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Corporate financial risks: Is there a role of insider incentives?

Arif Budi Satrio*
Universitas Widya Dharma Pontianak, Indonesia
*Email: arif.budi.satrio.li@gmail.com

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Abstract: Weak corporate governance in developing countries, the complexity of agency issues, and the lack of consensus on insider and corporate financial risk relations are the reasons why this issue is urgent to investigate. This study investigates the role of insider incentives on corporate financial risk with a sample of 234 non-financial companies in Indonesia for 2003-2018 using dynamic system GMM panel regression, taking into account the number of fundamental factors and firm-level characteristics in the test. Robust findings show that insiders significantly reduce firms' financial risk, and this effort became even more evident after the 2008 subprime crisis. These findings clarify agency issues in firms in developing countries and support the pecking order theory. These findings enrich the literature, especially regarding good corporate governance, and are helpful for regulators regarding regulations, especially in developing countries.

Abstrak: Lemahnya tata kelola perusahaan di negara-negara berkembang, kompleksitas masalah keagenan, dan kurangnya konsensus relasi orang dalam dan risiko keuangan perusahaan menjadi alasan mengapa masalah ini penting untuk diinvestigasi. Penelitian ini menyelidiki peran insentif insider terhadap risiko keuangan perusahaan dengan sampel 234 perusahaan non-keuangan di Indonesia pada tahun 2003-2018. Analisis dengan regresi panel GMM sistem dinamis, dengan mempertimbangkan jumlah faktor fundamental dan karakteristik tingkat perusahaan dalam pengujian. Hasil konsisten menunjukkan bahwa insider secara signifikan mengurangi risiko keuangan perusahaan, dan upaya ini menjadi lebih nyata setelah krisis subprime tahun 2008. Temuan ini memperjelas masalah keagenan di perusahaan di negara-negara berkembang dan mendukung teori pecking order. Temuan ini memperkaya literatur khususnya mengenai tata kelola perusahaan yang baik, dan bermanfaat bagi regulator terkait regulasi khususnya di negara-negara berkembang.

Introduction

Firms in most developing countries are characterized by family and are controlled by ultimate ownership (Ilhan-Nas et al., 2018; Porta et al., 1999), and Indonesia is no exception (Claessens et al., 2000). This ownership characteristic can lead to serious agency problems because it allows the tendency for entrenchment due to control by corporate ownership. In Indonesia, this is exacerbated by weak minority protection, high levels of information asymmetry, and slow corporate governance progress (Satrio, 2022a, 2022b).

Regarding the agency theory, corporate governance is getting stronger if there is an alignment of interests between principals and agents that can be realized with ownership incentives for management. This incentive is expected to mitigate agency problems in the ultimate ownership structure with the alignment effect (convergence of interest hypothesis (Jensen & Meckling, 1976)). Recent evidence by Vijayakumaran (2021) proves that this ownership positively affects firm investment by aligning management incentives with shareholder interests. The presence of an insider in a firm will reduce the risk of default in developing countries (Kopyrina & Stepanova, 2023).

Huge previous studies have documented the role of insiders, in particular, on firm performance and firm value (for example (Basu et al., 2016; Benamraoui et al., 2019; Bhabra, 2007; Drakos & Bekiris, 2010; Lin et al., 2021; McConnell et al., 2008)), even in corporate social responsibility issue (Hettler et al., 2021). When associated with the use of debt, the insider has been shown to increase in Thailand (Wiwattanakantang, 1999). Insider acts as a credible guarantee for creditors, helping to reduce agency costs and asymmetric information, thereby facilitating the firm's investment efficiency (Vijayakumaran, 2021).

Despite the well-documented alignment effect, the insider role is not always the case. Convergence of interest and entrenchment simultaneously appear when there are insider stakes, as evidenced by Australian firms (Shan et al., 2019). This ownership has a value-destroying effect (Florackis et al., 2020) by diverting risk-taking activities (Albring & Xu, 2018; Florackis et al., 2020). Managers' incentives are indeed more aligned with shareholder incentives when they own shares in the firms they manage, but the presence of insiders can also exacerbate agency problems and allow them to pass shareholder resolutions (Marquardt et al., 2018). Apart from shareholders, insiders can also harm stakeholders. The effect is seen in reducing corporate social responsibility activities (Hettler et al., 2021), harming bondholders, enabling more significant related party transactions, and reducing firm profitability (Bauer et al., 2021). This entrenchment problem is especially relevant for firms with poor investor protection (Cheng & Wang, 2021).

Based on agency theory, this study aims to provide insight into insiders' incentives in dealing with financial risk as reflected in the firm's financial structure.

At least three justifications exist for the importance of investigating this issue. *First*, based on conventional capital structure signaling theory predictions, the public should perceive debt positively. However, debt does not always convey good news (Su, 2004). *Second*, complex agency problems, especially in controlling insiders and outsiders in Asian countries (Kim et al., 2020). *Third*, as discussed earlier, refers to the empirical evidence related to insider stakes that has not been consistent in previous studies. This investigation is essential because so much previous literature analyzes insider and firm performance, but little is known about its relation to financial risk-taking (Rhou et al., 2019).

This study provides insight into the relationship between insider incentives and corporate financial risk. There are at least two contributions from this study. *First*, this research broadens the understanding of the role of insider incentives in corporate financial management, specifically regarding firm financial risk. This study provides insight into the results of a previous study by Satrio (2022b), which shows that firms in Indonesia facing high asymmetric information will tend to choose debt as a source of external funding. Will this be different from having insider incentives? *Second*, this research documents the latest empirical evidence of insider impact on changes in corporate financing risk in Indonesia by considering the issue of endogeneity, crisis period, and insider proportion in firms.

It is necessary to elaborate on several relevant theories to reconcile conflicting arguments regarding the role of insiders in the firm. Drawing on agency theory (Jensen, 1986, 1988; Jensen & Meckling, 1976), this study first examines how agency problems can influence decision-making. Without agency problems, the management will try to maximize shareholder wealth. But in reality, the manager's self-interest can cause decision-making problems. This problem is exacerbated by the principal's inability to verify what the agent is doing entirely and the risk-sharing that arises. This risk causes errors made by management to be borne by the principal.

Firm ownership significantly determines agency problems between internal control and external investors (Lemmon & Lins, 2003). In this case, management incentives in the form of sharing ownership with this party can mitigate agency conflicts with shareholders (Jensen & Meckling, 1976). Agency problems can be minimized by combining the ownership structures that can increase the owner's incentive to conduct monitoring (efficient monitoring hypothesis) while aligning the interests of managers and shareholders (alignment effect). Insider incentive is expected to reduce agency conflict so that the convergence of interest hypothesis is expected to produce superior performance (Jensen & Meckling, 1976) and can have a positive impact on the firm (alignment effect (Claessens & Fan, 2002)). Alignment of interests can improve the quality of corporate governance, impacting the risks faced by the firm. The combination of these organizational dimensions can reduce the tendency of fraud. Empirical evidence (Boubaker & Sami, 2011; Lassoued et al., 2017) supports the alignment effect hypothesis.

Insider stakes are relatively high, and managers with great control can also encourage more centralized personal interests than the interests of shareholders. Control and management shareholders will form a stronghold where increased power can divert stretched resources for its benefit (Wiwattanakantang, 2001). These conditions can cause a defensive effect on firm management (entrenchment hypothesis (Claessens & Fan, 2002; Hu & Izumida, 2008)). Financial control policies are only effective when managerial equity interests are relatively low and if managers with higher equity will inhibit the positive effect on financial control policies (Chu, 2015). These problems can be an insider cause to avoid an increase in funding risk because it can impact the increase in monitoring by external parties, including creditors.

Ownership control is better than managerial control (according to expectations of the managerial theory of the firm and agency theory (Moustafa, 2005)). The logic is that firms with management control will tend to passive behavior to control and cause moral hazard and adverse selection behavior. In subsequent empirical testing by researchers, it was also found that there was no positive relationship between higher audit fees and the managerial ownership structure (Nelson & Mohamed-Rusdi, 2015). The existence of adverse selection problems, followed by a decrease in audit fees, indicates a negative effort by insider and their unwillingness to be monitored. This reluctance can be worsened by the weakness of the law, which does not appear to offer minority shareholders the protection needed in emerging markets, including Indonesia. This condition is the cause of the possibility of a coalition between managers, major shareholders, and directors to fight the interests of minority shareholders.

The entire description illustrates the possibility of insider parties aligning their interests (alignment effect) with the interests of other shareholders while also allowing private perquisite to be carried out by avoiding additional monitoring by external parties. These conditions can be the logic of a negative association between insider stakes and acquiring funding sources from debt (financial risk). In this case, firm managers can act as agents who serve the firm based on the self-serving principle (Goranova & Ryan, 2014). These conditions encourage a significant loss in insider stakes (the managerial entrenchment hypothesis (Demsetz, 1983; Fama & Jensen, 1983)). Firms will also be less valuable when managers with significant equity have enough voting to ensure their position within the firm or allow them to be free from external inspection.

Insider, in principle, will also tend to obtain funding from internal sources compared to funding sources from debt issuance. There are at least two logics that can explain this statement. *First*, it refers to the pecking order theory (Myers & Majluf, 1984), which explains the hierarchy of funding sources. Internal funding will be preferred first to external financing because the firm faces asymmetric information problems. Of course, external funding has a higher risk because of these problems.

Recent research in Indonesia has proven this argument (Satrio, 2022b). *Second*, the choice of internal funding can be explained through the basic assumption of human nature, namely risk aversion (Eisenhardt, 1989; Jensen & Meckling, 1976). Assumptions about human self-interest (Eisenhardt, 1989) are inseparable from insider ownership, which causes ownership to be self-serving (Goranova & Ryan, 2014), including supervision from the existence of funding sources of external debt. Therefore, the hypothesis in this study is that insiders have a negative influence on the corporation's financial risk.

This article is divided into four parts. Following the introduction, the methodology is explained, while Section 3 and 4 presents the results and discussion. In the end, the conclusion is outlined in Section 5.

Method

The sample used in this study included 234 non-financial companies on the Indonesia Stock Exchange based on the company's initial public offering year prior to 2003. Companies in the analysis period that moved to the financial sector were also eliminated from the sample. The criteria for determining the sample with a period starting from 2003 to avoid the confounding effect of the global financial crisis that occurred in 1997-1998 and with consideration of the development of governance in Indonesia through the issuance of the code of good corporate governance in Indonesia by the Coordinating Minister for Industrial and Financial Economics No. Kep/31/M.EKUIN/08/1999. The next consideration related to the determination of 2003 as the beginning of the investigation is to get a more extended observation period, for sixteen years (2003-2018), to ensure consistency of results on testing. The investigation is not on non-financial companies, with the consideration that the companies have different financial characteristics. The research data is obtained from the Indonesia Stock Exchange.

This study's econometric modeling was conducted using the baseline and main models. *First*, the baseline model is done by referring to the company's characteristics built with considerations that have been commonly done in previous research. In this model, changes in financial risk are estimated by profitability, investment opportunities, liquidity, and asset maturity-investigation of all these factors with a number of considerations. Companies with higher profitability will depend less on external funding sources (Myers & Majluf, 1984). In contrast, investment opportunities and higher asset maturity can encourage increased funding in the form of debt (Deesomsak et al., 2009). Companies with investment opportunities will determine the different roles of ownership and control in agency problems (Martin-Reyna & Durán-Encalada, 2012). Liquidity, which is an indicator of the availability of internal funding sources, is also considered necessary (Deesomsak et al., 2009) because it is a factor that can reduce debt dependence on companies. *Second*, the main

model is carried out by including insider incentives in the baseline model. Estimation with panel data in all company samples and estimation with the baseline model in equation one and the main model in equation two below:

$$Risk_{i,t} = \alpha_1 + \beta_1 Profitability_{i,t} + \beta_2 IOS_{i,t} + \beta_3 Liquidity_{i,t} + \beta_4 Asset\ Maturity_{i,t} + \varepsilon_{i,t} \quad (1)$$

$$Risk_{i,t} = \alpha_1 + \beta_1 Insider_{i,t} + \beta_2 Profitability_{i,t} + \beta_3 IOS_{i,t} + \beta_4 Liquidity_{i,t} + \beta_5 Asset\ Maturity_{i,t} + \varepsilon_{i,t} \quad (2)$$

Measurement of profitability with return on assets (ROA) which is calculated from the comparison between operating profit after tax with total assets, investment opportunity set (IOS) by considering the assessment of external parties ((Martin-Reyna & Durán-Encalada, 2012; McConnell & Servaes, 1995; Russell, 2015)) with a price earning ratio proxy, liquidity with the current ratio, and asset maturity based on the availability of fixed assets to the total assets owned (Deesomsak et al., 2009). As explained in the previous section, insider incentives are measured based on the company's ownership proportion by management. Furthermore, financial risk is measured with debt to total assets (DTA) and equity to total assets (ETA) (Knopf & Teall, 1996). Equity considerations are carried out after issuing a minority equity interest to ensure consistency in the test results.

Result

Table 1 presents descriptive statistics on all variables used in this article. The summary results show the selection of funding sources that differed significantly between companies sampled in Indonesia (std. Dev 2.9937, minimum 0.0000, and maximum 163.2298). The diverse financial condition of the companies can be seen from the existence of companies with negative equity, as indicated by the minimum value of ETA. The capabilities and inter-company financial management policies sampled are also very diverse, as seen in the value of profitability, IOS, liquidity, and asset maturity. An interesting result is that some companies do not try to reduce type I agency conflicts by providing incentives to management, which is indicated by insider incentives with a minimum value of 0.0000. Still, there are also insider incentives that actually dominate (maximum value of 0.8944).

Table 2 presents the correlation matrix, which shows the correlation between the dependent and independent variables. A negative correlation of DTA on insider incentives, profitability, and liquidity is indicated by the values of -0.0206, -0.2728, and -0.0278, respectively. The correlation between independent and control variables that are all smaller than 0.9 indicates no multicollinearity in the estimation model in this study. This study also tested multicollinearity based on the VIF value. As a result, all tests show a VIF value of less than 5, which also means there are no multicollinearity problems.

Table 1. Descriptive Statistics

Variables	Mean	Std. Dev.	Min	Max
DTA	0.6479	2.9937	0.0000	163.2298
ETA	0.3418	2.9814	-162.2298	4.8118
Insider Incentives	0.0201	0.0651	0.0000	0.8944
Profitability	0.0065	1.8906	-112.4767	15.4777
IOS	56.0216	1621.6730	-40000	53750
Liquidity	3.4291	15.9316	0.0007	464.9844
Asset Maturity	0.5245	0.2284	0.0000	0.9998

Source: Output STATA 15

Table 2. Correlation Matrix

Variables	1	2	3	4	5	6	7
DTA	1						
ETA	-0.9955	1					
Insider Incentives	-0.0206	0.0187	1				
Profitability	-0.2728	0.2736	0.0028	1			
IOS	-0.0044	0.0043	0.0022	0.0027	1		
Liquidity	-0.0278	0.0277	0.0216	-0.0034	0.0477	1	
Asset Maturity	-0.0079	0.0061	-0.0322	0.0170	-0.0099	-0.0693	1

Source: Output STATA 15

Tables 3 and 4 show that estimation results are calculated using the dynamic GMM method. This technique can overcome bias due to lagged dependent variables or the endogeneity of other explanatory variables. This study's testing stages first began with determining the best modeling based on overall estimation (Bond et al., 2001). Post estimation refers to AR(2) and the Hansen Test. The AR(2) test is used to detect second-order autocorrelation, while the Hansen test is tested for validation of over-identifying restrictions. The test results in Table 3 show that the p-value on AR (2) is entirely greater than 0.05, which means that the estimation with the GMM model is consistent and unbiased. The estimation model with GMM in this study is also robust and valid, indicated by the p-value on the Hansen Test, which is also greater than 0.05. Overall, GMM estimation is acceptable.

Table 3 shows the baseline results documenting the impact of control variables on the company's financial risk. Test results show profitability and liquidity have a negative and significant direction on financial risk (consistent with the pecking order

theory related to the hierarchy of funding sources (Myers & Majluf, 1984)). The ability to generate higher profits will encourage internal funding sources, which causes companies to reduce external funding.

Table 3. Baseline and Main Model

Variables	Baseline Model (1)		Main Model (2)	
	DTA	ETA	DTA	ETA
Lag(1)	0.4131***	0.4124***	0.4128***	0.4124***
	(0.0062)	(0.0093)	(0.0062)	(0.0093)
Insider Incentives			-0.4155**	0.3346*
			(0.1890)	(0.1949)
Profitability	-0.4666***	0.4668***	-0.4655***	0.4654***
	(0.0064)	(0.0062)	(0.0064)	(0.0061)
IOS	0.0000	0.0000	0.0000	0.0000
	(0.0000)	(0.0000)	(0.0000)	(0.0000)
Liquidity	-0.0038**	0.0037**	-0.0038**	0.0036**
	(0.0018)	(0.0015)	(0.0016)	(0.0014)
Asset Maturity	-0.4894	0.5958	-0.5055*	0.5681*
	(0.3507)	(0.4685)	(0.2591)	(0.3372)
Constant	0.6851***	-0.1546	0.7041***	-0.1408
	(0.2620)	(0.3540)	(0.1967)	(0.2556)
AR(2)	0.9800	1.0000	0.9800	1.0000
	0.3260	0.3180	0.3260	0.3180
Hansen Test	31.9200	32.4900	31.2900	31.4500
	0.2350	0.2140	0.2600	0.2530

Note: This model estimates (1) the baseline and (2) the main model, where the financial risk is measured by debt to total asset (DTA) and equity to the total asset (ETA). The data period ranges from 2003 to 2018. The standard errors are stated in the figures in parentheses. The second-row numbers in AR (2) and the Hansen Test show probability values. ***, **, and * denote the level of significance of 0.01, 0.05, and 0.1, respectively.

Source: Output STATA 15

Companies with higher liquidity that indicates the adequacy of internal company funds can also result in non-dependence on debt financing. However, investment opportunities and asset maturity do not significantly contribute to estimating the company's financial risk.

The main model estimates in this study are shown in Table 3, which aims to estimate the role of insiders in controlling the company's financial condition. Overall testing results show consistency in the estimation results, namely, insider incentives is the cause of the decline in corporate financial risk. Insider incentives are the reason for using funding sources in the form of increasingly minimal debt (β= -0.4155; SE= 0.1890), which is significant at the 0.05 level. The test results also remain consistent after using the ETA proxy as a measure of low financial risk.

Table 4. **Insider Incentives and Financial Risk**

Variables	Financial Risk		
	(1)	(2)	(3)
Lag(1)	0.7726***	0.2930***	0.4126***
	(0.0892)	(0.0867)	(0.0064)
Insider Incentives	-0.2239	-0.6732*	-0.8673*
	(0.1614)	(0.3745)	(0.4754)
Profitability	-0.6390***	2.9719	-0.4647***
	(0.0021)	(2.3527)	(0.0064)
IOS	0.0000	-0.0000	-0.0000
	(0.0000)	(0.0000)	(0.0000)
Liquidity	-0.0024***	-0.0002	-0.0039**
	(0.0006)	(0.0024)	(0.0016)
Asset Maturity	0.0775	0.4186	-0.5837*
	(0.3121)	(1.0487)	(0.3002)
Constant	0.1365	-0.0096	0.6141***
	(0.1930)	(0.5600)	(0.1498)
AR(2)	1	-0.87	0.98
	0.318	0.382	0.325
Hansen Test	9.4	30.92	33.68
	0.401	0.369	0.175

Note: This model estimates the full model of financial risk as measured by debt to total assets (DTA) by division based on (1) before and during the 2008 crisis, (2) after the 2008 crisis, and (3) insider stakes of less than 20 percent. The data period ranges from 2003 to 2018. The standard errors are stated in the figures in parentheses. The second-row numbers in AR (2) and the Hansen Test show probability values. ***, **, and * denote the significance levels of 0.01, 0.05, and 0.1.

Source: Output STATA 15

Table 4 presents a re-examination of the main research model. This is done to ensure consistency in the test results. Two tests estimate the role of insider incentives in the main model. *First*, the investigation considers the effects of the crisis. The existence of a subprime crisis in 2008 and the development of governance in Indonesia motivated testing by grouping samples into two periods: (1) the period before and during the 2008 crisis and (2) the period after the crisis. Subprime crisis considerations (Lemmon & Lins, 2003) might be more appropriate when describing the endogeneity problems that arise (Demsetz & Lehn, 1985).

Second, consider the proportion of ownership. The investigation considers the proportion of insider stakes with the logic that the different portions of ownership will show a different role in corporate governance (Lins, 2003) because it deals with management entrenchment and convergence of interest (Chu, 2015). This retest is carried out on the portion of ownership below twenty percent to determine the role of insider incentives that are not high in changes in financial risk in Indonesia and ensure the consistency of the test results. Benchmark the proportion of twenty percent ownership based on Capital Market Law No. 8 of 1995 in Indonesia.

Investigation of the effects of the crisis and the development of governance in Indonesia showed no significant role of insider incentives in funding risk before and during the 2008 crisis (β= -0.2239; SE= 0.1614). This condition could be caused by Indonesia only beginning to implement corporate governance after the 1997-1998 crisis. These results confirm Indonesia's lack of corporate governance development (Dercon, 2007). Weak implementation of good corporate governance can cause the presence of insider incentives not to have an impact on changes in financial risk. Insider incentives have a significant role in determining financial risk in companies seen in the period after the 2008 subprime crisis (β= -0.6732; SE= 0.3745).

Discussion

The results of this study prove that the existence of incentives for managers will create a reluctance to use more debt. At least three logics can explain the existence of this impact. *First,* there is a cautious effect in determining the company's capital structure to anticipate financial difficulties. The use of debt seems to be increasingly avoided after the financial crisis in 2008. This proves that insiders with ownership incentives in the company will be increasingly careful using debt. This condition is not surprising in developing countries like Indonesia, which are faced with the problem of high information inequality. Again, the use of debt does not always convey good news (Su, 2004).

Second, the implementation of governance in Indonesia is increasingly showing developments. Seriousness regarding this issue is evidenced by the publication of the 2012 Good Corporate Governance Manual Book commissioned by the International Financial Corporation (IFC) as part of the governance program in Indonesia. The

development of better governance can cause insider parties who have ownership of the company to make better efforts to manage the company's finances.

Third, assumptions related to human nature, namely risk aversion (Eisenhardt, 1989; Jensen & Meckling, 1976) and self-interest (Eisenhardt, 1989), can be the reason why the provision of ownership incentives for managers causes the risk to be increasingly suppressed from the use of debt. Risk aversion (Jensen, 1986) is the logic of a decrease in funding sources from debt, even though the debt is beneficial to the company.

The results of this study at least enrich the body of knowledge and confirm two important issues. *First* is the agency problems' complexity and pecking order theory. Insiders inevitably have self-serving problems (Goranova & Ryan, 2014). This study confirms the complexity of agency problems, especially controlling insiders and outsiders in Asian countries (Kim et al., 2020). Insider incentive that reduces the proportion of corporate debt is consistent with the agency conflict assumption that occurs between the principal and management (Jensen, 1986, 1988; Jensen & Meckling, 1976) and a hierarchy of determining funding sources (pecking order theory (Myers & Majluf, 1984)).

Management efforts to minimize additional external funding in the form of debt can be justified if it is associated with the company's cost of capital. The company's efforts to increase the use of internal funds (with sources of equity and retained earnings) and dynamic funding mechanisms can encourage companies to obtain a lower cost of capital (indicated by the imposition of low-interest rates) and, in turn, the financial risks faced by the company as well. Banks impose low interest rates on companies due to the efforts these companies make to help banks reduce their agency costs. In this case, the banking sector helps channel funds to the right company so that the banking agency costs decrease. Continuous positive reciprocity from the imposition of relatively low-interest rates on companies is seen in corporate and banking relations. In this case, the corporation will be increasingly minimal in moral hazard, adverse selection, and debt default (Hellmann et al., 1998).

Second, it confirms the existence of alignment and entrenchment effects in developing country companies in Asia. Incentives for management, on the one hand, can provide an alignment of interests (alignment effect) among shareholders to minimize agency conflicts that can arise (convergence of interest hypothesis (Jensen & Meckling, 1976)). The principle of prudence proves this to reduce financial risk.

Incentives to management in the form of sharing ownership can encourage the alignment of interests between management and the principal (alignment effect and convergence of interest hypothesis). These good conditions can lead to superior performance (Jensen & Meckling, 1976), which can improve the quality of corporate governance and, in turn, impact efforts to reduce the cost of capital by reducing the risk of corporate funding. The decline in financial risk in companies, which is reflected in efforts to reduce the source of financing from debt, can indicate

management's efforts in considering the trade-off between benefits and risks from using debt. However, on the other hand, the higher the ownership incentives provided, the more likely it is that insiders will try to avoid monitoring from external parties. An increase in financial risk will lead to higher monitoring from external parties. This condition tends to be disliked by management. As in Australia (Shan et al., 2019), convergence of interest and entrenchment are simultaneously present in Indonesia.

Conclusion

This study clarifies the debate in the current literature regarding the relationship between insider incentives and agency problems by investigating an essential indicator of corporate finance, namely financial risk. Investigations conducted on non -financial companies in Indonesia with a long observation period were carried out systematically by considering firm-level characteristics in estimating the company's financial risk. Testing with the robust panel GMM regression shows that insiders significantly manage the company's financial risk. Insider seeks to increase funding sources, not from debt.

The results of this study contribute to the literature by providing the latest insights into the corporate governance literature by raising the topic of insider incentives in relation to financial risk in developing countries. The investigation confirms that insider incentives are essential to corporate governance and have become a determining factor for agency problems. The results of this study confirm the agency theory and pecking order theory. Insider also allows for self-serving and a reluctance to be monitored. However, insider stakes also positively impact the company's financial management, as the lower financial risk indicates. In this case, management that combines funding with sources of equity and retained earnings and dynamic funding mechanisms can encourage companies to obtain a lower cost of capital.

The findings in this study have important implications for principals and governments as policymakers. Considering agency theory, the portion of insider stakes that is not too high can benefit the company with the alignment effect and minimize entrenchment on the ownership. Such a portion of ownership means that management can still be controlled by the principal and monitored by stakeholders. This condition can have a good impact on the company's financial management.

Despite essential implications, as with other studies, this study is not without its limitations. The results of this study still need to be interpreted with caution, even though this study has used a relatively long observation period, included firm-level characteristics in the estimation, considered the crisis period, and the proportion of insider stakes. Subsequent research related to insider stakes can conduct assessments by tracing the role of insiders between companies. The insider who has a position in a

different company and served in more than one company with affiliates is expected to impact effectiveness in carrying out its functions.

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