Descendant CEO on Firm Performance: The Role of Audit Committee

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Abstract. Enhancing firm performance is one of several strategies that firms must take to flourish in a competitive climate. Optimizing organizational performance is critical for any business because it demonstrates how well a company manages and distributes its resources. Making the right decisions is a critical step toward increasing firm performance. The CEO is the most crucial individual to make tactical choices that affect a company's performance. The audit committee's role is critical to improving business performance. The audit committee supervises and enforces financial reporting standards, which have an impact on the quality of managerial decisions. The goal of this research is to determine how a firm's performance is influenced by its founder or descendant CEO, and whether the Audit Committee can control the relationship between founder or descendant CEO and Firm Performance in manufacturing companies listed on the Indonesia Stock Exchange between 2018 and 2022. A dummy variable is used to measure the CEO's ROA and Tobin's Q are used to measure the company's performance and audit committee size and independence are used to measure the audit committee. STATA is the application used to process data. The findings demonstrate that the Audit Committee can affect the relationship between the business's accomplishments and the founder or descendant CEO. The findings of this study assist decision-makers and business owners in taking into account the internal and external factors that impact firm performance to make appropriate.

Keywords: Audit Committee, Descendant CEO, Firm Performance

1 Introduction

Numerous changes have occurred in the contemporary corporate climate, leading to an increase in complexity and uncertainty. Businesses are under tremendous competitive pressure to operate more effectively and efficiently in this dynamic commercial climate (Taouab & Issor, 2019). Companies must take several measures to thrive in a competitive environment, and performance evaluation and improvement are two of them. If a corporation meets the criteria of multiple financial and non-financial measures, its performance can be deemed satisfactory. For investors to feel comfortable making more investments, a company's performance must be strong (Elhawary, 2021).

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A. A. N. G. Sapteka et al. (eds.), *Proceedings of the International Conference on Sustainable Green Tourism Applied Science - Social Applied Science 2024 (ICoSTAS-SAS 2024)*,
Advances in Economics, Business and Management Research 308,
https://doi.org/10.2991/978-94-6463-622-2_10

One effort to improve company performance depends on making the right decisions. The Chief Executive Officer (CEO) plays a crucial role in making strategic decisions that can enhance company performance (Altarawneh et al., 2020). According to the Upper Echelon theory, the characteristics and managerial background (decision-makers) can determine organizational decisions and performance. This theory states that the more complex a decision, the more important the personal characteristics of the decision-maker become (Hambrick & Mason, 1984).

There are several types of CEOs, including descendant CEOs (who are the owner's descendants) and professional CEOs (not the owner or their descendants). These different types of CEOs have different motivations for carrying out their duties. Descendant CEOs are expected to bring value to the company because they have higher responsibility, commitment, and ownership towards the company, thereby avoiding actions that could damage the company's reputation in the future. Compared to descendant CEOs, professional CEOs are more focused on short-term profits due to their limited tenure in the company (Sutrisno et al., 2022). However, a study conducted by Yopie & Itan (2016) showed different results, indicating that family-owned companies managed by non-family CEOs could contribute higher value compared to those managed by family CEOs.

Agency challenges, such as those that occur when the principal's and the agent's goals or wants diverge and make it challenging for the principal to confirm the agent's actions, are a part of running a business. When the principal and agent have divergent views on risk, problems can occur since the principal might not be able to confirm that the agent has acted appropriately. Because of differing risk preferences, the principal and agent may take distinct actions (Eisenhardt, 1989). Agency problems that occur in family businesses are known as agency problem type II. Agency problem type II is a conflict that occurs between majority shareholders and minority shareholders. The majority shareholders have the power to control the company and take advantage of it for their interests by maximizing their wealth and focusing on the capital they own. This can be done by providing excessive compensation, such as special dividends, which can reduce the value of minority shareholders (Shleifer & Vishny, 1986).

Agency theory explains that to anticipate asymmetrical relationships, good corporate governance (GCG) is needed in the company. GCG is defined as a system for managing and controlling organizations or companies to create added value for stakeholders and is one of the keys to the company's success (Manossoh, 2016). The audit committee is one area of GCG that needs improvement. The quality of financial reporting is overseen and upheld in part by the audit committee. Financial statements are meant to give different stakeholders accurate and helpful financial information so they can make well-informed decisions. Furthermore, minimizing conflicts of interest between agents and principals is the audit committee's main responsibility (Olayinka, 2019). Based on the phenomena and research gaps in the variables studied, this research is deemed urgent. This research is conducted on manufacturing companies listed on the Indonesia Stock Exchange.

1.1 The Upper Echelon Theory

The attributes of managerial backgrounds are said to determine organizational results, decisions taken, and performance levels according to the Upper Echelon Theory (UET). (Hambrick & Mason, 1984). According to this idea, the personal qualities of the decision-makers—such as age, tenure, and specialization become increasingly significant when making difficult decisions, including choosing strategic actions. The UET principle acknowledges that many attributes of senior managers, including age or work experience, impact their choices on strategy and structure and will have a direct impact on the strategic choices made by the company and the organizational performance (Nielsen, 2010). According to UET, executive backgrounds, traits, and experiences influence organizational decision-making and business results. According to UET's summary of research in psychology, sociology, economics, and strategy, people, organizations, and their competitive environment are all related (Hambrick & Mason, 1984).

Agency Theory. Addressing these two potential problems in agency interactions is the aim of agency theory. First, there is the agency problem, which occurs when the principal and agent have conflicting interests or aims and it is hard for the main to check what the agent is doing. The issue with risk-sharing emerges when the principal and agent have divergent views on risk, and it is problematic that the principal cannot confirm that the agent has acted appropriately. Because they have distinct risk tolerances, the principal and agent could favor different courses of action (Eisenhardt, 1989).

Descendant CEO. A descendant CEO is a CEO who comes from the founding family's members who have blood or marital relations. A professional CEO comes from parties other than the founder, one of the founders, or their descendants (Sutrisno et al., 2022). Measurement of the descendant CEO variable: The Descendant CEO is a dummy variable, assigned a value of one if the company is led by a Descendant CEO and assigned a value of zero if the company is led by a Professional CEO.

Audit Committee. The audit committee plays an important role in the company due to its duties, responsibilities, and work to ensure the quality of financial reports and increase the company's accountability (Husaini et al., 2019). The audit committee should have more than three members because the size of the audit committee is an important indicator of monitoring quality. When the audit committee has fewer members, the likelihood of fraudulent activities increases because fewer members agree to collude and conduct fraudulent transactions (Rahman & Ali, 2022). The independence of the audit committee can reduce fraudulent financial statements, which leads to an increase in firm performance (Bansal & Sharma, 2016). Measurement of Audit Committee using the size of the audit committee and proportion of independent audit committee.

Firm Performance. Company performance can be measured in several ways, one of which is by measuring Return on Assets (ROA). The ROA is found to be a superior approach to determining accounting-based company performance. The ROA is used as a proxy for measuring performance, calculated as the percentage of net income to total assets. Tobin's Q is the most commonly used measure to reflect market-based performance. Tobin's Q shows how investors view the company and is a relevant indicator of the company's survival (Shatnawi et al., 2022). Measurement of Firm Performance using Return on Assets (ROA) and Tobin's Q.

Research Hypotheses 1: The Influence of CEO Descendant on Firm Performance. CEO characteristics are categorized into three main dimensions based on background, personality traits, and leadership style. The background characteristics of a CEO can predict strategic choices and thus have a substantial impact on the CEO's decision-making and effectiveness in leading the organization (Crossland et al., 2014). The emotional attachment of a CEO who is a family member to their business can have a significant impact on the organization. According to Brown et al. (2011) employee engagement, which includes emotional attachment to the job, is associated with improved performance. This means that a CEO who is a family member and emotionally invested in the business will not only excel in performing their duties well but will also strive harder to support their colleagues and the organization as a whole. This higher level of engagement and emotional attachment has the potential to enhance the company's financial performance (El Abiad et al., 2024). H1: Descendant CEO affects Firm Performance.

Research Hypotheses 2: Audit Committee Can Moderate the Relationship Between Descendant CEO and Firm Performance. The relationship between the principal and the agent, which can be impacted by information asymmetry and raise agency costs, is shown by agency theory. Therefore, to lower agency costs, managers must be encouraged to take specific activities that are in the best interests of the principal by understanding and implementing effective corporate governance control systems (Zarefar & Narsa, 2023). The Audit Committee can reduce agency costs (Javeed et al., 2021). Significant agency expenses are generated by family-owned businesses, and this leads to an unfavorable environment in the corporate sector. The audit committee's main responsibilities are to supervise internal financial reporting procedures and make sure that management and shareholder conflicts are kept to a minimum (Olayinka, 2019). H2: Audit Committee can moderate the relationship between Descendant CEO and Firm Performance.

2. Methodology

Manufacturers that were listed on the Indonesia Stock Exchange between 2018 and 2022 were the subject of the study. From 2018 to 2022, 229 manufacturing businesses were listed in the consumer products, basic and chemical, and miscellaneous industries. A 200-company sample was employed. Purposive sampling was used to choose the

sample, and among the criteria were businesses that released full financial reports between 2018 and 2022 and weren't initial public offerings (IPOs). Data will be gathered by examining the financial reports of manufacturing companies listed on the Indonesia Stock Exchange (IDX) from 2018 to 2022. The variables to be studied (CEO Descendant or Founder, Audit Committee, and Firm Performance) will be measured based on predetermined measurements. The study's concept will be examined utilizing STATA application.

3. Result and Discussion

3.1 Result

Based on the hypothesis test results that have been conducted to determine the effect of descendants CEO on firm performance (ROA).

Table 1. Effect on firm performance (ROA)

Variable	Coef.	SE	z	p (Z)
Descendant CEO	0.050	0.008	5.84	0.000
Audit Committee	0.073	0.064	1.14	0.255
Descendant CEO* Audit Committee	0.120	0.058	2.08	0.037
Firm Size	0.001	0.001	1.43	0.152
Firm Age	0.0001	0.0003	0.32	0.750
CEO Tenure	0.00002	0.0005	0.04	0.966

The influence of Descendant CEO on ROA yielded a regression coefficient of 0.050 with a significance value (p) of 0.000 ($p < 0.05$), indicating a significant positive effect. This means that an increase in the value of Descendant CEO has a significant impact on changes in ROA, demonstrating an increase in ROA.

Table 2. Effect on firm performance (Tobin's Q)

Variable	Coef.	SE	t	p (t)
Descendant CEO	0.277	0.062	4.45	0.000
Audit Committee	0.376	0.456	0.82	0.411
Descendant CEO * Audit Committee	0.807	0.394	2.05	0.042
Firm Size	-0.0003	0.009	-0.04	0.971
Firm Age	0.001	0.004	1.63	0.105
CEO Tenure	0.002	0.005	0.42	0.674

The influence of Descendant CEO on Tobin's Q yielded a regression coefficient of 0.277 with a significance value (p) of 0.000 ($p < 0.05$), indicating a significant positive

effect. This means that an increase in the value of Descendant CEO significantly impacts changes in Tobin’s Q, demonstrating an increase in Tobin's Q.

Table 3. Moderating effect of the audit committee between Descendant CEO and ROA

Variable	Coef.	SE	z	p (Z)	Note
DescendantCEO	0.050	0.008	5.84	0.000	Significant
Audit Committee	0.073	0.064	1.14	0.255	Not Significant
Descendant CEO * Audit Committee	0.120	0.058	2.08	0.037	Significant

The results of testing the moderating effect of the Audit Committee on the relationship between Descendant CEO and ROA yielded a significance value (p) of 0.037, indicating a significant effect. The type of moderation by the Audit Committee in the relationship between CEO Descendant and ROA is pure. A variable is considered pure moderation if the moderating variable (Z) is not related to the criterion variable (Y) and/or the predictor (X), but interacts with the predictor variable (X). As a result, the variable only serves as a pure moderator. The presence of the moderating variable is purely a moderating variable and does not function as a predictor variable (X).

Table 4. Moderating effect of the audit committee between Descendant CEO and Tobin’s Q

Variable	Coef.	SE	t	p (t)	Note
Descendant CEO	0.277	0.062	4.45	0.000	Significant
Audit Committee	0.376	0.456	0.82	0.411	Not Significant
Descendant CEO * Audit Committee	0.807	0.394	2.05	0.042	Significant

The results of testing the moderating effect of the Audit Committee on the relationship between Descendant CEO and Tobin’s Q yielded a significance value (p) of 0.042, indicating a significant effect. The type of moderation by the Audit Committee in the relationship between CEO Descendant and Tobin’s Q is pure. A variable is considered pure moderation if the moderating variable (Z) is not related to the criterion variable (Y) and/or the predictor (X), but interacts with the predictor variable (X). As a result, the variable only serves as a pure moderator. The presence of the moderating variable is purely a moderating variable and does not function as a predictor variable (X).

3.2 Discussion

Descendant CEO Influence on Firm Performance. The Descendant CEO has a significant impact on changes in ROA and Tobin's Q, indicating an increase in both ROA and Tobin's Q, according to the panel regression test results. The UET is supported by this research. According to UET, executive backgrounds, traits, and experiences influence organizational decision-making and business results. According to UET, which compiles research from the fields of psychology, sociology, economics, and strategy, people, organizations, and their competitive environments are all related (Hambrick & Mason, 1984). The results strengthen the research conducted by El Abiad et al. (2024) who clarifies that a CEO who is emotionally committed to the company and a family member will not only do a better job of carrying out their responsibilities, but they will also make a greater effort to help their coworkers and the company as a whole. The increased degree of emotional investment and involvement may improve the business's financial results. The results of this study are also supported by research conducted by Ntoung et al. (2017) found that a family CEO or Chairman in the company creates more value and is more profitable.

Audit Committee as a Moderator of the Relationship Between Descendant CEO and Firm Performance. The test findings for the Audit Committee's moderating effect on the relationship between Descendant CEO and ROA and Tobin's Q showed that there is pure moderation. The UET and Agency Theory are supported by this study. Family businesses are more likely to experience type II agency issues. Family members may have the motivation to use their position as controlling shareholders to further their interests at the expense of noncontrolling shareholders, which could lead to these kinds of issues (Villalonga & Amit, 2011). By implementing GCG, the problem of information asymmetry can be reduced. The interactions between shareholders, managers, creditors, the government, employees, and other internal and external stakeholders are governed and controlled by the GCG. It guarantees that these parties' rights and obligations are in line with the main goal of making a profit. The GCG includes the audit committee. A company's audit committee is essential to maintaining transparency. Its members, who also hold directorships, are responsible for formulating plans to improve the company's financial health. The audit committee gives the CEO and the board of directors a truthful representation of the financial statements, which helps them to come up with better plans for enhancing the company's performance (Bansal & Sharma, 2016). There should be a minimum of three non-executive directors on the audit committee, and their supervisory responsibilities should be handled separately to reduce the possibility of conflicts of interest between management and shareholders. It is expected that this arrangement will be successful since the committee's independence enhances its capacity for oversight (Elhawary, 2021). An audit committee consisting of a large number of independent directors tends to provide

better oversight (Alqatamin, 2018). Research by Alqatamin (2018) also found that there is a positive relationship between the independence of the audit committee and company performance.

4. Conclusion

Increases in Tobin's Q and ROA are significantly impacted by the Descendant CEO, which suggests that both variables are rising. The agency theory and upper echelon theory are supported by this research. The link between Descendant CEO and ROA is moderated by the Audit Committee, suggesting a notable impact. Pure moderation is the style of moderation used by the Audit Committee in the connection between Descendant CEO and ROA.

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