CHAPTER I

INTRODUCTION

1.1 Background

Family firm is identical with the transition between one generation to the next generation. This condition may show whether the family firm reaches success or not to continue their family business. Thus, by learning the successful of family business, the dynamic of the transition between generation and the aspect that have important role in that transition can be seen. The transition in family business is also an important thing to guarantee the sustainbility means not only as business existence but also as business performance.

Family firms are companies in which one or more families linked by kinship, close affinity, or solid alliances hold a sufficiently large share of risk capital to enable them to make decisions regarding strategic management (Gulzar and Wang, 2010). Different from other types of company, family firm has unique characteristic. It is owned and even ruled by the family, in which each family has its own unique ethics, values, histories, unwritten rules and communication methods. As the family structure shrinks or expands, the company changes, particularly with the start of the second and third generations. Changes instigated by new generations can improve or harm the business. Families can also have a number of negative traits such as anger, tension, confusion, competitiveness, and strangled communication, which can affect a company to the detriment of all. These qualities are reflected into business ownership methods and styles, and can support or harm a company, To maintain the existence of a firm in global competition, it does not always about how to increase the profit and to expand the corporate subsidiaries. The businessman must think about how to maintain the good relationship with related parties, such as corporate's elements (shareholders, management and staffs), government and environment by showing reliable and transparent disclosure of corporate's activities and reporting. It is also useful to realize the concept of Good Corporate Governance (Rafiee and Sarabdeen, 2012)

According to Asian Corporate Governance Association (2013) some aspect of corporate governance must be concerned are as per table 1.1. below

Table 1.1

Asian Corporate Governance Market Category Score (%)

Country	Total	CG Rules and Pratices	Enforcement	Political and Regulatory	IGAAP	CG Culture
Hong Kong	65	61	71	69	72	51
Singapore	64	63	56	64	85	54
Japan	60	48	62	61	72	55
Thailand	58	62	51	48	80	50
Malaysia	58	55	47	59	85	43
Taiwan	56	48	47	63	75	47
India	54	57	46	58	57	51
Korea	49	46	46	45	72	34
China	45	42	40	44	67	34
Philipines	40	40	18	42	65	33

Indonesia	39	34	24	44	62	32

Source: Asian Corporate Governance Association

From the table above, it could be seen that Indonesia is placed in the last rank of market category score. As general, it is caused by the weak of regulation implementation and there is no improvement whether the regulatory system is fair and consistent or not (ACGA, 2013).

Corporate governance deals with complex subjects that are affected by a variety of factors including: managers relation; stakeholders relation; board structures; management compensation and capital structures. To address these conflicts, firms often rely on large shareholders, who combine substantial ownership and control rights to affect decisions. Around the world, the most common large shareholders are families (La Porta, Lopez-de-Silanes, and Shleifer, 1999; Villalonga and Amit, 2006). The prevalence of family firms has sparked a growing body of research that focuses on the governance of these firms.

The shareholders have a crucial role to play in influencing (controlling) a firm’s corporate governance practices (Mayer 1997). However, when ownership is dispersed shareholder control tends to be weak because shareholders individually bear a high cost in monitoring a company’s activities and receive only a small benefit (La Porta et al.,1999). Therefore, if all small shareholders behave in the same way, the incumbent management will retain most of the power in the principal-agent relationship, unless other stakeholders monitor (or alternative mechanisms exist for monitoring) the company’s management.

By way of contrast, once a company has a concentrated ownership structure, massive shareholders have both the motivation and resources to monitor management decisions so reducing agency costs (Shleifer and Vishny 1986). However, where there are large shareholdings (concentrated ownership) there is a risk that these large shareholders will represent their own interests and they could divert wealth from other smaller investors by, for example, paying themselves special dividends, or forcing the firm to make sweetheart deals with other companies they own in order to transfer wealth to themselves (Shleifer and Vishny 1997). Agency problems within this type of company may exist between the controlling owners (inside ownership) and other stakeholders (i.e. creditors and minority shareholders). Furthermore, the influence exerted by minority shareholders tends to be weak due to their limited power and access to information (Shleifer and Vishny, 1997). Thus, ownership structure can influence the nature of the agency problem and, therefore, understanding the potential impact of ownership structure might help identify those groups within a company that are likely to dominant in determining corporate governance policies. Therefore, ownership structure is an important component of corporate governance as it determines the nature of agency problem; that is, whether the dominant conflict within a company is likely to be between managers and shareholder, or between controlling and minority shareholders.

Family involvement in ownership, control and management is the main protagonist influencing the corporate governance of family closely-held companies. In line with to Berle and Means, ownership concentration can align the interests between ownership and management, and mitigate the number of agency costs.

Good corporate governance and family involvement are two factors that related to the firm performance, usually the better good corporate governance and family involvement of the company the better performance will be. Firm performance is also reflected in the company’s share price, the higher the share price, the better the performance of the company. However, a company has a good value only if the company has a good performance as well. One way that can be used by companies to increase the value of the company is to apply the principles of corporate governance mechanism into the company.

1.2 Problem Identification

Most of the big companies in the world came from a family firm (Anderson and Reeb, 2003). Family firms have more complex problems than non-family firms. In terms of corporate governance, family firms, like other corporations with ownership concentration, typically have a dominant shareholder. For example, family firms may face several conflicts that related to board structures, stakeholders relations, managers relations and substantial ownership to affect decision.

Therefore, this study examines the type of corporate governance indicators, such as board size, size of audit committee and family involvement that are expected to affect the firm value. Hence this study comes up with two problems identification, as follow:

a) Does family-controlled add value to the firm?

b) How does the ownership interact with other corporate governance mechanisms to affect firm value?

1.3 The Objective

The objective of this research is to investigate the relationship between the firm performance with the implementation of good corporate governance and family involvement in family firm. In detail the research objectives are as following:

a. To observe the effect of ownership and corporate governance on firm value in family firm in Indonesia Stock Exchange.

b. To investigate the impact of family ownership, control, and management on firm value under different corporate governance conditions.

1.4 Significance of Study

Benefit of this research are:

a. For family firm listed in Indonesia Stock Exchange: to give contribution for company and education to understand how important Good Corporate Governance concept on firm performance is and knowing what factors that can influence its firm performance so that they will know how to organize and manage their (family) existence for company going concern.
b. For Indonesian Financial Services Authority (Otoritas Jasa Keuangan): to give a highlight about the influence of good corporate governance implementation and family involvement towards firm performance in capital sector market. So that, OJK can be easier to do supervision and to set regulations foe creating growing and stable national economic especially for the family.

1.5 The Scope

This study focuses on the Kompas 100 companies listed in Indonesia Stock Exchange. This study analyses data for period 2012 – 2014. In line with Miller et al. (2007), this study define a family business as one in which multiple members of the same family – those who are related by blood or marriage – are involved as owners, managers or members of the board, either contemporaneously or over time. Similarly, this study differentiate between Lone-founder firms, in which there are no other family relatives in the business beyond the founder, and family businesses, in which there are multiple owners, managers or directors, commissioners from the same family. This study used family involvement in the ownership, control, management or governance of the firm as well as the firm's ownership concentration to build a classification of family businesses and to explore the relationship between performance and every type of family firm identified. Therefore, considerable time and effort was spent in collecting (and cleaning up) the data examined in this study using the following process:

a. Data on a firm's control variable was derived from annual reports which were obtained from two sources: the IDX library and Bloomberg.

b. Data on: ownership structure; the owners involvement in either the Board of Commissioners or the Board of Directors, supplemented by other sources such as: company prospectus.

1.6 The Outline Summary

The following are a summary of all the chapter in this thesis:

Chapter 1 Introduction

This chapter will discuss the research background, problem identification, objectives, significant of the study and the scope of the study.

Chapter 2 Literature Review

This chapter will explain related theories as a foundation to construct analysis and solve the problem formulation.

Chapter 3 Research Methodology

This chapter will explain research methods used to analysis and construct general hypothesis.

Chapter 4 Analysis

This chapter covers analysis, explanation, and result of the data collection, data processing, analysis process and provides answers to problems formulation.

Chapter 5 Conclusion and Suggestion

This chapter summarizes the entire thesis and provides recommendation as the final result.