CHAPTER II

LITERATURE REVIEW

2.1 Agency Problem

Separation between the principals (owners) and agents (managers) causes the difference in interest. Managers do not always act in the interests of the owners. Manager's interest to improve private safety, big salary, a fancy office, car facilities, and other personal benefits. These conditions will create a difference between the interests of company managers with the interests of shareholders (owners). This will lead to conflict agency (agency problems) between managers and shareholders. Villalonga and Amit (2006) calls this type of agency conflict as Agency Problem I.

Some countries showed that the agency problem comes from the conflict between the supervisor-owners and minority owners. Conflict between the majority owner with a minority owner is named Villalonga and Amit (2006) with the Agency Problem II. There are indications expropriation family owners to the minority owners. The foundation on which most family firm studies are built is the agency conflict framework. The unique characteristics of family firms affect the nature and extent of agency problems, which also vary with the type of family firm. There are two main agency problems in public companies: the conflict between managers and shareholders and the conflict between majority and minority shareholders. Below we discuss the two types of agency problems that apply to family firms relative to non-family firms.

2.1.1. The conflict between managers and shareholders

In the classic owner-manager conflict, as described in Jensen and Meckling (1976), the separation of managers from shareholders may lead to managers not acting in the best interest of the shareholders. This study refer to this type of agency problem as the Type I agency problem. However, the extent of Type I agency problems is reduced in family firms for several reasons.

First, as discussed above, family owners tend to hold concentrated and under-diversified ownership of their firms. As a result, family owners are likely to have strong incentives to monitor managers, reducing the free rider problem that is prevalent among other firms. [The benefit of monitoring does not outweigh the cost of monitoring for small atomistic shareholders, and as such, they tend to free ride on others' monitoring (Shleifer and Vishny, 1986).] Given the under-diversification of their portfolios, family owners bear the idiosyncratic risk associated with the firm and are thus concerned with the cash flows it generates. Founding families' long tenure and substantial involvement in management imply that they are knowledgeable about their firms' activities, which in turn enables them to provide better monitoring of managers.

Second, founding families tend to have much longer investment horizons than other shareholders. Their long-term presence in the firm implies that family owners are willing to invest in long-term projects. Thus, family owners can help to mitigate the managerial myopia problem (Stein, 1988 and Stein, 1989). Because the founding family views the firm as an asset to pass on to future generations rather than as wealth to be consumed during their lifetimes (James, 1999), firm survival is an important concern. Hence, family owners have even stronger incentives to monitor than other large and long-term shareholders.

Third, founding families are concerned with the family's reputation. They are more willing to build and protect their reputation, which is likely to have long-term effects on third parties, and hence the family business. Founding families are likely to deal with other stakeholders, such as banks, suppliers, and customs, for longer periods. This also gives family firms stronger incentives to execute effective monitoring than other large shareholders.

Lastly, in founder and descendant CEO firms, the owner and the CEO are one and thus there is no incentive misalignment and no Type I agency problem. Recall that Type I agency problems arise when the owners' and the managers' interest are not aligned. Agency conflict between shareholders and management can be minimized by concentrated ownership. Concentration of ownership may supervise management decisions, but it raises another problem. The agency problem between the agent and the principal can be overcome but the problem of conflicts between minority shareholders and majority shareholders began to emerge (Villalonga and Amit 2004).

In summary, compared to non-family firms, family firms face less severe Type I agency problems arising from the separation of ownership and control.

2.1.2. The conflict between majority and minority shareholders

The second type of agency problem is the conflict between majority and minority shareholders. As they hold substantial ownership and have controlling positions in the firm, majority shareholders may seek private benefits at the expense of minority shareholders (Shleifer and Vishny, 1986). We refer to this type of agency problem as the Type II agency problem. Family firms have a large shareholder (the family owner) and a fringe of small shareholders. As such, family firms are subject to severe agency problems between family owners and minority shareholders.

The primary source for this type of agency problem is founding families' concentrated equity holdings and substantial control in their firms, which gives them the opportunity to extract private benefits at the expense of other shareholders. Private benefits may be both the monetary and the non-monetary benefits from running a firm. For example, when discussing the CEO turnover decision in Ford Corporation, *Business Week* (August 21–28, 2006) comments that "[given his poor performance,] CEO Bill Ford would have been fired by now by most boards if his name were Smith." Families are also capable of expropriating wealth from the firm through excessive compensation, related-party transactions, or special dividends (Burkart et al., 2003).

Another important source of potential family entrenchment is the difference between their control rights and cash-flow rights. Villalonga and Amit (2009) show that founding families are the primary type of block holders to hold control rights in excess of their cash-flow rights in U.S. corporations. Based on 3006 U.S firm-year observations from 515 firms between 1994 and 2000, they find that founding families on average own 15.3% of the shares (cash flow rights), but control 18.8% of the votes in those firms. The wedge is primarily due to the issuance of dual-class shares. For example, Google's co-founders, Sergey Brin and Larry Page, own super-voting class B shares, which have 10 votes per share. Other high-tech firms, such as Facebook, have similar dual-class structures. Founding owners also obtain disproportionally higher control via disproportionate board representation, voting agreements, and pyramid ownership structures. Such a wedge provides them with the incentive and ability to pursue private benefits. While families may take actions that maximize their personal benefit, many of these actions can lead to suboptimal corporate decisions that reduce the value to minority shareholders.

In summary, compared to non-family firms, family firms face more severe agency conflicts between majority and minority shareholders.

2.2 Family Firm

According to Bennedsen, Gonzales and Wolfenzon (2010), A "family firm" is herein defined as an organization that shares four common traits:

Family. Two or more members of the same family (blood or marriage) are direct participants in the firm's formal governance institutions such as management and the board of directors.

Ownership. The family owns a "significant" fraction of the shares in the firm. Using classic portfolio theory as a benchmark, a significant threshold is defined as an investment exceeding the firms' share in the overall market portfolio. In other words, this threshold is not necessarily related to a fraction of shares held.

Control rights. Members of family exert "significant" control rights in the firm, where the control threshold is at least as large as the fraction of ownership rights held.

Preference for within firm inter-generational transfers. Families attach value to retaining their ownership and control rights within the family firm across generations.

2.2.1 Type of family firm

Different types of family firms is important because it can be used to understand the governance mechanisms that could explain the differences family firms value (Sharma, 2002). Different types of family firms can be seen from the role of family members in the company who can be identified through the ownership, management and supervision (Villalonga and Amit, 2006). The combination of ownership, supervision and management of the company will produce different level of dominance of family in the corporate.

Modifying components proposed by Bennedsen et al. (2010), this study classifies families based company through a combination of family engagement component ownership, commissioners (control-governance) and management (directors). The combination of these three components produces 8 types of firm consisting of 7 family firms and a non-family firm. This classification is based on the combination of components company ownership, commissioners and management (directors) can be seen in table 2.

Table 2.1 Type of firm

<table>
<tr><th>Ownership</th><th>Commissioner (control governance)</th><th>Management (Directors)</th><th>Firm Type</th><th>Potential of agency problem</th></tr>
<tr><td rowspan="4">Y</td><td rowspan="2">Y</td><td>Y</td><td>FOCM</td><td>Agency Problem II</td></tr>
<tr><td>N</td><td>FOC</td><td>No Agency Problem</td></tr>
<tr><td rowspan="2">N</td><td>Y</td><td>FOM</td><td>Agency Problem II</td></tr>
<tr><td>N</td><td>FO</td><td>Agency Problem I</td></tr>
<tr><td rowspan="4">N</td><td rowspan="2">Y</td><td>Y</td><td>FCM</td><td>Agency Problem I</td></tr>
<tr><td>N</td><td>FC</td><td>Agency Problem I</td></tr>
<tr><td rowspan="2">N</td><td>Y</td><td>FM</td><td>Agency Problem I</td></tr>
<tr><td>N</td><td>NF</td><td>Agency Problem I</td></tr>
</table>

From the table above can be explained, as follow:

FOCM is Family Ownership Control and Management. It is a company that is owned, controlled and managed by a particular family. Families have a significant ownership stake and putting family members on the board of commissioners and top management. Type FOCM is a type of family firm's most powerful families against corporate domination. This type of family firm maybe didn’t have a conflict between supervision and management, but is potentially causing expropriations against minority owners. This type of company is a potential trigger agency problem II

FOC is Family Ownership and Control. It is a company owned and controlled by certain families. The family had a considerable share in the control of the company as well as putting family members on the position of commissioner (supervision and advisory), but do not put family members in positions of directors (management). Company management is left entirely to the management of professional (non-family). The role of the family perform a supervisory role in the board of commissioners may reduce the agency conflict between management and the owner's family. This type of company is not much family raises agency problems I. Dominance supervisory by family commissioners may potential arise conflict of interest between family owners and minority owners but independent commissioners from outside the ranks of the family members provide the demand for management to further improve transparency, so as to give confidence to the owner who is not actively involved in the company. The potential emergence of agency problem II depends on the role of independent commissioners.

FOM is Family Ownership and Management. The company is owned and managed by the family but do not put family members on the position of commissioner. Potential conflict between management with the owner (agency problem I) does not exist as part of the family so that the directors of professionalism, talent and the ability to determine the performance of the management of the family firm. In the family firm type FOM is a family surveillance formally handed over to outsiders (non-family) so that commissioners are expected to provide insight and leads objective but if it is filled by the family crony then become less objectivity. More commissioner roles serve as a director (advisor) rather than supervisors. In this case, the possibility of conflict between family owner-minority owner (agency problem II) is very large.

FO is Family Ownership. The company is owned by the family without involving a family member in the board of commissioners and management. This type of company type is a passive type of family firms. Oversight and management functions delivered by non-family. Type a company like this is very rare because of the family (the owners) can be greatly harmed. Agency problem type II does not occur in this type of company, but the company is included in the family of this type has the potential to have a conflict between the owner and the management (agency problem I).

FCM is Family Control and Management. Company that its ultimate ownership is not owned by a particular family, but two or more family members or positions of commissioners and directors (managerial). Families may not have a dominant stock but very dominant in managing and overseeing the company. Type a company like this might be very rare. There is a possibility once the company was originally owned by the family but later sold their stock is owned by another party. Family only became minority owners. Another possibility is that there is a strong element of nepotism within the company. In this type of company like this, management has the potential to act opportunist. Based on agency theory, this type of company is likely to raise agency problems I.

FC is Family Control. Company that its ultimate ownership is not owned by the family, but two or more members of the family occupy the position of commissioner alone. Family only plays a minor role in the ownership of the company, but many provide a role in oversight. Type of company FC is probably a lot going on when the company is widely dispersed ownership structure. Enhancing control mechanism is done formally through the role of the family in the board of commissioners. Almost the same as the type of company FCM, the family has the potential to benefit personally through oversight role.

FM is Family Management. Company that its ultimate ownership is not owned by a particular family but put two or more family members in the managerial position (board of directors). Element of nepotism within the company may be very thick. If directors cannot do better than the supervisory function, it is potentially detrimental to the interests of the owners. Agency problems type I prevalent in this type of family companies.

NF is Non-Family companies. The family was not involved in the ultimate ownership, the commissioner or the management company. These types of companies are included as foreign firm and governments firms.

2.3 Corporate Governance

Corporate governance, the mechanism by which companies are controlled and directed (Macmillan and Downing 1999), is a complex subject that is impacted by a variety of factors including: managers relations; stakeholders relations; board structures and practices; management compensation; and capital structure. Shleifer & Vishny (1997) point out that corporate governance deals with the ways in which investors assure themselves of obtaining an appropriate return on their investment, considering they are not directly involved in the decision making and internal affairs of the corporation.

Corporate governance has traditionally been associated with the principal-agent relationship problem (Shleifer & Vishny 1997). This problem is based on the agency relationship hypothesized by Jensen and Meckling (1976). Investors (the principals) employ managers (the agents) to run firms on their behalf. The interests and objectives of investors and managers differ. Manager might be motivated to adopt investment and financing policies that benefit themselves, but impair the interests of outside shareholders. Notwithstanding the existence of this agency problem, standard finance theory assumes the single objectiveof the corporate management acts in the best interest of all shareholders. Corporate governance is concerned with ways of bringing the interests of managers and shareholders into line and to ensure firms are run for the benefit of investors (Mayer 1997).

An understanding of the behaviour of a corporate organization requires a deep knowledge of its corporate governance practices and the factors that determine the distribution of power among the parties involved (Jensen and Warner 1988). Such power is determined by the amount and pattern of share ownership by individuals and group of people within an organization which, in turn, influences the behaviour of the parties involved. It has been argued that the ownership structure of a company represents an important (perhaps the most important) factor influencing its corporate governance system (Jensen and Warner 1988; Shleifer and Vishny 1997; Kang and Sorensen 1999; Pedersen and Thomson 1999). For example, Shleifer and Vishny (1997) argued that it was one of the primary determinants of corporate governance and behaviour, while Pedersen and Thomson (1999) suggested it was a key determinant. Focusing on ownership structure does not mean that other factors are unimportant, however, corporate ownership is a measureable variable that plays an important role in economics as well as in management studies (Pedersen and Thomson 1999).

As companies differ in ownership structure and board structure across borders, corporate governance in different countries varies as well. This makes corporate governance an interesting field for research; however because of these differences results should not be thoughtlessly copied to countries adopting a different corporate governance system. Many articles have focused on corporate governance before and have often related differences in governance to firm performance or valuation (e.g. Bhagat & Black, 1996; Jensen, 1993; Yermack, 1996). This study does alike, however; this research focuses on one particular aspect of the difference in corporate governance; the difference between a one-tier board structure and a two-tier board structure. The main difference between the two lies in the separation of the supervisory board under the two-tier structure.

A one-tier or two-tier structure is often determined by law. Countries adopting civil law or Anglo-Saxon countries, like the United Kingdom and the United States, often prescribe a one-tier board structure, whereas in countries adopting common law, like Germany, Austria and Indonesia, a two-tier structure is imposed (La Porta, Lopez de Silanez & Schleifer, 1999). Though France is known as a common law country, it has not adopted the mandatory two-tier board structure, but provided the freedom to choose board structure. After the enactment of the new corporate governance code, Code Tabaksblat in the Netherlands, companies have the ability to choose their board structure as well.

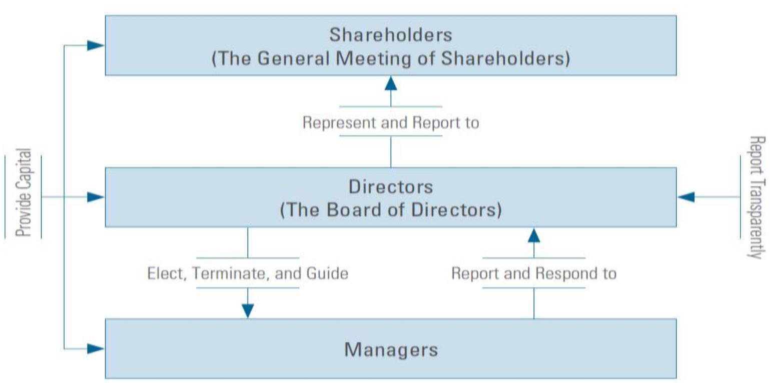
2.3.1 Good Corporate Governance concept

Good corporate governance indefinitely as a system which has authority and as a control to add value for all of stockholders. As principal of corporate governance have interest for all shareholders and stakeholders in corporate governance. Understand of corporate governance according to The Turnbull Report in the UK (April 1999) Corporate Governance is a company's system of internal control, which has principal to the management's risk which are significant to fulfill of its business objectives to safeguard the company's asset and enhancing over time the value of the shareholder's investment. The implementation involved development of GCG, have two related aspects, namely: hardware and software. The hardware includes the establishment of technical or structural change and organizational systems. The software includes more psychosocial change of paradigm, vision. In real-world business practices, most companies more emphasize hardware aspects, such as the preparation of systems and procedures and the establishment of organizational structure.

The definition according to Cadbury, said that Good Corporate Governance is direct and control the company, in order to reach balance between power of strength and authority of company. World Bank defines Good Corporate Governance is a collection of laws, regulations, and rules which have to fulfill and can push the performance of corporate resources as function efficiently, in order to generate economic value of sustainable long term for shareholders and society as a whole.

According to decree of Minister of state-owned enterprise No: PER-01/MBU/2011 regarding on the implementation of Good Corporate Governance practices in state-owned enterprise is principles underlying the process and mechanism of corporate governance based enterprise management regulations and business ethics.

Table 2.2. The Corporate Governance System



Source: IFC, March 2004

2.3.2 Good Corporate Governance's Legal Basis in Indonesia

In Indonesia, the implementation of good corporate governance guidelines have been made by Komite Nasional Kebijakan Governance (KNKG) through his new book released in 2006 entitled "Pedoman Umum Good Corporate Governance Indonesia". Devices Regulations and Legislation Circular of Minister of State for Investment and Development of State-Owned Enterprise PER-1/MBU/2011 of Implementation Practices of Good Corporate Governance (GCG) on SOEs. There has also been issued Decree of Minister of State Enterprises No.103 Year 2002 on Establishment of Audit Committee. For example for the shareholders power: the shareholders through the general meeting of shareholders (GMS) have the power to make decisions regarding appointment, replacement and dismissal, including setting the enactment of the appointment, replacement and dismissal of a member of the board of directors (BOD) or the board of commissioners (BOC) of a company. The majority shareholders can nominate people who will sit on the BOD and BOC. In common practice, members of the BOD and BOC are appointed through the particular influence of the party that nominated them. This practice certainly provides an opportunity for the majority shareholders to indirectly influence the company's affairs through designated parties, and to ensure that those shareholders' interests are met.

The power of the shareholders on the BOD can also be extended by way of agreements, be it a management agreement or technical assistance agreement, or others. Having and applying these agreements should not circumvent the authority and responsibility of the BOD in running and managing the company. Majority shareholder is not prohibited from providing suggestions to the BOD. However, this action shall not be abused or misused in such a way that it extends to any kind of pressure on or intimidation towards the BOD, which could result in the company's losing its capacity for independent judgement.

2.3.2.1 Basic Principles of Good Corporate Governance

Various rules and system as a regulator in management of company's need to be poured in form of principles that must be adhered to the concept of Good Corporate Governance. In generally, there are 5 (five) basic principles (KNKG.2006), namely:

Transparency

To maintain the objective of corporate must provide information, which is material and relevant in a way that is easily accessible and understood by stakeholders. Companies should take the initiative to reveal not only the problem that required by the law, but also the importance for decision-making by shareholders, creditors and other stakeholders. Corporate must provide the information timely, adequately, clearly, accurately, and all the important events that may affect the condition of corporate.

Accountability

Corporate must accountable for their performance in a transparent and fair. It must be properly managed, scalable and in accordance with the interests of the company to remain stakeholder's interests. Specify details of duties and responsibilities of each organization and all employees. Corporate must ensure that the organs of company and all employees have competent accordance with the duties, responsibilities, and roles in implementing Good Corporate Governance. Corporate needs to ensure an effective system of internal control to be manage in the company.

Responsibility

Corporate must comply with laws and regulations and carry out responsibilities for people and the environment. So, the business can be maintained in the long run and gained recognition as the Good Corporate Governance. The organization must adhere to the principle of prudence and ensure compliance with regulatory laws, statutes and regulations. Corporate should be carried out social responsibility. Corporate has to be responsible in management to the principle of corporate, as well as existing of some regulations.

Independency

The corporate should be managed independently, so the individual companies do not dominate other organs and no intervention by other parties. Each organ must avoid domination by any party, is not affected by particular interests, independent of other interests, influence and pressure. Each organ shall carry out the functions and duties in accordance with the statutes and regulations, and not dominate the other, or passing the buck between each other. Independency state whereas the corporate are managed by the professional without any conflict interest and pressure from any side, which will be affected to the health of corporate. To accelerate the implementation of Good Corporate Governance, the corporate should be managed independently, so their organizations do not dominate to the other and no intervention other parties. Each organization of corporate has to avoid the domination any party, not influenced by special interest, free from conflict and pressure, so the decision-making will be done objectively. Each organ must perform its function and duties in accordance with the statutes and regulations, do not dominate others and passing the buck each other to realize an effective internal control.

Fairness

To carry out these activities, the company should pay attention to the interests of stakeholders based on the principle of quality and fairness. Corporate provide equal treatment to all stakeholders. Corporate provides the opportunity for stakeholders to give advice and opinion for company's performance and open access of information in accordance with the principles of transparency within the scope of the position.

Equality and fairness defined as fair and equal treatment in fulfilling the right of stakeholder arising under treaties and laws, which have applied. Fairness also includes fulfilling the right of investors, legal system and enforcement of regulations, which protect investors. Fairness is expected to make the entire of company's assets are well managed and prudence, also expect to protect all members. Corporate should provide the opportunity for stakeholders to provide input and expression to the interests of companies and open access to information in accordance with the principle of transparency in their respective positions.

2.3.2.2 Good Corporate Governance Indicator

According to previous researcher (e.g.,Chandra Mishra et.al (1996), Ronald C Anderson et. al (1998), David Sraer and David Thesmar (2007)), there are several indicators of good corporate governance that can affect firm value, such as:

1) Board Size

Board size is the number of board of directors of the company which is generally composed of inside and outside members and responsible to run company's business. Most of researchers found that, larger board size negatively impacts the value of the firm. Literatures on board size and firm value are firstly emerged in the early 1990s with the articles of Lipton and Lorsch (1992) and Jensen (1993). They advocated small board since they believed boards would become ineffective when a group grows too large, thereby building on organizational behaviour theory, like Hackman (1990). In response to the suggested relationship of Lipton and Lorsch (1992) and Jensen (1993), Yermack (1996) writes a ground breaking article. He finds a significant negative relationship between large board size and firm value (as measured by Tobin's Q) for a sample of 452 U.S. corporations during 1984-1991.

However, there are also few researchers finding that the larger board size of the company will provide a form of control over the company's performance which is getting better and generate good profitability that will be able to increase its share price and the firm value will also increase. In line with the research conducted by Isshaq (2009) and Weterings (2011), the results of the researchers show that there is a significant positive relationship between board size and to the value of the company. If the company is well-managed, the company will able to provide better financial value and will be able to enchance shareholder value. Other studies of large US firms provide evidence that the board size effect depends on the organizational form. The same with, Jong et al. (2000) and Black et al. (2004) report insignificant effects in Dutch and Korean firms, respectively.

2) Size of Audit Committee

Institute of Internal Auditor states that the term audit committee refers to the governance body that is charged with oversight of the organizations audit and control functions. Although these fiduciary duties are often delegated to an audit committee of the board of directors, the information in this practice advisory is also intended to apply to ther oversight groups with equivalent authority and responsibilty, such as trustees, legislatives bodies, owners of an owner-managed entity, internal control committees, or full board of directors (IIA Practice Advisory 2060-2 of 2004 in FCGI 2001).

The term “audit committee”, as defined in Auditing Standard No.16, is a committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such as committee exists with respect to a company, the entire board of directors of the company. For audits of non-issuers, if no such committee or board of directors (or equivalent body) exits with with respect to the company, the person (s) who oversee the accounting and financial reporting processess of the company and audits of the financial statements of the company.

3) Family involvement

Family involvement in ownership and management is one of the main protagonists influencing the corporate governance of family owned companies. Berle and Means found that ownership concentration will align the interests between ownership and management, and mitigate the amount of agency costs. Thus, higher financial performance could be achieved. Similarly, Jensen and Meckling state that the presence of of managers that possess high level of ownership will most likely generate better corporate governance since an alignment of managers and shareholders incentives is automatically produced. Furthermore, if the majority of owners are not implicated in the firm’s management, they will be less able to to supervise and control agents (Shleifer &

Vishny, 1986). Therefore, they will endure more agency costs in their attempt to control and supervise the executives.

Usually family business have high involvement and long tenure in management. Thus, by their high involvement they will succeed at having a better sense of recognition of uncertainties and opportunities and also by establishing a long term focus (Zahra, 2005). Moreover, family firm proved to be better than non family businesses in the investment decision making process. In fact, the presence of family managers will consequent a long term focus and will mitigate managerial mypoia (Bertrand and Schoar, 2006). Family business has also out performed none family business in both profitability and financial structures. In addition, family involvement in terms of control highly affects the profitability of the company (Allouche, Amann, Jaussaud, and Kurashina, 2008). In fact, businesses where the largest shareholder is a family member, the existence of an institutional investor as second shareholder will foster the business value.

In further analysis, the resource based theory inspects the distinctive intangible resources particular to each company. These resources from particular competitive advantage of the firm over its peers (Barney, 1991). In fact, family businesses have also unique resources thay may award them a competitive advantage over their peers. Sirmon and Hitt have stated 5 foundations that favor family owned businesses over its peers: survivability, governance structures, patient, human and social (Sirmon & Hitt, 2003). In fact, family firms acquire all those sources and transmute them into competitive advantages by the focus on customer and aim on a market niche, that will result on higher profits, the concern of protecting the family name which will consequent a higher quality of products, concentrated ownership structure that will result on a long term focus on investment and will enhance corporate productivity and intersecting responsibilities between owners and managers which will mitigate agency costs (Poza, 2006).

Other argumentation exhibited the neutrality of the influence of family involvement on financial results. King and Santor stated that ownership concentration could not have a perceptible effect on the company performance (King and Santor, 2009). They added that inefficient ownership structures might fail over the long run. They summed this issue up by denying the existence of statistical relationship between ownership and performance.

Several empirical studies have backed the vision that the involvement of the family in business will foster its financial performance. In the study of more than 1600 Western European companies, Maury revealed that constant and active control by family executives was linked to higher profits, justified by the mitigation of agency problems between principals and agents (Maury, 2006). Another study of the S&P 500 by Martikainen et al. was done to question whether higher earnings of family owned companies was associated to efficiency and variations in production technologies (Martikainen, Nikkinen & Vahamaa, 2009). The end of the study showed no significance different between the production technologies between family and non family businesses, thereby proposing that differences in output is due to higher efficiency performed in family owned companies. A comparison was done by Andrees between family firms and its peers in Germany (Andres, 2008). The result resolved that not only do family owned companies outperform large owned firms, but also is more profitable that other companies having different types of blockholders. Nevertheless, he declares that this higher performance is conditioned by having the founder still active in management or on the board of directors.

Anderson and Reeb also studied that the S&P 500 and demonstrated the superiority of family firms to none family firms in term of performance (Anderson and Reeb, 2003). Their study resulted on higher performance of family firms in both accounting and market measures constrained by the presence of founders involved in the company. Their analysis also point to a difference in family business performance based on managerial status. In fact, top level positions occupied by family members whether founder or heirs demonstrate a positive link with accounting profitability. Nonetheless, according to the same study, higher market performance is only achieved when the managerial position is occupied by the owner or an outside director, heirs acting as managers did not affect market performance.

Therefore, by complying with what Fama and Jensen argued, family involvement contribute to an alignment of interest between agent and principal and consequent fewer agency problems (Fama and Jensen, 1983). In addition, the desire of protection of family name and long term focus are charateristics of family stewards.

The positive impact of family ownership is also found on lower cost of capital (Anderson, Mansi, & Reeb, 2003) and on minority shareholders (Anderson &Reeb, 2003a, 2003b; Villalonga & Amit, 2010). However, Maury (2006) states that the benefit from family controlling the firm is mainly for firms without majority ownership. He states that family control reduces agency problem between managers and the shareholders but creates conflict between the controlling family and minority shareholders if the protection to the minority shareholders is weak. These families are capable to take actions that benefit themselves at the expense of other shareholders or expropriating wealth from the firm.

Modifying components proposed by Bennedsen et al., (2010), this study classifies families based company through a combination of family engagement component ownership, commissioners (control-governance) and management (directors), as follow:

a. Family ownership (amount of shares owned by family member in the firm).
b. Family's manager/ director (proportion of family members in the firm).
c. Family's commissioner (proportion of family members in the firm).

4) Firm Performance

Firm performance, which is often associated with share price, is investors' perception of company. In fact, not all companies want high share prices because they are afraid they share can not be sold or can not attract the investors to buy it. It is why the share price should be made optimally, the stock price should not be too high or too low. Share price that too low, can be bad for the company's image in the eye of investors.

According to Keown et al. (2004), there are quantitative variables that can be used to estimate the value of the companies, among others:

a. Book Value

   The book value is total assets of balance sheet minus existing liabilities or owners of capital. Book value does not count overall the market value of a company because the calculation of book value based on historical data of company's asset.

b. The market value of the company

   The market value of the stock is an approach to estimate the net value of a business. If the shares are registered in the stock exchange and widely traded securities, the value approach can be built based on market value. Value approach is the most commonly used approach in assessing large companies, and this value can change rapidly.

c. Value of appraisal

The company based on independent appraiser would allow a reduction in the goodwill if the asset price firm increased. Goodwill is generated when the value of the purchase of the company exceeds the book value assets.

d. Value of expected cash flow

This value is used in the assessment of merger or acquisition. The present value of cash flows that have been specified maximum will be and should be paid by companies targeted (Target Firm), the initial payment can, then, be deducted to calculate net value from the merger. The present value is the future free cash flows that will come.

One alternative used in assessing the value of the firm is to use Tobin's Q. This ratio was developed by James Tobin (1967). The greater the value of Tobin's Q ratio indicates that the company has good growth propsects. This can occur because of the larger the market value of the assets of the company, the greater the willingness of investors to spend more sacrifices to own the company. According to Brealy and Myers (2000) stated that companies with a high Q value brand image usually has a very strong company, while the companies has a low Q value generally are in a highly competitive industry or the industry began to shrink. Tobin's Q measurement is accepted as a better measure of firm performance (Mayer, 2003) as it reflects the market performance measure rather than the accounting performance measure. Copeland *et al.* (2005) provides a framework for interpreting Q ratio. A low Q (between 0 and 1) means that the cost to replace a firm's assets is greater than the value of the stock implying that the stock is undervalued. Conversely, a high Q (greater than 1) implies that the firm's stock is more expensive than the replacement cost of its assets indicating that the stock is overvalued.

2.4 Previous Research

To discuss about founding family control and firm value in family firm, Chandra S. Mishra, Trond Randoy, Jan Inge Jenssen (1996) found a positive relationship between founding family control and firm value, outside director representation (board independence) does not improve corporate governance in founding family controlled firms, founding family controlled firms are more valuable than firms without such influence, and founding family controlled firms are governed differently than non-founding family controlled firms. Another research about the effect of family ownership to cost of debt found by Andersona, Sattar A. Mansib, and David M. Reebc (1998), was founding family ownership reduces the cost of debt financing, ownership structure affects the cost of debt financing and equity-ownership structure significantly influences the conflict between shareholders and bondholders. Differently, Lopez Delgado and J. Dieguez Soto (2007) suggested private Lone-founder firms outperform private family firms. Lone-founder firms outperform whereas concentrated professional family firms significantly under-perform by taking into two components of family involvement such as family ownership and family management.

Another supportive research from David Sraer and David Thesmar (2000) suggested that family founders simply have larger labor productivity, and they manage their labor force more efficiently.

Belen Vilallonga and Amit (2000) also found that family ownership creates value only when it is combined with certain forms of family control and management, family management add value when the founder serves as the CEO of the family firm or as its chairman with a nonfamily CEO, but destroys value when descendants serve as chairman or CEO. Another research in Indonesia found by Made Andika Pradnyana Wistawan, Bambang Subroto and Abdul Ghofar (2015) stated that conservatism is influenced by the existence of the audit committee. Audit committees can give specific suggestions for a more conservative in making decisions. The results also show that conservatism is not influenced by the proportion of independent directors. This condition is indicated that the post of independent directors only become the company's needs for regulatory compliance regardless of the function that should be run. In addition, the results also showed that the existence of accounting conservatism becomes weaken in the presence of family ownership as a moderating variable. Family ownership as the majority shareholder has the right to control the board of directors for their utilities. Majority shareholder is motivated to do expropriation by reporting financial statement in overstatement. Reporting financial report in overstatement conditions is against the principle of conservatism. The results also show that the presence of family ownership does not strengthen or weaken the audit committee relationship to conservatism. This condition proves that the existence of family ownership does not alter the functions or duties of the audit committee. Results of this study proved entrenchment effect that occurs in the family company listed on the Indonesia Stock Exchange. High control rights motivated the expropriation of the majority shareholder. With the right controls, family ownership can increase their utility through the hands of management or in this research board of directors. Improved control rights encourage the majority shareholders to maximize their own welfare with the distribution of wealth on the other side (expropriation of minority shareholders).

2.5 Theoretical Framework

Corporate governance is the process on which organizations are managed and controlled. Good corporate governance and firm involvement are two factors that related to the firm performance, usually the better good corporate governance and firm involvement of the company the better performance will be.

a. Corporate Governance and Firm Performance

Board Size

Board size is the number of board of directors of the company which is generally composed of inside and outside members and responsible to run company's business. The total member of director must be adjusted with the complexity of firm, but still considering the effectiveness of decision making. Lipton and Lorsch (1992), Jensen (1993) and Yermack (1996) finds a significant negative relationship between larger board size and firm value (as measured by Tobin's Q) for a sample of 452 U.S corporations during 1984-1991. However, the second school thought considers that a large board size will improve a firm's performance (Pfeffer, 1972; Klein, 1998; Coles and ctg, 2008). These studies indicate that a large board will support and advise firm management more effectively because of a complex of business environment and an organizational culture (Klein, 1998). Moreover, a large board size will gather much more information. As a result, a large board size appears to be better for firm performance (Dalton and ctg, 1999). However, Yammeesri and Herarth (2010) found no significant relationship between corporate governance and firm value and Bennedsen et al. (2010) found out no performance effect found when varying at below six directors, the typical range of board size in small and medium-sized firms.

Size of Audit Committee

The audit committee plays an important role in the firm value by implementing good corporate governance principles. The principle of corporate governance suggest that the audit committee should work independently and perform their duties with professional care. The audit committee monitors mechanism that improve quality of information flows between shareholders and managers (Rouf, 2011:240), which is turn, help minimize agency problems. Research done by Gill and Obradovich (2012), size of audit committee found that positively impact of the value of American manufacturing firms. Another finding from Indonesia, the audit committee who has specialized in the industry tends to understand and know the risks so that the industry can give specific advice to be more conservative in making financial decisions, especially related to accounting (Hamdan et al., 2012).

Family Involvement

Family firms usually represent the characteristic of being founded by a family enterpreneur owning most shares in the company. The potential benefits associated to family owners, such as their long-term horizons and their reputation concern. These characteristics along with a better knowledge of the company are likely to induce family owners to invest following value maximization rules. The research done by Salloum Charbel, Bouri Elie and Samara Georges (2013) found that there is significant positive relationship between family involvement and firm performance.

Since ownership and management of company were divided, conflict of interest between the outside shareholder and manager is the most critical deputy problem. One important method capable of resolving such a conflict of interest between shareholder and manager is to give shares to manager. By resolving the conflict of interest between the outside shareholder and manager, administrative cost will be reduced and firm value will be increased.

Villalonga and Amit (2006), proving that family engagement in the company have an influence on the firm value. Family firm which has control mechanism enhance and managed by the family (family CEO) has a lower performance than non-family firms. But the company's performance to be better when the family managed (family CEO) without the enhance control mechanism. Family firm with no control enhance mechanism have lower agency conflict than most other types of companies.

Furthermore Villalonga and Amit (2006) explains that the agency conflict between managers with owners (agency type I) have a higher cost than the conflict between family owners with non-family owners (agency type II) when the company's founder is still the CEO. Conversely, when the founder had not served as CEO, the conflict between family owners with non-family owners (agency type II) have higher agency costs. While Allouche, et al, (2009) proved that there are differences firm value between the strong control family business (family members involved in the management and major shareholders) with weak control family business (family members only involved in the management course or as a main course shareholders). Family of companies (strong control) in Japan have higher performance than companies that have family that weak supervision (weak control).

a. Family ownership

The ownership structure is divided into two groups which is concentrated and dispersed. Dispersed ownership occurs in some countries such as Britain and the United States. Instead, the concentrated ownership structure occurred in the company in the East Asia and Eastern Europe that centered on a particular owner (Bhasin 2010; Claessens et al. 2002). Dispersed ownership structure occurs when the ownership of company shares owned by many investors and each investor has a relatively small equity value or do not have the controlling rights. However, the concentrated ownership structure, shareholders grouped themselves into a controlling shareholder or a shareholder in a large amount of share. The majority shareholder in Indonesia owned by family holdings. This fact is explained by Alijoyo et al.,(2004). Family ownership may increase their right into cross-ownership structure, the pyramid, and through involvement in management company's. Increased ownership led to the magnitude of the ability of the majority shareholder to control the company. The ownership structure is said to be structured as a pyramid if there is the ultimate owner and there is at least one company in the chain of ultimate control rights owner (Claessens et al ., 2002; Siregar and Utama, 2008; Xu et al ., 2012). Thus, the ownership of the company can be traced directly (immediate) and indirectly (ultimate). Pyramid ownership structure allows the founding family control over a very large enterprise networks, both on closed companies or already listed on the stock exchange. Family firms usually represent the characteristic of being founded by a family entrepreneur owning most shares in the company. Yammeershi and Lodh (2004) study on 240 public firms in Thailand shows that family ownership is positively associated firm's return assets and net income to sales. Demsetz and Lehn (1995) assert that the concentration of investors in family firms generate economic incentives that reduce agency conflicts and maximize firm value, Specifically, since a family’s well-being is so closely tied to that of the firm, families have a strong incentives to monitor managers and to reduce the free riders typical among small shareholders. It must also be said that, if monitoring requires a knowledge of the firm’s technology and characteristics, the family potentially has a better vision, as its tenure allows it to move more swiftly along the experience curve. Founding families often maintain a long-term presence in the firm. This means that, compared to other shareholders they have much more extensive time scales within which to operate; thus they remain open to investment opportunities in equity long-term projects. Anderson (2002) further believes that this long-term feature of family ownership allows a family firm to have access to debt at a lower cost. However, Sciascia and Mazolla (2008) found that there is no significant linear between family ownership toward firm performance. In line with, Barklay and Holderness (1989) note that concentrated ownership reduces the possibility of access to external contributions, thus reducing firm value. Equally, hindering can be the selection of managers and directors by a family that seeks to maintain control through top management. Family ownership is measured by looking at the composition or percentage of ownership owned by family.

b.Family’s manager/ director

Usually family businesses have high involvement and long tenure in management. Thus, by their high involvement they will succeed at having a better sense of recognition of uncertainties and opportunities and also by establishing a long term focus (Zahra, 2005). Moreover, family firm proved to be better than none family businesses in the investment decision making process. In fact, the presence of family managers will consequent a long term focus and will mitigate managerial myopia (Bertrand and Schoar, 2006). Several empirical studies have backed the vision that the involvement of the family in business will foster it financial performance. In the study of more than 1600 Western European companies, Maury revealed that constant and active control by family executives was linked to higher profits, justified by the mitigation of agency problems between principals and agents (Maury, 2006). However, Mannarino et al. (2011) proved that family firms are not more productive when managed by their families member rather than be managed by professionals. Burkart et al., 2003 also argued that management of a firm by family members may be potentially less efficient and thus entail loss to the firm when compared to other firms which are managed by rather more professional managers. In line with these expectations, Smith and Amoako-Adu (1999) found that reaction of the market was negative when family firms hired family members as managers.

c. Family’s commissioner

Villalonga and Amit (2006), proving that family engagement in the company have an influence on the firm value. Family firm which has control mechanism enhance and managed by the family (family CEO) has a lower performance than non-family firms. But the company's performance to be better when the family managed (family CEO) without the enhance control mechanism. Charbel et al. (2013) found that there are very low negative relationship between presence of a family CEO in the business and earnings before interest and taxes and this relationship is not statistically significant. family CEOs might underperform due to the stiff tensions between family and business objectives (Christiansen, 1953; Levinson, 1971; Barnes and Hershon, 1976; Lansberg, 1983) and, perhaps most importantly, due to the fact they are selected from a small pool of managerial talent (Burkart, Panunzi and Shleifer, 2003; Pérez-González, 2006).

Hence, based on the literature above, author hypothesizes that:

H1: *There is an influence of corporate governance towards firm performance*

b. Control Variable and Firm Performance

Controlling variables are important for mitigating the potential endogeneity problems when conducting cross-sectional examination into corporate governance (Denis, 2001). Author has limited three indicators on control variable, as follow:

Firm Age

Following Fama and French (2001) and Pastor and Veronesi (2003) and assume that firms are "born" in the year of their first appearance on the CRSP tapes. Firm age is consequently the number of years (plus one) elapsed since the year of the company's IPO. Three most studies that look at firm age use the same definition. We refer to this variable as the firm's *listing age*. Shumway (2001) argues that listing age is the economically most meaningful measure of firm age, since listing is a defining moment in a company's life—it affects ownership and capital structure, multiplies growth opportunities, increases media exposure, and demands different corporate governance structures (Loderer and Waelchli, 2010).

The relation between age and performance could in principle be spurious. Extant research in empirical finance suggests that various firm characteristics that affect performance are simultaneously a function of age. Yet the evidence rejects this interpretation. Al Saidi et al. (2014) found that firm age had insignificant impacts on firm value and ownership concentration. Firm aging does not seem to be driven by family firms either (Anderson and Reeb, 2003; Villalonga and Amit, 2006).

Firm age is the logarithm difference between the end of year 2014 and the firm's founding year (McConaughy et al., 1998; Mishra et al., 2001).

Firm Leverage

These researchers generally argue that financial leverage has a positive effect on a firm's returns on equity provided that the firm's earnings power exceeds its interest cost of debt (Hutchinson, 1995) and that the level of leverage a firm should commit itself to depends on the flexibility with which the firm can adjust its debt usage should earnings power fall below its average interest cost (Hadlock and James, 2002). Mishra et al. (2001) found that significant negative correlation between firm leverage and firm value and Gleason et al. (2000) who report negative association between financial leverage and financial performance. Other studies also reported negative relationship between leverage and financial performance (Vitor and Badu, 2012; Majumdar and Chhiber, 1999; Gleason et al., 2000; and Simerly and Li, 2000; Hammes, 2003; Mesquita and Lara, 2003; Zeitun and Tian, 2007). Anderson (2002) further believes that this long-term feature of family ownership allows a family firm to have access to debt at a lower cost. Additional information provided by Cuong and Canh (2012), the optimal debt ratio (total debt to total assets ratio) should not exceed 59.27% because a higher debt ratio negatively impacts firm value.

ROA

Return on assets (ROA) measures the ability of a firm's assets to generate profit and is considered to be an indicator of the profitability of firms. This approach is in line with the work of Perez-Gonzalez (2006), Arosa et al. (2010) and Molly et al. (2010). ROA, as an accounting-based measurement, gauges the operating and financial performance of the firm (Klapper & Love, 2002). The measurement is such that the higher the ROA, the effective is the use of assets to the advantage of shareholders (Haniffa & Huduib, 2006). Higher ROA also reflects the company's effective use of its assets in serving the economic interests of its shareholders (Ibrahim & Abdul Samad, 2011).

Hence, based on the literature above, author hypothesizes that:

H2: *There is an influence of control variables towards firm performance*