Corporate Ownership and Supervisory Board; Impact on Firm Performance

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Abstract

This paper reviews literatures on corporate ownership and board governance and their impact on firm performance. In particular, the paper reviewed the governance characteristics related to the issues of concentrated and management ownerships prevalent in most of the Asian countries. Further, the analysis discuss the relation of such governance characteristics on firm performance. Various governance mechanisms were considered, expecially the existence of internal governance mechanisms that are ubiquitous in developing countries with emerging capital markets, such as Indonesia, in order to minimize the agency costs. Therefore, we conjecture that concentrated-ownership firms should perform better than dispersed-ownership firms since majority shareholders have enticement to monitor the management. Firms with management-ownership ought to have better performance than those with no management-ownership, as managers that have some portion of firm's equity ownership would result in better alignment of the interests between managers and shareholders. Further, the firms with affiliated supervisory board members were supposed to demonstrate superior in performance than those without affiliated supervisory board members. As such, effective monitoring by the supervisory board should be enhanced as they are affiliated to the owners of the company, and hence could minimize the agency costs.

Keywords: *governance mechanisms, ownership, agency costs, affiliated supervisory board, firm performance*.

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I. Introduction

Corporate governance has been discussed as one of the main factors that caused the East Asian financial crisis in 1997-1998 (Lee, 2008) and the collapses of multinational companies such as Enron, Tyco, and Adelphi during 2000s (Harris & Raviv, 2007). What is corporate governance actually? Corporate governance is like a big elephant (Turnbull, 1997). Many researchers view it from different angles and describe it from different perspectives. In the perspective of finance, corporate governance deals with the way in which people that finance the corporations make sure that they get return on their investment (Shleifer & Vishny, 1997). This leads to an agency problem; the separation of ownership and control, which is the essence of agency theory (Fama & Jensen, 1983).

The Agency theory reveals that owners and managers have divergent interests; shareholders want to maximize their interests while managers want to maximize their own which then resulting agency costs for monitoring the managements (Jensen & Meckling 1976). This usually happens in developed countries such as U.S and U.K where most of the companies have dispersed ownership structure. In developing countries-such as Continental Europe and East Asia countries- characterized by the majority of concentrated ownership companies, arises the power abuse of majority shareholders over minority shareholders (Shleifer & Vishny, 1997). This suggests that different type of ownership structure bears different type of agency problems.

Agency theory aims at explaining how different mechanisms can align incentives between contracting parties and minimize costs associated with agency problems (Padilla, 2003). Those mechanisms are generally classified into internal and external in nature. Internal mechanisms primarily consist of board composition and ownership structure (Suntraruk, 2009), which by means of ownership structure agency cost could be reduced through ownership concentration (Kumar, 2003) and managerial equity ownership (Han, 2004). Whilst external mechanisms rely on the takeover market in addition to the regulatory system (Omran, 2008). In most of developing countries, such as Indonesia, internal mechanism is more prevalent, since the market role as the external control mechanism to discipline the companies is restricted (Lukviarman 2004).

Previous studies regarding these relationship give diverse results. Ownership concentration is proven to have positive impacts on firm performance, this positive relation is generally known as 'monitoring hypothesis'. Besides, firm performance is also revealed to be negatively impacted by ownership concentration, this negative relation is widely known as 'expropriation hypothesis'. Management ownership is confirmed to have positive effects on firm performance, this positive relation is commonly known as 'convergence-of-interest hypothesis'. In addtion, firm performance is also negatively influenced by management ownership, this negative relation is broadly known as 'entrenchment hypothesis'. Affiliated supervisory board is demonstrated to bequeath either positive relation (Lukviarman, 2004) or negative relation (Yeh & Woidtke, 2004) to firm performance.

This paper elaborates the effects of concentrated ownership, management ownership and affiliated supervisory board on firm performance. Main propositions of this paper are; (1) performance of the firms characterized by concentrated ownership should be higher than those with dispersed ownership, (2) the performance of firms with management ownership should be higher than in the firms without management ownership, and (3) performance of the firms characterized by the existence of affiliated supervisory board should be higher than those without affiliated supervisory board.

The remainder of this paper is organized as follows. The following section describes the conceptual framework including the concepts of corporate governance, agency theory, ownership concentration, management ownership, affiliated supervisory board, and firm performance. Section 3 overviewed the literature review including monitoring hypothesis, expropriation hypothesis, convergence-of-interest hypothesis, entrenchment hypothesis, and other types of finding, board composition and affiliated board. It follows by a section elaborates the theory and hypothesis development based on prior findings and arguments. The final section summarizes the reviews as the concluding remarks of the paper.

II. Corporate Governance

It doesn't seem easy to define 'corporate governance' as it always happens with thriving new fields in which semantics turns out to become loose and tentative (Apreda, 2002). Nevertheless, Shahid (2003, p. 2) stated that "from a corporate perspective, governance means that companies should not only maximize shareholders wealth but also balance the interests of shareholders with other stakeholders such as employees, customers, lenders, suppliers and the public at large, in order to achieve long term sustained value".

Corporate governance systems are usually classified according to five key features (Miguel, Pindado & Torre, 2003): 1) the level of ownership concentration; 2) the effectiveness of boards; 3) the development of capital markets; 4) the role of the market for corporate control and; 5) the legal protection of investors. The dominance of concentrated ownership companies, the presence of management ownership and affiliated supervisory board, the lower level of capital market development, the absence of market take over as the common market control to discipline the corporations, and the weaknesses of legal protection for investors, are characteristics peculiar to the Indonesian corporate governance system which differentiate it from those in other both developed and developing countries.

2.1 Agency Theory

The dominant view of corporate governance hinges on the issue of separation of ownership and control within the firm which modeled by the agency theory (Lukviarman, 2004). According to Investorwords (2009), agency theory is a theory that explains the relationship between the principal (shareholders) and the agent (executives). Further, Jansen and Meckling (1976) define an agency relationship as a contract under which the principals engage the agents to perform some service on their behalf which involves delegating some decision making authority to the agent. An agency conflict/problem exists as the principal wants the agent to act in the principal's interests but the agent is expected to have his own interest and consequently may not act in the best interests of the principal (Padilla, 2003).

In aligning the interests of principals and agents appears an agency cost which may decrease firm performance. In corollary, Jensen and Meckling (1976) define agency costs as the sum of: monitoring expenditures by the principal, the bonding expenditures by the agent, and residual loss. These costs include: shirking, risk aversion, managers' pursuit of favored endeavors and projects, unproductive firm growth and empire building, misuse of free cash flows, incentives schemes that include excessive remuneration packages and perquisites, and costs of monitoring managers (Shleifer & Vishny, 1997).

According to Lukviarman (2004), there are two major agency problems arise in agency relationship: 1) the agency problem that exists between shareholders and managers which generally happens in dispersed-ownership companies such as in U.S and U.K; 2) one that exists between majority and minority shareholders which widely happens in concentrated-ownership firms such as in Continental Europe and East Asian countries. Thus, agency theory seeks to define the nature of contracts that will minimize agency costs of monitoring, motivating and ensuring the commitment of the agent (see Lukviarman, 2004) and aims to explain how different mechanisms can minimize costs associated with such problems.

2.2 Ownership Concentration

Ownership structure refers to the configuration of shareholdings of individual or organization in a company (Lukviarman, 2004). Based on the level of ownership concentration, ownership structure could simply be classified into concentrated and dispersed ownership. Concentrated-ownership company is a company with majority shareholder, whereas, dispersed-ownership company is a company without such shareholder. Majority shareholder is defined as a single shareholder who controls more than half of a corporation's outstanding shares, or sometimes, one of a small group of shareholders who collectively control more than half of a corporation's outstanding shares (Investorwords, 2009).

Following the early work by Berle and Means (1932) and until the 80s, the main concern of the literature on corporate governance was the conflict of interest between shareholders and managers (Jensen & Meckling, 1976). Since the 90s, careful observations of ownership structures across the world showed that dispersed shareholdings are much less frequent than expected, instead high degree of ownership concentrations occur widely (La Porta, Lopez-de-Silanez, Shleifer & Vishny, 1999), where potential expropriation of the minority investors by the controlling owners became the main concern (Faccio & Lang, 2002).

Those evidences indicate the relevant issue has shifted from the traditional agency conflict between professional managers and atomistic shareholders to an equally salient agency conflict between controlling shareholders and minority shareholders in continental Europe (Boubaker, 2005) and East Asia countries. In the absence of strong laws that protects minority shareholders, investors seek to own a significant proportion of the firm equity to protect their interests (Shleifer & Vishny, 1997). Ownership concentration which ensures better monitoring is supposed to lead to a better performance.

2.3 Management Ownership

Management is defined as officers and directors as usual (Lee & Ryu, 2003). Hence, management ownership refers to the ownership of firm's shares by its directors, managers and employees. Economists have been interested in the effects of the separation of ownership and control in the modern corporation at least since the classic works of Berle and Means (1932) and Coase (1937). The major focus of concern has been the potential conflicts of interest between managers (who run the firm) and shareholders (who own the firm). One method suggested to reduce this potential conflict is to increase the equity ownership of managers in the firms, therefore encouraging managers to work more efficiently to maximize shareholders' wealth and carry out less activities of self interest (Jensen & Meckling, 1976; Fama & Jensen, 1983; Shleifer & Vishny, 1986).

2.4 Affiliated Supervisory Board

In the absence of an effective market for corporate control prevalent in developing countries, it might be argued that board monitoring could provide better functionality in maximizing shareholders' value. In other words, effective monitoring by the governing board substitutes for other mechanisms external to the firm (see Lukviarman, 2004). However, not all firms experience the same level of agency conflict, and, hence may require different levels of internal monitoring by board. One of the major issues in this regard is the composition of the board of directors that will determine the level of monitoring activities. In Agency theory, the conflict-resolving role of outsider board members (Fama, 1980; Fama & Jensen, 1983).

Lukviarman (2004, p.76) proposes "an affiliated board member is identified as an owner-related board member who is a relative of a shareholder or has personal ties to a company and/or controlling shareholders". Based on this definition, an affiliated supervisory board member could be defined as an owner-related supervisory board member who is a relative of a shareholder or has personal ties to a company and/or controlling shareholders. The companies with the presence of affiliated supervisory board member in their supervisory board composition should have better performance than those without such member, since effective control could be applied as shareholders have superior information through involvement in supervisory board.

2.5 Firm Performance

To achieve long-term sustained value, companies should raise their performance from year to year. There is no unique definition of firm performance (Pattanayak, 2008). However, Investordwords (2009) define performance as 'the results of activities of an organization or investments over a given period of time'. Most of researchers classified firm performance into accounting and market performance to assess the performance of the firms. The accounting performance measures take account to the current status of the firm as the result of past performance, such as, return on asset (ROA), return on equity (ROE) and return on sales (ROS). Whereas, stock market performance measures take account to the future prospects of the firm, such as, Tobin's Q, market to book value of equity (MBVR), price-earnings (P/E) ratio, and price to book value (P/BV).

Lukviarman (2004, p. 46) states that "previous research utilising the agency theory perspective assumes that ownership features influence corporate behaviour and performance". As such, given various measurements of both ownership and performance variables and different institutional environments, it is expected that the outcome will also vary. Generalization of assumptions of agency theory remains an important issue that needed to be further explored. Furthermore, performance measurement continues to be a crucial issue in the study of corporate governance (see Lukviarman, 2004).

III. Theoretical Framework

There are extensive literatures examining different facets of corporate governance from various disciplines (see Lukviarman, 2004). This paper deals with typical agency constructs within corporate governance structure and their impact on corporate performance.

3.1 Ownership Concentration and Firm Performance

The results of previous studies of the relation between ownership concentration and firm performance could be grouped into three, namely; monitoring hypothesis, expropriation hypothesis and other types of finding.

3.1.1 Monitoring hypothesis

Berle and Means (1932) suggest the existence of a positive and linear relation between ownership concentration and firm performance, since dispersion creates free riding problems and makes manager monitoring difficult. Shleifer and Vishny (1986) confirms the above conclusion by showing how the price of the firm shares increases as the proportion of shares held by large shareholders rises. This result is generally known as monitoring hypothesis suggesting a positive relationship between ownership concentration and firm performance.

Hill and Snell (1988) shows ownership structure affects firm performance (profitability) through strategic choice; ownership concentration encourages the strategy that linked to value maximization and discourages the strategy that tied to manager-interested objectives. Hill and Snell (1989) confirm this positive relation on performance (productivity) for US firms. Agrawal and Mandelker (1990) also found the existence of large block holders leads to both better monitoring of managers and better performance.

In more recent studies, Deb and Chaturvedula (2003), studying 443 manufacturing and service listed companies in 2003, India, as an emerging market, revealed firm performance (Tobin's Q) is linearly positive and highly significant related to ownership concentration. Lukviarman (2004), observing 161 non-financial companies during 1994-2000 listed in Indonesia Stock Exchange (IDX) as an emerging market, discovered that majority-ownership companies (share>50%) outperform dominant-ownership (20%<share≤50%) and dispersed-ownership companies (share<20%) in performance (ROA & ROS). Grosfeld (2006), researching all non-financial listed companies during 1991-2003 in Poland, as an economy undergoing important changes in legal and regulatory framework, found a positive impact of ownership concentration on firm performance (Tobin's Q). Cho and Rui (2007), examining 4623 firm observations during 1999-2003 in China as an underdeveloped market, exposed the concentration of non-state ownership and the presence of foreign shareholders were positively related to firm performance (MBVR).

Lee (2008), analyzing 579 listed firms during 2000-2006 in South Korea, as an emerging market, uncovered firm performance (ROA) improves as ownership concentration increases. Ganguli and Agrawal (2008), scrutinizing 98 listed companies in 2007, India, detected a strong positive relationship between ownership concentration and firm performance (Tobin's Q). Omran (2008), investigating 52 newly privatized firms during 1995-2005 in Egypt as an emerging market, showed ownership concentration in particular foreign investors have a positive impact on firm performance for both accounting (ROA, ROS & ROE) and market indicator (Tobin's Q). Suntraruk (2009), observing 76 non-financial firms during 2005-2007 listed in Stock Exchange of Thailand as an emerging market, found a positive relationship between the concentrated ownership and firm performance (ROA).

3.1.2 Expropriation hypothesis

Leech and Leahy (1991), analyzing the implications of the separation of ownership and control for U.K firms, found a negative and significant relation between ownership concentration and firm value and profitability. This result bears the expropriation hypothesis suggesting firm performance is negatively related to ownership concentration. Also for the British case, Mudambi and Nicosia (1998) confirmed the negative relation between ownership concentration and performance (rate of return on stock market) for financial firms. Faccio and Lang (2002) found expropriation is likely to happen in firms where large shareholders are present. The potential expropriation of the minority investors by the controlling owners has also been shown by Johnson, La Porta et.al (2000); Lehman and Weigand (2000) and; Gugler and Weigand (2003).

In more recent studies, Boubaker (2005), studying 510 French non-financial listed firms in 2000, as characterized by poor investors' protection rule, discovered a negative and statistically significant relationship between the largest shareholders' control stakes and firm performance (Tobin's Q). Kirchmaier and Grant (2006), observing 473 non-financial Europe firms (98 Germany, 88 Spain, 97 France, 92 Italy and 98 U.K) in 2002, found dominant shareholders have a negative impact on long-term share price performance.

Bae, Baek and Kang (2007), researching 669 non-financial listed firms in South Korea, during the financial crisis 1997-1998 and post-crisis recovery period 1998-1999, revealed poorly governed firms (firms that have a high disparity between voting and cash flow rights, low equity ownership by controlling shareholders, low block ownership, and highly diversified) drop more in stock prices and suffer more loss of accounting profit during the crisis period. Zeitun (2008), investigating 167 non-financial listed firms during 1989-2006 in Jordan as an emerging capital market, uncovered a negative correlation between ownership concentration and firm performance (Tobin's Q & ROA).

3.1.3 Other types of finding

Other kinds of result regarding the relation of ownership concentration on firm performance are no relationship, non-linear relationship and mix results of monitoring and expropriation (quadratic and inverted U-pattern).

Demsetz and Lehn (1985), regressing of profit rate on the fraction of shares owned by the five largest shareholders, found no evidence of a relation between firm performance and ownership concentration. Morck, Shleifer and Vishny (1988) also found no significant relation between ownership concentration and performance

(Tobin's *Q* & accounting profit rate). Gedajlovic and Shapiro (1998) revealed non-linear relationship between ownership concentration and profitability in U.S and German firms. Loderer and Martin (1997), and Cho (1998) found no significant relationship between ownership and performance.

In more recent studies, Demsetz and Villalonga (2001), observing 223 all sectors firms in U.S, found no evidence to support the notion that variations across firms in observed ownership concentration result in systematic variations in observed firm performances. Miguel, Pindado and Torre (2003), researching 135 non-financial listed companies during 1990-1999 in Spain as characterized by less-developed both in capitalization value and in volume of share, revealed a quadratic relationship; the firm value rises as ownership concentration increases from 0% to 87% and beyond this breakpoint, market value of shares is negatively affected by ownership concentration.

Lauterbach and Tolkowsky (2004), studying 144 listed firms in 2002, in Israel as characterized with median investor protections, discovered an inverted-U pattern; firm performance (Tobin's Q) increases with control holders' vote up to a point close to 75%, then Q starts to decrease with vote. Rogers, Dami, Ribiero and Sousa (2007), investigating 176 non-financial listed companies during 1997-2001 in Brazil as a less developed market, concluded that ownership concentration does not have influence on firm market performance (Tobin's Q).

3.2 Management Ownership and Firm Performance

The results of prior studies of the relation between management ownership and firm performance could be grouped into three, namely convergence-of-interest hypothesis, entrenchment hypothesis and other types of finding.

3.2.1 Convergence-of-interest hypothesis

Berle and Means (1932) pointed out that the distribution of the firm's shares between its managers and outside owners is likely to affect the market value of the firm. Decades later, by proposing the agency theory, Jensen and Meckling (1976) argued that managers' natural tendency is to allocate the firm's resources in their own best interests, which may conflict with those of outside shareholders. As insider equity ownership increases, those conflicting interests converge, and hence the conflicts between managers and shareholders are expected to be resolved. This convergence-of-interest hypothesis suggests firm value increases as management ownership rises. Mehran (1995) provides evidence of a positive relation between managerial equity ownership and firm performance (ROA & Tobin's Q). Chung and Pruitt (1996) found a positive influence of CEO equity ownership on Tobin's *Q*.

In more recent studies, Seifert, Gonenc and Wright (2002), observing firms in U.S, U.K, German, and Japan, found the insiders influence firm performance (ROA) positively in all those four countries; insider ownership helps to align the interests of management with those of outside shareholders. Kaserer and Moldenhauer (2005), researching 648 non-financial firm observations for years 1998 and 2003 in German as characterized by lower level of investor protection and hampered market for corporate control, revealed a positive and significant relationship between insider ownership and firm performance (MBVR, stock price & ROA).

Leung and Horwitz (2007), studying 463 listed firms in Hong Kong which the financial infrastructure is similar to those of the U.S and U.K, showed that firms with higher concentrated management ownership had better market performance and better accounting performance (ROA) during the Crisis (1997-1998). Schmid and Zimmermann (2007), analyzing 145 non-financial firms in 2002, in Swiss, as characterized by tight stock-holdings and control structures are dominated by institutional investors, uncovered a positive and significant influence of managerial shareholdings on firm performance (Tobin's Q).

3.2.2 Entrenchment hypothesis

Fama and Jensen (1983) argue that significant insider ownership has offsetting costs, wherein even for low levels of insider ownership, market discipline may still force managers to pursue value maximization. In contrast, they argued that when managers own a substantial fraction of the firm shares which confers them enough influence, they may satisfy their non-value-maximizing objectives without endangering their employment and salary. This argument gives rise to the entrenchment hypothesis. According to this hypothesis, the excessive ownership by the insiders has rather negative impact on corporate performance, probably because the high level of insider ownership is liable to entrench them.

In recent studies, Lins (2002), observing 1433 firms from 18 emerging markets in 1995, found management group control in excess of its proportional ownership is negatively related to firm performance (Tobin's *Q*). Lee and Ryu (2003), studying 110 firms in the chemical industry, Japan, during 1981-1990, revealed a negative linear relation between management shareholding and firm performance (P/E ratio).

3.2.3 Other Types of Finding

Other kinds of result regarding the relation of management ownership on firm performance are no relationship and mix results of convergence-of-interest and entrenchment (non-monotonic, cubic relation, curvilinear *U-shaped*).

Demsetz (1983) argues that insider ownership is endogenously determined and hence cannot be a determinant of firm value. His arguments are supported by the evidence presented in Demsetz and Lehn (1985). Morck, Shleifer and Vishny (1988) found non-monotonic relationship of 371 Fortune 500 firms; the relationship is positive for managerial ownership between 0%-5%, negative between 5% -25% and positive thereafter. McConnell and Servaes (1990) showed the relationship to be positive between 0% and somewhere in the range 35%-50% and negative thereafter. Similar findings are exposed by Jarrell and Poulsen (1988) and Stulz (1988). Tsetsekos and DeFusco (1990) reported no significant differences in the returns on the various portfolios.

Hermalin and Weisbach (1991), studying 134 NYSE firms, found the relationship to be positive for CEO ownership between 0%-1%, negative between 1%-5%, positive between 5%-20% and negative thereafter. Loderer and Martin (1997) revealed no evidence that larger managerial stockholdings lead to a better firm performance. Mudambi and Nicosia (1998), observing 111 financial firms during 1992-1994 in UK, found a non-monotonic relation. Holderness, Krozner and Sheehan (1999) showed that low levels of managerial ownership increase firm value but at higher levels, firm value decreases. Himmelberg, Hubbard, and Palia (1999), controlling for possible unobserved firm heterogeneity, concluded managerial ownership does not affect firm performance. Faccio and Lasfer (1999), researching 1650 non financial companies for 1996-1997 in U.K, found that for the high growth companies, firm value is indicated positively related to managerial ownership. However, the relationship is cubic; firm value increases up to managerial ownership of 19.68% then decreases up to managerial ownership of 54.12% and increases, thereafter.

In more recent studies, Demsetz and Villalonga (2001), studying 223 firms from all sectors in U.S, found no evidence to support the notion that variations across firms in observed management ownership result in systematic variations in observed firm performances. Pattanayak (2008), analyzing 1833 listed firms during 2000-2003 in India, uncovered a significant non-monotonic relation; Tobin's Q first increases until the level of management ownership reach 20%, then decreases at the level of 20%-49%, finally rises beyond 49%. Ruan, Tian and Ma (2009), researching listed firms with 723 observations during 2003-2007 in China as characterized by weak protection of shareholders, revealed non-monotonic relation wherein Tobin's Q firstly increases when managerial ownership is less than 17.5%, and then it declines until reaches to 64.3%, then over 64.3%, it rises again. Suntraruk (2009), observing 76 non-financial firms during 2005-2007 listed in Stock Exchange of Thailand as an emerging market, exposed that managerial ownership is insignificantly related to firm performance (ROA & Tobin's Q).

3.3 Affiliated Supervisory Board and Firm Performance

The relationship between affiliated supervisory board and firm performance may best to be observed in companies with two-tier board system as it clearly separates the supervisory and management board. However, most studies have been conducted in Anglo-Saxon countries adopting unitary board system which condenses the supervisory and management board where the researchers mainly focuses on insider, outsider and independent directors. It is necessary to review researches in both types of the board.

3.3.1 Board composition and performance

Hill and Snell (1988) found a positive relationship between a proportion of outside directors and firm's performance. This finding is consistent to the evidence found by Baysinger and Butler (1985); Schellenger, Wood, and Tashakori (1989); Pearce and Zahra (1992); and Stearns and Mizruchi (1993). Bhagat and Black (1999), studying 500 American firms in 1997, revealed that there is no convincing evidence that greater board independence correlates with greater firm profitability or faster growth. Hermalin and Weisbach (2003) exposed a higher proportion of outside directors are not significantly associated with superior performance, for U.S firms. Hillier and McColgan (2004), observing 683 listed firms in U.K from 1992 to 1998, showed stock prices react favorably when companies announce the departure of a family CEO, but only when these directors are replaced by a non-family successor. Dahya and McConnel (2005), studying 1124 listed firms during 1989-1996 in U.K, concluded that by adding outside directors led to improve firm performance (ROA & stock price).

3.3.2 Affiliated Board and Performance

Lukviarman (2004), researching 161 non-financial companies during 1994-2000 listed in Indonesia Stock Exchange (IDX) as an emerging market, revealed that there is significant difference in performance (ROA & ROS) as firms with owner involved in supervisory board membership outperformed firms with no owners involved in their supervisory board.

Yeh and Woidtke (2004), observing 251 non financial companies in 1998 listed in Taiwan where the protection for investors is weak, discovered that there is poor governance when the boards of both management and supervisory are dominated by members who are affiliated with the controlling family but good governance when the boards are dominated by members who are not affiliated with the controlling family. They concluded that relative firm performance (ROA & Tobin's Q) is negatively related to board affiliation in family-controlled firms.

IV. Discussion

The aforementioned studies have shown: 1) ownership concentration is <u>positively</u> related (**monitoring hypothesis**) and <u>negatively</u> related (**expropriation hypothesis**) to firm performance; 2) management ownership is <u>positively</u> related (**convergence-of-interest hypothesis**) and <u>negatively</u> related (**entrenchment hypothesis**) to firm performance; and 3) affiliated supervisory board member is <u>positively</u> related (Lukviarman, 2004) and <u>negatively</u> related (Yeh & Woidtke, 2004) to firm performance. Based on these findings, it is eligible to argue that ownership concentration, management ownership and affiliated supervisory board influence firm performance, either increasing or decreasing.

However, performance of a firm is influenced by a host of factors. Omission of those factors may lead to spurious relation between firm value and ownership structure (Serlarka, 2005). Firm size and firm age are variables that mostly controlled in investigating the impacts of ownership structure on firm performance. Large firms may turn out to be more efficient as they are likely to exploit economies of scale, employ more skilled managers and the formalization of procedures that may lead to better performance (Kumar, 2003). Besides, larger firms can be less efficient than smaller ones because of the loss of control by top managers over strategic and operational activities within the firm (Sarkar & Sarkar, 2000). The prolonged period of learning experience and absence of the liabilities of newness augur well for old firm (Majumdar, 1997). But, older firms are prone to inertia, bureaucratic rigidities and may be less able to cope with new invention and late in adopting new technologies (Pattanayak, 2008).

4.1 Ownership concentration and firm performance

Ownership concentration is found to be positively related to firm performance in developed countries with liquid capital market such as U.S (Hill & Snell, 1989), in country with underdeveloped market such as China (Cho & Rui, 2007), and in country with transition economy such as Poland (Grosfeld, 2006), and also in developing countries with emerging capital market such as India (Deb & Chaturvedula, 2003; Ganguli & Agrawal, 2008); South Korea (Lee, 2008); Egypt (Omran, 2008); and Thailand (Suntraruk, 2009)

In concentrated-ownership companies, large block holders lead to better monitoring of managers because large shareholders have the incentives and resources to monitor management decisions and reduce agency costs (Shleifer & Vishny, 1986) and thus increasing firm performance. Large shareholders can pressure managers to align decisions to the interests of shareholders and increase the company's economic performance (Lukviarman, 2004).

As the opposite, in diffused-ownership companies, dispersed-ownership structure creates free-riding problems and makes manager monitoring difficult (Berle & Means, 1932).

Indonesia is a developing country with emerging capital market and low legal investors' protection and most of the listed companies are concentrated ownership. La Porta et.al. (1998 & 1999) argues that the existence of controlling shareholders is an attempt of minimizing the conflicts of agency in countries with low legal investor and institutional protection. Thus, concentrated-ownership companies that posses controlling shareholders should have better performance than dispersed-ownership companies since the latter do not posses majority shareholders. In this context, Lukviarman (2004) found that concentrated-ownership companies outperform the performance of dispersed-ownership companies in Indonesia. Therefore, in line with monitoring hypotheses, ownership concentration should lead to better firm performance.

4.2 Management ownership and firm performance

Management ownership is found to be positively related to firm performance in multi countries observation i.e. U.S, U.K, German and Japan (Wright, 2002), and in Continental Europe countries with bank-dominated corporate governance system such as German (Kaserer & Moldenhauer, 2007); Swiss (Schmid & Zimmermann, 2007) and also in Asia such as Hong Kong (Leung & Hortwitz, 2007).

Berle and Means (1932) pointed that when managers do not have an ownership interest in the firm; potential conflicts of interest arise between corporate managers and dispersed shareholders. Those conflicts generate agency costs as managers attempt to pursue their own goals rather than the shareholders' wealth which then would decrease the firm performance. Therefore, there is a need to align the interests of principals and agents to reduce the agency costs.

Jensen and Meckling (1976) argue that more equity ownership by the manager means better alignment of the monetary incentives between manager and other equity owners. As insider equity ownership increases, the conflicting interests between managers and shareholders convergence and hence the conflicts are likely to be resolved (Miguel, Pindado & Torre, 2003). Since the agency conflicts are resolved, agency costs will be reduced and thus increasing firm performance.

The relationship between managerial stake and market value of the firm would be positive as management and shareholder interests converge (Mudambi & Nicosia, 1998). When managerial ownership goes up to a considerably high level, the interest between managers and shareholders are fully aligned, in this situation, management would pursue best firm performance and firm value would be increased (Ruan, Tian & Ma, 2009). Thus, companies with management ownership should have better performance than those without management ownership. Therefore, in line with convergence-of-interest hypothesis, the performance of firms with management ownerhip should be better that those without management ownership.

4.3 Affiliated board and firm performance

Shareholders could minimize asymmetric information and apply effective control when they have superior information through involvement in boards of directors (Morck, Shleifer & Vishny, 1988). A firm's board structure could be viewed as a strong indicator of the majority shareholder's commitment to corporate governance, especially in the countries with weak investor protection. When the positive incentive effects of ownership concentration are high, controlling shareholders may select board members that are more likely to both monitor and provide professional expertise (Yeh & Woidtke, 2004) which reduces the monitoring cost and blocks the entrenchment effects from the managers, as the consequences firm performance will increase.

In Indonesia, 71.5% of all publicly listed companies are concentrated ownership with family as the controlling shareholders (Lukviarman, 2004). In such firms, board members are also the members of the family or relatives of the majority owners which then could be expected to have a profound impact on effective monitoring and reduce agency costs, thus improving firm performance. It has been showed that 90% of private-domestic listed firms in Indonesia have owner related members of the supervisory board. Since large shareholders invest significant shares, they don't like to risk of losing control but keen on having strong incentive to monitor the managers and wield more power to enforce their interests so that increasing the preference of the managers to maximize the shareholders' value. It also has been revealed that companies with their owner involved in supervisory board outperform the companies without their owner involved in this board. Therefore, companies with affiliated supervisory board member should perform better than those without such board member.

V. Concluding Remarks

To maximize shareholders value, firm performances should be increased year by year. To achieve long term sustained value, a good corporate governance is needed in order to balance the interests of shareholders with other stakeholders' (employees, customers, creditors, suppliers, government and public society) interests. Therefore, a sound governance mechanism is required to promote a good corporate governance implication. In an emerging market, such as Indonesia, where the investor protection is rather low, internal governance mechanism is more prevalent.

By concerning to internal governance mechanisms i.e. ownership concentration, management ownership and affiliated supervisory board, the agency costs might be reduced. Through ownership concentration, large shareholders have the incentives and resources to monitor the management decisions (Shleifer & Vishny, 1986) and reduce the agency costs for monitoring the managements (Jensen & Meckling, 1976). By way of managerial equity ownership, more equity ownership by the manager means better alignment of the monetary incentives between manager and other equity owners (Jensen & Meckling, 1976) which then result in reducing the agency costs. Via affiliated supervisory board, supervisory board members which also the members of the family or relatives of the majority owners could be expected to have a profound impact on effective monitoring and reduce agency costs (Lukviarman, 2004).

As the agency costs are reduced, firm performance may rise. The continuesly increases of firm performance period by period would bring about shareholders' maximizitation value, which then lead to long-term sustained value as all companies preferred and desired. Therefore, companies in the emerging market with low level of investors' protection, such as Indonesia; by having sound internal governance mechanism (ownership concentration, management ownership, and affiliated supervisory board), would have better performance than those without such mechanism since the mechanism is endeavoring to minimize the agency costs.

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