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FAMILY IN THE BUSINESS AND THE COST OF DEBT: EVIDENCE FROM FAMILY FIRM IN INDONESIA

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Abstract

The issue of efficiency in choosing funding sources has become a concern for researchers, especially during the Covid 19 pandemic. Our research seeks to investigate whether family involvement and ownership can contribute to funding efficiency, especially from debt. Then we extended the test to see if earnings management behavior could affect family involvement and ownership. For this purpose, we collect family companies that are listed on the Indonesia Stock Exchange for the period 2005 to 2020. The method we use is panel data regression analysis. The results of the study prove that family involvement in management and share ownership is able to contribute to reducing the cost of debt during the covid 19 pandemic. The results also provide empirical evidence that earnings management carried out through abnormal cash flows does not affect family involvement and ownership in contributing to lowering the cost of debt. This research is expected to provide implications for family companies, especially in determining funding decisions from debt schemes.

Keywords: *Family company; Family involvement; Cost of debt; Panel data.*

Abstrak

Isu efisiensi dalam memilih pendanaan menjadi perhatian para peneliti, terlebih selama pandemic covid 19. Penelitian kami berupaya menginvestigasi apakah keterlibatan keluarga dalam bentuk kepemilikan berkontribusi terhadap struktur pendanaan perusahaan keluarga dan meningkatkan efisieni dalam pendanaan. Kemudian kami juga memperluas pengujian untuk melihat bagaimana aktivitas manajemen laba mempengaruhi keterlibatan keluarga tersebut. Kami mengumpulkan perusahaan keluarga yang terdaftar di Bursa Efek Indonesia selama periode 2005-2020. Kemudian kami menganalisis data dengan menggunakan regresi data panel. Hasil penelitian memberikan bukti empiris yang cukup kuat bahwa keterlibatan keluarga dan kepemilikan keluarga dalam manajemen mapu menurunkan dan memberikan efisiensi dalam pendanaan dari skema utang selama pandemic covid 19. Hasil penelitian kami juga memberikan bukti empiris bahwa manajemen laba yang dilakukan melalui arus kas abnormal tidak mempengaruhi keterlibatan dan kepemilikan keluarga dalam berkontribusi menurunkan biaya utang. Penelitian ini diharapkan memberikan implikasi yang cukup luas bagi perusahaan keluarga terutam adlaam menentukan keputusan pendanaan dari skema utang.

Kata Kunci: Biaya utang; Data panel; Keterlibatan keluarga; Perusahaan keluarga.

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INTRODUCTION

The issue of efficiency in the selection of funding sources has become a concern for researchers, especially during the Covid 19 pandemic (Wang et al., 2023). It is interesting to examine how funding decisions are made by family companies. Family companies are companies with the characteristics of family involvement in management, majority share ownership by families and family succession. Our study aims to investigate whether family involvement and ownership can reduce the cost of debt during the COVID-19 pandemic. For this purpose, we collect family companies listed on the Indonesia Stock Exchange for the period 2005 to 2020.

This study was motivated by the high cost of debt of family companies listed on the Indonesian Stock Exchange. Indonesia Stock Exchange, especially at the end of 2019. Some family companies have debt costs ranging from 8-10%. This figure is far from the average cost of family company debt in other Asean countries of 7%. In addition, our research is also motivated by the inconsistent results of previous studies. For example, research conducted by Li *et al.* (2021) in the context of companies in the United States. The results of his research prove that there is a positive influence between family ownership and the cost of debt. His research provides empirical evidence that the absence of an internal audit mechanism in family firms contributes to the increasing cost of debt.

Another study conducted by Gao *et al.* (2020) in the context of China companies. The results of his research found that family control leads to a higher bond yield-spread in China. In contrast to these studies, the research conducted by Santos *et al.* (2014) in the context of companies in Europe found that family firms affect the level of leverage. According to him, this influence depends on the legal framework and institutional environment. Further research was conducted by Duréndez *et al.* (2019). The results of his research found that implementing succession in family businesses reduces information asymmetry and agency conflicts between families. This provides a positive signal for analysis in assessing the business risks of family companies, especially providing credit. Then research was carried out by Swanpitak *et al.* (2020) in the context of companies in Thailand. The results of his research found that family firms benefit from the strong and trustworthy relationships they established with creditors. This indicates low information asymmetry and has an impact on the low interest rate required in the contractual agreementwhich help to alleviate information asymmetry in Thailand's weak institutional environment.

We seek to fill this research gap by providing empirical evidence from the capital market in Indonesia. Provide an overview of family involvement and ownership in managing funding sources in the form of debt schemes. Previous studies have mostly explored family firms in developed countries. We try to provide empirical evidence in the context of developing countries like Indonesia. Developing countries have different investment characteristics and environments from developed countries. Then we traced family involvement not only from consanguineous relationships, but we also expanded to marital relationships. This work, based on the author's knowledge, has not been found in previous studies.

Financing decisions in the form of debt are very important to be studied. Callen & Chy (2023) argue that the high cost of debt will reduce investment opportunities that will be decided by investors. Investment is certainly very important for entities in developing their business. In other words, the high cost of debt incurred by an entity in obtaining its financing reflects the difficulty of obtaining potential investment opportunities. Then, Cheng *et al* (2014) argues that the level of the cost of debt is important information for managers in determining financial policies and protecting access to finance.

This research is expected to fill the debate among academics through the literature review that we present, then provide an overview of important aspects of debt financing and become important information for family companies listed on the stock exchange related to governance that has been carried out as well as providing empirical evidence of the results of the study. This research is expected to provide positive implications both managerially and theoretically. From a managerial perspective, this research provides important implications for entities or companies to maintain good governance. Carrying out monitoring mechanisms, especially strategic decisions in debt funding. Then from a theoretical perspective, this research provides supporting implications for agency theory and socioemotional wealth. Both theories are suitable and work well in developing countries like Indonesia.

We organize this research into four parts. First, the introduction contains a description of the objectives and motivations of the research, the importance of the research being conducted, the research gap and the research variables used. Second, literature review and hypothesis development which contains a review of research problems seen from accounting theory and previous studies that are relevant in developing hypotheses. Third, the research method which contains a description of research observations, models and techniques for analyzing data. Fourth, the results of research and discussion. The five conclusions and recommendations for future research

LITERATURE REVIEW

This research can be studied through agency theory. Agency theory is a theory popularized by Jensen & Meckling (1976). This theory assumes that agency costs will arise when there is information asymmetry. Agency costs in family firms can arise as a result of information asymmetry between majority and minority shareholders and between principals and agents. The majority shareholder is usually owned by the nuclear family of the company. Conflict occurs when the majority shareholder makes funding decisions that can harm the minority group. Conflicts in family firms can also occur between principals and agents. This conflict usually occurs when managers are appointed from external parties, and managers behave opportunistically so that they are self-interested and potentially inconsistent with the interests of the principal. This condition drives high agency costs.

Family involvement and cost of debt

Agency theory emphasizes that increasing share ownership, especially by internal ownership, will be able to align the interests of owners and managers (internal owners). Based on this theory, the selection of a financing scheme is one of the efforts in order to maintain the company's performance (Ghardallou, 2022). Referring to the agency theory, the concentration of family ownership is an effort to harmonize interests and maintain the

sustainability of family companies from generation to generation. Then, in line with the socioemotional wealth theory popularized by Berrone *et al.* (2012), the family will maintain its social and emotional wealth through family involvement in the company and maintain the continuity of the company through family succession.
In line with these two theories previous research provides empirical evidence that family control affects the cost of debt. For example, research conducted by Santos et al. (2014) in the context of companies in Europe. Likewise with the research conducted by Duréndez et al. (2019); Swanpitak et al. (2020). The results of his research came to the conclusion that to overcome agency problems, family companies tend to avoid debt. The family is present to provide an effective control mechanism, so that crucial funding decisions will be made based on careful consideration. Socioemotionally, their sense of ownership and interest in the continuity of the company they founded or their parents founded is greater than that of outsiders. As a reflection of this caution, they will choose funding that has low risk, which is reflected in the cost of debt. Based on this description, the authors formulate the first hypothesis as follows:
H_1: The presence of family members in key management can reduce the cost of debt.
H_2: Ownership of family shares can reduce the cost of debt.

Debt contracts are one of the financing contracts that are of concern to management (Hillier et al., 2018). Management will use earnings management practices to ensure a good picture of the company's performance. However, earnings management actions taken by management are able to affect the reliability of the accounting information produced. Empirical evidence provides confidence that earnings management practices can reduce earnings relevance. This is consistent with research conducted by Brahmono & Purwaningsih (2022). The results of his research prove that earnings management in Indonesia is opportunistic earnings management. Opportunistic earnings management behavior is behavior carried out by managers to benefit themselves. Managers carry out earnings management to fulfill their interests in various forms. For example, to maximize bonuses. The manager's behavior is in accordance with agency theory. Agency theory argues that in order to fulfill this satisfaction, managers encourage managers to carry out earnings management practices (Tabassum et al., 2015). Furthermore, the results of research conducted by Rudiawarni et al. (2017) found that earnings management will affect stock returns only when accruals are higher than operating cash flows. This proves that there is a close relationship between earnings management behavior and company performance and value. This means that the control mechanism through the presence of the family is not enough to minimize debt costs, if managers from both the family and outside parties carry out earnings management practices. The authors suspect that earnings management plays a role in weakening the influence of family involvement on the cost of debt.
H_3: Real earnings management weakens the effect of family involvement on the cost of debt.

RESEARCH METHOD

The research sample was taken purposively consisting of family companies listed on the Indonesia Stock Exchange, submitting complete financial reports in rupiah for 16 years from 2005 to 2020. The selection period was 16 years to provide a comprehensive depth of analysis and discussion. The total observations that we managed to collect were 2,716 observations from 190 companies. Table 2 represents the distribution of the research sample by industry.

Table 1. Sample Distribution

No	Industry	Number of Companies	Number of Observations	Percentage of Observations
1	Infrastructure	13	163	6%
2	Consumption	21	317	11%
3	Manufacture	19	295	11%
4	Trading	60	834	30%
5	Mining	4	60	2%
6	Agriculture, Plantation, Forestry	12	169	6%
7	Property	29	418	15%
8	other	31	486	18%
	Total	190	2.716	

Source: Idx (2022).

Based on table 2, our observations mostly involve companies engaged in the trading industry or about 30% of the observations. The trading industry is an industry that dominates family companies in Indonesia. The trading industry has ease in terms of establishment and the nature of the industry that is not directly related to the environment. At least the observations in this study involved family companies in the mining industry or as much as 2% of the total observations. This industry is the least sought after by family companies in Indonesia due to the complexity of requirements and its direct relationship with the environment.

Research Model

This research model consists of two models. The first model is to explain the relationship between family involvement, family ownership and the cost of debt. The second model to describe the opportunistic behavior of managers in influencing the cost of debt is to add real earnings management variables.

Model 1 :

$$COD_{it} = \beta_0 + \beta_1 FamInvol_{it} + \beta_2 Famowner_{it} + \beta_3 CFPerf_{it} + \beta_4 Tangi_{it} + \beta_5 Firmage_{it} + \varepsilon_{it} \tag{1}$$

Model 2 :

$$COD_{it} = \beta_0 + \beta_1 FamInvol_{it} + \beta_2 Famowner_{it} + \beta_3 REM_{it} + \beta_4 FamImvol * REM_{it} + \beta_5 Famowner * REM_{it} + \beta_6 CFPerf_{it} + \beta_7 Tangi_{it} + \beta_8 Firmage_{it} + \varepsilon_{it} \tag{2}$$

Where COD_{it} is the cost of debt of company i in year t, $FamInvol_{it}$ is the involvement of the family in the directors and commissioners of company i in year t. $Famowner_{it}$ is family ownership in the form of shares. REM_{it} is real earnings management which is measured using sales manipulation through abnormal cash flow. $Control_{it}$ is the control variable that we use. This variable consists of company age, cash flow performance and asset tangibility.

Variable Measurement

Cost of Debt

Cost of debt (Cost) refers to the borrowing cost for a business, which is the interest rate paid by a business for the most recently approved loans. The cost of debt is measured by comparing interest costs in period t+1 with the average total debt in periods t to t+1. This measurement has been used by previous researchers. For example, research conducted by Li Xi (2015); Muttakin *et al.* (2020); Shailer & Wang (2015); Vander Bauwhede *et al.* (2015); Palea & Drogo (2020). The formula for finding the cost of debt is as follows:

$$COD_{it+1} = \frac{Interest\ expense_{it+1}}{(Total\ Debt_{it} + Total\ Debt_{it+1})/2} \tag{3}$$

Family Involvment

Our family involvement measures through two proxies. First, the percentage of family members who sit in key management, namely directors and commissioners. Second, family share ownership in the company. Family share ownership can be in the form of share ownership of nuclear family members or companies other than state and foreign companies.

Real Earnings Management

Real earnings management was developed by Roychowdhury (2006). Referring to this model, the measurement of real earnings management can be done through three methods. The first is sales manipulation through abnormal CFO (AbCFO) proxies. Second, the reduction of discretionary costs through abnormal discretionary costs (AbDiscExp). The third is excessive production as measured by abnormal production costs (AbProdcost). The level of real earnings management is determined by the residual value of the three methods. This study uses sales manipulation through abnormal cash flow from operating activities (AbCFO) as a proxy for earnings management measurement. The formula for finding AbCFO is as follows:

$$\frac{CFO_{it}}{A_{it-1}} = \alpha_1 \frac{1}{A_{it-1}} + \alpha_2 \frac{Sales_{it}}{A_{it-1}} + \alpha_3 \frac{\Delta Sales_{it}}{A_{it-1}} + \varepsilon_{it} \tag{4}$$

CFO_{it} is the operating cash flow of company i in year t and Ai_{t-1} is the total assets of company i in year t – 1. ΔSalesit is the change in company sales between years t and $_{t-1.}$

Control Variable

Control variables are used to determine the effect of other variables outside the main variables that affect endogenous variables. The control variables that we involve in this study consist of firm age, cash flow performance and asset tangibility. We measure the age of the company from the time the company operates commercially until the end of the observation year, namely 2020. Doucouré & Diagne (2020) argue that the age of the company reflects the company's reputation with creditors and performance. Correspondingly, Pratama *et al.* (2024) argue that company age plays an important role in encouraging financial report disclosure. This provides a positive signal for investors in assessing company risk, especially in funding decisions. Then, asset tangibility is measured by comparing net assets with total assets and the authors measure cash flow performance by comparing cash flows from operating activities with total assets.

RESULT AND DISCUSSION

The first step we took was to download the financial statements of family companies listed on the Indonesia Stock Exchange. Then we manually input financial data according to the research variables needed. Specifically to determine the involvement in the composition of the commissioners and directors, we conducted a search from the names of the clans or families who occupy key management positions in the company to the children, sons-in-law and grandchildren of the founders of the company. After all the data is ready, then we process it through the eviews program.

The first test we did was a univariate test to analyze the data descriptively through the mean, maximum value, minimum value and standard deviation. This test is useful for providing a more comprehensive picture of the data. In addition, we also complete the univariate test through testing the correlation between variables or the correlation matrix. This test is useful to see whether there is a perfect correlation between variables. Table 2 represents descriptive and correlational tests.

Table 2. Descriptive Statistics

Panel A: Descriptive statistics

	COD	FamInvol	FamOwn	AbCFO	CFPerf	TANGIB	Firm Age
Mean	0.0539	0.2383	0.4129	0.0032	0.0569	0.5191	30.2964
Standard Error	0.0033	0.0040	0.0053	0.0015	0.0020	0.0043	0.2543
Median	0.0389	0.2000	0.4307	0.0002)	0.0426	0.5111	30.0000
Std. Dev	0.1725	0.2071	0.2744	0.0773	0.1064	0.2260	13.2519
Minimum	0.000	0.000	0.000	(2.4794)	(0.6315)	0.0514	2.0000
Maximum	0.319	0.7200	0.9900	0.8322	0.98	0.9808	105.000
Obs	2,716	2,716	2,716	2,716	2,716	2,716	2,716

Panel B: Correlation Matrix

	COD	FamInvol	FamOwn	AbCFO	CFPerf	Tangib	Firm Age
COD	1.0000						
FamInvol	-0.0258	1.00					
FamOwn	0.0259	0.12	1.00				
AbCFO	-0.0514	0.01	0.07	1.00			
CFPerf	-0.0207	-0.01	0.14	0.58	1.00		
Tangib	0.0085	-0.03	-0.13	-0.03	-0.03	1.0000	
Firm Age	-0.0353	-0.00	0.12	0.00	0.05	-0.16	1.0000

Source: Processed Data, 2022.

Based on the table, it is known that the average cost of debt is 6% and the highest is 30%. This means that the cost of debt in family companies in Indonesia is still relatively high. The average family involvement is 23%, with a maximum value of 72%. This means that on average the composition of the board of directors and commissioners involves the nuclear family in it, either the children or the son-in-law of the founders of the family. The rest involve professionals from outside the family. The average family ownership in the form of shares is 41% and the highest is 99%. In this case, family members are the controllers and have significant influence in the company. The average cash flow performance is 5%, the highest is 98%, and the lowest is 63%. In general, the cash flow performance of family companies is still relatively low. The average age of the company has reached 30 years, the highest is 105 years, namely Sampoerna company and the lowest is only 2 years. In terms of company age, on average it is a mature and long-established family company.

Based on the correlation matrix table, there was also no high correlation between variables. Each variable shows a correlational relationship that is free from the problem of multicollinearity. The highest correlation lies between family ownership variables of 2% and the lowest is the control variable of ownership assets of 0.8%.

The next step is choosing the right model from the panel data. Our tests were carried out through three test instruments, namely the Chow, Hausman, and LM tests. Based on the results of our tests, the right model to analyze this panel data is the fixed effect model. Here we present it in the table below.

Table 3. Hypothesis Testing

	Model 1	**Model 2**
Independent Variable : Cost of Debt		
Intercept	0.064 (0.000***)	0.063 (0.000***)
FamInvol	-0.024 (0.1000*)	-0.024 (0.1000*)
FamOwn	0.024 (0.0519*)	0.023 (0.055*)
AbCFO	-0.07 (0.016**)	-0.05 (0.259)
FamInvol*AbCFO		-0.04 (0.74)
FamOwn * AbCFO		-0.03 (0.65)
AbProdcost	-0.002 (0.50)	
CFPerf	-0.040 (0.2080)	0.01 0.66
Tangib	0.003 (0.8291)	0.002 (0.87)
Firm Age	0.0005 (0.0525*)	-0.005 (0.04**)
Obs	2.716	2.716
F Statistic	2.4	2.09
F Sig	0.01**	0.03**

Source: Data processed, 2022, *** significant at 1% level, ** significant at 5% level, *significant at 10% level.

Based on the table, we obtain information that the variable of family involvement in the company's business has an effect on reducing the company's cost of debt. Significance shows the numbers 10% and 5%. Family involvement in the composition of directors and commissioners as well as in the form of share ownership has proven to have an effect in reducing the cost of debt. Our research also confirms our proposed theory, namely agency theory in which monitoring carried out by family members is an effective mechanism in making funding decisions. The management carried out by the family can maximize the return of funds, thereby giving confidence to investors to invest. From the point of view of the socio emotionalwealth theory developed by Berrone *et al.* (2012), the results of our study are also in line. According to this theory, a family company will maintain the good name of the family and continue to control the family for generations. For example, Bakri company. Until now, the company is still owned by the children of the Bakri family. The presence of family members is not only an effort to harmonize various interests, but also as part of the goal of socio emotional wealth itself, which is to pass on the business to the next generation. Our results also confirm the previous study conducted by Santos *et al.* (2014); Duréndez *et al.* (2019); Swanpitak *et al.* (2020). Thus, the hypothesis that we put forward both the first and second hypotheses can be accepted.

Then the researcher developed this research design to see the extent to which earnings management behavior can help information in the capital market and create a low cost of debt, regardless of whether the information creates bias for investors. The results of the study provide empirical evidence that earnings management behavior through sales manipulation does not have a significant effect on family involvement and the cost of debt. This means that the alleged earnings management behavior carried out by family members causing high debt costs in this study is not proven. As an effort to maintain sustainability, family companies still place family members in the composition of directors and commissioners and choose a funding scheme in the form of debt. These results are also in line with research conducted by Brahmono & Purwaningsih (2022) Our research also strengthens that earnings management in Indonesia is opportunistic earnings management.

Additional Test

Additional testing was conducted to see how far the exogenous variables affect the endogenous variables under different conditions. We modify the test on the condition of family companies that have above average total assets and age. This test is carried out based on the assumption that family companies that have large assets and are of mature age, usually have their business management given to professionals so that the involvement of family members is minimal. The following table represents additional tests.

Based on table 4, in companies with below average asset levels, the significance values of family involvement in the form of share ownership and earnings management are 0.006 and 0.041, significant at the 1% and 5% levels. While other variables have no effect. In companies with asset levels above the average value of earnings management significance of 0.0018 is significant at the 1% level. Other variables have no effect. Thus, both in small companies and large companies, earnings management has a significant effect on the company's cost of debt. Furthermore, only share ownership for small companies has an effect on the cost of debt.

Table 4. Additional Test Based on Company Size

	Below Average Total Asset	*Above Average Total Assets*
	Independent Variable : Cost of Debt	
Intercept	0.039 (0.000)***	0.0888 (0.002)***
FamInvol	0.00398 (0.4088)	-0.0364 (0.4284)
FamOwn	0.009 (0.006)***	0.0321 (0.180)
AbCFO	-0.012 (0.041)**	-0.2974 (0.0018)***
CFPerf	-0.0008 (0.4242)	0.1581 (0.1473)
Tangib	0.0179 (0.000)***	-0.0298 (0.3479)
Firm Age	-0.0035 (0.000)***	0.00079 (0.064)*
Adjs R	0.0371	0.008
Obs	1.350	1.366
F Statistic	9.6	2.97
F Sig	0.0000***	0.006***

Source: Data processed, 2022, *** significant at 1% level, ** significant at 5% level, *significant at 10% level.

Table 5 is an additional test based on the age of the company. Based on table 5, we can conclude that sales manipulation both in newly established companies and in companies that have long been established has a significant effect at the level of 10%. This means that earnings management practices occur in almost all age levels of the company. In addition, family involvement in long-standing companies has a significant effect at the 10% level.

CONCLUSION

As we stated at the beginning of the meeting, the issue of investment efficiency in the capital market is an interesting area of attention, especially for family companies. This study aims to investigate whether family involvement can reduce the cost of debt during the COVID-19 pandemic. For this purpose, we collected family companies that were listed on the Indonesia Stock Exchange for the period 2005 to 2020. We collected 2,716 observations from various industries.

The results of the study provide strong empirical evidence that the presence of family members in the composition of commissioners and directors as well as share ownership is a strong signal in reducing the cost of debt. In an effort to maintain control of the family company from other parties, family companies can choose a funding scheme in the form of debt or debt. The results of this study confirm the theory we propose, namely agency theory where monitoring carried out by family members is an effective mechanism in making funding decisions. Investors who provide funds or debtholders believe that the management carried out by the family can maximize the return of funds, so that investors have high confidence in the family company. This research has provided quite broad managerial and theoretical implications. From a managerial perspective, this research provides important implications for entities or companies to maintain good governance. Carrying out monitoring mechanisms, especially strategic decisions in debt funding. Then from a theoretical perspective, this research provides supporting implications for agency theory and socioemotional wealth. Both theories are suitable and work well in developing countries like Indonesia.

This research still has limitations. One of them is the use of family involvement variables. Only two indicators of family companies that we use in this study are family involvement in the board of directors and commissioners and share ownership. Future research can use other indicators to measure the involvement of family members in the company. Furthermore, the limitation of this study is the observation that only involves family companies. Future research can compare research on family and non-family companies.

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