The Relationship of Ownership Structure, Multiple Directorships and Related Party Transactions: Evidence from Two-Tier Corporate Governance System

Abstract

This study investigates the role of internal governance mechanisms in dealing with wealth expropriation via related party transactions. Specifically, this study identify three forms of related party transactions namely related lending, related borrowing and related sales to be exposed against ownership concentration and multiple directorships as part of internal governance mechanisms. Test is conducted using data sets of the firms affiliated to business groups in Indonesia which has unique institutional setting with two-tier corporate governance system. Multiple directorships and multiple commissionerships are the two independent variables reflecting the dual board governance system in Indonesia. The multiple regression results show that minority ownership is negatively related with three types of related party transactions. The result also finds mixed position of multiple directorships when dealing with related party transactions. Multiple commissionerships that suppose to provide monitoring function fail to gain significant relationship toward all types of transactions. The implication of the finding is that the role of internal governance mechanisms still not really effective in resolving the problem of wealth expropriation in the family business environment with high concentration of ownership

Keywords: Related Party Transactions, Wealth expropriation, Minority Ownership, Multiple Directorships, Multiple Commissionerships.

1. Introduction

More than one decade since the Asian crisis 1997, the series efforts to improve the good corporate governance practice in Asian countries have been continuing. It is argued that the lack of good corporate governance practice was blamed as one cause of the crisis. In the aftermath of the crisis, the good corporate governance practice become prerequisite to attract foreign investment and ultimately has contribution toward national development. Therefore, some initiatives have been taken by some countries in Asia to adopt and releases the code of good corporate governance at national level (Claessens, 2006). Nevertheless, the revelation of corporate scandals still proved that the good governance rule does not always guarantee the good result whenever the enforcement of the code is still not consistently implemented.

It is widely known that many public companies in East Asian countries are characterized by the high concentration of ownership in the hand of family, the lack of separation between controlling families and top management, and the deviation of ownership and control (Claessens, Djankov, & Lang, 2000). When ownership is concentrated in the hand of controlling owners, there is benefit and cost of that condition to the implementation of good corporate governance. The lack of separation of ownership and control as a result of high concentration of ownership will give the imbalance position between controlling shareholders as insider and minority shareholders as the outsider. This imbalance position will potentially create the problem wealth expropriation where controlling shareholders will exert their control to extract private benefit at the cost of minority shareholders (La Porta, Lopez-de-Silanes, & Shleifer, 1999). This act actually represents the fundamental agency problem that occurs between majority and minority shareholders.

The perseverance of wealth expropriation in the business activities has been investigated in some corporate policies like related party transactions (Cheung, Rau, & Stouratis, 2006, 2008; Galerry, Gallery, & Supranowicz, 2008; Gordon, Henry & Palia, 2004; Henry, Gordon, Reed, & Louwers, 2007; Jian & Wong, 2006), dividend policy (Chen, Jian & Xu, 2009; Faccio, 2001), debt policy (Du & Dai, 2005; Faccio, Lang, & Young, 2003; La Porta et al., 1999; Nor & Ariffin, 2005), diversification strategy (Claessens et al., 2000; Ishak & Napier, 2006; Khanna & Palepu, 2000), and even earnings management (Denis, 2001; Lo, Wong & Firth, 2009). Among various means of expropriation, this study will focus on related party transactions in the specific country setting with unique governance characteristic, that is Indonesia.

The focus to the Indonesian context with its two-tier governance system is motivated by couple of reasons. First, Indonesia is among developing countries in Asia which has highest concentrated ownership structure (Claessens et al, 2000) and majority of Indonesian listed Companies are controlled by some family business groups. Second, the current research on related party transactions is heavily focused on China setting which has different institutional environment to the certain extent. While in China government still play important part as the dominant controlling owner for Chinese corporations, Indonesia has plenty of business groups as dominant player especially in Indonesian listed companies.

Since majority of firms in Indonesia are controlled by business groups, related party transactions is becoming a common feature in the business process of companies (Husnan, 2001). Such a mechanism is supported by complex ownership structure like pyramidal structure and cross shareholding. Nevertheless, related party transaction is one area that is still left largely unexplored although there are anecdotal evidences to suggest its pervasive abuse. Accordingly, related party transactions do not take proper place under desired levels of transparency and are not sufficiently regulated (Nenova & Hickey, 2006). In the close relationship between listed firms and their parent companies, these transactions may serve as a good channel to transfer funds (Jie, 2008).

The absence of comprehensive regulation concerning related party transactions coupled with weak enforcement of the rule of law has resulted in some corporate scandals in Indonesia. The current scandal in Century Bank in Indonesia for instance, caused the bail out cost of 6.7 trillion rupiah by government (Harrymurti, 2009). This suggests that the related party transactions still have common feature in the operation of business groups where domination of founding family has led them to make corporate policies in favor of their own interest at the expense of minority investor. Also the monitoring function at firm level as mandated by dual board system in Indonesia has been in question when supervisory boards often fail to prevent such misconduct by large shareholders and management.

Therefore, this research tries to explore the relationship between governance mechanisms and minority shareholder expropriation through related party transactions. Three types of related party transactions through which parents may expropriate the listed firms are examined, including related lending, related loan, and related sales. In order to test whether related party transactions is beneficial for minority shareholder or just giving benefit to controlling shareholder, two independent variables as governance mechanisms are employed namely minority ownership and multiple directorships. Multiple directorships will be investigated concerning the fiduciary duty of the board of commissioner and board of director.

The inclusion of multiple directorships in this research becoming important since very little research has been done concerning the effect of board directorships on wealth expropriation. In regard with related party transactions, previous studies only focused on its performance effect (Cheung et al, 2006), market performance (Gordon, Henry & Palia, 2004), and earnings management (Thomas, Herrmann, & Inoue, 2004). Therefore, it motivates this study to tests whether multiple directorships can facilitate or restrain the expropriation through related party transactions.

This article is organized into six sections. Section II discusses the literature reviews and hypotheses development. In Section III, it discusses data and methods. In Section IV, we examine the relation between the minority ownership and the number of directorships with the related party transactions as a proxy of wealth expropriation. Section V provides the robustness check and finally section VI will present the concluding remarks.

2. Literature Review and Hypotheses Development

2.1 Related Party Transactions

International Accounting Standard (IAS) No. 24 defines related party transactions as a transfer of resource or obligations between related parties, regardless of whether or not market price is charged. According to Indonesian Accounting Standard (PSAK) No. 7, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions (IAI, 2001). The related parties include subsidiaries, affiliates, holding companies and key director personnel. The Accounting Standard requires company to disclose these transactions in their annual reports.

In practice, there is not much disclosure of related party transactions. In case of business groups, related party transactions play significant portion to the activities of groups due to benefit of internal market. Related lending and borrowing, for example, would incur lower transaction costs. The transaction is becoming more complex when connected companies in the group have complex ownership structures that involve pyramidal and cross shareholding ownership. Regulation by regulatory body such as Indonesian Capital Market Supervisory Agency (BAPEPAM-LK) through its decree IX.E.9 only mention little portions of related party transactions as part of transactions that potentially resulting in conflict of interest. The inadequate and detailed regulation concerning related party transactions has resulted in loophole that potentially used by controlling owner to allocate company's resources without proper agreement from minority shareholders. Even when Indonesia has strict rule on the protection of minority shareholders, still it cannot prevent majority shareholders to abuse related party transactions to from being appropriate the asset.

The theoretical concept underlying related party transaction can be approached using agency theory and contracting theory. Both theories offered positive as well as negative effect from performing such transactions. While agency theory argue that related party transactions could resulted from opportunistic behavior, contracting theory, on the other hand, offer an explanation that such a transaction can reflect the efficient contracting mechanism (Kohlbeck & Mayhew, 2004).

Empirical research with regard to related party transactions show mixed result. Cheung et al. (2008) examined related party transactions in Chinese listed firms as a mechanism of expropriation to minority shareholders. They divide related party transactions into tunneling and propping transactions. They found that minority shareholders seem to be subject to expropriation through tunneling. Similarly, Jie (2008) who investigated the transactions between Chinese state owned companies and their publicly listed subsidiary also found the evidence of tunneling. Gordon et al. (2004) found negative association between industry-adjusted returns and total related party transactions. They suggested that market view related party transactions contain conflict of interest between controlling and minority shareholders. Such conflict of interests make clear picture on how market as representatives of minority shareholders will react to the related party transactions.

2.2. Ownership Structure and related party transactions

One central problem in agency relationship between principal and agent can be reflected in the condition of concentrated ownership around the world. The original agency problem as stated by Jensen and Meckling (1976) lied down on the conflict of interest between managers and shareholders. However, in the emerging market around the world there have been more particular agency problem, where conflict of interest existed more between controlling shareholders and minority shareholders (Shleifer and Vishny, 1997)

Controlling shareholders exist in countries with good law and also countries with bad law (La Porta et al., 1998). For instance, Indonesia that is characterized by lack of regulatory environment has high level of ownership concentration. Around 70% of controlling shareholders are family with one family on the average controlling four firms, the highest score in the region (Claessens et al, 2000). On the other hand, Sweden with good legal environment also has high ownership concentration (Gillan, 2006). Sweden has distinguished and very favorable investment climate since it has a high level of investors' protection and the low incidence of expropriation through private benefit extraction.

Private benefit of control extraction has become a way to distinguish the efficient from inefficient controlling shareholders. According to La Porta et al (2000), around the globe the governance system can be distinguished based on the law system. There are two major law systems, namely civil law and common law. They found that countries with civil law tend to have lower investor protection. Inefficient controlling shareholders have better chances to make corporate policy to favor their interests (La Porta et al, 1999). They argued that the cost to expropriate minority shareholders by controlling shareholders would depend on the level of investor protection. Hence, the likelihood to expropriate the firm resources will be greater in the country with weak investor protection.

Minority shareholders will prefer a controlling shareholder as long as the benefits from the reduction in managerial agency costs exceed the detrimental effects from the controlling shareholder's extraction of private benefits. The problem will arise as controlling shareholders who also controlling managers are trying to conceal their effort to gain private benefit of control through some hidden actions. Given corporate policies in concentrated ownership might be biased toward the interest of controlling owners; they have incentive to distort the true economic performance of firm. This is more pervasive if there were a high level of information asymmetry due to poor transparency and disclosure. It is difficult for public shareholders as minority party to disentangle the benefit and cost of concentrated ownership, especially in the emerging market (Claessens et al., 2002). Nevertheless the stringent enforcement of good corporate governance mechanism would constraint the opportunistic behavior of controlling shareholder (Gallery et al., 2008). Ownership structure as one of governance mechanisms would also consent to the monitoring of corporate policy that might be biased toward the interest of controlling shareholders. Related party transactions, for instance, is the area that potentially induces a conflict of interest and adding by the lack of disclosure and transparency. Consequently, minority shareholders would only perceive these transactions as the value destroying behavior by controlling shareholders. Based on the explanation, first hypothesis is as follows:
H1: Minority Ownership will negatively related to the extent of related party transactions.

2.3. Multiple directorships and related party transactions

Multiple directorships occur when one individual affiliated with one organization sits on the board of directors of another organization (Mizruchi, 1996). Literature based on resource dependence theory suggests that organization will undertake strategic actions to control the flow of resources as a response to its environment (Pfeffer and Salancik, 1978 in Au, Peng, and Wang, 2000). Organization need to coordinate and interact with its external parties and external environment in order to ascertain the fluent exchange of resources at the input as well as output of company's value chain. One way to achieve a better coordination with other organization is through interlocking of top management of the organization. The trend is that with the increased demands of their role, directors need to carefully structure their workloads to carry out their duties efficiently and effectively. However the actual number of directorships that a director should hold is debatable. The empirical evidences on this issue are still inconclusive. Li and Ang (2000) investigated the issue of whether the number of directorships held affects the effectiveness of the director.

Their findings were not conclusive. The number of directorships held does not necessarily affect the director's performance.

Studies carried out by Lawler and Finegold (2005) in the US examined the impact of multiple directorships on board effectiveness. Their findings indicated that board effectiveness and board membership limits for CEOs and executive directors were significantly related. However this was not the case for non-executive directors. A possible explanation was that CEOs and executive directors were already in full time roles, thus finding additional time for directorship roles could be difficult. The higher number of outside boards could easily have an overall negative impact as the time demands outweigh the learning opportunities (Lawler & Finegold 2005). Therefore, the impact of company performance of multiple directorships is still not conclusive.

Study by Fich and Shivdasani (2006) found that the firms with busy board, one with majority outside directors hold three or more directorships have weak corporate governance. These companies exhibit lower market to book ratio, weaker profitability and lower sensitivity of CEO turnover to firm performance. On the other hand, Perry and Peyer (2005) argued that negative impact of multiple directorships on firm value only present when the executive's firm facing greater agency problem. Their finding suggests that outside directorships for executives can enhance firm value through signaling of managerial quality. This evidence support previous finding by Ferris, Jaganathan & Pritchard (2003) who found that there was no evidence that multiple directors shirk their responsibilities when serving in board committees. Moreover, neither they found that multiple directors are associated with the likelihood of securities fraud litigation.

While considerably results indicate mixed result regarding multiple directorships, it is interesting to take picture on Indonesian context. Indonesia has unique governance system since it is influenced by civil law system that allowing two-tier system of governance structure. According to Indonesian Company Law No.40 year 2007, there is explicit separation of the monitoring and operating function of companies. The dual board system, known as supervisory board or Board of Commissioner and management board or Board of Director have been commonly applied in Indonesian companies.

In Indonesia, the recent discussion about multiple directorships has gained some debates on the call to limit the number of multiple directorships. The central issue is the individual who appointed as board of commissioners in some companies could carry out their duties efficiently and effectively while they concurrently sit in some positions (Warta Ekonomi, 2007). It has been argued that such concurrent position only resulting in the lack of monitoring to the management of corporate when effective monitoring requires a commitment of time and resources.

When board of directors holds multiple positions in other companies, they also have control to resources in their companies. The numbers of directorships held by director do not necessarily reflect bad commitment (Harris and Shimizu, 2004). As the supply of resources is expanded with the presence of interlocks, it will influence firm's performance. However, some previous researches show a mixed finding. For instance, Kiel and Nicholson (2006) find that the relationship between holding multiple directorships and financial performance is not significant.

Graziano & Luporini (2005) suggest that a two-tier structure of board can be a useful commitment device that enables the large shareholder to restrain from interfering with manager's choice and therefore it may be a valuable option in Continental Europe where firms' ownership (including large corporation) is concentrated and founding families may be "too active" in firm management. The explicit separation of operational and monitoring function by board of director and board of commissioner should be beneficial if the boards' configuration can do their job properly. For instance, the presence of board of commissioner with monitoring function should be coupled with independence status. Unfortunately, in the complex business groups structure joined with high concentration of ownership like in Indonesia, it make the independence among controlling shareholders and boards easily distorted. This is because member of directors are subordinate of controlling shareholder. Moreover, the monitoring function from the board of commissioner has fail when their member also connected to controlling shareholders. In this notion, when director occupy position in more than one position especially in the same business groups, their independence will be questionable.

The Indonesian corporate governance code states that an independent director should not have business relationships with the company or its associated companies. In addition, the code also requires an independent director to should not have too many outside positions that could shift the focus of her or his work. While this rule is good criterion to follow, in reality it is difficult to ascertain that this requirement is followed. Tabalujan (2002) reports that as of 2001, the number of individuals who hold multiple board positions in Indonesian listed companies were 228 with 174 of them holding two board positions. In the Italian context, Santella, Paone and drago (2007) documented the compliance level to the requirement of not having business relationship and not having too many concurring commitments outside the company was not satisfied. The compliance rates for both requirements are 4% and 16% respectively. This finding questions the issue of independence among external directors.

The presence of multiple directorships might be used by controlling owners to enable some degree of control over companies belong to the business groups (Yeo, Pochet, & Alcouffe, 2003). Therefore, multiple directorships can potentially serve as collusive behavior on behalf of controlling shareholder's interest. In this sense, multiple positions by insider will promote series of internal allocation of resources within the group that tend to collude and thus exacerbating agency problems between majority and minority shareholders. The tendency to collude and eventually expropriate the company wealth would be higher when multiple directorships occur. From the above justifications, the hypothesis will be stated as follows:
H2a: multiple directorships is positively related to the extent of related party transactions.

The existence of the board of commissioners is mandatory for Indonesian companies. While commissionerships are concerned with the role of supervisory and monitoring of the board, the position of commissioner should be independent from the influence of board of directors. Article 1 paragraph 3 of the Indonesian Company Law 2007 states that the duty of the board of commissioners is to supervise the policy of the Board of Directors in managing the company and to advise the Board of Directors in accordance with the company's article of association.

To facilitate the proper discharge of its supervisory duties, the Board of Commissioners was vested with specific powers. Commissioners have rights to obtain any information from the board of directors. Moreover, article 106 (1) in Indonesian companies law also states that board of commissioners has the power to suspend from office any members of the board of directors whenever such member has committed acts which are in violation of the articles of association or are harmful to the welfare of the company or such member has failed to properly perform his duties towards the company. In addition, an article 99(2) of the law declares that board of commissioners is able to represent the company in a court whenever board of directors has a conflict of interest for the company.

With the important roles of board of commissioners as mandated by regulation, it is conjecture that the supervisory board act as a safe guard to the board of directors' policy that could adversely affect the company. Given the importance of board of commissioners and the fact that the board does not involve intensively in the day to day decisions of a company, the board of commissioner has plenty of opportunity to sit in the other companies. The multiple positions held in various companies would enable the commissioners to be exposed to various issues and potential conflict of interest cases and this would only enhance their level of expertise. Based on the argument, the hypothesis will be stated as follows:

H2b: multiple commissionerships is negatively related to the extent of related party transactions.

3. Research Design

3.1 Data and sample

This study focuses on companies which are listed in Indonesian Stock Exchange (ISX) as the population of this research. The sample is selected using purposive sampling over the period of 2001-2008. All the sample must follows certain criteria. First, company is not included in the banking and finance industries. It is argued that these industries have different characteristics. Both banking and finance industries are regulated industries with tight requirements on capital structure by regulatory body. Secondly, the company should have affiliation with the business groups, and lastly company is not experiencing structural changes such as merger, go private or de-listed during observation periods. Justification for selecting year 2001 as beginning of sample period is based on important consideration. The official release of Indonesian code of conduct of Corporate Governance by National Committee of Corporate Governance (NCCG) in the year of 2001 made it possible to review the implementation of Good Corporate Governance practice in Indonesian Environment onward.

After selecting companies listed in Indonesian Stock Exchange, we have 127 companies in some industry sectors. In total we have maximum 1016 firm-year observations. Data was taken from main publication of company's annual report and supported by other source such as Indonesian Capital Market Directory (ICMD), and publication of Indonesian Capital and Financial Market Supervisory Agency or *Badan Pengawas Pasar Modal dan Lembaga Keuangan* (BAPEPAM-LK).

3.2 Measurement of variables

a). Ownership Structure

The concentration of ownership is proxied by the percentage of minority interest. It is defined as the proportion of ownership held by public shareholders as external investor. The higher the ownership by public shareholders, the more disperse or less concentrated the share ownership in the company. It is measured by the percentage of shares owned by external or public investor.

b). Multiple directorships

It refers to any individuals holding board positions in different companies. There is justification on why this multiple positions will lead to more related party transactions. As board position has strategic role in affecting corporate policies, an individual who holds simultaneously the position in different companies may not fully concentrate in performing his duties (Tabalujan, 2002). It is also conjectured that if an individual holds position in any related companies in the same group, it is presumably that lack of independence in the decision making will appear since companies activities will be directed to the benefit of controlling shareholders. In order to determine this variable, two alternative measurements are utilized as follows:

1. Multiple directorships (*MULTI-DIR*)
   It is a number of position hold by board of director in different companies. This variable is measured by the average number of directorships held by the directors of that firm.
2. Multiple Commissionerships (*MULTI-COMM*)
   This variable refers to the number of position hold by board of commissioner in different companies. With the explicit separation of board of director and board commissioner, it is interesting to know whether monitoring role performed by commissioner is effective when they hold multiple positions in other firms. The measurement of this variable is done by averaging the number of commissionerships for each the board of commissioners in the company.

c). Related Party Transactions

This variable is defined as the transfer of resource or obligations between related parties. A related party is individual or group who have relationship in some ways to the companies. A related party could include a family member or relative, stockholder, or a related corporation. There are three types of transaction that represent the most frequent transactions involving connected parties. They are related lending, related borrowing, and related sales. All transactions will be measured and calculated in terms of financial ratios. First, related lending is calculated by total related receivables to total current asset. Secondly, related borrowing is measured by ratio of total related loan to total liabilities. Finally related sale is calculated by total related sales to total sales.

d). Dummy Variables

There are three control variables in this study, namely dummy industry sector, board size, and firm size. Dummy industry variable will be classified based on two groups, namely manufacturing and non manufacturing firms. With the domination of manufacturing industries in Indonesian public companies, it is conjecture that this industry sector also engaging more related party transactions compared to the other sectors. Board Size is the number of board of directors as well as the board of commissioners that sitting up in the company. The higher number of the board will result in the more conservative policy toward related party transactions. Finally, firm size is measured by the log of total asset. In the pyramidal structure of business groups, companies in the bottom layer of the pyramid usually involved intensively in related party transactions than their holding companies at the apex of the pyramidal structure.

3.3. Model Specification

The model of this research can be expressed into equation as follows:

$$RPTs_{it}=\beta_{0it} + \beta_1 RPTs_{it-1} + \beta_2 PublicOwnrshp_{it} + \beta_3 Multi\text{-}Dir_{it} + \beta_4 Multi\text{-}Com_{it} + \beta_5 BoardSize_{it} + \beta_6 DumInd_{it} + \beta_7 FirmSize_{it} + \varepsilon_{it} \quad \text{.......................................}(i)$$

Where:

RPTs : related party transactions, it breakdown into three type of transaction:
- LnRb : Logarithmic Natural of related borrowing
- LnRl : Logarithmic Natural of related lending
- LnRs : Logarithmic Natural of related sales

PublicOwnrshp: public shareholding as representation of minority interest
Multi-Dir : multiple directorships
Multi-Comm : multiple commissionerships
Board Size : The number of board of directors and board of commissioners
Firm Size : Log of total asset
Dum Ind : Dummy Industry 1 = manufacturing and 0= non manufacturing industries

The equation is examined using panel regression analysis. The advantage using this approach is it combines the cross section and time series properties in one model. This condition allows to capture the unobserved heterogeneity. In addition, to capture the effect of past policy toward the current policy in doing related party transactions, a dynamic model of panel utilizing lagged of dependent variable is included in the equation.

4. Empirical results

a). Descriptive statistics

The descriptive statistics will present important characteristic of variables property through means, standard deviations, maximum, and minimum. The result is reported in table 1.

Table 1. Descriptive statistics of variables

Statistics	Mean	Median	Std. Dev	Minimum	Maximum
Related Borrowing	0.071	0.015	0.137	0.000	0.881
Related Lending	0.104	0.024	0.191	0.000	0.981
Related Sales	0.115	0.003	0.225	0.000	1.000
Public Ownership	0.306	0.286	0.189	0.000	0.967
Multiple Commissionerships	1.889	1.750	0.721	1.000	5.000
Multiple Directorships	1.634	1.400	0.723	1.000	5.333
Board Size	9.080	8.000	3.146	4.000	21.000
Ln Asset	27.610	27.451	1.529	21.526	32.022

Table 1 reports the descriptive statistics of all variables. At the top there are three consecutive related party transaction variables. Related borrowing which has mean value 7.1% indicates that on average around seven percents of total debt originated from connected parties. Related lending has value of 10.4%, it means that around one tenth of companies' current asset have been allocated as receivables to the related parties. Next, related party sales has mean value of 11.5% indicating that as much as 11.5% of the sales were coming from the sale to the related parties.

The next variable demonstrates the ownership concentration. The variable explicitly shows the proportion of interest held by minority shareholder which has mean value of 30.6%. It is also indicates that the concentration of ownership still show the high number. The directorships variables demonstrate the higher number of commissionerships than directorships. Basically, the fiduciary duty of the board of commissioners relied on the supervisory and monitoring function toward the activity of the board of director. Therefore, commissionerships positions do not demand any daily activities, which make the room to involve in some position of commissionerships concurrently. Further relationship of related party transactions with ownership and multiple directorships will be reported in table 2.

b). Regression analysis

Table 2. Regression analysis of related party transactions

Independent variables	Dependent variables		
	Related lending	Related borrowing	Related sales
Intercept	-0.80	6.97	-0.61
	(-0.40)	(6.04)***	(-0.25)
RL-1	0.41		
	(3.70)***		
RB-1		0.27	
		(4.86)***	
RPS-1			0.49
			(4.26)***
Multi-Dir	0.55	-0.23	0.27
	(3.12)***	(-2.11)**	(2.35)**
Multi-Comm	0.08	-0.25	-0.12
	(0.45)	(-1.13)	(-0.55)
Public	0.18	-2.04	-1.90
	(0.29)	(-3.03)***	(-2.48)**
Dumm-Industry	0.42	0.11	0.49
	(2.21)**	(0.37)	(2.05)**
Board Size	0.16	0.12	0.08
	(2.91)***	(5.72)***	(2.06)**
Ln Asset	-0.17	-0.34	-0.02
	(-1.85)*	(-6.61)***	(-0.36)
Adj R-Square	*0.60*	*0.53*	*0.64*
F value	*10.60****	*8.17****	*12.24****
Durbin Watson	*2.04*	*1.93*	*1.97*

*Notes: Related lending: ratio of related receivables divided by total current asset; Related borrowing: ratio of total related loan divided by total liabilities; Related sales: ratio of sales to related parties divided by total sales. Multi-Dir: number of position hold by board of director in different companies; Multi-Comm: the number of position hold by board of commissioner in different companies; Public: percentage of ownership held by public shareholders; Board Size: Total number of the board. *** denotes significant at the level 1%; **denotes significant at the 5% level; *denotes significant at the 10% level.*

Table 2 shows the result of regression analysis with each of related party transaction act as dependent variable. First variable represented by the lagged variable of dependent variable all show very significant result. It means that the transactions are persistent over time where it becomes a core of business routine in the business groups.

Minority interest which represents the view of minority shareholders, cast significant results for related borrowing and related sales model. The negative direction on the coefficient indicates that public perceives these transactions as opportunistic where it is only giving benefit to controlling shareholders.

For the directorships variable, multiple directorships show significant result with mixed sign. Positive relationship of multiple directorships toward related party transaction can be found in the related lending and related sales model, whereas it casts negative direction toward related borrowing. The unfavorable position of directorships toward related borrowing is due to the reputation effect when engaging this transaction. If a company is highly involved in related borrowing, this will bring the signal that the excessive borrowing will make the company into the high business risk. When the company is injected with high rate of internal borrowing, it also potentially indicates that the company was exposed to the financial distress. Board of directors will perceive that high profile of related borrowing will only erode their reputation.

In the case of multiple commissionerships, it gives no significant result for all models. The duty of commissionerships that is expected to perform supervisory task to the board of director seems did not effectively implemented when we look at the relationship. The above finding actually confirmed the existing criticisms about the effectiveness of the Board of commissioners in Indonesian corporations. Some of the problems including the absence of the required competence and failure to maintain independence were commonly found within the board members (Kamal, 2008). In addition, there is a cultural issue in which board members do not feel comfortable if their decisions are discussed or challenged openly. This could be because the members of the board were usually chosen because of their share ownership, their close relationship with the major shareholders, or due to their previous position in the government bureaucracy (Tabalujan, 2002).

Three control variables namely dummy industry, board size and firm size demonstrate significant result in various ways. Dummy of industries is consistently show positive direction and it shows significant result for the model of related lending and related borrowing. It means that related party transactions are dominated by manufacturing industries compared to the other industries. Board size is surprisingly showing positive directions significantly for all models when it should be negatively related with related party transactions. The higher number of the board should represent the more conservative view toward related party transactions. The positive sign indicates the compromise position of the board toward these transactions. It gives the interesting hint on the possibility of collusive behavior of the board in supporting related party transactions. If this is the case, it is reflecting the non neutral position of the board when in fact majority of them are still representations of the controlling shareholders. Log natural of total asset as the proxy of firm size consistently shows negative direction toward all related party transactions. It has significant result in the model of related lending and related party sales. The result indicates smaller firms are the subject of related party transactions especially for the related lending and related borrowing. In the pyramidal structure of the business groups, smaller firms usually located at the bottom of the pyramid. The ultimate shareholders at the apex of the pyramid will make the coordination of the series of related party transaction for all subsidiaries companies within the group.

5. Robustness Check

This study conceptualizes related party transactions as the means of wealth expropriation by controlling shareholders in line with the previous research (Cheung et al, 2006, 2008; Jian & Wong, 2006). However, question will still rise on how these transactions actually give impact to the performance of the company. The sensitivity analysis of the performance effect of related party transactions is conducted to provide supporting analysis on the real effect of exerting the transactions. There are two main performance indicators measurement, accounting performance as proxied by return on asset (ROA) and market performance as proxied by tobins q. Return on asset can be defined as the ratio of net income to total asset. Whereas tobins q is the ratio of total market value of equity plus book value of debt divided by book value of asset. The summary of the result is provided in table 3.

Table 3 The effect of Related Party Transactions to the Company Performance.

	Dependent Variable	
	ROA	Tobinsq
Intercept	-2.90	0.08
	(-7.92)***	(2.14)**
Lagged ROA	0.13	
	(1.05)	
Lagged Tobins q		0.39
		(3.80)***
Related Borrowing	1.61	-0.27
	(4.21)***	(-1.48)
Related Lending	1.02	-0.14
	(1.68)*	(-2.86)***
Related Party Sales	-0.16	0.19
	(-0.44)	(2.46)**
Adjusted R-squared	0.54	0.67
F-statistic	6.57***	14.87***
Durbin-Watson	1.61	2.12

*Notes: ROA: ratio of net income to total asset; Tobins q: ratio of market value of equity plus book value of debt divided by book value of asset; related lending: ratio of related receivables divided by total current asset; related borrowing: ratio of total related loan divided by total liabilities; related sales: ratio of sales to related parties divided by total sales. *** denotes significant at the level 1%; **denotes significant at the 5% level; *denotes significant at the 10% level.*

Table 3 presents the performance effect of related party transactions. Three types of related transactions reveal the mixed results regarding its relationship with ROA and tobins q. In the model of ROA, Related borrowing and related lending are significantly related to this accounting performance, whereas related sales shows negative direction though it was not significant. On the other hand, when regressed to tobins q, both of related borrowing and related lending present negative relationship where related lending has statistically significant sign. In addition, related party sales show positive relationship significantly toward tobins q. This mixed result indicates the divergent interest of the corporate insiders versus external investors in perceiving a series of related party transactions. Related borrowing and related lending as the most frequent transactions have shown positive direction toward internal performance. This means that both transactions have important role in contributing to the companies' income. However, the negative market performance suggests that the minority shareholders would perceive these transactions as opportunistic and its only give benefit to the controlling shareholders. The significant negative relationship between minority ownership and related borrowing confirmed this conjecture.

As for the case of related party sales, the positive response of this transaction with market performance is not accompanied with positive sign by accounting performance. When it linked with ownership profile, both of divergence and control rights variables cast their negative direction toward this transaction. It indicates that this transaction could be serve as efficient transaction. However when we look at the public ownership, the significant negative direction to related sales may suggests that there is still mixed perception toward the motivation of engaging this transaction. Further study is needed to uncover the motivation of controlling shareholders when exerting the related party transactions.

6. Concluding remarks

This research investigates the roles of ownership concentration and multiple directorships as part of internal governance mechanisms in influencing related party transactions. The study conceptualizes related party transactions as means of wealth expropriation by controlling shareholders. Three channels of related party transactions namely related borrowing, related lending, and related sales are investigated individually concerning the relationship of governance mechanisms to these transactions.

The evidence shows that the minority ownership significantly opposes related party transactions in view of their opportunistic characteristics. Multiple Directorships which provide top management power to arrange and facilitate series of connected transactions among affiliates companies tend to support the existence of related party transactions. While Board of Commissioners that should be supervise and monitor those transactions reveal insignificant result when facing with all three transactions.

The finding of this study suggests that as long as the business culture is still dominated by family relationship coupled with the high concentration of ownership, the persistence of wealth expropriation will continually present. The good rule of corporate governance seems cannot fully resolve the presence of wealth expropriation as shown by ineffectiveness of some internal governance mechanisms. Furthermore, what the important thing to do now is the consistency of enforcement of the code to protect the interest of minority shareholders.

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