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Governance of Family Dynasties in Financial Institutions and Public Listed Companies

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ABSTRACT
The regeneration of a family firm is an exciting thing to discuss. The transition from one generation to the next is a topic of concern. Moreover, the family firms are a group of companies or conglomerate. Conglomeration influences the economy of a country. Good corporate governance has also become an issue that has attracted the attention of businesses in various countries. Good governance will have implications for the sustainability of firms in the long term. Family dynasties influence corporate governance. The Indonesian Financial Services Authority (/OJK) has established the Indonesian Financial Services Authority Regulation (POJK) on good governance for listed companies and financial institutions. However, POJK are still limited to general governance. Governance regarding the influence of family dynasties is still not regulated in the POJK. This research uses a normative judicial method. This research aims to discover how to control family dynasties in the corporate governance of financial institutions and public listed companies in Indonesia. This research concludes that the regulator needs to determine the parties that have a relationship in running a public firm or a financial services firm.

Keywords: *banking, corporate governance, financial services, independent, public firm*

1. INTRODUCTION

Family-owned companies consist of 60% to 98% of the total number of existing companies globally. This composition varies depending on each region [1]. There is a myth that family firms can only last for three generations. The first generation builds the business, the second generation enjoys the results of the hard work of the first generation, and the third generation destroys it [2].

Several conglomerate families in Indonesia, such as the Djarum group, Salim group, Bakrie group, and Lippo group, have begun to shift their leadership to the second and third generations. Of these four groups, all of them have businesses in the financial industry, namely banking and other financial industries such as insurance and consumer financing companies. The next generation has started to be appointed to several strategic positions in the companies owned by the conglomerate family. Many conglomerate groups experience difficulties in continuing their business to the second and third generations. On many occasions, this generational transition has failed. The majority of new generations want to have their own business and have their way of working [3].

President Jokowi also paid attention to the second and third generations of this conglomerate. The first generation conglomerates have a hard time persuading the second and third generations to continue their business. The next generation has a way of working that is different from the previous generation [4]. President Jokowi has invited the next generation of conglomerates Bakrie Group, Salim Group, Djarum Group, Lippo Group, and Sinarmas Group, to the presidential palace. Four of the five groups have investments in financial institutions. In the meeting, they discussed the condition of the Indonesian economy [5].

Conglomerate succession is always an exciting topic to discuss. The transition from one generation to another involves a lengthy transition process. The first generation will involve the second generation in the business transition process. The first generation will coach the next generation with their involvement in their daily business activities. The transition to the financial industry and public companies is an exciting mechanism. There has been particular research on family firms in this transition process, such as a transition from generation to generation, in determining practical strategies for family firms in increasing firm value [6].

Family owners often interfere management decisions by ignoring the firm's management principles or good governance principle [7]. The involvement of the owner's family in the financial industry has attracted the attention of many parties, including regulators. Indonesia has experienced a financial crisis, and the world has experienced a global crisis in 1928 due to lending to firm related parties.

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Companies controlled by families have worse performance than companies controlled by non-family owners. This is the case in the export companies, where companies controlled by families have a low value [8]. Research shows the effect of family owners in depressing the firm's performance [9]. Research aligns with the research conducted on the franchise business, which finds that families run by families have worse performance than non-family franchisors [10]. Owners and their families are the main determinants of the behavior and performance of the firm as a whole [11]. The family's involvement, including the royal family, harms the firm's performance. This research was conducted to find the influence of the royal family in the Middle East [12].

Family ownership has a more significant influence on micro, small-sized and medium-sized enterprise than large corporation. Family influence is more diminutive in large companies. The effect of family ownership becomes more visible when combined with the active participation of the owner's family in day-to-day management operations [13]. Family involvement is having a different impact on the innovation process of the firm [14].

Independent directors may or may not function in family firms. The function of an independent director in a family firm is highly dependent on the existing corporate governance structure of firm. [15]. Corporate governance is not appropriately implemented because the management process has not been implemented. This is a result of conflicts between members of the owner's family [16]. The implementation of sound governance principles will reduce policy intervention by the family owners [17].

Corporate governance influences the task of Islamic banking business in Indonesia. Directors have a direct impact on the Islamic banking functioning [18]. Corporate governance has an influence on the firm value [19]. The number of unrelated commissioners in a firm is one of the variables in defining good governance. The good governance variables progress a positive result on commercial pressure [20]. Corporate governance stimuluses the firm's business results [21].

Companies controlled by the owner's family tend to carry out earnings management [22]. Family involvement will also increase participation in corporate social responsibility programs. However, the involvement of families as independent directors or commissioners does not increase reports on corporate social responsibility activities [23].

Research that discusses corporate governance in terms of family dynasties in firm management is still rare. Research that concerns the financial industry, in particular, is still scarce. The financial industry is an industry that supports the economic growth of a country.

This research discusses corporate governance with the involvement of family dynasties in the boards of financial services and public limited liability companies. The research question is: What is the definition of public firm governance and the financial industry according to the laws and regulations in Indonesia? What is the definition of a related party according to Indonesian laws and regulations? Does the involvement of family dynasties in the boards of the financial industry limited liability firm meet the criteria for good organizational governance?

2. METHOD

Per the research questions in this study, the research methodology used is the normative legal or literature research method. This research studies literature or secondary research materials. Legal research on legal literature or normative juridical includes research on existing legal principles and norms. This research uses a statutory approach. The research on the legislation is carried out thoroughly on the governance of public companies listed on the Indonesian capital market and financial services in normative law. The study examines regulations, identifies, and adapts to laws and regulations related to corporate governance of public and financial services companies. The analysis is also carried out on the systematics of existing laws and regulations, vertical and horizontal synchronization between relevant rules and principles related to company governance actions.

Research materials with a normative legal approach are key legal resources, supporting legal resources, such as secondary and tertiary resources, or other supporting materials. The main legal resources examined in this analysis are the Republic Indonesia 1945 Constitution, other decrees and rules related to the purpose of this research. The supporting legal materials studied are literature reviews in books, published legal, scientific journals associated with this writing, conference/proceeding results, and other scientific articles. Tertiary supporting legal research materials are materials that explain the primary legal materials and supporting legal materials. These supporting materials include news coverage on the internet and other materials that are available publicly [24].

3. DISCUSSION

3.1. Definition of Governance of Financial Institutions and Public Companies According to Legislation

Based on POJK Number 55/POJK.03.2016 on the Implementation of Governance for Commercial Banks, good governance is defining as a procedure in managing a bank that applies transparency, accountability, responsibility, independence, and fairness. These governance doctrines are vital in functioning the operational activities of financial institutions. These principles are abbreviated as TARIF. Financial firm reports must disclose all things that can be reported. Reporting must be held accountable for what is said. Reporting must also be independent of the interests of all parties. Reporting must also have reasonableness.

Meanwhile, based on the POJK Number 21/POJK.04/2015 on the Implementation of Guidelines for Public Listed Firm Governance, the Guidelines for Governance of Public Companies, called the Governance Guidelines, are guidelines for corporate governance for Public Companies issued by the OJK to encourage the implementation of governance practices per exemplary international practice. This governance practice refers to the governance principles, namely TARIF.

Financial institutions and public companies require good governance. Arrangements regarding related parties in providing loans have been regulated in Bank Indonesia Regulation (PBI). The implementation of good company governance has also been held in the POJK. The financial industry and public companies have important positions in an economy. Thus, good governance has been regulated by the regulator. This is illustrated in Figure 1.

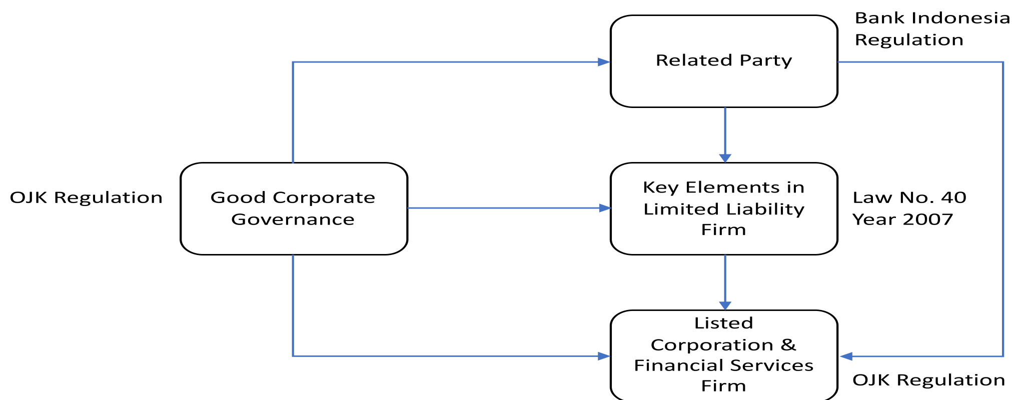

Figure 1 Regulations on Governance

3.2. Financial Institutions and Public Companies Require Good Governance

Financial institutions have an essential function in the economic growth of a country. Financial institutions obtain monies from the community, then channel these monies back to the community, especially in the productive industrial sectors. Financial institutions, especially banks, have a particular function, namely taking deposits. This function is only given to banks. Not all financial institutions are allowed to collect public funds. Banking has a systemic risk to the economy of a country. This is illustrated in Figure 2. Companies that collect public funds without permission will be subject to sanctions based on the rules and decrees.
A public firm is another form of public fundraising. The public firm offers shares to the public. The public has the opportunity to invest monies in the form of stocks in listed corporations. Public funds are collected through an initial public offering (IPO). People who buy shares in the initial offering of a public firm will deposit funds to a public firm. The purchase of shares in the IPO is different from purchasing shares in the capital market after the public offering. The public offering of shares is a direct purchase of firm shares in the early stages. The purchase of shares in the capital market is a sale and purchase deal among the seller and the buyer. This stock transaction has no implications for the firm's cash flow. Therefore, the public offering of shares in public companies must be regulated, the interests of the public are protected. This arrangement has been held in the Act of the Republic of Indonesia Number 8 of 1995 on the Capital Market and the POJK on the Capital Market.
Thus, financial institutions and public companies require good governance. Both institutions obtain funds from the public. Both institutions manage public funds either directly or indirectly. Laws and regulations regulate financial services industry such as banking, insurance, securities company and public listed companies.

3.3. Definition of Related Parties in Financial Institutions According to Laws and Regulations

Related parties or parties who have a special relationship with the decision-makers in a firm. This firm can be in the form of a financial institution or a public firm. Related parties already have a definition for the financial industry. Based on PBI Number 8/13/PBI/2006 on the Amendments to PBI Number 7/3/PBI/2005 on the Maximum Limit for Granting Commercial Bank Credit, the linked party is a firm or firm or entity that has a guiding relationship with the bank, either directly or indirectly across ownership, both in administration and finance.
Shareholders are the controlling parties in financial institutions or public listed companies. Shareholders have the right to appoint the directors and the BOC. Shareholders will choose trusted parties to manage their firms. These authorized parties can be classified as related parties if the related party has a relationship with the shareholders. Children or relatives of major shareholders can be classified

as related parties. Children or relatives are considered related parties.
However, this determination of related parties provides an opportunity for intervention by shareholders. This intervention may result in a violation of good corporate governance. Related parties are not independent in making firm management decisions. The related party has a relationship with the controlling shareholder. This relationship resulted in not being independent and violating good corporate governance principle.

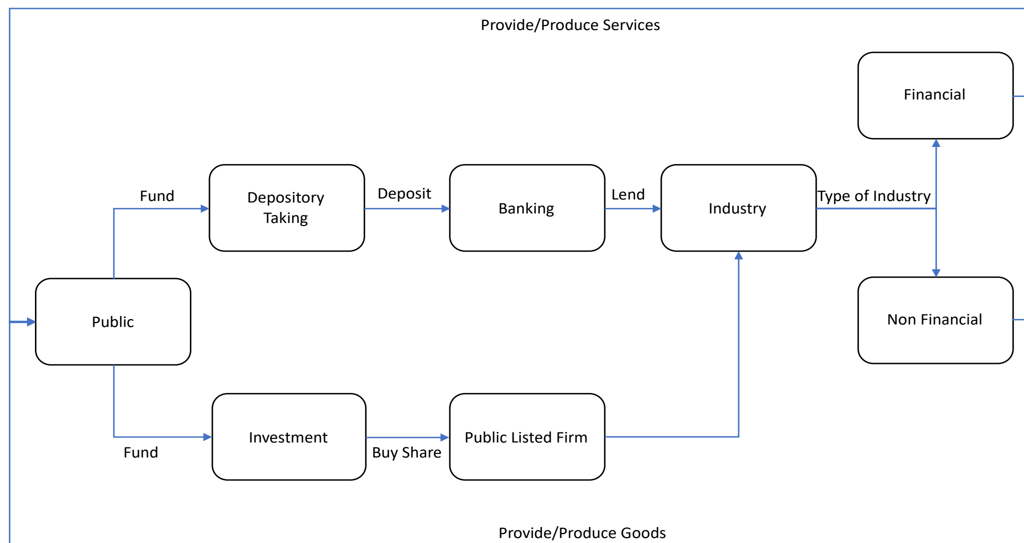

Figure 2 Systemic Risk

3.4. Family Dynasty Involvement in Limited Liability Companies and Financial Institutions Meets the Criteria for Good Organizational Governance

The firm owner will always trust people who have family ties to him to run the firm. Related parties include those related by blood or inheritors of the wealth of the firm owner who has struggled over the years to establish their firm.
Firm owners might have concerns if the results of their hard work fail to be carried out by people they cannot trust or control. Therefore, the firm owners tend to choose people they can trust can hold in running the firm. The appointment may fall on their children as the successors of their businesses.
The controlling shareholder has the right to assign the directors and the BOC. The controlling shareholder will nominate himself as the president commissioner. His son or daughter will be designated as director of his firm. The commissioner will supervise the director. This relationship pattern is typical. This is illustrated in Figure 3.
This relationship pattern is a sensitive issue. This pattern of a relationship becomes acute in the financial industry, especially in banking industry and public listed companies. The financial services or banking industry is an industry that manages public funds. A public firm is a firm whose stocks are owned by the community or traded in a capital market. This shared ownership depends on the percentage of ownership. This pattern of relationships will lead to a period of conflict of interest in management. The practice of management decision-making becomes ineffective and inefficient with the involvement of personal relationships between the commissioners and directors or between the shareholders and commissioners or between the shareholders and directors.
Shareholders of a firm or a conglomerate group will pass on their wealth to the next generation. Inheritance of wealth is not always the same as giving on a position to the next generation. Heirs can inherit wealth but do not need to inherit the obligation to carry out or run the firm.
This is different in some conglomerates. Some groups of companies or conglomerates form the transition from family companies to professional companies. A professional firm is a firm run by independent parties. Independent and professional parties are parties that do not partake a special affiliation with the majority shareholder. A special relationship is a brotherly relationship or family relationship with the controlling shareholder.
The placement of independent parties is not enough in the application of good governance. Restrictions on parties who have related relationships within the firm's boards or public companies, or unique industries, such as banking, will be necessary. Regulators need to determine the number of directors and commissioners on the boards of a limited liability firm. This appointment will build good governance. It will support the achievement of the principle of independence.
Recently, cross-boarding has been an issue of particular concern in some countries. Cross-boarding is an exchange of positions between directors and commissioners in

company A and company B. One becomes a director in company A and becomes a commissioner in company B. Another person becomes a commissioner in company A and becomes a director in company B. So that between them have a relationship and interdependent.

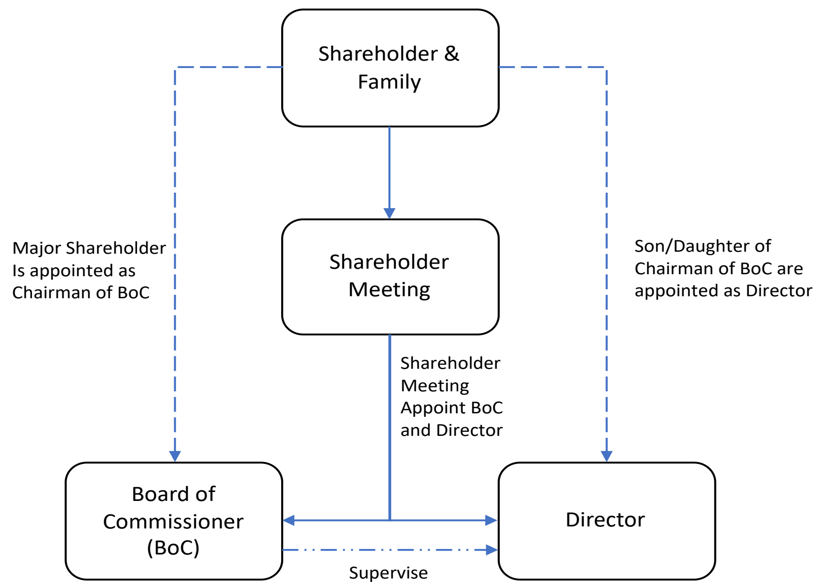

Figure 3 Structure of Appointment of Limited Liability Firm's Boards

4. CONCLUSION

The founders will inherit a conglomerate or group of companies to their successors. This legacy will cause concern for the group's founders. As the firm's transition process between generations happens, the firm's founders will involve their successors in the learning process of firm management. This involvement results in the appointment of related parties in the boards of the limited liability firm. The method of involving the next generation in business activities will generally not cause any problem in corporate governance. Applying the next generation in this learning process becomes a corporate governance issue, especially in the financial services industry and public companies, especially the banking industry. The application of good governance for sensitive sectors, such as banking, will require a review. Regulators need to implement and supervise companies that have related parties in running the firm. The definition of associated parties needs to be applied to the entities of a limited liability firm. Independent principles need to be used. Research on cross-boarding is still sparse. This research can be developed in the future.

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