Ownership Structure and Governance Implementation: Evidence from Indonesia

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Abstract

This paper investigates whether corporate governanceimplementationisassociatedwithownership structure.Using publicly traded firms in Indonesia, I regress different ownership variables on a corporate governance index (CGI) as my proxy for corporate governance implementation.I use family ownership, business group membership, institutional ownership, government ownership, and foreign ownershipfor ownership structure variables in the regression.I also run sensitivity tests to examine if the results are sensitive to how I measure the CGI. After controlling for variables that affect corporate governance, I find significant positive association between CGI score and government ownership and negative associations between the score and family ownership and institutional ownership. However, I do not find significant association between CGI score and foreign ownership or firms that are members of business groups. My findings suggest thatfirms with higher family ownershipor institutional ownershiptend to implement lower governance. This may indicate that majority family and institutional owners may have objectives that are negatively affected by good corporate governance practices and therefore, they choose not to implement them. Positive association betweengovernment ownership and corporate governance implementation suggests that the government is consistent with its efforts in promoting corporate governance among public firms in order to protect public interests.

Keywords: governance; ownership; family; group firm; conglomerate; firm value; government; institutional; foreign; performance.

1. Introduction

This paper examines whether ownership structureis associated with the implementation of corporate governance by public firms. I predict that theowners willinfluence corporate governance implementation because theymay have different objectives that are not always align with the objectives of other stakeholders. Therefore,theimplementation of corporate governance is likely to be affected by the owners' perception about whether it will help them achieve their objectives or whether it prevents them from achieving their objectives.

Indonesiaoffers an interesting settingto test whether governance implementation is associated with ownership structure.Indonesian government has put a lot of efforts to improve corporate governance after the Asian crisis in 1987 and 1988 and has issued several regulations. For example,the Jakarta Stock Exchange (the JSX) required public firms to have independent directors and independent audit committee by the end of 2002 (Siagian & Tresnaningsih, 2011).In 2002, the Indonesian Capital Market Authority (BAPEPAM)issued reporting and disclosure guidance (P3LKE) for public firms in order to improve the firms'reporting and disclosure quality (BAPEPAM, 2002).In addition, Indonesian market is characterized by significant ownerships by families,groups (more commonly known as Indonesian conglomerates), foreign investors,or government (Claessens, Djankov, Fan, & Lang 2002; Kompas, 1995; Pusat Data Business Indonesia, 1997).

As the proxy for corporate governance, I use the corporate governance index (CGI)that is developed by Siagian, Siregar, & Rahadian (2011). The index score is calculated for firms that were traded in the JSX during 2003 and 2004. I find that controlling-family ownership is negatively associated with governance implementation. This is consistent with family owners with higher ownership implement lower corporate governance because they want to retain control of the firms. Theresults also show that institutional ownership is negatively associated with corporate governance. This finding is consistent with the contention that the institutional investors are short-term oriented investors who put pressures on the managers to improve earnings (Bushee, 1998; Cheng & Reitenga, 2001). It does not support the hypothesis that institutional owners would implement governancebecause they have significant stake in the firm.

Finally, I find that government ownership is positively associated with governance implementation, which suggeststhatIndonesian government is consistent with its efforts andimplement corporate governance in firms that they own. Ido not find any significant association between corporate governance and foreign ownership or business firms.

I also find that corporate governance implementation is associated with firm size and firm value. Larger firms and high value firms tend to have better corporate governance implementation. My findings are consistent using both un-weighted and weighted CGI. I also use different proxies for firm value and find that the results are consistent with the main results.

This study contributes to the literature by providing evidence that implementation of corporate governance is associated with ownership structure. This suggeststhat owners do interfere corporate governance implementation and choose practices that will help them achieve their objectives. Because governance implementation may affect the owners' objectives in a positive or negative way, they implement only practices with positive impacts on achieving their objectives and avoid practices with negative impacts.

The remainder of the paper is organized as follows. I draw the theories about the subjects and develop the hypotheses in section 2. Section 3 describes the research method, sample selection procedure, and the descriptive statistics. I present the results of the tests in section 4 and conclude the study in section 5.

2. Hypotheses Development

Current corporate governance research demonstrates that corporate governance is positively associated with firm value (Klapper & Love, 2004; Gompers, Ishii, & Metrick, 2003; Alves & Mendes, 2004; Kula, 2005; Durnev & Kim, 2005; Beiner, Drobetz, Schmid, & Zimmermann, 2005; Siagian, Siregar, & Rahadian, 2011). A studyby Mitton (2002) finds that firms that implement corporate governance are in better condition during economic crisis. Agency theory predicts that the managers' objectives and the shareholders objectives may not be aligned. Managers tend to maximize their own utility and take actions that are not in the best interest of the shareholders (Fama & Jenses, 1983). It is predicted that corporate governance will help mitigate some of these agency problems because it improves communications among managers and different stakeholders, improves the board and committees independence, protects minority shareholders, and as the above studies find, improve firm value.However, because different owners have different objectives, they may have different corporate governance choice.

2.1. Family Owners

Similar to many countries, majority ownership by family is common in Indonesia (Villalonga & Amit, 2010; Claessens, Djankov, Fan, & Lang, 2002; Anderson & Reeb, 2003a, 2003b). There are mix evidence regarding the cost and benefit of family-controlled ownerships. Several recent studies find that family-controlled firms have higher values (McConaughny, Matthews, & Fialko, 2001; Yammeesri & Lodh, 2001; Anderson & Reeb, 2003a). Other studies find otherwise (Holderness & Sheehan, 1988; Chau & Gray, 2002; Claessens, Djankov, Fan, & Lang, 2002).

Fama & Jensen (1983) state that firms with family ownership are more efficient because of the lower monitoring costs in family-controlled firms. This is consistent with fewer conflicts between the principal and the agent. The families also may have advantages in monitoring the managers. Demsetz & Lehn (1985) state that large shareholders can act to mitigate managerial expropriation. These families are large shareholders and have substantial economic incentives to minimize agency conflicts because a significant portion of their wealth is tied to firm performance. McConaughny, Matthews, & Fialko (2001) find that firms controlled by family have higher value and are more efficient. Yammeesri & Lodh (2001) find positive association between family ownership and return and profitability.

The positive impact of family ownership is also found on lower cost of capital (Anderson, Mansi, & Reeb, 2003) and on minority shareholders (Anderson &Reeb, 2003a, 2003b; Villalonga & Amit, 2010). However, Maury (2006) states that the benefit from family controlling the firm is mainly for firms without majority ownership. He states that family control reduces agency problem between managers and the shareholders but creates conflict between the controlling family and minority shareholders if the protection to the minority shareholders is weak. These families are capable to take actions that benefit themselves at the expense of other shareholders or expropriating wealth from the firm.

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Holderness & Sheehan (1988) also find negative relation between family ownership and performance and find that the controlling family can use their dominance to transfer wealth from the minority shareholders. If the families want to maintain their dominance in the firm it is likely that they will limit corporate governance. Several studies find results that are consistent with this prediction. Chau & Gray (2002) find that firms controlled by family have lower disclosure. Claessens, Djankov, Fan, & Lang (2002) indicate that firms with concentrated ownership do not have adequate governance that should protect the minority shareholders from expropriation by the majority shareholders. These families are likely to retain their dominance in order to achieve their objectivesand hence, negatively affect corporate governance implementation. I hypothesize that firms with majority family ownership is associated with corporate governance. Whether the association is positive or negative becomes an empirical issue because there is a positive influence from efficient monitoring as well as a negative influence from desire to maintain dominance.

> H1: Corporate governanceis associated with family ownership.

2.2. Business Group

Recent studies show that business groups are common in emerging countries as well as other parts of the world. Kim & Yi (2006) and Chang (2003) use a set of Korean firms that are part of large business group called Chaebols that play a dominant role in Korean economy. Khanna & Palepu (2000a and 2000b) use Indian business groups (2000a) and Chilean business groups (2000b) in their study. Lins & Servaes (2002) use diversified firms in seven emerging markets (Hong Kong, India, Indonesia, Malaysia, Singapore, South Korea, and Thailand) suggesting that these firms are commonly found in those countries. Guillen (2002) states that business groups are becoming major players in the world economy.

A businessgroup is a "collection of firms bound together insome formal and/or informal ways" (Granovetter, 1995). In business group firms the majority shareholders' wealth is not concentrated in one firm but are spread out in many firms in the same group. These groups usually are a collection of companies (public and private) in various industries and are typically controlled by the same owners. This situation increases the probability of expropriation of the minority shareholders' wealth because the group owners will focus of the benefits of the whole groups rather than individual firms.

Kim & Yi (2006) study the impact of the existence of business affiliation on earnings management. They find that the magnitude of earnings management is higher for firms with business affiliation than firms without business affiliation. This indicates that firms with business affiliation give the controlling shareholders more incentives and opportunity to manage earnings for their own benefits. Lins & Servaes (2002) argue that severe market imperfections in emerging economies also increase the potential agency costs associated with diversification. They state that higher asymmetric information might allow management and large shareholders to more easily exploit the firms for their own purposes.

On the other hand, some studies find that business groupscan provide benefit to the member firms. Khanna & Palepu (2000a) shows that Indian business groups receive benefits from internal market created by the groups. Chang & Hong (2000) find that profitable firms help or cross-subsidize poorly performing firms in the group using various means. These actions will benefit both the majority and the minority shareholders and reduce agency problems within the firms.

The group owners are likely to make decisions for the best interest of all firms in the business group rather than of the firm. To be able to do this, they would not implement corporate governance that would deteriorate their power to make decisions that benefit the whole group rather than individual firms.On the other hand, studies show that firms and minority shareholders benefit from group firms suggesting that these firms may not have problem with corporate governance.I predictthat there is an association between corporate governance and group member. Whether the association is positive or negative is an empirical issue.

> H2: Corporate governance isassociated with business group ownership

2.3. Institutional Ownership

Institutional investors usually have significant investments in the firms and need to protect their investments. Large shareholders have both a strong incentives to monitor managers and the power to discipline the managers (Chang, 2003).

It is very important for them that the managersdo not pursue their own objectives at the expense of the shareholders.Corporate governanceoffers more protection to the shareholders because it provides mechanisms to monitor and control the managers. Therefore, institutional investors that have significant investment and interests in the firm are more likely to prefer firms that implement corporate governance. Lei & Teen (2005) find positive association between institutional ownership and corporate governance score for public firms in Britain. Chang (2003) states that many institutional investors are intermediate agents for final owners. They have quite different incentives and risk preferences because they are subject to scrutiny by the final owners and therefore, would perform better.

On the other hand, Cheng & Reitenga (2001) suggests that institutional non-blockholders are primarily interested in short-term performance, which will generate pressure on managers to deliver high earnings. This suggests that they will not implement corporate governance practices that prevent the managers to deliver high earnings. Bushee (1998) finds that a large proportion of ownership by institutions that have high portfolio turnover and engage in momentum trading significantly increases the probability that managers improve earnings. This finding also supports the contention that institutional investors may have short-term objectives that may not be benefited by governance implementation. I hypothesize that institutional ownership is associated withcorporate governance implementation. The direction of the association is an empirical issue.

      H3: Corporate governance isassociated with the institutional ownership.

2.4. Government Ownership

Governmentas a regulator is responsibleto protect the public and is responsible to make sure that firms implement corporate governance to protect their stakeholders. Recent studies still find mix results regarding corporate governance and government ownership. Mak & Li (2000) state that state-owned firms may have weaker governance than other firms because they have objectives related to the country's welfare and not just the firm objectives. State-owned firms receive fund from the government that tend to be a long-term investor and does not actively monitor its investment. Kole & Mulherin (1997) study firms with US government ownership of more than 35% and find that the performances of these firms are not significantly different from other firms in the same industry. However, publicly traded state-owned firms are among the best and therefore, most likely to implement a good corporate governance. Ihypothesize that government ownership is positively associated with corporate governance.

      H4: Corporate governance is positively associated with government ownership.

2.5. Foreign Ownership

Foreign investors tend to invest in firms with good corporate governance because effective corporate governance offers lower agency problems and therefore, lower risk (Leuz, Lins, & Warnock, 2008).Aggarwal, Klapper, & Wysocki (2005) find that US funds invest more in open emerging markets with stronger accounting standards, shareholder rights, and legal frameworks. At the firm level, US funds are found to invest more in firms that adopt discretionary policies such as greater accounting transparency.Dahlquist, Pinkowitz, Stultz, & Williamson (2003)suggest that there is an association between corporate governance and foreign investors. Their empirical analysis shows that the share of a country's equities in the stock portfolio of U.S. investors is negatively related to the share of the stock market capitalization of the country held by large shareholders. Kim, Eppler-Kim, Kim, & Byun (2010) find that foreign investors allocate a disproportionately higher share of their funds to Korean firms with foreign outside directors. This suggests that improvements on corporate governance attract more foreign investments.Baek, Kang, & Park (2004) find that during the 1997 crisis in Korea, firms with higher foreign ownership experience lower decrease in share price. They suggest that this is a function of firm-level differences in corporate governance.Ihypothesize that foreign ownership is positively associated with corporate governance level and hypothesize the following.

      H5: Corporate governance is positively associated with foreign ownership.

3. Research Method

3.1. Sample Selection

The sample in this study consists of firms traded in the JSX in 2003 and 2004 with complete corporate governance and financial data. Financial data are obtained from financial reports from the JSX database and I use corporate governance index (CGI) that are used in Siagian, Siregar, &Rahadian (2011). Table 1 shows the sample selection process.

Insert table 1 about here

Appendix A shows the CGI in detail. The checklist is divided into 5 groups according to OECD principles: rights of shareholders, equitable treatment of shareholders, role of stakeholders, disclosure and transparency, and responsibility of the board. I use year 2003 and 2004 because the BAPEPAM issued the Reporting and Disclosure Guidance in 2002 and public firms submitted reports to the BAPEPAM to show their adherence to the guidance. This allowsfor the development of the index for firms that submitted the reports (Siagian, Siregar, & Rahadian, 2011).

3.2. Model Specification

To test the hypotheses, I run multivariate regressions using CGI as the dependent variable and various ownership variables as the independent variables. I also include several control variables that may be associated with the dependent variable. The model used is as follows:

$$CGI_{it} = a_0 + a_1 FAM_{it} + a_2 GROUP_{it} + a_3 INST_{it} + a_4 GOVT_{it} + a_5 FOR_{it}$$
$$+ a_6 TQ_{it} + a_7 SIZE_{it} + a_8 GROWTH_{it} + a_9 OPINI_{it} + a_{10} LEV_{it} + e_{it}$$

Where:

CGI	=	Corporate governance index score
FAM	=	Percentage of shares owned by family
GROUP	=	Group member dummy variable (1 for firms that are a member of a business group or a conglomerate, 0 otherwise)
INST	=	Percentage of shares owned by institutional investors
GOVT	=	Percentage of shares owned by Indonesian government
FOR	=	Percentage of shares owned by foreign investors
TQ	=	Tobin's Q
SIZE	=	Log of total assets at year-end
GROWTH	=	Average growth of sales in the last three years
OPINI	=	Auditor opinion dummy variable (1 for unqualified opinion, 0 otherwise)
LEV	=	Leverage measured by debt-to-equity ratio

My main test predicts that $\square_1$ through $\square_5$are significant. I do not predict the signs of $\square_1$, $\square_2$, and $\square_3$ and predict that $\square_4$ and $\square_5$ to be positive. I control for firm value in the regression model because studies find associations between firm value and corporate governance (Siagian, Veronica, & Rahadian, 2011; Beiner, Drobetz, Schmid, & Zimmermann, 2005; Mitton, 2002; Klapper & Love, 2004; Black, Jang, & Kim, 2003; Gompers, Ishii, & Metrick, 2003; Alves & Mendes, 2004;Kula, 2005; Durnev & Kim, 2005)

Previous studies have used Tobin's Q and PBV ratio as proxy for firm value (Demsetz & Lehn, 1985; Morck, Shleifer, & Vishny, 1988; Yermack, 1996; Gompers, Ishii, & Metrick, 2003; Siagian, Siregar, & Rahadian, 2011). I use Tobin's Q in the main test and conduct separate test using PBV that we discuss in the sensitivity analysis section. I calculate Tobin's Q by comparing the market value of a company's stock (MVEQ + BVDEBT) and the value of a company's equity book value (BVEQ + BVDEBT). MVEQ is market value of equity and BVEQ is book value of equity. I use book value of debt (BVDEBT) for both the numerator and denominator because market value of debt is not available in Indonesia.

Size is included as a control variable because larger firms tend to have more complex agency problem and voluntarily chose more strict governance (Jensen, 1986). I use natural log of total assets as the proxy for size. I use the average growth of sales in the last three years as the proxy for firm growth (GROWTH). This variable is included in the regression because firms with high growth rate need large external financing and therefore will feel the need to improve their governance if they expect that better corporate governance reduce cost of capital (Sengupta, 1998).

I include Public Accountant Opinion (OPINI) that represents the quality of reporting as a control variable. Corporate governance,such as having a high quality audit committee and independent directors,is associated with better internal and external audit functions and reporting system (Siagian and Tresnaningsih, 2011).I also control for leverage (LEV) because it can affect the level of corporate governance.

Creditors require that firms implement corporate governance to protect their interest in the firms. Also, firms will implement corporate governance if it can reduce cost of debt (Sengupta, 1998; Anderson, Mansi, & Reeb, 2003).I include Debt-to-Equity ratio in the regression to control for firm leverage.

4. Analysis

4.1. Descriptive Statistics

Panel A of Table 2 presents the descriptive statistics for variables used in the regressions. The average corporate governance score (CGI) is 0.667 with standard deviation of 0.07, which is relatively small.[1] This shows that the CGI score among the firms does not vary too much. The average of shares owned by a family is 44%. 30% of the firms are members of business groups or conglomerates. More than half (52.9%) of the firms are family-owned with more then 50% share ownership (not reported). The average of institutional ownership and government ownership of the firms in the sample are 8.3% and 1.64% respectively. These are relatively small compared to the percentage of family ownership. The average foreign ownership is still relatively higher than government ownership or institutional ownership. On average 18.2% of the firms' shares are owned by foreign investors.

Insert table 2 about here

The average of Tobin's Q is 1.117 with a standard deviation of 0.543.[2]The average of firm size is 675 billion rupiah and the average sales growth in the last three years is 15.2%.[3]Majority (91.1%) of the firms receive unqualified audit opinion. The firm's leverage (debt-to-equity ratio) varies significantly with an average of 2.52 and standard deviation of 6.588. The detail CGI scores for all firms in 2003 and 2004 are presented in Panel B of Table 2. The average overall score are similar between 2003 and 2004 and the t-test (not reported) suggests that the mean difference is not statistically significant. Table 3 presents the Pearson Correlation for variables in the regression model. It shows that family ownership is negatively correlated with CGI while government ownership and foreign ownership are positively correlated with CGI. We also find that firm value, and size are positively correlated with corporate governance.

Insert table 3 about here

Family ownership has negative correlations with three other ownership variables (institutional, government, and foreign investors) suggesting that those investors may not be interested in investing in firms that are controlled by a family. It is positively correlated with group firms suggesting that group firms are also likely to be owned by majority families. Group membership is negatively correlated with corporate governance consistent with prediction that group owners focus on the welfare of the whole group rather than the firm and therefore, may limit corporate governance. It is also negatively correlated with institutional and foreign ownerships suggesting that institutional and foreign investors tend to avoid investing in firms that are part of Indonesian conglomerates. Also, there is a positive correlation between foreign ownership and institutional ownership suggesting that these investors are interested in similar firms.

4.2. Hypothesis Testing Results

I hypothesize the associations between corporate governance and ownership structures. Table 4 presents the regression results. Consistent with the first hypothesis that family ownership is associated with corporate governance, I find that FAM is significant with negative coefficient. This suggests that firms with higher family ownership tend to implement lowercorporate governance.

Insert table 4 about here

I do not find significant coefficient for group firms. This suggests that the association is still undetermined probably because group membership positively affects some firms and negatively affects others.I also find a significant negative association between institutional ownership and corporate governance (β_3).

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[1] In the sensitivity analysis, I regress the weighted CGI (WCGI) on various independent variables. The average of WCGI is 0.650 with standard deviation of 0.071. The descriptive statistics for WCGI are similar to those of CGI.

[2] I also conduct sensitivity analysis using PBV instead of Tobin's Q. The average PBV is 1.53 with standard deviation of 1.86. This suggests that the PBV of the firms vary significantly and the variation is higher than that of Tobin's Q.

[3] US $1 is approximately equal to 9,000 Indonesian rupiah.

This result support my third hypothesis that is consistent with the institutional investors tend to be short-term oriented and focus on maximizing earnings (Bushee, 1998; Cheng & Reitenga, 2001). The coefficient for GOV ($\square_4$) is positive and significant suggesting positive association between government ownership and corporate governance. It shows that firms with higher government ownership tend to have better corporate governance. This is consistent with Indonesian government's efforts to improve corporate governance among Indonesian firms. Finally, the results show that foreign ownership is not significantly associated with corporate governance. My finding does not support the prediction that foreign investors prefer firms with bettercorporate governance. I also find that two control variables, SIZE and Tobin's Q,consistently and significantly affect CG scores. The positive signs of the two variables suggest that larger and higher value firms tend to implement better corporate governance.

4.3. Sensitivity Analysis

4.3.1. Weighted CG Index

Following Siagian, Siregar, & Rahadian (2011), we also use the weighted CGI for sensitivity analysis by putting 20 % weight on rights of shareholders, 15% weight on equal treatment of shareholders, 15% on role of stakeholders, 25% on disclosure and transparency, and 25% on board responsibilities as recommended by the IICD.

Table 5 shows the results of the regressions using the weighted corporate governance index (WCGI) as the proxy for corporate governance implementation. The results are consistent with the main results suggesting that the results do not depend on how I measure corporate governance.

Insert table 5 about here

4.3.2. Price-to-book value ratio (PBV)

Prior studies have used both Tobin's Q and PBV ratio as proxies for firm value. To test whether the findings are sensitive to different measures of firm value, I also run regressions using PBV ratioto measure firm value. The regression results are presented in Table 6.

Insert table 6 about here

Table 6 shows that the findings are consistent with the findings in the main test. Family ownership and institutional ownership are negatively associated with corporate governance and government ownership is positively associated with corporate governance. No significant association is found for foreign ownership and group firm. The only difference is that thereis a significant positive association between LEV and CGI when PBV is used as the measure for firm value.

5. Conclusion

This paper provides empirical evidence that support the hypothesis of association betweencorporate governance andownership structures. Because different owners have different objectives, some owners have incentives for not implementing corporate governance if it impairs their ability to achieve their objectives.I use a corporate governance index (CGI) to measure corporate governance practice and run multivariate regressions to test the associations between the index score and various ownership structures while controlling for variables that may affect corporate governance.

I find that family ownership and institutional ownershipare negatively associated with governance. It is likely that families with majority shares want to retain control. If governance implementation reduces their power these families will tend to avoid such corporate governance practices. I find that institutional ownership is also negatively associated with corporate governance. It is possible that institutional investors in Indonesian firms are short-term oriented that may be more beneficial with low governance practices.

I find that corporate governance is positively associated with government ownership. This shows that Indonesian government is consistent with its campaign to improve corporate governance in order to improve firm performance and to protect the public. I do not find significant associations between corporate governance and foreign investors or group firms. I also find that firm size and firm valueto be positively associated with corporate governance. This finding suggests that larger firms and firms with better valuetend to implement better corporate governance.

In the sensitivity tests, Iuse weighted index (WCGI) as the proxy for corporate governance implementation and PBV as the proxy for firm value. The results from the sensitivity tests are consistent with the results from the main test. Due to data limitation I use only two years of data. Ideally, more data will provide stronger results. However, year 2003 and 2004 provide ideal setting because firms responded to the JSX regulation and the BAPEPAM reporting guidance in 2002 by submitting reports to those authorities. These reports are the bases for developing the index (Siagian, Siregar, & Rahadian, 2011).

For future research, it is important to study that investigates the association between ownership structureandindividual corporate governance practice rather than overall practice. It will help us understand which practices are supported and are not supported by certain types of owners. The implication of this research is that the authorities need to keep encouraging public firms to implement good governance because it benefits all stakeholders although some owners are likely to avoid or limit its implementation in their firms. Theyneed to focus on firms with majority family owners and firms with institutional investors because these are the firms that tend to have lower governance.

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Table 1 Sample Selection

	Total Firm-Year
Total firms or observation with CGI data	248
Total observations with negative book value	(26)
Total observations with incomplete financial	(18)
Total firm-year in the final sample	204

Table 2 Descriptive Statistics of Variables in the Regression

$$CGI_{it} = a_0 + a_1 FAM_{it} + a_2 GROUP_{it} + a_3 INST_{it} + a_4 GOVT_{it} + a_5 FOR_{it}$$
$$+ a_6 TQ_{it} + a_7 SIZE_{it} + a_8 GROWTH_{it} + a_9 OPINI_{it} + a_{10} LEV_{it} + e_{it}$$

Panel A: Descriptive Statistics for all Variables in both Years

	Mean	Std. Dev.	Minimum	Median	Maximum
CGI	0.667	0.070	0.538	0.662	0.859
FAM	0.440	0.302	0.000	0.510	1.000
GROUP	0.304	0.461	0.000	0.000	1.000
INST	0.083	0.161	0.000	0.000	0.778
GOVT	0.016	0.092	0.000	0.000	0.900
FOR	0.182	0.263	0.000	0.059	0.966
TQ	1.117	0.543	0.182	0.978	3.695
SIZE	27.238	1.700	21.392	27.229	31.661
GROWTH	0.152	0.345	-0.696	0.093	2.904
OPINI	0.911	0.284	0.000	1.000	1.000
LEV	2.521	6.588	0.000	1.090	72.270

Panel B: Descriptive Statistics for CGI by year

Year	N	Mean	Std. Dev.	Minimum	Median	Maximum
2004	88	0.675	0.074	0.541	0.670	0.859
2003	116	0.661	0.066	0.538	0.654	0.858

CGI = un-weighted corporate governance index score, FAM = percentage of shares owned by family, GROUP = Group member dummy variable (1 for firms that are a member of a business group or a conglomerate, 0 otherwise), INST = percentage of shares owned institutional investors, GOVT = percentage of shares owned by the government, FOR = percentage of shares owned by foreign investors, TQ = Tobin's Q, SIZE = log total assets, GROWTH = average growth of sales in the last three years, LEV = debt-to-equity ratio

Table 3Correlation of Variables in the Model

$$CGI_{it} = a_0 + a_1 FAM_{it} + a_2 GROUP_{it} + a_3 INST_{it} + a_4 GOVT_{it} + a_5 FOR_{it}$$

$$+ a_6 TQ_{it} + a_7 SIZE_{it} + a_8 GROWTH_{it} + a_9 OPINI_{it} + a_{10} LEV_{it} + e_{it}$$

	FAM	GROUP	INST	GOVT	FOR	TQ	SIZE	GROWTH	OPINI	LEV
CGI	**-0.360**** **(0.000)**	**-0.150**** **(0.032)**	-0.097 (0.166)	**0.276***** **(0.000)**	**0.137*** **(0.051)**	**0.280**** **(0.000)**	**0.485***** **(0.000)**	-0.042 (0.552)	-0.017 (0.806)	0.078 (0.269)
FAM		**0.517***** **(0.000)**	**-0.255***** **(0.000)**	**-0.194***** **(0.005)**	**-0.579***** **(0.000)**	-0.090 (0.203)	**-0.156**** **(0.026)**	-0.010 (0.893)	-0.089 (0.205)	0.050 (0.475)
GROUP			**-0.187***** **(0.007)**	-0.102 (0.149)	**-0.307***** **(0.000)**	-0.073 (0.298)	0.064 (0.365)	-0.047 (0.507)	**-0.170**** **(0.015)**	0.001 (0.990)
INST				-0.025 (0.723)	**0.344**** **(0.000)**	-0.073 (0.298)	-0.018 (0.794)	-0.024 (0.733)	-0.022 (0.753)	0.060 (0.394)
GOVT					-0.050 (0.474)	**0.143**** **(0.041)**	**0.124*** **(0.078)**	0.024 (0.736)	0.055 (0.432)	-0.008 (0.907)
FOR						0.040 (0.571)	0.003 (0.972)	-0.062 (0.00)	0.044 (0.536)	-0.026 (0.715)
TQ							**0.285***** **(0.000)**	-0.005 (0.945)	0.053 (0.454)	-0.003 (0.970)
SIZE								-0.031 (0.663)	-0.039 (0.578)	0.021 (0.771)
GROWTH									-0.089 (0.2072)	-0.070 (0.325)
OPINI										-0.087 (0.216)

N = 204, *** the correlation is significant at 0.01 level, ** the correlation is significant at 0.05 level, * the correlation is significant at 0.1 level, CGI = un-weighted corporate governance index score, FAM = percentage of shares owned by family, GROUP = group member dummy variable (1 for firms that are a member of a business group or a conglomerate, 0 otherwise), INST = percentage of shares owned institutional investors, GOVT = percentage of shares owned by the government, FOR = percentage of shares owned by foreign investors, TQ = Tobin's Q, SIZE = log total assets, GROWTH = average growth of sales in the last three years, LEV = debt-to-equity ratio

Table 4: Regression Results using CGI Score as the Dependent Variable

$$CGI_{it} = a_0 + a_1 FAM_{it} + a_2 GROUP_{it} + a_3 INST_{it} + a_4 GOVT_{it} + a_5 FOR_{it}$$
$$+ a_6 TQ_{it} + a_7 SIZE_{it} + a_8 GROWTH_{it} + a_9 OPINI_{it} + a_{10} LEV_{it} + e_{it}$$

Variable	Predicted Sign	CGI	
N		204	
Intercept		**0.262**	***
		(0.000)	
FAM	?	**-0.057**	***
		(0.003)	
GROUP	?	-0.011	
		(0.261)	
INST	?	**-0.070**	***
		(0.008)	
GOVT	+	**0.117**	***
		(0.009)	
FOR	+	0.007	
		(0.719)	
TOBIN'S Q		**0.015**	**
		(0.045)	
SIZE		**0.016**	**
		(0.000)	
GROWTH		-0.011	
		(0.361)	
OPINI		-0.017	
		(0.243)	
LEV		-0.001	
		(0.214)	
R^2		0.395	
Adjusted R^2		0.364	
Prob (F-statistic)		0.000	

N = 204, *** the correlation is significant at 0.01 level, ** the correlation is significant at 0.05 level, * the correlation is significant at 0.1 level, CGI = un-weighted corporate governance index score, FAM = percentage of shares owned by family, GROUP = Group member dummy variable (1 for firms that are a member of a business group or a conglomerate, 0 otherwise), INST = percentage of shares owned institutional investors, GOVT = percentage of shares owned by the government, FOR = percentage of shares owned by foreign investors, TQ = Tobin's Q, SIZE = log total assets, GROWTH = average growth of sales in the last three years, LEV = debt-to-equity ratio

Table 5: Regression Results using Weighted CGI Score as the Dependent Variables

$$WCGI_{it} = a_0 + a_1 FAM_{it} + a_2 GROUP_{it} + a_3 INST_{it} + a_4 GOVT_{it} + a_5 FOR_{it}$$
$$+ a_6 TQ_{it} + a_7 SIZE_{it} + a_8 GROWTH_{it} + a_9 OPINI_{it} + a_{10} LEV_{it} + e_{it}$$

Variable	Predicted Sign	WCGI	
N		204	
Intercept		**0.227**	***
		(0.002)	
FAM	?	**-0.059**	***
		(0.002)	
GROUP	?	-0.013	
		(0.227)	
INST	?	**-0.067**	**
		(0.013)	
GOVT	+	**0.117**	**
		(0.011)	
FOR	+	0.006	
		(0.780)	
TQ		**0.014**	*
		(0.080)	
SIZE		**0.017**	***
		(0.000)	
GROWTH		-0.009	
		(0.438)	
OPINI		-0.016	
		(0.270)	
LEV		-0.001	
		(0.233)	
R^2		0.395	
Adjusted R^2		0.363	
Prob (F-statistic)		0.000	

N = 204, *** the correlation is significant at 0.01 level, ** the correlation is significant at 0.05 level, * the correlation is significant at 0.1 level, WCGI = weighted corporate governance index score, FAM = percentage of shares owned by family, GROUP = Group member dummy variable (1 for firms that are a member of a business group or a conglomerate, 0 otherwise), INST = percentage of shares owned institutional investors, GOVT = percentage of shares owned by the government, FOR = percentage of shares owned by foreign investors, TQ = Tobin's Q, SIZE = log total assets, GROWTH = average growth of sales in the last three years, LEV = debt-to-equity ratio, LNAGE = natural logarithm of listing age, DYEAR = year dummy variable (1 for 2004, 0 for 2003)

Table 6: Regression Results using CGI and WCGI Scores as the Dependent Variables and PBV as the Proxy for Firm Value

$$CGI_{it} / WCGI_{it} = a_0 + a_1 FAM_{it} + a_2 GROUP_{it} + a_3 INST_{it} + a_4 GOVT_{it} + a_5 FOR_{it} + a_6 PBV_{it} + a_7 SIZE_{it} + a_8 GROWTH_{it} + a_9 OPINI_{it} + a_{10} LEV_{it} + e_{it}$$

Variable	Predicted Sign	CGI		WCGI	
N		204		204	
Intercept		**0.264**	*******	**0.229**	*******
		(0.000)		**(0.002)**	
FAM	?	**-0.058**	*******	**-0.060**	*******
		(0.002)		**(0.002)**	
GROUP	?	-0.011		-0.012	
		(0.275)		(0.238)	
INST	?	**-0.079**	*******	**-0.075**	*******
		(0.003)		**(0.005)**	
GOVT	+	**0.114**	******	**0.113**	******
		(0.011)		**(0.013)**	
FOR	+	0.008		0.006	
		(0.684)		(0.749)	
PBV		**0.007**	******	**0.006**	*****
		(0.033)		**(0.062)**	
SIZE		**0.017**	*******	**0.017**	*******
		(0.000)		**(0.000)**	
GROWTH		-0.012		-0.010	
		(0.309)		(0.387)	
OPINI		-0.020		-0.019	
		(0.164)		(0.194)	
LEV		**-0.002**	******	**-0.002**	******
		(0.017)		**(0.031)**	
R^2		0.397		0.396	
Adjusted R^2		0.365		0.365	
Prob (F-statistic)		0.000		0.000	

N = 204, *** the correlation is significant at 0.01 level, ** the correlation is significant at 0.05 level, * the correlation is significant at 0.1 level, CGI = un-weighted corporate governance index score, WCGI = weighted corporate governance index score, FAM = percentage of shares owned by family, GROUP = Group member dummy variable (1 for firms that are a member of a business group or a conglomerate, 0 otherwise), INST = percentage of shares owned institutional investors, GOVT = percentage of shares owned by the government, FOR = percentage of shares owned by foreign investors, PBV = price-to-book value ratio, SIZE = log total assets, GROWTH = average growth of sales in the last three years, LEV = debt-to-equity ratio

APPENDIX A

CORPORATE GOVERNANCE INDEX

	Rights of Shareholders
1	Assess the quality of the notice to call the annual general shareholders' meeting (RUPS) in the past one year. Does the notice include:
	a) Appointment of directors and commissioners
	b) Appointment of auditors
	c) Dividend payment
2	Is the decision on the remuneration of the board members (commissioners and directors) approved by the shareholders annually?
3	Is the remuneration of the board (commissioner and director) presented individually?
4	Do board members hold more than 25% of outstanding shares?
	Equitable Treatment of Shareholders
1	Have there been any cases of insider trading involving the company directors and commissioners in the past two years?
2	Does the company provide rationale/explanation for related-party transactions affecting the corporation?
3	Has there been any non-compliance case regarding related-party transaction in the past two years?
4	How many days in advance does the company send out the notice of general shareholders' meeting?
	Role of Stakeholders
1	Does the company explicitly mention the safety and welfare of its employees?
2	Does the company explicitly mention the role of key stakeholders such as customers or the community at large (or creditors or suppliers)
3	Does the company explicitly mention environmental issues in its public communication?
4	Does the company provide an ESOP (Employee Stock Option Plan) or other long-term employee incentive plan linked to shareholder value creation to employees?
	Disclosure and Transparency
1	Does the company have dispersed ownership structure?
2	Assess the quality of financial report in each of the following areas:
	a) Financial performance
	b) Business operations and competitive position
	d) Basis of board remuneration
	e) Operating risk
3	Is there any statement requesting the directors to report their transactions of company shares?
4	Does the company have an internal audit operation established as a separate unit in the company?
5	Are there any accounting qualifications in the audited financial statements apart from the qualification on uncertainty of situation?
6	Does the company offer multiple channels of access to information, include:
	a) Company website
	b) Analyst briefing
	c) Press conference/press briefing
7	Is the financial report disclosed in a timely manner?
8	Does the company have a website disclosing up-to-date information, include:
	a) Business operation
	b) Financial statement
	c) Press release
	d) Shareholding structure
	e) Organization structure
	f) Corporate group structure
	g) Downloadable annual report
	h) Downloadable interim report
	i) Available of both Indonesian and English
9	Does the company disclose fees paid to external auditors?
10	Does the company's Annual Report include a section devoted to the company's performance in implementing corporate governance principles?

11	If the complete list of BOC members is disclosed, is detailed information on each commissioner disclosed?
12	If the complete list of BOC members is disclosed, does it include details of previous employment?
13	If the complete list of BOC members is disclosed, are educational qualifications of commissioners disclosed?
14	If the complete list of BOC members is disclosed, are other commissionerships of commissioners disclosed?
	Responsibility of the Board
1	Does the company have its own written corporate governance rules that clearly describe its value system and board responsibility?
2	Does the board of commissioner provide code of ethics or statement of business conduct to all directors and employees to ensure that they aware of and understand the code?
3	Is there disclosure of company's guidelines of matters that require approval by the board of commissioner?
4	Does the annual report include report from board of commissioners?
5	Does the company have a corporate vision/mission?
6	Does the JSX/Bapepam have any evidence of non-compliance of the company with JSX/Bapepam rules and regulation over the last two years?
7	Have board members participated in corporate governance training?
8	Does the company report board meeting attendance of individual board of commissioner members?
9	How many times board of commissioner meet in the calendar year?
10	Does the company report board meeting attendance of individual board of director members?
11	How many times board of director meet in the calendar year?
12	Among board of commissioners, how many are independent commissioners?
13	Is the board of commissioner chairman an independent commissioner?
14	Does the company state in its annual report the definition of independence?
15	What is the size of board of commissioner?
16	Is individual performance of BOC members evaluated?
17	Is criteria for evaluating board of director performance disclosed?
18	Does the board appoint independent committees with independent members to carry out various critical responsibilities such as:
	a) Audit committee
	b) Compensation committee
	c) Director or nomination committee
19	Assess the audit committee based on following criteria:
	a) Audit committee size
	b) Independent members
	c) Financial/accounting background
	d) Chairman
20	Is disclosure made of the basis of selection of audit committee members?
21	Does the company disclose audit committee report in the annual report
22	Assess the quality of the audit committee report in the annual report, include the following items:
	a) Frequency of meetings
	b) Internal control
	c) Management control
	d) Proposed auditors
	e) Financial report review
	f) Legal compliance
	g) Scope, results, and effectiveness of audits
	h) Adequacy of internal audit function
	i) Conclusion or opinion
23	Is the complete list of audit committee members disclosed?
24	Does the corporate secretary attend all board of directors meetings?
25	Does the company provide contact details for a specific investor relation person?
26	Does/did the company have an option scheme for top management?