Family Ownership Structure and Firm Value (Case study on Big-Cap Public Companies)

Juniarti
Doctoral Students in Accounting, Airlangga University
Lecturer in Business Accounting Program, Petra Christian University
yunie@peter.petra.ac.id

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ABSTRACT

Some previous researches proved the positive association between family ownership and firm value or companies' performance. Contrary with these results, Jiang and Peng (2011) found that Indonesia is one of the country in which family ownership structure has a negative association with firm value. Moreover, Claessen et al. (2000), stated that as of 16.6% of Indonesia's public companies are controlled by a single majority shareholder. Claessens et al. (2000) also stated that higher entrenchment occurred in Indonesia together with Philipina and Thailand. Besides that the low law enforcement and the lowest corruption index in Indonesia (Jiang & Peng 2011), add opportunity to the majority to expropriate the minority. Therefore, this research aims to prove that there is a negative association between family ownership structure and firm value in which negative entrenchment of the majority to minority exists. This study shows that family ownership has a significant negative effect on firm value at significance level of 10%.

*Keywords: family ownership structure, firm value, negative entrenchment effect, expro*priation

INTRODUCTION

Familiy ownership structure has become as one of the interested topics to be studied, particularly its effects on firm value. Villalonga & Amit (2006), Maury (2006), Jiang & Peng (2011), Barontini & Caprio (2005), Anderson & Reeb (2003), Claessen et.al (2000) are some of the researcher that actively studied this topic. Villalonga & Amit (2006) examined whether family ownership, control and management, influent firm value. By using the company's data-Fortune-500 companies, during the years 1994 to 2000, Villalonga and Amit (2006) found that family ownership creates added value if the founder acts as the CEO or the Chairman of the Board of Commissioners with CEOs recruited from outside.

Maury (2006) conducted a study to examine how the performance of a company controlled by the family (family-control) compared with companies that are not controlled by the family in 1672 non-financial companies in the region of Western Europe. The study ojective was to confirm the existence of control by the family, whether the performance of the family control better than non-family control, given the diversity of the various results of previous studies. The results showed that family-controlled companies is positively associated with higher performance than companies that are not controlled by the family.

Jiang and Peng (2011) observed whether the family ownership and control play an important role in major companies in Asia. since there is still a puzzle regarding the

association between the family ownership concentration and control on the one hand and performance on the other, whether good, bad or not related. The study was conducted on 744 large public companies in eight Asian countries. The study was designed in two studies, Study I and Study II. The study II is study I added with a variable level of investor protection. The results of the study I showed that the existence of the family as the CEO is positively related to performance, supported by two countries. i.e Indonesian and Taiwan. The study II exhibited that the presence of the family as the CEO is positively associated with performance in the countries with low level of investor protection. Further, the existence of pyramid ownership on the contrary, was positively related to performance in countries with high levels of investor protection as supported by Hongkong, Malaysia and Singapore, except Indonesia and South Korea.

This result enhanced the previous research and provided better explanation on the diversity of the research related to whether family ownership contributes benefits to the performance of the company. This study successfully demonstrated that the supremacy of law in each country as shown by the level of investor protection is the useful factor to distinguish the presence or absence of a family control to the company's performance. It also entailed that the state is not always neutral in the relationship between family ownership and performance.

Barontini & Lorenzo (2006) searched 675 companies in eleven countries of Continental Europe. The purpose of the study was to investigate the association of ownership structure, firm value and performance. The study indicated that family ownership structures did not decrease firm value and performance. The existence of company's founder control and the presence of descendant in the board of director were significantly affect firm value and performance. However, if the descendant as CEO, the company's value and performance were not different from non-family corporate ownership. The results are in line with the findings of several previous studies that family ownership is positively related to the performance and firm value. However, care should be taken in interpreting these results due to several factors that have not been anticipated in the test, such as the level of investor protection as conducted by Jiang &Peng (2011).

Anderson and Reeb (2003), examined the relationship between the family as the founding family, ownership and corporate performance in the 403 companies included in the S & P 500, for period 1992 to 1999. The results denoted that the performance of firms with founding family firm is much better than with nonfounding family firm. Based on further analysis, it was found that the relationship between the founding family firm performance is nonlinear, family CEO has better performance as compared to non-family CEO. Overall these results reject the agency hypothesis, in other words, family ownership is an effective ownership structure.

On the other hand Demsetz (1983) argues differently, that concentration of ownership is the result of a decision to maximize the profit made by the shareholders at this time, therefore there is no effect on firm value. Some research supports Demsetz, (Demsetz &Lehn 1985; Himmelberg et.al 1999); Demsetz & Villonga 2001). Claessens et.al (2000), specifically stated that Indonesia is a country with concentrated ownership, 16.6% of the total listed companies as a public company controlled by the family as a sole proprietor. Meanwhile, Jiang & Peng (2011) said that the level of rule of law in Indonesia is relatively low at 3.98 and has the lowest corruption index among the countries in the East Asia region, ie 2.15, implied that the level of investor protection is very weak. In such condition, the family ownership has a big opportunities to expropriate minority shareholders.

It is therefore interesting to study further in the context of Indonesia, where the level of investor protection is weak and corrupt, to prove allegations that family ownership does not have a positive impact on firm value due to agency conflicts between owners actually exist, the latter, this study once wanted to confirm the results research Jiang and Peng (2011), that in Indonesia, the presence of family ownership negatively affect performance.

THEORETICAL REVIEW AND HYPOTHESES DEVELOPMENT

Family Ownership and Firm Value

The definition of a family firm or a company extensively owned by family, including (1) the company of one or more family members are as a director or board of directors or a majority shareholder, (2) a company that at least one of its members on the board of commissioners or management, (3) the company's largest voting rights or number of shares owned by the largest families, (4) the company's second generation of one or more family members are as management or directors, and so on (Villalonga& Amit, 2006). Family firms have advantages compared with non-family companies, which can overcome the agency problem between owners and management. Berle & Mean (1932), Fama & Jensen (1983) supports that the presence of family ownership in the company can resolve agency conflict between owners and management, because the owner has an interest to oversee management to ensure management actions that do not conflict with the interests of owners. On the other hand, a tight family ownership may create agency problems between majority shareholders and minority shareholders (Shleifer & Vishny, 1997).

A number of studies have shown that the market appreciates firms with family ownership (Barontino dan Caprio 2005; Villalonga & Amit 2006; Anderson & Reeb 2003; Ying &Peng 2010 dan Maury 2006). The results of these studies demonstrated that family ownership structure is positively associated with increased firm value. But Anderson & Reeb (2003) noted that it is occured, especially in countries that have well-established economic regulation. In countries with a low level of transparency, the presence of family ownership actually cause expropriation risk to minority shareholders. Furthermore, Maury (2006) warns that in countries with a low level of transparency, increased profitability can not be transferred into higher firm value.

Leemon & Lins (2001), revealed that companies's Tobins'Q in Asia where expropriation against minority shareholders exist, has declined an average of more than 12% compared to other companies. Meanwhile Claessens, Djankov, Fan, and Lang (2000) stated that high expropriation occurred in countries such as Indonesia, the Philippines and Thailand, while in the countries of Malaysia, Singapore and Taiwan, there was evidence of expropriation. As it is known that Malaysia, Singapore and Taiwan have a higher level of investor protection than Indonesia, the Philippines and Thailand.

According to Claessens et al. (2000), Indonesia is a country with concentrated ownership, in which 16.6% of the public companies controlled by the family as a sole proprietor. Moreover, with the low level of law, at 3.98 and the lowest position of corruption index among the countries in the East Asia region, i.e 2.15 (Jiang & Peng

2011), also indicated that the level of investor protection in Indonesia is still very weak. It has provided a great opportunity for the majority to expropriate the minority.

In the Indonesian context, where the level of investor protection is weak and corrupt, then the ownership of the family actually increase the risk of expropriation of the minority shareholders or known as the agency conflict II. With the enactment of Law 40 of 2007, the rights of minority shareholders has indeed been accommodated, but these rights don not directly reflect a legal protection of minority shareholders. It is recognized that a perfect legal protection to minority interests according to the principles of good corporate governance is still hard to apply in Indonesia (Priyatna 2012).

There are two approaches used to explain the possible behavior chosen by the controlling shareholder (Siregar, 2007) which is a positive incentive effect (PIE) and negative entrenchment effect (NEE). Although both of these approaches are built by assuming the presence of excess control rights is the difference between control rights and rights to dividends (Jensen and Meckling, 1976; Shleifer & Vishny, 1997), but it is still relevant to explain the possible behavior of family ownership as the holder of significant control. PIE assumed that controlling shareholder has an incentive and huge capacity to observe management intensively, thereby increasing the company's value and lower the cost of equity. On the other hand, NEE argue that controlling shareholders will take advantage of its large capacity to undertake actions for personal gain at the expense of minority shareholders.

Regardless the results of empirical results proved that market appreciates firms with family ownership (Barontino and Caprio 2005; Villalonga & Amit 2006; Anderson & Reeb 2003; Ying &Peng 2010 and Maury 2006), this research is intended to build hypothesis using NEE argumentation. There are some reasons supported this choice, (1) the low level of investor protection in Indonesia (Priyatna 2012; Jiang & Peng 2011), in such condition, the likelihood of the majority shareholder to expropriate minority is very large, (2) according to Anderson & Reeb (2003); Maury (2007) and Jiang & Peng (2011), ownership concentration is only effective to the contries that have established rule of law and counter-productive for un-transparence countries, otherwise decreasing firm value, (3) The results of some of the previos research, Claessens, Djankov, Fan, and Lang (2000), Darmadi (2012) showed that Indonesia as a country with high level of expropriation, also Lemmon & Lins (2000) uncovered that companies Tobis'Q in Asia, where expropriation to the minority exist, have experienced a decreasing of firm value, an average of more than 12% compared to other companies. (4) Ownership by a tight family may create agency problems between majority shareholders and minority shareholders (Shleifer & Vishny, 1997). Based on the NEE arguments, then the hypothesis of this study is:

H_1: Family ownership has a negative impact on firm value.

Control Variables

In many studies, the determinant of firm value other than the ownership structure, is the financial performance, company profiles associated with firm size, market share and firm age (Black, Jang & Kim 2006; Black, Carvalho, Khanna, Kim, Yurtoglu 2013; Baek, Kang & Park 2004). Black, Jang & Kim

(2006) employed a number of control variables such as market share, leverage and growth as the important determinant of firm value. Wide market share indicates high potential profitability. However, this study uses the change in operating profit, as a control variable, not market share, since operating earnings more represent the real performance of companies than market share. Companies whose profits increased from time to time will be more attractive and positively appreciated by investors. Another control variable is the leverage. High leverage represents a high risk enterprise. Companies with high leverage will be negatively associated with firm value.

Growing companies will be more interesting to investors, some previous studies support a positive association between growth and firm. In contrast to previous studies that use R & D as a proxy for growth (Vilalonga & Amit 2006, Black, Jang & Kim 2006; Black, Carvalho, Khanna, Kim, Yurtoglu 2013), this study chose sales as a proxy for growth, as sales better describe the actual growth experienced by the company and not just the potential for growth.

Research Methodology

Analysis Model

This study uses regression analysis to examine proposed hypothesis. Regression model is stated as below:

$$TQ_{it} = \beta_0 + \beta_1 FAMONR_{it} + \beta_2 LOBD_{it} + \beta_3 LEV_{it} + \beta_4 SGROWTH_{it} + \varepsilon_{it} \quad (1)$$

TQ_{it} : Firm value of company i at period t
$\beta_0\beta_1\beta_2\beta_3\beta_4$: regression coefficient
$FAMONR_{it}$: family ownership of firm i at period t
$LOBD_{it}$: Change of operating income of company i at period t
LEV_{it} : Debt to equity ratio of company i at period t
$SGROWTH_{it}$: Growth of company i at period t
ε_{it}, : error term

Operational Variables

	Variables	Operational definition	Scale
1	Firm value **(TQ)**	is the value of the business as an ongoing enterprise. Firm value is measured by Tobin's Q, as follow:	ratio

		$\frac{(\text{Total Assets} - \text{Book value of equity}) + \text{Market value of equity}}{\text{Book value of total assets}}$	
2	Family ownership **(FAMONR)**	company in which one or more family members act as a chief executive or are in a board of directors and as the majority shareholder (Vilalonga & Amit 2006). Majority shareholder limitation percentage is 10%, referring Siregar (2007); Claessens (2000) and La Porta (1999), that the 10% ownership level has been quite effective in controlling the company. Companies that meet the criteria of family members into the director / board of directors and have a share of at least 10%, given the numbers 1 and 0 otherwise.	nominal
3	Change in operating income **(LBOD)**	Operating income is income from the company's main activity which obtained by subtracting operating income to operating expenses.The formula changes in operating income is as follow: $\frac{\text{Operating profit}_{t-1} + \text{operating profit}_{t}}{\text{Operating profit}_{t-1}}$ Then, companies that have positive earnings change, given the numbers 1 and 0 if otherwise	nominal
4	Debt to equity ratio **(LEV)**	Proportion of equity that come from debt . $\frac{\text{Total Debt}}{\text{Total Equity}}$	ratio
5	Growth **(SGROWTH)**	The increased potential of the company to the next, as measured by growth in sales: $\frac{\text{Net sales}_{t-1} + \text{Net sales}}{\text{Net sales}_{t-1}}$	

Sample

Data was obtained from annual reports published in the website Indonesia Stock Exchange (IDX) and the respective company websites, for companies whose annual report data is not found on IDX sites, whereas the database shareholder obtained from the OSIRIS. This study uses all large cap companies (big capitalization) in 2008, 2009, 2010 and 2011 based on documents Fact Book published by the Stock Exchange in the years. The selection of companies with large market capitalization, referring to Anderson and Reeb (2003), Villalonga & Amit (2006) and Jiang & Peng (2011), which uses large companies in their research, in addition, large firms are also more concern to investors and analysts

than small companies (Chen & Jian 2006). Data qualified as sample as many as 146 observations, which is obtained from the following process:

The number of companies entering the big group of capitalization in 2008-2011	200
Companies that do not have complete data needed for the study.	(54)
The number of qualified samples to be processed	146

The data were processed with the aid of SPSS software version 19

Result and Discussion

The first classical assumption test on 146 observations, did not meet the four classical assumptions. The test results showed a number of data normality were identified as extreme data (outliers), a total of 37 observations were identified outliers are removed from observation and repeated testing. After dropping all outliers data, the second test against the 105 observations, shows the data meet the assumptions as indicated by multicollinearity VIF of each variable under 10 (appendix 1). There is no autocorrelation can be seen from the residual value of Durbin Watson for 1.289 is higher than the value of α is set at 0.05 (appendix 2). The model has also been free of heteroscedasticity, which can be seen from Spearman unstandardized residual values for all variables were above the α = 0.05 level (Appendix 3).

However, the data still can not fully meet the assumptions of normality (Appendix 4). One cause of the data does not meet the normal distribution because there are several variables like FAMONR and LBOD as a dummy variable with a value of 0 and 1, so it can not meet the required normality. However, because the number of observations is large enough (> 30), then theoretically meet the normal distribution of data, other than that based on the data plot (box-plot) the data have shown a normal distribution, and the value of R2 and numbers suitability model (F-test) have shown an increase in compared with the values of these parameters on the initial test.

Profile of 105 observations that have met the classical assumption test and descriptive statistics are presented in Table 1. Panel A shows the sample by

industry which dominated by a financial sector that is equal to 26% of the entire sample, and followed by the mining sector as much as 25%. Although the proportion is uneven, but almost all industry groups are represented except property sector, real estate and building. The number of observations is also fairly distributed between the family and non-family ownership.

Table 1. Sample Profile

Panel A. Industrial Sectors and Ownership Structure

Industrial Sector		
Agriculture	11	10%
Mining	25	24%
Basic Industries	13	12%
Others	3	3%
Consumer goods	9	9%
Insfrastructure, Utilies & Transportation	12	11%
Finance	26	25%
Investment	6	6%
	105	100%
Ownership structure		
Family	50	48%
Non-Family	55	52%
	105	100%

Panel B. Descriptive Statistic

	N	Minimum	Maximum	Mean	Std. Deviation
TQ	104	0.49	7.82	2.1463	1.4223
FAMONR	105	0	1	0.48	0.502
LBOD	101	0	1	0.69	0.464
LEV	105	0.22	12.05	2.9558	3.3471
SGROWTH	97	-0.21	1.03	0.2164	0.2341
Valid N (listwise)	96				

TQ = (total asset- book value of equity)+ market value of equity scaled by book value of assets; FAMONR = dummy variable of family ownership structure, 1= if family's member is assigned as a Chairman/CEO and has at least 10% of family ownership, 0 otherwise; LBOD = dummy variable of change in operating income, 1 if positive change and 0 otherwise ; LEV = total total debt to total equity; SGROWTH = changes in net sales

Panel B displays a general descriptive statistics for each variable. Regression analysis was performed on 96 valid observations , as presented in Table 1 above, because some variables are not available in full at 105 corresponding number of observations.

The model summary (Table 2), suggesting a correlation (R) are high among all predictor variables (FAMONR, LOBD, LEV, SGROWTH) with the response variable (TQ) of 0.539. Furthermore, the regression model also showed the adjusted R2 is quite high at 25.9% 0.259, it means that the changes of TQ variable can be explained by the four predictor variables together. Goodness regression model to the data can be seen from the F value of 9.296 and significant at $\alpha = 0.01$, respectively.

Testing the main hypothesis of this study (Table 2), shows that FAMONR significantly negative effect on the value of the company, at the 10% significance level. It is proven that firms with family ownership is perceived negatively by the market, this result once again consistent with the results of the research Jiang & Peng (2011), Lemmon & Lins (2001), Claessens, Djankov, Fan, and Lang (2000), which found that Indonesia is one of countries with the high-level expropriation where family ownership is negatively related to performance. The majority shareholder entrenchment cause negative effects, which utilizes a large capacity to undertake actions for personal gain at the expense of the minority shareholders. This behavior is possible since the level of investor protection in Indonesia is still very weak (Priyatna 2012, Jiang & Peng 2011).

The dominance of family ownership in large-scale enterprises to be inefficient, as investors are aware of the increased risk of exproriation on these companies which resulted in a decrease in the firm value. The movement of large companies more closely followed by investors than small firms (Chen & Jian 2006). Therefore investors are more sensitive to any possible risks as a result of actions taken by large-scale enterprises, and quickly anticipate such risks in the valuation of the company. These findings, although still preliminary and still need to be further tested its consistency, successfully wrecked the opinion of Demsetz & Lehn (1985), Himmelberg et.al (1999) and Demsetz & Villonga (2001), that the ownership structure is not related to performance and merely the results of the current shareholders's decision to maximize profits.

Table 2. Estimation Model

Regression model estimation

$TQ_{it} = \beta_0 + \beta_1 FAMONR_{it} + \beta_2 LOBD_{it} + \beta_3 LEV_{it} + \beta_4 SGROWTH_{it} + \varepsilon_{it}$

Variable	Predicted sign (+/-)	Coefficient	t-statistic	Sig	
(Constant)		2.476	9.090	.000	
FAMONR	-	-.465	-1.741	.085	*)
LBOD	+	1.041	3.425	.001	***)
LEV	-	-.209	-4.738	.000	***)
SGROWTH	+	-.986	-1.571	.120	

R	.539
Adjusted R^2	.259
F-stat	9.296 ***)
***), *) = each significant, at lthe evel 0.01 dan 0.1 TQ = (total asset- book value of equity)+ market value of equity scaled by book value of assets; FAMONR = dummy variable of family ownership structure, 1= if family's member is assigned as a Chairman/CEO and has at least 10% of family ownership, 0 otherwise; LBOD = dummy variable of change in operating income, 1 if positive change and 0 otherwise ; LEV = total total debt to total equity; SGROWTH = changes in net sales	

Control variables prove to affect the value of the company, namely the LBOD and LEV. High operating profit performance is perceived positively by investors, significant at $\alpha = 0.01$. The companies with good earnings performance show positively associated with firm value. In contrast, firms with high leverage indicates a high risk and perceived negatively by investors resulting in a decline in the value of the company, supported by the results of the test that the coefficient is significant at α = LEV 0.001. Meanwhile, growth which proxied by sales, proved not significantly affect the value of the company.

Conclusion, Implication and Limitation

This study aims to determine the impact of family ownership on firm value in the context of Indonesia, where the level of investor protection is weak and corrupt, and to confirm the results of research Jiang and Peng (2011), in particular the results stated that, the presence of family ownership in Indonesia negatively affect performance. A number of control variables are used to examine the determinants of the firm value in addition to the family ownership structure. Control variables used in this study is the change in operating income, which represents the risk and leverage growth proxied by changes in sales.

Research shows that family ownership structure negatively affect the firm value, at a significance level of 10%, consistent with Jiang & Peng (2011), Lemmon & Lins (2001), Claessens, Djankov, Fan, and Lang (2000), which found that Indonesia was a country with a high level of expropriation where family ownership was negatively related to performance. The majority shareholder entrenchment cause negative effects, which utilizes a large capacity to undertake actions for personal gain at the expense of minority shareholders. In addition it is evident that the change in operating profit significantly positive effect on firm value, whereas negatively affect leverage on firm value, respectively at a significance level 1%. While the growth of the company which is proxied by changes in sales, not shown to affect the value of the company.

However, this study does not exercise control over the level of investor protection as done by Gompers et al. (2003), which uses antitakeover index (GIndex) which is based on entrenchment index (EIndex) by Bebchuk et.al (2009). This study only assume the level of protection against expropriation of investors or existing investors based on the results of previous studies. Future research should incorporate control variables investor protection index, in order to obtain more accurate results. Besides, future research could compare with companies that do not include a large company, to gain a broader generalization of the results of the study. Measurement of family ownership structure can be traced by using the ultimate ownership as done by Siregar (2007), not only by ownership imediat as done in this study.

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APPENDICES

Appendix 1. Mulicollinierity Test

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	2.476	.272		9.090	.000		
	FAMONR	-.465	.267	-.158	-1.741	.085	.944	1.059
	LBOD	1.041	.304	.332	3.425	.001	.831	1.203
	LEV	-.209	.044	-.419	-4.738	.000	.997	1.003
	SGROWTH	-.986	.627	-.154	-1.571	.120	.816	1.225

a. Dependent Variable: TQ

Appendix 2 Autocorrelation Test

	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.539(a)	.290	.259	1.26929	1.289

a Predictors: (Constant), SGROWTH, LEV, FAMONR, LBOD
b Dependent Variable: TQ

Appendix 3. Heteroscedasticity Test

Correlations

			FAMONR	LBOD	LEV	SGROWTH	Unstandardized Residual
Spearman's rho	FAMONR	Correlation Coefficient	1.000	.187	.099	.169	-.004
		Sig. (2-tailed)	.	.062	.316	.098	.971
		N	105	101	105	97	96
	LBOD	Correlation Coefficient	.187	1.000	-.071	.435**	.013
		Sig. (2-tailed)	.062	.	.482	.000	.898
		N	101	101	101	97	96
	LEV	Correlation Coefficient	.099	-.071	1.000	.153	-.007
		Sig. (2-tailed)	.316	.482	.	.136	.947
		N	105	101	105	97	96
	SGROWTH	Correlation Coefficient	.169	.435**	.153	1.000	.069
		Sig. (2-tailed)	.098	.000	.136	.	.505
		N	97	97	97	97	96
	Unstandardized Residual	Correlation Coefficient	-.004	.013	-.007	.069	1.000
		Sig. (2-tailed)	.971	.898	.947	.505	.
		N	96	96	96	96	96

**. Correlation is significant at the 0.01 level (2-tailed).

Appendix 4. Normality Test

One-Sample Kolmogorov-Smirnov Test

		FAMONR	LBOD	LEV	SGROWTH	Standardized Residual
N		105	101	105	97	96
Normal Parameters(a,b)	Mean	.48	.69	2.9858	.2164	.0000000
	Std. Deviation	.502	.464	3.34707	.23407	.97872097
Most Extreme Differences	Absolute	.352	.439	.279	.133	.150
	Positive	.352	.254	.279	.133	.150

Negative	-.328	-.439	-.204	-.053	-.090
Kolmogorov-Smirnov Z	3.612	4.413	2.863	1.305	1.471
Asymp. Sig. (2-tailed)	.000	.000	.000	.066	.026

a Test distribution is Normal.
b Calculated from data.