CONCENTRATED FAMILY OWNERSHIP STRUCTURES WEAKENING CORPORATE GOVERNANCE: A DEVELOPING COUNTRY STORY

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Abstract

This research project examines the effect of ownership structures on corporate governance. Detailed analysis allowed for the identification of the ultimate owner by carefully tracing the chain of ownership. Our findings show that 65.14% of Indonesian firms are controlled by the owners who have a majority ownership and that 66.45% of firms are owned by an individual or group of family members. These ownership structures are more inhibited than most other countries (Claessens *et al.* 2000). Yet, the percentage of independent commissioners is only 37.09%. A majority of independent commissioner members remains a rare event in Indonesia. Multiple regression analysis reveals that both ownership type and identity are moderately (with p-values of 0.075 and 0.017 respectively) significant predictors for commissioner independence. Ownership structures in Indonesia do influence the level of commissioner independence. This Indonesian pattern is a somewhat extreme but not uncommon scenario in Asian financial markets. Western solutions may not be applicable or effective. New rules and regulations may be needed to provide more protection of the smaller investors.

Keywords: Ownership structures, governance, developing countries

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Introduction

This paper examines the relationship between ownership and governance structures in Indonesia. This is a classic Asian country with high ownership concentration and often large family ownerships. Therefore, the typical western-style corporate governance mechanisms (e.g. Sorbanes-Oxley approach) may be ineffective or counter productive in a developing country scenario.

The paper is structured as follows. Section 2 highlights the key literature and the agency theory links to the hypotheses development. Then the research approach is explained in Section 3. This is followed by the descriptive and statistical analysis in Section 4. The final section offers final conclusions.

Literature Review

Ownership Structure and The Agency Problem

One important issue in the organization of firms is how to solve or mitigate the agency problem that derives from asymmetric information. The nature of a corporation's ownership structure will affect the nature of the agency problems between managers and outside shareholders, and among shareholders. But the problems that occur when firm ownership is dispersed are different to those that arise when it is concentrated. When ownership is diffused, as is typical for US and UK corporations, conflicts of interest between managers and shareholders are a central problem (Jensen and Meckling 1976). However, when ownership is concentrated to the degree that one owner has effective control of the firm, as is typically the case for firms in Asia, conflicts of interest between controlling shareholders and minority shareholders becomes the main problem.

Claessens, Djankov and Lang (2000) investigated the separation of ownership in selected Asian countries. Their findings indicate that a controlling single shareholder is prevalent in more than two-thirds of the firms while the separation of management from ownership control was rare. Thus Asian countries' owners have significant power to pursue their own interests at the expense of minority shareholders, creditors and other stakeholders. As

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Shleifer and Vishny (1997) point out, controlling shareholders may not have a convergence of interests with minority shareholders. A greater degree of control by controlling shareholders implies a greater ability to expropriate wealth from minority shareholders.

Past studies document the relation between concentrated ownership structure and firm value. For example, Jensen and Meckling (1976) and Demsetz (1983) argue that managerial equity ownership will provide managers with incentives to maximize firm value. Stulz (1988), however, has provided a model of entrenched managers, where increased managerial ownership allows managers to pursue non-value maximizing agendas. Using US data, Morck, Shleifer and Vishny (1988) have empirically showed a non-linear relation between firm value and managerial ownership. They find that firm value increases up to a certain level of managerial ownership (i.e., 5%) and then decreases as management holdings rise further. Similar results were also reported by McConnell and Servaes (1990, 1995), Hermalin and Weisbach (2003) and Kole (1995).

Fan and Wong (2002) conduct a study on the relation between concentrated structure and financial reporting for the seven Asian countries. They report that earnings informativeness decreases as holding of the controlling shareholders increase. They argue that there is an expropriation of minority shareholders by controlling shareholders. Gaining effective control of a corporation enables the controlling owner to determine not just how the company is run, but also how profits are shared among shareholders. Although minority shareholders are entitled to cash flow rights proportional to their share of equity ownership, they face the uncertainty that an entrenched controlling owner may opportunistically deprive them of their rights. This creates an 'entrenchment effect' (Morck et al. 1988). The entrenchment problem created by a controlling owner is similar to the managerial entrenchment problem. Higher managerial ownership might entrench managers, as they are increasingly less subject to governance mechanisms (Chang, Hillman, and Watson 2005).

Separation of ownership rights and control rights can worsen the entrenchment problems caused by concentrated ownership. Controlling owners could extract wealth from the firm but only bear a part of the cost through a lower valuation of their cash-flow ownership. There is considerable literature documenting the existence of private benefits from control (Barclay and Holderness 1989; Zingales 1994; Zingales 1995 ; Nenova 2003; Dyck and Zingales 2004).[53] In particular, Nenova (2003) and Dyck and Zingales (2004) show that higher private benefits from control are associated with: less developed capital markets; less protected minority shareholders; and more concentrated ownership.

In addition to the 'entrenchment effect', concentrated shareholdings might create an 'alignment effect'. Once the controlling owner obtains effective control of the firm, any increase in voting rights does not further entrench the controlling owner (Morck et al. 1988). Fan and Wong (2002) argue that higher cash flow ownership will cost the controlling shareholder more to divert the firm's cash flows for private gain. High cash-flow ownership can also serve as a signal that the controlling owner will not expropriate wealth from minority shareholders (Gomes 2000) because if minority shareholders know that the controlling owner unexpectedly extracts more private benefits, they will discount the stock price accordingly and the majority owner's share value will be reduced (Fan and Wong 2002). Fan and Wong (2002) argue further, in equilibrium, where a majority shareholder holds a large ownership stake this will result (other things being equal) in a higher stock price for the company. Thus, increasing a controlling owner's cash-flow rights improves the alignment of interests between the controlling owner and the minority shareholders and reduces the effects of entrenchment.

Concentration of ownership and extensive family control characterize corporate ownership in most Asian countries and it is particularly most severe in Indonesia (Claessens *et al.* 2000). Claessens *et al.* (2000) documented that around 67% of Indonesian listed companies are family controlled while only 0.6% are widely held. They further find that Indonesia has the highest ownership concentration of any East Asian Country and has the largest number of companies owned by a single family.

Ownership Structure and Corporate Governance

Ownership structure plays an important role in corporate governance. It is a key organization variable influencing firm outcomes (Kang and Sorensen 1999). Ownership structure is a central distinguishing feature of financial systems (Lehmann and Weigand 2000) and a primary element in determining corporate governance and behavior (Qu 2004) and, therefore, along with other productive and technological resources can have a significant influence on company performance (Chrisman, Chua, and Sharma 1998). Further, Porter (1990) noted the importance of

[53] Private benefits, sometimes called control benefits, are benefits that accrue to managers or shareholders that have control of the corporation, but not to minority shareholders. They can be non-pecuniary, such as influence over who is elected on the board of directors or in CEO position, the power to build business empires (Nenova 2003), the ability to direct a company's resources to a cause one agrees (Demsetz and Lehn 1985), a preference for glamorous project (Jensen 1993).

ownership structure and corporate governance in determining corporate strategy:

Company goals are most strongly determined by ownership structure, the motivation of owners and holders of debt, the nature of corporate governance, and the incentive processes that shape the motivation of senior managers. The goals of publicly held corporations reflect the characteristics of that nation's capital markets (p.110).

Thus, ownership structure is an important component in determining the nature of the agency problem; that is, whether the dominant conflict is between managers and shareholders, or between controlling and minority shareholders. Ownership structure refers to the identities of a firm's equity holders and the size of their holdings (Denis and McConnel 2003). Accordingly, there are two dimensions of ownership structure: ownership concentration (ownership type) and the identity of owners (ownership identity) (Boubakri, Cosset, and Guedhami 2005).

There have been a number of studies on ownership concentration and, particularly, its association with firm performance (Demsetz and Lehn 1985; La Porta, Lopez-de-Silanes, and Shleifer 1998; Himmelberg, Hubbard, and Palia 1999; Demsetz and Villalonga 2001). La Porta *et al.* (1998), for example, use country-level explanatory variables to explain the ownership concentration in publicly traded firms among a wide set of developed and developing countries. They measure ownership concentration in each country by the average ownership stake of the three largest shareholders in the ten largest publicly traded companies. Another important aspect of corporate ownership structure is the identity of owners or the composition of the ownership groups. A shareholder can be an individual; a family; a bank; a holding company; an institutional investor; or a non-financial corporation. Not all owners are alike. Different types of owners might have different interests, thereby having distinct incentives and abilities to control the managers within a firm. As Lehmann and Weygand (2000) point out:

The commitment of owners and their willingness to intervene may crucially depend on who they are. In other words, the location of control rights can be a more important determinant of the degree of control exerted by owners than ownership concentration (p.162). Owners can be distinctly different from one another based on the specific expectations that they bring to the firm and the extent of their active monitoring of the firm (Monks and Minow 1995). For example, significant holdings by institutional investors are more likely to lead to improved monitoring and control than atomistic ownership (Hoskisson, Johnson, and Moesel 1994) because such parties have an incentive that is sufficient for them to incur the necessary costs to monitor performance (Alchian and Demsetz 1972; Schleifer and Vishny 1986; Holderness and Sheehan 1988; Tosi and Gomes-Mejia 1989; Ashton 1991; Sundaramurthy and Lyon 1998). In addition, financial investors may be interested in short-term returns on their investment, while corporate investors may be more inclined towards establishing a long-term relationship (Douma, George, and Kabir 2006).

Ownership patterns vary significantly across economies. In successful developed economies, supported by a well functioning legal and regulatory framework and with active oversight by reputable agents, adequate institutional and professional infrastructure, such as the US and UK, dispersed shareholdings have provided an efficient base for growth and capital accumulation. Much of the literature on corporate governance is based on this diffused shareholding assumption. Therefore, the literature mainly focuses on solving conflict between managers (as agents) and shareholders (as principles) that results from the separation of ownership and control.

However, a recent stream of literature brings into question the assumption of diffuse ownership and suggests in many economies a concentrated pattern of ownership is more typical. For example, Holderness, Kroszner and Sheehan (1999) documented an increase in managerial ownership in the US from 13% in 1935 to 21% in 1995. La Porta *et al.* (1998) found that average ownership by the three largest shareholders of non-financial firms from 49 countries is 46%. There have also been a number of studies that have documented the existence of ownership by families. For example, La Porta *et al.* (1999) examined the ownership structures of large corporations in 27 wealthy economies and found that these firms are typically concentrated within families. Similarly, Claessens *et al.* (2000) examined nine East Asian countries and found a concentration of family ownership and family management. A relatively recent study by Anderson and Reeb (2003) shows that family controlled firms represent one-third of the S&P 500 firms and, on average, constitute 18% of outstanding equity.

Compared to most developed economies, the business environment is quite different in many of the emerging market economies. For example, most companies in Asian countries are affiliated with a business group that is typically family controlled. The group can often comprise numerous public and private companies (Claessens, Djankov, Fan, and Lang 2002). The family achieves effective control of the companies in the group using stock pyramids and cross-shareholdings, which can be quite complicated in structure. Moreover, Claessens *et al.* (2000) point out that voting rights possessed by the family are frequently greater than the family's cash flow rights

from the firm[54] and the results of their study in nine East Asian Countries suggests that Indonesia has more than two-thirds (67.1%) of its publicly listed companies in family hands, and only 0.6% are widely held. In addition, within East Asia, Indonesia has the largest number of companies controlled by a single family (Claessens, Djankov, and Lang 1999).

The concentrated family ownership issue has also been confirmed in several single-economy studies; for example, Joh (2003) in South Korea, Yeh, Lee and Woidtke (2001) in Taiwan, and Wiwattanakantang (2001) in Thailand. Those studies suggest that concentrated family ownership corporate structures complicate the problems associated with asymmetrical information, imperfect monitoring, and opportunistic behavior and make corporate governance reform more complex.

As stated above, the differences in ownership structure have two obvious consequences for corporate governance. A concentrated pattern of ownership potentially allows insiders to have tight control of the firm, but it also opens up opportunities to expropriate wealth from outside shareholders. Prowse (1998) posits that much of debate about corporate governance in the US has been about the costs of dispersed equity ownership, and how to encourage increased concentration of ownership. Prowse (1998, p.24) points out that "It is only when high ownership concentration is combined with weak outside shareholder protection laws, an uncompetitive financial system, and opportunities for malfeasance and corruption by big powerful (insider) shareholders" that the costs associated with concentrated ownership become high.

Based on the above literature review, this study used two key explanatory variables (owner type and owner identity) to predict the level of independence of the board of commissioners in Indonesia. We expect that:

H_1: There will be a negative relation between high levels of ownership concentration and commissioner independence.

H_2: There will be a negative relation between high levels of family ownership concentration and commissioner independence.

Research Approach

Sample

To ensure data homogeneity, this study focuses solely on manufacturing companies identified by the Indonesian Capital Market Directory (ICMD). Another reason to choose manufacturing firms is that these khinds of firms are dominant in Asia and Indonesia. As Dhawan, Mangaleswaran, Padhi, Sankhe, Schwan and Paresh (2000, p. 42) noted: "Asia has become the workshop of the world: more than half of all manufacturing on Earth is estimated to take place there." Within the Indonesian context, Craig and Diga (Craig and Diga 1998, p. 248) noted that "Indonesia was represented strongly by manufacturing-type entities."

The sample examined in this study comprises all manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the longitudinal period 2003 to 2007. There are a total of 166 manufacturing firms listed on the IDX. However, we are unable to collect sufficient information to construct a full set of proxy measures for 74 entities; therefore, it is left with a final usable sample of 92 firms or 459 firm-years.

Data sources

The data sources used to trace the ultimate owner in this study originate from the ICMD publications issued by the Institute for Economic and Financial Research (2004). This data provides the firm's immediate owners. These owners are then traced and cross-checked through the Indonesian Business Data Centre (IBDC) (1997); Information Resoure Development (2000); Information Resoure Development (1998) and firm's prospectuses to determine a company's affiliation and, hence, its ultimate owner. Given a firm could have many ultimate owners; this study focuses on the largest ultimate owner.

To measure the degree of control, this study combines shareholdings registered in the name of the majority shareholder and other related shareholders (i.e. through shares held by individuals, family or companies that, in turn, are under his/her control). This procedure is justifiable since in Indonesia the majority of the companies listed on the capital market are family controlled. Following Claessens *et al.* (2000), this study does not distinguish individual family members and uses the family group as the unit of analysis. By identifying the name under which the shares are registered, this study delineates their family affiliation. Collective shares owned by individual family members are treated as a family ownership.

The data sources for measuring variables (dependent, independent and control variables) are collected from the IDX website: http://www.jsx.co.id/ and the IDX Monthly Statistics, April 2008, Volume 17, No. 4 issued by the IDX Research and Development Division.

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[54] 'Voting rights' refers the degree of control over a company, while 'cash flow rights' refers to shareholdings in the firm. If, for example, a family owns 60% of Firm A's equities, and Firm A owns 30% of Firm B's equities, then the family controls 30% of the voting rights of firm B but has only 18% (=60%*30%) of the cash flow rights.

Estimation of dependent and independent variables

This study examines the corporate governance of manufacturing firms listed in IDX for the fiscal years 2003 to 2007 using the ownership structure as the prime predictors. Corporate governance is measured using the percentage of the board of commissioners that is independent (Han and Wang 1998; Klein 1998, 2002). Ownership structure refers to the identities of a firm's equity holders and the size of their holdings (Denis and McConnel 2003). Thus, there are two key dimensions of ownership structure analyzed: ownership concentration (ownership type) and the identity of owners (ownership identity) (Boubakri *et al.* 2005).

Murali and Welch (1989) categorized ownership type into closely held and widely held firms and noted that "Effective control is assumed to exist when ownership by an individual or a small group is greater than fifty percent" (p.390). Holderness and Sheehan (Holderness and Sheehan 1988) classified ownership type as either majority held or diffusely held and argued that "A shareholder whose primary objective is expropriation might hold more than 50% of the stock" (p.326). Following Murali and Welch (1989) and Holderness and Sheehan (1988), this study dichotomously categorizes ownership concentration as either: majority ownership; or non-majority ownership. Majority Ownership is defined if one owner (person, family, family's company), the government (local or national), or a foreign multinational owning more than 50% of the shares in a company. A dummy variable is used to categorize firms, set equal to one if a firm has a majority ownership structure and zero otherwise.

Most prior studies of ownership structure emphasize immediate ownership; that is, common shares directly owned by individuals or institutions. Fan and Wong (2002) argued that immediate ownership is not sufficient for characterizing the ownership and control of Asian firms because these firms are generally associated with complicated indirect ownership structures. Therefore, this study focuses on the ultimate ownership of companies. The ultimate owner is defined as the shareholder who has the determining voting rights of the company and who is not controlled by anybody else (Fan and Wong 2002). The ultimate ownership structures were computed by following existing studies (Claessens et al. 2000; Faccio, Lang, and Young 2001; Claessens et al. 2002; Faccio and Lang 2002) that carefully traced the chain of ownership and identified the ultimate owner(s) that controlled the most voting rights (the controlling shareholder(s) by summing their direct and indirect ownership (voting rights) in a company[55]. In many cases, the immediate shareholders of a firm are themselves corporate entities, or investment companies and other legal entities (Yeh 2005). This study then identifies their owners, the owners of their owners, etc[56]. Following Fan and Wong (2002), to economize on the data collection, the ultimate owner's voting rights level is set at 50% and not traced any further once that majority level is reached. Claessens *et al.* (2000) who studied ownership structure and control in nine East Asian countries including Indonesia, documented that in most cases the ultimate owner was an individual or a family. This is an important motivator for this study considerable emphasis on family ownership.

This study then further classifies significant minority ownership where an individual, or group of family members, holds more than 20% of a firm's shares (voting rights) and is the largest controlling block in the company.[57] The use of the 20% cut-off point has also been adopted by prior researchers such as La Porta *et al. (1999)* who studied corporate ownership in 27 countries and Claessens *et al.* (2000) who investigated company ownership in nine East Asian countries including Indonesia. La Porta *et al.* (1999), for example, argued that the idea behind using a 20% cut-off is "this is usually enough to have effective control of a firm" (p.477). Moreover, according to the Indonesian Capital Market Law (Article (1) 1995) a person that directly or indirectly holds at least 20% of the voting rights of a company is called a 'substantial shareholder'. Similar to La Porta *et al.* (1999) and Claessens *et al. (2002)*, this study does not consider ownership by individual family members separately, but uses the family as the unit of analysis. Family ownership also covers the ownership interests of family members beyond their surnames (i.e. it includes blood and marriage ties) and families are assumed to own and vote collectively.[58] A company is then classified according to data extracted from the ICMD, IBDC, and INFORDEV publications, and firm's prospectuses. A dummy variable is used to

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[55] Direct ownership occurs through shares registered in the name of the ultimate owner. Indirect ownership occurs through shares held by entities that are controlled by the ultimate owner.

[56] In many cases, the ownership of these immediate companies can be collected from the prospectus of each company in the sample.

[57] There are several definitions of family firms, for example, see Villalonga and Amit (2004) . They include different combinations of family ownership, management, and control. This study is based on ownership.

[58] Indonesian Capital Market Law (Article 1, 1995) defines 'family affiliation' as a 'family relationship by marriage' and 'family relationship by descent' both to the second degree, horizontally as well as vertically.

identify the firms and is set equal to one if a firm is considered to be family owned (controlled) and zero otherwise.

Control variables

To control for compounding influences of cross-sectional factors, this study includes auditor type, size, leverage and firm performance as control variables in the regression analysis. The perceived quality of the auditor is also considered to be a possible determinant of the firm financial performance (e.g., Frankel, Johnson, and Nelson 2002; Gul, Chen, and Tsui 2003). Prior research usually distinguishes between non-Big 4 and Big 4 audit firms arguing the latter to be of a higher quality than the former (Heninger 2001; Mayhew and Wilkins 2003). This study includes *Big 4* as a control for perceived auditor quality. Indicator variable with firm *i* scored one if the firm's auditor is a Big 4 accounting firm; otherwise scored zero. Size is also to be expected has an impact on firms' governance structure (Black, Jang, Schmid, and Zimmerman 2003; Beiner, Drobetz, Schmid, and Zimmerman 2004; Brown and Caylor 2004). Thus, this study includes *Size* as another control variable in the regression model. *Size* is calculated as the natural logarithm of the total assets of firm *i*. *Leverage* is included as prior studies show that financing decisions might influence the firm's corporate governance (Black *et al.* 2003; Brown and Caylor 2004). We define *Leverage* as ratio of book value total liabilities of firm to book value total assets of firm *i*. Finally, following previous studies (e.g., Hermalin and Weisbach 1998; Klein 1998; Alijoyo, Bouma, Sutawinangun, and Kusadrianto 2004), we include return on investment (ROA) as a proxy for firm performance to predict corporate governance performance. Proxy measures for the dependent, independent and control variables are defined in Table 1 as follows.

Table 1. Variable definition and description

Variable Description	Variable Title
Dependent Variable	
Percentage of the board of commissioners of firm *i* that is independent.	*%IndCom*
Independent Variables	
Indicator variable with firm *i* scored one if one owner (person, family, family's company), the government (local or national), or a foreign multinational has a majority ownership (more than 50% of the shares in a company); otherwise scored zero.	*Owner Type*
Indicator variable with firm *i* scored one if an individual or group of family members holds more than 20% of a firm's shares (voting rights) and is the largest controlling block in the company; otherwise scored zero.	*Owner Identity*
Control Variables	
Indicator variable with firm *i* scored one if their auditor is a Big 4 accounting firm; otherwise scored zero.	*Auditor Type*
Natural logarithm of the total book reported assets of firm *i*	*Size*
Ratio of book value total liabilities of firm to book value total assets of firm *i*	*Leverage*
Ratio of net income to total assets of firm *i*.	*ROA*

Descriptive and Statistical Analysis

Table 2, Panels A and B, provides the descriptive statistics for the dependent, independent and control variables.

Table 2. Descriptive statistics (N = 459)

Panel A – Continuous variables					
	Mean	*Median*	*Std Dev*	*Minimum*	*Maximum*
%IndCom	37.09	33.33	11.11	0.00	80.00
Size	2,787,563	590,000	7,883,104	23,346	63,520,000
Leverage	62.94	53.95	56.53	5.29	519.14
ROA	3.88	1.30	12.46	-61.30	60.31

Table 2 continued

Panel B – Dummy regression variables

	Frequency	*Percentage*
Owner Type		
Majority	299	65.14
Non-majority	160	34.86
Owner Identity		
Family	305	66.45
Non-family	154	33.55
Auditor Type		
Big 4	266	57.95
Non-Big 4	193	42.04

Legend: *%IndCom*: Percentage of the board of commissioners of firm *i* that is independent. *Size*: Total assets of firm *i*. *Leverage*: Ratio of total liabilities to total assets of firm *i*. *Owner Type*: Indicator variable with firm *i* scored one if one owner (person, family, family's company), the government (local or national), or a foreign multinational has a majority ownership (more than 50% of the shares in a company); otherwise scored zero. *Owner Identity*: Indicator variable with firm *i* scored one if an individual or group of family members holds more than 20% of a firm's shares (voting rights) and is the largest controlling block in the company; otherwise scored zero. *Auditor Type*: Indicator variable with firm *i* scored one if a company's auditor is a Big 4 accounting firm; otherwise scored zero. *ROA*: Ratio of net income to total assets of firm *i*.

Panel A in Table 2 indicates that the percentage of independent commissioner has an average of 37.09% with a median of 33.33%. This is consistent with many other developing countries that the percentage of independent commissioners and independent members of the audit committee are under 50%. Size of the companies that are included in the sample has a wide range. Panel A shows that the size of the Indonesian companies has a mean of IDR2,787,563 million, ranging from IDR23,346 to IDR63,520,000 million. Average total liabilities to total assets ratio (*Leverage*) of the sample firms is 62.94%, demonstrating that Indonesian companies are heavily financed by third party funds rather than self financing. On the other hand, most of the sample firms earn relatively lower profits during 2003 to 2007 financial years. As presented in Panel A, the sample firms' net profit to total assets, on average, is 3.88% ranging from losses 61.30% to profit 60.31%. In relation to the ownership structure observed across the sample firms, Panel B of the table indicated that 65.14% of firms are controlled by the owners who have a majority ownership (more than 50% of a company's outstanding share). Panel B also shows that 66.45% of firms are owned by an individual or group of family members. This is consistent with Claessens *et al.* (2000) finding that Indonesian ownership concentration is higher than most other countries, with the major shareholders controlling 61.70% of all corporations. Finally, only 57.95% of firms hired a Big 4 audit firm as their auditor. This figure is similar to the case of Australian (57.54%) and lower than Singaporean context (86.38%) (Rusmin, Van der Zahn, Tower, and Brown 2006).

The main results[59] for testing hypotheses (H_1 and H_2) are reported in Table 3.

Table 3 regression model estimates[60] shows that the coefficient on *Owner Type* is positive and statistically moderately significant at p<0.075. This finding infers that ownership concentration has a positive impact on corporate governance. In other words, because of their significant economic stakes, the large shareholders have a strong incentive to oversee management activities by hiring commissioner members who are independent from management. Therefore, H_1 is not supported. However, this finding is consistent with Dechow at al. (1995) and Baubakri et al. (2005) who document that substantial outside block-holders is positively related to firm performance. Table 3 also shows that a negative and moderately significant association (at p<0.017) between *Owner Identity* and the corporate governance proxy. This result supports the acceptance of H_2 suggesting that the presence of high concentrated shareholdings by family members might have an inverse impact on corporate governance.

[59] A correlation matrix (not shown for brevity) reveals that *%IndCom* is positively (negatively) associated with the *Owner Type (Owner Identity)* both for Pearson and Spearman correlations. However, only *Owner Identity* is statistically significant (at p<0.01) associated with *%IndCom* both for Pearson and Spearman correlations. In addition, there is no significant correlation amongst the two independent variables. In respect to correlations between independent and control variables, and amongst control variables themselves, the highest correlation is between *Leverage* and *ROA*, with a coefficient of -0.50. This value is below the critical limit of 0.80.[59] Variance inflation factors calculated for all regressions reported in Table 3 for independent and control variables are providing further indications that multicollinearity is not a problem in the model estimations (Hair, Anderson, Tatham, and Black 1995; Greene 1999; Cooper and Schindler 2003).

[60] Further backward regression analysis (again not shown for brevity) finds confirmatory results illustrating that *Owner Type* and *Owner Identity* are significant predictors of firms' corporate governance (p-values 0.076 and 0.068 respectively).

Specifically, the concentrated family ownership prefers less proportion of commissioner members that are independent sitting on the board of commissioners. On the other hand, firms with a high family ownership concentration generally tends to appoint family members on commissioner boards to ensure that family interests are guaranteed (Ho and Wong 2001). Our result is in line with Siregar and Utama (2008) who find that a high proportion of family ownership is significantly associated with the practices of earnings management in the publicly traded Indonesian firms. This finding is also consistent with previous studies in several different countries. For example, Joh (2003) in South Korea, Yeh *et al.* (2001) in Taiwan, and Wiwattanakantang (2001) in Thailand document that concentrated family ownership corporate structures complicate the problems associated with asymmetrical information, imperfect monitoring, and opportunistic behavior and make corporate governance reform more complex. Additionally, in Hong Kong context, Jaggi and Leung (2007) reveal that the effectiveness of audit committees in reducing earnings management behaviors is weakened when corporate board is dominated by family members.

Table 3. Results of multivariate regression

	t-stat	Sig.
(Constant)	5.475	0.000
Owner Type	1.787	0.075
Owner Identity	-2.386	0.017
Auditor Type	1.158	0.248
Size	1.627	0.104
Leverage	2.145	0.033
ROA	2.812	0.005
Model Summary		
F-statistic	4.433	0.000
R-Square	0.056	
Adjusted R-Squared	0.043	
Sample Size	459	

Legend: *%IndCom*: Percentage of the board of commissioners of firm *i* that is independent. *Size*: Total assets of firm *i*. *Leverage*: Ratio of total liabilities to total assets of firm *i*. *Owner Type*: Indicator variable with firm *i* scored one if one owner (person, family, family's company), the government (local or national), or a foreign multinational has a majority ownership (more than 50% of the shares in a company); otherwise scored zero. *Owner Identity*: Indicator variable with firm *i* scored one if an individual or group of family members holds more than 20% of a firm's shares (voting rights) and is the largest controlling block in the company; otherwise scored zero. *Auditor Type*: Indicator variable with firm *i* scored one if a company's auditor is a Big 4 accounting firm; otherwise scored zero. *ROA*: Ratio of net income to total assets of firm *i*.

Further analysis using Independent Samples T-Tests reveals that the significant association between *Owner Identity* and *%IndCom* is driven[61] by the presence of high ownership concentration by family members in the firms. As shown in Table 4, the average percentage of independent board of commissioners in the family ownership firms (35.90%) is significantly lower (at p<0.003) than those of non-family ownership firms (39.45%).

Additionally, the fact that in East Asia, more than 50% of the businesses are family-controlled and many Asian family firms are owned and managed by Chinese (Tan and Fock 2001). In Indonesia, despite being an ethnic minority (3-4% of population) (Efferin and Hopper 2007), ethnic Chinese controlled 80% of number of largest firms (Carney and Gedajlovic 2002) and controlled 73% of market capitalization (Ball, Robin, and Wu 2003). The predominant prevalence of Chinese culture can in part be attributed to the Confucian culture, which purports a hierarchical system of social relations, and emphasizes on the value of family and filial piety (Zapalska and Edwards 2001), paternalism and collectivism (Tsai, Hung, Kuo, and Kuo 2006). In addition, Chinese culture advocates conformity rather than individuality (Begley and Tan 2001). Friends and acquaintances are trusted according to established mutual dependencies in *quanxi*- the practice of relationship that, inter alia, protect family resources (Efferin and Hopper 2007).[62]

Finally, Husnan (2001) argues that typically family firms in Indonesia maintain control through management. Most likely the Board of Commissioner (BOC) chairperson represents someone who very close to and trusted by the families. Thus, it is explainable that family-owned firms are only keeping

[61] Additional analysis, however, shows that that there is no significant difference between family and non-family-owned firms in placing independence board of commissioners of the companies (p=.123) with the *%IndCom* average 37.85 and 41.35 percentage respectively.

[62] See Efferin et al. (2007) who explored socio-cultural aspect of management control in a Chinese Indonesian manufacturing company.

outside members (independent BOC) as minimum as possible as required by the rules only (just follow the rules).

Apart from the independent variables, the coefficients on *Auditor Type, Size*, *Leverage* and *ROA* are all positive. However, only the last two variables (*Leverage* and *ROA)* are statistically and significantly related to *%IndCom* (both at $p<0.033$ and $p<0.005$ respectively). This finding is contrary to previous literature which assumed that Big 4 audit firms as a proxy for quality. Findings reported in numerous studies support that the Big 4 auditors provide higher quality audit than those Non-Big 4 (e.g., Becker, DeFond, Jiambalvo, and Subramanyam 1998; Francis, Maydew, and Sparks 1999; Gore, Pope, and Singh 2001; Krishnan 2003).

The insignificant relationship between *Size* and governance measurement is contradictive with previous research (e.g., Black et al. 2003; Beiner et al. 2004; Brown and Caylor 2004). The result on *Leverage* is consistent with previous works, for examples Brown and Caylor (2004) and Black *et al.* (2003), who report positive association between leverage and corporate governance measurements. Finally, the positive and significant association between firm performance measure and corporate governance is in line with several prior researches (e.g., Hermalin and Weisbach 1998; Alijoyo et al. 2004).

Conclusions

Asian companies have fundamentally different ownership structures than their Western counterparts. Indonesian companies are even more extreme with very large family ownership and little dispersion of shares (Claessens *et al.* 2000). This research project examines the effect of such ownership structures on corporate governance.

Two sophisticated measures for ownership structures are created. The first is ownership type. Great care was taken to determine the ultimate owner by carefully tracing the chain of ownership and identified the ultimate owner(s) that control the most voting rights by summing their direct and indirect ownership (voting rights) in a company. A dummy variable is used to categorize firms, set equal to one if a firm has a majority ownership structure and zero otherwise. Our findings show that 65.14% of firms are controlled by the owners who have a majority ownership. The second measure is that of ownership identity. A dummy variable is used to identify the firms and is set equal to one if a firm is considered to be family owned (controlled) and zero otherwise. Our data reveals that 66.45% of firms are owned by an individual or group of family members. This is higher than most other countries (Claessens *et al.* 2000*).*

Table 4. Descriptive statistics – *Owner Identity*

		%IndCom			
	N	Mean	SD	t-value	Sig
1 (Family)	305	35.90	12.60	3.013	0.003
0 (Non-family)	154	39.45	10.49		
	459				

In Indonesia, percentage of independent commissioners is only 37.09%. A majority of independent commissioner members remains a rare event in Indonesia. Multiple regression analysis reveals that both ownership type and identity are moderate significant predictors for commissioner independence. Ownership structures in Indonesia do influence the level of commissioner independence.

These findings are likely to be alarming for the Indonesian regulator (BAPEPAM). Very high ownership concentration levels further dominated by families are inherent to the Indonesian corporate landscape. Yet, these ownership patterns directly reduce the independence of commissioner members. Controls over the majority owners unfairly treating minority shareholders are thus weakened. This Indonesian pattern is a somewhat extreme but not uncommon scenario in Asian financial markets. Western solutions may not be applicable or effective. New rules and regulations may be needed to provide more protection of the smaller investors.

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