

**CASH FLOW PREDICTION PERFORMANCE FOR EARNINGS QUALITY AND
FAMILY FIRM: THE SEPARATION OF CASH FLOW RIGHTS, CONTROL RIGHTS,
AND EXPROPRIATION**

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ABSTRACT:

This study aims to investigate cash flow performance for earnings quality and family firm, the separation of cash flow rights, control rights, and expropriation. This research results that cash flow rights has a positive effect on earnings quality. These empirical findings supports the argument of positive incentive effect and suggests that controlling family has earnings quality and a commitment to maximize the value of firm so that it does not make the expropriation towards minority shareholders. These empirical findings suggest that when the rights of cash flows of the controlling family are high, the controlling family will not do the expropriation towards minority shareholders. Control rights have a positive effect on earnings quality. These empirical findings suggest that a high control rights can improve the quality of earnings and quality of family corporate disclosure. The family of controllers has the incentive and ability to monitor the manager in monitoring the interests of all shareholders. The firms with concentrated ownership has a commitment to be credible that the controlling owner is willing to build a reputation for not to expropriate the minority shareholders. This finding is consistent to that the control rights can be used to solve the agency problem.

Keywords: cash flow rights, control rights, expropriation, ultimate ownership

1. INTRODUCTION

The study on the phenomenon of family firm financial reporting quality by making predictions of cash flows over earnings quality has never been done in Indonesia. The relevance and urgency of this research are that, (1) the increasing ultimate ownership by the family can cause the agency conflict between the controlling shareholders and the minority shareholders, (2) the controlling family shareholders, by the family, have often use the control rights which exceed its cash flow, (3) the controlling shareholders often perform actions such as expropriation.

Ultimate ownership of the family firm has raised the issue that a concentrated ownership in the hands of controlling shareholders will have ineffective corporate governance (Bosec and Laurin, 2008). Ali et al. (2007, p. 239) stated that family firms face agency problems that arise between controlling shareholders and minority shareholders, so that controlling shareholders can do the manipulation of accounting profits such as hiding transactions with third parties or doing entrenchment in corporate management positions. Ali et al. (2007) and Anderson and Reeb (2003) stated that the first type of agency problems are more common in non-family firms.

The level of ownership can be increasing or decreasing the earnings information, depending on whether the incentive effect or the influence of information that dominating them. (Francis et al., 2005). Wang (2004) argue that family ownership affects the quality of accounting earnings in two opposite, which are the entrenchment effect and the alignment effect. Family firms are also able to expropriate the wealth of the company through compensation, transactions with third parties, or dividends (Anderson and Reeb, 2003).

Based on the background of the problem, the problem in this study relates to (1) testing the level of cash flow rights, control rights, CFRL (cash flow rights leverage), (2) testing the level of expropriation which is experienced by the minority shareholders, (3) testing the quality of family earnings in the ultimate ownership.

2. LITERATURE REVIEW AND HYPOTHESIS REFERENCES

Family firms and Quality of Financial Reporting

Corporate disclosure has been studied by Ali (2009), Ali et al. (2007), Francis et al. (2004), and Kaznik and Lev (1995). Ali et al. (2007) have investigated aspects of corporate disclosure that includes the quality of financial reporting, especially the quality of earnings and voluntary disclosure of the bad news through management earnings forecast.

Agency problems between owners of firms with corporate managers can be reduced by providing compensation based on earnings performance measures. Consistent with the argument of Chen (2005), which provide evidence that CEO payment is based on company profits. Direct monitoring by the family and their better knowledge of the family business is the reason that the opportunistic behavior of managers affect the family earnings. For example, the family members' knowledge on business conditions and relationships with suppliers and customers will make them more effective in detecting whether goods have been sent earlier to earn income or unwarranted discounts that have been made to determine the discretionary spending.

The second type of agency problems also leads to higher accounting earnings manipulation by the family firm. This manipulation is done for example by hiding adverse effect on third-party relationships or facilitate entrenchment of family members in management positions. Legal obligations and a reduction in stock prices is a result of the private benefit of helping to reduce both types of agency problems (Ali et al., 2007).

Ali et al. (2007) compare the quality of family earnings by non-family firms. Ali et al. (2007) used the model of Dechow et al., 1998; Barth et al. 2001 and Cohen, 2004, which include the quality of reported earnings model by testing the ability of its components to predict future cash flows. Ali et al. (2007) used the residuals obtained from regression of future cash flows from operations in the prior period earnings components. Ali et al. (2007) research result show that earnings quality is significant, which means that there is a significant differences in earnings quality between family firms with non-family firms. The predicted sign is consistent with previous research studies of Cohen (2004). Overall results showed that the profit component of the family firm is better at predicting future cash flows.

Family firms and Control Rights Ownership, Cash Flow Rights, Cash Flow Rights Leverage and Control Rights Ratio on Cash Flow Rights

Ali et al. (2007) examined the corporate disclosure by family firms. Their results show that family firms report better earnings quality but little did the family company disclosed about their corporate governance practices. They found that family firms make better financial disclosure.

Wang (2004) examined about family firm and the quality of accounting income by providing two opposing hypotheses, that are the entrenchment hypothesis and the alignment hypothesis. The results are consistent with the influence of alignment where family ownership created long-term incentive for the family firm and aligned with the interests of the family and other shareholders so as to improve the quality of accounting earnings.

Anderson and Reeb (2003) examined the family ownership and corporate performance. The result of their research show that family firms have better performance than non-family firms. Additional analysis shows that family firms and firm performance has a non-linear relationship when family members are also involved in the position of CEO, the company's performance is better with a CEO from outside.

In the literature, it is said that the concentration of ownership separate between control rights and cash flow rights. Controlling shareholder or a family firm can do the mechanisms by increasing of control rights in excess of cash flow (cash flow rights leverage / the discount between control rights and cash flow rights).

Cash Flow Rights

In a concentrated ownership, the controlling family has a concentration of cash flow rights (Claessens et al., 2000). Positive incentive effect argument states that controlling shareholders are committed to maximize the value of the firm by not doing expropriate. This argument is consistent with that expressed by Jensen and Meckling (1976) and La Porta et al. (2002) that the ownership concentration is beneficial for the firm. The definition of ownership by previous researchers is the cash flow rights. Cash flow rights can be used to address agency problems because it can have a positive effect on firm value (Jensen and Meckling, 1976).

Concentration of cash flow rights and control rights concentration can lead to or have an influence on the quality of corporate financial reporting. Cash flow rights is the financial incentives that led to the controlling shareholders or family to not conducting expropriation. Therefore, the cash flow rights of controlling shareholders will have a positive effect on the quality of corporate financial reporting. This happens because the controlling shareholders or their families are intended to show to the minority shareholders that the firm is managed properly and there is no fraud in the financial statements.

H1: Cash flow rights of the controlling shareholder of the family firm has a positive effect on earnings quality.

Control Right

Controlling shareholder controls the company through the mechanism of increased control. Improved control is done through a pyramidal ownership, cross ownership and stock with different votes (La Porta et al., 1999; Claessens et al., 2000a).

La Porta et al. (1999) stated that the control rights is the voting rights in determining the company's important policies. Control rights is used by the controlling shareholder as the power to determine policy such as expropriation. Shleifer and Vishny (1997) and La Porta et al. (2002) stated that there is a negative relationship between concentration of ownership in the firm. The negative control effect and the positive incentive effect arguments are used by Silva and Leal (2004) for the relationship between dividends and ownership structure and firm value. Based on the negative control effect, the controlling shareholder has an incentive to sacrifice the interests of other shareholders. Based on the positive incentive effect, the controlling shareholder has an incentive to monitor managers in order to consider the interests of all shareholders.

H2: The control rights of the controlling shareholders at family firm has positive effect on earnings quality.

Cash Flow Right Leverage

Cash flow rights leverage is a deviation between cash flow rights with control rights. Cash flow right leverage shows an increase in control rights through the mechanism of pyramidal ownership and cross ownership (La Porta et al., 1999). Cash flow right leverage is the incentive for controlling shareholders to use their power in order to get through the act of expropriation of private benefits. Cash flow right leverage showed an increase in shareholder control through various mechanisms such as pyramidal ownership and cross-ownership. Therefore, control rights and cash flow right leverage have an impact on the quality of financial reporting.

H3: The difference between control rights and cash flow rights of controlling shareholders in family firms have a negative influence on quality of earnings.

Expropriation of Free Cash Flow

Free cash flow is cash flow which is indicated as an excess of investment in positive NPV projects (Jensen, 1986). Bozec and Laurin (2008) stated that the company has a high free cash flow which led the controlling shareholders to have the opportunity to perform in accordance with company policy discretion. This cause the controlling shareholders have an incentive to expropriate against minority shareholders.

Ali (2009) examined the effect of expropriation of minorities at the level of disclosure that occurred in France where the agency problems arise between controlling shareholders and minority shareholders. His results indicate that there is an agency problem between controlling shareholders and minority shareholders. The controlling shareholders have private information on the cost of minority shareholders when they have control rights which exceed the cash flow rights, so that they make disclosures that are not qualified. His results show a positive relationship between the level of disclosure with the family control, the same as the findings of Ali et al. (2007).

Fan and Wong (2002) stated that controlling shareholders can expropriate minority shareholders' interests to benefit private interests. Expropriation is done through transactions with third parties by transferring profits to other firms in the control of the controlling shareholder. Thus, companies that have a separation of control rights and cash flow rights tried to hide the transaction and give bad information. Controlling shareholders have incentives to minimize and delay disclosure to avoid the intervention to other shareholders or base their decisions on inadequate information. Based on the above, it can be said that expropriation could affect the quality of financial reporting.

H4: The expropriation on the family firm has negative effect on the quality of earnings.

3. RESEARCH METHOD

Sample Selection and Data Collection

The research samples are public companies listed on the Indonesia Stock Exchange (IDX) for a period of 6 (six) years, ie from 2004 until 2009. The population in this study was all manufacturing companies listed on the Indonesia Stock Exchange. The selection of the research samples are based on purposive sampling method to obtain representative samples in accordance with the specified criteria.

Dependent Variable

In this study, the dependent variable is the quality of corporate earnings.

Independent Variables

Control Right

La Porta et al. (1999) stated that the control right (CR) is the right to vote to participate in setting corporate policy. Claessens et al. (2002) defines the control right as the actual ownership. Du and Dai (2007) stated that the control rights are the right to vote in determining corporate policy. Control rights are measured by using the La Porta et al. (1999, 2002). Control rights are measured from the right of direct control coupled with indirect control rights held by the ultimate shareholder. The direct control right is the percentage of ownership in the name of the controlling shareholder. The indirect control right is the minimum number in each chain of ownership.

Cash Flow Rights

Cash flow right is the right of shareholders to the company's finance (La Porta, 1999). whereas, Claessens et al. (2002) defines cash flow rights as actual ownership. Furthermore, Du and Dai (2007) argue that cash flow right is a right to get a dividend. Cash flow right is calculated using the formula of La Porta et al. (1999, 2002). Cash flow right is measured from direct cash flow rights added to the indirect cash flow rights. Direct cash flow right is the percentage of ownership in the name of the controlling shareholder. Indirect cash flow right is a multiply of the percentage of shareholders ownership in each ownership chain.

Cash Flow Right Leverage

Claessens et al. (2000) found that the ownership of companies in East Asia is a pyramid-shaped and cross-holding. This ownership arrangement created a separation of the separation of ownership in cash flow rights and the control right (voting rights). Because of the separation of cash flow rights from the control rights increases, controlling owners become more defensive or fortified (entrenched) with the level of control, while the cash flow rights (ownership) give a low alignment of interest between the controlling

owner and minority shareholders. The controlling owner can expropriate minority shareholder wealth, and corporate disclosure is a mechanism to facilitate controlling owners in masking their private benefits of control.

Cash flow rights and control rights can differ because the company issuing class shares give the control right that is different from cash flow rights (Faccio and Lang, 2002). Furthermore, Faccio and Lang (2002) stated that the cash flow rights and control rights are different because of the arrangement of the pyramid and holding through control chain which is folds. In this study, we use expropriation measure formula by Claessens et al. (2000) which calculate the difference of control rights and cash flow rights of the controlling shareholders. CFRL is calculated using the formula of La Porta et al. (1999, 2002). CFRL is calculated by deducting the control rights to cash flow rights.

Control Variables

Size

Classification of size or size is classified based on by the size of the total assets. In this study, size was measured from the natural logarithm of total assets.

Leverage

Leverage describes the company's capital structure, the greater the proportion of debt used by companies, investors bear the greater risk. In this research, we used Debt to Equity Ratio (DER) to measure leverage, that is by the total liabilities divided by total equity.

Research Model

Predictive Ability of Cash Flows

Prior to hypothesis testing of hypothesis 1 through 4, we conduct a prediction of earnings quality based on the components of operating cash flow of the future.

$$AKO_{t+1} = \alpha_0 + \alpha_1 AKO_{it} + \alpha_2 \Delta AR_{it} + \alpha_3 \Delta INV_{it} + \alpha_4 \Delta AP_{it} + \alpha_5 DEPR_{it} + \alpha_6 LAIN_{it} + \varepsilon_{it} \dots (1)$$

In this case:

OCF = Operating cash flow of firm i year t minus the accrual of extraordinary items and discontinued operations.

ΔAR = Change of accounts receivable (accounts receivable).

ΔINV = Changes in inventories (inventory).

ΔAP = Changes in trade payables (accounts payable).

DEPR = Depreciation and amortization expenses.

OTHER = other accruals, calculated by Profit - ($AKO + \Delta AR + \Delta INV - \Delta AP - DEPR$), where the profit is income before extraordinary items and discontinued operations (discontinued operations).

Empirical measure of earnings quality used the residual value and the model of earnings, and cash flow components of the future used the standard deviation value residualnya to measure the quality of financial reporting which is used by Cohen (2006) and Hutton (2007). In this study, we did not use the residual size but use earnings quality measures based on absolute predicted values. The relationship model between the components of earnings and cash flows of future is estimated using the prediction value to measure the quality of earnings.

Testing Hypotheses 1 to 4

The hypotheses testing of 1 to 4 is done by using multiple regression model to analyst the relationship quality of earnings with cash flow rights, control rights and cash flow rights leverage is as follows:

$$\text{Quality of Earnings} = \alpha_0 + \alpha_1 HK + \alpha_2 SIZE + \alpha_3 ROA + \alpha_4 LEV + \varepsilon \dots (2)$$

$$\text{Quality of Earnings} = \alpha_0 + \alpha_1 HAK + \alpha_2 SIZE + \alpha_3 ROA + \alpha_4 LEV + \varepsilon \dots (3)$$

$$\text{Quality of Earnings} = \alpha_0 + \alpha_1 CFRL + \alpha_2 SIZE + \alpha_3 ROA + \alpha_4 LEV + \alpha_5 Ekspropriasi + \varepsilon \dots (4)$$

In this case:

HK = Right controls.

HAK = Cash flow right

CFRL = difference between control rights and cash flow rights.

Size = Log of total assets.

ROA = Profit before extraordinary items divided by total assets.

LEV = Leverage is the ratio of total debt divided by total assets at the beginning of the fiscal period.

Expropriation = to determine the firms which experiencing expropriation, we rank the ratio of net operating cash flow divided by total assets. Higher the ratio of the suffering of expropriation (Bosec and Laurin, 2008).

Control variables in the model are based on Lev (1983) and Ali et al. (2007). They showed that the persistence of earnings related to the size of companies and various industry characteristics such as type of product, level of competition, and operating leverage. ROA and LEV are as control variables towards profitability upon persistence.

4. RESULTS AND DISCUSSION

Descriptive Statistics

Companies that are used are as many as 625 manufacturing companies, where there are 95 companies that are not complete. The sample companies used in the study are as much as 530 manufacturing companies from 2004 until 2009. The descriptive statistics can be seen in Table 1.

Table 1. Descriptive Statistics

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
CFR	530	.05	1.00	.5131	.22157
CR	530	.14	1.00	.5440	.21399
CFRL	530	-.28	.43	.0309	.07430
SIZE	530	.02	14.83	10.5637	1.96763
ROA	530	-1.52	6.08	.0457	.29365
NET AKO/TA	530	-56.45	.85	-.0504	2.45659
LEV	530	.00	522.27	4.2884	38.50557
Valid N (listwise)	530				

From Table 1, it can be seen that the cash flow right (CFR) has an average of 0.5131, while the control right (CR) has an average value of 0.5440. The cash flow rights leverage / CFRL has an average value of 0.0309. Family firms have an average value of SIZE for about 10.56 million, ROA of 0.0457, and the leverage of 2.28 million. The average value of expropriation is -0.05. This suggests that family firms did not experience any expropriation. This is consistent with that expressed by Bozec and Laurin (2008) that the ratio of Net Ako / Operating cash flow divided by low total assets shows that the company had no expropriation, and if they got a high ratio then it indicates that the company suffered from expropriation.

Cash Flow Prediction Capability Model for Quality of Earnings

Based on the study Ali et al. (2007), Dechow et al. (1998), and Cohen (2004), earnings quality is measured based on the ability of earnings components to predict future cash flows. Earnings quality measures derived from the regression residual operating cash flow that will come in the period of the components of earnings (Ali et al., 2007, Cohen, 2006 and Hutton, 2007). The regression equation is as follows:

$$AKO_{t+1} = \alpha_0 + \alpha_1 AKO_{it} + \alpha_2 \Delta AR_{it} + \alpha_3 \Delta INV_{it} + \alpha_4 \Delta AP_{it} + \alpha_5 DEPR_{it} + \alpha_6 LAIN_{it} + \varepsilon_{it} \dots \dots \dots (2)$$

Cash Flow Right Hypothesis

Cash Flow Right Model

$$\text{Quality of Earnings} = \alpha_0 + \alpha_1 HAK + \alpha_2 SIZE + \alpha_3 ROA + \alpha_4 LEV + \varepsilon$$

Table 2. Table of Cash Flow Right Anova

ANOVA^b

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.252	4	.063	3.427	.009 ^a
	Residual	9.633	525	.018		
	Total	9.885	529			

a. Predictors: (Constant), LEV, ROA, SIZE, CFR

b. Dependent Variable: Quality of Earnings

From Table 2 above, it shows that the model used to test the hypothesis of cash flow right (CFR) is a good model because the value of F indicates alpha = 0.009. This indicates that the components of cash flow can be used to predict the future earnings. These findings also indicate that the model can be used to predict earnings quality of family firms.

Empirical Hypothesis Testing of Cash Flow Rights

$$\text{Quality of Earnings} = \alpha_0 + \alpha_1\text{HAK} + \alpha_2\text{SIZE} + \alpha_3\text{ROA} + \alpha_4\text{LEV} + \varepsilon$$

Table 3. Coefficients of Cash Flow Rights

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.355	.036		37.847	.000
	CFR	.045	.027	.073	1.684	.093
	SIZE	.010	.003	.146	3.382	.001
	ROA	.000	.020	.001	.020	.984
	LEV	4.712E-5	.000	.013	.308	.758

a. Dependent Variable: Quality of Earnings

From Table 3, the empirical findings show that the cash flow rights leverage (CFR) was positively related to earnings quality and showed alpha = 0.093. These empirical findings support the argument of positive incentive effect and suggests that the controlling family is committed to maximizing shareholder value. These empirical findings suggest that when cash flow rights of the controlling family is high, the controlling family will get earnings quality so that it will not do the expropriation on minority shareholders. This finding is consistent with Jensen and Meckling (1976) and La Porta et al. (2002). This finding could solve the agency problems between controlling shareholders and minority shareholders.

Control Right Hypothesis

The research model used to test the hypothesis that control rights are as follows:

Control Right Model

$$\text{Quality of Earnings} = \alpha_0 + \alpha_1\text{HK} + \alpha_2\text{SIZE} + \alpha_3\text{ROA} + \alpha_4\text{LEV} + \varepsilon$$

Table 4. Control Right Anova

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.269	4	.067	3.672	.006 ^a
	Residual	9.616	525	.018		
	Total	9.885	529			

a. Predictors: (Constant), LEV, ROA, SIZE, CR

b. Dependent Variable: Kualitas Laba

From Table 4, it shows that the model used to test the hypothesis of control rights is a good model because the value of F indicates an alpha of 0.006. This suggests that cash flow has the ability to predict the quality of earnings. It also shows that the model can be used to predict the earnings quality of family firms.

Empirical Hypothesis Testing Control Rights

$$\text{Quality of Earnings} = \alpha_0 + \alpha_1\text{HK} + \alpha_2\text{SIZE} + \alpha_3\text{ROA} + \alpha_4\text{LEV} + \varepsilon$$

Table 5. Coefficients of Control Rights

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.348	.036		37.106	.000
	CR	.054	.028	.084	1.948	.052
	SIZE	.010	.003	.147	3.396	.001
	ROA	8.727E-5	.020	.000	.004	.997
	LEV	5.138E-5	.000	.014	.336	.737

a. Dependent Variable: Quality of Earnings

In testing the control right hypothesis, we conducted the classic assumptions test and eliminate data outliers. The hypothesis testing results about control rights can be seen in Table 5. Control right is a voting right to determine the company's policy and is usually used as a power in determining the policies that benefit private companies. In Table 5, it can be seen that control right has a positive effect on earnings quality with alpha of 0.052. These empirical findings suggest that a high control right can improve the quality of earnings and quality of family corporate disclosure. These findings support the argument of positive incentive effect (Silva and Leal, 2004) that the family of controllers have the incentive and ability to monitor the manager to pay attention to the interests of all shareholders. This finding also supports Gomes (2000) that firms with concentrated ownership has a commitment to be credible that the controlling owner is willing to build a reputation for not to expropriate minority shareholders. These empirical findings are also consistent with the findings of Ali et al. (2007) that family firms disclose finances better. This finding is also consistent with Anderson and Reeb (2003) that the family company run the company better and have better performance than non-family firms.

Cash Flow Right Leverage Hypothesis and Expropriation

CFRL Model, and Expropriation

$$\text{Quality of Earnings} = \alpha_0 + \alpha_1\text{CFRL} + \alpha_2\text{SIZE} + \alpha_3\text{ROA} + \alpha_4\text{LEV} + \alpha_5\text{Ekspropriasi} + \varepsilon$$

Table 6. Anova of CFRL and Expropriation

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.270	5	.454	31.233	.000 ^a
	Residual	7.615	524	.015		
	Total	9.885	529			

a. Predictors: (Constant), NET AKO/TA, LEV, ROA, CFRL, SIZE

b. Dependent Variable: Kualitas Laba

From Table 6, it shows that the model used to test the cash flow right leverage / CFRL hypothesis that cash flow rights leverage / CFRL, the separation and expropriation is a good model because the value of F indicates an alpha of 0.000. This suggests that cash flow has the ability to predict the quality of earnings. It also shows that the model can be used to predict firms earnings quality.

Empirical Testing of CFRL Hypotheses, and Expropriation

$$\text{Quality of Earnings} = \alpha_0 + \alpha_1\text{CFRL} + \alpha_2\text{SIZE} + \alpha_3\text{ROA} + \alpha_4\text{LEV} + \alpha_5\text{Ekspropriasi} + \varepsilon$$

Table 7. Coefficients of CFRL and Hypotheses

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.367	.029		47.420	.000
	CFRL	.032	.071	.018	.458	.647
	SIZE	.011	.003	.162	4.209	.000
	ROA	.003	.018	.007	.182	.855
	LEV	4.753E-5	.000	.013	.349	.727
	NET AKO/TA	.025	.002	.457	11.917	.000

a. Dependent Variable: Quality of Earnings

In testing the hypothesis of cash flow rights leverage / CFRL, we conducted the classic assumption test and eliminate data outliers. The testing results of CFRL hypotheses can be seen in Table 7. Then, all variables are divided by total assets to get good results, so that the SIZE variable has a positive coefficient on alpha of 0.000. This suggests that the larger the size, the more qualified is the firm's earnings. CFRL represents the difference between cash flow rights and control rights, not in relation with earnings quality. This suggests that CFRL has no effect in increasing earnings quality and family firm disclosure quality. This argument is consistent with the positive incentive effect (Silva and Leal, 2004) that the family of controllers have the incentive and ability to monitor the manager to pay attention to the interests of all shareholders and not to expropriate.

ROA had no effect on earnings quality. This suggests that the family company is experiencing growth so it does not focus on achieving profit. Leverage variable had no effect on earnings quality. Expropriation is positively associated with earnings quality as indicated by the alpha of 0.000. This suggests that for companies in Indonesia, a company that would expropriate actually show good earnings quality.

5. CONCLUSION AND LIMITATION

Conclusion

These results indicate that the cash flow right has a positive effect on earnings quality. These findings support the argument of positive incentive effect and suggests that the controlling family has a good earnings quality because it has a commitment to maximize the value of a company that does not make the expropriation of minority shareholders. This finding is consistent with Jensen and Meckling (1976) and La Porta et al. (2002) that high cash flow rights can be used to solve the agency problem.

Control rights have a positive effect on earnings quality. These empirical findings suggest that high control rights can improve the quality of earnings and the quality of family firm disclosure. These findings support the argument of positive incentive effect (Silva and Leal, 2004) that the family of controllers have the incentive and ability to monitor the manager to pay attention to the interests of all shareholders. These findings also support the research of Gomes (2000) that firms with concentrated ownership has a commitment to be credible that the controlling owner is willing to build a reputation for not expropriate minority shareholders. This finding is consistent with Jensen and Meckling (1976) and La Porta et al. (2002) that the control rights can be used to solve the agency problem.

The SIZE variable has a positive effect on earnings quality. This suggests that the family is growing so that it focused on achieving growth in earnings. These findings also indicate that inside the family firm, the greater the SIZE the more it get qualified earnings. Expropriation variable has a positive effect on earnings quality. This suggests that the family company in Indonesia which conducted expropriation actually has a qualified earnings.

Limitation

This study is a preliminary study and has limitations because the sample data is only from 2004 until 2009. The study also only used a sample of public listed manufacturing companies in Indonesia. Manufacturing company was selected because many manufacturing companies are owned by family. This study uses only manufacturing companies due to get the consistency of research results and to present the characteristics of different industries. By simply using the company's manufacturing industry, the aims are to get the same characteristics and to eliminate the differences in industry characteristics.

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