DIVERSIFICATION, FAMILY CONTROL, AND INTERNAL CAPITAL MARKET AS DETERMINANTS OF FAMILY BUSINESSES PERFORMANCES IN INDONESIA

(Study on Family Businesses Listed in IDX 2007 – 2016)

UNDERGRADUATE THESIS

Submitted as partial requirement to complete the
Undergraduate Degree (S1) of Management Department of
Faculty of Economics and Business Diponegoro University

Submitted by:

RATNA SATUTIKIRONO

12010114140162

FACULTY OF ECONOMICS AND BUSINESS
DIPONEGORO UNIVERSITY
SEMARANG
2018

THESIS APPROVAL

Author	: Ratna Satutikirono
Student ID	: 12010114140162
Faculty/Major	: Economic and Business/Management
Title	: DIVERSIFICATION, FAMILY CONTROL, AND INTERNAL CAPITAL MARKET AS DETERMINANTS OF FAMILY BUSINESSES PERFORMANCES IN INDONESIA (Study on Family Businesses Listed in IDX 2007-2016)
Paper Advisor	: Erman Denny Arfinto, S.E.,M.M.

Semarang, June 25th, 2018

Paper Advisor,

Erman Denny Arfinto, S.E., M.M

NIP. 19761205 200312 1001

\

EXAM COMPLETION APPROVAL

Author	: Ratna Satutikirono
Student ID	: 12010114140162
Faculty/Major	: Economics and Business/Management
Title	: DIVERSIFICATION, FAMILY CONTROL, AND INTERNAL CAPITAL MARKET AS DETERMINANTS OF FAMILY BUSINESSES PERFORMANCES IN INDONESIA (Study on Family Businesses Listed in IDX 2007-2016)
Paper Advisor	: Erman Denny Arfinto, S.E., M.M

Examiners:

1. Erman Denny Arfinto, S.E.,M.M. (……………………)

2. Dr. Irene Rini Demi Pengestuti, S.E.,M.E. (……………………)

3. Astiwi Indriani, S.E.,M.M. (……………………)

ORIGINALITY STATEMENT

I am who undersigned here, Ratna Satutikirono, claimed that this undergraduate thesis titled **“Diversification, Family Control, and Internal Capital Market as Determinants of Family Businesses Performances in Indonesia (Study on Family Businesses Listed in IDX 2007- 2016)”** is my own writing. Hereby I declare the truth that in this bachelor thesis, there is no writings which I took copy or imitate as a whole or a part in a form of sentences or symbols which represent another writer’s idea that I admitted as my own, and/or there is no part or a whole writing which I copied or took from other’s without giving consent to its owner.

Hereby, I declare if I took actions contrary to the matters above, whether it was on purpose or not, I will take back my proposed bachelor thesis which I admitted is my own. Later on, if it was proved that I copied or imitated other’s writings as mine, I will let my academic title and certificate which has been given to me to be invalidate.

Semarang, June 25th, 2018

Undersigned,

(Ratna Satutikirono)

NIM. 12010114140162

MOTTO

"… Indeed, Allah will not change the condition of people, until they change what is in themselves" (Qs. 13:11)

"… and seek help, in patience and prayer" (Qs. Al-Baqara:45)

"All that we are, is the result of what we have thought. All that we shall become, is the result of what we think now"-unknown

Life is an art of drawing, without an eraser.

-John W. Gardner

Be brave, take risks. Nothing can really substitute experiences

-Anonymous

I dedicate this thesis for my biggest supporters in life, Mama Retno, Alm Papa Rudi, Papa Kadir, Mbak Galuh, Adik Faza dan Dimas

ABSTRACT

The aim of this study was to see the effect of diversification, family control, and internal capital market to family businesses' performances. The diversification of a firm is calculated by the amount of segment and subsidiaries from ultimate parents. Family control is defined as the proportion of familial-related member of board, divided by the total amount of firm's board of directors and board of commissionaire. Internal capital market is examined from the debt novation transferred from subsidiaries to its ultimate parents. This study emphasized that diversification would hampered performance. Thus, the presence of familial-related in the board of directors and board of commissionaire had a positive impact to family businesses performances, even though in this research, it has been found statistically insignificant. The internal capital market mechanism proved to have a positive effect on family businesses performances. This study would also considered adding the control variable in order to provide a better model, such: firm's size, firm's total debt, and firm's revenue.

The sample of this study was family businesses listed in Indonesian Stock Exchange from 2007 until 2016. This study collected the total debt (short and long term debt), the assets, the revenue (net sales), ROA, TOBIN'S Q of the family businesses. The Ordinary Least Square method was used to analyze the determinants of family businesses' performances.

Keywords: Family Business, Diversification, Family Control, Internal Capital Market, Firm's Size, Total Debt, Revenue

ACKNOWLEDGEMENT

All praises and gratefulness to Allah SWT, because only with His blessings and authority, this undergraduate thesis entitled **"Diversification, Family Control, and Internal Capital Market as Determinants of Family Businesses Performances in Indonesia (Study on Family Businesses Listed on IDX 2007- 2016)"** can be completed.

This undergraduate thesis is written as the final assignment to complete the Undergraduate Program (S1) of Management Department of the Faculty of Economic and Business, Universitas Diponegoro. During the making of this undergraduate thesis, the writer has received many helps and endless support from all family, colleague and other related party. The writer hopes that this undergraduate thesis could be useful for the academic progress in the future. Lastly, the writer would like to say her biggest gratitude to:

1. Allah SWT who always give me strength and strong purpose in every decision I might have in these college year.
2. Dr. Suharnomo, S.E., M.Si. as the Dean of the Faculty of Economics and Business, Universitas Diponegoro, Semarang
3. Dr. Harjum Muharam, S.E., M.E. as the head of Management Department, Faculty of Economics and Business, Diponegoro University, Semarang.
4. Erman Denny Arfinto, S.E., M.M. as the writer's best advisor that has been supporting, believing and caring the writer during the college years and the making of this undergraduate thesis.
5. Mirwan Surya Perdhana, Ph.D., as the writer's guardian lecturers that have been taking care of the writer during the college years.

6. Dr. Irene Rini Demi Pengestuti, S.E.,M.E. and Astiwi Indriani, S.E.,M.M. as the advisor of Ratna's final paper that has been supporting, giving the knowledge and insights during the revision of this undergraduate thesis.
7. All of the Faculty of Economics and Business lecturers and staffs that have given their best knowledge, care, supports and advices for the sake of the writer.
8. The writer's big family that have always been listening and understanding, supporting the whole process of this college year. My dearest Mama Retno, Papa Kadir, Mbak Galuh, Dik Faza and Dimas for your truly support and help. Last but not least, my guardian, the strongest influencer in writer's life, Alm. Papa Rudi Sasikirono, *it was all for you Pa, I wish you are safe and happy there beside Allah SWT*.
9. Team Bimbingan Mr. Erman; my shoulders to cry on: Alfonsus Aristo, Caca, Aci, Ivan and Mas Axel Giovanni. I do hope everything will go on track after this. Good luck and I do really grateful for having you guys in this phase of college life.
10. To my 24/7 girls, my laughing machine: Awlikha, Baby Def, Maydini, Ulan, thank you beb for staying by my side no matter how this phase of life full of tears leads us to.
11. Irma Noerdianti, Carla Ferrina, and Mom Katerina Zakharenko you are completing my life and brings every tears into joy. Thank you for always giving me a hope for everything I may face in the future.
12. Executive Board Mandalawangi AIESEC LC UNDIP 1718, a place to grow and gain a superb experience: Donnie, Dista, Carla, Adi, Fika, Zola, Leoni, Javin, Algha, Zara, Firman, Meilani, Zulfa, Teresa. A bunch of intelligent people, yet super funny. I am glad to have such experience written in my memories.

13. The big family, AIESEC in UNIVERSITAS DIPONEGORO, thank you for every lessons and opportunities. Arsari, Adrian, Daniel, Raja, Capella, Shanaz, and every people I could not mentioned, thank you for every love, care, and support.
14. Dugong Family: Suesty Sondyarini, Viasti Intan Permata, Alfa, Indra, Nares, Aul, Pacil, Emil, Kyendi, Bintang, Yoma, Muil, Lala, Alto, Dewa. Thank you for your biggest support during my college year, I hope every path of life we will take, would become the best decision we could have.
15. “Anak Kontrakan Dayang-Dayang Ratna”: Kharisma Husen, Aditya Farhansyah, Faiz, Komeng, Kiki, Kudang, and Naufal Lapon. Thank you for every sudden 24/7 help for my life in Semarang. Things will become easier when you are around.
16. Rindu, Ka Pia, Bella, Zelda, Ojan, Dinda, Amanda, Dena, Azahra Refani, Aisha Talitha, Theresia Kristi, and Rizka Augusta. Thank you for your endless presence in Ebi’s Life. Things will be different without you.

The writer is fully aware that this undergraduate thesis is not perfect. Critiques and advices are welcomed whether to the undergraduate thesis or to the writer. Hopefully, this undergraduate thesis can be useful to those who need it.

Semarang, June 25th 2018

Yours Truly,

Ratna Satutikirono

12010114140162

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF GRAPHICS

LIST OF APPENDIX

CHAPTER I

INTRODUCTION

1.1 Background

Family business is one of the common form of business in many countries. Based on the PWC's survey of family business in 2014, 60% of listed company (publicly traded) in South East Asia were family business. Hence, there were more than 95% of businesses in Indonesia are owned and managed by family. Family business group in Indonesia have been contributing to the national gross domestic products, which can be seen in the PWC's survey of family business in 2014. Family business have contributed in 25% from the total of Indonesia's gross domestic products. The total amount of wealth of Indonesia's family business group have reached 134 trillions US dollar.

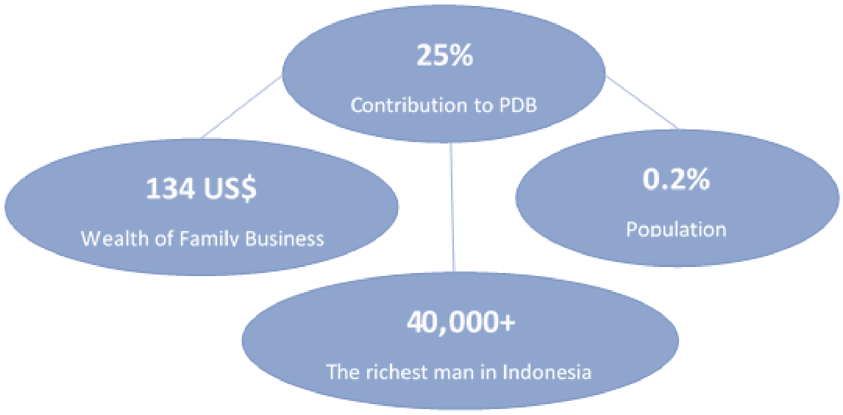
The main goal of forming a firm or a business was to achieve profits. When a firm entered the stage of developing a business, a firm would find a method to maintain its competitive advantage and was seeking forward to increase the firm's value. In a family business state, the nature of family is tend to determine its strategies (Aguilera and Crespi-Cladera, 2016).

The financial performance and market value of the company are two different yet very important things for company in its survival, in order to be able to grow and compete with the other competing company. The financial performance (such Return on Assets) would reflect the actual condition of a firm internally. The market value was the condition assessed by the external side (investors). Uniquely in the family business, the achievement of profits must align with family harmony, because family business are considered to be successful if it is able to create profit and keep developing along with increasingly harmonious family.

There are several family business that sell their companies to others who are not their family members. This was caused by several circumstances such: the need of developing a new business, the business was already collapse, or even the founder has died but the family members did not want to continue the business. The non-family firms incur, which was not belong to the founding family, thus automatically, did not have family involvement. Whether the involvement in board of directors, or board of commissionaire positions, they have been fully controlled by the new owner. Therefore, the shifting of the company from the founding family to the new owner is feared to degrade the corporate's performance and corporate's value due to increased agency cost, and misalignment of owner's commitment to the condition of a firm.

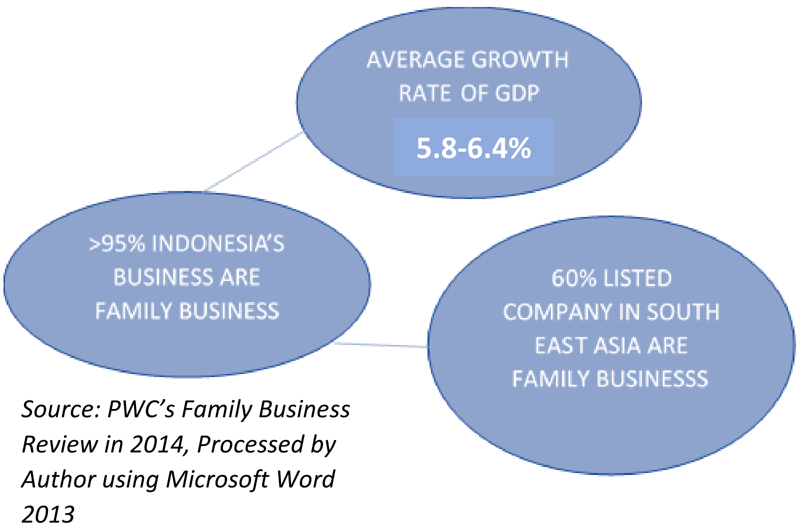
Figure 1.1 have shown the phenomenon of family business that were taken from the PWC's survey of Family Business in Indonesia. The Gross Domestic Products (GDP) index of Indonesia that equals to the GDP of Turkey and Netherlands, and the average growth rate of GDP in 5.8 to 6.4 %, Indonesia are predicted to be the 4th world's best economic power in the 2050. In condition of 60% listed company in South East Asia are family business, and more than 95% of business in Indonesia are owned by family, it can be assumed that family business had a great contribution to the overall GDP in Asia, especially Indonesia.

Figure 1.1
The Family Businesses Survey by PWC



Source: PWC's Family Business Review in 2014, Processed by Author using Microsoft Word 2013

Figure 1.2
The Family Businesses Survey by PWC

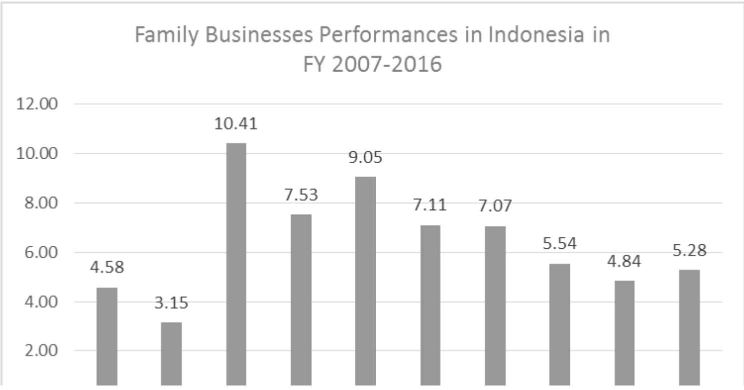


Source: PWC's Family Business Review in 2014, Processed by Author using Microsoft Word 2013

As seen in Figure 1.2, family business had 25% contribution to the total of national gross domestic products. More than 40,000 billionaire in Indonesia (0.2% of population) came from family business, which have the amount of wealth until 134 trillion US dollar. This phenomenon were strongly influenced many researchers to do some research in family business group. The 25 % contribution to the total of national GDP indicated that the family business are relatively good performers.

Figure 1.3 have shown the average return on assets of family business in 2007-2016. The net income of business might reflect the overall success of business. Hence, return on asset would measure the ability of a company to generate profits or earnings at the level of income, assets and capital stock. The return on assets reflected whether the company has been efficient in using its assets in operating activities to generate profits.

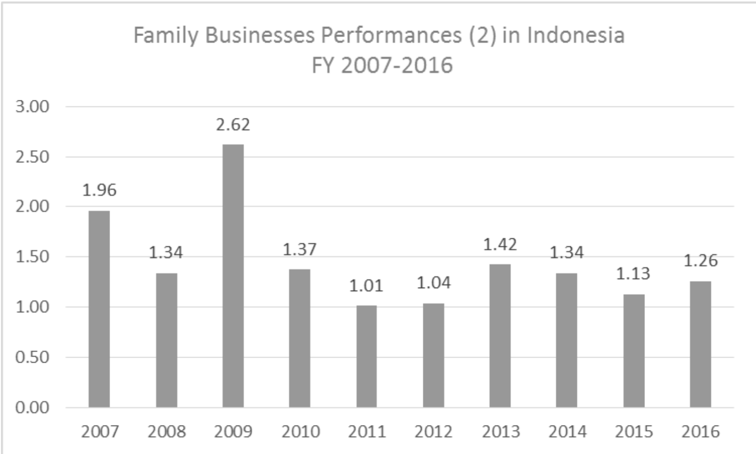
Figure 1.3
The Family Businesses Performances (ROA) in FY 2007-2016



Source: Bloomberg data, processed by Author using Microsoft Excel 2013

The return on asset of family business have decreased in 1.43% from 2007 to 2008 and extremely increased in 7.26% from 2008 to 2009. The fluctuation of return on assets (each year, in the period 2007-2016) indicated that there might be factors in determining the family businesses return on assets.

Figure 1.4
The Family Businesses Performances (Tobin's Q) in FY 2007-2016



Source: Bloomberg data, processed by Author using Microsoft Excel 2013

Figure 1.4 have presented the Tobin's Q value of family businesses in the financial year 2007 to 2016. From 2007 to 2008, the value had fallen from 1.96 to 1.34, and extremely grown from 2008 to 2009 which was 1.34 to 2.62. This problem occurred in 2008 when the IDX stock exchange have announced to suspended the transaction due to the impact of *subrime mortgage* in America. The increment of tobin's q value happened continuously in 2009 to 2011, and relatively facing the fluctuation in the observation from 2011 to 2015. From 2015 to 2016, the family businesses' tobin's q value had increase slightly 0.13 point.

The previous section have shown the phenomenon of performances in family business group. The nature of a family were aiming for a better performances and overall business development. In order to gain a better performance, a firm most likely develop its business strategies, such as diversification. Diversification occurs as a corporate-level strategy that focused on gaining competitive advantage with managing and selecting the un-related various business groups in a various industries and markets (Hitt, Hoskisson, & Kim, 1997).

Families are one of the most important shareholders in business organizations (Aguilera and Crespi-Cladera, 2016). Hence, the opportunity to become member of the board of directors, being involved in management, and owned a majority of shares, gave the family an authority to form business strategies. Dawson and Mussalino (2014) assumed that the family nature of a business group is to determine its strategies and its subsequent impact on firm's performance. Family members do not only pursue the overall financial targets, but aim to maintain their socio-emotional wealth (Cennamo, Berrone, Cruz, and Gomez-Mejia, 2012). Therefore, family groups would prefer a diversification strategy that was very compatible in maintaining the socio-emotional wealth that should not endanger survival, with a greater impact on firm's performance.

The capability of Indonesian firms to grow and develop its business may become an attractive subjects to be examined. Harto (2005) assumed that a lot of firms in Indonesia, especially a *go-public* company is a member of a business groups. Those firms, generally, led by a holding company that have subsidiaries in a various segment of business. Previous research discovered that diversification strategy is the right decision compared with other strategy; *focused* strategy, when it comes to the emerging markets (Khanna & Palepu, 2000). In emerging market, the institution is having struggle in product market, capital market, labor market, government regulations, and contract execution. This problem will affect firm in deciding the internal capital through diversification execution, especially for a big-classify company.

Family firms have more tendency to avoid the risk rather than non-family enterprises. In 2007, Gomez-Mejia et al reveals that a high degree of agreement in the finance, accounting, management and various social sciences that family firms are risk averse. Shleiffer and Vishny (1986, 1997), Faccio et al. (2001), and Anderson and Reeb (2003), also argued that family firms have a strong incentive to minimize firm risk given the undiversified nature of their holdings. From this statement, corporate diversification provide an opportunity to alleviate firm risk, and it becomes an appealing strategy with some benefits. First, it will reduce the volatility in earnings, and it also provides greater financial security to the family (Faccio et al., 2001). Corporate diversification may improve the chances of firm survival, a crucial concern for family members whose walfare and those descendants is inextricably tied to the future of a single-organization (Casson, 1999).

Diversification provide family firms an important financial utilities for reducing the business risk. In order to diversify, the family need external funding which can be found through debt financing or by issuing new stock. Since higher debt level increase the firm's dependence on outsiders (investors, shareholders, etc.), family owners would feel reluctant to borrow funds to support diversification activity. Family firms prefer to grow by utilizing internal resources, as this reduces external dependence (Casson, 1999).

Therefore, this research aims to examine the effect of diversification, family control, and internal capital market in Indonesia's family business groups to their performance. This research is expected to give several contributions, firstly, the analytical unit is a business group, comprising a listed parent company and a set of segments and subsidiaries in order to gained a clear information of diversified firms. Data will be taken from family business group listed in Indonesian Stock Exchange (IDX) from 2007 until 2016. This research will use two proxy to measure firm's performances; operational performance by Return on Assets (ROA) and market performance by Tobin's Q.

1.2 Research Problem

Family business group performances in Indonesia are relatively increased over the past ten years. Based on the PWC Survey for Family Business, more than 95% of business in Indonesia are owned and operated by family. Hence, as shown in the previous section, family business group in Indonesia have reached the total wealth in 134 US $. It can be concluded that family business are relatively a good performers and had successfully contributed 25% of the total GDP of Indonesia.

These phenomenon indicated that there might be factors in determining the family businesses performances. The factor that determines the performances can come from internal factor and external factor (as mentioned in the previous section, such as impact from the other countries downturn). Thus, this research assumed a several internal factors that might determine the performances of family businesses, which were diversification, family control, and internal capital market. As family business group in Indonesia are mostly conglomerates firm (hence, popularly stated as diversified firm and can be assumed that the internal capital market mechanism exists), owned and managed by family, so that these might become factors in determining the outcome of business, accounting-based performance and market performance. Thus, the several problems that need to be answered in this research are:

1. A) Does the diversification decision affect the performance (measured by Return on Asset) of family business group in Indonesia (2007-2016 period)?

   B) Does the diversification decision affect the performance (measured by Tobin's Q) of family business group in Indonesia (2007-2016 period)?

2. A) Does family control affect the performance (measured by Return on Asset) of family business group in Indonesia (2007-2016 period)?

   B) Does family control affect the performance (measured by Tobin's Q) of family business group in Indonesia (2007-2016 period)?

3. A) Does the internal capital market affect the performance (measured by Return on Asset) of family business group in Indonesia (2007-2016 period)?

   B) Does the internal capital market affect the performance (measured by Tobin's Q) of family business group in Indonesia (2007-2016 period)?

1.3 Objective of the Research

The purpose of this research are as follows:

1) To analyze the effect of diversification towards firm's return on assets and tobin's q value in Indonesia's family business group
2) To analyze the effect of family control towards firm's return on assets and tobin's q value in Indonesia's family business group
3) To analyze the effect of internal capital market towards firm's return on assets and tobin's q value in Indonesia's family business group

1.4 Writing System

This research is divided into five chapters, which will be organized as follows:

Chapter I **Introduction**

This chapter will explain and describe about the background of the research, research problems, the purpose of this research, and the writing system of this research.

Chapter II **Literature Review**

This chapter will explain about previous research literatures which aligned with the topic of this research.

Chapter III **Research Methodology**

This chapter will explain about the process of choosing samples, research data, data source, data processing method, and research model.

Chapter IV **Result and Discussion**

This chapter will explain about discussion of results analysis, using theories explained in CHAPTER II and using methods explained in CHAPTER III of this research.

Chapter V **Concluding**

This chapter will explain several conclusions which obtained while analyzing the data. This chapter also provide suggestion that can be useful for further lines of research