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The Role of a Company Board in Emerging Markets

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Many factors affect a company's performance, among them the advising role of a Board. Advising on company performance depends on the internal characteristics and external environment of the company. This study aims to examine the influence of 'the Board' on company performance in emerging markets that are dominated by family ownership. The findings demonstrate that a Board has a positive effect on company performance. However, family control weakens the influence of the Board's effectiveness in terms of enhancing company performance. This confirms that a Board has a critical role in providing advice to management. Nonetheless, the dominance of family ownership makes a Board unable to provide professional judgement, thereby reducing company performance.

Key words: *Advising Role, Company Performance, Family Ownership.*

Introduction

Improved performance is one of a company's strategic goals because with increased performance, companies can strengthen their competitive position and ensure survival in the future. Companies obtain sustainable competitive advantage through implementing strategies that explore internal strengths, respond to opportunities that exist in the environment, neutralise external threats and avoid internal weaknesses (Barney, 1991). These efforts can be carried out by implementing good corporate governance.

The management of a company is inseparable from the role of the Board (the Board). This is especially the case in capital markets in developing countries such as Indonesia. When external governance is less effective and legal protection for investors is weak, internal control mechanisms, such as the Board, are important to avoid conflicts of interest among stakeholders (Young, Peng, Ahlstrom, Bruton, & Jiang, 2008). The Board plays a role in connecting shareholders with other stakeholder groups (Pass, 2004); monitor performance, provide advice and supervise the Board of directors, determine the company's fundamental policies (Jungmann, 2006); and provide access to resources, including important company information (Pugliese, Minichilli, & Zattoni, 2014). The composition and role can be suitable for one company, but not necessarily for other companies, so it needs to adjust to the resources they have. Contingency perspectives cover various differences in the role of the Board that might occur in the company. This role difference is possible because of the contingency variables that are predicted to contribute to the relationship between the role of The Board and company performance, among others, the complexity of the company (Coles, Daniel, & Naveen, 2008), family/non-family control (Lam & Lee, 2008), and the level of the generation of families running the company (Arosa, Iturralde, & Maseda, 2010).

The relationship between the implementation of the role of The Board and performance depends on the conditions and characteristics of the company. Most public companies in Indonesia are owned by controlling shareholders or have a pyramid ownership structure. In accordance with La-Porta, Lopez-De-Silanes, and Shleifer (1999) which identifies companies on four continents, the result is that the most common ownership mechanism in developing countries is the pyramid ownership structure. Likewise, the study of companies in East Asia conducted by Claessens, Djankov, and Lang (2000) found that the highest pyramid ownership occurred in Indonesia (67%). Most controlling shareholders of public companies in Indonesia (56%, 57%) are owned by families (Darmadi, 2013; Siregar, 2008) and institutional shareholders, which consist of holding companies, but the management of the company is still dominated by the family (Sudarma, 2004).

Companies that are mostly owned by families tend to have corporate governance and agency problems that are solely concerned with one group of shareholders, namely the family and the neglect of other shareholder rights (Morck & Yeung, 2003). The Board of Directors of family companies tend to be less independent and dominated by family members (Anderson & Reeb, 2003). When shareholders choose The Board, shareholders tend to choose from their own family members or someone who has a special relationship. The focus of this study centres on company performance influenced by the role of The Board. Previous studies provide empirical evidence that the effectiveness of an advising role does not affect company performance (Brick & Chidambaran, 2010; Filatotchev, Lien, & Piesse, 2005). While other studies show that the effectiveness of The Board can improve company performance (Lin, Yeh, & Yang, 2014; Nuryanah & Islam, 2011), or vice versa; it actually decreases company performance (Chou, Chung, & Yin, 2013; Vafeas, 1999).

The difference in empirical results is because of differences in company size, management experience, company life cycle, and industrial turbulence, diversity of the Board and the presence or absence of family control within the company. These differences confirm the existence of internal or external contingencies that occur within the company. An elaboration of contingencies in the implementation of the role of the Board to influence company performance is also the focus of this study. Company performance can increase or decrease, because of the Board influence and the characteristics of the company. With regards to a contingency perspective determining the effectiveness of the Board, this study uses family control variables to determine changes in company performance. Thus, research problems will be answered through the following research questions: firstly, does the advising role of the Board have a positive effect on company performance? Secondly, does family control weaken the influence of the Board'sadvising role on company performance?

In line with the resources dependence theory, this study assumes that the Board is a company asset that provides access to the resources needed by a company (Pfeffer & Salancik, 1978) and contributes to sustainable value creation through increasing company value. In addition, this study can affirm the contingency theory. The conditions and characteristics of the company depend on the family and make a difference to the influence of the Board on company performance (Nicholson and Kiel, 2004). This study was able to provide empirical evidence that the existence of family control of a company, via the Board, reduced company performance. The results of this study can be a consideration for companies and stakeholders. In terms of its advisory capacity, the Board is oriented towards meeting the interests of all stakeholders so that it can better guarantee the continuity of the company's business in the future.

Literature Review

Contingency Theory

According to contingency theory, the role of the Board is shaped by the environment and the technical nature of the work performed. Contingency theory plays an important role in understanding the role of the Board, both from an internal and external environment. The role and function of the Board depends on the impact of the external environment or the internal structure of the organisation. In a public company, the Board acts as a means of controlling the external environment, whereas in private companies, The Board is required to supervise the operations of the company (Zald, 1969). Emphasis on the external environment of the company has an impact on the function of the Board related to networking phenomena or interlocking directorates. The Board working on two or more companies, will act as a liaison between these companies. Likewise, with the increasing ideology of pluralism, it encourages organisations to reconsider relations between stakeholders.

This study emphasises the role of the Board from an external environmental perspective, namely linking roles. Linking roles is the role of the Board in providing strategic resources for the company, including providing advice and counselling, creating legitimacy, making information communication networks with external organisations, and facilitating access to resources or support from important elements outside the company (Hillman & Dalziel, 2003). This role refers to the resource dependence theory.

Resources Dependence Theory

The resource dependence theory was introduced by Pfeffer and Salancik (1978), who identified a company as an open system and dependent on external environmental contingencies. In terms of reducing dependence on the external environment and the need for critical resources, companies need the role of a Board, one of which is having access to resources. The resource dependency theory holds that the Board provides access to resources that are not provided by others (Pfeffer & Salancik, 1978) and views board of commissioners as a corporate asset that contributes to sustainable value creation (Hillman, Withers, & Collins, 2009). The Board provides four benefits to the organisation (Pfeffer & Salancik, 1978), which provide information in the form of advice and counselling, access to information networks between companies and environmental contingencies, the importance of access to resources, and legitimacy. The role of the Board in providing advice and providing resources includes initiation of strategies, being actively involved in decision making and following up on strategic choices (Pugliese et al., 2014; Abdulrasheed, 2017). With the various roles that the Board can play, it provides an understanding that it can reduce dependence on the external environment and provide convenience for the company in obtaining the necessary critical resources.

Advising Role

Hung (1998) synthesises the role of the Board from previous studies in the typology of board of commissioners' governance. Referring to the contingency perspective, the role of the Board is grouped based on four supporting theories. Contingency perspective pays attention to the external environment and the internal characteristics of the company in classifying the various roles of the Board. The external environment makes the Board optimise their role in establishing relationships with parties outside the company in order to meet the needs of critical resources that cannot be provided within the company (linking resource dependence theory). In addition, the Board must also play a role in accommodating various interests of the company's stakeholders (coordinating role-stakeholder theory). The internal characteristics of the company encourage the Board to supervise management actions. This condition is a consequence of the separation of duties between the shareholder and the company manager, which assumes management is opportunistic and needs to be monitored (monitoring role-agency theory). However, it is not always between the shareholder and the management of the company that have opposite interests. The alignment of interests between management and the shareholder creates synergy in achieving the company's strategic goals, thereby increasing the company's value (strategic role-stewardship theory). Tan advisory role of the Board get broad support (Zahra & Pearce, 1989). This role includes the Board's active involvement in providing strategic advice to company executives, providing access to resources, including important company information (Pugliese et al., 2014), enhancing the company's reputation and stabilising relations with the external environment (Zahra & Pearce, 1989).

Company performance

Performance measurement of an organisation or company presents conceptual problems and methodologies, because there are various performance indicators available. Company performance can be seen in various perspectives, among others, viewed from a financial perspective or from a non-financial perspective. In traditional management, the measure of performance commonly used is a measure of financial performance commonly presented in the company's financial statements that offers the use of accounting numbers in its measurements. While non-financial performance such as increased productivity, increased competency, supplier relations, customer trust and efficiency of business processes are often overlooked because it is more difficult to measure. Non-financial measures are used to complement financial measures in order to obtain a more accurate level of measurement.
Improving company performance requires a great effort from various parties within the company. One of the factors that can influence performance is the effectiveness of the role of the Board. A study of the role of the Board on the performance or value to the company provides non-uniform evidence. The presence of internal and external contingencies is seen as a trigger for differences on performance. Differences in company size, board diversity, family control, management experience, industrial turbulence, corporate complexity and the company's life cycle contribute to differences in these empirical results (Nicholson & Kiel, 2004). Contingency theory states that there is no best or universal way appropriate for companies as they are dependent on the environment in which they are located.

Family Control

Companies can be categorised as family companies on the basis of ownership structure or on the basis of management, or a combination of both (Sacristan-Navarro, Gomez-Anson, & Cabeza-Garcia, 2011). Family companies are often associated with ownership originating from parties who have ties, via blood relations or because of marriage. However, family governance defines families within a broader meaning. The existence of kinship, such as close friends or professional advisers employed because of good relations, is also included in the family category (Angus, 2005). The existence of a family involved in the management or ownership of a company causes the family to have the freedom to control the company.

The impact of family involvement on performance has had mixed results. Families that are directly involved in managing the company (as CEO or a Board of Commissioners), have a business understanding and good information about the condition of the company (Anderson & Reeb, 2003). This condition can prevent opportunistic behaviour that management might do because the owner has the ability to control management actions. Family management results in nepotism in the selection of family members to occupy strategic positions in the company. Family members generally play an important role, both in the management team and on the Board. Moreover, if the majority shareholders are the founding family, family control has substantial voting rights. This condition creates great potential for information asymmetry between the founding family shareholders and other shareholders. Family members who hold positions as management will try to manage financial statements for the welfare of certain groups. This makes the transfer of welfare to family members easier. Therefore, often family companies are less productive and less efficient than non-family companies.

Development of Hypotheses

The role of advising relates to resource dependence theory where the Board plays a role in building relationships with the external environment and providing resources and information needed by the company. Relationships established by the Board illustrate their ability to provide useful advice and this ability is derived from the talents, experiences, perspectives and expertise they have (Coles, Daniel, & Naveen, 2012). Advising is usually done when the Board attends meetings with company management. It is at this meeting that the Board can, express opinions and formulate important policies and strategies that must be carried out by the company. Andres and Vallelado (2008) and Q. Liang, Xu, and Jiraporn (2013) gave the view that board meetings contributed to improving performance. The presence of the Board at meetings shows its commitment to achieving company goals.

Based on the above, the following research hypothesis is formulated:

H1: That the advising role of the Board has a positive effect on company performance.

Strategic advising of the Board increases the company's ability to create long-term value. However, the role of advising on the value of the company is contingent on the company's needs for advice and counselling itself. Coles et al. (2012) provides evidence that the role of advising has a positive effect on firm value, especially in companies of high complexity. Large-sized, diversified and high-leverage companies require additional advice from the Board which, in turn, triggers the growth of company value. Contrastingly, Chou et al. (2013) determined that there was a significant effect on attendance at Board meetings when they were concerned with the profitability of a family-controlled company or a company with a key shareholder(s). The attendance by the Board concerned (and not represented by others) is a manifestation of the Board's commitment to contributing to company strategic suggestions and decisions.

Companies with ultimate shareholders or family-controlled companies are usually relatively small-sized. Companies with these characteristics need valuable advice from the Board concerned. Thus, it can be concluded that the increasing role of counselling will increase the value of the company. The results show a stronger influence on companies with higher advising needs if management lacks control (Faleye, Hoitash, & Hoitash, 2013). As Golden and Zajac (2001) state, the weaker the CEO's strength, the increased influence of the Board on the company's strategy. Lack of power or the independence of company management, usually occurs in companies with majority shares owned by the founder or family. Family shareholders can control or intervene in the management of the company. This condition has an impact on weak corporate governance which is reflected in the lack of independence of the Board in carrying out their roles. The advising role does not work objectively and leads to consensus that is in favour of the interests of insider shareholders. The Board and company management collaborate to transfer wealth to controlling or family shareholders and expropriate minority shareholders. This has consequences for decreasing the company's performance. As with previous studies on family firms, it can be concluded that the agency conflict that arises is between controlling shareholders and non-controlling/minority shareholders (Young et al., 2008).

Based on the above, the following research hypothesis is formulated:

> H2: That family control weakens the effect of the Board's advising role on company performance.

Research Methodology

Population and Sample

The population and samples are companies listed on the Indonesian Stock Exchange (IDX) from 2008-2014. A limitation population avoids biases that might be caused by differences in company characteristics. The observation period was determined as such as in October 2006, Indonesia revised the principles and rules of corporate governance in line with the OECD (Organisation for Economic Co-operation and Development). The implementation of these principles and rules were effectively carried out in 2007 and 2008. Hence, the results were only analysed for 2008 (Ghofar, 2013). Samples were selected using the purposive sampling method. There were 792 samples selected for the purposes of this research.

Variable Research

Advising Role

A Board provides advice and independent analysis to company management and is carried out at Board meetings. The Board meeting is very important because it provides an opportunity for all parties to express their opinions and hold open discussions to obtain agreements for the progress of the company. The frequency of board meetings is often used as a measure of success in company management (Q. Liang et al., 2013; Xie, Davidson III, & DaDalt, 2003). The more often the Board attends the meeting, describing the conveying of advice and professional advice relating to the company's strategic policies and decisions. Accordingly, this study uses the frequency of Board meetings in a year as a measure for advising effectiveness.

Company Performance

This study uses financial measures to assess company performance. The company's financial performance used via accounting performance. Accounting-based performance measures focus on historical data and show company experience. This measure was developed as a reporting mechanism that covers various factors, including the Board’s successful activities for management (Kiel & Nicholson, 2003). This accounting measure uses Return on Assets (ROA) as employed by (Lefort & Urzua, 2008; Maury, 2006; Sacristan-Navarro et al., 2011; Tsao, Chen, Lin, & Hyde, 2009). ROA reflects the company's performance from an internal perspective and which is calculated by comparing earnings before extra-ordinary items and discontinued operations, divided by the book value of assets. The formula used to calculate ROA is as follows:

$$ROA = \frac{\text{Earning before Extra Ordinary Items \& Discontinued Operations}}{\text{Book Value of Assets}}$$

Family Control

Family control variables are measured via ownership-based calculations, namely shares owned by the founding family members and or by large individual shareholders (Filatotchev et al., 2005; X. Liang, Wang, & Cui, 2014). The definition of family members refers to the criteria set, namely members of the nuclear family and or extended family (family status caused by legal relationships, for example due to marriage). Family members are identified by the similarity of names (first or second surname) which indicates a blood relationship or because of marriage. This study uses a dummy to measure family control variables; scoring 1 if a company’s shares are owned by the family and a score of 0 if the company's shares are not owned by the family.

Data Analysis

Hypothesis testing uses Multiple Linear Regression, and is done for the following two models:

$Y = \alpha + \beta 1X1 + \varepsilon$ .... model 1
$Y = \alpha + \beta 1X1 + \beta 2X2 + \beta 3X1*X2 + \varepsilon$ .... model 2
Note:
Y = ROA
α = constant
X1 = Number of board of commissioners meetings in one year
X2 = Dummy Family Control
$\beta 1, 2, 3$ = The coefficient of each variable
ε = Error

Multiple Linear Regression testing will produce a statistical test t which shows how the influence of one independent variable on the dependent variable. The basis for decision making in the t test is if the significance is less than 0.05 (α <0.05). If this is the case, then the hypothesis is accepted.

Findings and Discussion

Regression testing results for Model 1 show a significance value of 0.036 <0.05 and means that the first hypothesis is supported statistically. Likewise, regression testing on Model 2 shows a significance value of 0.00 <0.05. Subsequently, the second hypothesis (H2) is supported statistically. The R square value in Model 1 is 0.006 and the R square in Model 2 is 0.023 and indicates an increase. This proves that the existence of family control provides additional guiding role on company performance. The coefficient $\beta 3$ is negative and indicates that family control weakens the effect of a guiding role on company performance.

Testing of the first hypothesis (H1) shows a positive influence on company performance and provides evidence that the Board, in a sample company, focuses its role on the formulation of strategy and company policy. The Board strives to determine policies that benefit the company and minimise risks. Precise policies implemented by the company will have an influence on improving the performance of the company. The results of this study confirm the findings of Young, Ahlstrom, Bruton, and Chan (2001) which conclude that the Board's role in developing countries places more emphasis on the role of resource dependence (linking role), rather than a service, control and research role. The resource dependence perspective assumes that the Board is a buffer and boundary, connecting organisations with critical resources and providing valuable information obtained through Board membership of other companies (directors interlocks) (Pfeffer & Salancik, 1978). As a result, this study confirms the resource dependence theory.

A similar undertaking was made in Q. Liang et al. (2013) and Andres and Vallelado (2008) which provides evidence that the number of Board meetings had a significant impact on improving banking performance. Board meetings are used as a means to express opinions, provide advice, and formulate policies and strategies that can create a competitive advantage for the company. This indicates that the advising role is effective, and shows the Board's proactive role in thinking about the company's progress. The results of the second hypothesis are consistent with the study of Coles et al. (2012) which provides evidence that providing good advice as measured by quality, quantity and sound counselling increases the value of the company, especially complex ones. The complexity of the company is reflected in large-sized companies, diversified shareholders and high leverage. Given this, it can be concluded that a Board can increase company value where shareholders are not concentrated in certain groups (families). Conversely, an advising role will reduce the company's performance if its share ownership is concentrated in a family. The study uses corporate complexity as a contingent variable which is predicted to strengthen the influence on firm value. With regards to this study, family control, from an ownership perspective, is a contingent variable predicted to weaken the influence of company performance. The characteristics of family companies that are altruistic and culturally oriented respect seniority, making agreements or decisions the role of senior family members. Family companies often prioritise consensus rather than professional advice, so an increase in advising results is a decrease in company performance.

The dominance of family members in corporations makes corporate governance weak such as unqualified family members (Young et al., 2008) from other professions (Kweh, Kuo, Wang, & Liu, 2015). This condition causes a close relationship between the Board, company management and company founders, so that the advising and counselling functions that the Board should provide company management cannot run properly. This is in accordance with Young et al. (2001) and Bruton, Ahlstrom, and Wan (2003) in studies on governance in family-controlled companies in Southeast Asia. The impact of family involvement in management and the Board allow for the transfer of wealth to controlling shareholders/founding families (Filatotchev et al., 2005) and expropriate minority shareholders. Previous studies such as Young et al. (2008) gave the view that in companies with a high concentration of family ownership, conflicts between controlling shareholders (majority) and non-controlling shareholders (minorities) arise. The principal-principals' conflict was identified as a major concern for governance in developing countries that have concentrated ownership structures, extensive family control and ownership and a weak protection of minority shareholders.

In line with previous studies, which conducted observations in emerging market countries, companies listed on the Indonesia Stock Exchange provided evidence that family-controlled companies significantly showed lower levels of company performance than those not controlled by families (Darmadi, 2013). The study of corporate governance in family-controlled companies in Southeast Asia provides evidence that family dominated Boards, have an impact on decreasing company performance (Bruton et al., 2003; Young et al., 2001). This confirms the view that companies controlled by families tend to be inadequate protectors of investor rights. Family interests dominate the interests of non-family shareholders. Attention to family welfare creates a preference for retaining wealth or profits only for certain groups as they are not used to maximise dividend payments to external shareholders (Filatotchev et al., 2005).

Conclusion and Recommendations

Companies need the role of the Board in providing advice, strategic resources and reducing the uncertainty of the external environment. These results support the concept of resource dependence theory. However, the positive influence of an advising role on performance does not occur in companies whose stock ownership is concentrated in the family. The dominance of the family causes a decrease in the independence of a Board and, consequently, management cannot run effectively. The difference in results due to the presence of family control variables proves that a Board's role is contingent on the presence or absence of family control in the company. Thus, the results of this study support the contingency theory which holds that there is no best or universal way that can be applied to all companies. The factors of the situation or conditions that occur in the company must be considered.

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Regression Testing Model 1

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,074[a]	,006	,004	12,42074

a. Predictors: (Constant), Meeting

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	678,541	1	678,541	4,398	,036[b]
	Residual	121877,048	790	154,275		
	Total	122555,589	791			

a. Dependent Variable: ROA
b. Predictors: (Constant), Meeting

Coefficients[a]

Model		Unstandardised Coefficients		Standardised Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	6,163	,592		10,417	,000
	Meeting	,164	,078	,074	2,097	,036

a. Dependent Variable: ROA

Regression Testing Model 2

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,153[a]	,023	,020	12,36295

a. Predictors: (Constant), MeetDumFC, Meeting, DumFC

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2846,376	3	948,792	6,208	,000[b]
	Residual	119522,804	782	152,842		
	Total	122369,180	785			

a. Dependent Variable: ROA
b. Predictors: (Constant), MeetDumFC, Meeting, DumFC

Coefficients[a]

Model		Unstandardised Coefficients		Standardised Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	7,189	,664		10,823	,000
	Meeting	,167	,078	,075	2,125	,034
	DumFC	-3,640	,994	-,131	-3,663	,000
	MeetDumFC	-,038	,129	-,010	-,291	,771

a. Dependent Variable: ROA