UNIVERSITAS SEBELAS MARET

SEBELAS MARET
BUSINESS REVIEW

Available online at http://jurnal.uns.ac.id/smbr

Business Group and Affiliated Firms' Performance

Wisnu Untoro

Faculty of Economics and Business, Universities Sebelas Maret
Corresponding author: wisnu.untoro@gmail.com

ARTICLE INFO

Article History:

Received 30 April 2016
Received in Revised Form 25 May 2016
Accepted 2 June 2016
Available online 15 June 2016

Keywords:

business group
affiliated firms
performance
Indonesia

ABSTRACT

Some argue that business groups in emerging could be beneficial for affiliated firms. On the other hand, however, group affiliation could also improve performance. In this paper, we empirically examine the impact of being a member of business group on financial performance by studying Indonesian firms over the 2004-2009 period. We test the empirical model using static panel method. Overall, our empirical results do not provide evidence that affiliation with business group could improve performance. However, some business group members perform superior than others.

INTRODUCTION

Attention on the big business groups (conglomerates) in Indonesia increased since the cronyism economy in the Soeharto[1] new order. A small number of Chinese Indonesian conglomerates such as Salim Group (Dieleman and Sachs, 2008) collaborated with Soeharto's family business groups dominated business resulted from

[1] Soeharto is the second Indonesian President. His regime led Indonesia over 32 years from 1966 to 1998. He step down because the reformation in 1998, preceded by financial, economic and political crisis.

privileges[2] that they received. These privileges, such as licenses to create monopolies (Mobarak and Purbasari, 2006), led them to control the overall country's economy which could be seen on market capitalization and gross national product (Claessens et al, 2000; Fisman, 2001).

Nowadays, the political power in Indonesia disperses. The constitution reform leads to legislative heavy since parliament authorities become larger. Parliament has initiative right to propose draft of laws and has authority to conduct fit and proper test for prospective members of state commissions and officials of state institutions such as governor and deputy governors of central bank and members of supreme audit council (Nys et al., 2015). It also implies that the country becomes more democratic and deregulated, to some extent (Mursitama, 2006). However, the ties between business groups and who possess the political power still exist. A number of owners of business groups even directly involve in the political system through political parties. Major public opinion argues that the involvement of business groups' owners in the political area is to secure their business and to seek other benefits such as access of funding to their firms.

In this present paper, we will empirically investigate the impact of being a member of business group, especially with regard to financial performance. Khanna and Yafeh (2007) argue that business groups in emerging market sometimes can be "paragons" but at other times can be "parasites" depending on the economic conditions. We therefore argue that in Indonesia where the market is not efficient, affiliation with a large business group could improve performance, more so if the ultimate owner of the group is involved in the political circumstances.

We categorize 10 large business groups in Indonesian capital market including Astra Group, Bakrie Group, Ciputra Group, Ex Astra Group, Lippo Group, Panin Group, Salim Group, Sinarmas Group, and MNC/ Tanoesoedibyo Group). However, in this empirical model, we exclude 2 groups which are Panin Group due to all of their members are financial firms which are excluded in our sample. The other group is Government Group (State-owned enterprises/ SOEs). However, SOEs are still included in the model as a control variable.

RESEARCH METHOD

We study the impact of being member of business group on firm performance by studying Indonesian 245 publicly-traded firms over the period of 2004-2009. We end up with 1,129 observations (firm-year).

Data to identify the members of business groups are retrieved from our database, while financial accounting data are collected from financial and annual reports.

We use a dummy variable (BUS_GROUP) taking a value of 1 for those affiliated with business groups and 0 otherwise. Going deeper, we also break down in details.

[2] See Mc Beth (1994) and Bennet (1995) for the example of privileges of politically connected conglomerates.

Therefore, we create a vector of dummy variables to represent each business group (Astra, Bakrie, Ciputra, Lippo, Salim, Sinarmas, MNC). Ex Astra Group is used as benchmark. Our dependent variable which is financial performance is proxied by the return on assets (ROA) and the return on equity (ROE) presented as percentage. We take into account some control variables. First, we include the firm size which is measured by the natural logarithm of total assets (LNTA). Second, the ratio of debt to total assets is accounted to represent the leverage (LEV). Firm age (AGE) which is the difference between date of incorporation and this study is also included. Finally, as mentioned earlier, we control for state-owned enterprises (SOE) which is a dummy variable.

The empirical models to be estimated using ordinary least square (OLS) are presented as follows:

$$ROA_{i,t} = \alpha_0 + \alpha_1 BUS\_GROUP_{i,t} + \alpha_2 LNTA_{i,t} + \alpha_3 LEV_{i,t} + \alpha_4 AGE_{i,t} + \alpha_5 SOE_i + \varepsilon_{i,t} \ldots\ldots\ldots \quad (1)$$

$$ROE_{i,t} = \alpha_0 + \alpha_1 BUS\_GROUP_{i,t} + \alpha_2 LNTA_{i,t} + \alpha_3 LEV_{i,t} + \alpha_4 AGE_{i,t} + \alpha_5 SOE_i + \varepsilon_{i,t} \ldots\ldots\ldots \quad (2)$$

$$ROA_{i,t} = \alpha_0 + \alpha_1 ASTRA_{i,t} + \alpha_2 BAKRIE_{i,t} + \alpha_3 CIPUTRA_{i,t} + \alpha_4 LIPPO_{i,t} + \alpha_5 SALIM_{i,t} + \alpha_6 SINARMAS_{i,t} + \alpha_7 MNC_{i,t} + \alpha_8 LNTA_{i,t} + \alpha_9 LEV_{i,t} + \alpha_{10} AGE_{i,t} + \alpha_{11} SOE_i + \varepsilon_{i,t} \ldots\ldots\ldots \quad (3)$$

$$ROE_{i,t} = \alpha_0 + \alpha_1 ASTRA_{i,t} + \alpha_2 BAKRIE_{i,t} + \alpha_3 CIPUTRA_{i,t} + \alpha_4 LIPPO_{i,t} + \alpha_5 SALIM_{i,t} + \alpha_6 SINARMAS_{i,t} + \alpha_7 MNC_{i,t} + \alpha_8 LNTA_{i,t} + \alpha_9 LEV_{i,t} + \alpha_{10} AGE_{i,t} + \alpha_{11} SOE_i + \varepsilon_{i,t} \ldots\ldots\ldots \quad (4)$$

We estimate the empirical models using panel data regressions. However, as some variables are time-invariant, we could not be able to control for individual fixed effect. We only include time effect (dummy variables for each year).

RESULTS

Table 1 presents the descriptive statistics of variables, while Table 2 exhibits the statistics of variables of each business group. The number of affiliated firms with business groups is 13% of our sample. The average ROA and ROE is 5.26 % and 8.18 %, respectively. The mean of natural logarithm of total assets and leverage ratio is 20.46 and 50.5%. The average firm age is 25.32 years. 4.3% of our sample is state-owned enterprises.

Table 1 Descriptive Statistics of Variables

	ROA	ROE	BUS_GROUP	LNTA	LEV	AGE	SOE
Mean	5.256	8.179	0.130	20.461	0.505	25.325	0.043
Median	4.170	9.760	0.000	20.506	0.516	24.000	0.000
Maximum	94.020	487.900	1.000	25.304	1.019	98.000	1.000
Minimum	-85.020	-916.540	0.000	13.426	0.000	2.000	0.000
Std. Dev.	13.447	64.280	0.337	1.748	0.225	13.377	0.204
Skewness	-0.391	-4.691	2.198	-0.234	-0.142	1.623	4.482
Observations	1129	1129	1129	1129	1129	1129	1129

Table 2 Descriptive Statistics for each Business Group

	ROA	ROE	LNTA	LEV
Astra	23.008	38.114	21.368	0.417
Bakrie	2.741	11.040	22.637	0.607
Ciputra	10.396	16.089	21.552	0.354
Eks astra	-0.121	-1.009	19.286	0.433
Lippo	3.075	6.092	19.087	0.588
Salim	11.727	15.860	21.560	0.473
Sinarmas	-1.257	-16.895	20.493	0.447
MNC	3.451	7.251	22.880	0.496

Table 3 shows the correlation matrix of variables. We only find small positive correlation between business group and performance. Significant correlations are found between performance and firm size. The dummy variable of state-owned enterprise is significantly and positively correlated with firm performance.

Table 3 Correlation Matrix of Variables

	ROA	ROE	BUS_GROUP	LNTA	LEV	AGE	SOE
ROA	1.000						
ROE	0.613	1.000					
BUS_GROUP	0.071	0.026	1.000				
LNTA	0.266	0.138	0.197	1.000			
LEV	-0.202	-0.086	-0.019	0.245	1.000		
AGE	0.253	0.105	0.008	0.252	0.132	1.000	
SOE	0.220	0.103	-0.082	0.287	0.016	0.104	1.000

Table 4 exhibits the regression results. Our variable of interest which is affiliation with business group does not have significant effect on performance neither ROA nor ROE. However, as shown in Table 5, some of business groups are significantly associated with financial performance. Those belong to Astra group have higher performance than others. Affiliation with Salim Group also brings positive effect on performance. Our result also provides evidence that firms affiliated with Bakrie Group significantly have lower performance than other firms. Our findings could be interpreted that belonging to

a business group not always improves performance. On the one hand, it may help firms to easily obtain sources of funding. However, on the other hand, belong to business group could also lower performance as one might argue that expropriation is more likely incurred in a business group rather than in an independent firm.

Table 4 Regression Results

	ROA	ROE
Business Group	1.685	0.405
	(1.479)	(0.064)
LNTA	1.445***	5.277***
	(6.269)	(3.957)
LEV	-12.005***	-42.941***
	(-13.087)	(-4.546)
AGE	0.207***	0.438***
	(7.258)	(2.768)
SOE	9.951***	17.726*
	(5.148)	(1.669)
Year dummies	Included	Included
Constant	Included	Included
Firms	226	226
Observations	1172	1172
Overall R-squared	0.056	0.051

The values in parentheses are t-statistics. *, ** and ***indicate significance at the 10%, 5%, and 1% levels, respectively.

Results of our control variables confirm the findings of Prabowo et al. (2014) that state-owned enterprises in Indonesia have higher performance than privately-owned firms. They may have higher market power and subsequently improve performance. We also document that large and long-established firms have higher performance than small and young firms. Leverage is found to be negatively associated with performance.

Robustness Checks

To check consistency of our results, we perform some robustness checks. First, we include dummy variables to account industry differences following the work of Prabowo et al. (2014). The regression results of our main variable are consistent. Second, we estimate the empirical models using two-step GMM (dynamic panel) to account for endogeneity. The effect of business group on performance is almost the same with those resulted from pooled regressions.

Table 5. Regression Results

	ROA	ROE
Astra	17.012***	17.661
	(5.684)	(1.052)
Bakrie	-6.922***	-8.714
	(-2.999)	(-0.675)
Ciputra	3.607	-0.083
	(1.281)	(-0.005)
Lippo	3.156	13.124
	(1.042)	(0.774)
Salim	4.891*	0.757
	(1.904)	(0.052)
Sinarmas	-4.975	-22.838
	(-1.386)	(-1.141)
Tanoe	-3.630	-10.032
	(-0.712)	(-0.353)
LNTA	1.409***	5.384***
	(5.995)	(3.862)
LEV	-11.696***	-42.547***
	(-12.955)	(-4.435)
AGE	0.227***	0.456***
	(7.980)	(2.833)
SOE	9.918***	17.223
	(5.200)	(1.611)
Year dummies	Included	Included
Constant	Included	Included
Firms	226	226
Observations	1172	1172
Overall R-squared	0.056	0.051

The values in parentheses are t-statistics. *, ** and ***indicate significance at the 10%, 5%, and 1% levels, respectively.

CONCLUSION

To our knowledge, no empirical paper specifically examines impact being affiliated firms with business group on performance in the context of Indonesia. This paper provides policy implications even though only little evidence is found. The affiliation with business group might improve the access to finance and ultimately performance of affiliated firms. However, as mentioned by Kali and Sarkar (2011) the diversification strategy of business groups might be intended to facilitate expropriation of minority shareholders by controlling insiders through tunneling. Strong governance

mechanism to mitigate the expropriation of majority shareholders in the business group to minority is strongly needed.

In addition, our comprehensive business group performance index could be beneficial for the regulator particularly the Indonesia Financial Authority Services (*Otoritas Jasa Keuangan*/ OJK) which is preparing to create an integrative supervision system for business groups (conglomerates). The integrative supervision for business groups can ease the regulator to monitor and maintain the financial stability.

REFERENCES

Bennett, M.S., 1995. Banking Deregulation in Indonesia. *University of Pennsylvania Journal of International Business Law* 16 (3), 443-481.

Claessens, S., Djankov, S., Lang, L. H. P., 2000. The separation of ownership and control in East Asian corporations. *Journal of Financial Economics* 58, 81–112.

Dieleman, M., Sachs, W. M. 2008. Coevolution of institutions and corporations in emerging economies: How the Salim Group morphed into an institution of Suharto's crony regime. *Journal of Management Studies*, 45 (7): 1274–1300.

Fisman, R., 2001. Estimating the value of political connections. *American Economic Review* 91,1095-1102.

Kali, R., Sharkar, J. 2011. Diversification and tunneling: Evidence from Indian business groups. *Journal of Comparative Economics* 39, 349–367.

Khanna, T., and Yafeh, Y. 2007. Business Groups in Emerging Markets: Paragons or Parasites? *Journal of Economic Literature*, 45(2): 331-372.

McBeth, J., 1994. Banking on friends: business and politics mix in Bapindo case. *Far Eastern Economic Review* 25.

Mobarak, A.M., Purbasari, D.P., 2006. Corrupt protection for sale to firms: evidence from Indonesia. *Working paper*, University of Colorado at Boulder.

Mursitama, T. N. 2006. Creating relational rents: The effect of business groups on affiliated firms' performance in Indonesia. *Asia Pacific Journal of Management* 23, 537–557.

Nys, E., Tarazi, A., Trinugroho, I. 2015. Political connections, bank deposits and formal deposit insurance. *Journal of Financial Stability*, forthcoming.

Prabowo, M.A., Untoro, W., Trinugroho, I., Angriawan, A. 2014. State-owned Enterprises, Efficiency and Performance: The Case of Indonesia. International Business Management 8(2), 153-158.