CEO-Family vs. CEO-Nonfamily: Who is a Better Value Creator in Family Business?

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Abstract

This study aimed to determine the effect of corporate governance on firm value of family companies listed in the Indonesia Stock Exchange (IDX). Family business Independent variables used in this study are CEO-family, audit committee, board size, independent commissioners, managerial ownership, and the control variables which used in this study are financial leverage, firm size, and return on assets.

The results of this study indicate that CEO-family has negative significant impact on firm value. The family firm which is managed by a nonfamily member can contribute higher firm value than a family firm which is managed by family members. The audit committee and board size have a significant positive impact on firm value in the family firm. These results also indicate that independent commissioners and managerial ownership have no significant effect on firm value in the family firm.

Keywords

Corporate Governance
Firm Value
Family
Family Firm
CEO-Family
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Introduction

Family enterprises are very dominant in the world, and plays an important role in a country, especially in improving the country's economic growth. The positive contribution of the Family company to the country's economic growth is the growth of GNP. Investors are facing a dynamic and changing international business environment; which forces them to adapt in preparing for inevitability of engaging with family-owned business (Global Business Guide Indonesia, 2016). Family businesses must adapt faster, innovate sooner and become more professional in the way they manage and run their business if they are to remain successful (PricewaterhouseCoopers, 2016). These are just some of the findings of the latest PwC survey of 2,802 family business executives in more than 50 countries worldwide, including Indonesia.

The majority of companies in Indonesia are family companies. Family Businesses in Indonesia have seen a much stronger growth than the global average over the last year; and are very bullish about future growth (PricewaterhouseCoopers, 2016). The Global Business Guide Indonesia Consulting (2016) reported that 95% of local businesses in Indonesia were family owned businesses.

Some of the well-known Indonesian founder-owners of family firms are Lim Sui Liong (owner of Salim group), Abidin (owner of Satnusa group), Achmad Bakrie (owner of Bakrie Group), and Alim Husain (owner of PT. Maspion). These companies are still owned by the founder. Those family owned companies are trying to sustain these businesses to pass to the next generation. In fact, some of Family companies have survivedthe economiccrisis’s in 1998 and 2008. It has proved that the existence of Family companies has a positive contribution to regain the national economy condition. One of the keys to sustain these companies is the practice of Good Corporate Governance.

Family business provides a positive contribution in economic improvement in most countries around the world, especially in Asia. Several empirical studies in Asia showed that family companies have a high company value in Hong Kong, Australia, Singapore, Taiwan, China and Indonesia. Family-run enterprises in

Indonesia have had a better performance than nonfamily companies. However, there is still little evidence in the research literature to examine the reasons behind this.

Some Family companies are run by family members and others are run by nonfamily members. The available literature indicates that family firms still fail to achieve the level of professionalism in control and decision making on behalf of the company vis-à-vis the founder’s personal interests. The Family company appears, in general, to be less skilled in achieving the transition from a traditional management to professional management (Sharma, Chrisman and Chua, 1997).

Previous studies have shown that there are differences in the corporate performance results generated by a CEO which who is one of the family members when compared to the performance generated by a nonfamily member. Some of the Family companies which are run by CEO-Family have been found to be superior than CEO-Nonfamily (Minichilli, Corbetta, and MacMillan, 2010). This is in contrast with the view of Perez-Gonzalez (2006) which states that the Family Company which is run by CEO-nonfamily is better in managing the company than the Family Company run by CEO-family.

The average ownership structure in Indonesia’s companies is mostly family owned. This would be detrimental to the minority shareholders because all power in decision-making and control is contained in the company's largest shareholder. If a company is controlled and managed by the Family, it will tend to work to maximize the wealth for itself as owner and manager. Companies managed by the nonfamily members tend to manage the company to pursue its own advantages which may be different interests of the owners. This will cause an agency conflict, which requires good corporate governance to ensure that the management of the company will significantly and positively affect the company's performance.

Family companies tend to have the intention to sustain the company in order to be passed on to the next generation. This has led the Family company to have a long-term investment horizon, which will bring superior return and lead the company's value to be increased (Miller and Le Breton, Miller, 2006). It has therefore been argued that the Family company has a competitive advantage in creating stability and a focus on profitability and long-term enterprise value. The high value of the company can maximize shareholder’s wealth. Company value is dependent on the company's corporate governance mechanisms that are applied to it (Gill and Obradovich, 2012). Corporate governance structure is necessary in maintaining the viability of both the family and the business from time to time.

Good corporate governance is a strong foundation in managing business and is an important factor that allows for the growth of the value of the family owned company. Corporate governance is a control mechanism for the overall business activity of a company; and includes the company's objectives, planning, and management structure that serve a wide range of stakeholders. Corporate governance provides assurance and confidence to investors that they can receive a good rate of return of their investment in the company.

Corporate governance performs various actions in solving various problems raised by various stakeholder parties. Resolution of the problems that arise due to the various stakeholders usually depends on a decision by the largest shareholder (the largest holdings and have the right to control and influence decision-making). In Indonesia, one of the largest shareholders is the family. Indonesia has the highest rank in term of the control of concentrations between nine countries in eastern Asia (Hong Kong, Indonesia, Japan, South Korea, Malaysia, Philippines, Singapore, Taiwan, and Thailand).

The Family company tends to pass the family ownership from one generation to the next. It is a key driver in improving good corporate governance to develop and deliver a healthy and efficient organization in the next generation. Mechanism of good corporate governance can be seen in the ownership structure, board structure, and the structure of the audit committee. Based on the above, the researcher was interested in investigating the influence of corporate governance mechanisms on firm value in family firms. The research is focused on a Family company that has a defined equity or shares (voting rights) of 20% (La Porta, Lopez-de-Silanes, and Shleifer, 1999, Robin and Amran, 2016). This research is focusing to know the effect of type of family firm (CEO-Family vs. CEO Nonfamily) as the core driver of firm value (Block, Jaskiewicz, and Miller, 2011; Le Breton-Miller, Miller, and Lester, 2011; Miller, Minichilli, and Corbetta, 2013). Family firms managed by the family member are superior in improving corporate performance rather than a Family company that is managed by nonfamily members (Anderson and Reeb, 2003).

Literature Review

Company Value

The company's value is a value that indicates the reflection of the equity and the book value of the company, whether it be the market value of equity, book value of total debt and the book value of total equity. The value of the company is an important measure of the wealth of shareholders (Gill and Obradovich, 2012). The value of the company's high level of prosperity will be followed by investors and owners.

Shareholder value will increase if the value of the company increased; as characterized by a high rate of return on investment to shareholders. Growth in the value of the company is very important in order to maximize shareholder value and to achieve overall corporate objectives. Therefore, it is important to explore all the possible factors that affect the value of the company.

Agency Theory

Agency theory is used to understand the basic principles of corporate governance. Jensen and Meckling (1976) define an agency relationship as a contract in which one or more owners (principal) hires a manager (agent) to perform some service on their behalf by delegating some decision-making authority to the manager. Jensen and Meckling (1976) stated that the management in running the company should give priority to the welfare of the owners of the company. An agency problem arises as a result of the gap between the interests of shareholders as the owners and management as the manager. The owners have an interest for the funds invested to get the maximum return, while a manager is interested in the acquisition of incentives for the management of the fund owners. Agency costs will arise to prevent agency conflicts.

Stewardship Theory

Stewardship theory is a theory that describes the condition in which the managers are not motivated by individual interests but rather aimed at the targeting primary outcome, namely the interests of the organization. The existence of a manager will be regarded as a good steward for acting as a trustee with responsibility for safeguarding assets and implementing various strategies (Donaldson and Davis, 1991). Stewardship theory is built on the philosophical assumptions about human nature that states that the essence of man is to be believed, able to act with full responsibility, integrity and honesty of the other party. One of the factors that can motivate managers can be seen from the non-financial side. Managers are motivated to achieve and obtain satisfaction through the implementation of strategies that will result in good performance in the face of a challenging environment. This will make managers assume the responsibilities and authorities, which in the end the manager will get recognition from the owner.

These assumptions in stewardship theory shows that the managers will seek to manage resources optimally and make the best decision for the organization. This is because the manager works based on the premise that the benefits are derived from both the managers and owners of companies. When the manager is able to manage the organization's full potential, primarily in efforts to create value for the company, then it means the manager has met the psychological aspects of this theory. Good management of the achieving full potential of this premise will create added value for companies which then can push the company's financial performance for the benefit of stakeholders.

Corporate Governance in Indonesia

Indonesia’s economy is facing tough challenges with a slowdown of GDP, and depreciation of the Rupiah. These events resulted in the Rupiah falling by almost 80% and dramatically increasing poverty. Indonesia’s Financial Services Authority in 2014 reported that, one of the causes of crisis is the weak of implementation of corporate governance. They also found that the recent global economy crisis is due to poor of corporate governance.

In the current market, those companies are operating under tougher competitive pressures. Most Indonesian companies regularly practice poor disclosure in term of corporate governance. Indonesian companies should restore trust to investor and raising Indonesia's standing as an attractive investment by the practice good corporate governance. This required the Indonesian business environment to increasingly take the initiative and work towards implementing good corporate governance; both from the government and private sectors. Efforts are being made in Indonesia in the form of the establishment of institutions of corporate governance, implementation of new laws and amendments to existing ones to support the implementation of corporate governance in this country. Indonesia has taken several steps to improve corporate governance standards and improve related legislation.

As Indonesia is part of the Asian Economic Community (AEC), Indonesian companies should improve its corporate governance practices and benchmark with international best practices to improve their competitiveness. These will increase investor confidence, reduce the cost of capital, and create sustainable company performance. In the year of 2014, the Indonesia Financial Services Authority is cooperating with the International Financial Corporation (IFC) to launch the Indonesian Good Corporate Governance Roadmap and Manual.

Theoretical Framework

Family Company

The Family company is a company with a family of control systems with requisite majority ownership structure in the hands of family ownership (Miller et al., 2006). According to the literature studied by Amran and Che Ahmad (2010), the Family company is the existence of family control of the company with ownership of at least 20% of the shareholders.

A company can be categorized as a Family company if the family has a right of ownership or control at least 20% of the voting rights. Limits to the use of 20% as a benchmark measurement of a Family company has been investigated in previous research (Robin and Amran, 2016) and there are also other alternatives such as the level of the limit of 10%, 30%, 40% has been used in research La Porta et al. (1999). Morck and Yeung (2003) states that the Family company has two criteria, namely (1) the largest shareholder in a company is a family party, (2) the proportion of ownership of the shares owned by the family must be greater than or equal to 20% of the voting rights.

Table 1: Research Framework

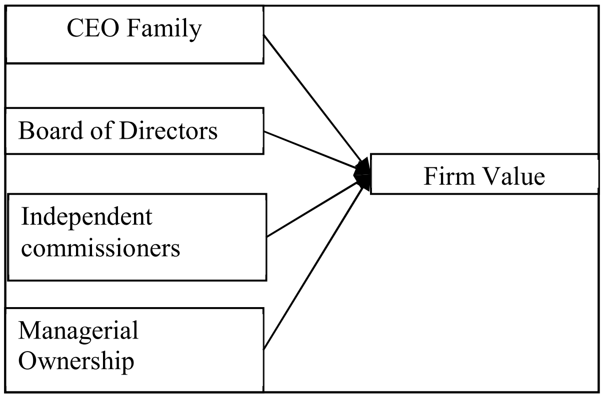

Table 2: Operational Definition and Measurement of Variables

Variable	Measurement
CEO-Family	(1) The founder is the CEO or a successor who has blood ties or marriage, or (2) At least two family members in management
Board of Director Size	The total number of members in the company's director
Independent Commissioners	The ratio of the total number of independent board members to total commissioners
Managerial Ownership	The proportion of the percentage of ownership of the management of the total ownership
Firm Value	Market Equity Value + Value Payable on Bookkeeping) / Total Assets on Bookkeeping

The formulation of the problem, research objectives, and the theoretical basis that has been stated above, the relationship between variables in this study can be expressed in a research model. This study has separated the analysis between board of directors and board of commissioners because Indonesia uses a two - tiers system board. The Model used in this study can be seen as follows:

There are several studies that argue that a nonfamily professional will manage a Family company better than the manager of the family (Burkart, Panunzi and Shleifer, 2002; Barth, Gulbrandsen and Schone, 2005; Chitoor and Das, 2007; Anderson, Duru, and Reeb, 2009). This is because the nonfamily managers are professionals and perceived to be more productive than family member managers. Therefore, it is hypothesized that:

H_1 = family CEO has a significant negative effect on the value of the company in the Family company

The Size of the Board of Directors

For a company controlled by the CEO of the family, there are arguments that the size of the board can improve the performance of the company. Some researchers have explained that the large size of the board can provide some useful information and advice to management to monitor the operation of the company well. Directors can further help the company to understand the corporate environment. The family business requires a large size of the board to manage the company and achieve good performance.

The structure of the board may also limit the level of earnings management practices through a control function in the operational management; thereby improving the quality of earnings and the company's performance and will be followed by an increase in stock price and value of the company (Rashid, 2011). Therefore, it can be hypothesized that the size of the board can be correlated to a higher value of the company.

H_{2a} = Size of the board of directors has a positive significant effect on firm value in the Family company managed by a CEO family.

For a company controlled by the CEO of the nonfamily, a large size of the board can help to monitor the company's operations and reduce conflicts of shareholders (Robin and Amran, 2016). A large board size can help companies to improve their bargaining position and can also monitor management. A large board size can provide different views and opinions based on the background of the directors themselves. The Directors can contribute and give different suggestions for improving the company's operations. Furthermore, it will be easy for large board size in a company to set up a committee to delegate tasks. Therefore, it is hypothesized that:

H_{2b} = Size of the board of directors has a positive significant effect on firm value in family firms managed by a nonfamily CEO.

Independent Commissioners

Generally, there have 2 types of board; there are one-tier board system and two tier board system.

This one-tier board invests both managerial and supervisory responsibilities in one unified board of directors. In two-tier structure, the executive directors in the management board decide about the company's objectives and implement the necessary measures. Meanwhile, the non-executive directors in the supervisory board monitor these decisions on behalf of other parties.

Indonesia uses a two-tier system board, with Commissioners and Director (BAPEPAM, 2004). Indonesia board structure is different from other Asia countries such as Malaysia which adopt one-tier board. In family firms, board commissioners can provide different view strategy, create new dimension of experience. Board commissioners also compromised their familiarity with the family members.

Indonesian company law made it mandatory for using two-tier board system in every Indonesian company. BAPEPAM (2004) reported that each Public listed company in Indonesia must have a minimum 3 members of board of director and a minimum 33.33% of independent commissioners in each company. The two-tier board system makes a clear separation between the Board of Directors charged with the management of the company and on the other hand, the Board of Commissioners charged with the supervision of the way the Board of Directors to manage the company in the interest of the company. In this way, two-tier Board enhances the checks and balances required for good corporate governance.

The ratio of the total number of independent board members to total commissioners is a useful measure to monitor. Activity monitoring of managers will be more effective if the number of independent commissioners are large; as they will avoid moral hazards of executive directors who are biased in terms of the company's interests through ownership accrual estimates which have an impact on earnings management so as to maximize the value of the company. This shows that with a growing number of independent commissioners, it will reduce earnings management that will enhance the value of the company. Therefore, an independent board will have a positive effect on firm value (Fama and Jensen, 1983).

In a Family company that is managed by the CEO of the family, the board can give unbiased views and bring new ideas based on their knowledge. Commissioners can provide the company with strategic direction and help the council to make decisions in achieving good performance. From the perspective of agency theory, the independence of the board is an important attribute that affects the performance of the company (Robin and Amran, 2016). Therefore, this study hypothesizes that:

H_{3a} = Independent Commissioners have a positive and significant effect on firm value in the Family company run by CEO family.

Robin and Amran (2016) states that the independent board that is more able to improve the performance of the company because the board members come from different backgrounds, and have diverse attributes, characteristics and skills that can contribute to the decision-making process. This leads to improved performance of the company. Larger members in board, will lead more powerful of corporate governance. Therefore, this study hypothesized that:

H_{3b} = Independent Commissioners have a positive significant effect on firm value in the Family company run by a nonfamily CEO.

Managerial Ownership

It can be argued that managerial ownership ensures that the management will try to improve its performance to gain maximum profit and also be careful in taking decisions, because the manager will share profits and bear the risk of any results of decisions made that affect performance. This will result in an increase in the performance of the company. If the performance of the company is increased, then the stock price will increase, resulting in a high value of the company (Jensen and Meckling, 1976).

Therefore, managerial ownership will affect positively on the value of the company. Based on stewardship theory, when managerial ownership is low, the director felt less responsible and do not have a sense of belonging on the company. However, when ownership increases, the directors take more effort to control and monitor the company because they feel the company is part of them (Robin and Amran, 2016). Larger managerial ownership in the company will motivate directors to maximize their responsibility and control of the company effectively. Thus, this study hypothesized that:

H_{4a} = Managerial ownership has a positive significant effect on firm value in the Family company is managed by a CEO family.

In contrast, it can also be argued that companies controlled by a nonfamily CEO have a negative correlation with the performance of the company. There are studies that show that at a high level of nonfamily managerial ownership, the company's performance will decline (Amran and Che-Ahmad, 2011). When the nonfamily directors have small holdings, they will manage and control the company effectively, thus improving the company's performance.

However, when nonfamily ownership increases, the manager began to manipulate the power and control they have. The nonfamily directors have the power and interest in the company when they have a larger number of shares. Therefore, they would prefer to seek personal interests rather than the interests of the company. Thus, the company's performance will decline. Based on the above discussion, this study hypothesized that:

H_{4B} = Managerial ownership has a significant negative effect on the value of the Family company run by a nonfamily CEO.

Results and Discussions

The sample of this study is based on 119 of family firm which listed in IDX. The period of 2010 to 2014 was selected because this study wants to examine the implementation effect of the revised Indonesian Code of Corporate Governance (2006) on family-controlled company. It starts with identify the family businesses listed in Indonesia Stock Exchange. Further, in this study omitted the financial sector because these are highly regulated and have different regulations compare to other nonfinancial companies.

The results as shown in Tables 3 indicate that the average firm value of family firm is higher than book value (147%). In Average, the family firm has 4 members of board and 40% of independent commissioner. It proved that majority of the family firm in IDX have followed the BAPEPAM guideline which stated that minimum board member should be 3 persons; and 33.33% of independent commissioners. The average family companies have 0.04% of managerial ownership. Some of them companies did not have managerial ownership which proved by the minimum is 0%. This proves that the interest of management to be shareholder is still low.

The results, as shown in Tables 4, indicate that the family firm which managed by CEO-family (52%) is more than CEO-Nonfamily (48%). This proves that the family companies are willing to pass the companies to their own families rather than non-families. It proved that most owners of family companies tend to pass their business to their next generation instead of outsider (professional).

The results of this study as shown in Tables 5 indicate that a Family company which is managed by a nonfamily CEO is better in creating enterprise value than it managed by CEO families. It proved that a family company can have a better value if managed by outsider (CEO- Nonfamily). Nonfamily managers are professionals and perceived to be more productive than family member managers. This result is consistent with this research hypothesis (Burkart, Panunzi and Shleifer, 2002; Barth, Gulbrandsen and Schone, 2005; Chitoor and Das, 2007; Anderson, Duru, and Reeb, 2009).

The larger size of the board has a positive significant effect on firm value on the Family company managed by CEO-Nonfamily. The larger number of board members in the company can provide more opinions in the decision-making process. The larger size of the board can create more opportunities and resources for better financial performance. This result is consistent with this research hypothesis (Rashid, 2011, Robin and Amran, 2016). However, it had no significant effect on the Family company managed by CEO-family.

The family company which managed by CEO-family usually made decision which only concern for their family's interest and the CEO-family can make decision without discuss with the other boards member. In this situation, the size of board will not impact to firm value. This result is not consistent with this research hypothesis.

The independent commissioners and managerial ownership did not significantly affect the value of the company. Independent commissioners are not directly related to the value of the company. Most of the companies in Indonesia which listed in IDX did not practice good corporate governance as well.

Sometimes their board members and independent commissioners which stated in their firm organization chart are just to fulfill the legal requirement only. In fact, they did not fully do their duty. Especially in family firms, the most powerful to make decision is the owner/founder which also as a CEO. So, the board members, the independent commissioner, and the manager cannot maximize their duty, they just can follow what their CEO-Family leads them to.

In this situation, it supposed there is no impact of the existence of the board members, independent commissioner, and manager to influence the firm value. This result is not consistent with this research hypothesis.

Table 3: Descriptive Analysis

Variable	N	Minimum	Maximum	Average	Std. Dev
Firm Value	593	0.2480	14.8837	1.4760	1.5696
Board Size	593	2.0000	10.0000	4.2732	1.8055
Commissioner	593	0.1429	0.8000	0.4025	0.1020
Managerial Ownership	593	0.0000	0.7000	0.0437	0.1146
Valid N (List-wise)	593				

Table 4: Frequencies Analysis

	Frequency	%	% valid	% cum.
CEO family	308	51,90	51,90	51,90
CEO nonfamily	285	48,10	48,10	100,00
Total	593	100,00	100,00	

Table 5: Hypothesis Analysis

Variable	sign	All Sample			CEO Family			CEO Non-Family		
		b	t	Sig	b	t	Sig	b	t	Sig
Constant		2.67	2.41	0	-2.7	-3.84	0	5.18	20.5	0.01
CEO Family	-	-0.79	-7.31	0						
Board Size	+	0.09	2.49	0	0	-1.33	0.19	0.18	20.47	0.01
Independent Commissioners	+	0.51	0.95	0.3	0.32	1.25	0.21	0.56	0.44	0.66
Managerial Ownership	+	-0.49	-1.02	0.3	-0.1	-0.38	0.7	-1.84	-1.64	0.1

Conclusion

This study was conducted to analyze the effect of corporate governance mechanisms on firm value in family firms. The purpose of this study is to determine whether there are differences in the value of the company which managed by a CEO-family and CEO-nonfamily. Based on the analysis and discussion that has been done, it can be concluded that there are many difference between the value of the company which managed by CEO-Family and CEO nonfamily.

The company's value in the Family company managed by a nonfamily CEO (professional) will be higher than a Family company managed by CEO-family. The board size significantly positive effect on firm value in family firms but not significant but have a positive relationship in a sample the Family company run by CEO of the family and the Family company run by a professional CEO. The size of the board a positive significant effect on firm value of the Family company run by CEO professional, but had no significant effect on the Family company is managed by CEO-family. An independent commissioner and managerial ownership had no significant relationship to the value of the company in the Family company run by either CEO-family or CEO-nonfamily.

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