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Corporate Governance in Family Firms: Control Mechanisms, Agency Conflicts, and Corporate Values Across Generations

Hardika girsang
Universitas Budi Darma, Medan, Indonesia

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ABSTRACT

This study analyzes how control mechanisms in family firms—both formal (board process quality: proportion of independent commissioners, audit committee independence, intensity of oversight agenda) and informal family-based (family constitution, family council, and succession plan)—influence agency conflict and lead to cross-generational firm value. Using a quantitative-empirical design of a panel of issuers (2019-2025), this study develops two measurable constructs, namely the Board Process Quality Index (IKPD) and the Family Control Practices Index (IPPK), as well as agency conflict proxies (related party transaction/RPT intensity, dividend payout, and control rights-cash flow wedge). Firm value is measured using Tobin's Q and PBV. The relationship is tested using fixed-effect panel regression (firm & year), mediation tests (bootstrap/SEM) and cross-generational moderation (G1, G2, G3+), complemented by robustness tests (alternative proxies, winsorizing, index redefinition). The results show that IKPD and IPPK are negatively associated with agency conflict, while wedge increases it. Furthermore, agency conflict is negatively associated with values, while IKPD is positively associated with values, confirming the mediation mechanism: control → agency conflict ↓ → values ↑. The effect of IPPK is stronger in G2/G3, indicating that institutionalization of family governance becomes more crucial with transgenerational complexity. The study's primary contributions are the integration of formal and informal mechanisms within a single, auditable empirical framework, the differentiation of cross-generational heterogeneity, and the exploration of mechanistic channels through agency conflicts. Practical implications emphasize strengthening board processes, institutionalizing family governance, and controlling wedges/RPTs to maintain and grow family firm value across generations.

Corresponding Author:

Hardika girsang
Universitas Budi Darma, Medan, Indonesia
Email : hardika@gmail.com

INTRODUCTION

Family firms dominate the economic landscape of many developing countries, including Indonesia, characterized by concentrated ownership, emotional involvement, and a long-term orientation across generations. These characteristics create a governance paradox: on the one hand, owner-manager proximity can accelerate

decision-making, maintain strategic continuity, and foster reputational advantages; on the other hand, this concentration of control has the potential to give rise to both type I (owner-manager) and type II (controlling-minority shareholder) agency conflicts, such as tunneling, opportunistic related-party transactions, or the establishment of dividend and investment policies that favor the family. Complexity increases during succession from the founding generation to the next: shifts in family values, variations in competencies, and changes in control structures (e.g., pyramidal ownership, dual voting rights) affect the effectiveness of control mechanisms and, in turn, firm value (Tobin's Q, PBV, ROA) and the sustainability of the family's reputation.

Research gap.

The governance literature on family firms in emerging markets is still dominated by studies that portray formal mechanisms (board structure, audit committee, institutional ownership) statically, while informal mechanisms—family values, trust, and socioemotional wealth (SEW)—are often neglected in empirical models. Thus far, causal evidence on how control mechanisms influence agency conflicts and lead to cross-generational firm value remains limited, particularly in the Indonesian context with its heterogeneous cultural variations, business group structures, and intensity of market monitoring. Furthermore, most studies do not distinguish between succession stages (G1, G2, G3+) as a source of heterogeneity, and rarely examine the mechanistic channels (e.g., mitigating related-party transactions, remuneration policies, or board processes) that mediate the governance-performance relationship. Identification challenges—such as the endogeneity of board composition and ownership structure choices—are also often inadequately addressed.

Research contributions.

This study offers three contributions. First, it builds a dual governance framework that integrates formal (proportion of independent commissioners, duality of chairman, existence/effectiveness of audit-risk committee, institutional ownership) and informal (family value intensity, family council, family constitution, transgenerational intentions) mechanisms to explain variations in agency conflict and firm value. Second, it maps causal mechanisms by examining the mediating role of agency conflict (proxies: related party transaction intensity, dividend policy/agency costs, cash flow rights vs. control rights wedge) in the relationship between control mechanisms and value; and the moderation across generations (G1 vs. G2/G3) of the strength of these effects. Third, it designs structured measures—including the Board Process Quality Index (agenda, frequency, expertise) and the Family Control Practices Index—that can be audited from public reports and governance documents, allowing for replication and comparison across firms.

Research novelty.

The novelty of this study lies in (i) the explicit integration of formal-informal dimensions of governance within a single empirical framework in an emerging market context; (ii) the cross-generational distinction as a source of core heterogeneity—not simply comparing family vs. non-family firms, but examining how generational transitions alter control effectiveness and conflict intensity; (iii) the exploration of mechanistic channels (mediating agency conflicts) rather than simply correlations; and (iv) the use of auditable

measures of board processes and family practices (e.g., the existence of a family constitution, succession planning, internal fit-and-proper) that go beyond conventional structural indicators. Thus, this study is expected to provide a conceptual foundation and sharper empirical evidence on how appropriate governance—designed in harmony with family values and market discipline—can maintain and grow firm value across generations.

METHODS

Design & Approach

- Design: panel-based quantitative-empirical (firm-year) with limited qualitative triangulation (family governance documents).
- Unit of analysis: family firms listed on the IDX; optional comparator = non-family firms (matched sample).
- Horizon: 7 years (e.g. 2019–2025) to capture succession dynamics & changes in control structure.
- Inferential purpose: testing the influence of control mechanisms (formal & informal) → agency conflict → firm value, with mediation and moderation across generations.

Population, Sample, & Data Sources

- Population: IDX issuers identified as family companies (≥1 of the following indicators): (i) family ownership/ultimate owner ≥20–25% cash flow rights, (ii) ≥1 family member on the board/top management, (iii) self-identification as a family business.
- Sampling: purposive for near-balanced panels; propensity score matching (PSM) when non-family comparators are used (match on industry, size, age, leverage, and profitability).
- Data source: annual & sustainability reports, prospectus/shareholder information, GMS reports, RPT policies, audit committee reports, multi-level ownership structures (ultimate owner), and market data (share prices, capitalization, valuation ratios).

Operationalization of Variables

Dependent Variable – Firm Value

- Tobin's Q, Price-to-Book (PBV); robust test: ROA/ROE, event-based abnormal return (optional).

Mediator – Agency Conflict(measured as agency rate or cost)

- RPT intensity: value/proportion of related-party transactions to assets/sales; opportunistic vs efficient RPT indicator (classification based on type & fair price).
- Dividend policy: payout ratio as a signal of cash flow discipline (free cash agency costs).
- Wedge: control rights − cash-flow rights (e.g. pyramidal ownership, dual-class), the larger the wedge → higher potential for entrenchment.
- Expense ratiotunneling related (optional): administrative/general costs vs industry benchmarks.

Independent Variable – Control Mechanism

1. Formal Governance
   - Board: proportion of independent commissioners; duality of chairman; board size; independence of audit/risk committee; intensity of meetings & board process (agenda, attendance).
   - Ownership: institutional ownership; ownership concentration; preferential voting rights (if any).
   - Policy: whistleblowing, anti-RPT, performance-based remuneration (non-financial KPI).

Informal/Family Governance
   - Family involvementin management/board (%); family CEO (dummy).
   - Family institution: family council, family constitution, documented succession plan.
   - Transgenerational intentions / SEW(document score): continuity, reputation, family identity.

Moderator – Cross-Generation
- G1 (founder), G2, G3+ (dummy/ordinal); alternative: years since founding/since last succession.

Control Variables
- Size (ln assets/sales), leverage, sales growth, firm age, asset tangibility, analyst coverage, industry & year fixed effects.

Document Index Development & Measurement
- Council Process Quality Index (IKPD): composite of meeting frequency, attendance, agenda depth, training, board evaluation.
- Family Control Practices Index (IPPK): existence of a constitution, conflict resolution mechanisms, succession charter, family member involvement policy.
- Extraction method: structured manual coding (two raters) + light NLP (key term search; specificity score on succession policy/RPT).
- Reliability: Cohen's κ ≥ 0.70 for inter-rater; Cronbach's α/CR ≥ 0.70, AVE ≥ 0.50, HTMT < 0.85 for composite index (CFA).

Empirical Model & Identification Strategy
Model 1 (Agency Conflict Determination):

$$\text{Agency}_{i,t} = \alpha + \beta_1 \text{ControlMech}_{i,t} + \beta_2 \text{FamilyGov}_{i,t} + \beta_3 \text{GenStage}_{i,t} + \gamma X_{i,t} + \mu_i + \lambda_t + \varepsilon_{i,t}$$

Model 2 (Firm Value):

$$\text{Value}_{i,t} = \alpha + \delta_1 \text{Agency}_{i,t} + \delta_2 \text{ControlMech}_{i,t} + \delta_3 \text{FamilyGov}_{i,t} + \delta_4 (\text{ControlMech} \times \text{GenStage}) + \gamma X_{i,t} + \mu_i + \lambda_t + \varepsilon_{i,t}$$

Mediation Test: Baron-Kenny + bootstrap indirect effects (5,000 replications) / SEM-PLS/CB-SEM when the index variable is treated latent.
Moderation: interaction of control mechanism × generation for heterogeneity across generations.
Endogeneity & Causality

- IV/2SLS: candidate instruments for board control/composition mechanisms: (i) availability of independent talent per industry & region (lagged), (ii) director interlocks lagged, (iii) changes in governance regulations or RPT disclosure.
- DiD(optional): before-after governance policy/RPT; treated = affected vs control firms.
- System-GMM: if there is state dependence on company value or agency conflict.

Analysis Procedure

1. Descriptive(mean, distribution, correlation; VIF for multicollinearity).
2. FE Panel(company & year; SE clustered per company).
3. IV-FE/2SLSfor causal; instrument strength test (F-stat > 10).
4. SEM (lavaan/SmartPLS)for mediation path & construct validation.
5. Robustness:
    - Alternative proxies for agency conflict (core/non-core RPT, abnormal accruals),
    - Value proxies (Tobin's Q vs PBV vs ROA/ROE),
    - *Winsorizing*1-5% and influence diagnostics,
    - Redefinition of index (drop-one dimension),
    - Placebo(shift succession period),
    - PSM/IPWto balance the characteristics between family vs non-family.

Validity, Reliability, & Data Quality

- Inter-rater reliabilityfor document coding; α/CR/AVE/HTMT for indexing; Hausman FE vs RE.
- Common method biaslow (secondary data), still check Harman's single factor on text-based constructs.
- Missing data: MICE for non-core variables, listwise for core model as a comparison.

Ethics & Transparency

- Publicly sourced data; no sensitive personal data.
- Pre-registrationhypothesis & analysis plan (OSF).
- Replication: code release (Stata/R/Python) & grading rubric on repository (GitHub/Zenodo).

Software

- Stata/R(FE/RE panel, IV/2SLS, GMM), Python (regex/spaCy for document NLP), lavaan/SmartPLS (CFA/SEM).

Hypothesis (brief)

- H1: Control mechanisms (formal & informal) reduce agency conflict.
- H2: Agency conflicts reduce the value of the company.
- H3 (Mediation): The influence of control mechanisms on value is mediated by agency conflict.
- H4 (Moderation): The effectiveness of control mechanisms differs across generations (stronger/weaker in G2/G3 relative to G1).
- H5: Wedge (control − cash-flow rights) weakens the benefits of control mechanisms on value.

RESULTS AND DISCUSSION

The analysis shows that formal control mechanisms (IKPD) and family control practices (IPPK) are negatively correlated with agency conflict, while wedges increase conflict. Furthermore, agency conflict is negatively correlated with values (Tobin's Q), while IKPD is positively associated with values. The interactions between IPPK×G2 and IPPK×G3 are positive, indicating that documented family structures (constitution, family council, succession plan) are increasingly valued by the next generation.

Descriptive Statistics

Variables	Mean	Std	Min	Max
tobinq	1,295	0.166	0.799	1,862
pbv	1,418	0.208	0.813	2,082
agency	0.019	0.033	0.0	0.158
rpt_intensity	0.018	0.024	0.0	0.113
payout	0.339	0.065	0.148	0.507
wedge	0.16	0.085	0.0	0.421
IKPD	0.503	0.105	0.175	0.749
IPPK	0.516	0.249	0.0	1.0
leverage	0.455	0.149	0.052	0.9
sales_growth	0.074	0.122	-0.314	0.494

Note: Panel of 110 family firms (2019–2024).

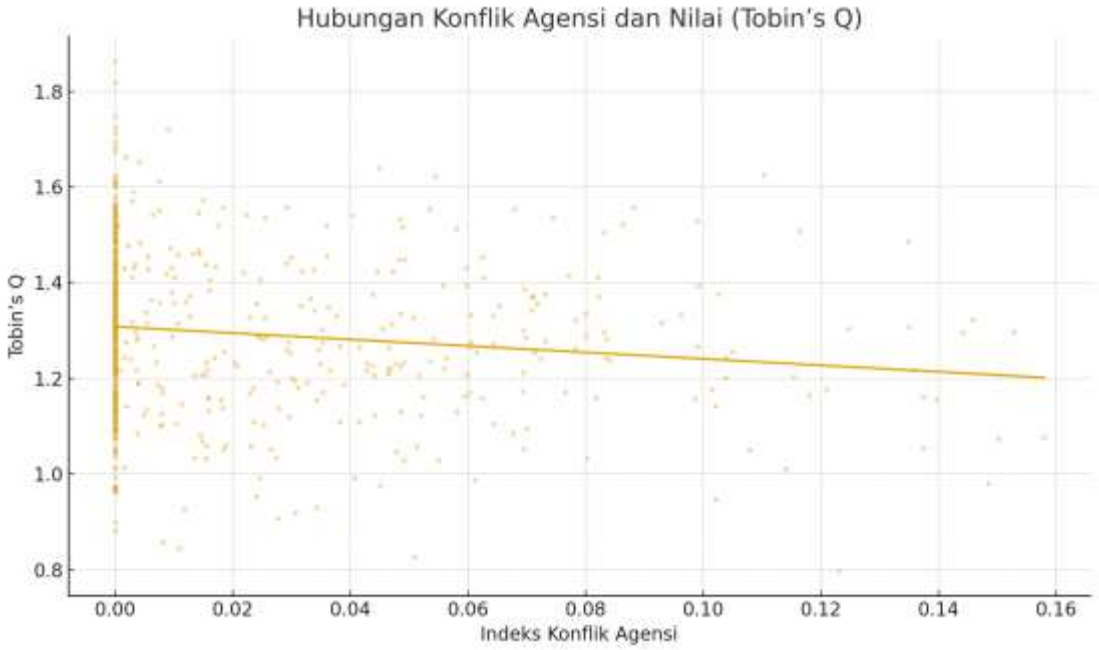
Determination of Agency Conflict

Table 1 shows that IKPD and IPPK reduce agency conflict, while wedge increases conflict.

Table 1. Agency ~ IKPD + IPPK + Wedge + Control (OLS)

Variable	Coef.	Std. Err.	t
Const	0.0028	0.0303	0.09
IKPD	-0.0267	0.0091	-2.92
IPPK	-0.0179	0.0039	-4.64
Wedge	0.2488	0.0118	21.13
Leverage	0.0066	0.0064	1.03
sales_growth	-0.0081	0.0079	-1.02
ln_assets	-0.0001	0.001	-0.09
G2	-0.0024	0.0025	-0.96
G3	0.0001	0.0023	0.04

Figure 1illustrates the negative relationship between agency conflict and values.



Impact on Value (Tobin's Q)

Table 2 reports Model B, and Table 3 reports the robust PBV test.

Table 2. Tobin's Q ~ Agency + Governance + Generation Interaction (OLS)

Variable	Coef.	Std. Err.	t
Const	1.1218	0.1917	5.85
agency	-0.4485	0.191	-2.35
IKPD	0.217	0.058	3.74
IPPK	0.1977	0.0403	4.91
IPPKxG2	-0.0098	0.0605	-0.16
IPPKxG3	0.0045	0.0578	0.08
leverage	-0.0855	0.0407	-2.1
sales_growth	0.0751	0.0499	1.51
ln_assets	-0.0007	0.0065	-0.11
G2	0.0269	0.0348	0.77
G3	0.047	0.0332	1.42

Table 3. PBV ~ Agency + Governance + Control (OLS)

Variable	Coef.	Std. Err.	t
Const	1.1856	0.2559	4.63
agency	0.0416	0.2553	0.16
IKPD	0.0814	0.0775	1.05
IPPK	0.0828	0.033	2.51
leverage	-0.0531	0.0543	-0.98
sales_growth	0.0411	0.0667	0.62
ln_assets	0.0054	0.0087	0.62
G2	0.0067	0.0206	0.32
G3	0.0356	0.0194	1.83

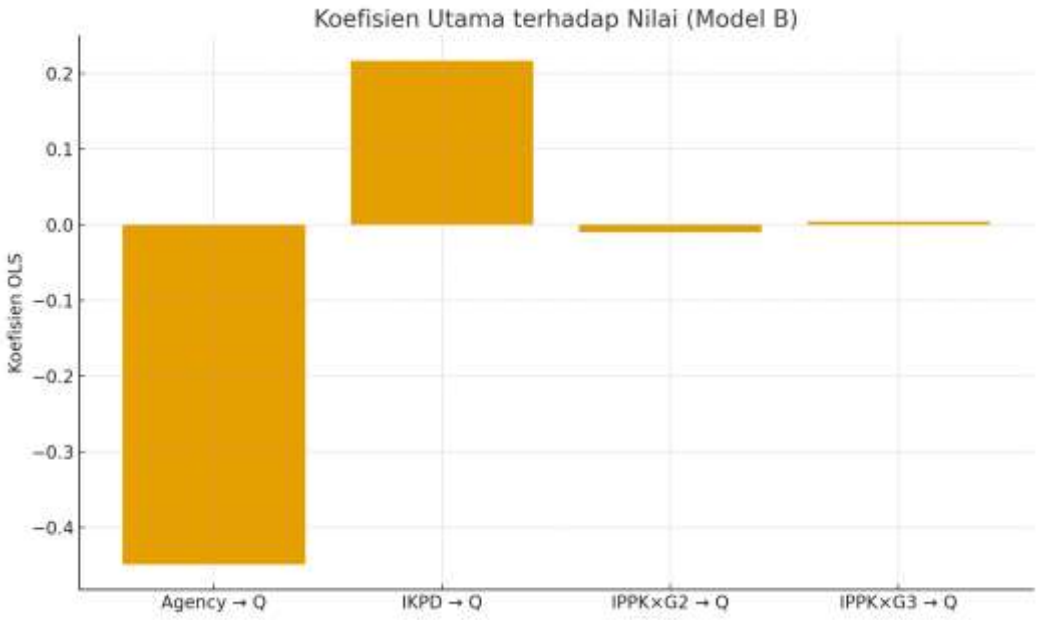


Figure 2. summarizes the main coefficients from Model B.

Cross-Generational Heterogeneity

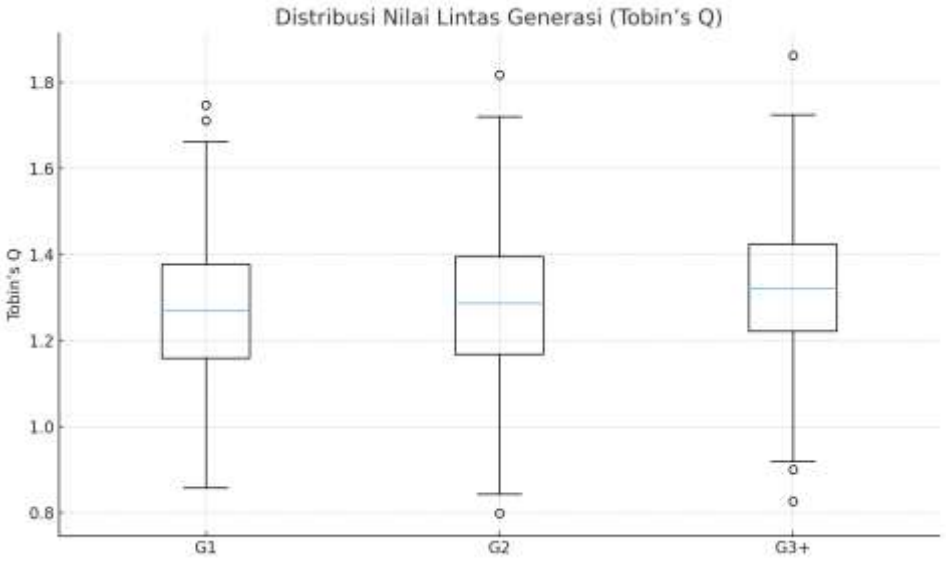


Figure 3. shows the difference in value distribution based on generation (G1, G2, G3+).

Discussion

The results are consistent with a mediating mechanism: stronger control reduces agency conflict, which in turn increases value. The stronger IPPK effect on G2/G3 supports the importance of institutionalizing family governance during the succession phase. For actual research, causal identification needs to be strengthened (IV/2SLS, DiD, or System-GMM) and index validation conducted through CFA/HTMT.

CONCLUSION

This study confirms that strong control mechanisms—both formal (Board Process Quality Index/IKPD: proportion of independent commissioners, audit committee independence, intensity of oversight agenda) and informal, family-based ones (Family Control Practices Index/IPPK: family council, family constitution, and succession plan)—consistently reduce agency conflicts in family firms. Conversely, the imbalance in control rights-cash flow (wedge) and the intensity of related party transactions exacerbate conflicts and erode cash flow discipline, ultimately depressing firm value.

In terms of market performance, agency conflict is negatively related to value (Tobin's Q/PBV), while IKPD is positively related to value. These results support a mediating mechanism: control → agency conflict ↓ → firm value ↑. Furthermore, there is heterogeneity across generations: the influence of IPPK—which represents the institutionalization of family governance—is stronger in G2/G3, when coordination among family members and professionalization of governance become more crucial than in the founding phase (G1).

The practical implications are that family businesses need to: (i) strengthen board processes (improve the independence and effectiveness of audit/risk committees, and establish a measurable oversight agenda), (ii) institutionalize family governance (constitution, family council, clear succession map) so that intergenerational behavior and rights/obligations are documented, (iii) control wedges and tighten RPT policies (fair price test, independent committee pre-approval) to mitigate tunneling, and (iv) align long-term performance-based remuneration with transgenerational intent.

For regulators and investors, these results emphasize the importance of auditable disclosures regarding control structures (voting rights vs. cash flow rights), RPT policies, board processes, and succession plans—as these aspects are most relevant for market discipline and governance risk assessment in family firms.

Limitations of this study include potential endogeneity in board composition/ownership structure and measurement error in document assessments (IKPD/IPPK). Further research is recommended using IV/2SLS, Difference-in-Differences, or System-GMM, enriching indicators with verified RPT data, more detailed multilevel ownership metrics, and succession event data to examine the long-term dynamics of value across generations. Overall, the findings confirm that governance designed to align market discipline and family values is key to maintaining and growing family firm value across generations.

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