Corporate Governance & Ethical Behavior affecting Performance:
Propositions and Peculiarities at Indonesian Firms within its Institutional context

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ABSTRACT

The study examines what specific corporate governance attributes are affecting financial performance in Indonesian public listed companies during the 2011-2014 period within a historical and cultural context of institutional voids. We contribute to the business ethics and global corporate governance literature by emphasizing the idiosyncratic characteristics of a corporate governance that help to reduce unethical and nepotistic behavior in an emerging market. This research elucidates firm level governance factors that most likely to impact firm performance in emerging markets. In doing so, we provide insight into how existing and potential domestic and foreign shareholders could reduce unethical behavior and by extension investment risk in emerging markets like Indonesia. Use of the big four auditors and transparency with respect to detailed ownership and specifying or forbidding related party transactions had a positive effect on firm performance. Foreign ownership and board training had a very mild positive correlation with operating performance, whereas family and state block-holding shares did not really affect financial returns.

Keywords: Unethical behavior in emerging markets, Transparency and RPTs, Family & State Ownership, Foreign Institutional Investors, Institutional voids and Firms at the Indonesian Stock Exchange.

INTRODUCTION

Corporate governance has become a mainstream concern when making investment decisions in boardrooms and policy circles around the globe. Several events have caused the heightened interest in corporate governance: corporate debacles, unethical behavior and fraud, economic and financial crises, and the growing global interdependency of financial markets. Indeed, the recent financial global crisis has reinforced how *failures in corporate governance* can harm shareholders and even ruin firms and adversely affect whole economies, both in the West as in other markets (Claessens & Yurtoglu, 2013; Hawley, 2011; Leuz, Lins & Warnock, 2008; Rajan & Zingales, 2003). Good *corporate governance practices* have been perceived by investors as reducing information asymmetries and thus limiting risk and improving performance, especially in emerging markets (Morck & Yeung, 2004; Brown & Caylor, 2006; Dvorak, 2005; Kang & Kim, 2010). Moreover, we interpret the implementation of better disclosure standards through particular corporate governance standards as a proxy to reduce unethical behavior (Khalil, Saffra & Trabelsi, 2015; Guedhami & Pittman, 2006 & 2011). Unethical behavior such as bribery or potential expropriation of minority shareholders' assets is often correlated with accounting standards and governance standards (Bushman & Smith, 2001; Baughn, Bodie, Buchanan & Bixby, 2010; Durnev & Kim, 2005; Kaufmann & Wei, 1999). In other words, good corporate governance practices and ethical behavior seem to be closely correlated.

However, we know little about how the effectiveness of corporate governance practices varies due to the institutional and cultural idiosyncrasies of different nations (Aguilera & Cuervo-Cazurra, 2004). For instance, Indonesia presents a unique cultural setting in a dynamic economy with the potential to advance the wellbeing of approximately 250 million people. Yet, we do not have a theoretical framework that explicitly addresses why corporate governance practices and thus executives' behavior differ across countries or over time (Aguilera & Jackson, 2002, 2003 & 2010),

and we consequently lack in-depth knowledge concerning the transferability of corporate governance practices from one context to another assumed to add value.

When firms or investors choose a country to invest in, the entire institutional legal framework of the country and its governance regulations plays a crucial role (Aguilera, Filatotchev, Gospel & Jackson, 2008; La Porta, Lopez-De-Silanes, Schleifer, 1999; Lien, Piesse, Strange & Filatotchev, 2005; Filatotchev, Strange, Piesse & Lien, 2007; Slangen& Van Tulder, 2009; Anderson & Gupta, 2009; Richter & Weiss, 2013; Fan, Wei & Xu, 2011; Verhezen, Williamson, Crosby & Soebagjo, 2016). When a host country is characterized by low governance quality – as in high opacity or a lack of transparency and high levels of perceived corruption – it deters some investors from entering, while high governance quality incentivizes foreign firms to operate or invest in the host country (Chang, Kao & Kuo, 2014; Chen, Chen & Wei, 2009; Doidge, Karolyi & Stulz, 2007; Kurzman, Yago, & Phumiwasana, 2004; Kurzman & Yago, 2007; Singh & Zammit, 2006). Due to this potential deterrence, a company in countries with relatively poor governance standards may decide to enhance and adopt its *firm-level corporate governance* to strengthen its competitive attractiveness to foreign investors within the existing in legal and socio-political institutions, and improve the firm's performance in the process (Klapper & Love, 2004; Khanna & Zyla, 2013; Adegbite, 2015; Cheung, Jiang, Limpaphayom & Lu, 2008; Aguilera & Jackson, 2003 & 2010).

This study contributes to the comparative corporate governance and international business ethics literature by providing insight into the differential performance effects of various firm-level dimensions of corporate governance in an emerging market context in which legal institutions often flounder (Khanna & Palepu, 2000 & 2006). We do so by exploring the influence of various governance variables – or "bundles" of governance practices – upon performance of publicly listed Indonesian firms (Aguilera, Desender, Kabbach de Castro, 2012). We also postulate that improved implementation of financial disclosure and reliance on credible intermediary gatekeepers such as auditors will positive affect the firm's performance in countries characterized by weaker legal

institutions (Ball, 2001; Ball, Robin & Wu, 2003; Barth, Lin, Lin & Song, 2009; Reddy, Locke & Scimgeour, 2010). We believe that this empirical research makes two main theoretical contributions. First, we extend the global corporate governance and international ethics business research in the context of emerging markets by identifying a number of corporate governance attributes that are most likely to affect the firm's performance in an emerging market context, and consequently may influence foreign investment in firms in an emerging country such as Indonesia. While progress has been made in exploring the diffusion of governance practices and their effectiveness (Aguilera, Filatotchev, Gospel & Jackson, 2008; Aguilera & Cuervo-Cazurra, 2008), there remains a dearth of research exploring how this diffusion has translated into more robust economic results; textured knowledge of what works (or does not) leaves prospective investors and minority shareholders without a framework for understanding whether to take comfort in assertions by emerging markets firms that they comply with international best practice in corporate governance. We add texture to understanding which dimensions of comparative corporate governance are most critical to operating performance and attracting investment in emerging markets through reducing the risks associated with governance. This provides guidance regarding which corporate governance practices are mostly likely to strengthen ethical behavior of management and board members at the firm level on the one hand and the firm's performance outcomes which could encourage further equity investment at the other hand. Further, we contribute to the business ethics literature within emerging market context by explaining some positive and/or negative effects of corporate governance practices within family business and to a lesser degree, state owned enterprises in emerging markets.

We test our hypotheses using a sample of 368 firm years from 85 listed firms on the Indonesian Stock Exchange and 10 non-listed Indonesian firms over a four year period from 2011 till 2014, enriched by 36 interviews of executive and non-executive directors of listed companies in Indonesia during 2013 and 2017. The findings of these interviews are mainly used to corroborate our empirical findings and to fine-tune the insights of both foreign and local executives and

investors within this very different institutional context. As noted above, some of the results were in line with the overall governance literature but some of the outcomes were quite counter-intuitive. The data from the published annual reports of listed companies in Indonesia provides evidence that a firm's financial performance is significantly influenced by various governance mechanisms and even more so by the independencies of corporate governance practices within Indonesia that is characterized by comparatively diverse technical, managerial and institutional context (Aguilera, 2005; Aguilera, Filatotchev, Gospel & Jackson, 2008; Aguilera & Cuervo-Cazurra, 2004 & 2009 Huyghebaert & Wang, 2012; Lozano, Martinez & Pindado, 2016; Utama, 2012; Andiani & Frensidy, 2015; Chen & Yu, 2012; Kim & Yi, 2006; Low 2004). However, possibly equally revealing are our non-findings across various other dimensions of corporate governance that are assumed mainstream in Anglo-Saxon governance context. This empirical research did not find the typical assumed agency problems, indicating that other linkages and interdependencies of corporate governance practices may play a more crucial role in an emerging institutional market context.

THEORY DEVELOPMENT AND HYPOTHESES

In this section, we take into account the embeddedness of Indonesian firms within the institutional emerging market context. First, we look how particular institutional characteristics influence the firm's corporate governance which in turn does affect investors in an emerging country as Indonesia, and second, we determine *which* specific governance attributes are relevant to affect the firm's performance in an emerging Indonesian market context, and subsequently, we specifically assess how we developed our hypotheses to effectively falsify which corporate governance attributes of the 85 randomly chosen publicly listed Indonesian companies among the biggest 300 firms on the Indonesian Stock Exchange (ISX) correlate with the firm's financial performance between 2011 and 2014. The insights we obtained from the interviews functioned as a check-and-balance of the statistically significant empirical results, and helped us to hypothesize some "rules of thumbs" to limit institutional deficiencies so characteristic in Indonesia.

LITERATURE REVIEW

Comparative Firm-Level Corporate Governance and Business Ethics

Comparative international governance research distinguishes between two main stylized corporate governance models – the outsider or Anglo-Saxon shareholder model versus the insider or stakeholder model (Aguilera & Jackson, 2003, 2010).

Under a narrow definition of corporate governance, the focus is on the rules in capital markets governing equity investments (Schleifer & Vishny, 1994 & 1997; Jensen, 2002), which includes listing requirements, insider dealing arrangements, disclosure and accounting rules, and protections of minority shareholder rights. This Agency Theory or [Anglos-Saxon] Shareholder Model sees the firm as a nexus of contracts between principals (owners) and agents each pursuing their own interest which often conflict (Berle & Means, 1932; Fama, 1980; Fama & Jensen, 1983a & 1983b; Jensen & Meckling, 1976). The Agency model assumes isolated bi-lateral contracts between principals and agents, focusing on contractual efficiency whereby corporate governance mechanisms aim at reducing this agency cost by aligning management to shareholders' interest, providing legal provisions such as information disclosure and accounting requirements to provide control, and efficient markets for corporate control (Aguilera & Jackson, 2002). However, this single focus seems to overlook the linkages or complementarities between culture and institutions in contexts that are fundamentally different from the mainstream Anglo-Saxon context.

In line with this focus on providers of capital in public listed firm, the corporate governance definition emphasizes how to protect outside investors against expropriation by insiders (Chang, 2003; Reese & Weisbach, 2002) or how potential conflicts of interest between various corporate claimholders can be reduced (Claessens & Yurtoglu, 2013; Chew & Gillan, 2009). This definition of corporate governance, at least, fine-tunes the differences between shareholders within one firm, but still ignores the socio-ethical assumptions, coalition-forming among multiple actors (whose

objectives may be conflicting or complementary) and institutional embeddedness of the firm in a broader cultural-political context (Granovetter, 1985; Cyert & March, 1963; Aguilera & Jackson, 2002).

A broader definition of corporate governance – as expressed by the OECD principles of corporate governance – reflects the determination of value-added by firms and the allocation of this value creation among its relevant stakeholders that have significant relationships with the corporation (Chen, Li & Shapiro, 2011; Coles, McWiliams & Sen, 2001; Rezaee, 2007; Zingales, 1998). The OECD Principles of Corporate Governance (2004) stipulate that all shareholders should be treated equally and that board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and both its shareholders and stakeholders. Broadening the stakes beyond shares, allows the stakeholder theory to recognize that the effectiveness of corporate governance practices also depends on the influence stakeholders may have on the firm (Freeman, 1984). From an institutional perspective, the focus turns to the interactions between insider-outsider conflicts and accountability conflicts in an emerging market context like Indonesia. We specifically argue that good corporate governance practices as in more transparency and better financial information disclosure will likely reduce the likelihood of majority shareholders expropriating the firm's assets at the expense of minority shareholders. Similarly, nepotistic non-meritocratic behavior by board members favoring some managers above others – all examples of unethical behavior by powerful boards – could be prevented by implementation of good corporate governance. Our governance research is aligned with the research that argues for higher disclosure standards, stronger litigation risks and possible sanctioning against auditors which will deter unethical behavior in general and in particular will limit possible "bribing" of government officials to secure government contracts for instance or misleading auditors who are assumed to be guardians of credibility for the information disclosed (Khalil, Saffar and Trabelsi, 2015; Fan & Wong, 2002; Leuz, Nand & Wysocki, 2003; Pacini, Rogers & Swingen, 2002).

Corporate governance then becomes the range of institutions, policies and power decision-making processes that are involved in making an organization function to create value (Cheung, Connelly, Estanislao, Limpaphayom, Lu & Utama, 2014). Institutions become the informal and formal rules of the game which usually serve the interests and ideas of the most powerful groups (North, 1990), or institutions can become a self-sustaining system of shared beliefs about a salient way in which the game is repeatedly played (Aoki, 2001b). Adhering an institutional approach, corporate governance can therefore be conceptualized as *the nexus of contractual agreements and relationships among shareholders and stakeholders in the process of decision-making and control over the firm resources to create value in a sustainable and ethical manner* (Aguilera & Jackson, 2003; Badaracco, 2013 & 2016; Charan, Carey & Useem, 2014; Verhezen, 2010).

Indonesian companies within a civic [Continental] law context have adopted a hybrid firm-level formulation of a "bundle" of corporate governance practices that suits their interests. These practices, thought to lower agency costs elsewhere in the world, have the potential to affect their financial performance; yet the institutional idiosyncrasies of any country are likely to impact the effectiveness of this bundle of practices (Garcia-Castro, Aguilera & Ariño, 2013). Organizational practices are therefore developed and adapted to address these potential conflicts, tensions, linkages and even complementarities among the different actors, all aiming to optimize their own interests and objectives (Aoki, 2001a; Aguilera & Jackson, 2002). Sometimes, a set of informal institutions or practices may shape, constrain and interact the boundaries of corporate law. Sometimes these informal institutions such as norms and particular practices may even substitute in filling "institutional voids" – i.e. the absence of specialist intermediaries, regulatory systems, and contract-enforcing mechanisms (Khanna & Palepu, 2006: 62; Aguilera & Jackson, 2010; Roe, 2002).

One of the main challenges for international or local investors who focus on emerging markets is to deal with considerable *information asymmetries* in those less transparent emerging markets that could negatively affect the expected long-term income or return on the investment (Dvorak, 2005; Black, Jang & Kim, 2006). Good corporate governance practices assumedly have

a positive impact an enterprise's performance both in the developed world and even more so in the emerging market (Utama, 2012; Agrawal & Kroeber, 1996; Andiani et al, 2015; Balusbramanian, Black & Khanna, 2010; Balsmeier & Czarnitzki, 2011; Demsetz & Villalonga, 2001). Indeed, research has convincingly shown us that an increased level of financial reporting transparency will reduce the chances of bribery since such enhanced openness and disclosure reduces information asymmetry and exposes management guardianship of valuable firm's assets to public scrutiny (Dyck & Zingales, 2004; Healy & Serafeim, 2012).

Particularly in emerging economies with weak institutions, the challenge for foreign investors is not the traditional agency problem between dispersed ownership and powerful top executives, but rather the agency costs resulting from information asymmetry between local majority owners and foreign (or local) minority owners (Chang, 2003; Claessens, Djankov & Lang, 2000; Claessens & Yurtoglu, 2013; Aguilera *et al*, 2003 & 2004; Verhezen, Williamson, Crosby & Soebagjo, 2016). These relatively high levels of information asymmetries causing specific governance risks – i.e. not protecting minority shareholders - are usually associated with underdeveloped or not-fully functioning legal and business environments, carrying a significant cost when operational or investing in emerging markets (Filatotchev, Strange, Piesse & Lien, 2007; Wright, Filatotchev, Hoskisson & Peng, 2005; La Porta, Lopez-de-Silanes, Schleifer & Vishny, 2000 & 2002). Agency and Institutional perspectives suggest that particular governance structures and relationship-based governance or network culture perspectives in emerging markets have a direct impact on strategic decisions such as foreign direct investments (Douma, George & Kabir, 2006; Li, 2003; Hillman & Thomas, 2003). When foreign or local investors seek opportunities across borders - investment or joint venture opportunities in listed companies on the Indonesian Stock Exchange - global brokerages seem to have a disadvantage in the short term, but show higher long-term profits compared to local brokerages, which can be partially explained by short-term information asymmetries between foreigners and locals that disappear over a longer period (Dvorak, 2005).

Corporate governance research demonstrates that in general, stronger corporate governance practices lower the cost of capital and positively influences firm value (Gompers, Ishii & Metrick 2003; Klapper & Love 2004; Durnev & Kim 2005; Claessens & Yortuglu, 2013). However, other research indicates some form of "reverse governance" in Korean firms, where high performing firms may adopt good governance practices, partially to signal the intention of good behavior by insiders towards outside minority (foreign) investors (Black, Jang & Kim, 2006). Foreign investors tend to invest in firms with good corporate governance because effective corporate governance offers lower agency problems and therefore lower risk (Leuz, Lins & Warnock, 2008). And the motivation to expropriate is lower when minority shareholders are more protected in a country with higher investor protection, such as in common law countries (La Porta, Lopez-De-Silanes, Schleifer & Vishny, 2000 & 2002; Lozano, Martinez & Pindado, 2016).

The specific characteristics of [weak] legal institutions where *potential conflict of interests* between majority and minority shareholders and *corruption* and *property rights violations* at all levels of society are rife (North, 1990; Aoki, 2001; Filatotchev, Jackson & Nakajima, 2003; Healy & Serafeim, 2012; Kaufmann, Kraay & Mastruzzi, 2010; Verhezen, Williamson & Soebagjo, 2018). We specifically focus on the attempt by majority [local] shareholders to signal the implementation of particular "best corporate governance" practices to lure [foreign] investors, who are well aware of these *potential conflicts of interest* and the rampant *corruption* and *property rights violations* in Indonesia (Verhezen, Williamson, Crosby & Soebagjo, 2016).

Despite the recommendations of some universal "context-free" governance principles, it is argued in this paper that no "one best corporate governance way" exists (Filatotchev & Jackson, 2013). Effective corporate governance depends upon the alignment of interdependent organizational, firm and environmental characteristics, and how the legal environment, the ownership structure, systems of governance and the functioning of the board of directors are often intertwined. The governance effectiveness depends on the costs, contingencies and complementarities associated with its [socio-political and legal institutional] context (Aguilera,

Filatotchev, Gospel & Jackson, 2008; Aguilera, Desender, Kabbach de Castro, 2012; La Porta *et al*, 1999 & 2000 & 2002; North, 1990; Pfeffer, 1972).

Most of the 85 firms analyzed as in a growing or mature phase of their life cycle, and their governance effectiveness partially depends on adapting to different monitoring, resource, and strategy roles – instead of conforming to a universalistic governance model. In a "relational-oriented governance logic", these Indonesian listed firms emphasize transparency and the increasing control and monitoring by external providers of resources (Aguilera, Filatotchev, Gospel & Jackson, 2008; Aguilera, Judge & Terjesen, 2016).

The business ethics literature has shown that crony capitalism and corruption not only negatively affect firm-level performance and transparency, but they also heighten uncertainty and raise costs for cross-border transactions (Attig, Guedhami & Mishra, 2008; Chen, Ding & Kim, 2010; Habib & Zurawicki, 2002; Brown, 2006). Corruption and other institutional voids significantly affect how governance mechanisms may or may not function in a particular emerging market context (Claessens & Yurtoglu, 2013; Verhezen, Williamson & Soebagjo, 2018; Aguilera, Filatotchev, Gospel & Jackson, 2008). Our fundamental insight implies that the centrality of a firm's desired reputational advantage – to reduce corruption and potential expropriation – vis-à-vis an investment community may be the key trigger of governance "deviance" from the agency theory in Indonesia.

Furthermore, the effects of politics in general and specifically corporate political connections systematically influence business practices around the world, and subsequently the performance of these politically connected enterprises (Habib & Zurawicki, 2002; Faccio, 2006; Faccio & Lang 2002; Aguilera, Filatotchev, Gospel & Jackson, 2008). In addition, when entering a host country with low governance quality and relatively high level of corruption, studies found that firms tend to choose joint ventures (JV) over wholly owned subsidiaries, since the JV partner can provide unique knowledge to overcome these challenges (Chang, Kao & Kuo, 2014; Slangen & Van Tulder, 2009). It means that foreign firms are willing to relinquish some control over foreign

subsidiary in exchange for local partners' resources and knowledge to address governance challenges as corruption.

A number of empirical studies demonstrate the value-relevance of corporate governance indices aggregating firm-level governance attributes (Bebchuk & Cohen 2005; Bebchuk, Cohen & Ferrell 2009; Gill, 2003; Gompers *et al* 2003). The vast majority of research on corporate governance in emerging markets has focused on *country level characteristics* (Clarke, 2007; La Porta *et al*, 1999 & 2000 & 2002; Claessens & Yurtoglu, 2013; Ghazali, 2010; Globerman, Peng & Shapiro, 2011; Habib & Zurawicki, 2002; Ho, 2005; Keong Low, 2004; Khanna & Palepu, 2000; Khanna & Rifkin, 2001; Phan, 2001; Van Essen, Van Oosterhout & Carney, 2011; Verhezen, Hardjapamekas & Notowidigdo, 2012), and only a few on *firm level features*; those studies have focused on patronage, political connections, corruption and other specific governance weaknesses in those emerging markets (Adigbite, 2015; Bhagat & Black, 2002; Bhagat & Bolton, 2008; Chen, Ding & Kim, 2010; Kim, Kitsabunnarat & Nofsinger, 2004; Li, 2003; Utama, 2012; Durnev & Kim 2005; Francis, Khurana & Pereira 2005; Pant & Pattanayak, 2007). We will explore corporate governance characteristics at the firm level and and unethical board practices their impact on the firm's financial performance within an Indonesian institutional and socio-cultural context.

***Ownership* S*tructure,* G*overnance and Ethical Behavior* in Indonesia**

Many listed companies in the emerging markets initially relied on founding families and to a lesser extent on bank credit to finance their operations and growth. Over half of the listed firms on nine local Asian stock exchanges were controlled by private families: using 20% share-ownership as cut-off level of control, private families controlled up to 9.7% in Japan and 71.5% in Indonesia (Claessens; Djankov & Lang, 2000). These Asian listed companies are often governed by insiders on the board, which create specific governance challenges for [foreign] minority shareholders (Chang, 2003; Mak & Li, 2001; Douma, George & Kabir, 2006; Fan, Wei & Xu, 2011; Low, 2004). Over the last three decades, the portion of foreign institutional investors has

steadily increased in those emerging economies as result of the internationalization of capital markets – especially in Singapore, South Korea, Taiwan and Malaysia since the 1990s (Mallin, 2004), but also in the other markets such as Indonesia (Siagian, 2011) and Thailand (Dhnadirek & Tang, 2003). The presence of institutional investors is likely to have influenced some elements of the corporate governance "bundle" (Aguilera *et al*, 2012) in Indonesia. The presence of reputable external auditors for instance may signal the willingness to take minority rights [more] seriously. These institutional characteristics on South East Asian markets indicate a complex pattern of ownership and control, where substantial family shareholding coexists with entrenched insider boards' control and minority shareholding by foreign institutional investors. Moreover, the question can be raised what kind of effect concentrated ownership and the structure, composition or size of the board may have on the monitoring function of management in Indonesia. In other words, the agency theory is here extended with the resource dependence notion that boards have distinctive incentives and abilities to monitor management (Hillman & Dalziel, 2003). This research argues that the effectiveness of the board's monitoring role must be seen in light of numerous contingencies related to ownership structure of the firm (Desender, Aguilera, Crespi & Garcia-Cestona, 2011). Indeed, concentrated ownership and the board of directors become substitutes in terms of monitoring top management. Independency will therefore play a less crucial role in such a context which needs to be complemented with clear other signals to neutralize for this lack of strength of monitoring role by the board.

Comparative corporate governance literature indicates that the following specific variables negatively affect investment in Asian companies: (1) concentrated ownership, (2) extensive cross-ownership ties and pyramidal ownership structures, (3) extensive family ownership with a high degree of overlap between controlling family ownership and management, (4) significant state ownership with direct political influence of management appointments, and (5) the relatively limited use of professional managers in top management (Globerman, Peng & Shapiro 2011).

Our corporate governance variables are constituted by academic research and generic governance variables as used by such as third party advisory intermediaries ISS, GMI and RiskMetrics to determine the extent firms have implemented best corporate governance practices, slightly amended with some additional variables specific for the Asian emerging market (Claessens & Yurtoglu, 2013; Douma, George & Kabir, 2006; Globerman, Peng & Shapiro, 2011; Klapper & Love, 2004; Li, 2003; Utama, 2012; Gompers, Ishii, & Metrick, 2003; Aguilera & Desender, 2012; Wasef & Kusumastuti, 2010). Subsequently, the total corporate governance list was reduced to about 33 independent variables, drawing on international business and comparative corporate governance research (Siagan, 2011; Utama, 2012; Wasef & Kusumastuti, 2010; Young, Peng, Ahlstrom; Bruton & Yiang, 2008; Filatotchev, Jackson & Nakajima, 2013; Aguilera, Filatotchev, Gospel & Jackson, 2008). Some of the original corporate governance attributes such as splitting the Chair and CEO function for instance are mandatory listing requirements under the Indonesian Capital Regulations imposed by OJK (Indonesian Capital Markets Regulator).

Finally, we winnowed down our focus to 18 corporate governance attributes (indicated with * in Table 1 and fully explained in Table 2 and 3). These chosen attributes are based (1) on the viability to obtain hand-held information from the respective annual reports and Indonesian listing requirements, (2) on the relevant distinctive comparative corporate governance attributes in the corporate governance in emerging markets literature review, and finally (3) on insights from the 36 interviews and about three decades of practical experience in the field of corporate governance in Asian Emerging Markets.

The following attributes were retained as relevant corporate governance variables at the firm-level explaining enterprise performance:

****** Insert Table 1 About Here ******

HYPOTHESES

In line with the comparative corporate governance and international business literature, we will hypothesize under specific institutional characteristics that particular good corporate

governance practices may enhance the firm financial performance. Although we emphasize that each of these governance constructs may capture different realities for each firm within a unique institutional context, and admit that these social corporate governance constructs may implicitly confirm some inherent theoretical biases - unless a more comparative global perspective could be construed -, we have followed the academic corporate governance indices as a starting point (Aguilera & Desender, 2012). Comparative corporate governance mechanisms have focused on (1) enabling boards to become more effective and efficient in monitoring, advising and coaching top executives; and (2) incentive alignment within a specific institutional context. Both of these mechanisms are argued to enhance firm performance (by limiting managerial agent scope for opportunistic and self-serving behavior) and limit the risks of appropriation by majority shareholders at the cost of minority shareholders. However, as noted above, the focus in this paper is on how losses imposed on minority shareholders can be limited or neutralized in emerging markets. We next develop hypotheses using various corporate governance practices that the literature suggests affect the performance of firms, and reduce potential pitfalls such as illegitimate corrupt behavior by any of the involved actors dealing with or within the firm or potential conflicts of interest between majority and minority shareholders.

Board Accountability and Responsibility

Good corporate governance may reduce the overall cost of capital (Schleifer & Vishny 1997; Bruno & Claessens 2010; Gillan, Hartzell & Starks, 2003; Gillan & Starks, 2003) and lead to higher stock price multiples as investors anticipate less cash flow deviation or expropriation, and a higher fraction of the firm's profits will come back in the form of interest repayments or dividends (Jensen & Meckling 1976; Jensen, 1986; La Porta *et al* 2002; Bhagat & Bolton, 2008; Gompers, Ishii, & Metrik, 2003; Bebchuk, Cohen & Ferrell, 2004). During the 1997 Asian crisis, the advantage of having implemented good corporate governance practices was obvious in the premium investors were willing to pay for well-governed firms in emerging markets, up to 27% for

Indonesian firms (Newell & Wilson, 2002), confirming the importance of good corporate governance at firm level in countries with weaker investors' protection (Durnev & Kim 2005; Klapper & Love 2004).

Despite the well-established business literature providing evidence about the negative effects on the firms' earnings performance of high-level political connections and corruption levels (Chen, Ding & Kim, 2010; Mauro, 2995; Mo, 2001; Kurtzman, Yago & Phumiwasana, 2004; Healy & Serafeim, 2012), Indonesia has been characterized by relatively high level of corruption and cronyism while achieving reasonable high growth rates (Brown, 2006; Claessens & Yurtoglu, 2013; Verhezen *et al*, 2012). The propensity to stimulate related party transactions (RPTs) is definitely affected by a relationship-oriented governance logic in Indonesia. Trust – a key cultural feature – is found to be at the cornerstone of any relationship inside the board, as well as within the organization and its stakeholders (Huse, 2007; Aguilera & Jackson, 2010; Charan, Carey & Useem, 2014). Moreover, wealth expropriation could occur by conducting related party transactions (RPTs) with other [pyramidal structured] companies that are also controlled by controlling shareholders at unfair and or with terms of transactions that benefit the majority shareholder at detriment of minority shareholders. RPTs refer to the transfer of assets or liabilities among related parties with or without the price settlement. Those RPTs can be considered as a proxy of potential cronyism and even outright corruption, especially in an institutional Indonesian context where the formal legal enforcement is rather weak and where [informal] relationships often trump formal rules. Hence, minimizing abusive RPTs can be achieved by increasing the transparency, disclosure and strictly imposed procedures of RPTs. One study indicates that the level of RPT disclosure in Indonesia is positively affected by corporate governance practices and the firm size, though marginally only (Utama & Utama, 2014).

Another tool to reduce asymmetric information is insisting on having more independent directors on the board, who are assumed to improve the monitoring role and thus reduce potential

agency problems (Jensen & Meckling, 1976; Bebchuk & Cohen, 2005; Arryman & Indrayadi, 2005; Chen, Li & Shapiro, 2011).

One of the main weaknesses of family companies can be found in weak or non-succession planning of the current CEO and or Chair of the company, usually a family member or an insider. Having a proper succession plan in place, helps the economic sustainability of the company and reduces the potential risks that go along with no planning or family quarrels who should lead the family company (Barton & Wiseman, 2015; Henry, 2017; Björnberg & Feser, 2015; Charan, 2016; Hooijberg & Lane, 2016; Lorsch & Clark, 2008).

We hypothesize that the presence of (1) having a clear succession plan of top executives and chair of the board, and (2) clearly formulated statements in the bylaws of the firm against rent-seeking behavior by not tolerating or clearly defining the specific process to grant a related party transaction.

Hypothesis 1.1: A clear succession planning for the CEO will have a positive effect on the firm's performance.
Hypothesis 1.2a. The fact that no related party transactions were recorded over the last 4 years has a positive effect on the performance of the Indonesian firm.
Hypothesis 1.2b: the strict formulation of the process and mechanisms under which related party transactions could be allowed and its strict compliance has a positive effect on the Indonesian firm's performance.

Transparency Through Financial Disclosure and Financial Control

Most Asian markets are perceived to be more opaque and less transparent than these more developed markets in the West (Kurzman, Yago & Pumiwasana, 2004; Claessens & Yurtoglu, 2013), and therefore improved transparency is assumed to benefit the firm's value or performance. The explicit use of political connections is more frequently found in countries with higher levels of corruption, more barriers to foreign investment and less transparent systems (Faccio, 2006; Baughn, Bodie, Buchanan & Bixby, 2010). "Cronyism" can be an important driver of borrowing and lending activities in many emerging markets, with obvious high costs, driving up to economic costs to at least 2% in some emerging economies (Khwaja & Mian 2005). First, a good reputation of a transparent firm and its owners may play a positive role in attracting potential external investment

to finance growth (Macey, 2013; Bebchuk, Cohen & Ferrell, 2009; Durnev & Kim, 2005; Boesso & Kumar, 2005; Biondi & Reberioux, 2012). Therefore, the more boards are entrenched, the more likely the oversight and monitoring function of the board may be undermined (Bebchuk & Cohen, 2005; Bebchuk & Ferrell, 2004). To signal proper ethical behavior to the outside world, especially potential new investors, companies opt to use of reputable external auditors who guarantee trustworthy information disclosure. Given their own credibility and reputation, the big four auditors are expected to demand stronger anti-corruption standards and disclosure requirements from the firms they audit (Healy & Serafeim, 2012), and the auditors are expected to notice irregular or unethical anomalies in the reporting (Bazerman, 2014), even if the actors behind causing those anomalies may be not fully conscious of them (Bazerman & Tenbrunsel, 2011). Moreover, one can argue that having strong anti-corruption standards in place and therefore improved disclosure, will positively affects the financial performance of firms over a longer period (Kwok & Taddesee, 2006), although in the short term, such anti-corruption may positively affect sales revenues, they do not have conclusive positive effect on the return on equity, especially in countries with a high perceived risk of corruption (Healy & Serafeim, 2012; Campos, Lien & Pradhan, 1999; Kahlil, Saffar & Trabelsi, 2015). A trustworthy intermediary, however, may potentially reduce information asymmetry between majority and minority owners. Specifically, firms with perceived entrenchment problems - captured by a relatively high degree of voting power of the largest controlling shareholders, and thus indicating agency conflicts – likely appoint one of the big four auditors to signal adherence to transparency (Fan & Wong, 2004; Guedami & Pittman, 2006 & 2011).

Second, the dominance of tycoon and group affiliations in Asian emerging markets lies in the privileges that they solicit from the government by obtaining exclusive exporting or importing rights, protection from foreign competition for extensive periods of time, granting of monopoly power in local markets, procurement of government contracts and other specific "favors" (Claessens, Djankov & Lang 2000; Dela Rama, 2012; Claessens, Djankov, Fan & Lang, 2002;

Chacar & Vissa, 2005). A business or economic group is a collection of firms together bound together in some formal or informal manner (Granovetter 1995). In such economic groups, the majority shareholders' wealth is not concentrated in one firm but spread out over a number of firms in the same [economic] group (Gilson, 2006). It seems that higher asymmetric information within such economic conglomerates might allow entrenched management and their large shareholders to exploit the firms for their own benefit (Lins & Servaes 2002; Kim & Yi, 2006; Chen, Chen & Wei, 2009). In a seminal paper, Morck, Shleifer and Vishny report a negative relationship between share ownership of the board of directors and firm value in the 5% to 25% ownership range which they argue is attributable to a possible domination of the entrenchment effect over the incentive alignment effect (1988).

Cash flow rights of the largest shareholder is a measure of the degree of *de iure* ownership, whereas the voting rights of the largest shareholder is a proxy for the degree of control that determine the *de facto* running of the firm. Obviously, ownership and group affiliation structures are both affected by legal and regulatory infrastructures in a country (Porta *et al*, 2000; Redding, 1996; Morck & Yeung, 2004; Morck, Schleifer & Vishny, 1998; Khanna & Rifkin, 2001; Douma, George & Kabir, 2006; Chang, 2003). Concentrated ownership is often materialized through effective "blockholding" power that can be families (e.g. Taiwan or Indonesia), state agencies (China), banks (e.g. Japanese *keiretsu* system) or complex inter-corporate and interdependent groups (e.g. Korean *chaibols*) (Filatotchev, Lien & Piesse, 2005). In East Asian companies in which the largest holder has at least 5% of the vote (or control), Thai corporations display the most concentrated *cash flow rights* with 32.84% on average, followed by Indonesian companies with 25.61% and Hong Kong companies with 24.30%; whereas the Japanese and Korean corporations have the least concentration of ownership rights at 6.90% and 13.96% respectively (Claessens *et al* 2000). Similarly, the concentration of *control [voting] rights* in the hands of the largest blockholder is extremely high for Thai and Indonesian firms, at 35,25% and 33.68% respectively, followed by Malaysian and Hong Kong companies at 28,32% and 28.08% (Claessens, Djankov & Lang, 2000).

There exists a potential trade-off between the incentives of proper monitoring and entrenchment of concentrated shareholding through rent-seeking effects (Filatotchev, Jackson & Nakajima, 2013). The control of East Asian corporations can be achieved with less than an absolute majority share of stock: ultimate control at the 20% ownership (or voting rights) level often involves the use of *pyramid structures* with equity cross-holdings amongst associated firms (Bebchuk, Kraakman & Triantis, 2000; Chen, Li & Shapiro, 2011; Khanna & Palepu, 2000; Kim & Yi, 2006; Filatotchev *et al* , 2005).

Family firms in Indonesia, indeed, exert control with a relatively small direct stake in its cash flow rights over a large network of firms through pyramid structures and cross-holdings, allowing effective control beyond ownership [or voting control rights] (Boubakri, Guedhami & Mishra, 2010). Some studies estimate that the use of pyramid structure in Indonesia reaches 66.9% ultimate control at a 20% benchmark cut off level, which is among the highest in Asia (Claessens, Djankov & Lang, 2000, La Porta, Silanes, Schleifer 1999; La Porta *et al*, 2000). Pyramid structures are somehow associated by the market with value discounts because they facilitate non-market-based financial transfers among corporations within a group, either horizontally or vertically (Bebchuk, Kraakman &Triantis, 2000). In East Asia, up to 38.7% of East Asian firms apply those pyramidal structures, whereas in Western Europe only 15% uses these structures – which even lower percentages in the USA (Faccio & Lang, 2002).

Moreover, in about approximately 80% of the cases, the controlling family in Indonesia will appoint a family member to a top position in management which may counter-intuitively reduce the traditional agency costs (Claessens *et al,* 2000). In other words, although the separation of management from family ownership control is rare in Indonesia, the potential clashes between a controlling majority and minority shareholders is considerable. In other words, the impact of family ownership (or state ownership) and control on firm value depends on the level of shareholder protection embodied in the legal and regulatory institutions in Indonesia (Zhou & Peng, 2010; Verhezen, Hardjapamekas & Notowidigdo, 2012).

Hypothesis 2.1: Having a reputable external auditor performing the annual accounting and financial audits, securing trustworthy disclosed information, will have a positive effect on the firm's performance.
Hypothesis 2.2a: Having the Internal Audit subcommittee directly reporting to the supervisory board has a positive effect on the firm's performance
Hypothesis 2.2b: Having a separated Internal Audit Unit within the firm has a positive effect on the firm's performance
Hypothesis 2.3a: The financial information that can be accessed at different channels will have positive effect on the firm's performance
Hypothesis 2.3b Timely disclosed financial reports has a positive effect on the firm's performance

Protection of Shareholder Rights

Since insiders dominate the corporations in Indonesia (that itself is characterized by institutional voids), *the protection of minority rights* likely matter more in these emerging markets. Asian markets distinctively differ from the US and UK financial markets where agency problems arise from conflicts of interests between hired managers and shareholders (Jensen & Meckling 1976; Jensen, 1986). Consequently, applying an institutional approach of governance indicators may indicate that good corporate governance practices in Indonesia will not be a direct copy of what functions in the USA or the UK (Cheung *et al*, 2014; Claessens *et al*, 2000; Claessens *et al*, 2013; Leong, 2005; Ho, 2005; Keong, 2004; Aguilera *et al*, 2003, 2004 & 2008). Moreover, some efforts to reform and to enhance corporate governance practices in East Asia have been met with resistance or worse indifference by the owners and their top executives (Low, 2004; Mehra, 2005).

Independency of the board may be crucial for good corporate governance in the USA where dispersed ownership prevails (Agrawal & Knoeber; 1996; Hermalin & Weisbach 2003). It is assumed that independent directors add real value to a company's ability to monitor management (Felton, Hudnut & Witt 1995; Monks & Minow, 2004; Farinha, 2003; Farinha & Lopez de Foronda, 2005; Lawler, Finegold, Benson, Conger 2002), especially in enterprises with majority block-holding families or state ownership. However, the emphasis on independency may be overrated at the cost of a broader issue of diversity and insider knowledge; and some research even argues that

independence is negatively correlated with contemporaneous and subsequent operating performance (Bhagat & Black, 2002; Bhagat & Bolton, 2008).

Since most Asian stock exchanges require at least one third legally defined independent non-executive members on the board, board independence has become a formalistic rather than substantial compliance issue in most of those Southeast Asian markets. Having an outspoken family member on the board who have been professionally trained and may have proven to have the integrity could sometimes be more useful and functional than an increased number of paid outsiders to comply with or to transcend the independency quorum. An increased number of outsiders does not immediately improve the functioning of the board, we assert that the notion of independency is rather a *state of mind.*

In Indonesia, two thirds (67%) of its publicly listed companies are in family hands, and only less than 6% is widely held, making monitoring less effective in spite of the formal obligation to have one third independent members on the supervisory board (Claessens *et al* 2000 & 2002; Verhezen *et al*, 2012). In countries with relatively low legal protection of minority investors, controlling shareholders may be inclined to expropriate assets at the expensive of these minority shareholders, resulting in "private benefits of control" (Filatotchev et al, 2013; Grossman & Hart, 1988). The *risk of expropriation* of minority shareholders by large controlling shareholders is an important principal-principal problem in most emerging countries, and even more so in Indonesia where that gap between control and cash flow rights may be less outspoken, and where both voting and cash flow rights are relatively among the highest (concentrated ownership) in Asia (Claessens *et al*, 2002; Boubakri *et al*, 2010; Lozano *et al*, 2016). The degree to which certain ownership and control structures are associated with *entrenchment* discounts (Durnev & Kim, 2005; Farinha, 2003) in Asian emerging markets depends on institutional specific contexts at country level rather than firm level, such as the legal and judicial protection of individual shareholders, the degree of financial disclosure required, the quality of the banking system. Indeed, weak institutional development has a negative impact on corporate governance. The incentive-entrenchment trade-off

associated with concentrated share ownership depends to a high extent on both formal hard legal institutions that regulate shareholders' protection and a wider set of informal social norms or soft law shaping the identities and [ethical] behavior of large owners (Filatotchev *et al*, 2013; Aguilera & Jackson, 2010; Aguilera & Cuervo-Cazurra, 2004 & 2008).

Weak institutionalized shareholder rights cause additional agency costs, negatively affecting the firm's stock returns and operating performance (Gompers *et al*, 2003; Claessens *et al*, 2000; Faccio, Lang & Young, 2001). Moreover, controlling family ownership is negatively associated with governance implementation in Indonesia (Siagian 2011). This is consistent with the idea that family owners or state with relatively high ownership are inclined to implement lower corporate governance standards because they want to retain control of the firms which hypothetically may negatively impact the firm's performance.

> **Hypothesis 3.1**: the annual report clearly discloses the beneficial ownership - allowing to determine who precisely controls the board – and this transparency or clarity about the ultimate ownership positively affect the performance of the Indonesian firm.

Market Control & Monitoring Procedures

It can be easily assumed that outside investors – who usually constitute a minority position – are less willing to provide financing and are likely expecting higher rate of returns if they are less assured that the organization is properly and thus ethically managed or that they will get an adequate rate of return. The possible entrenchment – or tunneling effect – often outweighs the possible alignment effect in these family businesses. Tunneling is accomplished when resources from the company to the controlling shareholder through intercompany dealings whose terms favor the company in which the controlling shareholder has the larger equity stake (Gilson, 2006). When an insider board is heavily entrenched with management, there is an increased potential for expropriation of those minority shareholders' rights. Studies of Korean and Thai firms exemplify this kind of destructive "tunneling" effects where family-controlled pyramid structures destruct long term value (Boubakri *et al,* 2010; Bertrand, Johnson, Samphantharak & Schoar, 2008).

When, on the other hand, the family's relatively distant investment horizon allows the family to closely monitor managers (who usually concentrate on short term earnings) and ensure that the firm's long term value is measured, the benefits of the alignment effect may exceed the potential costs of entrenchment. The higher the cash flow rights of the largest shareholder, the higher the cost this family owner may bear to appropriate, and therefore, the more incentives the majority owner may have to be aligned with the minority shareholder (Fan & Wong, 2004). Ownership may decrease or get diluted over time; however, the largest shareholder's wealth may become less tied to the company, and thus, the incentive becomes less aligned with minority shareholders. Yet, a firm's value with substantial family ownership may be higher than a non-family firm (or a firm with a small family stake) since family control may in this instance benefit all shareholders (Demsetz & Villalonga, 2001; Boubakri *et al*, 2010).

Moreover, in an economy with institutional voids and corruption, a trusted family may be a preferred business partner where the founding and controlling family runs its firm(s) directly, creating a certain competitive financial advantage by adhering to a long term strategic perspective, and inciting some benevolent behavior (Morck & Yeung, 2004; Young *et al*, 2008; Bebchuk *et al*, 2009; Aguilera & Jackson, 2003; Aguilera & Cuervo-Cazurra, 2008). It is the focus of complying to non-corrupt behavior that (institutional) investors feel are crucial to warrant investment in trustworthy enterprises, underpinned by good corporate governance (Klapper & Love, 2004; Gillan & Starks 2003). Strict monitoring by foreign institutional investors of managers is meant to reduce the possibility of traditional rent-seeking behavior, be it corruptive behavior or the possibility of expropriation (Young, Peng, Ahlstrom, Bruton & Jiang, 2008; Mehra, 2005; Khanna & Rifkin, 2001; Claessens, Djankov & Lang, 2000). It is assumed that the presence of institutional investors leads to more informative prices (less information asymmetry), and consequently lower monitoring costs for all investors (Gillan & Starks, 2003; Claessens *et al*, 2000 & 2013).

Institutional ownership, however, can also be negatively associated with corporate governance in Indonesia, consistent with the contention that institutional investors could be short-

term investors who put pressure on the managers to improve earnings which does not seem to support the popular hypothesis that institutional investors would strictly implement good corporate governance because they merely own stock in the firm (Bushee 1998; Siagian 2011). Moreover, ownership by institutional investors is generally small in emerging markets, and these institutional investors have little direct influence through voting and board representation for instance, and are usually more concerned about short term profitability taking and about protecting themselves against expropriation, rather than with disciplinary management measurements (Claessens & Yurtoglu, 2013).

The governance indices in research by Gompers *et al* (2003) and Bebchuk *et al* (2009) use the protection of shareholder rights in corporate takeovers as a proxy for governance. However, the market of mergers and acquisitions is currently rather limited in Asia and is almost irrelevant for Indonesia, with the exception of post-Asian crisis of 1997-2002 whereby the financial and banking sector went through a serious consolidation phase during which quite a number of merger and acquisitions took place (Habir, 2016; Rhandawa, 2005).

An absolute majority of 50% shareholding by a family or state may reduce incentives to "maximize" profitability and thus have a negative effect on the potential return of investment over a longer period. At the other hand, significant long-term investing by foreign institutional investors may reduce rent-seeking behavior through better monitoring and alignment and thus optimize Indonesian firm's performance over a longer period. Therefore, we hypothesize:

Hypothesis 4.1: The presence of absolute majority of family or state blockholding group is negatively related to firm performance.
Hypothesis 4.2: A company that is part of an economic group where parent or controlling shareholders also controls key suppliers or related businesses – an Indonesian conglomerate – can be expected to follow a long-term strategy and will have a positive effect on the firm's performance.
Hypothesis 4.3: Foreign ownership is expected to positively influence the firm's performance

Board Functioning, Board Behavior and Board Effectiveness

In studying boards, academic research has emphasized three board characteristics – being affected by the interdependencies of institutional and resource related governance variables - that apparently played a role in constituting more effective boards: (1) *composition*, (2) *leadership structure*, and (3) *size* (Aggrawal & Knoeber 1996; Aguilera et al, 2008 & 2012; Coles *et al*, 2001; Charan 1998 & 2005; Levrau & Van den Berghe 2009; Abbott, K.W. & D. Snidal, 2000). Moreover, research reveals that concentrated ownership and independent board members function as substitutes in monitoring top management, partially because the information asymmetries is likely smaller compared with dispersed ownership structures and other incentive systems exist to strengthen the agency controlling function (Desender *et al*, 2011).

However, as some European research reveals, mainstream board research has been influenced by financial economics, ignoring some *"soft" factors* that definitely affects the board effectiveness (Levrau *et al,* 2009; Hillman & Thomas, 2003; Hillman, Cannella & Poetzold, 2000). We could even argue that owners within civic law systems will adopt governance codes – or "soft law" - signaling to protect all shareholders, to make up for the lack of minority shareholder rights' protection (Aguilera & Cuervo-Cazurra (2004 & 2008). Such an adoption of codes of good governance could serve as a mechanism to compensate for weak legal rights protection and increase the *effectiveness* of corporate governance. Companies competing in a global economy trying to attract international investment may also promote transparency and accountability – as in codes of conduct - among directors and shareholders to *legitimatize* their governance practices (Aguilera *et al*, 2004).

The board's inner functioning and human chemistry among the board members are likely as important factor as composition, structure and size that improves the effectiveness of a board. In emerging countries, where relationship still prevail over mere contractual arrangements – despite the dark side of such relationship building (Verhezen, 2008; Chen *et al*, 2010) – well-connected board members (both insiders and outsiders) play an important role in the functioning of board's

effectiveness (Charan, 1998; Kim & Yi, 2006; Li, 2003; Redding, 1996; Charan, Carey & Useem, 2014).

One also can assume that the role of chairman is crucial in structuring boards more effectively, especially by reducing potential tensions among the board members and inciting candid and open dialogue at the board with a focus to create long term enterprise value (Charan, 1998 & 2005; Korac-Kakabadse, Kakabadse & Kourmin, 2001; Macey, 2008; Mobius, 2003; Pfeffer, 1972; Roberts & Summerville, 2016). In other words, surveying the effectiveness of boards suggests that a wide range of interconnected institutional, structural (such as diversity and expertise/competence) and behavioral soft factors (such as trust, attitude, norms and conduct) shape the board's effectiveness in better performing their roles (Levrau *et al*, 2009; Globerman *et al*, 2011; Claessens *et al*, 2013; Cheung *et al*, 2014). Moreover, informal and formal training may enhance the abilities and competencies of the board members (Moldoveanu & Narayandas, 2016).

> **Hypothesis 5.1:** Regular training of board members will have a positive effect on the firm's performance.

METHODOLOGY

Data

The empirical context for this study is provided by an analysis of 85 listed and 10 non-listed companies in Indonesia over a four-year period from 2011 till 2014, strengthened by 36 interviews of board members between 2013 and 2017 – lasting between 45min and 120min each on average - in a number of those companies analyzed. The interviews covered questions about governance variables that were considered relevant to investment in Indonesia, enabling us to create the list in Table 1.

We randomly choose 85 of the most liquid 300 biggest publicly listed companies on the Indonesian Stock Exchange, and we randomly added 10 non-listed medium sized Indonesian companies. We excluded the smallest 200 companies since quite a high percentage of those smaller companies are hardly traded and thus illiquid. This illiquidity could skew a completely random

choice among the 503 listed companies on the Indonesian Stock Exchange in 2014; or 567 listed companies as of early 2018. Two research analysts were employed to extract the financial and qualitative information from these reports that enabled us to populate our database with the variables described below.

Variables

Independent variables. The various dimensions of governance that we use as independent variables in our regression models to test our hypotheses are outlined in Table 2. We use various binary variables; in each case they are coded 1 if the answer to the question being posed is yes, or zero otherwise. We outline these variables below.

We capture dimensions of board quality, such as the use of *succession planning* and the *training of the board in corporate governance*. We examine whether the company is *part of an economic group* where the parent or controlling shareholder controls other parts of the supply chain or related businesses. We have two binary variables associated with related party transactions: one to indicate the *existence of related party transactions* and the other to indicate whether there has been a *ruling on related party* transactions that a transaction has breached compliance rules. These variables are taken from an examination of the published annual reports.

We have three binary variables associated with disclosure and transparency: one that asks if it is *easy to identify beneficial ownership*, another that asks whether a board of non-executive directors' (*Board of Commissioners) or* a board of executive directors' *(Board of Directors) shareholdings are disclosed* and a third that asks if the company offers *multiple channels to access information*. We have three binary measures related to audit. First, we ask whether the *internal audit department is a separate department* within the company. Second, we ask whether the company's *external auditors are one of the Big 4* accounting firms. Third, we ask if the *internal audit group reports directly to the BOC*. We use a binary variable to ask whether the company's

financial report is disclosed in a timely manner. These variables are taken from a combination of annual reports and interviews with executives.

We also have three continuous variables that offer insights regarding governance. They are government ownership percentage, family ownership percentage, foreign institutional ownership percentage and family ownership percentage. Each of these variables have been prominent in exploring governance issues in emerging markets and developed markets.

We use firm size as a control given this is standard in research predicting firm performance (eg., Hambrick & Quigley, 2014). Each independent variable also provides a control for analysis of other governance variables.

****** Insert Table 2 About Here ******

Dependent variables. Given we are interested in how foreign investors are likely to respond to the performance impact of governance mechanisms in emerging markets, we scanned the literature to gain empirical insights into performance measures commonly used by managers and in investment decisions. We use two measures of financial performance commonly used in the management literature: return on assets (ROA, calculated as net income divided by total assets) and net income. ROA is perhaps the most common measure of financial performance used in the management literature (Hambrick & Quigley, 2014). Shleifer and Vishny (1997, p. 703) explain that "corporate governance deals with the agency problem: the separation of management and finance. The fundamental question of corporate governance is how to assure financiers that they get a return on their financial investment." Hence, consistent with prior governance research we use return of assets (ROA: net income divided by total assets) as a measure of financial performance. This covers the returns to both debt and equity investors and is consistent with the performance measure used commonly in governance and management research (cf., Bromiley & Harris, 2014; Hambrick & Quigley, 2014).

We also include a regression model that uses net income as a performance measure (the dependent variable). This measure is commonly referred to by analysts and executives when measuring financial performance (eg., Bhagat & Bolton, 2008; Bromiley & Harris, 2014). Net income benefits from not being a ratio (which ROA is); ratios are subject to the criticism that the variance can be driven by denominator or numerator (Wiseman, 2009). Net income does not suffer from this problem and given we control for firm size, offers an alternate econometric approach. We extract these variables from the financial reports, as described above.

Estimation and Analyses

Our regression models predict ROA and net income with the aforementioned independent variables using ordinary least squares regressions. We do not use firm fixed effects, given our theory is not confined to within-firm analyses; that is, our theory can be tested by analyzing both between-firm and within-firm variance in the performance effect of governance variables. Hence, our estimation method allows us to capture both within and between firm variation. We conducted our analysis using Stata. Given we are using binary variables or percentages, we did standardize our variables. We control for industry and year (using dummies for each). The industry controls allow us to control for the idiosyncrasies or industry performance and the year controls allow us to control for macro factors that may have impacted the results in a given year.

RESULTS

Table 3 presents the descriptive statistics and correlations. As is normally the case, firm performance and firm size are highly correlated. Foreign institutional ownership strongly correlates with internal audit related variables, consistent with prior research. Table 4 offers regressions predicting firm performance using ROA and net income.

Hypothesis 1.1 predicts clear succession planning for CEO will have a positive effect on the firm's performance. This is strongly supported in the predictions for ROA, with succession planning leading to an improvement in ROA of 0.291 of an ROA standard deviation (which is

approximately 0.1). Hence, succession planning on average leads to a higher ROA of approximately 3% (almost a 50% improvement in the mean ROA).

Hypothesis 1.2a argued that no related party transactions recorded over the last 4 years has a positive effect on the performance of the Indonesian firm. This is supported, given the existence of related party transactions has a significant negative effect of net income, suggesting firms' net income will be reduced by 1.63 times the standard deviation of net income if there are related party transactions. Hypothesis 1.2b postulates that the strict formulation of the process and mechanisms under which related party transactions could be allowed and its strict compliance has a positive effect on the Indonesian firm's performance: having no proper ruling for RPTs results in a reduction of 0.709 times the standard deviation of net income, which equates to approximately 4.9 billion IDR or 3.8 million USD on average per firm.

Hypothesis 2.1 claims that a reputable external auditor performing the annual accounting and financial audits, securing trustworthy disclosed information, will have a positive effect on the firm's performance. Consistent with this hypothesis, net income is significantly and positively influenced by the existence of a big 4 external auditor ($b=0.323$, $p<0.01$). It confirms that reputable third intermediaries play a positive role within contexts of weak institutions as in Indonesia.

Hypothesis 2.2a predicts that having the Internal Audit subcommittee directly reporting to the supervisory board has a positive effect on the firm's performance. This is not supported given the coefficient for this variable is insignificant in predicting both net income and ROA. Hypothesis 2.2b argues that having a separated Internal Audit Unit within the firm has a positive effect on the firm's performance. This is not supported by our analysis, given that the variable is not a significant predictor of performance in Table 4 ($p>0.05$ for net income and ROA models).

Hypothesis 2.3a suggests the financial information that can be accessed at different channels will have a positive effect on the firm's performance. This is not supported, given the coefficients are not significant. Hypothesis 2.3b argues that timely disclosed financial reports have

a positive effect on the firm's performance: this is not supported by our data ($p>0.05$ for net income and ROA models).

Hypothesis 3.1 postulates that the annual report which clearly discloses the beneficial ownership – allowing to determine who precisely controls the board – results in an improved transparency or clarity about the ultimate ownership and will positively affect the performance of the Indonesian firm. In Table 4, the "Transparent Ownership" variable is not a significant predictor of financial performance, meaning this hypothesis does not find support ($p>0.05$ for both net income and ROA models).

Hypothesis 4.1 predicts that the of family or state ownership is negatively related to firm performance. The variables 'State Ownership' and 'Family Ownership' are not significant predictors of performance as Table 4 suggests and thus this hypothesis is not supported by our data ($p>0.05$ for net income and ROA models).

Hypothesis 4.2 postulates that a company that is part of an economic group where parent or controlling shareholders also controls key suppliers or related businesses – an Indonesian conglomerate – can be expected to follow a long-term strategy and will have a positive effect on the firm's performance. This is not supported given that 'Supply Chain Control' is not a significant predictor of performance in Table 4 ($b = -0.071$; $p<0.01$).

However, Hypothesis 4.3 posits that the presence of foreign institutional ownership is expected to positively influence the firm's performance. Consistent with this prediction, Foreign Institutional Ownership in Table 4, indeed, shows a significant and positive effect on the financial performance (ROA) ($b = 0.171$; $p<0.01$; but not on net income: $b = -0.008$ with $p>0.05$). This hypothesis is therefore valid when predicting ROA.

Hypothesis 5.1 predicts that regular training of board members will have a positive effect on the firm's performance. Consistent with this prediction, board governance training positively and significantly influences net income ($b = 0.463$ with $p<0.01$).

DISCUSSION

In this study, we have theoretically and empirically explored the impact of various governance attributes on firm performance in emerging markets, using Indonesian data. Our findings can be summarized as follows: (1) strong positive association between firm performance and succession planning, board governance training, using big four auditors and foreign institutional ownership' (2) strong negative association between firm performance and related party transactions (including rulings on these) and disclosure of Non-Executive and Executive (BOC/BOD) shareholdings. We have aimed to advance emerging markets research regarding firm level governance mechanisms most likely to have an impact on performance. We elaborate on our contributions and insights below.

Implications for International Business Studies

Our initial starting point stated that there is no single global governance standard that could be literally applied to any situation. The governance effectiveness of most of the 85 firms analyzed, which are in their growing or mature phase of their life cycle, depends on adapting to different monitoring, resource, and strategy roles – instead of conforming to a universalistic governance model. The corporate governance deviance was based on the dominant national relationship-based governance in Indonesia as well as its entrepreneurial identity motives (Aguilera *et al,* 2012). In addition, the interviews allowed us to distill some generic basic "rules of thumb" when foreign investors decided to line up with local Indonesian partners: clearly stating the responsibilities of the different (majority and minority partners) in the venture –where applicable-; carefully choosing a reputable and trustworthy partner with similar objectives and goals, and finally to emphasize an effective pro-rata financial investment in the firm's ownership structure (Chambers & Verhezen, 2016). In addition, during the interviews board members emphasized the importance of adopting rules beyond "comply and explain" - where needed - to incite long term effectiveness of board practices and adapt to the local socio-cultural context. These practical governance insights are

congruent with an ongoing hybridization of corporate governance models and a growing heterogeneity of organizational practices within Indonesia's national boundaries. Indeed, the importance of monitoring and advisory role is influenced by other elements of the corporate governance bundle, such as the reputation of family shareholders attempting to neutralize the weak legal institutional protection of shareholders. Therefore, *concentrated ownership of family businesses or state owned enterprises* so characteristic in an Indonesian institutional setting were our departing practice to analyze other governance variables that could affect performance.

Moreover, in line with recent comparative global corporate governance and international business ethics literature, this study contributes by emphasizing the institutional context of weak legal enforcement and concentrated ownership in Indonesia that often results in potential conflicts of interest between majority owners and minority shareholders on the one hand, and in unethical behavior and violations of any form of individual property rights, including intellectual property rights breaches on the other hand. Our findings confirm that firms with high disclosure policies seem to designate to combat corruptive behavior (Healy & Serafeim, 2001). Indeed, governance policies that reduce the chances of expropriation at the expense of minority shareholders, and the presence of reputable family shareholding – with these conglomerates usually having long term strategic commitment to the firm - are highly valued by international investors in perceived high "corruption" countries (Luo, 2011; Peng & Yang, 2014; Salter, 2012; Jain, Kuvvet & Pagano, 2017).

From an institutional context, the focus turns to the interactions between insider-outsider conflicts and accountability conflicts in an emerging market context. Obviously, foreign but also domestic [minority] institutional investors are willing to pay a premium for good governance and they search for firms that have good governance practices and promote the adoption of voluntary codes of good governance as in a self-regulatory "comply or explain approach" complying with the 1992 influential Cadbury report (which may function as cross-border mimetic isomorphism). The pressure for foreign capital and product markets may not necessarily lead to convergence to

international standards. Board independence, for instance, is not systematically linked to positive performance, and concentrated ownership monitoring its top management functioned as a substitute for *pro forma* independent directors who arguably did not have any significant impact on performance. With a controlling shareholder such as in most listed companies in Indonesia, the fundamental governance problem is not necessarily opportunistic rent-seeking behavior by executives and directors at the expense of public shareholders at large, but rather inappropriate or opportunistic behavior by the controlling family shareholders at the expense of minority shareholders.

Where shareholder rights are not well protected, investors will compensate for this deficiency by taking controlling positions in the firm, or expect clear idiosyncratic governance practices to be put in place to guarantee some minimum level of proper oversight of top management but especially over majority shareholders to neutralize for potential expropriation of assets away of the listed company.

However, we see some form of hybridization in a sense that "best governance practices" are adopted and customized according to their particular circumstances and institutions. The use of reputable auditors and inclusion of RPTs in the shareholder agreement indicate such signaling effects. Nonetheless, the level of compliance with codes entails significant implementation costs (Aguilera *et al*, 2008) and remains relatively low in most emerging markets.

Governance research has hardly adopted a firm level approach to examining the effects of governance mechanisms on firm performance in Indonesia or another emerging market context. Neither has governance research used such a broad range of governance variables to examine their effects upon firm performance. Adopting a firm level approach, focused on a large emerging market economy and its institutional context, provides an important advancement to the comparative governance research, given we have provided insights into the effectiveness of a range of corporate governance practices when used in a unique institutional and cultural context. Hence, we suggest that our study has advanced the study of corporate governance in the international business and

emerging markets contexts. In particular, we have leveraged hand collected data to provide insights regarding the mechanisms most likely to provide impact – in terms of financial performance – that could appease minority shareholders, including foreigners who may have foregone these investment opportunities due to a perceived risk of appropriation by dominant family or government shareholders in an Indonesian context.

We found that only a few out of the corporate governance firm-level attributes had a statistically strong significant correlation with the firm's financial performance. Some of the governance attributes at firm level have not been used in research focused on developed markets. For instance, in our research based on Indonesian data – in line with other Asian markets – we added or emphasized the following attributes to the ISS/RiskMetrics list: (1) "Company being part of a blockholding group, or state, or family group", (2) "The Internal Audit is a separated entity from Executive Team and directly reports to Supervisory Board", (3) "Significant Foreign Institutional Investment", (4) "Specific constraints for RPTs in Bylaws" (in additional to the implementation of not allowing RPTs), (5) "Reputable big Four Auditors signing off on Financials" (securing more transparency and higher chances for trustworthy disclosure), (6) "Specific disclosure of ownership by Board Members (BoC and BoD level)", "Company discloses beneficial ownership (blockholding owners)". We have added these variables based on conversations with representatives of the IFC – International Finance Corporation of the World Bank -, who expressed interest in understanding how those variables impacted performance. The presence of these variables therefore attempts to refresh this stream of literature to reflect the relevance to prominent stakeholders and profound influence of [weak] institutions in emerging markets.

Our research indicates that the presence of reputable auditors (big *Four Auditors*) has a positive effect on the financial performance, which we argued to be due to the improved transparency and disclosure. Considering the weak legal enforcement and less than stellar protection of individual shareholder rights under Indonesian law, these listed firms on the ISX signal their willingness to be more transparent and thus reliable or trustworthy by engaging a

reputable third party intermediary. Similarly, our findings reveal a positive effect of the implementation and strict rules to constrain or forbid *Related Party Transactions* that could be interpreted as a proxy for potential expropriation, collusion and corrupt behavior. In other words, by having proper mechanisms and procedures in place that will limit the potential of corruption or expropriation of cash flow or assets, the Indonesian firm indicates its willingness to limit unfair practices or to curb possible corruption.

In addition, block-holding family- or state-owned ownership is predicted to negatively affect the net income of the firms in countries with weak corporate governance such as Indonesia. When we analyzed whether the correlation of family or state ownership and performance (along the 20%<ownership<49% range), we did not get any significant correlation when predicting financial performance (either net income or return on assets) in Table 4. However, there was a significant relationship between foreign institutional ownership and firm performance as measured by ROA. This is likely due to these institutional owners bringing governance best practice, reflected in the strong positive correlations between foreign institutional ownership and the governance variables in Table 3. These correlations suggest that the relationship between foreign institutional ownership and performance are conservative, given that those correlations make it more difficult for this ownership variable to find significance in Table 4.

We argue that understanding and addressing the specific corporate governance attributes identified in our study may allow equity and debt investors to focus on the most impactful governance mechanisms while taking "advantage" of the usual institutional voids and information asymmetries in Indonesia and other Asian emerging markets (in line with Dvorak 2005 and Utama 2012). Similarly, it provides valuable guidance for boards and corporate regulators in terms of where to focus when instigating corporate governance reform. Enforcement is key to making a good corporate governance work. Although our research does not explicitly study the importance of institutional reform affecting corporate governance, our research strongly indicates the

importance of institutional gatekeepers like external auditors, and the strict implementation of measurements that reduce the chance of rent-seeking behavior such as minimizing RTPs.

From the perspective of the company's management, corporate governance can be interpreted as reducing risk when investing, rather than a mere legal obligation or a pure cost factor. From a corporate governance and international business perspective, we did not find clear evidence that the presence of block-holding family or state ownership is undermining financial performance (as noted above), which provides some comfort to potential investors in Indonesia. Our data offers empirical proof that international trust can be provided by (for instance) clearly limiting or forbidding related party transactions or by emphasizing the presence of foreign investors, and reputable foreign third party intermediaries that positively affect the financial performance of the Indonesian firm.

Limitations and Future Research

While the empirical data may provide interesting insights, a limitation of our study is that the random sample is limited to 85 Indonesian listed companies and 10 non-listed companies over a 4-year period with a likely oversized sample of old traditional big [Indonesian non-pribumi or Chinese] conglomerates and state owned companies. At the risk of stating the obvious, the relatively ***small sample size, combined with a large number of independent variables, makes it quite difficult for any independent variable to be statistically significant. Our data limitations are a reflection of the limits of access to reliable information and to a lesser extent our financial resources. An analysis of all 503 public listed companies in Indonesia may indicate a slightly different result since all sizes and all different industries would be included. Or a study of privately held firms would also be fascinating. Second, it would be interesting to determine how far the Asian crisis of 1997-2001 has changed the landscape of conglomerates and its ownership structure, compared to the current situation. We did not provide any historical recent data since***

we limited ourselves to the period 2011-2014. Furthermore, an update of some of the earlier empirical research data regarding country-level corporate governance may be advisable. Fourth, the analysis provides some interesting indicators on which corporate governance factors did have a significant effect on the financial performance: for instance, the presence of foreign investment has a positive effect on the performance, confirm to the literature in corporate governance. However, we did not analyze whether specific joint ventures between such foreign investors and local partners had a significant positive effect on the financial performance. Knowing which joint ventures or alliances were more successful over a considerable time frame, and why, would contribute to the international business literature. Finally, we believe it is crucial that further specific research in countries - where comparatively speaking institutions do not function that well to protect [minority] investors and stakeholders, and where regulatory enforcement if lax and where standards are obtuse - how a relationship-oriented governance logic affects a "bundle" of governance practices and how to better understand its interdependencies.

TABLE 1: GOVERNANCE ATTRIBUTES

1. Board accountability & responsibility

1. Non-executive board members or commissioners have a formal session without executives or directors once a year or more
2. The Supervisory board has regular joint board meetings with Executive Board
3. Board performance is periodically evaluated
4. Company discloses a code of ethics for senior executives and explicitly refers to behavior that is to related-party transactions *
5. Board or a committee Is responsible for CEO succession planning *
6. There have been no related-party transactions in the past three years *
7. The bylaws foresee a clause on related-party transactions *
8. The governance/nomination committee is composed of independent board members
9. Board is controlled by more than 50% of independent outside directors *

2. Transparency, Financial disclosure and internal control

10. Company uses one of the big four top tier Auditors *
11. The Internal Audit directly reports to Supervisory Board (and not just to Exec Board) *
12. The internal Audit is a separated unit within the company *
13. Company offers multiple channels to access information *
14. Company has not had a material earnings restatement in the past three years, timely disclosure *
15. Audit committee is wholly composed of independent board members

3. Shareholder rights & equitable treatment of all shareholders

16. Vote results (& financial results) for the last shareholder meeting are disclosed within 14 calendar days *
17. Shareholders have a right to convene at EGM with 10% or less of the shares requesting one
18. It is easy to identify beneficial ownership *

4. Remuneration and performance

19. Company discloses performance targets for the next fiscal year
20. Disclosure of ownership by non-executive and executive directors *
21. Detailed information of remuneration of individual executive and non-executive directors is disclosed *

5. Market for control

22. Company does not require a supermajority vote to approve a merger
23. No single shareholder or shareholder group with majority of voting power
24. Company is part of an economic group where parent/controlling shareholder also controls key suppliers, or other related business *
25. Company or Government ownership concentration *
26. Significant foreign institutional investment *

6. Corporate Behavior and Board Effectiveness

27. Company does not have pending criminal litigation against it
28. Company discloses its environmental performance *
29. Company discloses a Corporate Social Responsibility (CSR) report *
30. No regulatory investigation for a material issue other than for accounting irregularities
31. Company discloses its policy regarding corporate level political donations
32. The board members regularly received board training *
33. The size of the board should not be too big to allow proper functioning, but not too small to deprive specific knowledge

Source: The authors' interpretation of RiskMetric variables and corporate governance attributes provided by Governance Metrics International (GMI) - cf Footnote 1 - applicable to Asian emerging market context

*Note: those variables with * indicate some specific focus in our regression analysis*

TABLE 2: Variables and Measures Governance Variable		Measure
Board Quality	Succession Planning	Binary
	Board of directors are trained in corporate governance	Binary
Is the company part of an economic group where parent/controlling shareholder also controls key suppliers, customers, or other businesses?		Binary
Related Parties Transaction	Existence of RPTs	Binary
	Non-Compliance ruling on RPT	Binary
Disclosure/Transparency	Easy to identify beneficial ownership	Binary
	BOC or BOD shareholding disclosed	Binary
Audit	Internal Audit as a separate unit in the Company	Binary
	Does the company perform an external audit using independent and reputable auditors (big 4)?	Binary
	Does the Internal Audit department report to BOC	Binary
Does the company offer multiple channels to access to information		Binary
Is the Financial Report Disclosed in a timely manner?		Binary
Government ownership percentage		Continuous %
Family ownership percentage		Continuous %
Foreign institutional ownership percentage		Continuous %

TABLE 3
DESCRIPTIVE STATISTICS & CORRELATIONS

		Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
1	ROA	0.072	0.102	1.000																
2	Net income (billions)	7.030	98.500	-0.147	1.000															
3	Firm size (billions)	16.998	2.201	-0.184	0.546	1.000														
4	Succession planning	0.403	0.491	-0.137	0.018	-0.090	1.000													
5	Board governance training	0.189	0.392	-0.376	0.603	0.499	0.035	1.000												
6	Supply chain control	0.892	0.311	-0.045	0.257	-0.036	0.071	0.009	1.000											
7	Existence of RPT	0.970	0.170	-0.017	0.021	0.042	-0.038	0.031	0.034	1.000										
8	Transparent ownership	0.678	0.468	0.086	-0.062	-0.053	-0.089	-0.158	-0.019	0.003										
9	BOC/BOD shareholding disclosed	0.470	0.500	-0.009	-0.093	-0.089	0.003	-0.072	-0.047	0.001	0.059	1.000								
10	Internal audit separate	0.559	0.497	-0.137	0.163	0.116	0.066	0.221	0.046	0.015	0.157	0.014	1.000							
11	Internal audit reports BOC	0.546	0.499	-0.071	0.434	0.271	0.023	0.339	0.046	0.034	0.085	0.000	0.145	1.000						
12	Multiple channels to access information	0.976	0.154	0.013	0.100	0.028	0.030	-0.009	0.031	-0.002	0.257	0.019	0.049	0.113	1.000					
13	Financial reports timely	0.989	0.104	-0.139	0.757	0.454	0.019	0.568	-0.001	0.011	-0.078	-0.074	0.122	0.407	0.068	1.000				
14	Ruling on RPT	0.046	0.210	-0.089	0.148	0.199	-0.271	0.145	-0.025	0.061	0.036	0.015	0.063	0.131	0.025	0.025	1.000			
15	Auditor is Big 4	0.643	0.480	-0.138	0.257	0.229	0.076	0.300	-0.020	0.038	-0.050	-0.035	0.122	0.103	-0.022	0.225	0.223	1.000		
16	Foreign institutional ownership	0.226	0.311	-0.055	0.456	0.378	0.025	0.476	0.055	0.040	0.134	-0.013	0.229	0.288	0.111	0.356	0.169	0.277	1.000	
17	Gov't shareholding	0.176	0.326	-0.098	0.325	0.208	-0.074	0.248	0.088	0.018	0.159	0.005	0.131	0.308	0.087	0.292	0.340	0.175	0.294	1.000
18	Family ownership	0.314	3.227	-0.139	0.533	0.332	-0.039	0.411	0.078	0.018	0.097	0.007	0.157	0.428	0.088	0.526	0.272	0.273	0.383	0.737

Note: If correlation is greater than 0.04, then it is significant at $p<0.05$
N=368

Our results when predicting net income (firm performance) are summarized as follows:

TABLE 4: REGRESSION RESULTS PREDICTING FIRM PERFORMANCE				
	DV: Net Income		DV: ROA	
	Beta	S.D.	Beta	S.D.
Firm size	-0.001	(0.068)	-0.193**	(0.070)
Local owners (5% to 25%)	-0.015	(0.215)	-0.070	(0.222)
Local owners (25% to 45%)	0.086	(0.258)	0.090	(0.266)
Succession planning	-0.007	(0.131)	0.291*	(0.134)
Board governance training	0.463**	(0.161)	-0.133	(0.165)
Supply Chain Control	-0.071	(0.155)	0.027	(0.160)
Existence of RPT	-1.630***	(0.327)	-0.182	(0.336)
Transparent Ownership	0.183	(0.124)	0.166	(0.128)
BOC/BOD Shareholding Disclosed	-0.178	(0.167)	-0.422*	(0.171)
Internal Audit Separate	0.136	(0.313)	0.348	(0.322)
Internal Audit Reports BOC	-0.058	(0.312)	0.011	(0.321)
Multiple Channels to Access Information	0.568	(0.366)	0.135	(0.377)
Financial Reports Timely	-0.161	(0.485)	0.304	(0.499)
Ruling on RPT	-0.709**	(0.264)	0.139	(0.272)
Auditor is Big 4	0.323**	(0.112)	0.136	(0.115)
Foreign Institutional Ownership	-0.008	(0.062)	0.171**	(0.063)
Gov't Shareholding	-0.022	(0.038)	-0.011	(0.039)
Family Ownership	-0.007	(0.037)	-0.013	(0.038)
R Squared	0.142		0.090	
N	368		368	

Key: *** denotes p value of less than .001; ** denotes p value of less than .01; * denotes p value of less than .05; † denotes p value of less than .1;
Industry and year dummies are included in the regressions but not listed.

Note that the findings we comment on above were significant at $p<0.05$ (less than 5% chance that they do not predict net income). We controlled for firm size, year and industry.

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