“Implementation of corporate governance, family ownership, and family-aligned board: Evidence from Indonesia”

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IMPLEMENTATION OF CORPORATE GOVERNANCE, FAMILY OWNERSHIP, AND FAMILY-ALIGNED BOARD: EVIDENCE FROM INDONESIA

Abstract

This study aims to examine the impact of family ownership on the composition of the board of directors and the number of family-affiliated directors. In addition, it analyzes how it affects corporate governance. Big capital and middle capital companies among the top 50 IICD (Indonesia Institute for Corporate Directorship) awards issuers from 2017 to 2019 make up the study population. The sample consists of 57 middle capital companies and 72 big capital companies. The link between the variables is examined using multiple linear regression. Both the partial coefficient test and the model accuracy test were performed. First, the study findings indicate that family-owned businesses have a higher proportion of family-affiliated board members and commissioners on their boards in big capital and middle capital companies. Second, while family ownership has a favorable impact on middle capital companies, it has a negative and significant impact on the application of corporate governance in big capital firms. Third, since big capital companies exhibit different signals than middle capital companies, it can be inferred that the number of directors and commissioners who are members of the same family affects the adoption of good governance practices and, consequently, the development of sound policies to deal with challenging issues that may arise within a company. This study is innovative in that it divides the sample into big capital and middle capital companies.

Keywords big capital, middle capital, family-aligned board, family ownership, corporate governance

JEL Classification G32, G34, G38

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INTRODUCTION

When there is a division between firm ownership and company control, an agency conflict occurs, leading to corporate governance. One needs corporate governance that can persuade investors that their investments can generate returns, with good corporate governance expected to reduce agency conflicts within a company. Differences in interests make it challenging for investors to verify that their money is not misappropriated or used to fund unprofitable projects, leading to agency conflicts between management and investors (Tulung et al., 2018). Good corporate governance (GCG) is a requirement for all businesses since it calls for a system of governance that can encourage shareholder trust and ensure that all stakeholders are treated fairly.

The method will guarantee that management acts in the company's best interests and successfully protect shareholders by allowing them to get their money back fairly, appropriately, and efficiently. To maintain operational credibility, transparency, and effective transmission of company values to stakeholders, corporate governance is linked to the organization's composition in terms of personal, ideological, business fundamentals, and operations. In theory, this system was devel-

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oped to match the dynamics of economic transactions with the interests of stakeholders in the industry (Zulfikar et al., 2020). In East Asian countries, the founding families or individuals are in charge of more than two-thirds of firms (Claessens et al., 2000).

Family members typically hold management positions inside family-owned businesses in addition to the status of proprietors. As a result, family members have a lot of influence on company policy, which helps to prevent conflicts between business owners and management. On the other side, disputes between majority and minority shareholders may result from family members playing a prominent role (Benjamin et al., 2016). The percentage of shares owned by a number of people, organizations, or families is known as the concentration of ownership or ownership structure (Obigbemi et al., 2017). Furthermore, corporate governance is said to be significantly influenced by a company's ownership. Therefore, the effects of family ownership vary according to the corporate governance framework.

Controlling shareholders is encouraged to select managers with strong family links utilizing a voting method where their voice is overwhelmingly heard due to the large percentage of family ownership. Considering the family element's predisposition to uphold the status quo in order to sustain profits as the dominant shareholder over the minority, shareholders may result in poor corporate governance. In addition to management, the family-affiliated board of commissioners may accomplish this (Haque et al., 2011). According to Benjamin et al. (2016), a company is more likely to distribute sizeable dividends when family owners own a sizable percentage of stocks. Furthermore, some businesses are more ready to hire managers with family ties even when the individual lacks managerial qualifications (Xu et al., 2015; Beuren et al., 2016). The oversight function of concentrated ownership of the level of compensation for the company's leadership can, therefore, no longer function if the proportion of members of the board of commissioners and directors has a relatively high proximity to the controlling shareholder (Ulupui et al., 2015).

Anderson and Reeb (2003) discovered evidence that family firms perform better than non-family firms, mainly when a family member serves as the firm's CEO, contrary to the findings of other researchers. According to Maury (2006), businesses that family members actively control perform better. Additionally, he discovered that family businesses are valued more highly. This study differs from earlier studies. It divides the sample into big and middle capital companies to identify which companies are actively controlled by families by examining the composition of the board of commissioners and directors associated with the family (family-aligned board) and their influence on the governance process. The uniqueness of this study lies in the fact that it is the most recent study to link family-aligned boards (FAB), family ownership, and corporate governance, dividing samples into big and medium capital businesses.

1. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

According to Jensen and Meckling (1976), an agency relationship is one in which a principal delegates decision-making responsibility to an agent. There could be a conflict of interests between the principal and the agent in a relationship of agency. Therefore, a work contract is necessary to regulate rights and obligations. One mechanism that can reduce the agency problem in a company is the ownership structure. One such structure is family ownership (Wang, 2006; Prencipe et al., 2008; Jiraporn & DaDalt, 2009; Dwiyanti & Astriena, 2018).

The idea of corporate governance, founded on agency theory, is intended to act as a tool to provide investors with confidence that they will see a return on their investments. Corporate governance is related to investors' perceptions of managers' potential benefits and how investors appoint and remove managers (Kusumawati et al., 2015). GCG implementation supports the

community, the environment, and stakeholders (Trisnawati et al., 2019).

Corporate governance arises from an agency conflict, in which there is a division between business ownership and management. In order to discover openness and accountability, firms must have excellent governance, also known as strong corporate governance; in other words, corporate governance is necessary for every business organization (Sarwoko, 2016). In this case, one needs corporate governance that is able to convince investors that their investments will eventually generate returns. Along with good corporate governance, it is expected to reduce agency conflicts within a company. The corporate governance of each country is distinguished based on the prevailing regulations, culture, distribution of power, and corporate ownership structure. The distribution of power and influence over the operational activities of a company is reflected in the share ownership structure. The practice of corporate governance has undergone rapid changes over the past two decades, where companies in developing countries are controlled by companies with concentrated ownership systems or family ownership. The development of companies with concentrated ownership structures requires appropriate corporate governance and can be used to improve company performance. Therefore, corporate governance significantly affects companies with a concentrated ownership structure (Michael & Goo, 2015).

The percentage of shares owned by many people, organizations, or families is known as the concentration of ownership or ownership structure (Obigbemi et al., 2017). It goes on to say that the type of ownership in an organization is explained by the proportion of firm shares owned by a number of institutions, people, or families. According to Beuren et al. (2016) and Pukthuanthong et al. (2013), family companies transfer ownership to the descendants of family members who control and manage the business. According to Pukthuanthong et al. (2013), there are two ways to recognize family-owned businesses. First, the highest shareholders in a company are founders and/or family members of founders, who collectively possess at least 20% of the shares. Second, a family member is the company's CEO or the board of directors chairman (Beuren et al., 2016). According to Pukthuanthong et al. (2013), even if a business only satisfies one of these criteria, it can still be classified as family-owned. In other words, a corporation qualifies as a non-family company if neither criterion is met.

As a controlling shareholder, a family has the incentive and power to obtain benefits for themselves in the form of excessive compensation, related transactions, or dividends in the form of company expenses for the benefit of a company (Haque et al., 2011). Benjamin et al. (2016) found that a corporation is more likely to pay dividends when family shareholders own a sizable portion of stocks. Furthermore, even when a candidate lacks managerial qualifications, certain companies are more willing to hire family-related managers (Xu et al., 2015; Beuren et al., 2016). The oversight function of concentrated ownership of the level of compensation for a company's leadership can, therefore, no longer function if a percentage of members of the board of commissioners and directors who have a close relationship with a controlling shareholder is relatively high (Ulupui et al., 2015).

Haque et al. (2011) showed that the ownership structure had a negative impact on how Bangladesh's board of commissioners and directors were chosen to conduct corporate governance. The more members of the family that serve as directors and commissioners, the more decisions will favor the controlling shareholders and hurt the minority shareholders.

Corporate governance has changed dramatically over the past 20 years, with family-owned businesses or corporations with concentrated ownership now controlling businesses in developing nations. Corporate governance must be appropriate for developing businesses with concentrated ownership structures and can enhance business performance. An organization's performance that has a concentrated ownership structure is significantly impacted by corporate governance (Michael & Goo, 2015). Since they have more control than allowed, they frequently take advantage of minority shareholders with fewer control rights. As a result, sophisticated corporate governance in a developing country's economy must defend shareholder rights (Azim et al., 2018).

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In growing firms, excellent corporate governance is one of the keys to success and profit in the long term and to winning the global business rivalry. Good corporate governance and quality will impact establishing good policies to manage problems that arise in a company. In addition to preventing and mitigating internal issues, agency conflicts, and the exploitation of minority shareholders, companies with strong governance can also enhance performance by raising company value, which is reflected in the share price. This is founded on the idea that the market needs to be effectively managed in order to attract investors. Therefore, companies that correctly implement sound corporate governance tend to attract investors (Azim et al., 2018).

This study aims to examine the relationship between family ownership and the composition of the members of the board of commissioners and directors affiliated with the family and its effect on the implementation of corporate governance. The following hypotheses have been developed based on the literature review:

H1: Family ownership has a positive effect on the composition of the board of commissioners and directors affiliated with families in the company.

H2: Family ownership and the composition of the board of commissioners and directors affiliated with the family have a negative effect on the implementation of corporate governance.

2. METHODOLOGY

This study adopted a quantitative design by testing the hypotheses. The population was big capital and middle capital companies in the top 50 IICD awards issuers in 2017–2019. This study used a purposive sampling technique, choosing 72 big capital companies and 57 middle capital companies.

The dependent variable is the implementation of good corporate governance (GCG). The calculation in the GCG assessment used the ASEAN CG Scorecard instrument. Information can be

Table 1. Sampling results

Inclusion Criteria	BIG CAPITAL	MIDDLE CAPITAL
Top List di IICD Awards	50	50
Listed in consecutive years	29	21
Presented using IDR	24	19
Total sample (x 3 years)	72	57
Outlier data	0	0
Processed data	72	57

Table 2. Dependent, independent, and control variables

Variable name	Variable code	Measurement method	Impact Direction
Dependent Variable			
Corporate Governance	CGI	Assessment of corporate governance using the CG scorecard	
Independent Variables			
Family Ownership	FOWN	Share Owned by Family/Outstanding shares *100	(–)
Family-Aligned Board	FAB	Percentage of the number of members of the board of commissioners and directors who have family relationships	(–)/(+)
Board of Directors from the Family	FEXC	The dummy variable for the chairman of the board of directors from the family of the controlling shareholder	(–)/(+)
Control Variables			
Company Size	SIZE	Ln x Total Assets	(+)
Competition Asset	CASS	Fixed Asset/Total Asset	(+)
Leverage	LEV	Total Debt/Total Asset	(–)
Profitability	PROF	ROA = Net Income/Total Assets	(+)
Company Age	AGE	Year under the study – Year the company established/listed on IDX	(+)
Industry Classification	INDS	Namely sector 1 agriculture, sector 2 mining, sector 3 basic industry and chemicals, sector 4 various industries, sector 5 consumer goods industry, sector 6 property, real estate, and building construction services, sector 7 infrastructure and transportation, sector 8 financial, sector 9 trade, services, and investment	(+)

obtained from the company's annual report, the company's official website, company articles, and others. According to ACMF (2017), the ASEAN CG Scorecard instrument falls into two stages with a total of 184 points. Table 2 presents all the variables used in this study.

The research model for the first hypothesis (H_1) is:

$$FAB = \alpha + \beta_1(FOWN) + \beta_2(SIZE) + \\ +\beta_3(CASS) + \beta_4(PROF) + \beta_5(LEV) + \\ +\beta_6(AGE) + \beta_7(INDS\ dummies) + \varepsilon. \quad (1)$$

The research model for the second hypothesis (H_2) is:

$$CGI = \alpha + \beta_1(FAB) + \beta_2(FEXC) + \\ +\beta_3(FOWN) + \beta_4(SIZE) + \beta_5(CASS) + \\ +\beta_6(PROF) + \beta_7(LEV) + \beta_8(AGE) + \\ +\beta_9(INDS\ dummies) + \varepsilon. \quad (2)$$

3. RESULTS

Table 3 summarizes the statistics for each variable used in the study for *H1*. The sample includes 57 middle capital companies and 72 big capital companies in Indonesia listed on the Indonesia Stock Exchange between 2017 and 2019. The test results demonstrate that the data can be utilized in the investigation.

The data for each variable utilized for *H1* are descriptively summarized in Table 3. For example, in middle-sized businesses, up to 7.9% of the board of directors or commissioners' memberships have family ties, compared to an average of 2.3%.

The statistics of each variable utilized for *H2* are descriptively summarized in Table 4. The results of the test description show that it is possible to use the data in the investigation.

According to Table 4, a family owns an average of 1.3% of the shares in a big capital company, com-

Table 3. Descriptive statistics (*H1*)

Variable	Big Capital				Middle Capital			
	Minimum	Maximum	Mean	Std. Deviation	Minimum	Maximum	Mean	Std. Deviation
FAB	0.00	0.50	0.0231	0.10175	0.00	0.67	0.0795	0.15512
FEXC	0.00	0.31	0.0129	0.06270	0.00	0.06	0.0042	0.01404
FOWN	31.45	41.79	37.0322	2.96786	24.83	30.64	27.6692	1.35907
SIZE	0.00	0.71	0.2779	0.27752	0.00	0.87	0.2376	0.22114
CASS	–0.30	0.53	0.1022	0.16200	0.00	0.06	0.0089	0.01676
PROF	0.15	0.88	0.6401	0.21999	0.16	0.94	0.5400	0.21386
LEV	4.58	38.60	18.8824	10.77356	3.08	30.93	12.7724	8.75038
AGE	2.00	9.00	7.2083	2.07270	4.00	9.00	6.0556	1.76354
INDS	0.00	0.50	0.0231	0.10175	0.00	0.67	0.0795	0.15512

Table 4. Descriptive statistics (*H2*)

Variable	Big Capital				Middle Capital			
	Minimum	Maximum	Mean	Std. Deviation	Minimum	Maximum	Mean	Std. Deviation
CGI	78.94	112.00	96.4178	7.75961	61.51	88.56	75.0402	5.37422
FOWN	0.00	0.32	0.0135	0.06294	0.00	0.06	0.0041	0.01380
FAB	0.00	0.50	0.0533	0.12065	0.00	0.67	0.0799	0.15327
SIZE	30.44	41.79	37.1190	3.39400	24.83	30.64	27.6885	1.33795
CASS	0.00	0.71	0.2334	0.25058	0.00	0.87	0.2579	0.24399
PROF	–0.30	0.53	0.0897	0.13929	0.00	0.26	0.0194	0.04752
LEV	0.15	0.88	0.6396	0.23155	0.16	0.94	0.5306	0.21357
AGE	4.58	38.60	21.1036	9.80373	3.08	30.93	12.6449	8.69113
INDS	2.00	9.00	7.0833	1.96984	4.00	9.00	6.1579	1.80069

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Table 5. Regression analysis results (*H1*)

		Big Capital				Middle Capital			
Testing	**Variable**	**Coef.**	**Itself**	**Info**	**Conclusion**	**Coef.**	**Itself**	**Info**	**Conclusion**
Test t	FOWN	1.615	0.000	Significant	*H1* accepted	9.240	0.000	Significant	*H1* accepted
	SIZE	0.000	0.607	Insignificant		0.016	0.117	Insignificant	
	CASS	–0.034	0.020	Significant		–0.223	0.005	Significant	
	PROF	–0.055	0.016	Significant		2.511	0.000	Significant	
	LEV	0.010	0.591	Insignificant		–0.153	0.044	Significant	
	AGE	0.002	0.002	Significant		0.001	0.583	Insignificant	
	INDS	0.002	0.288	Insignificant		0.013	0.088	Insignificant	
Test F			0.000				0.000		
R^2			0.981				0.817		
Adjusted R^2			0.978				0.790		
FAB = – 0.016 + 1.615 FOWN + 0.000 Size – 0.034CASS – 0.055PROF + 0.010LEV + 0.002 AGE + 0.002INDS+ e						FAB = – 0.388 + 9.240 FOWN + 0.016 Size – 0.223CASS + 2.511PROF – 0.153LEV + 0.001 AGE + 0.013INDS+ e			

pared to only 0.4% of the shares in a middle capital company. The relationship between family ownership and the board of commissioners and directors related to the company's families is examined in this study and indicated in Table 5.

According to the findings, family ownership favors the percentage of board members and directors who are related to the family in the aforementioned big capital and middle capital companies. While middle capital enterprises have a coefficient value of 9.240 (positive) and a significant value of 0.000 below 5%, they have a coefficient level of 1.615 (positive). The findings demonstrate that *H1* is accepted and that family ownership is correlated with more closely aligned boards in large and middle capital enterprises.

This study examines the relationship between family ownership and the composition of the board of commissioners and family-affiliated directors. This has a negative effect on how corporate governance is implemented, as shown in Table 6.

The *H2* regression findings for family ownership, the make-up of the board of commissioners, and the presence of family-affiliated directors have a detrimental impact on the application of corpo-

Table 6. Regression analysis results (*H2*)

		Big Capital				Middle Capital			
Testing	**Variable**	**Coef.**	**Itself**	**Info**	**Conclusion**	**Coef.**	**Itself**	**Info**	**Conclusion**
Test t	FOWN	–73.638	0.008*	Significant	H2 accepted	243.432	0.057**	Significant	H2 accepted
	FAB	15.404	0.302	Insignificant		–25.760	0.009	Significant	
	FEXC	0.935	0.804	Insignificant		0.637	0.896	Insignificant	
	SIZE	0.808	0.012	Significant		2.041	0.010	Significant	
	CASS	–6.401	0.197	Insignificant		–13.636	0.014	Significant	
	PROF	–0.359	0.960	Insignificant		8.723	0.593	Insignificant	
	LEV	–15.686	0.040	Significant		1.909	0.711	Insignificant	
	AGE	0.366	0.007	Significant		0.028	0.771	Insignificant	
	INDS	1.171	0.073	Insignificant		1.141	0.053	Significant	
Test F			0.000				0.016		
R^2			0.389				0.385		
Adjusted R^2			0.301				0.204		
CGI = 62.003 –73.638FOWN + 15.404 FAB+ 0.935FEXC + 0.808 SIZE – 6.401CASS – 0.359PROF –15.686LEV + 0.366 AGE + 1.171INDS+ e						CGI = 14.210 + 243.432FOWN – 25.760 FAB+ 0.637FEXC + 2.041 SIZE – 13.636CASS + 8.723PROF + 1.909LEV + 0.028 AGE + 1.141INDS+ e			

Note: * significant at < 0.05, ** significant at < 0.1.

rate governance. Big capital firms have a negative coefficient value level of –73.638 with a significance value of 0.008 below 5%. In contrast, middle capital companies have a positive coefficient value of 243.432 with a significance value of 0.057 below 10%. According to the findings, *H2* is accepted: family ownership benefits medium capital enterprises but has a negative and significant impact on how corporate governance is implemented in big capital organizations. The proportion of directors and commissioners who are family members will affect the adoption of good governance practices and, as a result, the establishment of sound governance since big capital organizations present distinct influence signals from middle capital enterprises.

4. DISCUSSION

According to the findings for the first hypothesis (*H1*), it is shown that family ownership has a positive effect on the composition of the board of commissioners and directors who are affiliated with the family. These findings support the claims made by Anderson and Reeb (2003), Wirawan and Diyanty (2012) that family-dominated businesses tend to avoid independent candidates and opt for directors and commissioners with close family links. According to Pagano and Volpin (2005), this occurs because a family will use its power as a controlling shareholder to pick commissioners and directors. This will allow controlling shareholders, in this case – a family, to benefit from the minority shareholders' profits. These results also align with Haque et al. (2011) that family ownership plays a significant and positive role in the composition of the board of commissioners and directors affiliated with a family.

As shareholders, families are interested in minimizing conflicts of interest and managing a company to create value for the company. According to Anderson and Reeb (2003), family-controlled businesses outperform non-family businesses in terms of both performance and valuation. This is especially true when a family member holds the CEO position (Maury, 2006). Thus, family-owned companies can only affect the company's performance if a family has a strong relationship with business people and acts as a controller in this company (Azim et al., 2018). The performance of family-owned companies is only able to be higher if a family has a role and is active in the company's management, both as executives and the board of directors. The higher the percentage level of family ownership in a company, the higher the positive effect on company performance (Yasser et al., 2017).

The second hypothesis (*H2*) was tested on large capital enterprises, and the findings indicate that family ownership (FOWN) significantly hinders the application of corporate governance. However, the FEXC and FAB factors did not demonstrate a significant impact. This study backs up the arguments made by Bebchuk and Neeman (2005) and Haque et al. (2011). Big capital companies, or those in the blue-chip stock category, are often managed by qualified people, have reasonably sound fundamentals, and are controlled in Indonesia with high standards and sound performance based on references to good corporate governance (GCG). A small family shareholding cannot influence a company, as evidenced by the fact that the average share owned by a family is relatively small, at 1.3%. The board of directors' membership ranges from 6 to 20 individuals, demonstrating that the more board members a company has, the more managerial and administrative problems are addressed. A decision's certainty will also be higher if it has been assessed and taken into account by a large number of people. To prevent conflicts of interest between the company's shareholders, safeguard small shareholders, and strike a balance between the interests of different groups of shareholders, independent members of the board of commissioners and directors are expected to be present in order to strengthen corporate governance.

The results of testing the second hypothesis (*H2*) indicate that family ownership (FOWN) has a favorable impact on the application of corporate governance. On the other hand, the FAB variable had a considerable impact, whereas the FEXC variable did not. This demonstrates the impact of family ownership on the application of sound corporate governance. Apart from being primarily family-owned, council mem-

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bers also promote this family ownership. The more family members that hold positions on the board of directors and commissioners, the better the governance. The effectiveness of the company's governance, which affects the formulation of sound policies to address issues that develop inside the organization, is evaluated. One of the cornerstones to a business's ability to prosper over the long haul is good corporate governance. The developed corporate governance must defend the interests of shareholders in the economies of developing nations if it is to succeed in global business rivalry. These findings support Azim et al. (2018) and Sarbah and Xiao (2015). However, the findings of this study are at odds with those of Haque et al. (2011).

CONCLUSION

The relationship between corporate governance, family-aligned boards, and family ownership has been studied extensively by previous authors, but often with non-financial firms. Corporations are seen in this study based on market capitalization values (large capital and medium capital), which are used as research subjects. This paper's uniqueness is in applying the research topic to big capital and medium capital organizations. Overall, this study shows that the greater the family ownership, the greater the incentive for the family to appoint family members or affiliates to key management positions, such as directors or members of the company's board of commissioners.

The results also demonstrate that family ownership has a detrimental impact on the application of corporate governance in big capital enterprises. Less family ownership in major capital corporations will result in stronger corporate governance implementation. Family ownership, nevertheless, has a favorable impact on the application of corporate governance in middle capital enterprises. This demonstrates how family ownership impacts how effective corporate governance is. The corporation is evaluated more on how well its governance is implemented, which impacts developing effective procedures to handle internal conflict and, to a significant part, maintaining the status quo.

Overall, the findings of this study can help regulators create strict guidelines or regulations that will encourage the implementation of good corporate governance. This is because a family holds the primary control of the majority of Indonesian corporations with a concentrated ownership structure.

AUTHOR CONTRIBUTIONS

Conceptualization: Erma Setiawati.
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Formal analysis: Erma Setiawati, Eskasari Putri, Nashirotun Nisa.
Funding acquisition: Erma Setiawati.
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Methodology: Erma Setiawati.
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Software: Erma Setiawati, Eskasari Putri, Nashirotun Nisa.
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Visualization: Erma Setiawati, Eskasari Putri, Nashirotun Nisa.
Writing – original draft: Erma Setiawati.
Writing – review & editing: Erma Setiawati.

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