensuring the proper functioning of the governance system. The supervisory function conducted by the board of commissioners can be linked to agency theory (Sutrisno & Fella, 2020). The representation of women on the board can reduce agency costs and eventually enhance firm value (Khan et al., 2020). A perspective states that women on the board of commissioners have better ethical values and their presence will strengthen the supervisory function of the board, thereby minimizing the negative impact of agency costs (Wijaya, 2021). Increased gender diversity through the presence of women in the board composition leads to improvements in corporate governance system and management control (Sutrisno & Fella, 2020). Moreover, it will encourage the board of commissioners to steer the board of directors toward achieving company performance standards (Sutrisno & Mohamad, 2019). Furthermore, gender-diverse board composition can enhance the independence of the board, broaden perspectives, and promote a wider range of thinking, thereby developing the quality of monitoring and control mechanisms (Thoomaszen & Hidayat, 2020).

H_4 : Female board of commissioners moderate the relationship between agency costs and firm value.

3. Data and Methods

We obtain the data for this study from audited financial report of companies available on the Indonesia Stock Exchange website and the respective company websites. The data collection technique used is documentation and the data analysis employed is regression analysis based on Partial Least Squares Structural Equation Modeling (PLS-SEM).

The population for this study consists of non-financial sector companies listed on the Indonesia Stock Exchange during the period 2019-2021. The sample criterias for selection are shown on Table 1.

Table 1. Sample criterias

No.	Kriteria	Jumlah
1.	Non-financial sector companies listed on the Indonesia Stock Exchange during the period 2019-2021.	561
2.	Excluding companies that were delisted during the specified period.	(7)
3.	Excluding companies that reported negative equity during the research period.	(22)
4.	Excluding companies that do not use the Indonesian Rupiah as the reporting currency.	(82)
5.	Excluding companies that did not disclose financial statements, annual reports, and the required data during the research period.	(164)
Total sample		286
Sample period		3
Total observation		858

The dependent variable in this study is firm value, which is proxied by return on assets (ROA) and return on equity (ROE). ROA is calculated by dividing net income by total assets, while ROE is calculated by dividing net income by total equity. The independent variables are agency costs, which are proxied by asset turnover ratio, operating expense ratio, and administrative expense ratio. The asst turnover ratio is calculated by dividing sales by total assets. The operating expense ratio is calculated by dividing operating expenses by sales, while the administrative expense ratio is calculated by dividing administrative expenses by sales.

The moderating variable, female commissioners, is calculated by comparing the proportion of female board of commissioner's members to the total number of board of commissioner's members. There are two control variables used in this study, namely leverage and firm size. Leverage is calculated by dividing total assets by total debt, while firm size is calculated by taking the logarithm of total assets.

To obtain more comprehensive research findings, two additional robustness tests will be conducted. First, the testing will focus on the period during the Covid-19 pandemic, specifically the years 2020 and 2021. Second, a dummy variable for female commissioners will be used as a moderating variable. A value of 1 will be assigned if there are female commissioners present, and a value of 0 will be assigned if there are no female commissioners. These tests aim to provide further insights into the relationship between the variables under study.

4. Result

Table 2 indicates that the mean return on assets is 0.029, the mean return on equity is -0.008, with a standard deviation of 0.098 for ROA and 0.363 for ROE. This signifies a considerable degree of variability in the data values of firm performance.

Table 2. Descriptive statistics

Variable	Mean	Minimum	Maximum	St. Deviation
Return on asset (ROA)	0.029	-0.484	0.717	0.098
Return on Equity (ROE)	-0.008	-4.881	1.491	0.363
Operating Expense Ratio (OPR)	0.298	0.006	21.504	0.844
Administration Expense Ratio (ADM)	0.192	0.000	6.309	0.401
Asset Turnover Ratio (ATR)	0.874	0.001	8.576	0.953
Proportion of Female Commissioner (PFC)		0	1	0.202

The mean operating expense ratio is 0.298, while the average administration expense ratio is 0.192. This implies that agency costs, as reflected in the operating expense ratio, account for 29.8%, and administrative expense ratio accounts for 19.2% of the total sales. The mean asset utilization ratio is 0.874. A higher asset turnover ratio suggests lower agency costs. The average representation of female commissioners is 0.142, indicating a relatively small percentage of agency costs and the number of female board commissioners.

Hypotheses testing

Table 3 and 4 show that OPR (Operating Expense Ratio), ADM (Administrative Expense Ratio), and ATR (Asset Turnover Ratio) have a significant impact on firm value. The negative coefficients indicate that an increase in OPR and ADM leads to a decrease in ROA and ROE, while the positive coefficient of ATR indicates that a higher ATR enhances ROA and ROE. Therefore, Hypotheses 1, 2, and 3 are accepted, supporting the hypotheses that OPR, ADM, and ATR have significant effects on firm value.

Table 3. The influence of agency costs on return on assets (ROA)

Variable	ROA					
	(1a)		(2a)		(3a).	
	Coefficient	p-value	Coefficient	p-value	Coefficient	p-value
Constant	0.052	0.007***	0.069	0.000***	0.030	0.114
OPR	-0.014	0.000***				
ADM			-0.065	0.000***		
ATR					0,024	0.000***
Control var:						
LEV	-0.123	0.000***	-0.139	0.000***	-0.130	0.000***
SIZE	0.003	0.039**	0.003	0.039**	0.003	0.032**
Adj. R-Square		0.084		0.139		0.124

Note: ***significant level < 1%, ** significant level < 5%, *significant level < 10%.

Table 4. The influence of agency costs on return on equity (ROE)

Variable	ROE					
	(1a)		(2a)		(3a)	
	Coefficient	p-value	Coefficient	p-value	Coefficient	p-value
Constant	0.141	0.048	0.181	0.010	0.100	0.161
OPR	-0.043	0.002***				
ADM			-0.576	0.000***		
ATR					0.029	0.021**
Control var:						
LEV	-0.536	0.000	-0.576	0.000	-0.530	0.000
SIZE	0.009	0.115	0.009	0.121	0.009	0.112
Adj. R-Square	0.105		0.130		0.101	

Note: ***significant level < 1%, ** significant level < 5%, *significant level < 10%.

Table 5. The influence of female commissioners' moderation on the relationship between agency costs and return on asset (ROA)

Variable	ROA					
	(1a)		(2a)		(3a)	
	Coefficient	p-value	Coefficient	p-value	Coefficient	p-value
Constant	0.061	0.027	0.071	0.010	0.036	0.185
OPR*PFC	0.102	0.086*				
ADM*PFC			0.069	0.319		
ATR*PFC					0.061	0.002***
Control var:						
LEV	-0.125	0.000	-0.138	0.000	-0.134	0.000
SIZE	0.003	0.158	0.003	0.167	0.003	0.094
Adj. R-Square		0.098		0.146		0.140

Note: ***significant level < 1%, ** significant level < 5%, *significant level < 10%.

Table 6. The influence of female commissioners' moderation on the relationship between agency costs and return on equity (ROE)

Variabel	ROE (1a)		(2a)		(3a)	
	Coefficient	p-value	Coefficient	p-value	Coefficient	p-value
Constant	0.173	0.050*	0.187	0.034**	0.121	0.181
OPR*PFC	0.371	0.037**				
ADM*PFC			0.263	0.083*		
ATR*PFC					0,232	0.000***
Control var:						
LEV	-0.544	0.000***	-0.571	0,000***	-0.544	0.000***
SIZE	0.008	0.328	0.008	0.341	0.010	0.229
Adj. R-Square		0.119		0.137		0.146

Note: ***significant level < 1%, ** significant level < 5%, *significant level < 10%.

Table 5 indicates that female commissioners can moderate two proxies of agency costs (OPR and ATR) in relation to ROA, although the significance level for OPR is not as significant as for ATR. However, the moderating role of female commissioners is not found for ADM and ROA. The positive coefficients indicate that the presence of female commissioners can strengthen the influence of ATR on ROA and weaken the influence of OPR on ROA. Therefore, it strongly supports the Hypothesis 4, especially for two proxies (OPR and ATR).

Based on the p-values in Table 6, it can be observed that female commissioners can moderate the relationships between agency costs (proxied by all three variables OPR, ADM, ATR) and ROE, although at different significant levels. The positive coefficients show that the number of female commissioners can positively moderate the relationships between ATR, OPR, ADM, and firm value. Therefore, Hypothesis 4 is accepted, suggesting that female commissioners play a moderating role in the relationship between agency costs and firm value.

Robustness tests

The purpose of the first robustnesst test is to investigate the female commisioner's moderating role during the pancemic time. Indeed, while there is currently no official regulation regarding the composition of female commissioners on boards, it is important to examine this phenomenon to gain insights into the role of female commissioners during the pandemic. The findings in Table 7 shows that during the Covid-19 pandemic, agency costs proxied by OPR and ADM have a negative impact on firm value, ROA and ROE. Only ATR has a positive impact on ROA but does not significantly affect ROE. Overall, during the Covid-19 pandemic, the significant role of female commissioners only strengthens the relationship between ATR and firm value (ROA and ROE). This suggests that even during the pandemic, the role of female commissioners as a moderating variable still contributes to strengthening the relationship between agency costs (ATR) and firm value. Therefore, these findings are consistent with the main results of the study, particularly regarding the relationship between ATR and firm value (ROA and ROE).

Tabel 7. First Robustness Test: Covid-19 period

Variable	Coefficient	*p-value*
OPR -> ROA	-0.060	0.000***
OPR -> ROE	-0.170	0.000***
ADM -> ROA	-0.062	0.000***
ADM -> ROE	-0.167	0.000***
ATR -> ROA	0.025	0.002***
ATR -> ROE	0.026	0.138
OPR*PFC -> ROA	0.056	0.462
OPR*PFC -> ROE	0.252	0.169
ADM*PFC -> ROA	0.064	0.390
ADM*PFC -> ROE	0.264	0.111
ATR*PFC -> ROA	0.042	0.024**
ATR*PFC -> ROE	0.232	0.002***

Note: ***significant level < 1%, ** significant level < 5%, *significant level < 10%.

Table 8. Second Robustness Test:
Female Commissioner as Dummy Variable

Variable	Coefficient	*p-value*
OPR* DUM -> ROA	0.064	0.018**
OPR*DUM -> ROE	0.191	0.013**
ADM* DUM -> ROA	0.027	0.408
ADM* DUM -> ROE	0.122	0.093*
ATR*DUM -> ROA	0.025	0.010**
ATR*DUM -> ROE	0.108	0.000***

Note: ***significant level < 1%, ** significant level < 5%, *significant level < 10%.

As the second robustness test, Table 8 focuses on female commissioners as a moderating variable (dummy variable) for the entire research period.

The results show that female commissioners, represented by a dummy variable, can positively moderate the relationship between OPR and ATR with firm value, as well as ADM with ROE. These robustness test results demonstrate consistency with the main findings of the study stating that there is strong role of female commissioner to strengthen the linkage between agency cost and firm value.

5. Discusssion

The Effect of Operating Expenses on Firm Value

The research findings demonstrate that agency costs, proxied by OPR, have a negative impact on ROA and ROE. This negative relationship implies that the lower the agency costs, the higher the firm value, and vice versa. The findings of this research are supported by the agency theory proposed by Jensen & Meckling (1976), which highlights the existence of conflicting interests between management and company owners. These conflicting interests give rise to agency costs as an effort to reduce the conflicts. Jensen & Meckling (1976) state that managers will increase non-monetary compensation to maximize their utility without supervision and considering other rules. This contradicts the interests of the principals and does not enhance shareholder wealth. According to Baykara & Baykara (2021), operating expenses, which directly reflect the measurement of agency costs, indicate expenditure inefficiency that can worsen company's financial performance. Savitri (2018) states that high agency costs indicate the management's inability to effectively manage operational expenses, leading to a decline in company performance. These findings are consistent with the research results of Khuyen (2021), April & Handayani (2018), dan Hoang et al. (2019).

The Effect of Administrative Expenses on Firm Value

The findings of this research prove that ADM has a negative impact on firm value. According to Liang et al. (2020), management gains welfare and perks by utilizing administrative expenses to cover excessive expenditures. Consequently, excessively high administrative costs trigger agency cost issues and draw attention from shareholders. According to Khan et al. (2020) and Nugraheni & Wiratno (2022), administrative expenses constitute a significant portion of the costs incurred by company, which can lead to a decline in profit and reduce company's financial performance. This is consistent with the research findings of Nugraheni & Wiratno (2022) stating that high administrative costs will diminish the achievement of competitive advantages, which in turn affects company performance. Conversely, low administrative costs will enhance firm value.

The Asset Turnover Ration on Firm Value

The research findings demonstrate that ATR has a positive impact on ROA and ROE. According to Ang et al. (2000), agency costs can be measured by the loss of income resulting from the inefficient utilization of assets. Inefficient asset usage leads to a decline in revenue (Houqe et al., 2022). Hoang et al. (2019) states the asset turnover ratio evaluates the efficiency of asset utilization, and a high asset turnover ratio indicates low agency costs. Nasution et al. (2019) reveal that a higher asset turnover ratio signifies effective utilization of company assets, which can lead to increased profitability. This aligns with the studies conducted by Sapuan et al. (2021) and Nasution et al. (2019), which confirm that the asset turnover ratio has a positive effect on firm value.

The Moderating Effect of Female Board of Commissioners on Relationship Between Agency Costs and Firm Value.

According to the data collected in this study, the average proportion of female commissioners is found to be only 14.1%, indicating that the involvement of women in the board of commissioners is still low. However, we empirically found that female commissioners can moderate the relationship between OPR and ATR with ROA and moderate the relationship between OPR, ADM, and ATR with ROE. These research findings align with the results of Hoang et al. (2019), which assert that the presence of women in leadership positions on the board is seen as a factor that can help counteract or reduce the negative influence of agency costs on the financial performance or value of the firm. Regarding the moderating variable, the composition of female commissioners in Indonesia is not regulated by legislation (Deloitte, 2018). According to Linggih & Wiksuana (2015), gender diversity in the board improves financial performance by enhancing board independence, allowing better control and supervision over the company. Improved supervision reduces agency conflicts and encourages agents to improve performance. This is further reinforced by the robustness tests that have been conducted, confirming the consistency of the role of female commissioners during the pandemic and throughout the research period.

6. Conclusion and Suggestion

Conclusion

The research findings indicate that agency costs have an impact on firm value. Furthermore, the test results also demonstrate that female commissioners can positively moderate the influence of the operating expense ratio and asset turnover ratio on firm value. The results of this study, which show that the presence of women on the board of commissioners weakens the influence of agency costs and enhances firm value, can serve as a basis for governments to establish regulations regarding gender quotas in board structures. Such regulations have been implemented in several countries, including France, Iceland, Italy, Norway, Malaysia, Greece. Portugal specifically mandates a minimum representation of women on the board of commissioners at 33%, while Germany has a minimum quota for female commissioners set at 40% (Deloitte, 2018). This research also provides insights for companies in shaping their corporate governance to include women in board compositions.

Suggestion

In future research, it is recommended to consider additional factors as moderating variables in examining the relationship between agency costs and firm value, such as institutional or managerial ownership, board size, board independence, and other monitoring mechanisms. Incorporating these factors into the analysis will provide a more comprehensive understanding of how these factors interact with agency costs and firm value. By including these factors, future research can provide a more comprehensive overview of the interplay between various governance factors, agency costs, and firm value. Such insights are valuable for policymakers, practitioners, and researchers in advancing corporate governance practices and policies.

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