

# The Effect of Corporate Governance and Corporate Strategy Toward Family Firm Performance in Indonesia

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# The Effect of Corporate Governance and Corporate Strategy Toward Family Firm Performance in Indonesia

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ABSTRACT: This paper aims to analyze the influence of corporate governance and corporate strategy on the performance of family firms listed on the Indonesia Stock Exchange. Corporate Governance is proxied with Family Ownership and Independent Commissioner and Corporate Strategy with Diversification and Compensation Strategy of Directors. This research used a sampling method with purposive sampling, which is a family company listed on the Indonesia Stock Exchange (IDX) from 2014 to 2018. Data analysis used multiple linear regression methods. The results of this study indicated that family ownership had a significant effect on company performance, either using a proxy of ROA or ROE. While the diversification and compensation strategy of directors had no effect firm performance measured ROA or ROE.

Keywords: Family ownership, business strategy, corporate performance.

## 1 INTRODUCTION

Good Corporate Governance (GCG) is a concept that relates to the company's structure, division of tasks, division of authority, and division of responsibilities of each element of the company. The principles of GCG include Transparency, Accountability, Responsibility, and Fairness. It is definitively a system that regulates and controls companies that create value-added for all stakeholders, both primary stakeholder investors such as employees and managers, suppliers, business partners, and the community and secondary stakeholders such as government, business institutions, social groups, academics, and competitors.

Agency theory shows that family management is useful in achieving family goals and will later influence decisions, which then have an impact on company performance (Anderson et al. 2003). Families that manage companies tend to look for additional skills to improve the well-being of themselves and the company and increase the family's reputation. Allouche et al. (2008) found that based on 1998-2003 data, family firms in Japan showed better performance. However, Cucculelli & Micucci (2008) research concluded no indication of performance

superiority in family companies in Italy. Sciascia & Mazzola (2008) stated a negative relationship between family interference in management and company performance in 620 private companies in Italy. The research of Miralles & Miralles (2014) also showed a negative impact between family management and company financial performance. In Portugal and Spain, the impact of family management on company performance can be positive or negative. Anderson et al. (2011) argued that this happens because families do not always act in the best interests of the company. Research by Leung et al. (2014) scrutinized that the appointment of an independent director in the directors of a family company does not affect the company's performance. Kim (2013) found that the long-term goals of the company bridge the relationship between family management and company performance.

Fernandes (2008) studied that directors' compensation has no effect on and company performance. However, Duffhues & Kabir (2008) found a negative relationship between compensation for the board of directors and company performance. Kato & Kubo (2006) analyzed CEO compensation for companies in Japan and found a positive pay-performance relationship. In the Philippines, Unite

et al. (2008) found a positive relationship between executive compensation and company performance. Theeravanich (2013) also concluded a positive relationship between directors' compensation and the performance of family companies and also higher compensation payments to family companies in Thailand.

The existence of family business groups in Indonesia usually starts from companies that are purely owned by the family. The development of the company's business follows a predictable pattern according to their business development. The development of the company has the characteristic of concentration of family ownership, which is maintained even though it eventually becomes a public company through selling shares to the capital market. Family ownership in the corporate governance system is something that needs to be considered because businesses in Indonesia are more owned by families (Harjito & Martono, 2014). Lukviarman (2016) explained that family-based business is based on two main things, namely to protect family interests and distrust of family members with other parties that are outside the family. According to Cucuelli & Micuci (2006), family share ownership has a negative impact on financial performance. Anderson & Reeb (2004) explained that family ownership has a negative impact on financial performance because the legal protection provided to investors in ownership structures tends to be weak. Based on the description, the first hypothesis in this study is:

H1: There is a negative influence between family ownership on company performance.

An independent commissioner is a party that ensures the existence of Good Corporate Governance in the company by providing input and supervision to the Board of Directors for company's benefit. Fama & Jensen (1983) stated that non-executive directors (independent commissioners) could act as mediators in disputes between internal managers and oversee management policies and provide management advice. Independent commissioners are members of the board of commissioners from outside the company who are not employees and do not have financial, management, and share ownership relationships. Research conducted by Manik (2011) showed that Independent Commissioners have a positive effect on company performance. Trisnantari (2008) described that the Independent Commissioner also has a positive effect on financial performance. Based on these descriptions, the second hypothesis in this study is

H2: There is a positive influence of the Independent Commissioners on the company performance.

Compensation is an essential factor that influences why so many people work in a particular organization and not in other organizations, in this case, the company must be comprehensive in providing compensation to employees to maintain and provide appropriate compensation for them. There are two types of compensation given to employees, intrinsically and extrinsically. Intrinsic compensation is compensation in the form of praise given to employees with the impact obtained is a psychological impact, while extrinsic can be in the form of things that are direct and indirect. Direct compensation can be exemplified as a basic salary while indirect ones such as benefits provided to employees. According to Conyon (2006), the amount of compensation given along with the large company performance in that period, if the company's financial performance falls, then the compensation of directors will also decline, and vice versa. However, if the directors get the compensation that is too high compared to the industry on average and is not in accordance with the complexity of their duties and responsibilities, it is feared that it can affect the company's performance (Chen 2013). Canarella & Nourayi (2008) instead of Chen (2013) found a non-linear relationship between compensation and company performance. Based on the description, the third hypothesis in this study is:

H3: There is a positive influence between the Compensation of directors on Company Performance.

Diversification strategy is defined as a strategic alliance of the core competencies of various skills and technologies owned by the company so that resources can be implemented in an alliance business concept that exists in the company. Diversification strategy based on competencies, resources, and core business owned by the company is the implementation of a diversified relationship (related diversification). Chatterjee & Wernerfelt (1991) found that diversification strategies have a positive influence on firm performance so that the fourth hypothesis of this study is:

H4: There is a positive effect of the Diversification Strategy on company performance.

## 2 RESEARCH METHODS

The populations in this study were family companies in Indonesia with a sample of 112 companies listed on the Indonesia Stock Exchange (IDX) over the 2014-2018 period (5 years) using a purposive sampling method determined based on specific criteria. Seventy companies were obtained as a sample of companies listed on the Indonesia Stock Exchange

during the study period. The dependent variable in this study is a performance which was proxied by Return on Assets (ROA) and Return on Equity (ROE). While the independent variables are: First, family ownership, which was measured using a large percentage of family ownership of total ownership in the company. Second, the directors' compensation, which was measured the total compensation given to the Board of Directors. Third, an independent commissioner, which was measured using an indicator of the total number of independent commissioners from outside the company of all sizes of the company's board of commissioners. Fourth, the diversification strategy is shown by using the number of business units or subsidiaries owned by the company obtained from the company's financial statements.

### 3 RESULTS AND DISCUSSIONS

Descriptive statistics of 70 sample companies can be seen in Table 1:

Table 1: Descriptive Statistics

No	Variable	Mean	Minimum	Maximum
1	Return on Asset	6.9%	1%	26.80%
2	Return on Equity	13.3%	1%	31.94%
3	Family ownership	42.22%	18%	84.11%
4	Independent Commissioner	32.92%	16.67%	66.67%
5	Diversification	4	1	8
6	Director compensation (in Billion)	Rp3,422	Rp1,289.	Rp7,130

The regression results of Family Ownership, Independent Commissioners, Diversification, and Directors' Compensation for Financial Performance which is proxied by the value of Return on Assets (ROA) are as follows:

Table 2: T-test Results for Linear Regression Dependent Variable ROA

Variable	Beta ( $\beta$ )	t-stat	P-Value
Constant	0.230	0.056	0.850
Family ownership	-0.022	-2.055	0.035
Independent commissioner	0.038	2.620	0.014
Diversification	0.021	0.034	0.820
Compensation of directors	0.009	0.515	0.342

The regression results of Family Ownership, Independent Commissioners, Diversification, and Directors' Compensation for Financial Performance

which is proxied by the Return on Equity (ROE) value are as follows:

Table 3: T-test Results for Linear Regression Dependent Variable ROE

Variable	Beta ( $\beta$ )	t-stat	P-Value
Constant	0.041	0.245	0.871
Family ownership	-0.037	-2.875	0.028
Independent commissioner	0.211	2.796	0.003
Diversification	0.011	1.327	0.321
Compensation of directors	0.004	0.146	0.763

Source: Processed Data, 2019.

The first hypothesis testing results showed that family ownership significantly influences family company performance in Indonesia, using both ROA and ROE proxies. This is consistent with research conducted by Cucuelli and Micuci (2006) that said family ownership has a negative impact on financial performance and in accordance with the results of research conducted by Anderson and Reeb (2004) that also stated family ownership has a negative impact on family businesses in Indonesia.

The second hypothesis testing results showed that the independent commissioner had a positive effect on the company's financial performance using both the ROA and ROE proxy. The third hypothesis testing results indicated that the diversification strategy had no effect on financial performance, either with the dependent variable of Return on Assets (ROA) or Return on Equity (ROE). This result is in accordance with research conducted by Setyawan (2013) that diversification does not affect the company's performance, both ROA and ROE. The fourth hypothesis testing results indicated that there is no effect of Compensation on the Performance of Family Companies in Indonesia, both proxy by Return on Assets (ROA) and Return on Equity (ROE). This is in accordance with research conducted by Theeravanich (2013), which stated that Directors' Compensation does not affect company performance. This compensation strategy, as one of the tools of the management control mechanism, is to attract the interests of workers from outside as well as to regulate the rate of management turnover in the company.

### 4 CONCLUSION

This study showed that family ownership influences family company performance, both using ROA and ROE proxies. Independent commissioners significantly influenced the company's performance, both



using ROA and ROE proxies. Meanwhile, the strategy of diversification and compensation of directors did not significantly influence either using ROA or ROE proxy.

Suggestions for future research include the need for additional observation years for more optimal results. It is also necessary to add other GCG indicators such as the activities of the Board of Commissioners, the Board of Directors, Managerial Ownership, and Institutional Ownership. It can also be added to the Remuneration and Nomination Committee indicators as well as several other indicators that can be used so that the results of the study can better predict factors that affect financial performance in addition to the indicators that have been studied. Finally, the company's strategy can use another indicator that is low cost and focus as additional variables. The measurement of company performance in this study used profitability ratios, namely ROA and ROE, so that future research can use the performance measures of other companies such as Tobin'Q.

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