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Evidence from Indonesia**

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**The Determinants of Board Compensations:  
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THE INDONESIAN INSTITUTE OF ACCOUNTANTS  
COMPARTMENT OF ACCOUNTING EDUCATORS





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FAMILY VOTING RIGHTS, BOARD CHARACTERISTICS, AND SHAREHOLDER  
VALUE: THE EMPIRICAL EVIDENCE FROM INDONESIAN PUBLIC LISTED  
COMPANIES

BY

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*Abstract*

*This study examines the relationship between board of director characteristics and shareholder value. Moreover, this study also investigates the moderating role of family voting rights on the relationship between proportion of independent member on board and shareholder value. Based on 88 samples of Indonesian public listed companies for periods 2002 to 2005 (352 observations) and using random effect panel data analysis, the results showed that the proportion of independent member on board is positively significant associated with shareholder value. It means that the role of independent board director in advising and monitoring management to act in the best interest of shareholders is effective whether in developed or in developing market including Indonesia. Furthermore, while this study also found that lower proportion of family voting rights lead to strengthen the positive relationship between independent board and shareholder value.*

*Keywords: board characteristics, corporate governance, shareholder value, family voting rights*

## **1. INTRODUCTION**

Husnan (2001) revealed that financial performance of Indonesian listed firms during Asian financial crisis was dropped not only in term of return on equity but also in term of return on assets (ROA). On the other hand shareholder value of some Indonesian listed companies is low. The percentage of Indonesian listed companies with Tobin-Q ratio less than 1.00 increased from 23.72% in 1999 to 30.13% and 39.10% in 2000 and 2001 respectively.

Asian Development Bank (ADB, 2000) and Claessens and Fan (2002) identified important factors that caused Asia economic crisis 1997 as weak corporate governance. It is the consequence of corporate governance characteristics of Indonesian public listed companies such as concentrate ownership and ineffectiveness of board of directors. Such perception motivate academics, media, government, corporations, institutional investors, auditing firms, etc to direct their attention an issues pertaining to good corporate governance as attempt to seek solution to enhance shareholders' value.

Corporate governance practices have been widely discussed in developed countries when managers in 1980's were blamed for neglecting shareholders' interest that marked with on going declining stock price (Toksai, 2004). In emerging markets, issues on corporate governance have captured considerable attention since 1997 when many of the Asian countries suffered from financial crisis that also impact to other emerging markets like Latin America and East European countries Over the years, institutions and researchers have conducted a number of surveys and studies on corporate governance practices as an attempt to analyze and understand the relationship between corporate governance practices and shareholder value. Different approaches and measurements have been used in various surveys and studies.

In 2001 CLSA conducted a study on corporate governance from seven specific aspects i.e. disciplines, transparency, independence, accountability, responsibility, fairness, and



social responsibility. Questioners were sent to financial analyst, the rating of Indonesian companies varies from 13.9% to 64.9% in weighted average scores. In detail, Indonesian corporations obtained the lowest score in transparency, discipline, accountability, responsibility, and fairness among corporations among four Southeast Asian countries i.e. Indonesia, Thailand, Malaysia, Singapore. Moreover, the survey also demonstrated the score on aspect of country macro determinant of corporate governance, Indonesia received the lowest score in that aspect i.e. 2.9 score among 25 emerging market (CLSA, 2000). Factors that contribute to weak corporate governance of Indonesian firms are the firms' individual governance structure and weaknesses of Indonesian regulatory enforcement.

Anecdotal observation as well as some empirical studies indicated that governance structures of Indonesian corporations can be summarized as follows: *firstly*, highly concentrated ownership by family members, the ownership structures of Indonesian firms are concentrated on first and second largest ownership (Husnan, 2001) and the first largest ownership is dominant by family ownership (Classens, Djankov, and Lang, 2000), and family members are dominant persons in board of directors and commissioners (Tabalujan, 2002).

Consequence of highly concentration and family based is little divorce between ownership and control, because majority ownership remains control the public companies. It is reasonable that conflict of interest in Indonesian corporations is not between shareholders and managers instead conflict of interest between majority and minority shareholders, because majority shareholders and board of directors tend to expropriate minority shareholders. *Secondly*, the stock market is not strong enough to control manager behavior. Market for corporate control or hostile takeover that is able to control or give an impact on managers' behavior is not common in Indonesia. Although merger and acquisition transactions do occurred, most of the transactions are within family's corporation or internal merger. *Thirdly*, legal protection for minority ownership is weak. Klapper and Love (2004)

showed that Indonesia is poor in legality, anti-director' rights, and judicial efficiency. *Fourthly*, the role of bank to control management behavior is ineffective, because the affiliation companies have at least one bank that serves finance for group activities (Petrick, 2002).

As part of the effort to improve corporate governance practice of Indonesian corporation, government of Indonesia forms a national committee on corporate governance (NCCG). Forming this committee also aims to fulfill the requirement by International Monetary Fund (IMF) as stated in the new letter of intent. NCCG released Indonesian code on good corporate governance on April 2001. One of the objectives of the code is to maximize shareholder and firm value by enhancing transparency, accountability, reliability, responsibility, and fairness. In order to achieve its goal NCCG focuses on monitoring system for manager's behavior by reforming composition of board of directors and board commissioners to have at least 20% independent member and formation of an audit committee. Its reforming is based on the argument that qualified independent members on board will be able to control managers and majority shareholders behavior effectively; therefore, minority right is protected.

At present, most of the Indonesian companies have reformed their composition of independent members on board directors and commissioners to at least 20%. As a result, the percentage of companies with two or more family members on board has decreased from 59.8% in 1997 to 40.7% in 2001, although they still represent the dominant influence ones in board composition (Tabalujan, 2002).

Prior studies on appeared to provide mixed findings on the impact of corporate governance practice and firm performance and firm value. In particular, studies on specific corporate governance practice-firm value relationship can be grouped into two categories. *Firstly*, ownership structure-firm value relationship and *secondly* board structure firm value

relationship. Board structure-shareholder value relationship, studies were conducted in board composition and board size. For board composition, some studies showed positive relationship between outside directors and firm value. (see Bai, Liu, Lu, Song, & Zhang, 2003; Hossain, Prevost, & Roa, 2001; Judge, Naoumova, & Koutzevol, 2003). The other researchers revealed that shareholder value is not related to proportion of outside directors (Bhagat & Black, 2000; Hermalin & Weisbach, 1991; Klein 1998; Weir & Laing 2001). Dalton et al (1998) conducted meta-analyses of some empirical studies with regard to the relationship between board composition and firm value He found little evidence with respect to the relationship between board composition and firm value. For board size, most studies showed negative relationship between board size and firm value (Eisenberg, Sundgren, & Wells 1998; Yermack 1996).

In the context of Indonesia, studies on corporate governance-shareholder value relationship have been conducted by a number of researcher (for example Darmawati, Khomsiyah, & Rahayu, 2004; Lukviarman, 2004). Darmawati et al. (2004) examined the relationship between corporate governance perspective index and shareholder value measured by Tobin-Q and return on asset (ROA). They found that corporate governance index is significantly related to ROA, but it is not significantly related to Tobin-Q. Lukviarman (2004) examined the relationship between ownership structures and owners' involvement in board and shareholder value that measured by return on asset (ROA) and return on sales (ROS). By exploring ANOVA method, he found that ownership structure and owners' involvement in board member are related to shareholder value. However, when he tested those relationships with multiple regression method, he only showed that owners' involvement in managing board was positively influenced shareholder value.

Mixed findings derived from prior studies with regards to the relationship between specific corporate governance and shareholder value reflect that further research efforts are

required to understand the phenomena in more specific manner and with greater details. Poor corporate governance and lack of transparency are perceived as the major factors that lead to 1997 Asian crisis and caused poor performance and value determination to many Indonesian corporations. As attempt to improve corporate governance practice of Indonesian corporation, Indonesian regulatory authorities formed the NCCG after the Asian financial crisis. NCCG then issued the code of good corporate governance with the objective to maximize shareholder and firm value by enhancing transparency, accountability, reliability, responsibility, and fairness. These also caused institutional and foreigner emerged as the dominant shareholders beside family ownership.

Despite the widely accepted perception that poor performance (both accounting and market performance) suffered by Indonesian companies during the financial crisis was the result of poor corporate governance, little empirical evidence have been provided to support such view. Based on earlier discussion on the unique characteristic of the governance structure of Indonesia companies as well as research findings from prior studies on the relationship between some corporate governance variables and shareholder value (see Bai, et al, 2003; Hermalin & Weisbach, 1991; Hossain, et al., 2001; Judge et al., 2003; McConnell & Servaes, 1990), Anecdotal evidence indicated that volatility of shareholder value among companies varied during the financial crisis periods (for example the stock price of some companies were able to rebounded in a short period of time, while certain companies took very long period to recover).

Since board of director is important factors on corporate governance structure, by reforming board of director characteristics with increasing percentage of independent director will enhance corporate governance practice then affect to greater shareholder value. The study intends to examine the relationship between board characteristics and shareholder



value. This study will also examine the impact of family voting right on the relationship between board composition and firm value among Indonesian listed companies.

## **2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT**

### **2.1. Shareholder Value**

It is widely accepted that objective of shareholders in profit-oriented organization is to maximize shareholders wealth. Shareholders wealth maximization is generally defined in term of stock price maximization, profit maximization, and firm value maximization is the purpose of founding of a company. To determine whether companies achieve their goal or not, the performance of the companies should be continuously evaluated. At least, there are two approaches that commonly employed in measuring firm performance i.e. financial accounting based measures (FAB) such as return on asset (ROA), return on equity (ROE), and return on sales (ROS), financial market based measures (FMB) such as stock return, market to book ratio, and Tobin-Q.

Most studies on corporate governance-shareholder value relationship measured value by FMB i.e. Tobin-Q ratio and market to book value. However Pandey (2005) argued that the best measurement for shareholder value is market to book ratio. Wiwattanakantang (2001) argued that measures of performance that are commonly used in studies of developed countries (including Tobin-Q and market to book ratio) are not absolutely appropriate to be implemented in developing economies. Moreover, for the case of Tobin-Q and market to book ratio, she concluded that it is difficult to obtain the true stock price value in emerging markets, because the capital markets are illiquid and there is a lack of timely disclosure. In order to consider the best measurement for shareholder value (Pandey, 2005) and the illiquid and lack of timely disclosure problem in emerging market Indonesia including, we measure shareholder value by average market to book value.

## **2.2. Corporate Governance**

Jensen and Meckling (1976) stated that the agency problem arise when managers' ownership is less than 100% as a result of divergent interest opportunism by the agent. The agency theory is generally underlying theoretical arguments for the adoption of corporate governance mechanism by organizations. Shareholders hire managers (the professional entrepreneurs) as agent in their firms to maximize their wealth, unfortunately managers are motivated to maximize themselves interest. As a result it is difficult for the financier to assure that their funds are not expropriated or wasted on unproductive project by managers (Shleifer and Vishny, 1997).

Corporate governance mechanisms refer to the ways to deal with agency problems between managers and shareholders as well as between controlling and minority shareholders (Gibson, 2002). It aims to protect minority shareholders from the expropriation by managers and controlling shareholders (Mitton, 2002). Denis (2001) argued that corporate governance mechanisms should be able to narrow the gap between managers' and shareholders' interest and have important impact on firm value.

According to Toksal (2004), corporate governance can be defined as a system by which corporations are directed and controlled. The control mechanism of managers' behavior can be divided into internal and external mechanism. The internal mechanisms refer to management-discipline instruments which include voting rights, firm provision on management liability, representative supervisory boards, and incentive base compensation.

On the other hand, the external mechanisms refer to market-based control such as equity, product, and managers market. Therefore ownership structure, board of director, audit committee, disclosure quality, legal system, takeover market, and product market are important elements of corporate governance mechanism. In order to measure good corporate

governance, there are two approaches i.e. overall score and specific approaches. In overall score approach quality of corporate governance is measured by index of all attributes corporate governance. In contrast, specific approach measure corporate governance attribute individually. This study explores specific approach where this study measured corporate governance board structure. Specific corporate governance is very possible method to measure corporate governance practice of Indonesian listed firms, since some study difficult to obtain data of overall quality ( see CLSA, 2001; Darmawati et al. 2004; Khomsiyah, 2004; Nam and Nam, 2004), .The board structure in this study consists of three attributes i.e. board size (the number of board o commissioner), proportion independent member on board, and proportion of board of commissioner that has family relationship.

### **2.3. Board Characteristics and Shareholder Value**

Chiang (2005) argued that companies are facing dilemma to find optimum number of board members. Large board members will decrease efficiency due to process to achieving agreement among board members lead to be time consuming. On the other hand, small board members will decrease decision-making precision due to inadequate personnel to\ participation in discussions. Erickson, Park, Reising, and Shin (2004) reported the negative relationship between shareholder value and board of director size of Canada firms. Mak and Kusnadi (2004) found an inverse relationship between board size and shareholder value for firms' Singapore and Malaysia. Hossain, et al. (2001) found negative relationship between board size and Tobin's- Q ration in New Zealand. Yermack (1996) find an inverse association between board size and shareholder value in a sample of 452 large U.S. industrial corporations between 1984 and 1991. In contrast, Dehaene, De Vuyst, and Ooghe (2001) revealed positive association between board size and firm performance (return on asset and



return on equity) in Belgium. However, Eisenberg, et al. (1998) presented evidence that a negative correlation between board size and profitability extends to small firms with small boards in Finland. As no studies have been done in Indonesia related board size-shareholder value relationship, we refer to studies as mention above and free-rider problem to predict that increasing board size will be associated with decreasing shareholder value.

**H1: There is a negative relationship between board size and shareholder value**

Yeh and Woidtke (2005) concluded that boards which are linked to controlling families are associated with strong, negative entrenchment effect or greater agency problems, and firm with such board structures are valued less by investors. In contrast, boards that are independent of controlling families are associated with strong, positive incentive effect or lesser agency problems, and .firm with such board structures are valued more highly by investors. Lukviarman (2004) found that the performance of controlling shareholder involvement is better than the firms with controlling shareholders is not involve neither board of director nor board of commissioners. However, he did not test the proportion family member on board that can increase firm performance. In anecdotal evidence suggested that the professional managers are more productive than family members in Indonesia as election of family member on board of commissioners is not based professionalism. Therefore we predict that increasing proportion of family member on board will be associated with decrease shareholder value.

**H2: There is a negative relationship between proportion of family member board and shareholder value**

The role of board director is to advise and monitor management to act in the best interest of shareholders. Erickson, et al. (2004) reported that a negative relationship between

shareholder value and the proportion of outside directors in Canada. Bai, et al. (2003) and Judge, et al. (2003) showed negative impact of executive director chairperson on shareholder value, but outside director on board enhances shareholder value. Hossain et al (2001) showed positive association between outside director and firm value, but the relationship between CEO as chairperson of board and Tobin's Q is not significant. Vafaes and Theodorou (1998) revealed that percentage of outside director does not relate to shareholder value. In Indonesia, it is a common practice to placed professional person such as academician or lecturer, economic analyst, capital market analyst as independent director. It is expected that their professionalism will increase an effective monitoring system of managers' behavior, in turn thus will increase firm value. Therefore we predict that increasing proportion of independent members on board will be associated with increase shareholder value.

**H3: There is a positive relationship between proportion of independent board and shareholder value.**

Independent board of directors will work based on their professionalism since there is no other parties that puss them to something which not relevant to their knowledge. In addition professionalism of independent board depends on the selection process of board arrangement. In context of Indonesia, board of director is selected by shareholder in annually general meeting. In this process, dominant ownership actively involve in determining who are elected as the board members. Even though the independent members on board hope fully maintain the minority shareholder wealth, they not perform well when a family is the dominant ownership.

**H4: The positive relationship between proportion of independent board and shareholder value is strong in low family voting right company.**

### **3. RESEARCH METHOD**

#### **3.1. Variables Definition and Measurement**

##### ***3.1.1. Dependent variable***

The dependent variable of this study is shareholder value (SV) that measured by average market book value (AMTB), According to Pandey (2005), the formulation to calculate

AMTB is:

$$AMTB_{it} = MVCS_{it}/BVE_{it} \quad (1)$$

Where:

$MVCS_{it}$  = the market value of common stock shares of firm i, year t

$BVE_{it}$  = the book value of equity of firm i, year t.

The difference measurement AMTB in this study and Pandey (2005) is in calculation of market value. Market value of common stock in this study is equal to outstanding common stock multiple with average of three months stock price i.e. stock price at april 1<sup>st</sup> to june 30<sup>th</sup> of the year after the end of accounting period.

##### ***3.1.2. Independent Variable***

Independent variables of this study consist of board size, family members on board, and independent chairperson of board. Board size is total number of members on board of directors and commissioners. Family member on board is total number of member on board of director and commissioners who are family. Independent members on boards are total number of independent member on board of director and commissioners who are independent divide total members on board of director and commissioners.



### ***3.1.3. Moderating Variable***

The moderating variable in this study is family voting right. Family voting right is the proportion of voting right that held by one family. This study adopts methodology developed by Claessens et al., (2000) to determine family voting right. Claessens et al., (2000) differed between corporate ownership related cash-flow right and control related to voting rights. In addition they argued that pyramiding and cross-holding cause different in ownership and control rights. To determine ultimate voting rights of one family we sum up that voting right by tracing pyramidal and cross-holding chains individually. For example if a family owns 10% shares of firm P that owns 15% shares firm Q and the same family owns 20% shares of firm R that owns 5% shares of firm Q. The proportion of voting rights of this family in firm Q 20% ( $\min(10\% ; 15\%) + \min(20\% ; 5\%)$ ).

### ***3.1.4. Control Variable***

Previous studies showed that some non corporate governance structure variables are significant related to shareholder value (see Carter et al., 2002; Douma et al., 2002; Faccio & Lasfer, 1999; Ho & Wong, 2001, Klopper & Love, 2004). Therefore to better examine the relationship between board structure and shareholder value, we put two control variables namely firm size and leverage ratio. Proxy for firm in this study is natural logarithm of total asset. Meanwhile, leverage is the total liabilities divided by total book value of equities.

## **3.2. Population and Sample Selection**

Population in this study is companies that listed in Jakarta stock exchange (JSX). Sample will be selected base on following criteria:

1. The companies were not classified as banking and financial industry, because of different characteristics and government regulated

2. The companies have issued annual report that ending period is December, 31<sup>st</sup>.
3. The companies have information about board of director, board of commissioner composition, and ownership structure in their annual report.
4. The companies have not been de-listed during observation periods i.e. 2002 to 2005
5. The companies have a positive equity balance.

### **3.3. Data Sources**

Data used in this study will consist of four years observation of selected Indonesian listed firms in Indonesia Stock Exchange (IDX) between 2002 and 2005. Data required in this study are stock prices, book value of asset, outstanding stock, book value of debt, ownership structure, and board composition. The data can be obtained from Indonesian capital market directory (ICMD), companies' annual report, and data base of accounting development centre of Gadjah Mada University (PPA-UGM).

### **3.4. Data Analysis**

Börsch-Supan and Köke (2000) argued that endogeneity, missing variables, sample selectivity, and variable measurement error, are econometric problems of many previous studies that will be caused the bias and inconsistent results on impact of corporate governance board structure included on shareholder value. They suggested that the endogenous of independent variables is generally occurred in two forms i.e. structural reverse causality and unobserved firm heterogeneity. They can be solved by using panel data analysis. Therefore, this study will test hypothesis by panel data analysis method. In addition this study will also explore non linear method if theory suggests that particular variables are not linear influence on firm value.

As Baron and Kenny (1986), this study will also explore hierarchical regression model as follow:

$$\blacksquare \text{ SV} = \beta_0 + \beta_1\% \text{FMO} + \beta_2 \text{Firmsize} + \beta_3 \text{LEV} + e \dots\dots\dots(\text{model 1})$$

$$\blacksquare \text{ SV} = \alpha_0 + \alpha_1\% \text{FMO} + \alpha_2 \text{BS} + \alpha_3\% \text{IB} + \alpha_4\% \text{FB} + \alpha_5 \text{Firmsize} + \alpha_6 \text{LEV} + e \dots\dots\dots(\text{model 2})$$

$$\blacksquare \text{ SV} = \Omega_0 + \Omega_1\% \text{FMO} + \Omega_2 \text{BS} + \Omega_3\% \text{IB} + \Omega_4\% \text{FB} + \Omega_5 \text{BSx} \text{FMO} + \Omega_6\% \text{IBx} \text{FMO} + \Omega_7\% \text{FBx} \text{FMO} + \Omega_8 \text{Firmsize} + \alpha_9 \text{LEV} + e \dots\dots\dots(\text{model 3})$$

Where;

SV: shareholder value measured by average market to book ratio

%FMO: percentage voting right held by one family

BS: number of board of commissioners

%IB: percentage of independent members on board of commissioners

%FB: percentage of independent members on board of commissioners

Control variable:

Firm size: natural logarithm of total asset

LEV: total liabilities to total equity ratio

## 4. EMPIRICAL RESULTS AND DISCUSSION

### 4.1. Descriptive Statistics

Table 1 showed that an average value of total asset is 2,174.28 billion *rupiah*. The smallest firm that included in this study has the total asset value of 18.86 billion *rupiah* and the total asset of largest firm is 46,986 billion *rupiah*. So this study focuses on the large firms and small firms as well. Meanwhile, the mean of leverage ratio (liabilities to total equity) is 2.19 times and the range value between 0.02 times (minimum value) and 54.75 times (the maximum value).



The mean of board size is 4.43 and the number range between 2 persons as smallest and 13 persons as largest of this board size. The mean percentage of independent members on board of directors is 38% with the range from the highest 71% and the lowest 20%. This indicated that all Indonesian public listed companies have complained to NCCG regulation (the minimum independent members on board is 20%), but there some companies have no complained to Jakarta stock exchange regulation (the minimum independent members on board is 33%). The average family member on board of directors is 9% with the range from the highest 67% and the lowest 0%. This finding consistent with Tabalujan (2001) who stated that after financial crisis the average family members on board was decreased. The mean of voting right held by family is 43% with minimum and maximum right is 0% and 94.14% respectively

For the periods of study, the mean of AMTB is 1.41 with the range from the highest 14.91 to the lowest 0.10. This indicated that on average shareholder value is created even some companies created higher shareholders value where book value of shares is lowers than market value of shares. However, there were some of Indonesian public listed companies that destroyed shareholder value where their book value of shares was higher than market value of shares.

**Table 1****Descriptive statistics of variables**

This table presents descriptive statistics of 88 (352 total panel balanced observations) Jakarta stock exchange listed firms during 2002 to 2005. Total asset is the total asset of the company at December 31<sup>st</sup> for each year of research periods. Leverage is total liabilities divided by total equity. Family voting right (FMO) is the total voting right held by one family. Board size (BS) is the size of board of commissioners. Independent board is the percentage of the board of commissioners is made up independent commissioners. Family board is the percentage of board of commissioners that have family relationship. AMTB is the number of outstanding shares time average stock price during 3 months (April 1<sup>st</sup> to June 30<sup>th</sup> next year) divided by book value of equity. Statistical significant at the 1percent level are denoted by \*\*\*

Variable	Minimum	Maximum	Mean	Std. Dev
Total asset	11.86	46986.00	2174.28	5232.34
Leverage	0.02	54.75	2.19	5.02
FMO	0.00	94.14	43.00	28.11
BS	2.00	13.00	4.43	2.08
IB	0.20	0.71	0.38	0.10
FB	0.00	0.67	0.09	0.19
AMTB	0.10	14.91	1.41	1.82

**4.2. Correlation Matrix****4.2.1. Correlation between independent variables**

Firstly, this study analyzed the correlation among independent variables in order to detect multicollinearity problem. Hair, Black, Babin, Anderson, and Tatham (2006) stated that multicollinearity problem occurs since the correlation among independent variables is 0.90 and higher. Table 2 presents the correlation matrix among independent variables. FMO is negatively significant correlated to IB ( $r = -0.24$ ,  $p \text{ value} < 0.01$ ), but it is positively significant related to FB ( $r = 0.40$ ,  $p \text{ value} < 0.01$ ). Meanwhile, BS is negatively significant related to FB ( $r = -0.12$ ,  $p \text{ value} < 0.05$ ). The last IB is negatively significant associated with FB ( $r = -0.28$ ,  $p \text{ value} < 0.05$ ). This result indicated that there is no multicollinearity problem occurred in this study.

**Table 2****Pearson correlation matrix among independent variables**

This table presents Pearson correlation matrix of 88 (352 total panel balanced observations) Jakarta stock exchange listed firms during 2002 to 2005. Family voting right is the total voting right held by one family. Board size is the size of board of commissioners. Independent board is the percentage of the board of commissioners is made up independent commissioners. Family board is the percentage of board of commissioners that have family relationship. Statistical significant at the 1 and 5 percent levels are denoted by \*\*\* and \*\* respectively.

	FMO	BS	IB
BS	-0.24***	1.00	
IB	-0.24***	0.04	1.00
FB	0.40***	-0.12**	-0.28**

**4.2.2. Correlation between independent and dependent variables**

Table 3 shows the correlation between dependent variables (AMTB) and independent variables and moderating variable (FMO, BS, IB, and FB). AMTB is positively significant associated with BS ( $r = 0.12$ ,  $p$  value  $< 0.05$ ), and IB ( $r = 0.21$ ,  $p$  value  $< 0.05$ ), but it is negatively significant related to FMO ( $r = -0.24$ ,  $p$  value  $< 0.01$ ).

**Table.3.****Pearson correlation matrix between dependent and independent variables**

This table presents Pearson correlation matrix of 88 (352 total panel balanced observations) Jakarta stock exchange listed firms during 2002 to 2005. AMTB is the number of outstanding shares time average stock price during 3 months (April 1<sup>st</sup> to June 30<sup>th</sup> next year) divided by book value of equity. Family voting right is the total voting right held by one family. Board size is the size of board of commissioners. Independent board is the percentage of the board of commissioners is made up independent commissioners. Family board is the percentage of board of commissioners that have family relationship. Statistical significant at the 1, 5, and 10 percent levels are denoted by \*\*\*, \*\*, and \* respectively.

	AMTB
FMO	-0.24***
BS	0.12**
IB	0.21**
FB	-0.06

**4.3. Hypothesis testing**

This section presents the testing hypothesis 1, 2, and 3. This study tests those hypotheses by employing the multivariate regression method. The regression was exploring average market

to book value as shareholder value measurement, the multiple regressions results figured that proportion independent members on board of directors is positively significant related to shareholder value. Hence, the hypothesis number 3 was supported, but hypothesis number 1 and 2 were not supported. The explanation power of regression is 2.3%. The finding of this study consistence what previous study such as Bai, et al. (2003), Judge, et al. (2003), and Hossain et al (2001).

**Table 4**  
**Multivariate regression result**

This table present regression results of 88 (3 52 total panel balanced observations) Jakarta stock exchange e listed firms during 2002 to 2005. cross-section random effects method was used in this study since observation periods (4 year) is lower than the number of cross-sectional observations. AMTB is the number of outstanding shares time average stock price during 3 months (April 1<sup>st</sup> to June 30<sup>th</sup> next year) divided by book value of equity. Family voting right is the total voting right held by one family. Firm size is natural logarithm of total asset. Leverage ratio (LEV) is total liabilities divided by total book value of equity. Meanwhile, statistical significant at the 1, 5, and 10 percent levels are denoted by \*\*\*, \*\*, and \* respectively.

	Model 1		Model 2		Model 3	
Independent Variables	Coeff	t-Stat	Coeff	t-Stat	Coeff	t-Stat
CS			0.102	1.286	0.102	1.281
IC			<b>3.895**</b>	2.306	<b>3.893**</b>	2.287
FC			0.162	0.181	0.158	0.175
LOG(TA)	-0.005	-0.122			-0.005	-0.130
LEV	-0.011	-0.862			-0.011	-0.872
R-squared	0.002		0.021		0.023	
Adjusted R-squared	-0.004		0.012		0.009	
F-statistic	0.385		<b>2.464*</b>		1.620	
Prob(F-statistic)	0.681		0.062		0.154	

In context of moderating effect of family voting right, we tested it by employing hierarchical regression model (Baron and Kenny, 1986). Moderator variable (family voting right) determines under circumstances a significant relationship exists between proportion of independent board and average market to book value. The moderator effect of family voting

right represents the strength of the relationship between proportion of independent board of director and shareholder value. The relationship between proportion of board of director and shareholder value may be higher or lower by employing family voting right.

**Table 5**  
**Hierarchical regression result**

This table present regression results of 88 (3 52 total panel balanced observations) Jakarta stock exchange listed firms during 2002 to 2005. cross-section random effects method was used in this study since observation periods (4 year) is lower than the number of cross-sectional observations. AMTB is the number of outstanding shares time average stock price during 3 months (April 1<sup>st</sup> to June 30<sup>th</sup> next year) divided by book value of equity. Family voting right is the total voting right held by one family. Independent board (IB) is the percentage of the board of commissioners is made up independent commissioners. Family board is the percentage of board of commissioners that have family relationship. Firm size is natural logarithm of total asset. Leverage ratio (LEV) is total liabilities divided by total book value of equity Meanwhile, t-statistics are shown in parentheses and statistical significant at the 1, 5, and 10 percent levels are denoted by \*\*\*, \*\*, and \* respectively.

Independent Variables	Model		
	1	2	3
<b>IB</b>	<b>3.887</b> <b>(2.384)**</b>	<b>3.585</b> <b>(2.152)**</b>	<b>7.403</b> <b>(2.922) ***</b>
<b>FMO</b>		<b>-0.008</b> <b>(-1.525)</b>	<b>0.047</b> <b>(2.045)**</b>
<b>FMO*IB</b>			<b>-0.117</b> <b>(-2.223)**</b>
<b>LOG(TA)</b>	<b>-0.006</b> <b>(-0.147)</b>	<b>-0.005</b> <b>(-0.131)</b>	<b>-0.007</b> <b>(-0.181)</b>
<b>LEV</b>	<b>-0.011</b> <b>(-0.863)</b>	<b>-0.011</b> <b>(-0.869)</b>	<b>-0.011</b> <b>(-0.812)</b>
<b>R-squared</b>	<b>0.018</b>	<b>0.030</b>	<b>0.053</b>
<b>R-squared Change</b>	<b>0.018</b>	<b>0.012</b>	<b>0.023</b>
<b>Adjusted R-squared</b>	<b>0.010</b>	<b>0.013</b>	<b>0.028</b>
<b>F-statistic</b>	<b>2.160*</b>	<b>1.798*</b>	<b>2.129**</b>
<b>Prob(F-statistic)</b>	<b>0.092</b>	<b>0.099</b>	<b>0.027</b>

Table 5 shows the result of linear regression analysis using hierarchical regression method. The relationship between the proportions of independent members on board of director is positively significant related to shareholder value (see model 1). On overall 1.8% of variation in shareholder value is explained by proportion of independent member on board and control variable size and leverage ratio at 10% confidence level. By employing family

voting right as a predictor (model 2), the explanation power of the proportion independent of board of director has increased to 3%. Then when family voting right was included as moderator variable (interaction family voting right-proportion independent board), the family voting right provides additional 2.3% explanation power (see model 3), The negative sign of coefficient moderator variable (interaction family voting right-proportion independent board) figures that the positive relationship between proportion of independent member on board and shareholder value is strong when the percentage of total voting right that held by one family is low.

## **5. IMPLICATION**

This study is important for its theoretical and practical contributions. Theoretical contribution of this study especially in international corporate governance perspective that comprises environmental and methodological perspectives In environmental perspective, this study will provide empirical evidences on corporate governance- shareholder value relationship of Indonesian listed firms that have unique corporate governance structure involve the regulation, family business group dominant, and different in board composition (unique twotier board). The result of this study showed that independent directors play an important role in order to enhancing shareholder value. This result is consistent with some previous studies such as Hossain et al (2001). This implies that the role of independent board director in advising and monitoring management to act in the best interest of shareholders is effective whether in developed or in developing market including Indonesia. Furthermore, this study also found the proportion of voting right held by a family affected the effectiveness of independent director in management monitoring process in order to enhance shareholder value. The lowest proportion of voting right held a family in an Indonesian public listed company; strengthen the positive relationship between independent board and shareholder

value. In context practical implication, this study gives significant input to Indonesian regulatory bodies especially to the capital market executive agency of Indonesia (BAPEPAM and NCCG) in setting and evaluating corporate governance regulation especially in setting board structure, this study suggest that higher independent member on board will be followed by effectiveness of advising and monitoring function of board in order to make sure that management act in the best of shareholder interest.

## **6. LIMITATION AND SUGGESTION FOR FUTURE RESEARCH**

The few limitations are identified in conducting this research that may be lead to unsupported two hypothesis of this study. Firstly, this study is limited by measurement percentages of family member on board which only focus on family relationship by name and information of board characteristics. This study is not tracing the family relationship of board by other sources, so sometime the real family relationship of board of director in Indonesian public listed companies can not be determined by the last name. We suggest future research can replicated this study by improving measurement of family relationship board. Second limitation of this study is in term of relative short period (4 year), it consequence is that this study can not employ fixed effect panel data analysis that has itself advantages and disadvantages. Future research can extend the period of observations, in order to find the smart result. Last but not list, the explanation power of this study is too low, it means that so many other variables mainly other corporate governance attributes such as audit committee and board meeting which can explain the variation of shareholder value had not included in this study. Therefore, future research should employ those variables for enhancing explanation power of the relationship corporate governance and shareholder value.



## 7. CONCLUSION

The objectives of this study are to examine the relationship between board of director structure and shareholder value and to investigate the effect of proportion of voting right held by a family to the relationship between proportion of independent member on board and shareholder value. Based on 88 samples of Indonesian public listed firm for periods 2002 to 2005 (352 observations) and using random effect panel data analysis, the results showed that the proportion of independent member on board is positively significant associated with shareholder value. This study also found that the positive significant relationship between proportion of independent director and shareholder value is strong when the proportion of voting right held by a family is low. Since the result of this study is consistent with some previous studies in developed market such as Hossain et al (2001), we concluded that the role of independent board director in advising and monitoring management to act in the best interest of shareholders is effective whether in developed or in developing market including Indonesia. Furthermore, while this study also found that lower proportion of voting right held a family in an Indonesian public listed company; strengthen the positive relationship between independent board and shareholder value; we also concluded the non family Indonesian public listed companies intent to hire the professional persons as independent director.

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