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Family Management, Executive Compensation and Financial Performance of Indonesian Listed Companies

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Abstract

Most of Indonesian listed companies are managed by family. This trait is an interesting trait to be investigated with regards to financial performance. This study aims to examine the effects of family management and executive compensation on financial performance. The research sample is 303 Indonesian listed companies. This study finds that family management has no effect on ROA but has a negative effect on Tobin's Q. This finding indicates that investors perceive this as unadvantageous conditions. This indicates that family management is harming minority shareholders. Another result shows that executive compensation has a positive effect on financial performance.

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Keywords: Family Management, Executive Compensation, Financial Performance, ROA, and Tobin's Q.

1. Introduction

Family business is an interesting phenomenon to be studied. This is because family business has an important role in the economy of a country, especially in developing countries such as Indonesia and other Asian countries. It has been shown that family business occupied approximately 50% of all listed firms and 32% of total market capitalization (Fan et al.2011). Fan et al. (2011) also showed that family businesses outperformed listed firms in Indonesia Stock Exchange (IDX) after the economic crisis. Indonesian family business'stock performance is the best from the 10 countries studied by the increasing P/E ratio from 5.3 times to 22 times. Indonesian family business' market

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capitalization reaches 61% of Indonesia Stock Exchange (IDX) market capitalization.

Several previous researches investigating the relationship between family management and firm performance were conducted in western countries. However, the results of some of the studies are inconsistent especially when associated with company performace (Anderson & Reeb, 2003). Family managers tend to seek additional skill to improve his own and the corporation's welfare, as well as to enhance family reputation. On the contrary, family business has a negative relationship with firm performance (Allouche et al., 2008; Cucculellia & Micucci, 2008; Sciascia & Mazzola, 2008; Miralles-Marcelo et al., 2014). This is because families do not always act for the best interest of the company (Block et al., 2011). Another reason is that the appointment of independent directors on the board do not affect firm performance (Leung et al., 2014; Kim & Gao, 2013).

Results of studies which show positive effect to company performance are because the company has good control. The control of board director in family business can be done by concentrating interest or the presence of family member in the board director (Jaggi et al., 2009). The presence of a director with family ties gives a huge benefit for the firms in S&P 500; this could be caused by families that have a better understanding of the firm and assumed themselves as stewards (Anderson & Reeb, 2003). In Japan, family firms already outperformed non-family firms (Saito, 2008). The presence of family management and family ownership in Lebanon's firms has a positive relationship with financial performance (Charbel et al., 2013). The presence of directors with family ties in Taiwan also has positive relationship with the firm performance (Chen, 2013).

Another issue related to family management is about management compensation. This issue is related to how a firm will pay the family member on the board, whether they will be paid equally to professionals or not (Anonim, 2013). Some previous studies show inconsistent results. Fernandes (2008) investigated a relationship between board compensation and firm performance, but he did not find any relationship, while Duffhues & Kabir (2008) found a negative relationship between board compensation and firm performance. Kato & Kubo (2006) analyzed CEO compensation in Japanese firms and found a positive payment for the performance. Unite et al., (2008) found a positive relationship between executive compensation and firm performance. Theeravanich (2013) found that family firms' performance had a positive relation on board compensation and also excess compensation for family firms.

This research at least can contribute in two ways. First, this research will offer the effect of family management on firm performance. In addition, it also provides the effect of executive compensation on firm performance in Indonesia.

2. Literature Review and Hypothesis Development

2.1 Agency Theory and Family Management

Agency theory type I is a theory based on contract between principal and agent on the firm (Jensen & Meckling, 1976). Agency theory type I highlights the conflict between managers and shareholders. Based on agency theory type I, the firm with family management is one of the efficient organization forms and with least agency cost (Fama & Jensen, 1983). Besides, the unique structure of family business motivates family managers to work, achieves company's goal and contributes to firm performance (Kim & Gao, 2013). Based on agency type I, family management will impact firm performance positively.

In accordance with agency theory, Saito (2008) and Gonzalez et al. (2012) found a superiority performance at firms with family management. Allouche et al.(2008), Chen(2013), Charbelet al.(2013) and Sciascia (2014) showed a positive relationship between family management and firm performance, while Blocket al.(2011) found that family management had an ambiguous effect on firm performance. In addition, Sciascia & Mazzola (2008) Cucculellia & Micucci (2008) and Miralles-Marceloet al. (2014) found that family management negatively impacted firm performance.

H_1: Family Management affects firm performance positively.

2.2 Optimal Contracting Hypothesis and Executive Compensation

Executive compensation is one of the problems of family business. Compensation is naturally related to the firm performance (Shao et al., 2012; Jensen & Meckling, 1976). The relationship between compensation and executive