Conference Paper

Family Ownership and Firm Performance in Indonesia

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Abstract

The purpose of this paper is to investigate the influence of family ownership on the financial performance of firms listed on the Indonesian Stock Exchange from 2008 to 2012. The methodology used is multiple linear regression. The financial performance is measured with return on assets (ROA). The research shows that family ownership does not significantly influence firm performance. This paper is particularly important to the policymakers and shareholders of firms in Indonesia and other developing economies since it provides a comprehensive insight into the family ownership – firm performance relationship and therefore it helps them to formulate the best policies.

Keywords: *ROA, family ownership, firm performance*

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1. Introduction

Publicly traded firms across the globe commonly are controlled by family shareholders [5]. Anderson and Reeb (2003a) found that one third of Standard and Poor (S&P) 500 firms are owned by families and family ownership accounts for 18 percent of outstanding equity. Such controlling families often hold large equity stakes and are represented in the corporate board [10]. Turnover and recruitment costs in family firms are lowered because trust and loyalty are fostered by the working environment [14].

Due to its dominance in the global economy, the authors are interested to undertake a research on family ownership. There are ample literatures that have discussed the effect or influence of family ownership on firm performance. While those literatures mainly deal with the context of developed economies, this paper examines the relationship between family ownership and financial performance of listed companies in Indonesia, one of developing economies in Asia.

The organization of this paper is structured as follows. Section 2 presents the literature review on directors' ownership. Section 3 describes the research methodology. Section 4 presents the summary of the findings, and Section 5 concludes.

2. Literature Review

Anderson et al. (2003) posit that founding families "represent a special class of large shareholders that potentially have unique incentive structures, a strong voice in the firm, and powerful motives to manage one particular firm." In addition, Anderson et al. also argued that two respects distinguish founding families with other shareholders: the family's interest in the firm's long-term survival and its concern for the firm's (family's) reputation.

Anderson and Reeb (2003b) posited that founding families have strong incentives to minimise firm risk due to the undiversified nature of their holdings and their desire for firm survival. Firm risk can be reduced by founding families in two ways. First, firm's investment decisions may be influenced by families through pursuing projects with imperfectly correlated cash flows relative to existing projects (corporate diversification). Second, capital forms that bear low probabilities of default may be chosen by families (more use of equity financing or less use of leverage in the firm's capital structure). However, these strategies can impose costs on diversified and minority shareholders.

Family ownership also has potential drawbacks. Fama and Jensen (1985) claimed that since the interests of the family are not necessarily in line with those of other shareholders, the combination of management and control in the hand of family might lead to sub-optimal investment decisions. Demsetz and Lehn (1985) argued that families may pursue nonpecuniary private benefits of control. According to Shleifer and Vishny (1997), the family executives might remain active in the firm although they are no longer competent (entrenchment effect).

Andres (2008) found that families might be different with other types of large shareholders when they serve as board members. Through serving as board members, families possibly have a deeper relationship with the firm they own-manage or might even feel responsible for other shareholders.

Furthermore, it is possible that family shareholders own shares of a firm indirectly. Indirect ownership means a shareholder hold the shares through entities that he or she controls [9]. Sacristan-Navarro and Gomez-Anson (2007) argued that indirect ownership occurs when the significant shareholders hold the shares through an intermediate firm. Thus, family shareholders are considered to have an indirect ownership stake at a firm if they hold shares of another firm who is a corporate shareholder of the aforementioned firm.

3. Research Methodology

3.1. Data, variable and sample characteristics

The data population is 140 industrial and manufacturing companies listed on the Indonesia Stock Exchange. The population comes from an independent website about listed firms on the Indonesia Stock Exchange. Of the population, 43 companies meet the sampling criteria.

The sampling criteria are as follows:

1. Listed on the Indonesia Stock Exchange on or prior to 2 January 2008 and remain listed until 31 December 2012.
2. Have complete information required in this research.
3. Financial year end at 31 December from 2008 to 2012.

The sample size is considerably small if compared to the population. The smallness of the sample size is largely a result of the incompleteness of information required from the firms. Hence, firms with incomplete required information have to be removed from the samples.

In this paper, firm performance is measured with return on assets (ROA). Family ownership is measured with the total percentage of common stock owned by family/families. Firm size (measured with total assets) and sales growth serve as control variables.

The research method used in this paper involves the collation of data of 43 manufacturing companies available from online financial databases (secondary data), i.e. Thomson One and Orbis.

3.2. Regression model

To investigate the influence of family ownership on firm performance in Indonesia, the following multiple linear regression model is used:

$$ROA = ß_0 + ß_1FO + ß_2TA + ß_3SG + u$$

where:

ROA = return on assets

FO = family ownership

TA = total assets

SG = sales growth

4. Empirical Results and Data Analysis

4.1. Return on assets

The sampled firms listed on the Indonesia Stock Exchange have an average ROA of 6.61% during the period of 2008 to 2012. The average ROA reached the lowest level in 2008 (3.64%) and it reached its highest level in 2011 (7.58%).

4.2. Family ownership

Below is the table of regression result of the relationship between family ownership and return on assets:

Table 1: Regression result of the relationship between family ownership and ROA in Indonesia.

Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	5,011	,846		5,920	,000
	Family Ownership	,003	,061	,003	,051	,959
	Total Assets	,004	,003	,083	1,216	,226
	Sales Growth	,079	,022	,235	3,502	,001

a. Dependent Variable: Return On Assets

On Table 1, we can see that the *p* value of family ownership (0.959) is greater than α value (0.05). Therefore, family ownership does not significantly influence ROA of firms in Indonesia. Table 1 in Appendix shows that the value of R square is 0.068; meaning that 6.8% of the variation of ROA can be explained by independent variables in the model and 93.2% of it is explained by other variables not included in the model.

Table 1 also shows that sales growth significantly and positively influences ROA (*p* value = 0.001). To further investigate such influence, the samples of firms are divided according to their sales growth and then the regression using samples of growing and non-growing firms is conducted. Firms with sales growth above average fall into

growing firms category, and those with sales growth below average fall into non-growing firms category. The average sales growth of firms in Indonesia in this research is 12.65%. Below are the tables of the regression analysis for both firm groups.

Table 2: Regression result of the relationship between family ownership and ROA of growing firms in Indonesia (101 observations).

Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	8,653	1,505		5,751	,000
	Family Ownership	,010	,069	,015	,151	,880
	Total Assets	,007	,003	,200	2,001	,048
	Sales Growth	-,040	,035	-,113	-1,138	,258
a. Dependent Variable: Return On Assets						

Table 3: Regression result of the relationship between family ownership and ROA in non-growing firms in Indonesia (114 observations).

Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	6,472	1,280		5,057	,000
	Family Ownership	,000	,095	,000	,004	,996
	Total Assets	-,001	,005	-,014	-,149	,882
	Sales Growth	,250	,060	,368	4,131	,000
Dependent Variable: Return On Assets						

It appears on Table 2 and Table 3 that family ownership does not significantly influence ROA of both growing and non-growing firms in Indonesia (family ownership p value of growing firms = 0.88; family ownership p value of non-growing firms = 0.996). In addition, sales growth only significantly and positively influences ROA of non-growing firms (p value = 0).

The results above show that the ROA of firms in Indonesia is not significantly influenced by family ownership. This finding contradicts the literature mentioned in this paper which shows positive or negative relationship between family ownership and ROA.

4.3. Multicollinearity and autocorrelation test

In order to check whether the regression models are free from multicollinearity and autocorrelation, collinearity statistics and Durbin-Watson values are used. Multicollinearity does not occur when tolerance value is equal to or above 0.1 (Field, 2013) and variance inflation factor (VIF) is below 5 or 10 [11]. On the other hand, positive autocorrelation occurs when d is less than d_l (lower bound) and negative autocorrelation occurs when $(4 - d)$ is less than d_u. The multicollinearity and autocorrelation and tests show that the regression models are free from these statistical problems. More details on these tests can be seen in the Appendix.

5. Summary & Conclusions

This paper addresses the question whether family ownership influences firm performance in Indonesia. The results presented in this paper conclude that family ownership does not significantly influence firm performance in Indonesia. The finding of this paper shows that the argument put forward by Anderson and Reeb (2003a) which stated that founding families have strong incentives to minimise firm risk due to the undiversified nature of their holdings and their desire for firm survival does not apply in Indonesian context. In addition, the claim that the combination of management and control in the hand of family might lead to sub-optimal investment decisions [7] cannot be confirmed in this paper. The findings of Demsetz and Lehn (1985) and Andres (2008) are also not supported.

The insignificant relationship between family ownership and firm performance found in this paper might be evidence that the existence of family ownership should not be taken into account as the consideration of investment decision. Therefore, shareholders are recommended to put more focus on other factors that might influence firm performance.

This paper has some limitations that need to be addressed by future researchers:

1. The samples are only collected from manufacturing industry. Future researchers are advised to incorporate samples from all industries to facilitate better and more comprehensive investigation of directors' ownership-firm performance relationship.

2. The relatively small sample size might weaken the validity and reliability of the research in this paper. Future researchers are advised to increase the sample

size that can be achieved through incorporation of samples from other industries and/or primary data collection on the firms.

3. The non-existence of family ownership on a firm cannot be 100% guaranteed because it is possible that the firm is owned *indirectly* by family/families through pyramidal ownership. Future researchers are recommended to also take into account the existence of pyramidal ownership to identify family ownership.

Appendix

Table 4: R-Square and Durbin-Watson values of regression model of all firms.

Model Summary[b]					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	,260[a]	,068	,054	8,67824	2,154
a. Predictors: (Constant), Sales Growth, Family Ownership, Total Assets					
b. Dependent Variable: Return On Assets					

Table 5: R-Square and Durbin-Watson values of regression model of growing firms.

Model Summary[b]					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	,222[a]	,049	,020	7,14870	2,099
a. Predictors: (Constant), Sales Growth, Family Ownership, Total Assets					
b. Dependent Variable: Return On Assets					

Table 6: R-Square and Durbin-Watson values of regression model of non-growing firms.

Model Summary[b]					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	,367[a]	,135	,111	9,33142	2,221
a. Predictors: (Constant), Sales Growth, Family Ownership, Total Assets					
b. Dependent Variable: Return On Assets					

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Table 7: Collinearity statistics for regression model of all firms.

Coefficients[a]			
Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	Family Ownership	,976	1,025
	Total Assets	,956	1,046
	Sales Growth	,979	1,021
a. Dependent Variable: Return On Assets			

Table 8: Collinearity statistics of regression model of growing firms.

Coefficients[a]			
Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	Family Ownership	,980	1,020
	Total Assets	,977	1,024
	Sales Growth	,993	1,007
a. Dependent Variable: Return On Assets			

Table 9: Collinearity statistics of regression model of non-growing firms.

Coefficients[a]			
Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	Family Ownership	,968	1,033
	Total Assets	,957	1,045
	Sales Growth	,988	1,012
a. Dependent Variable: Return On Assets			

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