

# Does the pyramidal ownership mechanism negatively affect the firm's performance?

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## ABSTRACT

This research aims to evaluate the effect of family control, which is obtained through both direct or pyramidal ownership mechanism, and company performance. It also examines the mediating effect of founder leadership as represented by founding family members occupying the top management position and the effectiveness of Board of Commissioner. This study used Ordinary Least Square regression for the data analysis with 670 data as the sample from 134 sample companies from year 2009 to 2013. The results show that family control through direct ownership mechanism enhances company performance (alignment effect). On the other hand, family control through pyramidal ownership mechanism weakens company performance (entrenchment effect). The results also show that founder leadership boosts the alignment effect and limits the entrenchment effect. However, this research fails to confirm the role of the effectiveness of the Board of Commissioner in increasing the alignment effect and limiting the entrenchment effect.

## ABSTRAK

Penelitian ini bertujuan untuk mengevaluasi pengaruh kontrol keluarga, yang diperoleh melalui mekanisme kepemilikan langsung dan secara piramida, dan kinerja perusahaan. Penelitian ini juga menguji pengaruh mediasi kepemimpinan pendiri yang diwakili oleh anggota pendiri keluarga yang menduduki posisi manajemen puncak dan Efektifitas Dewan Komisaris. Ordinary Least Square Regression digunakan untuk menganalisis data sampel 670 dari 134 perusahaan sampel dari 2009 hingga 2013. Hasil penelitian menunjukkan bahwa kontrol keluarga melalui mekanisme pemilikan langsung meningkatkan kinerja perusahaan (alignment effect). Di sisi lain, kontrol keluarga melalui mekanisme kepemilikan piramida melemahkan kinerja perusahaan (entrenchment effect). Hasil penelitian juga menunjukkan bahwa kepemimpinan pendiri meningkatkan efek keselarasan dan membatasi entrenchment effect. Namun, penelitian ini gagal untuk mengkonfirmasi peran efektivitas Dewan Komisaris dalam meningkatkan alignment effect dan membatasi entrenchment effect.

## 1. INTRODUCTION

The difference of the company ownership structure is one of factors that makes agency problem varies among countries. For example, a dispersed ownership is only found in countries with strong law enforcement over company's owner, as argued by La Porta et. al. (1999). In general, companies in East Asia have concentrated ownership structure, which are ownership with cash flow rights and controlling rights held by certain parties, e.g. family, government, public-owned financial institutions, etc. More

than 50% companies in Indonesia have concentrated ownership structure of which the strongest control is on the hand of founding family (Diyanty 2012) through pyramidal ownership mechanism.

The family obtains controlling shares through both direct and indirect ownership mechanism such as the pyramidal structure. Control through the direct ownership is acquired by a simple ownership structure, whereas the control through pyramidal ownership mechanism that goes through a series of ownership chain in other companies (La

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Porta, Lopez-de-Silanes and Shleifer 1999). This pyramidal ownership allows a party to execute its control over a company with relatively lower ownership and investment percentages, thus the control rights of the controlling shareholders surpasses its cash flow rights (Claessens, et. al. 2000; Diyanty 2012).

Ownership and control by founding family encourage controlling shareholders to be deeply involved in managing the company and even tend to carry out the expropriation of the non-controlling shareholders through the provision of overcompensation towards family members who sit in the managerial positions, related-parties transactions or the enactment of policies on special dividend to controlling shareholders which, in this case, is family (Andersen and Reeb 2003). Family as the largest controlling shareholders wants special dividend policies that will affect policies on company's strategy plans about business expansion, leading to poor operation and eventually will affect the stock price performance (Andersen and Reeb 2003).

This condition triggers the agency conflict between controlling shareholders, which is assisted by management, and non-controlling shareholders. This condition is exacerbated when the controlling shareholder increases its control through the pyramid structure by maintaining low number of holdings (cash flow rights) but having greater control rights than the sum of its holdings, so as to encourage the emergence of entrenchment problems (Morck et al. 1988).

The growing share ownership of the family on a company affects the improvement of the company's performance. Resources invested in the company becomes greater thus the risk of loss faced by the family becomes larger (Anderson and Reeb 2003). In the direct ownership mechanism, greater the direct ownership of the family on a company lead to higher the alignment effect. This condition tends to discourage the family from expropriating the company (Fan and Wong 2002) and to enhance the socio emotional wealth of the family that motivates them to maintain and develop the company (Gómez-Mejía, et.al. 2007). In the direct ownership mechanism, the amount of cash flow rights will be the same as the controlling rights on the company so that the controlling shareholders will not have the motivation to take action against the expropriation of the non-controlling shareholders.

On the other hand, the pyramidal ownership mechanism enables the family to gain control over a company with a relatively small investment, thus the family has larger control rights than the in-

vested amount and great difference between cash flow rights and control rights occurs (La Porta, Lopez-de-Silanes and Shleifer 1999; Claessens, Djankov, Fan and Lang 1999). Fan and Wong (2002) revealed that the difference in cash flow rights and control rights motivates the family in doing expropriation. Lower cash flows rights can reduce the risk of potential losses from expropriation. Through this ownership mechanism, controlling shareholders have the opportunity to use the company's resources in order to satisfy personal interests so that the use of corporate resources is not optimal, which in turn gives impact on the performance of the company (Morck, Wolfenzon and Yeung 2004). This condition referred to as negative entrenchment effect (Diyanty 2012). Expropriation carried out by controlling shareholders could potentially affect the value of the company.

Although prior literature suggests that family ownership and control can lead to poor performance, family influence can also provide competitive advantage. Specifically, when the family prosperity is highly related to company prosperity. Family as the major controlling shareholders has a strong incentive to monitor managers thus will minimize free rider problem inherent with small atomistic shareholders. If monitoring required knowledge of the firm technology, family potentially provides superior oversight because their lengthy tenure permits them to move further along the firms learning curve (Andersen and Reeb 2003).

Provided that the largest control is on the hand of the founder family, they will put themselves as main leaders of the company (Peng and Jiang 2010). Claessens et al. (2000) found that most of companies in Asian countries are controlled by family. The CEOs of about 60 percent companies of which ownership is concentrated on family, are people who have family relations with controlling shareholders. The placement of family members on the company's main leadership positions is an attempt or a strategy to align family's goals with company's management (Anderson and Reeb 2003; Peng and Jiang 2010). Eventually family control will affect the company's performance (Peng and Jiang 2010; Chung and Chan 2012).

Andersen and Reeb (2003) argued that family control obtained through direct and indirect ownership would generate a greater positive impact when the CEO is a member of founding family. The reason for this is that company founder has higher sense of belonging and socio emotional wealth that motivate them to maintain the sustainability of the company.

In order to limit expropriation by controlling shareholders, adequate capital market regulations, accounting standards as well as corporate governance mechanisms are needed. Board of Commissioners (BOC) play an important roles in overseeing and ensuring the implementation of good corporate governance. The surveillance has to be able to ensure protection of stakeholders rights. The oversight function performed by BOC is also enhanced through issuance of the Indonesia Financial Services Authority Regulation No. 33/POJK.04/2014 on Board of Directors and Board of Commissioner of Issuing or Public Company. This regulation mandates at least 30 percent of the total members of BOC of a public company must be independent<sup>1</sup>. The presence of the independent member is expected to enhance the effectiveness of oversight function performed by the BOC over the board of directors. Eventually, it is expected to limit the chance of improper expropriation upon non-controlling shareholders.

The researcher believes that this study is beneficial when conducted in Indonesia setting because ownership structure in this country is largely dominated by family ownership. Diyanty (2012) and Ulupui (2009) found there was 88 percent, among public companies in Indonesia, that were owned by the family of which members were appointed as director and or commissioner. The findings support previous research by Lukviarman (2004) which states that 80 percent of companies in Indonesia experienced family interference in management positions as well as commissioners. The dominance of controlling ownership by the family triggered the intense agency conflict between controlling family and non-controlling shareholders.

This study is expected to serve as a set of reference for the regulators in increasing their role in: (i) improving its surveillance in the capital market through rules on the implementation of good corporate governance and rules aimed to improve the effectiveness of the board of commissioner, (ii) improving the monitoring mechanism in order to provide protection upon investors and non-controlling shareholders. The results are also expected to provide considerations in the issuance of policies on the disclosure of the ultimate ownership chain in the financial statement. The disclosure is

expected to provide an overview on the largest controlling shareholders and whether these shareholders obtained their control through direct or pyramidal ownership mechanism. The disclosure is also important in providing an overview on the control carried out by the controlling shareholders over several companies in the same control.

## **2. THEORETICAL FRAMEWORK AND HYPOTHESES**

### **Ownership Structure and Agency Conflict**

One of the factors that causes agency conflict is company's ownership structure. The presence of asymmetric information between managers and shareholders as well as the difference of interests between managers and shareholders allow managers as agents to take decisions contrary to the owner's personal goals.

There is a condition when agents do not always act in the best interests of the shareholders, as a consequence of agency relationship (Jensen and Meckling 1976). This situation could happen when agents have better information than shareholders and act to maximize their own interests at the expense of shareholders which is called expropriation. Expropriation is defined as the use of authority over the control to maximize the welfare of their own and take over the wealth of others, especially the wealth of shareholders (Claessens et al. 2000).

Agency conflict between shareholders and management arise in countries with dispersed ownership structure characteristics such as the US and UK (Jensen and Meckling 1976). La Porta et al. (1999), Claessen et al. (1999) and Diyanty (2012) suggest that with highly-concentrated ownership structure evident in Asia (including Indonesia), the agency problem that occurs is no longer between management and shareholders, but between the controlling shareholders (as agent) assisted by management and the non-controlling shareholders. In the concentrated ownership structure, management represents controlling shareholder.

Control over a company can be obtained through two ownership mechanisms, direct and pyramidal ownership (La Porta, Lopez-de-Silanes and Shleifer 1999; Claessens, Djankov and Lang 2000). Control through direct ownership mechanism is obtained by direct equity investment in a company (La Porta, Lopez-de-Silanes, & Shleifer 1999). With the direct ownership mechanism, control rights held by shareholders is equal with the amount invested in the company, thus there would be no difference between cash flow rights and control rights of shareholders. The higher the invest-

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<sup>1</sup> The independent board of commissioners is a party without financial, organization, ownership, or family relationship with the other board of commissioner members, directors, or controlling shareholders or other relationship, which influence their ability to perform their tasks independently (Regulations of Bank of Indonesia No 8/4/PBI/2006).

ment is, the higher the commitment of the controlling shareholders in increasing company value. This condition is called alignment effect. A cash flow right is financial claims of shareholders on their investment in the company. While the control rights are voting rights to participate in decision making process in determining the policy of the company. Control obtained through pyramid ownership mechanism goes through a series of ownership chain in other companies (Almeida and Wolfenzon 2006). Control obtained through the pyramidal mechanism is a series of complex ownership and allows the voting rights held by the controlling shareholders to exceed their cash flow rights (Chung and Chan 2012).

Claessens et al. (1999) and Diyanty (2012) found that 71.5 percent of total companies in Indonesia are controlled by family and 66.9 percent controlling shareholders of companies in Indonesia tend to have voting rights or control rights that exceeds their cash flow rights through pyramidal ownership structure (Claessens et al. 2000; Diyanty (2012). Through the pyramidal ownership mechanism, controlling shareholders have direct control over the company while at the same time they also have control over some other companies that eventually forms a common way in controlling the non-controlling shareholders by separating control rights from cash flow rights (Claessens et al. 2000; Faccio and Lang 2002). This condition potentially leads to negative entrenchment through actions which could harm non-controlling shareholders (Shleifer and Vishny 1997).

The separation of ownership and control is more evident in companies controlled by the family and in small-scale companies. Claessens et al. (2000) concluded when there is a considerable difference between control rights and cash flow rights (wedge) through the pyramidal ownership mechanism and when the major controlling shareholder is family, then the level of the expropriation of the non-controlling shareholders would be higher.

One of ways to eliminate entrenchment problem from the controlling shareholders is to increase ownership of the controlling shareholders or even through the go-private decision. Higher ownership (cash flow rights) by the controlling shareholders lead to higher commitment and enhancement or alignment of interest between controlling and non-controlling shareholders (Gomes 2000). This condition is called alignment effect (Fan and Wong 2002) or Positive Incentive Effect (Yeh 2005).

Almeida and Wolfenzon (2006) found that as

consequences of pyramidal ownership structure is that the companies involved in the pyramidal structure operate in different industries with the controlled companies. In addition, the value and the performance of the affiliated companies controlled through pyramidal ownership structure are lower than the value and the performance of non-affiliated companies. Moreover, the research also indicates that when additional affiliated companies were added into the pyramidal structure in the family business group, the non-controlling shareholders faced negative return. Therefore, the pyramidal ownership structure has negative implications toward the company and the non-controlling shareholders.

### Family Company

Chua et al. (1999), and Liu, et al. (2010) define a family company as family ownership, control over voting rights, involvement of family in managerial positions, and control over election of board of commissioner and board of directors. Diyanty (2012) concluded that a family company is a company whose major ultimate control is on the hand of family (one person or a group of people who have family relationship). The control is obtained both through direct ownership or pyramidal ownership mechanism and through direct involvement of family in company management.

The involvement of company founder are in the top managerial position. These founding family members hasve a strategy to increase their control over the company (Peng and Jiang 2010). The greater control rights owned by family lead to higher power to align family goals with the goals of the company and the management. This is possible because they family members who sit at the top managerial positions have a broad access to the utilization of company resources. In addition, the controlling family has a broader investment horizon that will provide benefits for the company (Liu, Yang and Zhang 2010; James 1999).

The placement of founding family also maintains a long-term presence in the company. Casson (1999) argued that founding family views the company as an asset to be passed on their descendants rather than wealth to be consumed during their lifetimes. Therefore, company survival is an important concern for the family, suggesting they advocate long-term value maximization.

Morck, et al. (1988) suggests that founder CEO brings innovative and value-enhancing expertise to the company. Davis et al. (1997) explains that family members act as stewards and as such identify

strongly with the firm and view company performance as an extension of their own wellbeing. Andersen et al. (2003) supports this notion by concluding that the presence of family in company managerial positions will give incentive to keep company reputation in order to enhance company performance.

Higher controlling power obtained with direct ownership mechanism lead to higher motivation for controlling shareholders to keep their socio-emotional wealth and thus reduce the incentive for expropriation. This occurs because expropriation has an economic burden for the family (Fan & Wong 2002). Hence, higher ownership by controlling shareholders through direct ownership mechanism leads to higher motivation to enhance company performance. Appointing member of founding family as company top managerial positions enable the controlling shareholders to take strategic decisions in order to enhance company performance (alignment effect).

### **Board of Commissioners**

The Board of Commissioners (BOC) is responsible for supervising and advising the board of directors. In carrying out its oversight function, the BOC is also responsible for monitoring the board of directors as well as managers so their performance will be in accordance with the interests of both controlling and non-controlling. BOC also serves to provide advice and recommendations in order to improve management performance (Public Company Law No. 40 of 2007). The effectiveness of BOC will benefit the company.

The presence of BOC in company structure is a form of adherence to the sixth OECD principle<sup>2</sup>. The last OECD principle states that good corporate governance should ensure the availability of strategic guidance for the company, the effective oversight over managers by the BOC, and each of BOC and board of directors is accountable to the company and shareholders.

Based on the Regulations of Indonesia Financial Services Authority No 33/POJK.04/2014, the number of BOC in a company must be at least two people, with either one must be appointed as the BOC chairman. The chairman task is as *primus inter pares*, which is to coordinate BOC activities.

Each BOC member, including the chairman, holds equal level of position.

### **The Effect of Family Control on Company Performance**

Higher family ownership indicates higher cash flow rights and control rights owned by controlling shareholders, which leads to the higher socio-emotional wealth of the family and helps to stabilize company business. Larger shares owned by family means higher commitment over resources that was invested in the company (Anderson and Reeb 2003). This condition signals the existence of the alignment effect. The presence of alignment effect and the high commitment from the family as controlling shareholders have positive impacts on company's performance through expropriation cost channel (Fan and Wong 2002). Therefore the first hypothesis is:

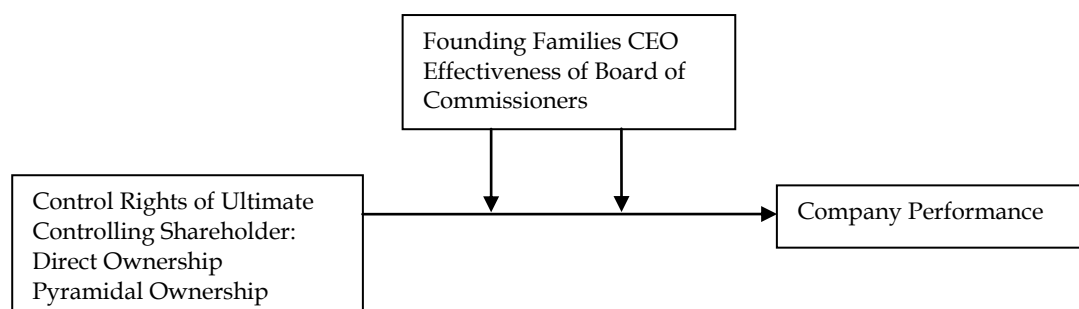
H1: Higher the family ownership leads to better company performance.

The family control rights obtained through pyramidal ownership mechanism allows a company to have control rights that exceeds cash flow rights and triggers the negative entrenchment effect (Fan and Wong 2002; Claessens S, Djankov, Fan and Lang 1999). Control rights obtained through pyramidal ownership mechanism allows family as the major controlling shareholders to use company resources to satisfy their own interests, leading to company poor performance (Morck, Wolfenzon and Yeung 2004). Based on this argument, control rights obtained through pyramidal ownership mechanism would generate a negative effect on company performance, so called entrenchment effect. Therefore, the second hypothesis is:

H2: Higher family control rights obtained through pyramidal ownership mechanism lead to poorer company performance.

Appointing company founder at the top managerial positions or the CEO means that the CEO has higher motivation to maintain company performance. Behind this argument is that when the founders sit at the top managerial positions, agency conflict between controlling and non-controlling shareholders would be limited. The controlling shareholders can easily align their own goals with company goals (Claessens, et al. 1999). The company founders would try to keep their socio-emotional wealth by maintaining the company sustainability (Andersen and Reeb 2003). The placement of founding family as the ultimate decision maker makes it easier to align family goals and company goals.

<sup>2</sup> OECD has six corporate governance principles: (1) To ensure the effective corporate governance foundation, (2) To ensure shareholders' rights and important functions in ownership, (3) Equal treatment upon all shareholders, (4) Stakeholders' roles in corporate governance, (6) Disclosure and transparency, (6) BOC's and BOD's responsibilities.



**Figure 1**  
**Research Framework**

Based on the argument it can be concluded that having founding family members placed at company top managerial positions are expected to strengthen the positive impact of family control rights through direct ownership and weaken the negative impact of family control through pyramidal ownership mechanism on company performance. Therefore the third hypothesis is:

H3: Having family members at the top managerial positions strengthen (weaken) positive (negative) effect of direct (indirect) ownership mechanism on company performance.

Board of Commissioners is responsible to oversee company policies taken by the board of directors and assess the current company performance. With a good quality oversight function, the BOS is expected to enhance the positive (negative) impact of family control through direct (indirect) ownership mechanism on company performance. The effective BOC will oversee company management, which resulted in enhancement of management performance and broaden management strategic view with their knowledge. Therefore the fourth hypothesis is:

H4: Effective BOC will enhance (weaken) the positive (negative) relationship between family control through direct (indirect) ownership mechanism on company performance.

### 3. RESEARCH METHOD

#### Research Framework

This research analyzes the hypotheses using the underlying framework as shown in Figure 1.

#### Types and Sources of Data

This research used secondary data from the company ownership structure, company leadership structure, the board of commissioners, and company performance. This research used company annual reports as primary data source to identify family ownership within a company. The annual reports were obtained from Thomson Reuters Ei-

kon, Indonesia Stock Exchange, and the company website. In the case that data of ultimate controlling shareholder could not be obtained from the annual reports, this research used data from the Department of General Law Administration, Ministry of Justice and Human Rights of the Republic of Indonesia to identify the ultimate owners of the company. The annual reports were also used to gather the data of company leadership, the effectiveness of the board of directors, and the age of the company. To determine whether the main leaders of the company are a founder or member of the family controlling the company, data of family relationships from a study by Diyanty (2012) was used.

#### Population and Sample

Population for this research is all companies listed on the Indonesia Stock Exchange from 2009 until 2013. The sample selection method is purposive sampling based on following criteria:

1. The company is in the non-financial industries
2. The company has annual financial statements in IDR.
3. The company does not have negative equity during the observation period.
4. The company is listed on the Indonesia Stock Exchange during the study period is 2009 to 2013 (never delisted, suspended, or go private during the study period).
5. The company does not engage in corporate control action, such as mergers, acquisitions, divestitures during the study period.
6. Non-State Owned Enterprises.
7. The company is not categorized as ASTINDO<sup>3</sup>

<sup>3</sup> Companies that are included in the ASTINDO category are companies of which the ultimate owners are foreign entities but in practice are still controlled by the Indonesian founding family. This practice is prevalent after the economic crisis in 1997 and 1998 when many original owners/founding family who once controlled the company were prohibited to own the shares of the

**Table 1**  
**Selection of the Companies for the Sample**

No.	Criteria of the Samples	Total
1	Companies listed on the Indonesia Stock Exchange in 2013	453
2	Companies in financial industry	79
3	Companies that have negative equity	7
4	Non-state-owned companies reporting financial statements in foreign currency	59
5	Companies of which ownership cannot be traced ownership and are not listed on stock exchanges in consecutive year 2009-2013	41
6	Companies controlled by the government	24
7	Companies controlled by foreign entities and companies categorized as ASTINDO	109
The number of samples companies		134

Source: Developed from the sample observations.

company.

The 134 sample companies were found to have fulfilled all the criteria so that the total data observation from year 2009 until 2013 was 670 data sample. Summary of sample companies' selection is available in Table 1.

#### Data Analysis Techniques

This research applied Ordinary Least Square (OLS) regression models to analyze the data. Since the data for this research is a combination of time series data and cross section data, this research applied data panel analysis. The regression model used control variables to controls other company characteristics that may affect performance. The characteristics are size of the company, age of the company, and leverage of the company.

#### Research Model

Following equation is the research model to test H1 and H2:

$$ROA_{it} \text{ or } PBV_{it} = a + \beta_1 D\text{-Own}_{it} + \beta_2 P\text{-Own}_{it} + \beta_3 Founder\text{-CEO}_{it} + \beta_4 BOC_{it} + \beta_5 Size_{it} + \beta_6 Age_{it} + \beta_7 Leverage_{it} + \varepsilon. \quad (1)$$

Following equation is the research model to test H3 and H4:

$$ROA_{it} \text{ or } PBV_{it} = a + \beta_1 D\text{-Own}_{it} + \beta_2 P\text{-Own}_{it} + \beta_3 Founder\text{-CEO}_{it} + \beta_4 BOC_{it} + \beta_5 Founder\text{-CEO}_{it} * D\text{-Own}_{it} + \beta_6 Founder\text{-CEO}_{it} * P\text{-Own}_{it} + \beta_7 BOC_{it} * D\text{-Own}_{it} + \beta_8 BOC_{it} * P\text{-Own}_{it} + \beta_9 Size_{it} + \beta_{10} Age_{it} + \beta_{11} Leverage_{it} + \varepsilon. \quad (2)$$

company. Consequently, the original owners attempted to regain control over their company through restructuring (Kim 2003). The original owners bought the company shares using foreign entities that they established or bought for that specific purpose. These foreign entities were established in countries that do not require companies to report the sources of funding and ownership structure such as British Virgin Islands or Mauritius (Kim 2003). The ASTINDO companies is identified based on data from the Business Data Centre Indonesia.

## 4. DATA ANALYSIS AND DISCUSSION

### Descriptive Statistics

Table 3 shows the descriptive statistics of sample companies. From 2009 to 2013, the majority or family owners gained controls through indirect ownership mechanism such as pyramidal ownership structure. Only 11% of the sample companies are controlled by family through direct ownership mechanism. The data were in accordance with argument presented Almeida and Wolfenzon (2006) and Diyanty (2012) in their research. They indicate that family would prefer to gain control of the company through pyramidal ownership mechanism. Weak investor protection in several countries, especially countries in Asia, enables family to applied this mechanism.

Table 4 shows the descriptive statistics of data sample. Data shows that family control through direct ownership in average has a value of 0.528 with a maximum value of 0.918. The median-value of 0 indicates that half of the family company is not controlled through direct ownership. The result is align with the results shown by Table 3 which shows the company controlled by the direct ownership is no more than 11.2% of total sample company.

In contrast, the data of control rights gained through pyramidal ownership mechanism of the ownership of the pyramid shows higher trend. Control rights gained through pyramidal ownership mechanism has an average value of 48% with maximum value of more than 90%. The median value of control rights gained through pyramidal ownership is 0.533, which indicates that family with pyramids ownership of more than 52.39% controls more than half of sample companies. It can be concluded that high control rights is largely gained by the controlling family through pyramidal ownership mechanism. This result is consistent with those presented in Table 3.

Based on the data observations, founder family still held leading positions as managing director or

**Table 2**  
**The Operational of Variables**

<b>Independent Variables</b>	
Company performance	This variable measure company's performance using ROA (accounting performance) and PBV (market to book value) as proxy. ROA is measured as net income divided by total assets.
<b>Dependent Variables</b>	
D-Own	This variable is measured in percentage of control rights through direct family ownership. Total control that were obtained by the family through direct ownership (Chung and Chan 2012).
P-Own	This variable measure control through the pyramidal ownership mechanism. Firstly, the ultimate owners of the sample company were identified. Subsequently, familial relationship between ultimate owners with other shareholders was identified to determine how much control the family group has through pyramidal ownership structure. This step is necessary since shareholders that had an alliance (i.e. family relationship) would take collective decisions in order to align their interests (La Porta, Lopez-de-Silanes, and Shleifer 1999). Family was considered to had control of a company through pyramidal ownership structure if the control gained by the family through ownership in the company's institutional shareholders was higher that the control gained by the family through direct ownership of the company. This variable is measured in percentage of control rights gained through pyramidal ownership structure.
<b>Moderation Variables</b>	
Founder-CEO	This variable measures the involvement of the founder family shareholders in the company operation. Founder of the company occupying leadership position company is expected to have a positive impact on business performance because it can mitigate the agency conflict between shareholders and the company's management due to the alignment of management goals and family goals that create a socio-emotional wealth (Anderson and Reeb 2003; Liu, Yang, and Zhang 2010). To measure the involvement, proxy of founder family member occupying company leader position such as managing director or CEO serve as proxy (Anderson and Reeb 2003). This variable is a dummy variable: 1 (one) if the company's founder family occupies a leading position within the company, and 0 (zero) if others.
BOC	This variable measures the effectiveness of the board of commissioners. This research adopts the scoring for effectiveness of the Board of Commissioners in the ASEAN Corporate Governance Scorecard that is issued by the ASEAN Capital Markets Forum (ACMF). A part of the scorecard, the responsibility of board, consists of 74 questions within five main aspects: board duties and responsibility, board structure, board processes, people of the board and board performance. The questions are yes or no type of questions. The scorecard measures the performance of Board of Directors (BOD) and Board of Commissioners (BOC). Since this research aim to evaluate the effectiveness of BOC, the questions that were not related to the BOC were omitted. To measure the effectiveness of BOC, a yes answer was given a value of 1 and no was given a value of 0. The maximum score of BOC effectiveness was 63 and the minimum was 0. Higher score indicate higher BOC effectiveness in performing its supervisory function. This variable is measured in relative score of the sample company BOC effectiveness toward the maximum score of 63.
<b>Control Variables</b>	
Size	The size of the company that is measured by the normal logarithm of the company's total assets at the end of the year.
Age	The age of the company is measured in years since the company was established.
Leverage	Leverage is measured by total debt divided by total assets.

CEO in 40.3% of sample companies. Meanwhile, the relative score of BOC effectiveness is on average 0.63 with median score of 0.69. The score means that the on average sample companies answer yes to around 39 out of 63 questions about BOC effectiveness. The median score of 0.691 and maximum score of 0.798 indicate that in more than half of the sample companies, the BOC was not yet effective in performing

their supervisory roles. The data shows that significant number of sample companies owned by the family is led by founder family members and have BOC that are not sufficiently effective.

Table 4 also shows the characteristics of sample companies in term of the company age, size, and leverage. Regarding the age, the average age of sample companies is 27 years old while the

**Table 3**  
**Type of Family Control**

Type Control	2009-2013	
	Amount	Percentage
Controlled directly	14	11.19%
Controlled indirectly	120	88.08%

Source: Computed from data observations.

**Table 4**  
**Summary of Data Sample**

Variable	Observation	Mean	Std. Dev.	Min	Median	Max
ROA	670	0.054	0.157	-1.729	0.058	0.517
PBV	670	1.863	1.875	0.152	1.079	15.543
D-Own	670	0.528	0.210	0	0	0.918
P-Own	670	0.488	0.239	0	0.533	0.972
BOC	670	0.630	0.292	0	0.691	0.798
Age	670	27.870	14.518	3	26	107
Size	670	20.988	1.648	15.441	21.119	25.065
Leverage	670	0.149	0.273	0	0.075	3.429

Founder-CEO = 40.356 %

Non-Founder-CEO = 59.644%

Source: Computed from data observations.

youngest company is only 3 years old and oldest company reach 107 years old. The median age of sample company is 26 years, which means half of the sample companies used has been in operation for more than 26 years. The age of the sample company is highly varied as shown by the high standard deviation value of 14 years. Regarding the size of sample companies that were measured by the natural logarithm of the total assets, the average value is 20.9884 with a standard deviation of 1.648. Meanwhile the leverage, which is the ratio of long-term debt to total assets, of sample companies has an average value of 0.149 with a standard deviation of 0.273. The median leverage value is 0.075, which means that more than half of sample companies had relatively low ratio of long-term debt to total assets at less than 0.075. The data indicated that majority of sample companies were not dependent on funding from debt.

### Hypotheses Testing

This research applied regression with robust standard errors. Result of the regression analysis is shown in Table 5 and Table 6. Table 5 shows the result of model (1) and (2) with accounting performance as dependent variable. Accounting performance was represented by ROA ratio. Table 6 shows the result of model (1) and (2) with market performance as dependent variable. Market performance was represented by ratio of stock market value to book value (PBV). The result shows that both model (1) and model (2) were significant at

99% confidence level. It means that in overall the model was reliable to explain the variances in dependent variable, either the accounting performance or market performance.

### The Effect of Direct Ownership on Corporate Performance

Table 5 and Table 6 show significant positive result for direct ownership variable when tested using both the accounting performance and market performance as dependent variable. This result indicates that proposed hypothesis of positive effect of the control rights by controlling family gained through direct ownership to company performance is confirmed. It provide an evidence that direct ownership trigger alignment effect between controlling shareholders which is assisted by company management and non-controlling shareholders. The alignment effect enable them to work together to improve the company's performance.

This result supports the results of research conducted by Chung and Chan (2012), which concluded the higher family control through direct ownership mechanism boost the company's performance. The high control rights obtained through direct ownership ensure that controlling shareholders and company management were committed to enhance the value of the company and develop the company's business (Gómez-Mejía, et al. 2007). Controlling shareholders had high commitment to improve the performance of the company since the direct control was acquired using significant in-

**Table 5**  
**Regression Result with Accounting Performance as Dependent Variable**

Model (1)

$$ROA_{it} = \alpha + \beta_1 D\text{-Own}_{it} + \beta_2 P\text{-Own}_{it} + \beta_3 \text{Founder-CEO}_{it} + \beta_4 BOC_{it} + \beta_5 \text{Size}_{it} + \beta_6 \text{Age}_{it} + \beta_7 \text{Leverage}_{it} + \varepsilon$$

Model (1): Prob. F = 0.0076; R-Squared = 0.31812

Model (2)

$$ROA_{it} = \alpha + \beta_1 D\text{-Own}_{it} + \beta_2 P\text{-Own}_{it} + \beta_3 \text{Founder-CEO}_{it} + \beta_4 BOC_{it} + \beta_5 \text{Founder-CEO}_{it} \times D\text{-Own}_{it} + \beta_6 \text{Founder-CEO}_{it} \times P\text{-Own}_{it} + \beta_7 BOC_{it} \times D\text{-Own}_{it} + \beta_8 BOC_{it} \times P\text{-Own}_{it} + \beta_9 \text{Size}_{it} + \beta_{10} \text{Age}_{it} + \beta_{11} \text{Leverage}_{it} + \varepsilon$$

Model (2): Prob. F = 0.005; R-Squared = 0.2875

Variables	Sign	Model 1		Model 2	
		Coef	Prob	Coef	Prob
Constants		-0.134	0.056	-0.34	0.056
D-Own	+	0.251*	0.075	0.242*	0.053
P-Own	-	-0.153*	0.066	-0.450*	0.086
Founder-CEO	+	0.012**	0.020	0.433**	0.015
Founder-CEO*D-Own	+			0.544***	0.001
Founder-CEO*P-Own	+			0.243***	0.007
BOC	+	0.016**	0.034	0.056**	0.046
BOC*D-Own	+			0.567	0.899
BOC*P-Own	+			0.345	0.556
Age	+	0.001**	0.0291	0.456*	0.078
Size	+	0.023	0.870	0.548	0.651
Leverage	-	-0.113**	0.0166	-0.245*	0.056

\*\*\*Significant at the 1% level ( $p \leq 0.01$ ); \*\*Significant at the level of 5% ( $p \leq 0.05$ ); \*Significant at 10% ( $p \leq 0.1$ ).

Source: Computed from data observations

vestment so that controlling shareholders was highly motivated to oversee the performance of company management that would ultimately improve the company performance.

### The Effect of Pyramidal Ownership on Company Performance

Table 5 and Table 6 show significant negative result for pyramidal ownership variable when tested using either the accounting performance or market performance as dependent variable. The results confirm the hypothesis that control rights gained through pyramidal ownership structure have significant negative effect on company performance. Results of this research provide evidence to the argument that the family owners who controls the company through pyramidal ownership structure tends to expropriate (Claessens, Djankov, Fan and Lang 1999). The pyramidal ownership mechanism enable the family owners to gain strong control of the company with relatively small investment which lead to differences between the cash flow rights and the voting rights or the control rights owned by the family owners (La Porta, Lopez-de-Silanes and Shleifer 1999; Claessens, Djankov, Fan and Lang 2002). The differences means that the risk of loss borne by the family through pyramidal

ownership is smaller when compared to risk of loss borne by the family through direct ownership and consequently the family would have higher motivation to expropriate (Claessens, Djankov, Fan and Lang 2002). Expropriation done by the family would cause suboptimal utilization of company resources that would adversely affect the performance of the company (Morck, Wolfenzon and Yeung 2004).

The performance of the company is also affected by the risk that is borne by the company. Control rights obtained through direct ownership structures require relatively large investment so that the risk of loss borne by the family is larger (Anderson and Reeb 2003). Consequently, the family would lead the company to be conservative and only take on projects that have low risk with relatively smaller returns (Ben-Amar and Andre 2006). On the other hand, pyramidal ownership structures enabled the family to gain control with relatively low investment so that the risk borne by the family is lower (La Porta, Lopez-de-Silanes and Shleifer 1999). Therefore, the family would direct the company to choose project that have higher risk to get additional higher revenues as well. However, higher risk projects also poses higher risk of loss for the company.

**Table 6**  
**Regression Result with Market Performance as Dependent Variable**

Model (1)

$$PBV_{it} = \alpha + \beta_1 D\text{-Own}_{it} + \beta_2 P\text{-Own}_{it} + \beta_3 \text{Founder-CEO}_{it} + \beta_4 BOC_{it} + \beta_5 \text{Size}_{it} + \beta_6 \text{Age}_{it} + \beta_7 \text{Leverage}_{it} + \varepsilon$$

Model (1): Prob. 00 F = 0.00 ; R-Squared = 0.2241

Model (2)

$$PBV_{it} = \alpha + \beta_1 D\text{-Own}_{it} + \beta_2 P\text{-Own}_{it} + \beta_3 \text{Founder-CEO}_{it} + \beta_4 BOC_{it} + \beta_5 \text{Founder-CEO}_{it} * D\text{-Own}_{it} + \beta_6 \text{Founder-CEO}_{it} * P\text{-Own}_{it} + \beta_7 BOC_{it} * D\text{-Own}_{it} + \beta_8 BOC_{it} * P\text{-Own}_{it} + \beta_9 \text{Size}_{it} + \beta_{10} \text{Age}_{it} + \beta_{11} \text{Leverage}_{it} + \varepsilon$$

Model (2): Prob. 00 F = 0.00 ; R-Squared = 0.1762

Variables	Sign	Model 1		Model 2	
		Coef	Prob	Coef	Prob
Constants		-0.254	0.456	-0.435	0.087
D-Own	+	0.015*	0.017	0.765**	0.025
P-Own	-	-0.167***	0.001	-0.766**	0.016
Founder-CEO	+	0.011*	0.062	0.542*	0.074
Founder-CEO*D-Own	+			0.542*	0.067
Founder-CEO*P-Own	+			0.786*	0.096
BOC	+	0.654**	0.023	0.086	0.45
BOC*D-Own	+			0.542	0.654
BOC*P-Own	+			0.732	0.321
Age	+	0.021***	0.00291	0.167***	0.001
Size	+	0.56	0.621	0.823	0.154
Leverage	-	0.342	0.0752	0.986	0.078

\*\*\*Significant at the 1% level ( $p \leq 0.01$ ); \*\*Significant at the level of 5% ( $p \leq 0.05$ ); \*Significant at 10% ( $p \leq 0.1$ )

Source: Computed from data observations.

### The Moderation Effect of Founder Leadership

The third hypothesis in this research is that the moderating effects of founder leadership to the effect of family control on company performance. This research argue that founder leadership increase the alignment effect and decrease the entrenchment effect of family control on company performance. The results of model (2) in Table 5 and Table 6 shows that the moderation effect of founder leadership to direct ownership and the moderation effect of founder leadership to pyramidal ownership is significant and positive. The result confirms that the founder family occupying principal director or CEO position of the company strengthen the alignment effect and reduce the entrenchment effect of family control on corporate performance.

Placing the founder of company in a top management position strengthen the motivation of company leaders to maintain the company performance. In addition, having the founder of the company in the top management position reduce the agency conflict between controlling shareholders and non-controlling shareholders since occupying the top management position enable the founder family as the controlling shareholders to easily align its objectives with company goals (Claessens, et al. 1999). Founder of the company have high so-

cio-emotional wealth connection with the company so that he will be continuously motivated to develop and improve the performance of the company, which would ultimately enhance shareholders value.

Founder of the company will also strive to maintain its socio-emotional wealth by maintaining the continuity of the business (Andersen and Reeb 2003). Placement of members of the founder family as the main leader of the company, which is the top position in determining the policies taken by the company, facilitates the family to maintain its socio-emotional wealth. Another benefit of founder of the company occupying main leadership position of the company is that it provides unique access to the resources needed by the company through relationships with beneficial parties and wider investment horizon that benefit for the company (Liu, Yang and Zhang 2010; James 1999).

However, by restricting the leadership position of the company to the founder of the company or to members of founder family, it narrows the possibilities for the company to obtain higher quality corporate leaders who did not come from the family (Anderson and Reeb 2003). This could give the company a competitive disadvantage in the future.

### The Moderation Effect of BOC Effectiveness

Board of Commissioners is an important part for the implementation of good corporate governance and is expected to provide oversight and advice to support the performance of the management of the company as stated in the Company Act of 2007. This research attempted to see how the role of the Board of Commissioners through its supervisory function could improve alignment effect and reduce the entrenchment effect.

The results of model (2) in Table 5 and Table 6 shows that the moderation effect of BOC effectiveness to direct ownership and the moderation effect of founder leadership to pyramidal ownership is not significant. The results indicate that effectiveness of the Board of Commissioners in performing its supervisory function is not confirmed to increase alignment effect and reduce entrenchment effect. One explanation is in Indonesia there are no rules or code of corporate governance practices that explicitly state the obligation of BOC to develop performance indicators or to approve certain company transactions. The World Bank in the report of corporate governance practices in Indonesia in 2010 reports this issue. In addition, Annual General Meeting, which was dominated by family owners as the major shareholders with higher vote, appointed the Board of Directors as well as the Board of Commissioners. Therefore, the ability of Board of Commissioners to oversee the actions of the family owners and the company management is limited. It means that the Board of Commissioners cannot reduce the negative impact of the family control either through direct ownership or through the pyramidal ownership on company performance.

### 5. CONCLUSION, IMPLICATION, SUGGESTION, AND LIMITATIONS

This research was conducted to examine the effect of family as controlling shareholders to company performance. This research differentiates between family control acquired through direct ownership mechanism and family control acquired through pyramidal ownership structure. This research is important because most companies (over 50%) in Indonesia are controlled by family (Claessens et al. 2000; Diyanty 2012). Results of this research on the impact of family control through direct ownership on company performance shows that results that family control through direct ownership mechanism positively influence the performance of the company. On the other hand, family control through pyramidal ownership mechanism is confirmed to have negative

effect on the company performance. Both proxies of company performance, which are accounting performance and market performance, show the same result. The negative effect is significant enough to signify the importance of the information about the pyramidal ownership structure toward investors and non-controlling shareholders. Therefore, this information should be disclosed.

This study also examined how leadership of the founding family and the effectiveness of the board of directors affect the relationship. The research found that founder of the company occupying main director or CEO position was confirmed to improve the alignment effect that occurs when family control the company through direct ownership mechanism. Founder leadership was also confirmed to decrease the negative entrenchment negative that the family control obtained through pyramidal ownership structure on company performance. This result provide an evidence that while appointing founder or member of founder family as CEO or president director might have disadvantages, the benefit is also apparent and significant. Therefore, regulators, investors, and non-controlling shareholders should consider the appointment of founder or member of founder family as an option to ensure the family as controlling shareholder would take appropriate actions to ensure the maintenance of company value and the continuity of the business.

The examination of the role of the Board of Commissioners effectiveness indicated that Board of Commissioners was unable to affect alignment and entrenchment effect of family control to company performance. The result signify the need to improve the role of Board of Commissioners in ensuring that the management (which in some cases controlled by the family) to act for the best interests of the company. From the perspective of the investors and non-controlling shareholders, it could means stricter and or more efficient appointment and evaluation process of Board of Commissioners. From regulator point of view, more regulation and or more effective law-enforcement is necessary to ensure that the Board of Commissioners role is optimal.

Nevertheless, this research has several limitations, which need to be considered when interpreting the results of this research. One of the limitations is that this research was unable to trace the ultimate owners of some companies since the companies are owned by foreign entities. Data on these foreign entities is essential to find out the real ultimate owner the Indonesia companies. In addition, this research only used secondary data in the as-

assessment of the effectiveness of the board of commissioners. It means that the degree of accuracy of the data is not guaranteed. Therefore, future research could consider the use of primary data in the measurement of the effectiveness of the board of commissioners.

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