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# Family Ownership, Good Corporate Governance and Audit Fee in Family Companies Indexed by LQ45

**Wiea Putri Anggun Rahma**[a], **Iswajuni**[b*], [a,b]Department of Accountancy, Faculty of Economics and Business, Universitas Airlangga, Email: [b*]iswajuni@feb.unair.ac.id

This study aims to examine the relationship between family ownership and good corporate governance on audit fee in family firms. The researcher analyses family ownership using two proxies consisting of the proportion of family ownership and family members who serve as CEOs, while GCG uses three proxies consisting of the proportion of independent boards, audit committee size and firm size. The method used in this study is the analysis of multiple linear regression methods with a significance level of 5%. The population in this study comprises family companies listed on the Indonesia Stock Exchange (IDX) for the period 2014–16 according to the LQ45 Index. Samples were selected using purposive sampling according to certain criteria that have been determined previously and 12 companies were selected for each period to generate 36 observations. The results of this study indicate the family CEO and the proportion of independent commissioners have a significant relationship to the audit fee, while the proportion of family ownership, the size of the audit committee and the size of the firm have no relationship with the audit fee.

**Keywords:** *Family ownership, Good corporate governance, Audit fee.*

## Introduction

In order to compete, companies are under pressure to be more transparent in disclosing financial information, both as a form of accountability and as a basis for decision-making. Most companies in Indonesia are family owned. Claessens, Djankov and Lang (2000) and Arifin (2003) found that more than 50% of companies in Indonesia are family controlled. Jakarta Consulting Group (2008) states that 88% of national private companies are in the hands of families. Villalonga and Amit (2006) state that a firm is called a family firm if there is ownership of shares of 5% or more listed on the exchange, from shares owned by the family or group (an institution) owned by the family. La Porta et al. (1999) show that family control influences firm performance, depending on the level of transparency and regulations applied.

Family companies differ from non-family companies with regard to corporate governance. Recent studies suggest that family firms differ significantly from non-family companies on various dimensions, including political connections, managerial short-termism, corporate governance, asymmetry information, earnings quality, firm value and performance (Harymawan et al., 2019; Harymawan et al., 2020; Ghoufur & Sukmaningrum, 2018; Lennox, 2005; Dechun, 2006; Ali et al. 2007; Chau and Gray, 2010). Family companies are considered vulnerable to conflicts of interest between majority and minority shareholders, as well as between owners and managers. Therefore, an agency conflict resolution is needed in the firm. The implementation of corporate governance is expected to improve the quality of financial statements, which in turn can improve accounting information power. The quality of financial statements can be measured by the market reaction to the announcement of financial statements.

The assessment results of the implementation of good corporate governance (GCG) using the ASEAN CG Scorecard (International Institute for Communication and Development 2013; 2014) put Indonesia in fifth place in ASEAN with an index value of 43.29 in 2012 and 54.55 in 2013. This shows that the application of corporate governance has increased but still lacks both the regulations that govern and compliance with existing regulations (Asian Development Bank 2014). The results of the assessment also show that many public companies in Indonesia have received negative ratings on the corporate governance index related to transparency and the responsibility of the board of commissioners.

The board of directors and board of commissioners are responsible for the implementation of good corporate governance, while the audit committee carries out independent oversight of the process of implementing corporate governance. Orphans, Kent and Clarkson (2006) also state that the recommendation of the number of audit committees is consistent with the desire to improve the audit committee's organisational status. In accordance with the recommendations of the Blue-Ribbon Firm (1999), this study argues that a larger audit committee will improve the quality of financial statements, which results in a low external audit fee. However, the audit fee may also increase if the audit committee requests a higher audit quality (Larasati et al., 2019).

Law no. 8 of 1995 concerning the capital market (the Capital Market Law) contains regulations relating to GCG, especially regarding the principle of disclosure (openness). In addition to the implementation of GCG, another factor that affects the value of the firm is the size of the firm, which is considered able to influence the value of the firm because the larger the size or scale of the firm, the easier it will be for companies to obtain funding sources – both internal and external (Dina, 2013). The size of the firm, measured by high total assets, makes the audit process more complicated so that the determination of audit fee will also be higher (Nugrahani & Sabeni, 2013).

The characteristics of a family firm can also affect the level of audit fee. Ho and Kang (2010) show that low audit fees in family firms result in low demand for audit services due to lower intensity of agency problems (between principal and agent) and higher intensity of other types of problems (among holders controlling and non-controlling shares). Family firms tend to have lower demand for high-quality external audit services and external auditors (Ho & Kang, 2010). From a demanding-party perspective, it is expected that companies with controlling shareholders, and especially family control, need less audit services, which are associated with low audit fees. It can also be argued that the presence of family members on the board of directors and management team and the firm's reputation can have a positive effect on the firm (Khan & Subramaniam, 2012).

The researchers chose family companies included in the LQ45 index because the index consists of companies that have the highest average capitalisation in the last 12 months, showing good firm performance. The researchers wanted to know whether a relationship existed between family ownership, implementation of good corporate governance and audit fees in family companies. The sample used in this study is a family firm that is included in the LQ45 index for the research period 2014–16. The results of this study indicate that family CEOs and the proportion of independent commissioners have a significant relationship to audit fee, while the proportion of family ownership, the size of the audit committee and the size of the firm have no relationship with the audit fee.

The structure of this article is as follows: Part 2 presents a literature review and hypotheses development; Part 3 provides a sample description and research variables; Part 4 includes the results and discussion; Part 5 presents the conclusions and limitations, and suggestions for future research.

## Literature Review

### *Theoretical Framework*

Agency theory is the basis of the theory for the firm's business practices used so far. This agency theory was first coined by Jensen and Meckling, who state (1976: 17) that an agency relationship is a contract between a manager (agent) and an investor (principal). Agency theory states that if the principal (owner) and agent (manager) have different interests, agency conflict will emerge (Jensen & Meckling, 1976). Based on classical agency theory, both principals and agents tend to maximise benefits and positions using the interpretation of their individual contracts (Fitri et al., 2019; Putra, Pagalung & Habbe, 2018).

Research by Peter et al. (2000) explains that conflicts consistent with agency theory can still arise in family businesses. There are two characteristics of a family business that give rise to requests for audits that can be measured directly. The first is the proportion of non-family management. This characteristic is related to the use of personnel to carry out firm operations that come from non-family members. It is possible for family business owners to delegate some level of management responsibility to non-family members. This will increase the demand for auditing services due to incurring of other costs, such as the cost of monitoring, to achieve confidence that delegated responsibility is not misused and that the loss of control of the owner of the firm is increased. If the proportion of non-family management increases, firm owners will show greater demand for supervision to reduce management evasion regarding information asymmetry between non-family management and firm owners.

The second characteristic is the proportion of non-family representatives on the board of commissioners. This is the cause of increased demand for audit services in family businesses when they seek capital from outside investors (non-family members). An increasing ownership difference creates a conflict of interest because the majority owner (family) has an incentive to divert resources for personal use. This can cause limited resource flow to impact non-family owners. Benston (1985, in Peter et. al., 2000) states that the capacity and incentives for non-family owners to initiate supervision will depend on their level of ownership and their representation on the board of commissioners. If the proportion of non-family ownership and representation of directors has increased, there will be a demand for greater supervision.

Carcello et al. (2002) state that one way to send signals to the capital market is to use more complex audit services. Fan and Wong (2005) say that another way is to choose a credible information service provider. These two studies led to the use of more complex and high-cost audit services. In general, companies that want to send signals to this market are in a good state and have good governance.

Signals of good corporate governance are expected to improve perceptions of the firm so that in the future it will obtain financing from the market, increase firm value or reduce financing costs. Therefore, companies that have good corporate governance tend to be willing to pay a higher audit fee to gain credibility.

The theory of substitution was first put forward by Williamson (1983). It states that good corporate governance will reduce agency costs, so that the risk of the firm being audited will be lower and therefore the audit fee charged will also be lower (Wu, 2012). Audit is considered a form of external corporate governance that can be replaced by internal corporate governance at a certain level (Naser et al., 2013). Cohen et al. (2002) state that auditors also consider governance factors, especially the role of management in planning and conducting audits. Bedard and Johnstone (2004, in Griffin et al., 2008) state that the value of audit fee included in the engagement letter increases in line with earnings management risk and the interaction of earnings management risk with corporate governance risk.

## Hypotheses Development

### *Family Ownership and Audit Fee*

Agency theory states that if the firm owner – in this case. the family firm – and the management of the firm have different interests, it will trigger the emergence of an information asymmetry and agency conflict. Weak corporate governance can occur if the owner's family does not supervise the firm's activities directly and strictly, with the risk that each party will tend to try to benefit themselves. This can trigger an increase in agency costs so the firm requires higher audit risk and audit effort assessments, and can result in high audit fees. Nevertheless, family ownership by directly supervising firm activities means controlling family members have good information, which can reduce the demand for audit services and require lower audit efforts. This can result in lower audit fees.

Based on this explanation, the following research hypothesis was formulated:

**H1:** There is a relationship between family ownership and audit fee.

### *Family CEO and Audit Fee*

The founder who holds the position of CEO in a family firm is expected to be able to run the firm well because of their orientation to maintaining the good image of the firm (Anderson et al., 2003). Chan, Ezzamel and Gwilliam (1993) use ownership control as an explanatory variable in identifying the determinants of audit fee in the United Kingdom. Agency theory hypothesises that the level of demand for audit services is a function of the ownership control variable. That is, companies with diverse ownership structures need audit quality that is broader and higher than required to be able to meet the minimum mandatory requirements.

The majority of high control rights by the CEO can lead to management entrenchment, which is a condition in which the firm's management does not follow the control governance and control mechanisms of the firm (Berger, Ofek & Yermack, 1997). In the study, it was found that high ownership control was negatively related to audit fee, indicating that the majority of stakeholders could really oversee management activities through direct board membership and other informal sources.

**H2:** There is a relationship between the family CEO and audit fee.

### *Good Corporate Governance Implementation and Audit Fee*

GCG is a system and structure of good corporate governance with the aim of increasing added value for all stakeholders in the firm. According to Egon Zehnder (in Palestin, 2007), the essence of corporate governance in ensuring the implementation of corporate strategy, overseeing management in managing the firm, and requiring accountability is the duty of the board of commissioners. In accordance with previous research, elements of GCG used in this study are audit committees (Irawati et al., 2019; Muda et al., 2018), an independent board of commissioners and firm size (Irawati et al., 2019; Tandean & Winnie, 2016).

The audit committee has a very important role in the supervision and control of the firm so that the existence of an audit committee in a firm is expected to increase the effectiveness of supervision. The independent audit committee offers a monitoring mechanism to reduce earnings management practices and is able to effectively control management of opportunistic behaviour related to accounting choices (Bukit & Iskandar, 2019). A larger audit committee is expected to be able to better maintain the firm's performance, because it will increase the committee's oversight of the firm's management. Based on this description, the following hypothesis was formulated:

**H3:** There is a relationship between audit committee size and audit fee.

The greater proportion of independent commissioners is expected to be able to improve performance and conduct objective oversight, and thus protect the interests of the firm, so they will ask for more help from qualified auditors and impact an increase in audit fees. Based on this explanation, the following hypothesis was formulated:

**H4:** There is a relationship between independent commissioners and audit fee.

The firm size is a big picture of a firm that is shown by total assets, total sales, average total sales and average total assets (Fery & Jones, in Sujianto, 2001). Maria (2012) mentions that firm size is basically divided into three: small firms, medium firms and large firms. Determination is based on high total assets, which will make the audit process carried out by external auditors more complex and mean the audit duration will be longer. Based on this explanation, the following hypothesis was formulated:

**H5:** There is a relationship between firm size and audit fee.

## Research Design

### *Sample and Data Source*

The population in this study comprises family companies that are included in the LQ45 index for the research period 2014–16. Researchers choose family companies that went public and were included in the LQ45 index because the index consists of companies that have the highest average capitalisation in the last 12 months, showing a good firm performance.

Researchers were interested in whether a relationship existed between family ownership, implementation of good corporate governance and the amount of audit fees paid by family companies. Secondary data sources used in this study were financial reports and annual reports on family companies listed in the LQ45 index for 2014–16, obtained from the website www.idx.co.id.

### *Data Definition and Variable Measurement*

The dependent variable in this study is the audit fee received by the auditor for the audit services provided. The independent variables are family ownership, family CEO, audit committee, independent board of commissioners and firm size. The audit fee variable was measured using the natural logarithm of the audit fee. Family ownership is the involvement and influence of the family on the firm, which can be seen from the percentage of shares owned by members or certain family groups in the firm. In Indonesia, the IDX stipulates that family firm shares must be owned by at least 25% of certain family members or family groups. If the share ownership is less than 25%, then a family member must be on the firm's board of directors or board of commissioners. Using dummy variables, the family CEO who is proxied with a family member who acts as the board of directors or the board of commissioners of the firm is given a value of 1, while the family member of the firm owner who does not act as a board of directors or board of commissioners of the firm is given a value of 0. The audit committee is proxied by using the number of members of the audit committee in the firm. Independent commissioners are measured by the percentage of the total number of independent commissioners from all members of the board of commissioners by dividing the number of independent commissioners by the number of commissioners in the firm. Firm size is measured using the natural logarithm of total assets (Jao & Pagulung, 2011).

### *Research Method*

The analysis used in this study was multiple linear regression analysis using SPSS. The classic assumption test, which consists of a normality test, a multicollinearity test, a heteroskedasticity test and an autocorrelation test, was also performed. Following is the regression model used in this study:

$$Aud\_Fee = \alpha + ß_1 Fam\_Own + ß_2 CFAM + ß_3 Aud\_Com + ß_4 Ind\_Com + ß_5 Firm\_Size\ e$$

## Results and Discussion

### *Descriptive Statistics*

Based on Table 1, the average shareholding by the family in the firm in the study was 55.6903, or 55.69%. The standard deviation of 16.51123 indicates that the variability of family ownership variables in this study amounted to 18.38%. The highest value of the family ownership variable is 85.00, indicating that 85% of the shares are owned by the family, while the lowest value of the family firm variable is 25.57, with only 25.57% of the shares owned by the family.

**Table 1:** Descriptive statistics

| **Description** | **N** | **Min.** | **Max.** | **Sum** | **Mean** | **Std. Dev.** |
|---|---|---|---|---|---|---|
| Fam_Own | 36 | 25.57 | 85 | 2004.85 | 55.6903 | 16.51123 |
| CFAM | 36 | 0 | 1 | 30 | 0.83 | 0.378 |
| Aud_Com | 36 | 3 | 5 | 114 | 3.17 | 0.561 |
| Ind_Comm | 36 | 25 | 80 | 1346.75 | 37.4097 | 14.04897 |
| Firm_Size | 36 | 29.79 | 39.88 | 1116.64 | 31.0178 | 1.64158 |
| Aud_*Fee* | 36 | 20.01 | 25.23 | 805.65 | 22.3792 | 1.36628 |
| Valid N (*listwise*) | 36 | | | | | |

### *Family Ownership and Audit Fee*

The results of this study indicate that family ownership is not related to audit fee. This can be seen from the regression coefficient of family ownership of 0.010 with a significance value of 0.545. It can therefore be concluded that Hypothesis 1 is rejected, where family ownership is related to audit fee.

**Table 2:** Multiple linear regression results

| **Dependent Variable** | **Independent Variable** | **Coeff. of Regression** | **Std. Error** | **t-Statistic** | **Sig.** |
|---|---|---|---|---|---|
| Aud_*Fee* | (*Constant*) | 24.300 | 4.702 | 5.168 | 0.000 |
| | Fam_Own | 0.010 | 0.016 | 0.612 | 0.545 |
| | CFAM | -2.528 | 0.820 | -3.082 | 0.004 |
| | Aud_Com | 0.478 | 0.394 | 1.212 | 0.235 |
| | Ind_Comm | -0.056 | 0.026 | -2.167 | 0.038 |
| | Firm_Size | 0.007 | 0.129 | 0.057 | 0.955 |
| Std. Error of Estimation | | 1.23267 | | | |
| R Square (R2) | | 0.302 | | | |
| F - Statistic | | 2.600 | | | |
| Sig. F | | 0.046 | | | |

Hypothesis testing results show that when a family has a role in the ownership of a firm where some or some family members have a majority share or a certain number of shares, this does not influence the amount of audit fee paid for audit services that have been performed by external auditors. Based on several previous studies, the audit fee incurred by family companies is related through two theories: substitution theory and signalling theory, depending on the agency problem and corporate governance. Conflicts that occur within the family firm are also very influential, based on alignment effect and entrenchment effect.

***Family CEO and Audit Fee***

The results showed that the family firm CEO was associated with audit fee. This can be seen from the regression coefficient of –2.528 with a significance value of 0.004. It can therefore be concluded that Hypothesis 2 is accepted, with the CEO of the family firm related to audit fee.

The results of hypothesis testing show that when a family member occupies a CEO position in a firm and at the same time acts as a shareholder (principal and agent), this encourages the CEO to monitor the firm more than if they were just controlling the firm, even though they have effective control. This is expected to reduce agency problems within the firm and result in reduced agency costs and audit risk, causing the audit effort undertaken by external auditors to become narrower and result in a lower audit fee.

***Audit Committee and Audit Fee***

The results of this study indicate that the size of the audit committee is not related to audit fee. This can be seen from the regression coefficient of 0.478 with a significance value of 0.235. It can therefore be concluded that Hypothesis 3 (is rejected, with the size of the audit committee not related to the audit fee.

Hypothesis testing results indicate that the size of the audit committee or the number of members of the audit committee in the firm is not a reason to be able to influence the amount of audit fee paid for audit services that have been performed by external auditors. Arguments that might to explain the insignificant relationship, or the number or number of members of the audit committee in the firm do not affect financial reporting for the better, thus reducing the work of external auditors, but not the quality and competence of the audit committee.

***Independent Commissioners and Audit Fee***

The results of this study indicate that the proportion of the independent board of commissioners is not related to the audit fee. This can be seen from the regression coefficient of –0.056 with a significance value of 0.038. It can therefore be concluded that Hypothesis 4 is accepted, with the proportion of independent commissioners related to audit fee.

The results of the hypothesis show that the greater proportion of independent commissioners in the firm affects the quality of the firm's performance. Corporate governance is specifically implemented through the board of commissioners. An independent board of commissioners has primary responsibility for superior supervision so corporate financial reporting is reliable and valid (Beasley, 1996). This is expected to reduce the efforts and risks of external auditor audits, leading to lower audit fees.

### *Firm Size and Audit Fee*

The results of this study indicate that firm size is not related to audit fee. This can be seen from the regression coefficient of 0.007 with a significance value of 0.955. It can therefore be concluded that hypothesis 5 is rejected, with the size of the firm not related to audit fee.

Hypothesis results show that the size of the firm does not definitely influence the amount of audit fee paid for audit services that have been performed by external auditors. This can indicate that the size of a large firm does not make the audit process carried out by the auditor more complicated, so that the amount of the audit fee is not related.

## Conclusion

This study aimed to determine whether a relationship existed between family ownership, good corporate governance and the audit fee paid by family companies. Family ownership was analysed using two proxies: the proportion of family ownership and family members who serve as CEO. Based on the results of data analysis, it can be concluded that family ownership is not related to the amount of audit fee incurred, with the presence of family members who serve as CEOs in the firm related to the amount of audit fee incurred by the firm. Auditors tend to charge lower audit fees due to reduced effort and audit risk when conducting audits in family companies. This is a result of reduced agency conflict between manager-shareholding due to CEO duality, which acts as principal and agent. This can be explained by a negative (alignment effect) or positive (entrenchment effect) relationship between audit fee and family shareholdings.

Good corporate governance is analysed using three proxies: the proportion of the size of the audit committee, the independent board of commissioners and the size of the firm. Based on the results of data analysis in this study, it can be concluded that the size of the audit committee is not related to the amount of the audit fee issued by the firm. The independent board of commissioners deals with the amount of audit fee incurred by the firm. This will reduce the assessment of audit risk and result in lower audit effort so the audit fee incurred by the firm will also be reduced. The size of the firm is not related to the audit fee issued by the firm.

This research was limited to companies listed in the LQ45 Index for the period 2014–16 that were family firms, thus providing a less comprehensive picture of the condition of publicly listed companies in Indonesia. It is therefore expected that further research can increase the number and region of the study sample, so research results can be obtained with a higher level of generalisation. Future studies should develop or use other measurement instruments to calculate good corporate governance of public companies in Indonesia – for example, assessments by the scorecard or corporate governance index (CGPI, ASEAN CG Scorecard, and scorecard according to ACMF), so that the number of research samples can be wider. Future studies are also expected to be able to add research variables (independent, moderating and other variables) that can strengthen or weaken the dependent variable.

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