Family Ownership in Indonesia, Good or Bad?

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Abstract. Indonesia is one of the countries that adopt the two-tier system, where there are separation functions between directors and commissioners. Indonesia is also dominated by family firms. In relation to the agency problem, the concentration of ownership by the family in the company and the existence of independent directors in the company's board of directors are two things that are importantly considered as corporate governance practices. This study aims to find out how family ownership in Indonesia influences the demands of corporate governance practices and examines how independent directors moderate those relationships. The study used 69 companies listed in the ASEAN Corporate governance Scorecard with a four-year study period from 2012 to 2015. Using the regression method of panel data, this study found that the greater the family ownership of firms in Indonesia, the smaller the company's demands to good corporate governance practices. While the independence of directors and the size of the board moderate the relationship positively.

Keyword. corporate governance, family firms, independent director, agency theory

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INTRODUCTION
Good corporate governance practices are one of the pillars of the market economy system and are related to the company trust also. The practices of good corporate governance encourage the creation of healthy competition. Therefore, the implementation of good corporate governance by companies in Indonesia is very important to support sustainable economic growth and stability (National Committee on Governance Policy, 2006).

One of the basic principles that exist in corporate governance is to focus on managing the problems that arise from the separation between ownership and control of the company. In this case, it is not just a problem between shareholders and management but also involves problems between controlling shareholders and minority shareholders (OECD, 2004). In family companies, shareholders consist of majority shareholders who are family members, and minority shareholders who are not family members. The existence of majority and minority shareholders is what often causes conflict or agency problems in family companies. This happens, due to differences in interests held by shareholders, according to Briano-turrent & Poletti-Hughes (2017), the agency problem will affect corporate governance. Therefore, in improving corporate governance practices, companies need to reduce or even eliminate agency problems.

Some research in Indonesia regarding corporate governance and family ownership, usually associated with seeing how corporate governance or family ownership has effect on company performance (Rahmawati and Handayani, 2017; Sekar, 2017). Or in other words, the research is only limited to corporate governance as an independent variable. While research that looks at corporate governance as a dependent variable has not been found in Indonesia and has only been found in countries that adopt a one-tier system. 

Corporate Governance
Corporate governance is a series of relationships between management, directors, board of commissioners, shareholders, and other stakeholders that regulate and direct corporate activities (OECD, 2004). The responsibility of the directors in corporate governance, one of which is to determine the company's strategy, supervise management, and also provide
company performance reports to shareholders, which shareholders appoint directors (OECD, 2004, 2015; Corporate and Factbook, 2017). Good corporate governance must reflect transparent and fair market conditions, and efficient allocation of resources. This needs to be done in all aspects of the company, including financial aspects, performance, or company ownership (OECD, 2004).

In family firms, the majority shareholders who are families will tend to keep their wealth able to survive for generations after, they also tend to hold strategic positions to pursue personal interests (Anderson and Reeb, 2004; Briano-turrent and Poletti-hughes, 2017). Therefore, as protection in maintaining investor confidence, better corporate governance practices are needed in order to mitigate the expropriation of minority shareholders. Within family companies, this corporate governance practice aims to align the interests of the majority shareholders with minority shareholders.

However, this is different from what happened in Indonesia, where enforcement of rules regarding corporate governance is still a big problem (Utama and Utama, 2016). Furthermore, it can be said that what happens in Indonesia is that families have the motivation to expropriate the company.

**H1: Family ownership will show a lower value of corporate governance compared to non-family companies in Indonesia**

**Composition of Independent Directors on Corporate Governance**

In family companies, boards have a relevant role in reducing agency problems, not only between shareholders and managers, but also the agency problem between majority shareholders and minorities (Acero and Alcalde, 2016). Therefore, it can be said that the existence of independent directors will be able to influence corporate governance practices for the better.

**Board Size**

The definition of a board size is the total number of board of directors (Zabri, Ahmad and Wah, 2016). In managing the company, the effectiveness in the arrangement of the board can be said to be very important. Board size in various countries is quite varied, because each country has a different culture. In Malaysia and Singapore, Mak and Kusnadi (2005) state that the company's performance will reach the highest value when the board of directors consists of five members. While Leblanc and Gillies (2003) said the ideal number of directors was eight to eleven people. Meanwhile, Epstein et al. (2002) and Goshi et al. (2002) said that the number of directors considered optimal was an average of sixteen people. Yermack (1996) says that the small size of directors will contribute more to the success of the company, in line with the view that if board size exceeds seven or eight people, the function of the board will be less effective (Lipton and Lorsch, 1992; Jensen, 1993). But this contrasts with Callen, Klein and Tinkelman (2003) who say that companies that have a large board size will have better company performance. This is because, the bigger a board, the better the monitoring function and strategic decision-making process. Larger directors will have more knowledge and improve company information. In family companies, larger boards can play a better role, because they have greater knowledge and are better at practicing good corporate governance (Laksmana, 2008).

**H2: The larger the board size, will weaken the influence of family ownership which worsening CG practice**

**Director Independence**

The existence of an independent director is needed in the management of the company to be able to supervise management and play a role in minimizing the occurrence of agency...
problems, because independent directors are considered to be able to minimize the potential for opportunism of management or the largest shareholder in the company. In family companies, independent directors can help companies to improve organizational capabilities because they have special professional knowledge and more connections and networks than insiders (Su and Lee, 2012). So that the existence of an independent director can strengthen CG and reduce information asymmetry among investors (Kor and Misangyi, 2008).

H3: The greater the proportion of independent directors, the weaker influence of family ownership which worsening CG practice

**METHOD**

The data in this paper are based on the data of the ASEAN Corporate Governance Scorecard, which used as corporate governance score, published by Indonesian Institute for Corporate Directorship (IICD). From 130 firms, we eliminated those firms with incomplete data, generating a final sample of 69 firms. The panel dataset comprises 276 firm-year observations during period of 2012 to 2015. Financial data were collected from Datastream database, and the board data were compiled from annual report.

**Dependent variable**

Most previous studies, using governance indexes to measure the quality of governance (Bhagat, Bolton, & Romano, 2008). In Indonesian research, the governance index has been widely used. In this study, the dependent variable used is the ASEAN Corporate Governance Scorecard from the Indonesian Institute for Corporate Directorship (IICD).

**Independent variable**

The independent variable in this study is family firms. In previous research, the classification of family firms is quite diverse. González, Guzmán, Pombo, & Trujillo (2014) used dummy variables to classify family firms that equals one when the largest shareholder of the firm is part of the family, otherwise is zero. While Claessens, Djankov, & Lang, (2000); La Porta, Lopez-de-Silanes, & Shleifer (1999) says that company control can be known indirectly by looking at the pyramid, and also that significant control can be known from a minimum of 20% of the voting rights. Thus, Briano-turrent & Poletti-hughes (2017) in their research classify family controls with the largest shareholder ownership of at least 20% as individuals, and match the last name of the founder with the largest shareholder. In research in Indonesia, that classification cannot be fully used. Thus, in this paper family firm is measured with dummy variable that equals one when the largest shareholder at least 20% of the shareholding is individual or company owned by a family or a group, by looking at the annual report.

**Moderating and Control variable**

In this research model, there are two variables that can moderate the effect of the independent director's composition on corporate governance on the family firms: the board size and the board independence. Board size is measured by the number of directors on the board of directors, and the board independence measured by the number of independent directors of the board size (Briano-turrent & Poletti-hughes, 2017; Su & Lee, 2012). In addition, the number of control variables in this study is based on previous research: firm size, firm age, leverage, Tobin's Q as a proxy of growth opportunity, and ownership concentration. The firm size measured by the natural logarithm of the total asset, the firm age measured by number of years since IPO, financial leverage measured by debt ratio, or total liabilities
divided by total asset, and the ownership concentration measured by the percentage of shares held by the largest shareholder at the end of financial year.

RESULTS AND DISCUSSION

Here is the regression models:

\[ CG_{it} = \alpha + \beta FAM_{it1} + \gamma SIZE_{it1} + \gamma AGE_{it1} + \gamma LEV_{it1} + \gamma OC_{it1} + \varepsilon_{it1} \]  

(CG1)

\[ CG_{it} = \alpha + \beta FAM_{it1} + \beta FAM_{it1} \ast BS_{it1} + \gamma SIZE_{it1} + \gamma AGE_{it1} + \gamma LEV_{it1} + \gamma OC_{it1} + \varepsilon_{it1} \]  

(CG2)

\[ CG_{it} = \alpha + \beta FAM_{it1} + \beta FAM_{it1} \ast BI_{it1} + \gamma SIZE_{it1} + \gamma AGE_{it1} + \gamma LEV_{it1} + \gamma OC_{it1} + \varepsilon_{it1} \]  

(CG3)

Research regression uses Fixed Effect Model, this model takes into account the intercepts assumed to exist in the model. The assumed interpretation varies with the individual and is constant with time. This model can show the difference in constants between objects, even with the same regression coefficients.

<table>
<thead>
<tr>
<th>Table 1. Descriptive Statistic</th>
</tr>
</thead>
<tbody>
<tr>
<td>NON FAM</td>
</tr>
<tr>
<td>Mean</td>
</tr>
<tr>
<td>CG_it</td>
</tr>
<tr>
<td>BS_it</td>
</tr>
<tr>
<td>BI_it</td>
</tr>
<tr>
<td>Size_it</td>
</tr>
<tr>
<td>Age_it</td>
</tr>
<tr>
<td>Lev_it</td>
</tr>
<tr>
<td>OC_it</td>
</tr>
</tbody>
</table>

Based on the table, that is known that the average value of corporate governance (CG) in family companies is smaller than the average value (CG) in non-family companies, namely 3.886 vs. 4.176, with the distribution or standard deviation of the family company of 0.283, and for non-family companies of 0.217. Then, the average director size variable (BS) which is the number of directors in the directors of family companies is 7,064, greater than the average (BS) in non-family companies which is 6,975, and the distribution value is not much different, namely amounting to 2,076 in non-family companies, and 2,090 in family companies.

While the level of independence of directors (BI) in the form of the value of the proportion of independent directors at the board of directors, the family company has an average of 0.099 with a standard deviation of 0.090, and in non-family companies, the average value (BI) is smaller, which is equal to 0.042 with a standard deviation of 0.072. This shows that the number of independent directors in the board of directors is still quite small, so the level of independence of the directors is small.

In addition, the first control variable, namely company size (SIZE), which is measured based on the company’s total assets, has an average value of 24,586 in non-family companies, and 23,704 in family companies. With a distribution of 1,339 in non-family companies and 1,167 in family companies. While the age of the company (AGE) is measured in years, the
family company has an average value of 15,548 and in non-family companies is smaller, which is equal to 14,960.

For average corporate financial leverage (LEV) as measured by the debt ratio value, as well as ownership concentration (OC) which is the percentage of ownership from the largest shareholders, the average value in family companies is equally smaller than in non-company family. With a value (LEV) of 0.511 vs. 0.635, and the value (OC) of 0.527 vs. 0.625.

Table 2. Regression Model Result CG 1

<table>
<thead>
<tr>
<th>Variabel Independen</th>
<th>Variabel Dependan CG</th>
<th>Coef</th>
<th>t-stat</th>
<th>Prob 1 tail</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td></td>
<td>1.8216</td>
<td>***</td>
<td>6.650</td>
</tr>
<tr>
<td>FAM</td>
<td></td>
<td>-0.2004</td>
<td>***</td>
<td>-6.560</td>
</tr>
<tr>
<td>SIZE</td>
<td></td>
<td>0.0938</td>
<td>***</td>
<td>7.690</td>
</tr>
<tr>
<td>AGE</td>
<td></td>
<td>0.0003</td>
<td></td>
<td>0.190</td>
</tr>
<tr>
<td>LEV</td>
<td></td>
<td>0.0066</td>
<td></td>
<td>0.100</td>
</tr>
<tr>
<td>OC</td>
<td></td>
<td>0.0646</td>
<td></td>
<td>1.020</td>
</tr>
</tbody>
</table>

Based on the regression results, it is known that the existence of a family company shows a lower value, it is seen significantly at a confidence level of 1%. Whereas for the control variable, the four have a positive influence on CG, but only the size of the company has a positive and significant influence, that is equal to 1%, while the others have no significant effect.

Table 3. Regression Model Result CG 2

<table>
<thead>
<tr>
<th>Variabel Independen</th>
<th>Variabel Dependan CG</th>
<th>Coef</th>
<th>t-stat</th>
<th>Prob 1 tail</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td></td>
<td>2.0128</td>
<td>***</td>
<td>6.790</td>
</tr>
<tr>
<td>FAM</td>
<td></td>
<td>-0.3532</td>
<td>***</td>
<td>-4.760</td>
</tr>
<tr>
<td>FAM*BS</td>
<td></td>
<td>0.0205</td>
<td>**</td>
<td>2.250</td>
</tr>
<tr>
<td>SIZE</td>
<td></td>
<td>0.0865</td>
<td>***</td>
<td>6.910</td>
</tr>
<tr>
<td>AGE</td>
<td></td>
<td>0.0001</td>
<td></td>
<td>0.070</td>
</tr>
<tr>
<td>LEV</td>
<td></td>
<td>-0.0005</td>
<td></td>
<td>-0.010</td>
</tr>
<tr>
<td>OC</td>
<td></td>
<td>0.0567</td>
<td></td>
<td>0.910</td>
</tr>
</tbody>
</table>

Based on the regression results using the fixed effect model, the CG 2 model shows that the size of the board of directors, which is seen by the number of directors, positively moderates family ownership relationships with corporate governance. The relationship has a confidence level of 5%. Similarly, the three control variables are firm size, company age, and ownership concentration which have a positive influence on corporate governance, but only on the variable size of the company that has a confidence level of 1%. While leverage has a negative influence on corporate governance and is not significant.

Table 4. Regression Model Result CG 3

<table>
<thead>
<tr>
<th>Variabel Independen</th>
<th>Variabel Dependan CG</th>
<th>Coef</th>
<th>t-stat</th>
<th>Prob 1 tail</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td></td>
<td>1.602</td>
<td>***</td>
<td>5.560</td>
</tr>
<tr>
<td>FAM</td>
<td></td>
<td>-0.259</td>
<td>***</td>
<td>-7.560</td>
</tr>
<tr>
<td>FAM*BI</td>
<td></td>
<td>0.708</td>
<td>***</td>
<td>3.390</td>
</tr>
<tr>
<td>SIZE</td>
<td></td>
<td>0.101</td>
<td>***</td>
<td>8.330</td>
</tr>
<tr>
<td>AGE</td>
<td></td>
<td>0.001</td>
<td></td>
<td>0.450</td>
</tr>
<tr>
<td>LEV</td>
<td></td>
<td>0.008</td>
<td></td>
<td>0.120</td>
</tr>
<tr>
<td>OC</td>
<td></td>
<td>0.111</td>
<td>**</td>
<td>1.750</td>
</tr>
</tbody>
</table>

Based on the results of subsequent regression, it is known that the level of independence of directors positively moderates the relationship of family firms with corporate governance, at a 1% confidence level. Whereas in the control variable, only the company size variable...
had a significant positive effect on the 1% confidence level and ownership concentration which had a significant positive effect on the 5% confidence level. While other variables have no significant effect.

CONCLUSION

Based on the results of the calculations that have been described, it is known that family ownership in Indonesia does not require higher corporate governance practices. But on the contrary, the greater the family ownership, the lower the corporate governance value of the company. This means that in Indonesia family ownership is just ignorant of corporate governance practices. These findings can be a reference that in Indonesia, although guidelines on corporate governance have been made and socialized since 1999, apparently companies with family ownership, can be said to still not practice good corporate governance.

In addition, the results of this study are different from the results of research conducted in countries that adopt a one-tier system. Research conducted by Briano-turrent and Poletti-Hughes (2017) in Latin America concludes that as a whole, family companies will be more compliant with better corporate governance practices, especially in the aspect of transparency. However, the study also found that in the three aspects of corporate governance studied, namely: 1) composition and function of directors, 2) shareholders’ rights and conflicts of interest, and 3) other corporate governance practices, no significant differences were found between family companies and also non-family. This means that even in countries that have a one-tier system, family companies have not practiced all aspects of good corporate governance. Therefore, in accordance with the research above, there are differences in good corporate governance practices in countries that adopt a one-tier system and two-tier systems.

Also in this study, it was found that the size of directors and also the level of independence positively moderated the relationship between family ownership and the demands of corporate governance practices. This proves that the existence of independent directors as measured by the size of the board of directors and the level of independence of the board of directors is considered to be able to weaken the influence of family ownership which exacerbates CG practices. So that it can be said that the characteristics of the directors’ structure have an impact on family companies. This is supported by research conducted by Liu, Y., Valenti and Chen, (2016), although examining direct and non-moderating effects, found that the level of independence of directors and the size of directors had a direct and positive effect on corporate governance ratings.

Thus, it can be concluded that, family ownership in Indonesia shows lower corporate governance values. This means that in Indonesia family ownership is only negligent towards corporate governance practices, and family ownership tends to worsen corporate governance practices. In this study also, it was proven that the existence of independent directors as measured by the size of the board of directors and the level of independence of the directors, was considered to be able to weaken the influence of family ownership which exacerbated corporate governance practices.


