

# Corporate governance and ownership structure on performance

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Received: 25 December 2021

Accepted: 02 January 2022

DOI: <https://doi.org/10.32479/pssj.11354>

## ABSTRACT

The aim of this study is to investigate how Corporate Governance structures, Related Party Transactions, and Family Ownership could influence Firm Performance in Indonesia. The data is collected from companies listed in LQ45 index from 2016 to 2018. Multiple regression analysis is used to examine the relationship between Corporate Governance, Related Party Transaction and Family Ownership towards Firm Performance, specifically on ROE. Corporate Governance can be measured by Independent Directors and Board Size in which the ratio of independent directors to the total of directors in the board whereas Board Size is the number of members sitting on the board. For Related Party Transaction, the measurements used is by utilizing the total amount of related party transactions by total of assets. Dummy variable will be used to indicate a Family Ownership, that is whether there is an affiliation member in the board. If there is a family member in the board, this will indicate as 1, and if there is no family member in the board, it will be indicated as 0. ROE is used to measure Firm Performance, that is net income divided by shareholder's equity. The results concluded that only Independent Directors have positive significant to Firm Performance. Due to Independent Directors have higher control compare to other directors. This indicates the level of supervision of the company will also certainly increase which implies whenever a firm company is well monitored it will improve the firm performance especially the profit factor measured, i.e. ROE.

**Keywords:** related party transaction, family ownership, ROE, agency theory, family owned business.

## 1. INTRODUCTION

Corporate governance is a framework that explains how firms are operated and regulated. Board of directors are important for governing companies. The portrayal of governance's shareholder is to designate the directors and the auditors to set the appropriate corporate governance in the company. In addition, the board's obligation is to set the company's main objectives, grant the leadership to bring them into effect, handle the business management as well as notifying to shareholder regarding their supervision. Hence, corporate governance is both about what the board does as well as how it establishes the values of the company, and it is to be separated from the everyday operational management of the company (ICAEW, n.d.). In fact, good corporate governance is a vital part in basing the principle and capability of financial markets. However, poor corporate governance undermines the ability of a company and also allows for financial stress and misconduct. When companies are well governed, they can surpass other companies and attract investors who can maintain to bolster their finance growth (OECD, n.d.).

Most codes of governance apply good governance principles underline the idea that separate individuals should involve the positions of CEO and Chairman of the company in order to remove unchecked power over one individual and improve the company's performance. In the literature of Gordon, Henry and Palia (2004), governance mechanisms such as board characteristics and CEO pay-performance sensitivity are valuable in enhancing management company problems. In addition, higher leverage as well as significant shareholder ownership are capital structure aspects that also have a position in governance to reduce problems with agency issues. Previous research cited in Gordon, Henry and Palia (2004) for instance, large board size, which can be detected and reported in proxy reports, are found to be negatively associated with firm quality and considered as a poor CG indicator.

Extensive knowledge explores the connection between corporate governance and firm performance. Prior studies have provided mixed results in which one study source indicates a positive relationship between corporate governance and corporate performance (Klapper & Love, 2004) while there is no significant correlation between corporate governance and corporate

performance (Klapper & Love, 2004) while there is no significant correlation between corporate governance and corporate performance in other literature (Klein, Shapiro, & Young, 2005). Past studies acknowledge that the duality of CEOs would significantly affect firm performance, however results were mixed. Azeez (2015) argued that one personality's presence as the firm CEO Chairman would breach decision management's isolation from decision making. Therefore, they conclude that this would lead to uninvested control over an individual leading prejudice over another individual, giving higher chance for the individual to act in accordance with his personal interest, which is harmful to the company's shareholders. Azeez (2015) conclude that there is a clear and consistent positive cooperative between CEO duality and company bankruptcies, supporting the view that separating CEO and Chairman positions will lead to better results.

Abdul, Rahman, and Haniffa (2003) claimed distinct board leadership appears to achieve well-measured by the standard of accounting and that duality's position seem to be inadequate. Dahya, Lonie and Power (2006) indicate that the market is reacting positively to the separation of the two positions and unfavorably to the consolidation of these two duties over one person, and further suggests that the accounting quality of firms implementing a 'dual CEO' tends to decline following this transition. Nevertheless, the positive effects of CEO duality are illustrated by another source of literature. Azeez (2015) argued that CEO duality maintains companies with strong leadership and is an indicator of the stability of companies, improving firm contact and eventually leading to greater shareholder confidence in the company.

Prior research by Luan and Tang (2007) found firms with a higher corporate profit chose to appoint independent outside directors. Their result suggests that the appointment of independent outside directors on the board is positively linked to firm performance. Additionally, Ponnu (2008) have indicated that the ratio of independent directors is correlated with firm performance. Ponnu (2008) also implied that firms with independent directors appear to be much more profitable compare with fewer independent directors. It was also concluded that increasing the ratio of independent directors should consequently improve firm performance, since they are more effective manager monitoring. It was also argued, however, there is no relation among the ratio of independent directors and the performance of dominant firms.

In this research, the author would like to discuss and examine firm performance in Indonesian firms listed in LQ45 index from the year period 2016 to 2018. Based on prior studies, the author believes that firm performance can be affected by various factors, specifically corporate governance, related party transactions and family ownership.

## 2. LITERATURE REVIEW

### A. Family Business

A family owned business can be specified as a business that is simultaneously owned and/or operated by more than one

member of the same family (Entrepreneur, 2010). The owners of a family business are different compare to shareholders in companies owned by public investors. Moreover, as stated by Gersick et al (1997), "family-owned employees understand the difference family control makes to their working lives, the company culture, and their careers. Marketers recognize the advantage given to consumers and families by the idea of a family business that being together in business is a strong party of their lives".

In family businesses, there are two added bodies that has been established and they are the family council and the business council (Brenes et al., 2007). With the family council, there are two stockholders that associates to the family, the current and potential stockholders. They meet once a year to discuss objectives and plans, as well as to evaluate disputes in parallel to family commitments to the firm. Contrarily, business council consists of entirely family members who are operating within the family business. In addition, the business council presents to the family council regarding the progress of the family's company and evaluates family predictions for the company, such as different projects, investments, business ideas and deliver them to the CEO and the board of directors (Brenes et al., 2007).

### B. Firm Performance

Studies indicate that corporate governance can have an impact on firm value due to reduced insider expropriation as well as improved expected cash flows that can be distributed to investors (Klapper & Love 2004). There are various measurements of firm performance. The financial performance indicators used in empirical corporate governance analysis fit into both market-based and accounting measures. Return on assets (ROA), return on equity (ROE) as well as earnings per share (EPS) are commonly utilized accounting-based measures. Prior studies such as Velnampy and Pratheepkanth (2013) found there is a positive correlation between board structure and corporate reporting with variables of ROE, ROA and NP as the measurements of firm performance. Previous research states that improved corporate structures favour companies with greater access to financing, lower capital costs, improved performance and better treatment of all stakeholders. It was reported that poor corporate governance not only results in poor firm performance and risky financing practices but is also vulnerable to macroeconomic crises like the East Asian crisis of 1997 (Coleman & Biekpe, 2008).

### C. Corporate Governance

In the early 1990s, the reputation of London's financial center was considerably suffered because of the failures of major companies due to various reasons, such as corporate fraud, director misconduct and because of these complications, it was not revealed by the published accounting report (Cadbury, 1992). Henceforth, a committee to examine the financial factors of corporate governance was formed by the Financial Reporting Council, the London Stock Exchange (LSE) and the accounting profession. Their objective was to create a code of best practice and at the same time avoiding an inflexible one size fits all approach. According to several researcher in order to strengthen the unitary board process of all listed companies, the Cadbury Report established three relevant arguments: the structure and responsibilities of boards of directors, the position of auditors and advice to the accounting profession, and shareholders' rights and responsibilities. Corporate governance can be

defined as the system of rules, practices and processes by which a firm is directed and controlled (Fernando, n.d.). Corporate governance helps companies to be governed and to what purpose, it is also to ensure that businesses have the proper decision-making process and balancing the interest of stakeholders. In terms of corporate level, corporate governance consists of all the processes, in which a company's objectives are set and are pursued related to social, regulatory and as well as the market environment. Additionally, it is interested with the procedures and practices in order to make sure that a company is run alongside with achieving its objectives and goals, while ensuring the stakeholder's confidence in that company is well established in accordance to the principles of transparency and accountability (Juneja, n.d.).

### 3. METHODS

Sampling method will be used to collect the research sample that are based on certain criteria. The criteria for the sampling method companies listed in LQ 45 Index in the year 2016, family business will be based on the presence of family member in the board/management, family business is included in equation as dummy (1 = family business, 0 = non-family business). Moreover, the time period of this research will be of 3 years i.e. 2016 - 2018.

The data collection will be from secondary data in which data is already available to be collected from other sources. Moreover, the secondary data will be collected from annual reports of companies listed in the LQ 45 Index. The author will provide descriptive statistics for the collected data. This is where the data will be described or summarized in ways that are meaningful and useful to this research. Furthermore, the multiple regression analysis is used to examine the relationship between Corporate Governance, Related Party Transactions and Family Ownership. The research model is provided in the following equation:

$$ROE_{it} = \beta_0 + \beta_1 INDDIR_{it} + \beta_2 BRDSZE_{it} + \beta_3 RPT_{it} + \beta_4 FAM_{it} + \varepsilon_{it}$$

Where:

ROE is the Return on Equity

INDDIR is the Independent Directors

BRDSZE is the Board Size

RPT is the Related Party Transactions

FAM is the Family

In accordance with the sample selection criteria specified in the previous chapter, the sample selection procedure is presented briefly.

## 4. RESULT

At this stage the author presents 135 data from companies that are included in the LQ45 Index. The data is taken from 45 companies with a span of time between 2016 until 2018. The results of these data is presented in the following table 1.

**Table 1. Descriptive Statistics**

Variable	N	Minimum	Maximum	Mean	Std. Deviation	
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic
ROE	135	-1,0590	1,3585	,171836	,0230213	,2674828
RPT	135	,0000	9,1200	,247951	,0776187	,9018480
Indep_Director	135	,0000	,3333	,099728	,0072732	,0845071
Board_Size	135	1,00	12,00	6,9037	,18923	2,19862
Family	135	,00	1,00	,2667	,03820	,44386
Size	135	29,0699	34,8151	31,357546	,1170425	1,3599107
Valid N (listwise)	135					

In the table above, the Author understands that ROE has an average value of 0,17 and an average standard error of 0,023 and a standard deviation of 0,267. The RPT has an average value of 0,247 and an average standard error of 0,077 and a standard deviation of 0,901. Independent Directors have an average value of 0,099 and an average standard error of 0,007 and have a standard deviation of 0,845. Board Size has an average value of 6,903 and an average standard error of 0,189 and has a standard deviation of 2,198. Family has an average value of 0,266 and an average standard error of 0,038 and has a standard deviation of 0,443. All of these values are derived from a total of 135 total data per variable. Size as Control Variable has an average value of 31,357 and an average standard error of 0,117 and has a standard deviation of 1,359. All of these values are derived from a total of 135 total data per variable.

**Table 2. Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,335a	,253	,227	0,107144
a. Predictors: (Constant), FAM, BRDSZE, RPT, INDDIR, SIZE				
b. Dependent Variable: ROE				

From the table above, it shows that the variables entered independent variables such as Family, Board\_Size, Indep\_Director, RPT. Whereas the removed variable does not exist. In the model summary, here the Author can obtain information about the magnitude of the influence of all independent variables on the dependent variable. The influence is symbolized by R (correlation). As seen in the summary table model value in column R is 0.335, it means that the influence of the Family, Board\_Size, Indep\_Director, RPT and Size on ROE LQ45 is 33,5% (0.335 x 100%), but that value can be said to be "contaminated" by various noise values which might cause measurement errors, for that SPSS provides an alternative

value for R Square as a comparison of the accuracy of its effect. It can be seen that the value of R Square is 0,253, which means 25,3%. This value is smaller than the R value due to an adjustment, but as a note, the value is not necessarily smaller than R, but also sometimes bigger. For more accurate predictions of our influence, it can also be based on the value of Adjusted R Square, which is the value of R Square, which has been more adjusted and is usually the most accurate. It can be seen that the Adjusted R Square value is 0.227 or 22,7% the influence of the independent variable on the dependent variable. The next column in the Model Summary table shows the accuracy of the regression model can be seen in the Standard Error of The Estimate column, there are numbers 0,107144. Pay attention to the descriptive statistical analysis that the standard deviation of the ROE value is 0,26748 which is much greater than the standard error, because it is smaller than the standard deviation of ROE. The regression model is quite reliable in acting as a predictor of ROE value.

**Table 3. ANOVA**

Model	F-stat	Sig.
Regression Residual Total	2,479	.047b

Anova test is a special form of statistical analysis that is widely used in experimental research. This analysis method was developed by R.A Fisher. Anova test is also a form of statistical hypothesis testing where we draw conclusions based on inferential statistical data or groups. The null hypothesis of the Anova test is that the data are simple random from the same population so that they have the same expected mean and variance. Although the t test is a statistic that is often used, only the t test is limited to testing the hypothesis of two groups. Anova Test or Analysis of Variance (ANOVA) was developed to enable researchers to test the comparison hypotheses of more than two groups. Thus, the t-test and ANOVA test are both statistical methods for comparison. F test results indicate a value of 0.047 or smaller than 0.05 this indicates that there are significant differences between these variables. This means that simultaneously the independent variable has an influence on the dependent variable.

**Table 4. Coefficients**

Variable	Coefficient	T-stat (Sig.)
Constant	-3,296	-1,274 (.205)
RPT	.087	.845 (.400)
Independent Director	2.704	2.083 (.039)
Board Size	.051	1.073 (.285)
Family	.505	2.304 (.023)
Size	.158	1.900 (.600)
Adjusted R-square	.227	
F-stat (Sig.)	2.479 (.047)	

In the coefficient table, it is presented with various information, important information consists of the names of variables, Constant values, t values and significance values. Whereas the beta value in the standardized coefficient does not need to be discussed here because the value will be useful if you do path analysis, while the author is currently not doing any path analysis.

As the author stated before this table can be used to see the effect per variable. The author measures it by looking at the sig value. On each variable, if the value is sig. it is smaller than 0,05, the conclusion is the smaller the sig. then more influential.

The table above shows a constant value of -3,296 showing that the value of ROE if the variable X is equal to 0 or we can call it Y intercept this can be seen in the graph when the line intersects on the Y axis because X = 0

- The table above shows the positive coefficient value of RPT of 0,087 but the significance has a value of 0.400 > 0.05 then the effect is not significant so we can conclude that H0 is accepted or H1 is rejected. This means that if the RPT variable increases, the ROE increases by 0,08 but the effect is not significant
- The table above shows the positive coefficient value of Independent Directors of 2,704 but the significance has a value of 0.039 < 0.05 then the effect is significant so we can conclude that H0 is rejected or H2 is accepted. This means that if the Independent Directors variable increases, the ROE increases by 2,704 but the effect is significant.
- The table above shows the positive coefficient value of the Board Size of 0.051 and the significance value of 0.285 > 0.05, the effect is insignificant so we can conclude that H0 is accepted or H3 is rejected. This means that if the Board Size variable increases, ROE increases by 0,051 and the effect is not significant.
- The table above shows the positive coefficient value of Family of 0.505 and the significance has a value of 0.023 < 0.05 then the effect is significant so we can conclude that H0 is rejected or H4 is accepted. This means that if the Family variable increases, ROE has increased by 0.505 and the effect is significant.
- The table above shows the positive coefficient value of Size as control variable of 0.158 and the significance has a value of 0.060 > 0.05 then the effect is insignificant. This means that if the Size variable increases, ROE has increased by 0.158 and the effect is not significant.

From the data presented in the table above, the regression formula equation can be formulated as follows:

$$ROE_{it} = -3,296 + 2,704 \text{ INDDIR}_{it} + 0,051 \text{ BRDSize}_{it} + 0,087 \text{ RPT}_{it} + 0,505 \text{ FAM}_{it} + 0,158 \text{ Size}_{it} + \epsilon_{it}$$

In this study and based on the results of the table above stated that the related party transaction does not have a significant effect this is in line with research by Umobong (2017) which states that the related party transaction does not have a significant effect because firms are not using related party transaction to increase earnings but probably use it to enhance its effectiveness in collaboration with the efficient transaction hypothesis. However, positive relationships are espoused by the study of its potential for being used for manipulative motives. Previous research observed that the market price of shares of firms with huge related party transaction continues to fall up to twelve months after related party transaction



disclosure indicating that investors penalize such firms for a long time after related party transaction reporting in financial statements.

In this research finding, the independent director has a positive and significant influence on ROE. This is in line with research conducted by Luan, CJ, & Tang, MJ (2007) research in China that independent directors have far-reaching oversight higher than other directors which indicates that the level of supervision of the company will also certainly increase thus when a company is well monitored it will improve the performance of the company especially the profit factor measured one of them by ROE.

The variable board size has a positive but not significant effect this is in line with research conducted by Brenes et al. (2011) when using a sample of companies listed in the UK that there is no significant effect between board size and ROE this is because not the amount but the quality and performance of leaders needed by companies that have gone public to provide trust to shareholders and stakeholders. Previous research did not appear to contribute sufficient controls for most of these factors and therefore it was challenging to determine if the family ownership was accountable for the performance differences or whether one of the other factors was accountable for the differences.

This study found that family has a significant influence in line with research conducted by Basco, R. (2014) in private companies, because the family has a greater responsibility to maintain their company which is a legacy from their predecessors so that the problem of agents and shareholders will be resolved in the company controlled by the family.

Agency theory claims that whenever the objectives of a company's directors (owners) and their agents (managers) are matched, there will be few "agency costs" due to shirking, opportunism, adverse selection or moral hazard. In regards of a family firm, the owners are also the agents, the agency cost of the organization should be low because their priorities are fully aligned — all things being equal, a family-owned company should be more efficient than a non-family-owned company where directors and agents are in dispute with each other. Nevertheless, when the problem of "altruism" is placed into the equation of principal – agent, a possible agency problem arises: family members may not be willing to monitor and keep other family members responsible because of their relationship with each other. Under these circumstances, in a family firm where shirking, opportunism, are likely to be occurred, thereby incurring the costs of service. In addition, disputes between family owners may also be deleterious to firm success when members of the family do not share the same objectives.

## 5. CONCLUSIONS

To conclude, this study empirically investigates whether the effect of related party transactions, CG and family ownership affects firm performance. To collect these data, the Author

attained from companies that are listed in the LQ45 Index from the period 2016 – 2018. The results obtained concluded that only two of the independent variables is positively significant towards Firm Performance.

There are several plausible reasons as to why only Independent Directors variable is positively significant towards Firm Performance. Based on the results from the Descriptive Statistics, prior findings suggested in China, Independent Directors have higher control compare to other directors. This indicates the level of supervision of the company will also certainly increase which implies whenever a firm company is well monitored it will improve the firm performance especially the profit factor measured, i.e. ROE (Luan & Tang, 2007).

There are so many reasons why families affect firm performance one of the most important is agency cost in companies that have a family capital structure or family leadership factors of common interest become important in the family by putting aside personal interests that are often experienced by non-family companies as research conducted by Basco, R. (2014) which explains how family influences many factors of company performance.

From the four independent variable and Related Party Transaction, as well as Board Size are insignificant in this study as based on prior research by Umobong (2017) stated that the related party transaction does not have a significant effect because firms do not use related party transaction to raise profitability but use it in conjunction with the efficient transaction to improve its effectiveness. The variable board size has a positive but no significant impact. This is in line with research conducted by Brenes et al. (2011) when using a sample of companies listed in the UK that there is no significant effect between board size and ROE. This is because not the amount but the quality and performance of leaders needed by companies that have gone public to provide trust to shareholders and stakeholders.

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