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The relations of family ownership, characteristics of board of directors, and company performance

L Purnamasari, S Hasnawati & E Hendrawaty
Universitas Lampung, Lampung, Indonesia

ABSTRACT: This study examined the effect of family ownership and characteristics of the board of directors on company performance. The companies in this study are manufacturing companies listed on the Indonesia Stock Exchange in 2016-2018. Based on previous studies, family ownership has a negative impact on company performance. This is likely due to interest differences between family ownership and company management, which causes agency conflicts. Hence, to reduce these negative effects, family-owned companies can place their family members in company management, such as the company's board of directors. Thus, all activities and corporate decision making can be controlled, and agency conflict can be avoided.

1 INTRODUCTION

Each company has a different shared ownership structure. One of the structures is family ownership. Chang and Shim (2015) stated that a company categorized as family ownership when its directors have a family relationship and ownership, indicating that the company policies are dominated by family members. Although not all companies are categorized as a family shared ownership structure, there are currently a high number of companies with this type of structure.

Cooper (2014) argued that 60% of companies in Southeast Asia are publicly listed companies and belong to family ownership. Leadership inheritance, thus, is considered as one of the company's priorities. Numerous family ownership companies are listed on the Indonesia Stock Exchange and are spread in various sectors. In the manufacturing industry, for instance, there are more family-owned companies compared to others. According to the Ministry of Industry of the Republic of Indonesia (2016), based on data released by the United Nations Statistics Division in 2016, Indonesia was ranked fourth out of 15 countries in the world in which manufacturing industries contributed to over 10% Gross Domestic Product (GDP). Indonesia could contribute up to 22% after South Korea (29%), China (27%), and Germany (23%). This shows that the 22% contribution of Indonesian GDP came from the manufacturing industry accounting for 50% of family-owned companies in Indonesia.

Previous studies found different results regarding relations between company performance and family ownership. Gibb Dyer Jr (2006) revealed that company performance is poor when the company is categorized as family ownership. The majority shareholders in the family-owned company are family members; thus, the majority of shared ownership offers them the power to appoint their other families rather than those who are more capable and professional in managing companies. Also, there is a tendency from management to provide a high salary for family members. Agency problems can also emerge when the acquisition of minority shares is conducted by majority shareholders, such as family ownership (Faccio, Lang and Young, 2001). In contrast, Shyu (2011) argued that family ownership in companies could improve company performance. As the majority of shareholders are family members, they can provide easy access to internal information. Hence, stakeholders and management can easily predict the company's future prospects.

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According to Chang and Shim (2015), family ownership companies usually have family member representatives at the company's board of directors as well as CEO (Chief Executive Officer). This is intended to allow family members to participate in corporate governance. A company that is able to run good corporate governance and improve company performance will create a good image in the eyes of investors. Fama and Jensen (1983) posited that agency costs could be reduced while company performance can be increased with the presence of family members on the board of directors since they can act as effective monitors. James (1999) stated that the existence of family directors would lead the company to a long-term investment, which will provide incentives for the company. In addition, since a sense of ownership exists within the company's management, it will make them work harder and better to improve company performance.

2 THE RESEARCH PROBLEMS

Corporate family ownership indicates that these organizations have limited capital, intergenerational squabbles, executive entrenchment, and nepotism. All of them can lower company performance (Allen and Panian, 1982); (Schulze, Lubatkin, and Dino, 2003). Shareholders owning large shares, i.e., family ownership, enable them to control companies. The majority of shareholders most likely extracts personal benefits and sacrifice minority shareholders (Burkart, Panunzi, and Shleifer, 2003). In addition, family ownership tends to overlook profit maximization activities because their financial preferences often conflict with minority shareholders' interests, which is highly detrimental to minority shareholders and the company (Anderson and Reeb, 2003).

Several questions will be discussed in this study as follows. Does family ownership negatively affect company performance? Does the proportion of family directors have a positive effect on company performance? Does the CEO of a family-owned company have a positive effect on its performance? All the companies in this study are manufacturing companies listed on the Indonesia Stock Exchange in 2016-2018.

3 LITERATURE REVIEW

The theories used in this research are agency theory and corporate governance. Jansen and Meckling (in Arifin, 2005) stated that agency theory provides a framework for conducting analysis on the basis of contractual relationships both explicitly and implicitly. It is when one or more people (called principals) ask others (called agents) to take action on behalf of the principal. The presence of a contractual relationship is the delegation of several decision-makers to the agent. Agency problems in companies can arise in various forms, including conflicts between managers and shareholders, majority shareholders and minority shareholders, and shareholders or managers and lenders (Arifin, 2005). In this case, agency problem that might arise in family-owned companies is different interests between shareholders and company management.

Agency conflict in family-owned companies can be reduced by the participation of family members in corporate governance. According to Rajagopalan and Zhang (2008), one of the reasons family ownership companies place family members on the company's board of directors is to improve corporate governance, to increase investor confidence in companies located in developing countries, and to raise capital access to these companies. Denis and McConnell (2003) argued that problems in corporate governance could be overcome with a different application of internal or external mechanisms. The internal mechanism includes the board of directors and the company's equity, while the external mechanism includes an external market mechanism for corporate control (takeover market) and the legal system.

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