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**DISAGGREGATING THE CONTROL DEVICES OF FAMILY-BASED
GOVERNANCE: THE CASE OF INDONESIA**

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Abstract

I extend the family-based governance study by examining the impact of controlling family ownership, controlling family involvements in management, and the involvement on the board on firm performance in Indonesia. This paper is the first to incorporate all possible control devices and investigate its impact on organizational outcome. The conceptual framework is derived from agency theory assuming that the governance mechanisms affect the behaviour of contracting parties. Using a dataset consisting of 190 Indonesian listed firms, I find that all control devices are negatively related to accounting earnings. The presence of family involvement in management and on the board negates the significant impact of family ownership on firm performance. Further analysis reveals that the involvement on the board lessens the significant relationship between the involvement in management and firm performance. These findings have two important implications. First, the presence of controlling families does not necessarily harm firm performance unless they involve in management and on the board. Second, the entrenchment problem of the involvement on the board is higher than those of family ownership and the involvement in management. The result underlines the necessity to disentangle control mechanisms by the family as it potentially creates different impact on organizational outcome.

Keyword: Corporate Governance, Control devices, Family-based Governance, Firm Performance

JEL Classification: G32

1. Introduction

In contrast to the dispersed assumption, the ownership of corporation around the world is concentrated in the hand of few wealthy families (La Porta et al., 1999) where the agency problem is related to the conflict between controlling owners and minority shareholders. Governance studies investigating the relationship between control devices of the family and organizational outcome heavily focus on ownership structure. Yet, it is a norm that controlling owners engage in control-enhancing mechanism through the appointment of their family members to serve in management and on the board of directors. Surprisingly, there is no work incorporates all possible control device of the family-based governance in a single study simultaneously. My paper is aimed at filling in this gap in relation to Indonesia.



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I investigate the relationship between different control-enhancing devices of the family-based governance and organizational outcome. Particularly, I examine the impact of controlling family ownership, the proportion of management and directors who are the family members of controlling owners, and the presence of such a director serving as a board chairperson on firm performance of Indonesian listed firms. Using the framework where the family serves as the unit of analysis, I argue that the directors who are the family member of controlling owners have properties identical to those of insider directors in a one-tier board system. The framework also implies that the involvement of controlling family in management and on the board potentially creates insider ownership issue.

I find that all possible control devices are negatively related to firm performance. The presence of family involvement in management and on the board negates the significant impact of family ownership on firm performance. These suggest that the presence of controlling families does not necessarily harm firm performance unless they involve in management and on the board. The presence of family involvement on the board lessens the significant relationship between family involvement in management and firm performance. This indicates that entrenchment problem of the involvement on the board is higher than those of family ownership and the involvement in management. The finding underlines the necessity to disentangling different control mechanisms by the family and its different impact on firm performance.

This study contributes to the governance literature in several ways. First, I further disentangle and incorporate all possible control devices of the family-based governance. To the best of my knowledge, I believe that my study is the first to address this issue. Secondly, I focus on the Indonesian setting that has been documented as having ineffective legal system (Durnev & Kim, 2005), less developed and inactive market for corporate control (Asian Development Bank, 2000, Nam, 2004), ownership concentration in the hand of controlling family (Claessens, Djankov & Lang, 2000). Third, following the work of Prabowo and Simpson (2009), I argue that the family members of controlling owners might have properties identical to those of insider directors in that of one-tier board system. This argument implies that the substance of combined leadership exists in Indonesia although this country adopts a two-tier board system.

The remainder of the paper is organized as follows. Section 2 develops the hypotheses. Section 3 describes the data, sample and methods. Section 4 presents the empirical results. The last section discusses and concludes the empirical findings.



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2. Theoretical Background and Hypotheses

Based on the work of Berle and Means (1932), the first generation of the governance literature hinges on the assumption of a dispersed ownership in public corporations (Denis & Mc Connell, 2003). Agency problems in such firms spring from the divergence of interests between those of powerful management and the disempowered dispersed shareholders. However, academic research has documented the prevalence of ownership concentration in most economies. For example, La Porta et al. (1999) find that ownership by the top three largest shareholders is a salient feature of larger non-financial firms in 49 countries. Accordingly, the dominant agency problem in most economies is related to the conflict between controlling owners and minority shareholders (Shleifer & Vishny, 1997).

The presence of large shareholders might serve as governance mechanism that facilitate disciplinary action and create the condition necessary for effective corporate governance (Smith & Walter, 2006). This view is grounded on the premise that large ownership provides the holders with sufficient voting power to exercise voice strategy and with the incentive and economic rationale to monitor management (Maug, 1998, Shleifer & Vishny, 1986). On the other hand, a particular level of stockholding grants the large shareholder almost complete control over the firm's decisions. Eventually, substantial voting power enables the large shareholder to entrench themselves and to design contracts that facilitate them pursuing their own interest even at the expense of minority shareholders (La Porta et al., 2000).

Although large shareholders might have two competing effect, previous works have documented that ownership concentration negatively affects firm performance in East Asia (Claessens et al., 2002) and in developed countries (Ehrhardt & Nowak, 2003, Gadhoun, 2000) whenever such concentration is held by family. Morck and Yeung (2003) suggest that control by family serves as a device in pursuing the private interest of the family that is not shared with the other shareholders. Aside from the type of owners, it is asserted that the beneficial effect of large shareholders is also contingent upon the presence of strong investor protection (Faccio, Lang & Young, 2001) and developed capital markets Dyck and Zingales (2004). These conditions are consistent with the features of Indonesia that has been documented as having ownership concentration in the hand of few families (Claessens, Djankov & Lang, 2000), ineffective legal system (Durnev & Kim, 2003, Beck, Demirgüç-Kunt & Maksimovic, 2003) and less developed and inactive market for corporate control (Asian Development Bank, 2000, Nam, 2004). Therefore I predict that ownership concentration is negatively related to firm performance.

The prevalence of significant ownership by the controlling family has been quoted as providing a rationale to use the family, instead of individuals, as the unit of analysis. This approach is based on the premise that the family members of the controlling owners share the same interests and accordingly they will pursue similar and



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collective behaviour in the contracting environment (Urutiaga & Tribo, 2004). Borrowing this framework, Prabowo and Simpson (2009) argue that the directors who are the family members of controlling owners share the same interest with management and are unconstrained by information access. This line of reasoning implies that the directors who are the family members of controlling owners have properties identical to those of insider directors. Consequently, the family member of controlling owner serving as the board chairperson necessarily creates a combined leadership issue as advanced by Jensen (1993). Therefore, combined leadership, to some extent, is also prevalent empirically in a two-tier regime, whenever the controlling owner appoints their family member to serve as a board chairperson.

As the directors who are the family members of controlling owners have identical properties to those of insider directors, thus the presence of such directors on the board might mitigate information problem that lead to better control decision (Adams & Ferreira, 2007). On the other hand, the involvement of controlling family on the board facilitates those diverting firm resources (Yeh & Woidtke, 2005). However, Scott (Scott, 1999) suggests that, in the weak institutional environment such as in Indonesia, it would be beneficial to enhance board independence in order to compensate for the absence of external governance mechanisms. This view implies that the presence of directors who are the family members of controlling owners might lessens the board monitoring effectiveness as they share the same interest with management. Thus, I expect that the presence of directors who are the family members of controlling owners serving on the board and the presence of such a director serving as a board chairperson are negatively related to firm performance.

The family as the unit of analysis implies that the shareholding of a single family member is treated identically to the aggregate shareholdings of family members of the controlling owners (Claessens et al., 2002). Therefore, the shareholding of managers and directors who are the family members of controlling owners might be treated equally to the shareholding of their family. Accordingly, when the family members of controlling owners serve in management, the outcome may be the type of managerial ownership problem advanced by Morck, Shleifer and Vishny (1988)

Higher insider ownership potentially lessens management incentive to pursue self-interested action and therefore enhances the convergence of interests of agent and principal (Jensen & Meckling, 1976). On the other hand, such ownership provides insiders with sufficient voting power to secure their position that might lead to entrenchment problems (Seifert, Gonenc & Wright, 2005). The disadvantage of insider ownership is grounded on the premise that a necessary condition for effective corporate governance is that badly performing managers may be replaced (Macey, 1997). In this circumstance, firm disciplinary mechanisms are unable to function to remove poorly performing managers whenever an entrenchment effect associated with higher insider ownership exists (Volpin, 2002). Empirical works reveal that the



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association between CEO turnover and firm performance is negated by the presence of insider ownership (Gibson, 2003) as such insiders have excessive influence over the decision-making process (Campos, Newell & Wilson, 2002). This view is consistent with Nam (2003, p.2), who argues that "...the beneficial effect of large shareholders can be expected only when the management is separated from ownership, or when proper corporate governance mechanisms are in place and operating so that outside shareholders can effectively oversee corporate management". However, this condition is not fulfilled in Indonesia that has been documented as having low score of investor protection provided by the legal system is weak and having an illiquid and inactive capital market, (ADB, 2000). Accordingly I predict that the presence of family members of controlling owners serving in management is negatively related to firm performance.

3. Research Method

Following Claessen et al. (2002), the data is compiled from various sources namely: Annual Report (AR), Indonesian Capital Market Directory (ICMD), Profile of Publicly Listed Company (PPLC), Prominent (PRO), and Jakarta Stock Exchange (JSX) list of independent directors. Performance indicator is obtained from ICMD manual database. The first step in identifying the ultimate owners and external large shareholders refers to the annual reports. As documented by Claessens et al (2002), the common feature of ownership of Indonesian listed firms is the prevalence of pyramidal ownership. Under such structure, the immediate owner of a listed firm is another company that is controlled by the ultimate owners. The next step is to trace the immediate owners to the PPLC that presents the information regarding the business group where such immediate owners belong to. The third step is to identify the ultimate owners¹ of immediate shareholding firms based on PPLC. The fourth step is to accumulate the ownership of immediate firms to construct immediate shareholding of the controlling owners². Following the argument of La Porta et al. (1999), although it might be stale, this source provides the most recent reliable data. Himmelberg, Hubbard and Palia (1999) suggest that ownership structure of listed firms remains stable over time despite of insignificant changes that might occur. The data of directors and management are gathered from AR which stipulates the name and number of directors. The name of directors is then traced to the JSX publication and PRO in order to identify the directors and management who are the family members of controlling owners and the independent directors.

The sample is based on all industrial firms that were listed in Jakarta Stock Exchange (JSX) as at 31 December 2002, excluding banking and financial services firms as these industries have been claimed as having specific accounting standard. Firms that

¹ In most cases, the ultimate owner has two names, their original Chinese and their Indonesian name.

For example, the ultimate owner of PT Indofood Sukses Makmur, Tbk is Liem Sioe Liong alias Soedono Salim, and the ultimate owner of PT Lippo Karawaci Tbk is Mochtar Riady alias Lie Mo Tie.

² In some instances, the ultimate owners are the coalition between several families.

were not presented in all data sources are deleted, leaving 190 firms as the final sample. The sample consists of 30 industries and mostly comprises manufacturing industries (72%). The remaining 28% are engaged in wholesale and trade, property, transportation service, communication, holding and investment companies, and others.

Firm performance is measured using Return on Assets 2002 defined as the ratio of earning before interest, extraordinary item, and taxes to total asset as of 2002. I aggregate the individual shareholding of family members of controlling owners to construct controlling family ownership³. Controlling family ownership is defined as the family immediate ownership using a 20% shareholding as a cut-off in differentiating between dispersed firms and family-controlled firm⁴. Controlling family involvement in management is defined as the proportion of family members of controlling owners serving in management to total number of managers. The proportion of family members of controlling owners serving in the board to total number of directors serves as the proxy of controlling family involvement on the board. The board leadership is measured using a nominal scale equal to 1 if board chairperson is held by an independent directors and 2 is held by a grey director and 3 is held by the family member of controlling owner. Board size is the total number of directors serving on the board. The representation of independent directors is measured using ordinal variable equal to 1 if the board of directors consists of non-independent directors entirely, 2 if the proportion of independent directors serving on the board is $0 < \text{proportion of independent directors} < 30\%$, 3 if the proportion of independent directors serving on the board is $30 \leq \text{proportion of independent directors}$ ⁵. Assets are the log natural of the book value of assets and industry is a nominal scale based on 2-digit JSX industry classifications. Table 1 summarizes the operational definition, measures, and data sources of variables.

Table 1: Operational definition and the data source of variables

Variables	Acronym	Operational Definition	Source
Firm performance	ROA	Earning before interests and taxes divided by total assets	ICMD

³ The study follows the Capital Market Law 1995 (article 1) that defines the family affiliation as a relationship by marriage and/or blood both to second degree vertically and horizontally.

⁴ See for example LaPorta, Lopes-de-Silanes, and Shefler (1998) and Claessens, Djankov and Lang (2000). However, it should be noted that this cut-off point is best viewed as “researcher discretionary” as there is no theoretical work justifying this point.

⁵ The study relies on the JSX list of independent directors in identifying the directors’ affiliation. JSX officially defines independent directors as “individual without any affiliation with management, directors, controlling owner, and do not serve as commissioner in other affiliated firm (interlocking director) See SE-03/PM/2000, Kep-315/BEJ/062000, and Kep-339/BEJ/07-2001 art C.2. This definition is consistent with Lukviarman (2004) claiming that the concept of “directors’ affiliation” in Indonesian setting should refer to the controlling owners. The scale is selected to avoid multicollinearity problem between controlling family involvement on the board and the representation of independent directors.



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Controlling family ownership	OWN	The proportion of shares owned by controlling family through the immediate shareholding.	AR, PPPLC, PRO
Controlling family involvement in management	FMG	The proportion of family members of controlling owners serving in management to total number of managers.	AR, PPLC, PRO, JSXL
Controlling family involvement on the board	FBD	The proportion of family members of controlling owners serving in the board to total number of directors	AR, PPLC, PRO, JSXL
Board leadership	LED	Dichotomous variable equal to 1 for independent director serving as board chairperson and 2 for affiliated director and 3 for the family member of controlling owner.	AR, PPLC, PRO, JSXL
Board size	BSZ	Total number of directors serving on the board.	ICMD
The representation of independent directors	DIR	Ordinal variable equal to 1 if the board of directors consists of non-independent directors entirely, 2 if the proportion of independent directors serving on the board is $0\% < \text{independent directors} < 30\%$, 3 if the proportion of independent directors serving on the board is $30\% \leq \text{independent directors}$	
Assets	AST	Log natural of the book value of assets	ICMD
Industry	IND	Nominal scale based on 2-digit JSX industry classifications	ICMD

ICMD is the Indonesian Capital Market Directory, PPLC is the Profile of Publicly Listed Companies, PRO is the Prominent, JSXL is the list of independent directors published by the Jakarta Sock Exchange.

The relationship between control devices and firm performance is analysed using the following model. The model includes governance mechanisms (board size and the representation of independent directors) and firm characteristics (industry and assets) as control variables. Board size has been quoted as having two competing effects (Yermack, 1996, Coles, Daniel & Naveen, 2008) while the representation of independent directors improve board independence that might lead to better monitoring. The type of industry reflect the nature of business that potentially affects corporate performance while assets might drive the level of agency problems (Barnhart, Marr & Rosenstein, 1994)

$$ROA_{it} = \alpha + \beta_1 OWN_{it} + \beta_2 FMG_{it} + \beta_3 FBD_{it} + \beta_4 LED_{it} + \beta_5 BSZ_{it} + \beta_6 DIR_{it} + \beta_7 AST_{it} + \beta_8 IND_{it} + \epsilon_{it} \dots \dots \dots$$

(1)

where:

- OWN_{it} : controlling family ownership of firm i at year t
- FMG_{it}: the proportion of family members of controlling owners serving in management of firm i at year t
- FBD_{it}: the proportion of family members of controlling owners serving on the board of firm i at year t
- LED_{it}: leadership structure of firms i at year t
- BSZ_{it}: board size of firm i at year t
- DIR_{it} the representation of independent directors of firm i at year t

AST_{it} assets of firm i at year t
 IND_{it}: industry group of firm i at year t

4. Results

4.1. Descriptive and Correlations

Table 2 presents descriptive statistics and the correlation of variables of interest. The mean shareholding by controlling owners (OWN) is 57%, where the presence of controlling shareholders is evident in 88% of the sample. This figure confirms the work of Claessens, Djankov, Lang (2000) and Lukviarman (2004) revealing the prevalence of ownership concentration in Indonesia and that only small numbers of Indonesian firms have dispersed ownership structure.

Table 2: Descriptive Statistics and Correlation

This table presents descriptive statistics and pairwise correlations. Variables definitions are given in Table 1. ^a, ^b and ^c represent significance at the 1%, 5%, and 10% level respectively.

	OWN	FMG	FBD	LED	BSZ	DIR	AST	IND	ROA
Min	0.000	0.000	0.000	1.000	2.000	1.000	10.459	1	-0.210
Max	99.380	1.000	1.000	3.000	10.000	3.000	17.714	35	0.425
Mean	57.739	0.300	0.302	2.142	4.337	2.911	13.591	17.100	0.057
St.D.	25.371	0.270	0.237	0.912	1.794	0.321	1.345	10.288	0.097
OWN	1.000								
FMG	0.278^a	1.000							
FBD	0.433^a	0.631^a	1.000						
LED	0.439^a	0.406^a	0.596^a	1.000					
BSZ	-0.019	-0.201^b	-0.273^a	-0.081	1.000				
DIR	-0.043	0.120	0.066	0.044	-0.003	1.000			
AST	-0.091	-0.112	-0.164^b	-0.104	0.449^a	-0.080	1.000		
IND	0.095	-0.015	0.022	-0.011	0.002	-0.061	-0.013	1.000	
ROA	-0.269^a	-0.298^a	-0.310^a	-0.231^a	0.081	-0.058	0.134^c	-0.079	1.000

On average, management consists of 36% of managers who are the family members of controlling owners (FMG). The involvement is observed in 133 firms representing 70% of the sample, where family-dominated management exists in 40 firms or one fifth of the sample as the management teams comprise more than 50% of controlling-family members. These descriptions are consistent with ADB (2002) claiming that controlling owners' involvement in management is prevalent in Indonesian listed firms. The average proportion of directors who are the family members of controlling owners (FBD) is 30%, ranging from 0% as the minimum and 75% as the maximum fraction. These figures indicate that family members dominate the boards of directors in several companies, whereas, on the other side, family members are absent from the boards of some firms. The family member of controlling owners also serves as the



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board's chairperson (LED) in 94 firms, representing 49% of sample. Overall, descriptive statistics reveal the prevalence of ownership concentration by the controlling family and the controlling family involvement in management and on the board.

The correlation coefficient between family involvement on the board and board leadership is positive indicating that family dominated board is more likely to have director who is the family member of controlling owners serving as board chairperson. Thus, the family controlled firms in Indonesian are less likely to compensate the higher proportion of insider directors with an independent leadership of the board. Consequently, such a composition enables controlling family to effectively control the board as insider directors dominate the board and at the same time hold board chairperson position. The devices of family control (ownership, the involvement in management and on the board, and affiliated leadership) are negatively related to firm performance (ROA). These finding supports the claim that family control devices are more likely to create entrenchment effects rather than alignment effect.

Board size (BSZ) is positively correlated with assets suggesting that larger firm tends to have larger board. Daily and Dalton (1992) argue that higher assets are associated with complex decisions and accordingly require more people to deal with. However, the association between firm size and outsider representation (DIR) is insignificant. Given that outsider directors reflect a board monitoring ability, this association indicates that the Indonesian listed firms are more likely to prevent scrutiny from internal governance mechanism. This supports the work of Fan and Wong (2002) claiming that firms in East Asian countries prefer to operate in greater secrecy in order to secure rent-seeking activities, irrespective of the firm size. Another plausible explanation is that larger assets represent the potential for growth opportunity that require more insider directors in order to enable the board emphasizing on the advisory role and to provide management with more discretion in pursuing investment opportunities (Hutchinson & Gull, 2004).

4.2. Multivariate Data Analysis

Single Control Device

Table 3 reports the results from OLS regressions linking the family control and firm performance measured by return on assets. The F-value for all specification is significant at the conservative level except for equation 4. Controlling family shareholding (OWN) is found to have a negative relationship with accounting performance at 0.01% levels of confidence (specification 1). The negative sign suggests that firm performance is better with more diffused share ownership. This finding is inconsistent with Haniffa and Hudaib (2006) documenting a higher accounting performance in concentrated ownership of Malaysian listed firms. However, their work did not differentiate between controlling family and unrelated

large shareholders' ownerships, which might confound their results. Specification 2 reveals that the involvement in management (FMG) is negatively related to firm performance at the 1% significance levels, suggesting that better accounting performance is more likely to be found in the firms with lower numbers of controlling family members serving in management. Given that shareholding by management of controlling family is relatively high⁶, this result suggests that accounting performance would be lower whenever disciplinary action provided by the market for corporate control is ineffective in disciplining the higher fraction of the management team.

Table 3: Cross-sectional OLS Regression of ROA Single Control Devices of Family-based Governance (N=190)

This table presents cross-sectional OLS regression of ROA on single control devices of family-based governance.. The specifications are based on model (1). Variables definitions are given in Table 1. ^a, ^b and ^c represent significance at the 1%, 5%, and 10% level respectively.

	1	2	3	4
(Constant)	0.086 (0.835)	0.016 (0.165)	0.048 (0.480)	0.060 (0.584)
AST	0.006 (1.114)	0.008 (1.420)	0.007 (1.306)	0.007 (1.224)
IND	-0.001 (-0.815)	-0.001 (-1.191)	-0.001 (-1.052)	-0.001 (-1.169)
BSZ	0.002 (0.466)	-0.001 (-0.334)	-0.003 (-0.584)	0.001 (0.249)
DIR	-0.020 (-0.929)	-0.006 (-0.280)	-0.011 (-0.496)	-0.014 (-0.642)
OWN	-0.001^a (-3.625)			
FMG		-0.104^a (-4.037)		
FBD			-0.124^a (-4.164)	
LED				-0.023^a (-3.055)
R ² -Adj.	0.068	0.082	0.087	0.049
F	3.743	4.392	4.607	2.960

Column 3 presents regressions of board composition on family involvement on the boards. The presence of controlling family involvement on the board (FBD) is negatively related to firm performance. This relationship is significant at the 1%, suggesting that such an involvement discourage firm performance, and thus providing empirical support to the notion that the involvement is more likely to create an

⁶ The average shareholding by controlling family is approximately 54% (see table 2).

entrenchment effect, rather than an alignment effect. Model 4 shows the effect for companies with the family member of controlling owners serving as board chairperson. The coefficient for the variable is significantly negative at the 1% level, indicating that such a leadership is more likely to exacerbate agency problems. Jensen (2000) contends that the chairperson poses the power and greater influence to organize board activities and thus family member serving as board chairperson potentially discourage effective board monitoring role. Another plausible explanation for this result is that higher performing firms might appoint outside director as their board chairperson since that firms have more resources to adopt better governance (Heaney, 2007)

Overall the analyses reveal that all possible devices of the controlling family are detrimental to the organizational outcome. Controlling family involvement in management exhibits a highest explanatory power while leadership structure demonstrates lowest explanatory power. The results provide empirical evidence supportive to the claim that the involvement in management is the strongest control device of the family.

Multiple Control Devices

Table 4 reports the results from OLS regressions of ROA on the presence of two control devices of the family⁷. The F-value for all specification is significant at the conservative level.

Table 4: Cross-sectional OLS Regression of ROA on Multiple Control Devices of Family-based Governance (N=190)

This table presents cross-sectional OLS regression of ROA multiple control devices of family-based governance. The specifications are based on model (1). Variables definitions are given in Table 1. ^a, ^b and ^c represent significance at the 1%, 5%, and 10% level respectively.

	1	2	3	4	5
(Constant)	0.078 (0.781)	0.090 (0.893)	0.104 (1.007)	0.041 (0.418)	0.049 (0.488)
AST	0.007 (1.185)	0.006 (1.138)	0.006 (1.061)	0.008 (1.343)	0.007 (1.301)
IND	-0.001 (-0.947)	-0.001 (-0.876)	-0.001 (-0.910)	-0.001 (-1.117)	-0.001 (-1.208)
BSZ	-0.001 (-0.130)	-0.001 (-0.297)	0.002 (0.373)	-0.003 (-0.669)	-0.001 (-0.281)
DIR	-0.011 (-0.505)	-0.014 (-0.670)	-0.018 (-0.826)	-0.006 (-0.304)	-0.006 (-0.301)
OWN	-0.001^b (-2.638)	-0.001^b (-2.033)	-0.001^b (-2.536)		

⁷ The multicollinearity problem exists when three control devices are taken simultaneously into one model.

FMG	<i>-0.084^a</i> (-3.162)			<i>-0.062^c</i> (-1.919)	<i>-0.086^a</i> (-3.067)
FBD		<i>-0.094^a</i> (-2.849)		<i>-0.080^b</i> (-2.157)	
LED			<i>-0.014^c</i> (-1.665)		<i>-0.013^c</i> (-1.648)
R ² -Adj.	0.111	0.102	0.077	0.100	0.091
F	4.939	4.593	3.612	4.509	4.147

The results show that the coefficients of family ownership, family involvements in management and on the board remain significant at least at the 5% level. As compared to the Table 3, the presence of multiple control devices enhances the adjusted R² indicating a complementary relationship among control devices. Specification 1 shows that the value of adjusted R² is 0.11 when the family ownership and family involvement in management is taken into the model simultaneously. Model 2 experiences a lower adjusted R² (0.10) with the presence of the involvement on the board and ownership in the specification. These results indicate that the family involvement in management is the most powerful predictor of firm performance relative to the family ownership and the family involvement on the board.

However, the significant effect of family ownership decreases with the presence of family involvement in management (model 1) and the involvement on the board (model 2). The same pattern occurs for the family involvement in management when the involvement on the board is taken into account (specification 4). Leadership structure also experiences a decreasing significance with the presence of family ownership and the involvements in management and on the board. The results reveal that the proportion of directors who are the family members of controlling owners is the strongest control device of family-based governance while a family member of controlling owners serving as the board chairperson is weakest control device

Interaction Effects

Table 5 reports the results from OLS regressions of ROA on the presence of the interaction effect of two family control devices. The F-value for all specification is significant at the conservative level. Overall, the devices of family control are more likely to harm firm performance. Specification 1 reveals that the coefficient of interaction effect between family ownership and family involvement in management is negative at 1% significance level. The same result holds true for the rest of specifications. Thus, it is confirmed that the significance and the direction of the relationship between control devices and firm performance remain unchanged when the devices are expressed in interactions term. The results thus provide supportive evidence to the claim that the family members of controlling owners act collectively in preserving the interest of their family and thereby neglect the existence of internal labor market for corporate control among the family members of controlling owners.

Sensitivity Analysis

The relationship between governance mechanisms and firm performance has been quoted as being sensitive to the measurement issue (Dalton et al., 1998). Accordingly, the study re-ran OLS regression analyses using alternative measure of dependent and independent variables. Specifically, the performance indicator is measured using return on equity (ROE) while the devices of family control (ownership, the involvement in management and on the board) is measured using a three ranks ordinal scale based on the above and below average in order to better depict the differences in staffing philosophies (Baysinger & Butler, 1985). The results (not reported here) remain unchanged suggesting that the detrimental effect of the various family control devices on firm performance is robust after controlling for measurement issue.

Table 5: Cross-sectional OLS Regression of ROA on the interaction Effect of Two Control Devices (N=190)

This table presents cross-sectional OLS regression of ROA on controlling family shareholding, controlling family involvement in management and on the board, board size, the representation of independent directors, assets, and industry. The specifications are based on model (1). Variables definitions are given in Table 1. ^a, ^b and ^c represent significance at the 1%, 5%, and 10% level respectively.

	1	2	3	4	5	6
(Constant)	0.083 (0.824)	0.044 (0.448)	0.076 (0.748)	0.010 (0.094)	0.039 (0.382)	0.019 (0.188)
AST	0.005 (0.954)	0.007 (1.171)	0.006 (0.987)	0.008 (1.464)	0.007 (1.267)	0.008 (1.379)
IND	-0.001 (-1.113)	-0.001 (-1.307)	-0.001 (-0.939)	-0.001 (-1.189)	-0.001 (-1.151)	-0.001 (-1.352)
BSZ	-0.001 (-0.262)	-0.001 (-0.163)	0.002 (0.425)	-0.001 (-0.331)	-0.001 (-0.265)	-0.001 (-0.169)
DIR	-0.016 (-0.772)	-0.010 (-0.465)	-0.017 (-0.818)	-0.010 (-0.460)	-0.012 (-0.576)	-0.009 (-0.436)
OWNxFBD	-0.002^a (-4.296)					
OWNxFMG		-0.002^a (-4.309)				
OWNxLED			0.000^a (-3.828)			
FBDxFMG				-0.135^a (-3.175)		
FBDxLED					-0.033^a (-3.386)	
FMGxLED						-0.031^a (-3.403)



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R ² -Adj.	0.092	0.093	0.075	0.053	0.060	0.060
F	4.836	4.859	4.055	3.114	3.398	3.422

5. Conclusion, Discussions, and Limitations

The study finds that the ownership of Indonesian listed firms is concentrated in the hands of majority shareholders. Although the presence of large shareholders might serve as governance mechanism (Jensen & Meckling, 1976, Shleifer & Vishny, 1986), ownership concentration in Indonesia is negatively related to firm performance. Consistent with the finding, previous studies have documented that ownership concentration negatively affects firm performance whenever such concentration is held by family (Ehrhardt & Nowak, 2003, Gadhoom, 2000). Morck and Yeung (2003) suggest that control by family serves as a device in pursuing the family interest that is not shared with the other shareholders. Accordingly, the finding supports the view that ownership concentration by family is more likely to be related to the expropriation hypothesis.

The family members of controlling owners serving in management and on the board are the salient feature of Indonesian listed firms. The family involvement in management and on the board might promote the convergence of interests of agents and principals and mitigate contract enforcement problems as the family members share the same interests. However, the study finds that the involvements are negatively related to firm performance, suggesting that the involvement is more likely to combine management and control decisions in the hands of the controlling family. Consequently, the findings provide the undeniable fact that a proper check and balance system is absent in most Indonesian listed firms.

The presence of family involvement in management and on the board negates the significant impact of family ownership on firm performance. The presence of family involvement on the board lessens the significant impact of family involvement in management on firm performance. This indicates that entrenchment problem of the involvement on the board is higher than those of family ownership and the involvement in management. These findings suggest that the presence of controlling families does not necessarily harm firm performance unless they involve in management and on the board. Nevertheless, this finding underlines the necessity to disentangling different control mechanisms by the family and its different impact on firm performance.

The different effects of such involvements might help to explain as to why controlling owners appoint their family members to serve in management teams and on the board of directors simultaneously. The involvement in management facilitates the controlling family in ensuring that management decisions are consistent with their private benefit. On the other hand, involvement on the board of directors enables the controlling owners to prevent effective monitoring from internal governance



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mechanisms. The higher family involvement on the board and in management thus permits controlling owners to deprive minority investors from their rights and, at the same time, lessens the ability of internal mechanism to perform a monitoring role. Consequently, higher family involvement in management and on the board is more likely to worsening agency problems that discourage firm performance.

Several caveats are in order. First, controlling family ownership relies on the immediate shareholding that leads to the absence of separation between the entrenchment effect of voting rights and the alignment effect of cash flow rights. This procedure might understate the incentive of controlling owners in committing expropriation as the expropriation is more pervasive in firms with the divergence between voting rights and cash flow rights and firms that are a part of business groups Zhang (2003). Second, performance indicator uses accounting numbers that have been quoted as being suffered from earnings management (Chung, Firth & Kim, 2004). Fan and Wong (2002) find that Indonesian listed firms inflate their earning statement generously that is partly attributable to the ownership structure and thus the study might fail to capture the true firm performance. Third, the study leaves endogeneity and non-linearity issues left unaddressed that might distort the interpretation of the empirical results.

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