The Impact of Ownership Structure on Family Firm Performance: Evidence from The Indonesia Stock Exchange

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***Abstract*—**This paper examines the impact of ownership structure on performance of family firms in Indonesia. According to the list of family firms arranged by Indonesia Institute of Family Firm Universitas Islam Indonesia, The researcher found ownership structure of the family firms consists of foreign, institutional, managerial, and family ownership. Family firms are a unique group of organizations, involvement of family in management and ownership structure differs from non-family firms. This empirical study analyzes data on the family firms listed on Indonesia Stock Exchange from 2010 to 2014. Unlike previous studies which treated foreign, institutional, and managerial ownership separately, this study combines and tests these ownership types to find out the impact of ownership structure on family firm performance. Using multiple regression for hypotheses testing, the results of hypotheses testing show performance of the family firms is positively affected by foreign and institutional ownership. On the other side, managerial ownership has no influence on performance of the family firms.

***Keywords*—**Family Firm, Ownership Structure, Firm Performance, ROA.

I. Introduction

SEVERAL previous studies that examine the effect of ownership on corporate performance have been done. Ownership structure is one of the most debated issues in the literature focused on the effect of different types of shareholders on firm performance. The researcher observes the ownership structure of family firms listed in Indonesia Stock Exchange (IDX) which issued by Indonesia Institute of Family Firm Universitas Islam Indonesia (IIFF-UII). The observation found the family firms have various ownership of shareholders. There are some of the family firms accept ownership intervention from foreign party with large and small proportion of ownership. Even exist some of the family firms refuse foreign party to have ownership in their ownership structure. There are several reasons why founding family receives foreign ownership. First, human resource brought by foreign investor is more capable than domestic investor in utilizing technology for corporate management [11]. Second, Foreign investor has better assets, capital, and access to international market than domestic investor [31]. In addition to foreign ownership, institutional ownership founded in ownership structure of the family firms. There is a main reason why founding family receives institutional ownership. Agency conflict encourages family firms to involve institutional investor in ownership and management. Every go public company has agency problem in ownership structure. [5] explains monitoring process from institutional investor would be more effective to overcome the agency problem. In addition to institutional ownership, managerial ownership can reduce agency problem. [20] conclude managerial ownership will align the interest of management and shareholder, because manager as one of the shareholders will receive advantage directly from the correct decision and consequence of wrong decisions. Another ownership type can be founded in family firms is family ownership. This ownership becomes a uniqueness that distinguishes with non-family firms, as it only can be founded in family firms [25]. Based on the explanation, the ownership structure consists of foreign ownership, institutional ownership, and managerial ownership. Therefore, This study investigates the effect of various ownership in family firms on financial performance measured by return on asset (ROA).

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II. Literature Review

A. Foreign Ownership

Foreign investors buy some shares of local companies for long-term and short-term investment. Foreign investors are normally sophisticated institutional investors who have superior analytical skills and investment experience. Thus, foreign investors are able to analyze market condition, make optimal investment and perform better on average than local investors [16].

B. Institutional Ownership

Institutional ownership is number of shares from firms owned by bank, insurance company, pension fund and others. [8]. According to [34] supported by [5], explains institutional ownership enable manager to be monitored and influenced better than the other investors.

C. Managerial Ownership

Managerial ownership is number of shares owned by manager or board of directors compared to outstanding shares [29]. Agency theory by [20] predicts that higher levels of managerial ownership should result, holding other things constant, in increased firm performance as higher ownership levels help to mitigate the inherent conflict of interest between managers and owners. [20] shows that agency problem can be minimized by providing incentives to control the managerial ownership (insider ownership) and as a bonding to the management. The bonding mechanism is created by increasing

the dividend payout and the number of debt. This action could reduce the opportunity of the management to differ which will increase the business value. However, this method will generate cost that will reduce the business value which usually called agency cost.

D. Family Ownership

Family business is defined by [12] as an organization is called family company if there are at least (must have) two generations in the family are involved and have decision power in influencing company's policy. [12] which is supported by [6] describe that the founder or even the founder's family still has the control in running the business, where the founder's family ownership has to have the largest percentage of shares compared to other shareholders. [33] confirm that family business ownership and leadership succession are those which have been going for at least from first to second generation. The family business founder is hoping that the following generations such as their children, grandchildren can maintain

E. Firm Performance

To measure firm performance, this study uses return on asset (ROA) as a measurement or proxy of firm performance. ROA is often used by previous studies [19], [8], [31], [28]. ROA shows ability's manager in generating earning after tax from total assets.

III. Previous Research And Hypothesis

Due to the impact of ownership structure on firm performance, the previous studies give contradictive results (e.g., positive impact, negative impact, and no impact). Several previous studies conducted by [32], [18], [7], [23], [24], found positive impact on firm performance. [32] conducted a research that analyze 750 companies in Canada and found foreign ownership has positive impact on profitability. Result of the study also explains companies owned and controlled by individual or institution from United States (US) are more profitable than individual or institution from Canada. [18] explains companies in Canada with foreign ownership perform better than local ownership. [7] explains if foreign ownership compared to local ownership, foreign ownership has better supervision process and reduce agency cost. By lower agency costs and effort effective supervision, foreign ownership is able to create the company's performance better than local ownership. [23] perform micro – panel data to examine difference between company's performance of local ownership with foreign ownership. The finding explains foreign ownership performs better than local ownership. Foreign parties bring benefit to local companies such as capital, skill, and human resource. [24] test the impact of foreign ownership on financial performance by using 102 Pharmacy companies in India. The finding explains foreign ownership has positive impact.

There are contradictive finding that founded by [22], [27]. Kim and Lyn (1990) explains there is no impact of foreign ownership on return on equity (ROE) significantly but the result shows local ownership give higher ROE than foreign ownership. [27] conducted panel data analysis in England from 1994 to 1998. The result explains negative impact on profitability. The other results [2]-[4] found foreign ownership has no impact either positive or negative on firm performance. [2] conducted a research in two countries, Portugal and Greece. The finding found foreign ownership has no impact significantly on firm performance. [3] conducted data envelopment analysis (DEA) on Istanbul Stock Exchange during 2003-2007 and found there is no impact of foreign ownership on productivity. [4] examine the impact of foreign ownership on ROA and ROE with regression model. The result explains foreign ownership has no impact on ROA and ROE. Based on the above explanation, the following hypothesis is formulated:

Hypothesis 1: foreign ownership has effect on ROA family firms

According to the previous studies, the effect of institutional ownership on firm performance is unclear. [8] found institutional ownership has positive impact on ROA and Tobin's q. This result supports other researches conducted by [26], [30], [36], [10]. Some previous studies such as [1], [21], [13], [14], explains institutional ownership has no effect on firm performance. Based on the explanation, the following hypothesis is formulated:

Hypothesis 2: institutional ownership has effect on ROA family firms

With an increasing amount of company shares held by the manager, his behavior becomes more aligned to the owners interest (incentive effect). But at the same time ownership shares also result in higher job security for the manager and, hence, make him powerful enough to pursue own goals and disregard owners' interests (entrenchment effect). Increasing managerial ownership will reduce agency conflict and encourage manager to reach maximal performance in managing company. The findings related with the effect of institutional ownership on firm performance are contradictive. [35] conducted an empirical analysis using 182 firms in Slovenia from 1995 to 1999. The result explains managerial ownership has positive impact on firm performance. Another same result founded by [29]. By using small medium enterprises in Germany, the result found managerial ownership has no impact on firm performance. The different findings which explain managerial ownership has negative impact on firm performance founded by [15] in [35], [9]. Based on the explanation, the following hypothesis is formulated:

Hypothesis 3: managerial ownership has effect on ROA family firms

IV. Research Methodology

A. Population and Sample

To achieve the objectives of this research, the study has adopted the use of Indonesia Capital Market Directory (ICMD) and corporate annual reports of listed firms on The IDX as our main source of data. According to the IIFF-UII database, the population for this study is comprised of all listed firms on IDX at 31 December 2014 as much as 271 family firms. A purposive sampling method implemented on this research to determine samples which will be used to

represent the population. The data used for 5 years annually from 2010 to 2014. The data are readily available and easily accessible.

B. Analysis Method

Several analysis used in this research is descriptive statistics, classic assumption test, and hypothesis testing. Descriptive statistic is used to describe data by seeing the mean, maximum, minimum, and standard deviation. Descriptive statistic is implemented to ease in understanding the research variables. The classic assumption need to be done as the term used in regression analysis. The hypothesis testing uses F test to test the simultaneous effect of independent variables toward the dependent variable and the T test to test the individual effect of independent variables toward dependent variable. In this research, there are more than one independent variable, therefore the regression analysis used is multiple regression. In addition, while the study has adopted return on assets (dependent variable) as a measure of firm performance since ROA is an accounting ratio often used to as a measure for the effective performance of management. According to the previous studies [17], [8], [35], the independent variables would be identified by foreign ownership (FOWN), institutional ownership (IOWN) and managerial ownership (MOWN) respectively. Firm size (SIZE) has become such a routine to use as a control variable in empirical corporate finance studies that it receives little to no discussion in most research papers even though not uncommonly it is among the most significant variables. Similarly, in order to assess the impact of ownership structure on family firm performance; we use the following multiple regression model:

$$ROA = \alpha_1 + \beta_1 FOWN + \beta_2 IOWN + \beta_3 MOWN + \beta_4 SIZE + u_1$$

Explanation:

$\alpha 1$: Constant

$\beta 1 \ldots \beta 6$: Coefficient

u1: Error

ROA : Earning after tax / Total assets

FOWN : Total shares owned by foreign ownership / total outstanding shares

IOWN : Total shares owned by institutional ownership / total outstanding shares

MOWN : Total shares owned by managerial ownership / total outstanding shares

SIZE : log (total assets of book value)

V. Analysis And Discussion

The table 1 displays a number of samples from the population of family firms listed on IDX. According to the purposive sampling method, only 153 family firms fulfill the requirements to be observed. Table 1 represents 32 sectors have family firms and 3 sectors have no family firms.

TABLE I
Distribution of the Samples according to IIFF-UII

No	Sector	Total Family Firms	Total Samples
1	Agriculture, Foresty and Fishing	13	10
2	Animal Feed and Husbandry	1	1
3	Mining	17	6
4	Construction	3	3
5	Food	13	10
6	Tobacco	2	2
7	Textile	7	4
8	Apparel	4	1
9	Lumber & Wood Product	3	3
10	Paper and Allied Product	5	2
11	Chemical & Allied Product	7	4
12	Adhesive Product	3	3
13	Plasctic And Glass Product	7	4
14	Cement	0	0
15	Metal & Allied Products	5	2
16	Fabricated Metal Products	2	2
17	Stone, Clay, Glass and Concrete	3	3
18	Cables	2	2
19	Electronic and Office Equipment	0	0
20	Automotive and Allied Products	6	3
21	Photographic Equipment	0	0
22	Machinery	1	1
23	Pharmaceuticals	4	1
24	Consumer Goods	2	2
25	Transportation Services	11	8
26	Telecomunication	4	1
27	Wholesale & Retail Trade	12	9
28	Banking	25	11
29	Credit Agencies	8	5
30	Securities	10	7
31	Insurance	6	3
32	Real Estate and Property	37	12
33	Hotel and Travel Services	12	9
34	Holding and Other Investment	8	6
35	Others	28	13
	Total	**271**	**153**

Source: ICMD 2014 analyzed by IIFF-UII

The result of Hypothesis testing can be obtained from the table 2 which displays the outcomes of the analysis. As the table represents, the control variables used in this study have certain significant impacts on ROA. The results of the model show that the profitability is positively and significantly affected by firm size ($p = 0.0187$ or < 0.05), which is consistent with previous empirical studies. It means that larger family firms perform better than smaller family firms in generating the profitability. First independent variable, FOWN, has positive and significant effect on ROA ($p = 0.0220$ or < 0.05). This result supports [7], [18], [23], [24] that family firms open to foreign investors to join in their ownership structure and management. Next independent variable, IOWN affects positively and significantly on ROA (p

= 0.0109 or p < 0.05 respectively). This finding conclude institutional investors have good monitoring and controlling process on family firms. This finding supports the previous studies [26], [30], [36], [10]. Another finding displayed in the table 2 is positive but no significant impact of the variable MOWN on ROA (p = 0.0719 or > 0.05). The result is consistent with the result of [29] , [35]. F test is used to see whether there is an impact of FOWN, IOWN, MOWN, and SIZE simultaneously to ROA. The probability value of F test is 0.000. This indicates that there is a significant impact of FOWN, IOWN, MOWN, and SIZE on ROA.

TABLE II
THE RESULTS OF HYPOTHESIS TESTING

Independent Variable	ROA (p)
FOWN	0.0220
IOWN	0.0109
MOWN	0.0719
SIZE	0.0187
F-Test	0.0000

α = 5%

Source: Processed Data

VI. CONCLUSION

There has long been a debate about the impact of ownership structure on firm performance. A way to examine this debate is to analyze financial performance of the firms with respect to their ownership structures and evaluate the impact on financial performance which measured by ROA. By using three ownership that consists of foreign, institutional, and managerial ownership as independent variables, the results of hypothesis testing provide several findings which support and argue the previous studies. Based on the empirical results, foreign ownership affects positively the family firms' performance. Another independent variable i.e. institutional ownership gives same result that explains this ownership type has positive impact on the family firms' performance. Another different result given by managerial ownership. The result states managerial ownership has no impact on the family firms' performance. These findings describe some family firms listed on IDX are open to accept involvement of foreign and institional investors in ownership and management. Family as the owner believes that foreign and institutional investors give more benefit than local or individual investors.

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