

## FAMILY OWNERSHIP AND CORPORATE PERFORMANCE

I Putu Sugiarta Sanjaya<sup>1)\*</sup>, Rayenda Khresna Brahmana<sup>2)</sup> Wimpie Yustino Setiawan<sup>3)</sup>

<sup>1</sup>Department of Accounting, Faculty of Business and Economics,  
Universitas Atma Jaya Yogyakarta,  
Jl. Babarsari No. 43 Sleman DIY, 55281, Indonesia.  
E-mail: [putu.sugiarta@uajy.ac.id](mailto:putu.sugiarta@uajy.ac.id)

<sup>2</sup>Department of Accounting and Finance, Faculty of Economics and Business,  
Universiti Malaysia Sarawak, Jl. Datuk Muhammad Musa, Sarawak 94300, Malaysia.  
E-mail: [brkhresna@unimas.my](mailto:brkhresna@unimas.my)

<sup>3</sup>Department of Accounting, Faculty of Business and Economics,  
Universitas Atma Jaya Yogyakarta,  
Jl. Babarsari No. 43 Sleman DIY, 55281, Indonesia.  
E-mail: [wimpie.setiawan@uajy.ac.id](mailto:wimpie.setiawan@uajy.ac.id)

\*Corresponding author

### Abstract

*The paper aims to investigate whether family ownership as controlling shareholder effect on firm performance. This paper uses ultimate (direct and indirect) ownership to identify a listed firm owned by family or non-family. Family ownership is majority shareholder for listed companies in Indonesia. Family ownership will be good impact (competitive advantage) or bad impact (private benefit) on companies. The study also motivates to study this topic because investigating on family ownership as controlling shareholder is limited in Indonesia. The study uses panel data or pooled data. The method for collecting data is archival. Unit of analysis of the study is organization. Sample of this study is 604 observations during 2001-2007. This study uses purposive sampling to collect data from the Indonesian Stock Exchange. This study collects and searches ultimate ownership on chain of ownership structure in manufacturing companies listed in the Indonesian Stock Exchange. This study uses ultimate ownership to identify family ownership or non-family ownership because the reality of ownership structure in public companies in Indonesia is concentrated. This study identifies direct and indirect ownerships on chain of ownership. Based on direct and indirect, this study can identify ultimate ownership whether are family or non-family ownership. This study uses return on assets to proxy firm performance. The return is operating income. To analysis data, this study uses multiple regression model. Dependend variable is firm performance and independen variable is family ownership. The results of this study are family ownership negatively affect to firm performance. It indicates that ownership by family reduce firm performance. These results suggest that entrenchment effect is more dominant than alignment effect on the family ownership. The research focus only for manufacturing industry and data is only from 2001-2007. The results of the study will impact for regulation to lead listed companies have to disclosure the ultimate owner because it is a potential agency problem in Indonesia. The results also give information for potential and existing investor to give more pay attention on financial statements because it is potential to mislead on the statements.*

**Keywords :** Ultimate Ownership, Family, Firm Performance, Entrenchment Effect

**JEL Clasification :** M410, G320.

## **1. Introduction**

The purpose of this paper is to investigate the influence of family as the ultimate owner on the firm performance. The issue is importance to be investigated because a lot of listed companies in Indonesia are owned and controlled by family Siregar (2008) and Sanjaya (2011a). Second, some researchers in Indonesia use immediate or direct owner to determine the ownership of the firm by the family. One researcher who used immediate ownership is Prabowo and Simpson (2011). Immediate ownership could not be used to determine the ownership of the company by the family or non-family because this did not indicate the ownership of the real property in Indonesia. If the writer focuses only on immediate ownership therefore the writer is false in measuring what should be measured because there is still a chain of custody under the immediate ownership which is not found in the annual financial statements. Third, studies that explored the ultimate ownership in Indonesia is still very limited such as conducted by Febrianto (2005), Siregar (2008), Septiyanti (2007), Kresnawati (2007), Sanjaya (2010, 2011a, 2011b, 2012). Public firm ownerships in Indonesia are mostly done using the pyramid ownership structure (Siregar, 2008; Sanjaya, 2011a).

One anecdotal evidence of pyramid ownership structure to trace the family as the ultimate owner is on PT GT Petrochem Industries Tbk in 2001 and PT Tunas Baru Lampung Tbk in 2001 which is obtained from Indonesian Business Data Center. The ultimate shareholder is not found in the ownership of PT GT Petrochem Industries Tbk at immediate ownership level. In the direct ownership chain, there is no family or individual name as the shareholder of PT GT Petrochem Industries Tbk. The shareholders in direct ownership are a non-public firm and a public firm, PT Gajah Tunggal Mulia (19.20%), PT Gajah Tunggal Tbk (50.19%), and public (30.61%). The trace of ownership chain of PT Gajah Tunggal Tbk is PT Gajah Tunggal Mulia (57.18%), PT Gajah Tunggal Sakti (10.08%), PT Surya Grahareksa (0.01%), Koperasi (0.29%), and public (32.50%). There is no name of a family or individual in the chain of direct ownership of PT Gajah Tunggal Tbk.

The trace continue by tracing the ownership of PT Gajah Tunggal Mulia and there is found Sjamsul Nursalim (2.50%) and PT Power Patria Corporation

(97.50%). In this chain of ownership is still not yet known who the ultimate owner of this firm is. The trace is done on the ownership of PT Daya Patria Corporation. There are found several names such as Sjamsul Nursalim (41.25%), Itjih Sjamsul Nursalim, Gustimego (3.13%), Fredy Gozali (2.50%), Muljati Gozali (3.13%), and Hendra Soerijadi (2.50%). Itjih is Sjamsul Nursalim's wife. Gustimego, Fredy Gozali, and Muljati Gozali are Itjih Sjamsul Nursalim's relatives and therefore they could be categorized as one family. Based on this trace, Sjamsul Nursalim's family is the ultimate owner of both the PT GT Petrochem Industries Tbk and PT Gajah Tunggal Tbk. Fredy Gozali became the Director President of PT GT Petrochem Industries Tbk and Gustimego became the Vice Commissioner President of PT GT Petrochem Industries Tbk. While Sjamsul Nursalim became the Commissioner President of PT Gajah Tunggal Tbk and Gustimego and Mulyati Gozali became the Vice President and Director of PT Gajah Tunggal Tbk.

This is one of the general illustrations of the firm ownership in Indonesia. According to Siregar (2008), there is a 55.61% public firm which used pyramid ownership structure. While Sanjaya (2011b) finds that 68.49% of public firm in manufacture industry during 2001 until 2007 is controlled or owned by family. This phenomenon is important to be researched whether ultimate ownership by family give positive or negative impact to the firm performance.

In some countries, majority listed firms are owned and controlled by family in Sri Lanka (Masulis, Pham, and Zein, 2011; Wellalage, Locke, and Scrimgeour, 2012). In Japan majority firms are owned by family (Kurokawa and Ogawa, 2011). Aminadav and Papaioannou (2016) find family ownership is persistent year to year. They find the percentage of ownership by family does not change in their samples much over time.

McConaughy, Walker, Henderson Jr, and Mishra (1998) and Anderson and Reeb (2003) explain that control by family should increase firm value. Family as the shareholder has the authority to minimize the authority conflict and manage the firm to create value for the firm. When the family still has the relation with the company for a long period, they have a long-term perspective that is more conducive to plan in creating the value for the firm. James (1999) states that family invests efficiently

because they focus with wealth transfer for their generation compared to own consumption in their lifetime. The needs to maintain a good relationship with the investment community to facilitate increased future cash and obtain lower capital costs encourages optimal decisions for the company.

Studies that examine the relationship between family ownership and value of the firm produced varied results (mixed). Smith and Amoako-Adu (1999), Morck, Stangeland, and Yeung (2000), Perez-Gonzalez (2006) show that family ownership affects the firm performance negatively. This means family ownership degrading firm performance. The larger the family as the owners of the firm leads to the lower performance of the firm. While McConaughty et al. (1998), Anderson and Reeb (2003), and Barontini and Caprio (2004) state that there is a positive relation between controls by the family and the firm performance. This means the larger the ownership by the family, the higher the firm performance.

This study has some contributions. First, the identification family or non-family, this study uses direct and indirect ownership. Therefore, measurement company owned by family is more valid than study only focus on direct ownership in the context concentrated ownership such as Indonesia. Therefore, this study has contribution on measurement of variable. Second, this study has contribution on economic. The results of this study will give information based on empires that family as controlling shareholder in listed firms has cost for non-controlling shareholders. Expropriation in listed firms will be done by family for the private benefit. Therefore, this study has contribution for practice the potential loss if invest in listed firms in Indonesia which are controlled by family. Third, this study give support for bad side family as controlling shareholder in the company. The performance of company decreases when family as dominant or controlling shareholder. The fact, the company performance decrease when family as controlling shareholder in the company.

In the next section, this paper explains about the theoretical review and the hypothesis development. Further, this paper explains about research design. On the fourth section of this paper, the writer explains the result of the research. On the last section this paper explains the conclusion, limitation, and suggestion.

## **2. THEORY AND HYPOTHESIS DEVELOPMENT**

### **2.1. Family Ownership**

Historically, the separation of ownership and management became an important basis in the corporate governance. The indirect relationship between owners and management had a close relationship in the terms of firm management. If the owner as the sole shareholder in their firm, they probably followed the development of the firm and supervised the firm management as happened in the family firm.

When the shareholding is spread, it becomes more difficult to maintain direct supervision by the shareholders. In the case of shareholding spread in a public firm, the strength of supervision by the owner becomes nothing. Managers were more interested in thinking about their own interests than the interests of shareholders. This creates a conflict of interest between shareholders and managers that is known as the theory of "principal-agent". In a model, someone looks for a disciplinary mechanism to push managers so that they pay more attention to the interests of shareholders. In such case, an independent director serves as one of much leverage that were fundamental. Another disciplinary mechanism is share form remunerating or options to control and change the firm management that has poor performance.

Whatever the model of the firm, the shareholders still delegate the authority to the board of directors. The board of director watches, supervises, and establishes the general policy and strategy of the firm. It shows that the management is trusted to implement the strategy and firm's plan. Specifically in a family company, it needs independent directors and professional because a family company has less professional supervision by the shareholders.

Family firm is a firm which the founding members to continue their ownership position in the top management. Family firm is characterized by concentrated ownership of the founding family of firm and actively involving members of the family in the management of the firm. This is categorized as concentrated ownership by the firm founding family and involving the family members in the firm management as the top executive or direction.

Villalonga and Amit (2020) review the existing literature about firms owned by family in around the

world. Villalonga and Amit (2020) document the evidence family is owner for corporation around the world persistently and prevalently with its impact on performance.

In the public firms, the firms that are controlled by the family show a significant amount in Asia and Europe (Faccio and Lang, 2002; La Porta, De-Silanes, and Shleifer, 1999). According to Anderson and Reeb (2003), around 1/3 firms that are owned publicly in United States is classified as firms that are controlled by family. The impact of family control in a firm might be different between public firms that are controlled by family and private firms because public firms tend to face agency costs between manager and shareholders that sometimes never happen in the private firms. Furthermore, public firms might face other agency costs between the controlling shareholder and non- controlling because of the pyramid ownership structure and cross-ownership.

Family ownership might have positive impact. Villalonga and Amit (2010) classify it as competitive advantage. Family company is often related to innate household. Family as the family shareholders have a tendency to move control to the children to keep controlling the firm (Lubatkin, Schulze, Ling, and Dino, 2005). As a result, the family shareholders can be encouraged to invest in the firms more effectively (Bruton, Ahlstrom, and Wan, 2003; James, 1999; Westhead and Cowling, 1998). Furthermore, a family company is often related to a high family involvement and long periods in management. Thus, the firms that are controlled by the family have more experiences in the opportunist recognition and uncertainties and have long-term insightful planning (planning horizons). It does not only promote continuous improvement, but also encourages family to have patience during investment in new business opportunities to create family wealth (Casson, 1999 and Zahra, 2005).

Furthermore, agency theory asserts that the separation of ownership and control in public firms might cause the managers to do their interests rather than the interests of the shareholders (Jensen and Meckling, 1976). According to Jensen and Meckling (1976), Shleifer and Vishny (1986), and Anderson and Reeb (2003), when the family becomes the shareholders, they will have an incentive to minimize the agency problems and

supervise the managerial decisions that is related to the firms' effective project. According to Bruton et al. (2003), this is done to maintain the long-term firm value and encourage the management to allocate resources that could optimize the value of the firm.

Family ownership could be a barrier or give negative impact to the firm because of the nepotism effect. Villalonga and Amit (2010) classify negative impact as private benefits of control. Based on this effect, the firms that are controlled by the family might prefer to put the family members who are relatively less competent. According to Lubatkin et al. (2005), the firm's value decreases when an employee of the family members who is not qualified placed in the firm management team position. Nepotism might also reduce the effectiveness in agent supervision by the family. This is caused by the relationship between children and parents that is potentially becomes a bias in the agent performance assessment because the agent is their own child. (Lubatkin et al., 2005; Schulze, Lubatkin, and Dino, 2003; Schulze, Lubatkin, Dino, and Buchholtz, 2001).

In this nepotism, family owners only benefit themselves when they decide to cut the development of the firm. In this nepotism, they are also wrong to use firm resources in the firm activities for personal gain. Pyramid and cross ownership facilitate the owner's family to control the firm when the rights of control is greater than the rights of cash flow. This ownership structure is very popular in Indonesia (Siregar, 2008; Sanjaya, 2011a). In such case, the family as the controlling shareholder becomes more motivated to expropriate the firm resources for personal gain and become a burden to the non-controlling shareholders (Claessens, Djankov, Fan, and Lang, 2002; La Porta et al., 1999). Investments in firm projects that is controlled by the family is not intended to enhance the firm value. This occurs because the pyramid ownership structure will make a difference between control rights and cash flow rights. Rights of control will be used by the family as the controlling shareholder to influence the decision making in the shareholders general meeting to put someone into directors position. In this meeting, they will propose their family members to be directors even though these family members are less competent. This is one of the controlling shareholder expropriation

indication towards the minority shareholders. The benefit is obtained by the controlling family shareholders in the form of salary and bonus and other incentives while non-controlling shareholders have to bear the burden.

## **2.2. Competitive Advantage or Positive Side of Family Controlling towards the Firm**

Competition between the family firms and non-family firms can be viewed from two perspectives: ownership and management. From the perspective of ownership, the uniqueness of the family firm is that a family member takes control of the firm assets substantially. From the perspective of management, the main characteristics of the family firm is that a member of the family become the firm's top management.

Demsetz and Lehn (1985) state that a concentrated equity position and management control, which includes the presence of the founding family of the firm, give the family an advantage to control the firm. Concentrated investors have a greater incentive than dispersed ownership to avoid conflicts between owners and managers and to optimize the firm performance. When the wealth of the firm is strongly correlated with the firm performance, the family members have a strong incentive to supervise the professional managers. As a result, free-rider that is related to non-family firm with dispersed share ownership could be reduced. Due to the ownership concentration, family members also have greater power of other shareholders to achieve their goals. Anderson and Reeb (2003), and Burkart, Panunzi, and Shleifer (2002) observe that firms which family members have more active involvement tend to have better performance.

Lubatkin et al. (2005) states that the unique characteristics of a family company is the relationship between children and parents in the business. In this connection, family members try to ensure that they have the rights to allocate the firm property (Stark and Falk, 1998). This view has an important consequence because it could help align the growth strategy choices and risk-taking between the family and the firm. Family shareholders are more interested to invest in projects that could enhance the firm value. Based on household relationships, family members often consider the other party than the outsiders. This will align the

incentives between family members (Eshel, Samuelson, and Shaked, 1998). As a result, the family manager would be committed to run the organization properly (Lubatkin et al., 2005).

From the perspective of stewardship, individuals have needs at a higher level such as self-actualization organizationally and collectively. Family managers want to commit to create the success of the organization above the personal interests (Davis, Schoorman, and Donaldson, 1997). Both effects of household relations and stewardship assert that managers in the firms that are controlled by the family probably do not become the facility to fulfil the personal needs only but they often act to the benefit of its stakeholders (Fox and Hamilton, 1994). Family shareholders also often have better information about the firm that could encourage them to run the firm with a long-term perspective (Bruton et al., 2003). Davis (1983) asserts that family bonds could make the family firms excel in competition than non-family businesses.

Professional manager could also participate in the operationalization of the family public firm. This could create conflicts of interest between the professional managers and the family as the controlling shareholder (Chua, Chrisman, and Bergiel, 2009). Agency-theory-based literature states that the controlling shareholders have sufficient powers and incentives to supervise the manager's decision efficiently. According to Shleifer and Vishny (1997), a large shareholder could reduce the conflict of interest between managers and shareholders.

Controlling family might also have the same incentives, powers, and information for supervising the managers. For the example, the representation of the controlling family could reduce the possibility of a managers to fulfill their personal interests (Anderson and Reeb, 2003). Concentrated ownership could help the owners reduce manager's discretion (Jensen and Meckling, 1976; Shleifer and Vishny, 1986). Anderson and Reeb (2003) and Hoskisson, Johnson, and Moesel (1994) assert that blockholders might not permit a bad strategy to be followed which will give an impact on the firm performance.

## **2.3. Private Benefits of Control or Negative Side of Family Controlling towards the Firm**

Nepotism effects in a public firm that is controlled by the family could also cause family members to believe that they are free ride and do not have relation to the responsibility (Lubatkin et al., 2005; Perez-Gonzalez, 2006; Schulze et al., 2003). In nepotism, a family firm might have a desire to give the family member a comfortable working environment that could not be found elsewhere. However, the family members might not have enough qualification to be in that position because the family firm would prefer to put their family members than choosing a professional party (Perez-Gonzalez, 2006; Weidenbaum, 1996). When a CEO or director is limited to family members, this option could give bad impact for the firm because there are risks in the selection of the projects that do not give benefit to the firm (Ben-Amar and Andre 2006; Lubatkin et al., 2005; Yeh and Woidtke, 2005).

Nepotism might also systematically profitable to the family than the firm. This could reduce the effectiveness of supervision and disciplining in the families agent (Schulze et al., 2003). When the family power protects the family agent, this agent could allocate the firm resources for inefficient projects without pressure to be replaced (Ben-Amar and Andre, 2006; Schulze et al., 2001; Villalonga and Amin, 2006). Yeh and Woidtke (2005) state that firms in Taiwan with some directors who are related to the family as the firm control cause the decreasing firm value.

Nepotism could create more specific agency costs in the family firm. This is a result of incentives obtained by the family that is related to nepotism (Schulze et al., 2001). Self-controlling problem happens because of lack ability and discipline supervision that should be performed. Family public firms would be faced with the problems of self-control because they obtain funds from various sources easily compared to private firms. As a result, the controlling shareholder in a public firm has the opportunity to use the firm's assets for the benefit of family members (Lubatkin et al., 2005).

When a public firm is followed by self-control problem and nepotism, it is very difficult for family manager to develop the firm in increasing the firm value in the future. For the example, through participation in joint ventures, family manager would expand their network to obtain social benefits such as status or prestige. This could create economic benefits such as an employment chance in

the firm or cooperative organizations (Reuer and Ragozzino, 2006). This economic benefit is more profitable for the family members.

#### **2.4. Previous Research Result**

Some results of the previous research show that family ownership have negative impacts for the firm because the firm that is controlled by the family tends to benefit the family and ignoring the interests of other owners. This is proved empirically by the previous researchers as follows.

Ng (2005) examines the relationship between family ownership and firm performance in a family ownership environment which is made into proxy with managerial ownership. This study shows that the relationship between family ownership and financial performance as in the cubic form with pattern-alignment-entrenchment. These results demonstrate the managerial ownership 1% - 16.86% led to the firm performance to decrease. When the managerial ownership ranges between 16.87% - 63.17%, family ownership increases the firm performance. When the family ownership more than 63.17%, the firm performance decreased.

Yeh, Lee, and Woidtke (2001) analyzes the control by family and corporate governance using a sample of Taiwanese firms. The results of the research Yeh et al. (2001) shows that there is no linear relationship between the firms controlled by family and the firm performance. The firms that are controlled by family that have a low level control have lower performance compared to firms that are controlled by family with higher level control.

Anderson and Reeb (2003) investigate the relationship between the firm founded by the family and the firm performance. The research found that a family firm has a better performance than a non-family firm.

Villalonga and Amin (2006) analyze the issue of the control rights and cash flow rights separation on a sample of firms which belong to Fortune 500 list during 1994 until 2000. Villalonga and Amin (2006) record that the family ownership concentration is positively related with profitability. This result confirms that family ownership could improve the firm performance. However, the mechanisms that could increase the control through cross ownership, pyramids, and multiple voting shares affect the firm performance negatively.

Klein, Shapiro, and Young (2005) analyze the relationship of the firm value measured with Tobin's Q and effective corporate governance index for 263 samples of public companies in Canada. Klein et al. (2005) show that family ownership as a part of corporate governance affected the value of the firm negatively. It implies that family ownership in Canada did not produce a better corporate governance but worse corporate governance.

Ibrahim and Samad (2011) compare the corporate governance and firm performance owned by family and non-family in Malaysia from 1999 to 2005. This study indicates that the firm value of family-owned firm was lower than non-family-owned firm.

Prabowo and Simpson (2011) analyze the relationship between the board member and firm performance in the family-controlled firms. Prabowo and Simpson use samples from non-family-controlled firms registered in Indonesia Stock Exchange. Prabowo and Simpson (2011) state that independent director in board members have no significance relationship with firm performance. The result of this analysis show that the family-owned firms negatively related to the firm performance. It means the bigger the family ownership the lower the firm performance. Family ownership in Indonesia does not give good news to capital market participants since they use the advantage of their control to the firms that would give a bad impact to the firm performance.

Lam and Lee (2012) investigate the role of family ownership as moderating variable on relation between board committees and firm performance. They research listed firm for the periods 2001-2003 in Hong Kong. Publicly available data is from financial databases and annual reports of a sample of 346 firm-year observations. Lam and Lee (2012) find the existence of family ownership has a significantly negative effect on remuneration committee-performance relationship.

Dharmadasa (2014) examines the relationship between family ownership and firm performance in Sri Lanka and Japan. Dharmadasa (2014) uses 151 listed firms at Colombo Stock Exchange in Sri Lanka and 753 listed firms at Tokyo Stock Exchange in Japan on period 2011-2013. Dharmadasa (2014) find that family ownership increases firm performance in Japan. But in Sri Lanka, family ownership decreases firm

performance. The concentrated ownership is term causing the opposite results between Sri Lanka and Japan. Ownership listed firm in Sri Lanka is more concentration than Japan.

Im and Chung (2017) show that managerial ownership (family) negatively affects profitability in the short run. Jaskiewicz, Block, Combs, and Miller (2017) investigate family ownership moderate relation between CEO incentive compensation and firm performance. They want to give empirical evidence that family ownership has positive moderation. The sample of this study is consisting of Standard & Poor's 500 firms. Jaskiewicz et al. (2017) find family ownership has positive moderation between CEO compensation and firm performance.

Masset, Uzelac, and Weisskopf (2019) investigate relation between family-owned businesses, asset levels, and corporate performance. Masset et al. (2019) use 112 listed firms in hospitality from 16 Western European countries. The period of this study is 2004 to 2016 and 776 firm-year observations. Both corporations owned by family and non-family as block holders negatively impact firm performance.

Saidat, Seaman, Silva, Al-Haddad, and Marashdeh (2020) examine the impact of female directors on the financial performance of family and non-family Jordanian firms. Saidat et al. (2020) select sample of 103 Jordanian public firms listed on Amman Stock Exchange for the period 2009-2015 was selected. Saidat et al. (2020) find that firm performances are different between family and non-family owned. The firm performance for family owned is -0.012 and firm performance for non-family owned is 0.532. The results indicate that firm performance is better for non-family owned than family owned.

## **2.5. Hypothesis**

Family firms are the firms in which the firm founders continue the ownership positions as top management, board members or block holders. The main characteristic of a family firm is that the ownership is concentrated on the founders. There are two perspectives in family firms, namely ownership and management. Based on the ownership perspective, the family members control the firm's assets. Meanwhile, from the management

perspective, the family members became the firm's top management.

Family ownership could be good or bad for the firm. The firm founders are the advantage to supervise the firm. The family has a great opportunity to supervise professional managers to maintain the firm performance. Villalonga and Amin (2006), Anderson and Reeb (2003) and Burkart et al. (2002) record the positive impact of the family firm empirically.

The family firm's unique characteristic is the relationship between children and parents. It could align the strategy of choice for the growth of a firm. Family is interested in the projects that could increase the firm value. On the nature of household relationship, family is more concerned with other parties rather than theirs. In such case, the manager of the family would be committed to running the organization properly.

There is a self-actualization in the family so that the manager of the family is committed to running the firm properly. Family has more information about the firm in the long-term perspective. The controlling family also has the incentive, the power, and the same information to supervise the manager. Family could reduce the possibility that managers act only for personal purpose. Concentrated ownership can also help owners to reduce the discretion of the manager. Family also does not permit a bad strategy that affects the firm performance.

Family firms also have a negative side because of nepotism as stated by Klein et al. (2005), Ibrahim and Samad (2011), and Prabowo and Simpsons (2011). As a result of nepotism, family members could be a free rider. In nepotism, the owner's family would provide comfort to family members when they do not have an adequate qualification. Family firms prefer choosing the members of his family to the professionals to fill certain positions in the firm.

When the position for the director of firm is limited for a family member, it will be bad for the firm (Ben-Amar and Andre, 2006, Lubatkin et al. 2005, Yeh and Woidtke, 2005). Nepotism is only profitable for the family rather than the firm. It could reduce the effectiveness of supervision on family agents and therefore the agents could allocate the firm resources to a non-profitable project. Family firm scope with a self-control issue

and therefore they tend to use the firm assets for the benefit of the family. Self-control and nepotism are very difficult for managers to increase firm value.

Family firms in Indonesia are owned by the pyramid ownership structure. There is a direct and indirect ownership in this structure. Indirect ownership data is not available to the public. In fact, these firms do not voluntarily disclose the data in its financial report. It is proved in the case of PT Bank Century Tbk (listed firm in the Indonesian Stock Exchange in which the controlling shareholder did not exist in direct ownership in the financial reports. The family that has a public firm has done through private companies that are less accessible to the public. It becomes a great incentive for the family as the controlling shareholder to do expropriation. Sanjaya (2010, 2011b, 2012b) finds that the entrenchment effect is more dominant than the effect of alignment of public companies in Indonesia. This study therefore assumes that the family as the ultimate owner or controlling shareholder leads the firm performance down. To prove this conjecture empirically, this study is to formulate hypotheses as follows.

***H1: The family as the ultimate owner has a negative impact on the firm performance.***

### **3. RESEARCH METHODOLOGY**

#### **3.1. Sample**

The study sample is an industrial manufacturing firm listed on Indonesia Stock Exchange (BEI) in 2001 to 2007. Sampling was done by purposive sampling. The samples are manufacturing industry groups registered for 2001-2007. The companies published annual financial statements from 2001 to 2007. Data collection techniques of this study are archive data. One of the forms to collect the archived data collection is secondary data. Secondary data were obtained from several sources such as the Indonesia Stock Exchange for the audited financial statements and OSIRIS Database and Data Center Business Indonesia for the ultimate ownership. The number of firm years is 604 firm years.

#### **3.2. Variables**

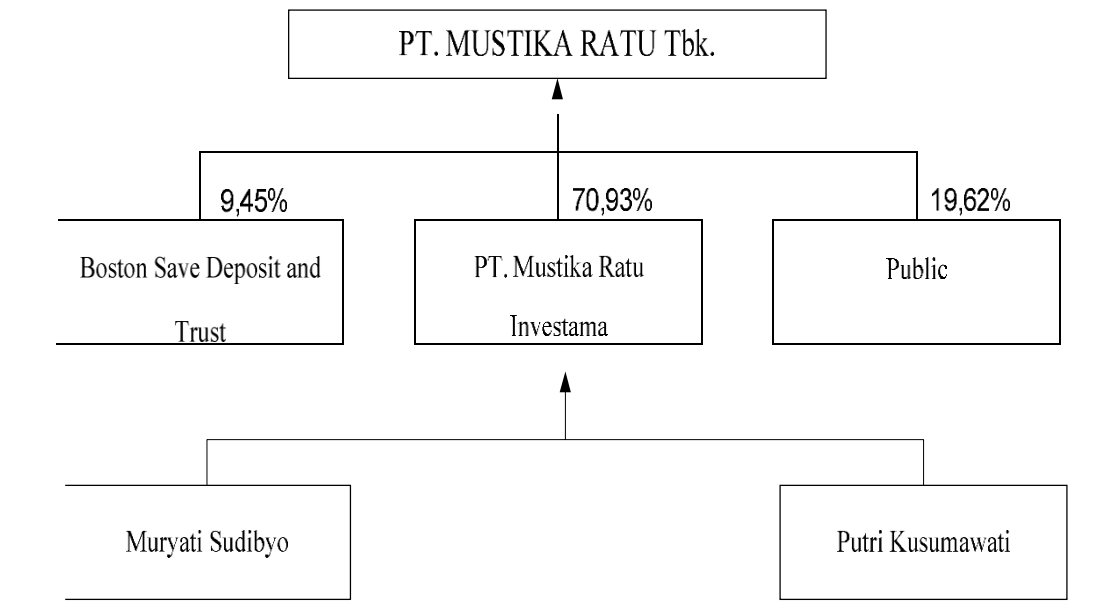
The independent variable in this study is the family ownership. This variable is assessed using nominal scales. Point 1 is the family ownership and 0 is the other. The writer uses dummy variables



since minimal control rights in this study is 10% and 10% of control rights have significant power to affect the firm. The use of 10% control rights cut-off corresponds to statements by Claessens, Djankov, and Lang (2000), La Porta, De-Silanes, Shleifer, and Vishny (2002) and Claessens et al. (2002), which emphasizes that the 10% of control rights are effective enough to control the firm. All data in this study has at least 10% control rights. If

it is below 10%, the firm is taken out from this study. To know whether the public firm owned by the family as the ultimate owner, the writer conducted a search in the chain of firm ownership directly and indirectly.

The following illustration is the ownership structure without a mechanism on PT Mustika Ratu Tbk (listed firm at the Indonesian Stock Exchange).



**Figure 1:** The ownership structure of PT Mustika RatuTbk

Putri Kusumawati is the daughter of Mooryati Soedibjo and Soedibjo Purbo Hadiningrat and therefore PT Mustika Ratu Investama is 100% owned by the family of Mooryati Soedibjo. Control rights and cash flow rights of Mooryati family is thus 70.93%. Mooryati Soedibjo's family is a controlling shareholder family because Putri Kusumawati is the daughter of Mooryati Soedibjo.

The dependent variable in this study is the firm performance. This performance is made into proxy by the ROA (Return on Assets). Ratio is measured by dividing operating profit with total assets. Hendriksen and Breda (1992) confirm that firms that operate efficiently will have an impact on the current dividend payments or the use of internal funds such as retained earnings to develop a firm that would have an impact on the dividend payment in the future. Shareholders and potential shareholders are therefore very interested in the firm management efficiency in managing the firm. Shareholders can now evaluate the current

management and replace them with new management if they do not work efficiently. A firm efficiency measurement provides a basis for decision-making.

Interpretation of efficiency shows the ability to get maximum output with minimum resources. Efficiency is a relative term, and it has meaning only when compared with an ideal base. This study therefore uses ROA as a proxy for the firm performance which is net income while total assets are the resources used to obtain the results. In addition, there are many researchers used ROA as a proxy for the firm performance such as Villalonga and Amit (2006), Barontini and Caprio (2004), Perez- Gonzalez (2006), Lam and Lee (2012), Dharmadasa, P. (2014), Jaskiewicz et al. (2017), Masset et al. (2019), and Saidat et al. (2020). This ratio means that the higher the ratio

the more efficient the firm utilizes the existing resources in the firm.

In SFAC No. 8 (FASB 2010) on the resources information report, claims and changes in resources and claims also confirms that changes in a resources and claims report are entity results of the firm financial performance. Information of entity financial performance reports helps users to understand the return that the entity has produced at its economic resources. Information of the entity return gives an indication of how a management achievement makes the use of resources efficient and effective from the entity report. Information of the variability and return components are also specifically important in the assessment of the uncertainty of future cash flow. Information of an entity report on past financial performance and how management deals with its responsibility could usually help in predicting the entity's future returns and economic resources.

In this study the writer also used other proxies to measure the firm performance. Return on Assets is a measurement of performance based on the book value found in the financial reports. Another proxy is based on the performance of the market is Market to Book Value of Equity (MBVE) measured by (the number of shares outstanding x closing share price)/total equity. Lam and Lee (2012) also use MBVE to proxy firm performance.

In this study there are two control variables namely firm leverage and firm size. Both variables

are consistently used as a control variable so that the study model gets better to explain the causality between an independent and a dependent variable. The following researchers use leverage and firm size as the control variables such as Barontini and Caprio (2004) and Masset et al. (2019). Both variables affect the firm performance. Leverage is measured by total liabilities divided by total equity. Firm size is measured by the natural logarithm of total assets.

### 3.3. Empirical Model

The empirical model in this study using multiple regressions as follows.

$$ROA_{it} = \alpha_{it} + \beta_1 Family_{it} + \beta_2 Leverage_{it} + \beta_3 Size_{it} + e_i \quad (1)$$

Where:

ROA<sub>it</sub>: Return on Assets of firm i on period t.

Family<sub>it</sub>: The family as the controlling shareholder in the firm i on period t measured by dummy variable that is 1 (family) and 0 (the other).

Leverage<sub>it</sub>: Firm i leverage on period t.

Size<sub>it</sub>: firm i size on period t.

e<sub>i</sub>: error term.

## 4. RESULTS ANALYSIS

### 4.1. Descriptive Statistics

**Table 1:** Descriptive Statistics

	Mean	Max.	Min.	Std. Deviation
ROA	.0567	-.08	.24	.05665
LEVERAGE	1.4018	-.66	13.07	1.77459
SIZE	27.2960	24.22	31.78	1.50951
FAMILY	.7086	.00	1.00	.45478

The output of descriptive statistics in Table 1 indicates that the amount of the samples is 604. The mean of the firm performance is 0.0567. The standard deviation of the firm performance's mean is 0.05665. The leverage is 1.4018 and the standard deviation is 1.77459. The size's mean is 27.2960 and the standard deviation is 1.509.

### 4.2. Hypothesis Test Results

Before conducting a hypothesis test, this study has conducted classic test assumptions. Normality, auto-correlation, multicollinearity, and heteroscedasticity did not exist in the empirical model.

**Table 2:** Hypothesis Test Results

Independent Variable	Model
Intercept	-.018 (-.476)
FAMILY	-.051 (11.710)***
LEVERAGE	.011 (8.830)***
SIZE	.001 (2.564)**
R-squared	0.271
Number of observations	604
F-test	74.354***

This table reports the results of the family regression on the firm performance.  
\*\*\* and \*\* show significance at the alpha level of 1% and 5%

The data analysis in Table 2 shows that the family negatively and significantly affected the firm performance. It is indicated that a coefficient value of the family is -0.05101 and it is statistically significant at 1% alpha. These results indicate that the presence of the family as the controlling shareholder or the ultimate owner is not profitable for the firm. It also emphasizes the bad side of the presence of the family in a public firm. Based on the results of this analysis, the study hypothesis (H1) is supported. The results of this study are consistent with several studies conducted in other countries like Ibrahim and Samad (2011), Prabowo and Simpson (2011), Klein et al. (2005), Smith and Amoako-Adu (1999), Morck et al. (2000), Perez-Gonzalez (2006) and Claessens et al. (2002) which show the family ownership could negatively affect the firm performance.

These results occur because the phenomenon of corporate ownership in Indonesia is dominated by the family who becomes the ultimate owner or controlling shareholder. Managers of family firms in Indonesia are dominated by the controlling family members. In a family firm, founders of the firm continue the ownership filling the positions for both top management and board of commissioners. The ownership of family in a firm could deter a firm from investing in an attempt to improve the

firm performance or to increase the investment spending.

The fact of investment in Indonesia published in Trust magazine (2003) is that PT BPT Tbk (listed firm) acquired 60% of PT EML (private firm). The owner of both companies is PP (initial). The firm shares sold by PP were PT EML shares whose 40% of the shares were already owned by PT BPT Tbk. The reason why they acquired PT EML was a very rational business consideration. Full control over PT EML made PT BPT Tbk guarantee the continuity of raw materials supply for other subsidiaries namely PT TELP and P (private firm). In PT EML, PP had 60% share in PT TSP (50%) and PT MK (10%). The overall sale value of 60% PT EML shares to PT BPT Tbk was US\$ 255,600,000. It included US\$ 213,000,000 as the price of 50% PT TSP shares and US\$ 42,600,000 as the price of 10% PT MK shares.

The discussion of the purchase of such shares was carried out as though it would be held in the shareholders meeting that was held in the end of March in 2003. In fact, a huge amount of down payment had been received by PP since 1998. PT TSP and PT MK were owned by PP who owned 60% of PT EML shares. At the same time, PT MK controlled 1.16% of PT BPT Tbk shares and PT TSP controlled 23.81% of PT BPT Tbk shares. This incident was PP's attempt to step over PT T which owned 15.22% of PT BPT Tbk shares. PT Tas was more supportive if the payment for the

acquisition was used to pay the accumulated firm debt. PT Tas also speculated the possibility of 'marked-up' in the acquisition process. PT Tas assumed that US\$ 255,600,000 for 60% of PT EML shares was too expensive. PT EML annual income was no more than US\$ 20,000,000. It was PP's way to break into PT BPT Tbk funds.

In this acquisition, PT Tas and the non-controlling shareholders were disadvantaged. During PT BPT Tbk loss of Rp959,000,000,000 in 1998, PT BPT Tbk still owned US\$ 204 million cash that had already been disbursed to : If it was divided by the total area controlled by PT ELM, the sale value of each hectare reached Rp58,000,000. In fact, the most expensive land price at that time was Rp10,000,000 per hectare. As a result of the abnormal acquisition, PT BPT Tbk share price went down. At the time political crisis started hitting Indonesia in June 1998, PT BPT Tbk shares could have still reached Rp825 per share. However, in March 1999 when 1998 financial reports were issued, PT BPT Tbksh are fell to Rp225 per share. When PT BPT Tbk got disclaimer assessment, PT BPT Tbk shares directly plunged to Rp75 per share.

PT BPT Tbk case illustrated how PP as the controlling shareholder of PT BPT Tbk obtained private benefits that harmed the non-controlling shareholders. It could be traced. First, when the sale value of each hectare of land was supposed to be Rp10,000,000 it turned out to be Rp58,000,000. The increase in land prices was clearly disadvantageous to non-controlling shareholders since PT BPT Tbk was supposed to issue Rp10,000,000. It indicated that there was an excess of cash issued by Rp48,000,000 per hectare. Second, PT BPT Tbk shares consecutively plunged to Rp75 per share from Rp825 per share. The decrease in PT BPT Tbk shares price was also disadvantageous to the non-controlling shareholders because PT BPT Tbk stock market price decreased significantly. The acquirement of PT EML by PT BPT Tbk was PP's willingness as the controlling shareholder. It was an act of expropriation carried out by the controlling shareholder.

The case of the wrong expropriation and investment that might cause a decrease in the firm performance occurred because of nepotism. In

nepotism, a firm prefers to put the family members who are relatively incompetent. It will reduce the firm value if inadequate family members are placed in the composition of management firm. Nepotism reduces the effectiveness of supervision of an agent by family. It occurs because there is a relationship between the child and the family to facilitate parents. Nepotism can benefit themselves as well as in the development firm. Family misused firm resources only for personal gain.

The practice of pyramid ownership structure and cross-ownership facilitate the owner's family to control the firm on a larger control right than cash flow rights. The structure is popular in Indonesia. It is proved empirically by Siregar (2008), and Sanjaya (2011a). Family is more motivated to expropriate the firm resources for personal gain which would be a burden to the non-controlling shareholders (Claessens et al., 2002). Investments in firm projects controlled by family are not intended to increase the firm value.

In nepotism, family firms have a desire to give family members the convenience of work that is not available elsewhere. Family members do not have sufficient qualifications to fill the position. The firm prefers putting their family members to choosing the professionals. Family members are often involved in top management of companies controlled by the family. It can be bad for the firm because there are risks involved in the selection of projects that do not benefit the firm systematically. Nepotism is systematically profitable for the family than for the firm. When the family has a power to protect the managers, they could allocate the firm resources that are not efficient. Nepotism could induce agency costs that are associated with nepotism. Family might have an interest to use the firm assets for the benefit of family members.

Such conditions decrease the firm performance. This loss is to be borne by non-controller shareholders. They cannot receive the benefit while family can get something. The fall in the firm performance indicates that the achievement of the firm during such period is poor. It would affect the share capital that is declines in

stock prices that lead the non-controlling shareholders do not get capital gains.

To support the toughness of result analysis, the writer uses another proxy to measure the firm performance namely Market to Book Value of

Equity (MBVE) as a measure of market performance. MBVE replaces ROA as a proxy for the firm performance. The result is as follows.

**Table 3:** Hypothesis Test Using MBVE

Independent Variable	Model
Intercept	1.36E+09 (6,153885)***
FAMILY	-3.07E+08 (-2.278594)**
LEVERAGE	.0401041 (.2727)
SIZE	-.086866 (-1.178210)
R-squared	.012454
Number of observations	604
F-test	2.522216*

Notes: this table reports the results of the regression families on the firm's performance. \*\*\* and \*\* show significance at the alpha level of 1% and 5%.

Based on the results shows in Table 3 the results are consistent with the test results in Table II that uses ROA as a proxy for the firm performance. This result confirms that the ownership of the family as the holder of the controlling firm lowers the firm financial performance based on the book value and market value. However, all the control variables in Table 3 do not significantly affect the firm performance. This is in contrast with the analysis results in Table 2.

## 5. CONCLUSION

The study concludes that the purpose is accomplished because it records the results of the study that the family causes the firm performance to be worse. These results indicate that the presence of family on public companies do not give a positive impact. It is possible to happen because strong nepotism still exists in public firms. It could be traced from the fact that the corporate managers are family members of the controlling shareholders or the ultimate owner. The results of this study further confirm that the entrenchment effect more likely occurs in Indonesia public firms. The results could be used as valuable information in Indonesia Stock Exchange or for potential investors and

creditors and for potential creditors to consider this phenomenon in its risk management.

The study is only limited to the period 2001-2007. This is because the data of the ultimate ownership collected by the authors was only this period. To add more data, the cost and time restricts the writer to collect the data because the data is very difficult to be obtained.

The writer suggests that, first; further study could develop this result in non-manufacturing industries to generalize the results of this study. Second, future researchers could test with different proxies that could be used to measure the firm performance. Third, future researchers should focus again phenomena agency problems on family-owned firms. The ownership seems vulnerable to the agency problem which leads to a public loss. Forth, next researchers can investigate the impact of family ownership on non-financial performance.

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