

The Governance Role of Independent Directors in Indonesian Family and Non-Family Firms

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Abstract

This paper examines the governance role of independent directors in Indonesia using family and non-family firm samples. The literature suggests that independent directors can mitigate conflicts of interest between controlling families and non-controlling or minority shareholders among family firms. This study utilizes panel data of firms listed from 2005 to 2019, comprising 4,865 firm-year observations. Our result reveals that the performance of family firms is significantly worse than that of non-family firms measured by Tobin's Q and that among family firms, independent directors or commissioners have an insignificance impact on firm value. Our findings support the expropriation theory and are not in line with the notion that independent directors can mitigate agency problems among family firms. Our analysis, however, provides strong evidence that independent directors or commissioners in non-family firms positively affect firm performance.

Keywords: agency theory; family control; firm value; independent directors; two-tier board

JEL: D74, G32, H11

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1. INTRODUCTION

The study examines independent or outside directors' governance or monitoring role in countries that adopt a two-tier board. The governance and finance literature show that independent directors can play a more effective management supervision role than affiliated directors, leading to better firm financial performance. Extant research also indicates that firms that do not have family owners perform better in several countries than firms that have family owners. The evidence can be explained by the agency theory that posits that controlling or majority shareholders in family firms may conduct expropriation toward non-controlling or minority shareholders (expropriation hypothesis). Therefore, this study attempts to investigate whether independent directors play supervision roles effectively in family-controlled firms that can mitigate minority shareholder expropriation, leading to better firm performance.

This study utilizes panel data of Indonesian publicly listed firms over the period of 2005 to 2019. Indonesia can be an interesting research field for this study due to several reasons. First, unlike most developed countries that adopt a one-tier board system (i.e., comprising non-executive directors who supervise executive directors), Indonesia applies a two-tier board system (i.e., board of commissioners who supervise board of directors). Most of the study on this issue has been conducted in countries with one-tier board systems. Only a few studies have been done in countries that adopt a two-tier board system. Most of these studies have been conducted only in developed countries (De Massis et al., 2018). This study attempts to examine whether a two-tier board system may provide better managerial, supervisory mechanisms that can result in less minority shareholder expropriation and better firm performance. Indonesia also has a unique feature that the board of commissioners does not have legal representatives of employees (Mulyani et al., 2016). Secondly, most of the publicly listed firms in Indonesia are controlled by families. For example, Masulis et al. (2011) show that family business groups own more than half of Indonesian publicly listed companies' market capitalization. In addition, Claessens et al. (2000) show that the pyramid structure which causes differences in cash-flow and control rights is significantly prevalent in Indonesia. Thus, the agency problem between majority and minority shareholders is more pronounced and severe. Finally, in Indonesia, legal shareholder protection is weak, and the capital market is relatively illiquid, minimizing certain governance tools such as the market for corporate control. This governance mechanism limitation causes minority shareholders to rely more on the governance role that can play by independent commissioners on the board.

2. HYPOTHESES DEVELOPMENT

The Governance Role of Independent Directors

Independent or outside directors are an important internal governance mechanism since they can enhance the effectiveness of managerial monitoring. They can also represent shareholders to exercise control on management (e.g., Corbetta and Salvato, 2016). According to Agency Theory, the main role of independent directors is to protect minority shareholders' interests (Villalonga and Amit, 2006).

A substantial number of studies have been done on this issue, but the empirical findings on the association between board structure and firm performance are still up in the air. For instance, Khosa, A. (2017) find that independent directors positively relate to the firm value of group-affiliated firms. Meanwhile, an insignificant relationship between board independence and firm performance is reported by a number of studies (e.g., Vintila and Gherghina, 2013). Interesting evidence is documented by Dahya et al. (2008). The authors who studied a sample comprised of 22 countries found that independent/outside directors enhance firm value. The correlation is more significant in a subsample of countries with the weaker legal system. The authors' finding suggests that independent directors on the boards could counterweight the firm value damage due to high potential minority shareholder expropriation in countries with weaker legal.

Corporate Governance and Family Firms

The literature suggests two arguments of the benefits of family firms. First, family controlling shareholders may control both non-monetary and reputational benefits by preserving control of the firm (Anderson and Reeb, 2004). Second, family controlling shareholders may expropriate the wealth of minority investors by maintaining control

over the firm. Indeed, shareholders who control the firms may take benefits at the cost of other owners. One can assume that families have potentially bigger motivation to extract benefits of controlling firms.

Furthermore, Villalonga and Amit (2006) argue that family large shareholders may enjoy the less diluted private benefit of controls than other types of block-holders, suggesting they have greater incentives to expropriate their firm's minority shareholders. Private benefits of control can be defined as any value captured by shareholders who control the firm and not shared with non-controlling owners. Private benefits of control stem from "tunneling" of non-controlling or shareholders through self-dealing transactions. e.g., asset sales and transfer pricing that only benefits are controlling families, excessive executive salary for controlling families, loan guarantees, or through non-asset transfer, e.g., insider trading, discrimination transactions, acquisition.

As such, family firms may potentially encounter a higher degree of agency conflicts between controlling or majority and non-controlling or minority shareholders. For example, Claessens et al. (2000) posit that family control has a negative impact on firm performance in East Asia, primarily due to private benefit of controls and poor governance practices (e.g., excessive conglomeration cronyism and corruption).

In contrast, Anderson and Reeb (2004) suggest that large firms controlled by families in the United States outperformed non-family controlled firms and are less diversified than non-family firms. They argue that these are not indicators of minority shareholder wealth expropriation. But, Anderson and Reeb also reveal that U.S. family firms have a better performance than their non-family counterparts only if they have more independent boards. The result suggests that independent directors in the U.S can play a significant role in family-controlled firms by curbing minority shareholder expropriation.

Mixed results can be found in the research of family firm financial performance. For example, Anderson and Reeb (2004) and Villalonga and Amit (2006) find that family control positively impacts performance. In the U.K, Poutziouris et al. (2015) find that the relationship between family control and firm performance is non-linear. In Australia, Setia-Atmaja et al. (2009) find that family control is negatively associated with performance. Moreover, In Indonesia, Prabowo and Simpson (2011) indicate that family ownership has a negative impact on performance, especially when a family is very active in the decision-making process. Bambang and Hermawan (2013) find a similar result for Indonesia-listed firms in the consumer goods sector. Suyono (2018) also found that family ownership has a negative impact on firm productivity.

Independent Directors and Family Firms

According to agency theory, the presence of independent or outside directors is essential to make sure owner-managers behave responsibly. They are generally professional and independent of firm management to better monitor owner-manager or controlling family. Owner-managers can indeed appoint and remove independent or outside directors. But they should consider costs incurred from replacing independent directors. In addition, independent or outside directors may have greater motivation to monitor owner-manager if there is a market for independent or outside directors.

According to stewardship perspective, family controlling shareholders may act as stewards of company value. Indeed, the advisory role of directors is considered more

valuable than the supervisory role of directors. Controlling family shareholders may appoint independent directors to assist management in deciding to create value for all shareholders. Bettinelli (2011) argues that independent or outside directors are considered to have a greater commitment to their jobs. They are also perceived to be more skillful and cohesive. Hence, both agency and stewardship perspectives predict that independent or non-affiliated directors would enhance firm performance.

There has been a number of studies that empirically examine this issue, but the findings are mixed. For example, Anderson and Reeb (2004) reveal that independent or outside directors can effectively monitor large family firms in the United States. In particular, they find that family firms can only have better performance than non-family firms if there is a higher proportion of independent or outside directors on board. The authors also report that institutional shareholders attempt to minimize family opportunism by asking for more independent directors because family firms generally prefer less board independence. Arosa et al. (2010), who studied Spanish family firms, also found a positive contribution of independent or outside directors. Setia-Atmaja (2010) finds that Australian family firms tend to have lower board independence, implying that owner-manager or controlling family shareholders tend to have a board with less independent directors who can monitor them more effectively. Ironically, the author also finds that independent or outside directors are associated with firm value creation among closely-held firms. Setia-Atmaja (2010) also documents that independent or outside directors in Australian family firms effectively ensure owner-manager to pay higher dividends. Setiawan et al. (2020), who study Indonesia family firms, indicate that the proportion of independent commissioners on the board have a positive impact on firm performance measured by return on assets. In comparison, Zachro and Utama (2021) report that family firms in Indonesia strengthen the governance role of Commissioners who hold multiple positions to reduce the risk of stock price crashes. Albawwat et al. (2020), who study firms in Jordan, also reveal that independent directors positively impact firm performance.

A more recent study by Samara and Berbegal-Mirabent (2018) reveals that family firms' governance structure influences the firm performance impact of independent directors. In addition, Cuadrado-Ballesteros et al. (2015), who examined a sample of internationally listed companies, find that a higher percentage of independent directors on board leads to better company's corporate social responsibility information disclosure. However, this positive impact of board independence only exists among non-family firms. In family firms, this positive association disappears. The authors suggest that "the independence" of independent directors vanishes because they are strongly influenced by controlling families.

Moreover, several studies document that independent or outside directors are ineffective in monitoring owner-manager or controlling families, but they can be more effective in providing advice. For example, Anderson et al. (2017) report that is controlling shareholders in family firms tend to have outside or independent directors who have experience on other family firms' boards. The authors call this board "family-friendly directors." The controlling family makes this decision despite perceiving that appointing "family friendly directors" in family firms decreases the firm value. The authors also document that the probability of management improper behavior increases with "family friendly directors." However, they find that during mergers and acquisitions, these results in positive abnormal returns. These two findings imply that

“family friendly directors” cannot effectively monitor management or control families but can provide valuable advice.

Prabowo and Simpson (2011) also find that the presence of independent/outside directors on board is not related to the performance of Indonesian publicly listed firms, which may be caused by problems in the process of appointing independent directors/commissioners. Hence, the authors recommend a governance reform in Indonesia to prevent controlling shareholders (families) from exerting imprudent control over firms. In addition, Fuzi et al. (2016), who studied Malaysian listed firms, indicate that board independence has no significant association with firm performance. A more recent study by Tran (2021), who examines 20 countries across Asia, America, and Europe, reveals that board independence on firm profitability is statistically insignificant.

Our review of the literature leads to the following three hypotheses. Under agency theory, the hypothesis is as follows.

Hypothesis 1: “There is a positive association between the proportion of independent commissioners and firm performance.”

In addition, under the expropriation theory, this study constructs the following hypothesis.

Hypothesis 2: “There is a negative association between family control and firm performance.”

Finally, under the agency perspective, the study forms the third hypothesis.

Hypothesis 3: “The percentage of independent commissioners moderates the association between family control and firm performance.”

3. METHODS METHOD, DATA, AND ANALYSIS

Sample

This study uses panel data from 2005 to 2019. The sample consists of publicly listed firms in Indonesia Stock Exchange (IDX). Firms incorporated in the study sample should have annual reports available for 2005-2019. This study excludes bank and financial services since they are highly regulated. This study also excludes firms that have incomplete data. As such, this study has a panel data of 4,865 firm-years from 408 firms in the final sample. All financial and ownership data are downloaded from Capital I.Q. and Bloomberg.

Research Model

The following model 1 is used in this study to examine the relationship between board dependence on firm performance (Hypothesis 1) and the relationship between family control and performance (Hypothesis 2).

$$LNQ = f(\text{Indcom}, \text{dfam}, \text{size}, \text{debt}, \text{age}, \text{dividend}, \text{industry}, \text{year}) \quad (1)$$

LNQ (natural logarithm of Tobin’s Q) is approximated by the natural logarithm of the market value of equity plus the book value of all liabilities divided by total assets.

INDCOM is defined as a number of independent commissioners divided by a total number of commissioners on the board of commissioners.

We categorize family-controlled firms as firms with families or individuals controlling 35 percent or more shareholding and sitting on the firm's boards. A thirty-five percent is the control threshold adopted in Indonesia's takeover regulation. We use DFAM, which is equal to one for family firms, zero otherwise.

For example, in 2007, the largest or majority shareholder of P.T. Charoen Popkhand Indonesia, Tbk is P.T. Cipta Pertiwi (55.34%). Meanwhile, public investors only own 23.48 percent of the company shares. P.T. Cipta Pertiwi's prospectus reveals that the majority or controlling shareholder is the Jiavaranon family. As such, P.T. Charoen Popkhand Indonesia, Tbk is defined as a family-controlled firm.

If needed, this study also traces back ownership if its controlling shareholder is a publicly listed firm. For instance, Firm X is controlled by Firm Y, which is a family-controlled firm, then Firm X is categorized as a family-controlled firm. If a family doesn't control firm Y, then it is defined as a non-family firm. For example, in 2009, P.T. United Tractors, Tbk, has the largest shareholder of PT Astra International, Tbk, which owns 59.50% of company shares. This study then traces the ownership structure of Astra International, Tbk, and finds that the company is controlled by the Jardine Cycle & Carriage of Singapore, controlled by the Jardine Matheson Group. Keswick family actually controls the latest. Therefore, although P.T. United Tractors, Tbk has the largest shareholder that can be categorized as widely firm, it is defined as a family-controlled firm because its ultimate shareholder is a family firm.

This study controls for potential factors that can affect Tobin's Q such as SIZE (defined as the natural logarithm of a total asset), DEBT (measured by total asset divided total liability), AGE (defined as the natural logarithm of the number of years since the firm's incorporation), and DIVIDEND (defined as a total dividend paid divided by total assets). In addition, to control the industry differences, this study utilizes seven dummy variables based on The IDX industry classification. This study also controls for year differences using dummy variables. Since the family variable (DFAM) is relatively stable over time, random effects, not fixed effects, are used to estimate the model.

To examine how board independence (namely the percentage of independent or outside directors or commissioners on the board of directors or commissioners) moderates the relationship between family control and firm performance (Hypothesis 3), this study utilizes the following model 2:

$$LNQ = f(Indcom, dfam, Dfam*Indcom, size, debt, age, dividend, industry, year) \quad (2)$$

4. RESULTS

Descriptive Statistics

Table 1 describes the statistics of our sample. On average, firms have 40 percent of independent commissioners on the board of commissioners. Firms controlled by families represent 78.5 percent of the sample.

Table 1. Descriptive Statistics

Variable	Mean	Std. Dev	Min	Max
Q	1.5521	1.6191	0.0198	25.1798
INDCOM	0.4010	0.1225	0	1
DFAM	0.7854	0.4106	0	1
Total assets	5,983,212	23,500,000	0.6664	1,070,000,000
SIZE	12.8814	3.6260	-0.4059	20.7926
DEBT	0.1322	0.2103	0	4.8344
AGE	33.7096	21.3513	2	202
DIVIDEND	0.0174	0.0486	0	0.9986

Univariate Analysis

Table 2 reports differences between family-controlled and non-family-controlled firms in terms of the percentage of independent commissioners on the board, debt, firm size, and firm age. In terms of board independence, family firms have a significantly higher percentage of independent commissioners. On average, the family firm's board of commissioners comprises 40,4 percent independent commissioners versus 39 percent for non-family firms. On average, family firms are also significantly smaller, less valuable (Tobin's Q of 1.46 versus 1,88), and younger (31.5 years versus 41.6 years). However, in terms of debt level, the two types of firms are similar.

Table 2. Univariate Analysis

Variable	NonFamily Firm	Family Firm	Difference	t-statistic
Q	1.8816	1.4620	0.4195	7.4614***
INDCOM	0.3902	0.4040	-0.0138	-3.2219***
Total Assets	12,500,000	4,208,637	8,269,455	10.1633***
SIZE	13.1529	12.8073	0.3457	2.7315***
DEBT	0.1057	0.1394	-0.0337	-4.6029***
AGE	41.6619	31.5368	10.1251	13.8427***
DIVIDEND	0.0340	0.0128	0.0213	12.7168***
Observation	1,044	3,821		

*** Significant at the 1%

Correlation Analysis

Table 3 reports correlations of all variables utilized in the regression model. As reported in Table 3, a correlation between INDCOM and LNQ is significantly positive, while DFAM and LNQ are significantly negative. This gives a primary indication that independent commissioners lead to better performance and that family firms underperform non-family firms. In general, coefficients of correlations of all independent variables are relatively low, suggesting no multicollinearity when conducting regression analyses.

Table 3. Correlation Analysis

	Q	INDCOM	DFAM	SIZE	DEBT	AGE	DIVIDEND
Q	1						
INDCOM	0.1085***	1					
DFAM	-0.1064***	0.0462***	1				
SIZE	0.0568***	-0.0391***	0.0643***	1			
DEBT	0.0270*	0.0659***	0.0862***	-0.0006	1		
AGE	0.1311***	-0.1947***	0.0047	0.1551***	-0.0407***	1	
DIVIDEND	0.4793***	-0.1794***	0.0371***	0.0872***	-0.1331***	0.2406***	1

*** Significant at 1% ** Significant at 5% * Significant at the 10%

Panel Regression Analysis

In Column 1 of Table 4, we present the regression result for Equation (1) using random-effects regressions. The coefficient of INDCOM is significantly positive, which supports Hypothesis 1 that the percentage of independent commissioners on the board has a positive association with firm performance. The result is consistent with the notion that independent directors can mitigate agency problems.

Table 4. Regression Results

Q	All firms	Family Firms	NonFamily Firms	All firms
INDCOM	0.4370** (0.021)	0.2810 (0.154)	1.0561** (0.044)	0.8775** (0.044)
DFAM	-0.2373** (0.011)	-	-	-0.0205 (0.924)
DFAM*INDCOM	-	-	-	-0.5413 (0.260)
SIZE	-0.0319*** (0.001)	-0.0225** (0.037)	-0.0290 (0.151)	-0.0320*** (0.001)
DEBT	0.5722*** (0.000)	0.7024*** (0.000)	-0.2130 (0.657)	0.5711*** (0.000)
AGE	0.0016 (0.453)	-0.0016 (0.584)	0.0010 (0.747)	0.0017 (0.427)
DIVIDEND	8.8864*** (0.000)	12.3421*** (0.000)	6.1335*** (0.000)	8.8733*** (0.000)
IND1			0 (omitted)	
IND2	-0.2679 (0.214)	-0.3893* (0.099)	0.1088 (0.821)	-0.2607 (0.227)
IND3	-0.1582 (0.432)	-0.1869 (0.392)	-0.0723 (0.872)	-0.1574 (0.435)
IND4	-0.189 (0.375)	-0.1999 (0.383)	-0.0729 (0.879)	-0.1855 (0.384)
IND5	0.6058*** (0.004)	0.3087 (0.172)	1.4464*** (0.004)	0.6052*** (0.004)
IND6	-0.1765 (0.380)	-0.2813 (0.193)	-0.0495 (0.916)	-0.1729 (0.390)

Q	All firms	Family Firms	NonFamily Firms	All firms
IND7	-0.2415 (0.253)	-0.1836 (0.433)	-0.1998 (0.665)	-0.2420 (0.252)
IND9	0.1746 (0.362)	0.0568 (0.784)	0.4212 (0.353)	0.1795 (0.349)
Y2005	0 (omitted)			
Y2006	0.1998* (0.081)	0.1747 (0.139)	0.2800 (0.379)	0.1992* (0.082)
Y2007	0.5617*** (0.000)	0.3769*** (0.001)	1.2439*** (0.000)	0.5606*** (0.000)
Y2008	-0.0144 (0.896)	-0.0360 (0.755)	0.0086 (0.977)	-0.0120 (0.914)
Y2009	0.098 (0.372)	0.0298 (0.796)	0.3254 (0.263)	0.1013 (0.357)
Y2010	0.3744*** (0.001)	0.2810** (0.014)	0.6681** (0.020)	0.3769*** (0.001)
Y2011	0.3430*** (0.001)	0.3072*** (0.007)	0.4130 (0.147)	0.3459*** (0.001)
Y2012	0.4684*** (0.000)	0.3950*** (0.000)	0.6815** (0.016)	0.4703*** (0.000)
Y2013	0.3706*** (0.000)	0.3390*** (0.002)	0.4491 (0.111)	0.3719*** (0.000)
Y2014	0.4499*** (0.000)	0.4371*** (0.000)	0.4786* (0.087)	0.4503*** (0.000)
Y2015	0.3076*** (0.004)	0.3217*** (0.004)	0.2570 (0.355)	0.3079*** (0.003)
Y2016	0.3759*** (0.000)	0.3514*** (0.002)	0.4828* (0.082)	0.3761*** (0.000)
Y2017	0.3878*** (0.000)	0.3492*** (0.002)	0.5255* (0.059)	0.3879*** (0.000)
Y2018	0.2578** (0.016)	0.2748** (0.016)	0.2275 (0.418)	0.2579** (0.016)
Y2019	0.0750 (0.500)	0.1093 (0.358)	-0.0512 (0.860)	0.074903 (0.501)
CONSTANT	1.4323*** (0.000)	1.2833*** (0.000)	1.0012* (0.081)	1.2522*** (0.000)
Adjusted R ²	0.2428	0.2725	0.2701	0.2412
Observations	4,865	3,821	1,044	4,865

*** Significant at the 0.01 level ** Significant at the 0.05 level * Significant at the 0.1 level

The top number in each cell is the coefficient, and the bottom number in parentheses is the significance level.

Notes: "Q" is the market value of equity plus the book value of total liabilities divided by total assets. "INDCOM" is a percentage of independent commissioners on the board of commissioners. "DFAM" is one of the family controls the firm, and zero otherwise. "SIZE" is the natural logarithm of total assets. "DEBT" is long-term debt divided by total assets. "AGE" is counted from the year

the firm was established. "DIVIDEND" is the total dividend paid divided by total assets. "IND1-IND9" is a dummy variable for industry based on the Indonesian Stock Exchange industry classification. "Y2005-Y2019" is a dummy variable for the year 2005 up to 2019.

The coefficient of DFAM is significantly negative at the conventional level. The result supports Hypothesis 2 that family control negatively affects firm performance, suggesting that family-controlled firms underperform their non-family counterparts. The result is consistent with the expropriation hypothesis. Column 4 of Table 4 presents the estimation of Equation (2) using random-effects regressions. One moderating variable (i.e., DFAM*INDCOM) is added into Equation (1). This variable captures the moderating effect of board independence on the association between family control and firm performance. The coefficient of DFAM*INDCOM is statistically insignificant at the conventional level. This suggests that the percentage of independent commissioners on the board has no impact on the performance of family-controlled firms.

Interestingly, the coefficient of INDCOM is still positive and significant at a five percent level. This suggests that among non-family firms, a higher percentage of independent commissioners on the board leads to better firm performance. The significant relationship between INDCOM and LNQ in Column 1 stems from non-family firm observations.

This study divides all sample firms into two subsamples to confirm these results: family-controlled firms (observed firm years 3,821) and non-family-controlled firms (observed firm years 1,044). This study then runs Equation (1) without the DFAM variable for both subsamples. Columns 2 and 3 of Table 4 report the subsample of family firms and a subsample of non-family firms, respectively. It shows that the coefficient of INDCOM is statistically insignificant among the family firm subsample. In the non-family firm subsample, however, the coefficient of INDCOM is significantly positive at a five percent level. Combined, the results in Columns 2 and 4 imply that, on average independent commissioners in the family firm do not enhance firm performance. This is not in line with the Agency and Stewardship perspectives.

In contrast, combined, the results in Columns 3 and 4 imply that, on average, independent commissioners among non-family firms increase firm performance. The overall results show that (1) performance of family firms is worse than that of non-family firms, (2) among family firms, independent commissioners have little impact on enhancing firm performance, and (3) independent commissioners play a better monitoring role among firms controlled by non-family firms than those of controlled by family firms.

5. DISCUSSION

Why are independent commissioners ineffective among family firms? It is not because the proportion of independent directors/commissioners on the board of family firms is so low that independent commissioners cannot do their monitoring tasks effectively. In fact, in our sample, the average percentage of independent commissioners on a family firm's board is 40%, a bit higher than that of a non-family firm's board (39.6%).

The possible explanation is that independent directors or commissioners among family firms are not “really independent.” They can be friends of controlling family members, “friendly” professionals who tend to agree with most controlling family member decisions, or professionals who have experience on other family firms’ boards (Anderson et al., 2017). Cuadrado-Ballesteros et al. (2015) remind that family owners can dominate independent/outside directors in family-controlled firms. Most boards of commissioners among family firms in Indonesia are not chaired by an independent commissioner but by founding family or family members. While among non-family-controlled firms in Indonesia, it is more common that the chairman of the board of commissioners is an independent commissioner.

The Indonesia Stock Exchange (IDX) requires listed companies to have boards with a minimum of only 30 percent independent commissioners (Kep-339/BEJ/07-2001) contributes to this phenomenon. In particular, firms listed in IDX, controlled by a family or non-family large shareholders, tend to have less than 50 percent independent commissioners on their board.

6. CONCLUSION, LIMITATIONS, AND SUGGESTIONS

Conclusion

This study investigates the governance role that independent directors or commissioners can play in a country adopting a two-board system using family and non-family firm samples. Using data of publicly listed firms in the Indonesia Stock Exchange traded from 2005 to 2019, this study finds that family-controlled firms underperform non-family-controlled firms. The result is similar to a number of extant findings such as Claessens et al. (2000) and Setia-Atmaja (2010). The panel regression results also reveal that independent directors or commissioners do have little impact on the performance of family firms. It implies that independent directors or commissioners do not play significant monitoring or governance role among family firms. This finding is in contrast to that of Anderson and Reeb (2004) in the U.S. It doesn’t support the argument that independent directors or commissioners can monitor management or control families in a better way.

Interestingly, our regression analysis also indicates that non-family firms with a higher proportion of independent directors or commissioners perform better. This suggests that independent directors or commissioners can do a better job in monitoring management or controlling shareholders without the presence of controlling families. As such, this finding follows Anderson and Reeb (2004). The finding also supports the argument that independent directors on the boards could counterweight the firm value damage due to high potential minority shareholder expropriation in countries with weaker legal (Dahya et al., 2008).

Most of the extant research that examines this issue has been done in developed countries with a one-tier board system, strong legal system, and relatively low concentration of firm ownership. Therefore, this study enriches the corporate governance and ownership structure literature by providing evidence on this issue from a country that adopts a two-tier board system, weak legal protection, relatively high ownership concentration, and many family firms.

Limitation and Suggestions

There are many definitions of family firms. It should be aware that different definitions may lead to a different results. In addition, we quantitatively measure board independence as the percentage of independent commissioners on the board. We do not have any qualitative measure of board independence, such as how independent commissioners play a supervision role on family directors. It is possible that there are a number of independent commissioners who do not act as “independent” directors, thus affecting the result of the study.

For the future study, research objectives may include financial sector companies as well apply other methodology that can increase the validity of the research, especially in measuring the board independence. Future studies may also consider using an alternative definition of family firms.

The study’s findings have an important implication for capital market regulators. Currently, the Indonesia Stock Exchange (IDX) requires listed companies to have boards with a minimum of 30 percent independent commissioners (Kep-339/BEJ/07-2001). Firms in our sample have an average of 38 percent independent directors or commissioners on boards. Since the presence of independent directors or commissioners on the boards of non-family-controlled firms enhances firm performance, the regulator should consider the requirement of publicly listed firms to have a higher percentage of independent directors or commissioners on boards, for example, a minimum of 50 percent. The higher percentage of independent directors or commissioners on the board can also enhance the quality of managerial or controlling family monitoring by independent directors or commissioners among family firms.

Acknowledgment

We acknowledge useful feedback from participants at the Asian Finance Association Annual Meeting 2017 in Seoul. We also thank Athalia Hidayat and Edward Loe for providing us with the list of family firm data from their undergraduate thesis.

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