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RESEARCH ARTICLE

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The Effect of Board of Commissioners on Family Firms Performance in Indonesia

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This study aims to examine the effect of internal corporate governance mechanisms namely the board of commissioners and independent commissioners on family firm performance. This study used return on equity (ROE) as measurement for firm performance. The samples of this study were 122 family controlled companies which were listed in Indonesia Stock Exchange from 2010 to 2014. The finding reveals that independent commissioners have a positive relationship with firm performance. The larger number of independent commissioner can provide unbiased views and strategy that were not found in family directors. However, the board of commissioners size have no significant relationship with firm performance. The board commissioners who stay for a long time in the company may build a good relationship with directors which may impact on the decision-making and independent judgement of board commissioners in terms of enhancing the firm performance. Further, these finding also enrich the literatures and knowledge on family firm's performance in Indonesia.

Keywords: Board of Commissioners, Family Firms, Firm Performance, Indonesia.

1. INTRODUCTION

Corporate governance is defined as a set of guidelines which is a company controlled, including the objectives, strategy and planning structure of companies with a view achieving the interest of stakeholders and enhancing the firm performance.[16] Implementation of good corporate governance is a form of accountability for owners because it shows the transparency of the company by revealing the company information in the financial.[5]

Family-controlled companies has different unique characteristic with other types of company. It is owned and ruled by families, which each family companies has own ethics, values, histories and communication method.[9] Family-controlled companies are found to be common in Asian countries especially in Indonesia. Family-controlled companies started from small and local companies and over the time developed to become big enterprise or success listing in Indonesia Stock Exchange.[9] These evolutions of family controlled companies are accompanied by profound changes in strategy and corporate governance.[15] Family controlled companies in Indonesia have increased from 68.6 percent to 71.5 percent since 2013 to 2015.[9] Further, family-controlled companies have contributed around 70 percent of gross domestic product in Indonesia.[3]

Several family companies in Indonesia had not fully operated their firms professionally. This is because there are some parties that have concentrated ownership and affiliation with the owners, supervisors and managers.[22] Further, previous study[8] claimed that owner did not have access to adequate sources to obtain information for control and monitor the managers' action. Therefore, Indonesian companies need a party who can solve this problem namely the board of commissioners.[12] The functions of board commissioners are as a watchdog to monitor the action of managers and address the agency problem.[3] The board of commissioner represents the main internal mechanism to control the management opportunistic behaviour and align the interest of shareholders and managers.[14]

Independent commissioner is the board who originates from unaffiliated party and do not have any business relationship with member of directors.[11] The existence of independent commissioner meant that the company's decision can be taken effectively, precisely and independently.[9] Independent commissioner in Indonesia as stipulated in Code of Corporate Governance implies that at least 30 percent of board commissioner members must be independent. This requirement provides a balance of authority between inside and outside directors.[18] Previous study[17] argued that family companies need board of commissioners who are more accountable to shareholders and not only to have an independent judgement.

To maintain the independence and balance of decision-making, it was required that independent commissioners to sit in the board of commissioners.[3] Previous study[20] claimed that companies which show lower number of independent commissioners has higher fraud as compared to companies which has a high number of independent commissioners. The reason is that the board of commissioner in Indonesia does not implement control functions to directors and managements' company. The role of

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an independent commissioner who serves as the representative of shareholders and other stakeholders in particular was expected to resolve the issue and protect the stakeholder interest. Independent commissioner would be able to encourage the creation of justice and equality among the various interests.[12] It also encourages the implementation of principles and practice of good corporate governance in the company. Therefore, the board of commissioner is a measurement to determine whether the company has been exercising good corporate governance or not.[3]

The contribution of this study is to determine the effect of internal corporate governance mechanisms namely board of commissioners on family controlled companies in Indonesian Stock Exchange. Further, this study expects to provide more information related to independence of commissioners in terms of enhancing the firm performance. For practical information, the results of this study will provide the inputs to the regulators and academicians in Indonesia.

2. THEORIES UNDERLYING CORPORATE GOVERNANCE

2.1. Agency Theory

Most of the corporate governance research is based on the agency theory. Corporate governance focuses on the separation of ownership and control that may create the principal-agent problem, due to dispersed ownership in the modern enterprise.[1] Corporate governance is a mechanism in which the board as a group of important people in the company that can help to minimise the problems and act as part of the monitoring mechanism.[7]

In context of company, agency problems refer how investors to ensure the fund which their invested are use effectively by management or not.[14] According to previous study,[10] the agency conflicts arise because the decision-making related to fundraising activities and how the fund raised are invested.

2.2. Stewardship Theory

The stewardship theory posits a strong relationship between the manager and the success of the company; therefore, the manager will protects and maximise the shareholders' wealth through the company's performance. The stewardship theory has another view, i.e., the separation of the role of Chairman and CEO, the appointment of a person to the position of Chairman and CEO and the majority of the executive directors, is supported.[2]

3. BOARD OF COMMISSIONERS AS A MECHANISM OF GOOD CORPORATE GOVERNANCE

Agency problem arises when the issue of how funds invested by investors will bring benefits and ensure that the manager did not manipulate the profit of company in terms of using for the personal interest which could harm the interests of other shareholders.[10] One of the efforts is to ensure the management can manage the company in accordance with the interests of the owner by having good corporate governance.

The principles of good corporate governance shows the protection against shareholders and all parties involved in the company, including the public.[3] Good corporate governance is a system in which business entities are managed and supervised, so that with regards to the distribution of rights and obligations to shareholders, board of commissioner, investors, creditors, directors, managers, and governments.[9] Good corporate governance is an important rule for economy system that linked with companies' confidence.[15] Implementation of good corporate governance encourages healthy competition and conducive business climate.[6, 11]

Implementation of good corporate governance cannot be separated with management problems. Indonesia provisions concerning the position of directors and commissioners are stipulated in Law No. 1 of 1995 regarding Limited Liability Company.[19] Under the Act, the position of director and commissioner is strictly separated. Indonesia adopted a two-tier board system which consists of the board of directors as running the business operation and board of commissioner as a watchdog of the company. However, both parties have their responsibilities in maintaining the long-term sustainability of the business enterprise.[3]

Board of commissioners as the members in charge of the company and is collectively responsible to supervise and advise the board of directors and to ensure that the management company has implemented good corporate governance.[9] According to the National Committee on Governance,[11] the board composed of commissioners who are from affiliated parties. Commissioner affiliated is a commissioner who has a business relationship and familiar with the controlling shareholders, directors and members of other commissioners, as well as the company itself.[15] While the independent commissioner is the commissioner who does not come from an affiliated party or does not have any business relationship and not familiar with the controlling shareholders, directors and commissioners as well as the company itself, which may affect their ability to act independently or act solely in the interests of the company. The existence of an independent commissioner may help the company's decision to be made effectively, appropriately, and independent.[9]

4. FIRM PERFORMANCE

Performance can be interpreted as the results of the company at a certain period. The firm's performance resulted after the company has implemented the strategies to achieve the corporate objectives.[3]

Financial statements are often used as the basis for assessing the firm's performance. One type of financial statements that shows the success of the company's operations for a given period is the income statement. The financial statements are useful to help investors, creditors, potential investors and other users in order to make investment decisions, credit decisions, stock analysis and determine the prospects of a company in the future. By comparing the data in the income statement (financial ratios), shareholders can know the financial condition and performance of the company.[12]

5. THEORETICAL FRAMEWORK AND HYPOTHESIS DEVELOPMENT

Based on the above discussion, this study proposes theoretical framework based on the following variables.

Return on Equity (*ROE*). This study uses the ratio profitability namely a return on equity (ROE) as a proxy of firm performance. ROE measures the effectiveness of the management which results from the company financing policy. ROE is defined as net income divided by shareholders' equity.[21] This ratio explains the ability to generate profits on the book value of shareholders' investment and is often used in comparing two or more companies in the industry. High equity returns may reflect acceptance of the company on a strong investment opportunity and cost-effective management.

Board of Commissioner Size (*BCSIZE*). Based on the Indonesian regulations, Indonesia companies adopt a two tier board system. Board of commissioners' size (BCSIZE) is defined as total number of board commissioners. The measurement has been applied in previous studies in Indonesia.[3,15]

In Indonesia, the board of commissioners plays an important role in enhancing corporate governance in a company. Board commissioners can provide the company with strategic direction and help to make decisions and achieve firm performance. From the agency theory perspective, board of commissioners is an important attribute influencing firm performance.[15] Therefore, it is hypothesize that:

H_1: There is a positive relationship between board of commissioner size and family firm performance.

Independent Commissioners (*BCINDE*). The Code of Corporate Governance in Indonesia requires at least 30% of board commissioners to be independent. Independent commissioners (BCINDE) is defined as percentage of independent board commissioners divided by total board commissioners. This measurement has been applied in previous studies in Indonesia.[9] Independent commissioners can assist the board to take care of stakeholders' interests.[13] The number of independent commissioners has an influence on firm performance. High proportion of independent board commissioners could create stifling strategic actions, over-controlling and monitoring and lack of independence of management.[3]

The separation of corporate ownership and control leads managers to seek personal interests.[10] To solve the agency conflict, there is a need for an independent board of commissioners to monitor the managers' actions, thus helping the company to increase firm performance.[9] Independence of board commissioners is important when the capital is low.[15] In addition, stewardship theory claims that independent commissioners bring advantageous to the company because they have wide networking.[15] Based on discussion above, it is hypothesized that:

H_2: There is a positive relationship between independent commissioners and family firm performance.

6. DATA AND RESEARCH METHODOLOGY

6.1. Sample

Sample for this study were 122 public listed family companies in Indonesia Stock Exchange, excluding the financial sector because financial sectors have highly regulated and different regulations. This study used secondary data from financial report from 2010 to 2014. The criteria of family controlled companies are that company must have 20% shareholding or more and owned by family members.

6.2. Model Specification

For internal mechanisms corporate governance are board of commissioner size (H_1) and independent commissioners (H_2), for dependent variable is return on equity (ROE) as a proxy of firm performance, and for control variables are firm size and debt.

The model used is as follows:

$$\mathrm{ROE}_{it} = \alpha_0 + \alpha_1 \mathrm{BCSIZE}_{it} + \alpha_2 \mathrm{BCINDE} + \alpha_3 \mathrm{FSIZE}_{it} + \alpha_4 \mathrm{DEBT}_{it} + \varepsilon_{it} \quad (1)$$

Where by; ROE = return on equity. BCSIZE = number of board commissioners. BCINDE = percentage of independent commissioners divided by total board of commissioners. FSIZE = natural log of the book value of total assets. DEBT = book value of long-term debt to total assets. ε_{it} = the disturbance or error term.

7. FINDINGS AND DISCUSSION

7.1. Descriptive Analysis

From Table I, the average value for ROE is 0.7109 or 71% for 122 family controlled companies. This indicates that the firm performance on family controlled companies have been able to produce a high return for investors and shareholders. The average number of board commissioner size is four people per board, meanwhile, that majority of family controlled companies have followed the guidelines from Bapepam-LK. For firm size, the average number of firm size show 12 billion Rupiah, meanwhile the family controlled companies in Indonesia is a large company because it exceeds the requirement of listed companies with a value of net assets is more than 10 billion Rupiah. Further, family controlled companies in Indonesia using debt to finance their company around 61%, and only 39% is from their own capital.

For commissioner independent, from Table I, the average value of commissioners independent is 40%. Meanwhile, majority family controlled companies in Indonesia Stock Exchange has followed the regulation for implementing the good corporate governance. From Table II, there are some family controlled companies in Indonesia Stock Exchange that still not complying with the guideline from Bapepam-LK which required a minimum of 30% commissioner independent to sit in the company.

7.2. Panel Regression Analysis

From Table III, Hausman test results show that the value of Prob. Cross Section F is 0.1825, meanwhile cross section F is bigger

Table I. Min, max, mean and standard deviation on family companies.

Variables	Max	Min	Mean	SD.
ROE	3.8509	−7.6848	0.7109	0.5285
BCSIZE	10.000	2.0000	3.8672	1.4879
BCINDE	0.7500	0.1429	0.4052	0.1057
FSIZE	13.917	10.047	12.071	0.7262
DEBT	7.6941	0.0003	0.6100	0.5953

Table II. Frequency and per cent commissioners independent on family companies.

	<30%		>30%	
Year	Freq.	%	Freq.	%
2010	5	4.10	117	95.90
2011	4	3.28	118	96.72
2012	5	4.10	117	95.92
2013	4	3.28	118	96.72
2014	3	2.46	119	97.54

Table III. Hausman test for panel data.

Effect test	Prob.	Conclusion
Cross section *F*	0.1825	Random effect model

Table IV. Regression analysis.

Variables		Coefficient	*t*-statistic	Prob.
C		1.7895	1.3402	0.0904
BCSIZE	H_1	0.5325	0.7726	0.4385
BCINDE	H_2	0.2564	0.6657	0.0306
FSIZE		−0.1245	−1.0574	0.2645
DEBT		0.7129	5.6725	0.0000
R^2		0.1945		

Notes: *Significant at 0.1 (2 tailed); **Significant at 0.05 (2 tailed); ***Significant at 0.01 (2 tailed); ROE = return on equity; BCSIZE = number of board of commissioners; BCIND = percentage of independent board of commissioners divided by total board commissioners.

than α (0.05), so the regression model that is most appropriate is random effect model (REM).

The result of panel regression analysis in Table IV shows that hypothesis H_1 is not supported. It indicates that the number of board of commissioners do not contribution to firm performance. This finding is consistent with previous study.[15] Next, H_2 is supported, whereby independent commissioner show a positive effect on the firm's performance as measured by return on equity (ROE). The function of independent commissioner could reduce the opportunistic behavior of directors and management, hence it enhance the firm's performance to be more effective. These findings are consistent with previous study.[4]

8. CONCLUSION AND LIMITATIONS

This study evidences that independent commissioners has a positive relationship with firm performance. The larger number of independent commissioners provide unbiased views, bring a fresh and experience that not may be found among family directors. Further, larger number of independent commissioner provides problem solving, more strategies and critical judgement. However, the board of commissioner size does not contribute to ROE. It is expected that board of commissioner who stay for a long time in a company could build a good relationship with director; therefore, it will impact decision-making in terms of enhancing the firm performance. This study focus only on family controlled companies in Indonesia Stock Exchange, therefore, future research may consider to comparing the family and non-family controlled companies. Also, future research can include board commissioner education and board commissioner meeting to be examined.

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