The Effect of Related Party Transactions on the Performance of Indonesian Listed Companies

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Abstract. *The purpose of this paper is to analyze the impact of related party transactions (RPTs) on company performance using a panel data regression on 388 non-financial companies listed in Indonesia Stock Exchange during the 2015-2018 period. RPT variables used in this study are divided into several categories, namely transactions with related parties in the operational field (operational RPTs), financial field (financial RPTs), other fields (other RPTs), and total RPTs (sum of the three previous types). The study finds a significant negative relationship between financial RPTs and other RPTs on company performance. This finding is consistent with the precedent research that non-operational RPTs (i.e., financial RPTs and other RPTs) are commonly used by controlling shareholders as tunneling channels to expropriate minority shareholders. The results suggest policymakers to monitor more closely RPTs, particularly financial and other RPTs, that are more likely to be used as tunneling activities that are detrimental to firm performance. The results of this study are robust to various proxies of firm performance, providing additional empirical studies on RPTs in emerging countries with concentrated ownership structure, and shedding direct light on which type of RPTs that is mainly used as tunneling channel.*

Keywords: *Efficient transaction hypothesis, firm performance, Indonesia, related party transactions, type II agency problem*

Abstrak. *Tujuan dari makalah ini adalah untuk menganalisis pengaruh transaksi pihak berelasi (RPT) terhadap kinerja perusahaan dengan menggunakan regresi data panel pada 388 perusahaan nonkeuangan yang terdaftar di Bursa Efek Indonesia selama periode 2015-2018. Variabel RPT yang digunakan dalam penelitian ini dibagi menjadi beberapa kategori yaitu transaksi dengan pihak berelasi di bidang operasional (RPT operasional), bidang keuangan (RPT finansial), bidang lainnya (RPT lainnya), dan total RPT (penjumlahan dari ketiga jenis RPT yang disebutkan sebelumnya). Penelitian ini menemukan hubungan negatif yang signifikan antara RPT finansial dan RPT lainnya terhadap kinerja perusahaan. Temuan ini sejalan dengan penelitian sebelumnya bahwa RPT nonoperasional (RPT finansial dan RPT lainnya) biasanya digunakan oleh pemegang saham pengendali sebagai sarana untuk mengambil alih dari pemegang saham minoritas. Hasilnya menyarankan para pembuat kebijakan untuk melakukan pemantauan lebih terhadap RPT, terutama RPT finansial dan lainnya, yang lebih mungkin digunakan sebagai aktivitas tunneling yang merugikan kinerja perusahaan. Penelitian ini menunjukan hasil yang kuat untuk berbagai proksi kinerja perusahaan, sehingga memberikan studi empiris tambahan tentang RPT di negara-negara berkembang dengan struktur kepemilikan terkonsentrasi, dan menjelaskan langsung jenis RPT yang terutama digunakan sebagai saluran tunneling.*

Kata kunci: *Efficient transaction hypothesis, Indonesia, masalah keagenan tipe II, performa perusahaan, transaksi pihak berelasi*

Introduction

According to Utama (2015), there are two contradictory views about RPTs, namely the efficient transaction hypothesis and the conflicts-of-interests hypothesis. In their research, Bansal and Thenmozhi (2020) suggest that RPTs can be beneficial as it improves firm value and destructive as it destroys firm value. Cheung, et al. (2009) as well as Riyanto and Toolsema (2008) also state that RPTs have a dual effect known as tunneling and propping. Moreover, Cheung (2006) also find that tunneling and propping are two of three motivations of publicly listed companies to conduct RPTs other than earnings management. According to the efficient transaction hypothesis, RPTs give beneficial effects through the simplified negotiation process, reduction of transaction cost, economies of scale and scope (Gordon, et al., 2004; Chang & Hong, 2000) which improve the efficiency of resources allocation among related parties. On the opposite side, the conflicts-of-interests hypothesis (Shleifer & Vishny, 1997) postulates that RPTs can generate a detrimental effect due to the conflicts of interests between minority shareholders and controlling shareholders. Moreover, minority shareholders' value is proven to be shrinking due to particular RPTs in its company (Cheung, 2006).

The results of empirical studies on the impact of RPTs on firm performance are also still inconclusive. Bansal and Thenmozhi (2020) that scrutinize publicly listed firms in India over 2002-2015 find that companies use RPTs as mechanism for efficient transaction. They suggest that firms undertaking RPTs are associated with higher firm value and this result is even stronger for firm with higher concentration ownership. In another research, by using panel data regression analysis in 382 Korean companies during the period of 2001-2003, Shin et al. (2019) find that RPTs have a significant positive result on company earnings. They document that RPTs, especially the operational RPTs, enhance the process of income smoothing to improve the information

quality of earnings reported by companies. Their conclusion is supported by Rasheed et al. (2019) that study 2,002 companies that were listed on the Bombay Stock Exchange from the 2011-2017 period. They discover that the RPTs, especially transactions related to income and expenses, have a significant positive effect on the company's ROA. The RPTs reduce the transaction costs and facilitate the sharing of resources among affiliated parties.

Other empirical studies present inverse results in support of the conflicts-of-interests hypothesis. Chen et al. (2009) using a sample of 763 China's registered companies during the period of 2002-2006 find that RPTs have a negative influence on firms' operational performance. Azim et al. (2018) also discover that RPTs have a negative and significant impact on firms' ROA and ROE. Wang et al. (2019) and Munir and Gul (2010) also draw similar conclusions after examining the RPTs within the companies that were listed on the Taiwan Stock Exchange & Gretai Securities Market and Malaysia Stock Exchange, respectively.

Another stream of empirical studies finds insignificant impact of RPTs on firm performance. Using a sample of manufacturing companies in Nigeria during the period of 2006-2014, Umobong (2017) finds no significant relationship between RPTs and the companies' ROA and EPS. Okoro and Jeroh (2016) and Anastasia and Onuora (2019) also draw similar conclusions after examining companies registered in Nigeria but during different time periods.

In China, Ying and Wang (2013) find that propping and tunneling have no significant relationship with the companies' ROA during the period of 2002-2008. Leung (2014) also find similar results when analyzing the impact of RPTs on the performance of companies registered in the China Stock Market and Accounting Research Database (CSMAR) from 2007-2011. The insignificant relationship between RPTs and firm performance is also observed in other countries such as Pozzoli and Venuti (2013) that use a sample of 40 companies registered in Italy from 2008-2011.

In Indonesia, some studies have been done regarding RPTs and company performance, but also with inconclusive results. Hendratama and Barokah (2020) that scrutinize 274 observations from firms listed in the Indonesian Stock Exchange (IDX) over 2015-2015 suggest a significant negative relationship between related party sales and firm value as well as related party purchases with firm value. Therefore, they find positive relationship between related party payables with firm value. Similarly, a research by Supatmi et al. (2019) in 40 banks on the IDX from 2013-2016 shows the RPTs, specifically the receivables RPTs, have a positive and significant effect on profitability, but payables RPTs are negatively related to performance. Furthermore, research conducted by Ardaninggar (2019) on 21 public companies in the real estate sector in Indonesia from 2015 to 2017 shows that RPTs have a positive effect on Tobin's Q but have no influence on ROE. Their study suggests that the market view RPTs positively and does not consider RPTs as a tool for expropriation.

Given the inconclusive evidences on the impact of RPTs on firm performance, this study attempts to provide additional empirical evidence on this topic especially in Indonesian context. The number of studies on this topic using Indonesian sample is still limited and those studies are usually focused only on certain sectors. Therefore, this study offers additional empirical evidence by conducting research with a wider range of sample using all non-financial companies listed on the Indonesia Stock Exchange (IDX) across different sectors. Furthermore, this research uses more recent sample period which is 2015-2018.

We consider Indonesia is a suitable research setting for this topic due to some considerations. First, majority of companies in Indonesia have concentrated ownership structure in which there is a majority shareholder with ownership and controlling interests of more than 10% of the total shares (Claessens et al., 2002). Second, approximately two-thirds of companies in Indonesia are group affiliated firms (Khanna & Yafeh, 2005).

Third, the total market value of these Indonesian business groups account for more than 50% of the total market capitalization of all companies listed on IDX (Shinta & Ahmar, 2011; Tambunan et al., 2017). Finally, more than 90% of companies listed on the IDX conduct RPTs (Utama, 2013).

Due to the concentrated ownership structure and the prevalent of business groups, Indonesian companies are more likely to engage in the related party transactions (RPTs) for the purpose of maximizing the wealth of the largest controlling shareholders (Utama, 2015; Utama et al., 2010). These RPTs are often used by the management who serves the largest controlling shareholders to transfer economic resources, services, and obligations among related parties within those business groups (Shin et al., 2019).

The rest of the paper is organized as follows. Section 2 reviews prior literature and the recent development of Indonesian regulations that are pertinent to RPTs. This section also explains the development of hypotheses. Section 3 discusses the data sources, sample selection, empirical models, and the operational of variables. Section 4 analyzes the results and explains the robustness tests.

Literature Review
2.1. *The efficient transaction hypothesis*
The efficient transaction hypothesis postulates that RPTs have positive impact on firm financial performance due to the reduction of related parties' transaction costs and increase company resource utilization (Bansal & Thenmozhi, 2020; Chen et al., 2009; Chan & Hong, 2000). For example, Chang and Hong (2000) observe that business groups in Korea gain benefits through the economies of scale and economies of scope by performing a lot of RPTs. RPTs within groups create organizations that are more economically efficient by minimizing transaction costs due to the inefficient market that is commonly observed in the developing countries.

Furthermore, Gordon et al. (2004) argue that RPTs are more economically efficient and create more value to the shareholders because the transactions eliminate trust and asymmetric information problems. RPTs do not only encourage reciprocal relationships among parties, but also accelerate the problem-solving mechanism and the creation of new ideas that may not be possible in unrelated party transactions (Umobong, 2017). The RPTs also enable business groups to set up new business ventures in various industries more quickly and at lower costs (Guillen, 2000). Overall, social bonds that symbolize business groups enable affiliates to reduce uncertainty, increase trust, and reduce transaction costs to access new business opportunities (Granovetter, 1995; Luo & Chung, 2005). Therefore, market might respond to RPTs conducted by listed firms in a positive way indicating a positive impact or RPTs on the firm value (Wong, et al., 2015).

2.2. *The conflicts-of-interests hypothesis*
Under the agency problem theoretical framework, the conflicts-of-interest hypothesis predicts a negative relationship between RPTs and firm performance. Jensen and Meckling (1976) first coined agency theory that discusses type I agency problems between managers (agents) and owners of economic resources (principal). Furthermore, Shleifer and Vishny (1997) suggest a conflict of interests between minority shareholders and controlling shareholders which is then identified as the type II agency problem. The type II agency problem arises when the company has a concentrated ownership structure because according to Lim and Yen (2011), the decision of largest controlling shareholders can affect the company performance and also the wealth of minority shareholders. Furthermore, Shleifer and Vishny (1997) state that the largest controlling shareholders tend to act based on their own personal interests which do not always in accordance with the interests of other shareholders, or with the interests of employees and managers. Therefore, in the process of maximizing their own personal welfare, the largest controlling shareholders

may carry out the transfer of wealth among related parties under their control at the expense of minority shareholders' wealth. In addition, controlling shareholders, as insiders of firms with highly concentrated ownership, have better access to information that allow them to secure higher bargaining position than minority owners (Hendratama & Barokah, 2020). According to Asward and Lina (2015), the higher ownership of the majority shareholder, the more opportunities and incentives for those shareholders to take over company resources at the expense of the minority shareholders. According to Wang et al. (2019), the expropriation of the largest controlling shareholders at the expense of minority shareholders often occur in developing countries through various channels, including the RPTs (Shleifer & Vishny, 1997; Nenova 2003).

Silveira and Junior (2008) argue that the disputes and conflicts that occur between two groups of shareholders will eventually reach the public and can incur agency costs that are detrimental to the company. This condition is even worse when there is a weak legal environment and enforcement Bansal and Thenmozhi (2020).

2.3. *Information disclosure*
Because RPTs might have detrimental impact on the shareholders' wealth, the companies are mandated to properly disclose all necessary information. A company's negligence in implementing information disclosure can cause huge losses, for example in the case of Enron, which uses Special Purpose Vehicles to hide its debts so that its financial statements look favorable. In this case, the implementation of good corporate governance (GCG) has a substantial role for the company with transparency as one of its principles. This principle is important because it forces the board of directors and managers to be responsible for their decisions and mistakes to prevent fraud. Moreover, transparency can be a means for shareholders to build their trust in the company and management (Price, 2018).

Aside from transparency, a company's GCG system is also related to how a company manages assets so that it will affect the company's performance (Indarti & Extaliyus, 2013). The company's performance is important because it determines investor decisions in maintaining their investment. One method for assessing company performance is through financial ratios (Sundjaja & Barlian, 2003). According to Kasmir (2011), a company's profitability can be used as an indicator of a company's ability and performance in obtaining profits. The profitability ratio that is commonly used is return on assets (ROA) which identifies the company's ability to manage assets to generate profits. Therefore, the efficiency of a company when carrying out its business activities can be conceived by this ratio (Kasmir, 2011).

2.4. *Indonesian accounting regulations*

The Indonesian accounting regulation, particularly the Statement of Financial Accounting Standards (PSAK) No. 7 of 2010, requires the disclosure of all related parties in the companies' financial statements and explicitly mention that the related parties are the entities or persons who are related to the entities that issue the financial statements. The related parties are usually referred to as the affiliated parties through several possible connections, as seen in the first edition of the Indonesian Corporate Governance Manual (2014). Furthermore, the PSAK 7 also discusses in details how the RPTs should be disclosed in the financial statements. There are also other regulations regarding RPTs, namely the Laws of Indonesia Republic Number 40 of 2007 regarding approval to conduct RPTs and the Bapepam-LK Regulation Number IX.E.1 about reporting affiliate transactions to Bapepam-LK and announcing disclosure of information to the public, as well as regarding the conflicts of interests to protect the minority shareholders from the adverse impact of RPTs (Utama, 2015).

2.5. *Hypothesis Development*

According to the efficient transaction hypothesis, RPTs can reduce companies' transaction costs so that companies can operate more efficiently (Gordon et al., 2004). For example, Claessens (2006) shows that financially limited companies are benefited from being affiliated to their business groups. Rasheed et al. (2019) find RPTs have significant positive influence on firm value measured by ROA. Chandera et al. (2018) also discover that being parts of business groups can lower member companies' borrowing costs due to the co-insurance effects among related parties within business groups.

On the other hand, there is a possibility that conflicts of interests and tunneling can occur through RPTs. With a concentrated ownership structure in Indonesia, it can lead to conflicts of interests between minority and majority shareholders because the largest controlling shareholders tend to prioritize their own personal interests (Shleifer & Vishny, 1997; Lim & Yen, 2011). In a research in India, tunneling is found within group firms in the form of earning shocks from firms where the controlling shareholders have high rights for cash flow to firms where they have the low rights through non-operating items (Bertrand, et al., 2002).

This indicates that tunneling might occur in the form of asset transfers (Cheung, et al., 2006). There is also another proof of tunneling in the form of intercorporate insurance related to financial distress where lower-level firms can be saved from bankruptcy because the higher-level firms in the pyramid group give funds in the form of investment (Riyanto & Toolsema, 2008). Furthermore, a relationship is found between an increase in earnings due to suspicious related party sales transactions before the company Initial Public Offering (IPO) and tunneling activity after the IPO (Aharony, et al., 2010). This can be an indication that related party purchase activity is carried on at a higher price than non-related transactions (Hendratama & Barokah, 2020). Although sales transaction is only one example of various RPTs that a company might undertake, it can be a proof of how RPTs deteriorate listed firms' financial performance.

According to the findings from previous studies, this can lead to a negative relationship between RPTs and firm performances because the largest controlling shareholders use RPTs as their tunneling channels to transfer cash and/or resources for their own personal benefits, such as found in Chen et al. (2009) that measure the impact of RPTs on companies' ROA and Tobin's Q. Their results are in line with Wang et al. (2019) that also study the impact of trade RPTs (consist of sales and purchases transaction) on companies' ROA and Tobin's Q.

Because there is an indecisive relationship between RPTs and company performance, we consider this research as an empirical problem. In other words, we are not able to take a position in determining the direction of the relationship between the two variables. Consequently, we propose the following hypothesis:

H_1: Total RPTs have a significant effect on company performance

In order to examine the relationship between certain type of RPTs and firm financial performance, we develop another hypothesis that breakdowns total RPTs into several categories. Some previous studies have focused on various types of RPTs by grouping RPTs into sales RPT, purchase RPT, asset RPT, loan RPT, guarantee RPT, rental RPT, and other RPT (Chen et al., 2009). Other studies cover more specific RPT variables, for example Wang et al. (2019) who only use trade RPT (i.e., sales RPT and purchasing RPT).

Our study breakdowns the Total RPTs into operational RPT, financial RPT, other RPT, and total RPT based on the consideration that this type of categorization allows a better understanding on how RPTs might affect company performance based on three main corporate finance activities (i.e., operating, financing, and other activities). Therefore, we propose the second hypothesis as follows:

H_2: Operational RPT, financial RPT, and other RPT individually has a significant effect on company performance

Research Methodology

3.1. *Data sources and sample selection procedure*

This study is an explanatory research using a quantitative approach through data obtained from secondary sources. The data source for the RPTs is the audited financial statements of the company which are downloaded through the IDX website and the website of each company. The company characteristics data are all obtained from Bloomberg.

The population of this research is all companies listed on the IDX from 2015-2018. The purposive sampling method is used in the selection of samples with predetermined criteria. These criteria are non-financial companies because financial companies have different financial statements reporting standards. We also limit our samples to those companies that have accessible audited financial statements and complete information during the period 2015 to 2018. Table 1 showcases the sample selection process. The final sample is an unbalanced panel data consists of 1,515 observations.

3.2. *Empirical models and operational of variables*

To empirically test each of those hypotheses, this study runs panel data regression analysis based on two empirical models. The first model describes the effect of overall RPTs on company performance (H1):

$$ROA = \beta_{i,t} + \beta1RPT\_TTL_{i,t-1} + \beta2SIZE_{i,t} + \beta3DER_{i,t} + \beta4GROWTH_{i,t} + \beta5YEAR_{i,t} + \varepsilon_{i,t} \quad \text{......................(1)}$$

The second model analyzes the impact of each RPT category on company performance (H2):

$$Model\ 2: ROA = \beta_{i,t} + \beta1RPT\_OPS_{i,t-1} + \beta2RPT\_FIN_{i,t-1} + \beta3RPT\_OTH_{i,t-1} + \beta4SIZE_{i,t} + \beta5DER_{i,t} + \beta6GROWTH_{i,t} + \beta7YEAR_{i,t} + \varepsilon_{i,t} \quad \text{.............................(2)}$$

Following Wang et al. (2019), we use return on assets (ROA) as the dependent variable as a proxy for company performance. High ROA implies that the company has a good capability in managing its assets to generate profits (Ross et al., 2016). The value of ROA is obtained by dividing the net income by the value of total assets.

Table 1.
Sample Selection

Category	Total
Companies listed on the IDX from 2015 to 2018	494
Less: financial companies listed on the IDX	(95)
Less: companies that do not have audited financial statements and have incomplete data from 2014 to 2018	(11)
Number of research samples	**388**

Table 2.
Variable Operationalization

Variable	Indicator	Definition	Equation
Dependent Variable			
ROA	Performance (return on assets)	The level of net profit from each asset of the company	ROA = Net Income/ Total assets
Independent Variable			
RPT_TTL	Total RPT	The ratio of total RPT (TTL) from total assets	RPT_TTL = Total RPT/ Total assets
RPT_OPS	Operational RPT	The ratio of operational RPT (OPS) from total sales	RPT_OPS = Operational RPT/ Total sales
RPT_FIN	Financial RPT	The ratio of financial RPT (FIN) from total assets	RPT_FIN = Financial RPT/ Total assets
RPT_OTH	Other RPT	The ratio of other RPT (OPS) from total assets	RPT_OTH = Other RPT/ Total assets
Control Variables			
SIZE	Firm size	The size of a company is measured by total assets (TOTALASSET)	SIZE = Ln (Total assets)
DER	Debt to equity ratio	The proportion of liabilities and equity	DER = Total liability / Total equity
GROWTH	Sales growth	Company's sales growth rate	GROWTH = $(\text{Sales}_t - \text{Sales}_{t-1})/ \text{Sales}_t$
YEAR	Year dummy	Dummy variable to control the fixed effect of the year	There are 3 year dummy variables used

Notes: This table describes the definition and measurement of each variable used in this study, as well as the indicator represented.

Our independent variables are calculated as follows. First, total RPT (RPT_TTL) is obtained by dividing the total RPT by the total assets of the company. The operational RPT (RPT_OPS) is defined as the proportion of the sum of the sales RPT, purchase RPT, cash and cash equivalent RPT, accounts receivable RPT, and short-term debt RPT with total income. Financial RPT (RPT_FIN) is obtained from a ratio of the amount of long-term debt RPT to total assets while other RPT (RPT_OTH) is derived from the proportion of the number of RPT not classified in the RPT that has been mentioned, with the total assets. In each model, we use a one-year time lag because the impact of the RPTs on firm financial performance may not be observed directly in the same period. In addition, models with time lag are more robust because they reduce the likelihood of endogeneity that occurs when the independent variables are correlated with error terms in the model (Hill et al., 2016).

Furthermore, the control variables included in the models are company size (SIZE), obtained by calculating the natural logarithm of total assets, debt to equity ratio (DER) which is the proportion of liabilities and company equity, sales growth (GROWTH) obtained from the percentage change of year-on-year sales, and year dummy variable to control the fixed-effect of the year in the research period. Table 2 lists all variables included in this study and explains the definition and measurement of each variable.

Results and Discussion

4.1. Descriptive Statistics
Table 3 presents descriptive statistics of all variables used in this study. The table shows that during 2015-2018 period, the average ROA of our sample is 1.86 with a standard deviation of 15.01. Furthermore, for the independent variable, the total RPT has an average of 2,928 trillion Rupiahs. When viewed by each category, the RPT with the largest average is OPS followed by OTH and FIN with a value of 2.423 trillion Rupiahs, 0.312 trillion Rupiahs, and 0.192 trillion Rupiahs, respectively.

Table 4 shows the proportion of each of these RPT categories to the total RPT. It can be seen that RPT_OPS dominates other types of RPT (82.77% of the total RPT). This proportion implies that companies conduct RPTs mainly for their operational activities compared to financing (6.57%) and other activities (10.66%)

4.2. Regression Results and Analysis
Based on the results of preliminary tests, the data of this study meets the classic assumption test criteria, namely the normality test, multicollinearity test, and autocorrelation test. However, there is a heteroscedasticity problem. To overcome this, the robust standard error will be used in hypothesis testing with the random effect model as the best model based on the results of the research estimation model test.

Table 5 shows the results of regression analysis to test the hypotheses. Overall, each of the regression models are able to significantly explain the companies' ROA at the p-values of 0.0433 and 0.000. In model 1, the partial significance test shows that RPT_TTL has an insignificant negative effect on ROA. Furthermore, in model 2, we find two types of RPTs that have significant impact on ROA. First, we observe that RPT_FIN has a negative and significant effect on ROA with a p-value of 0.025 and a regression coefficient of -11.38590. In addition, RPT_OTH also has a significant and inverse effect to ROA with a p-value of less than 0.05 which is 0.000 and a regression coefficient of -2.32463.

In model 2, we detect that RPT_OPS do not have a significant effect on ROA (a p-value of 0.709). Nevertheless, the regression coefficient of -0.02850 indicates that RPT_OPS and ROA have an inverse relationship. Furthermore, SIZE, DER, and GROWTH as control variables produce insignificant influence and have a positive direction for SIZE, while the rest are negative. Also, the YEAR dummy variable has no significant relationship with ROA except for models 2 in year 2017 and 2018.

Table 3.
Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
ROA (ratio)	1515	1.86	15.01	-172.82	209.23
OPS*	1515	2,423,083.27	13,079,453.05	0.00	412,977,401.55
FIN*	1515	192,275.50	1,163,458.54	0.00	19,123,222.33
OTH*	1515	312,160.43	1,528,720.23	0.00	24,547,398.99
TTL*	1515	2,927,519.20	13,875,644.07	0.00	412,977,401.55
Total Asset*	1515	9,853,956.34	23,425,944.45	53.00	344,711,000.00
DER (ratio)	1515	129.90	608.78	0.00	12,153.17
GROWTH (%)	1515	56.86	886.12	-100.00	30,275.36

Notes: This table shows the number of observations, the arithmetic mean, the standard deviation, the minimum value and the maximum value of each variable.
*OPS, FIN, OTH, TTL are expressed in millions of Rupiah.
Source: Bloomberg and authors calculation (2020)

Table 4.
RPT Proportion

Variable	Amount*	Proportion
OPS	3,670,971,149	82.77%
FIN	291,297,378	6.57%
OTH	472,923,058	10.66%
Total	**4,435,191,585**	**100.00%**

Notes: This table illustrates the amount and the proportion of each RPT category. *The transaction amounts of OPS, FIN, OTH are expressed in millions of Rupiah.
Source: authors calculation (2020)

Table 5.
Panel Data Regression Results

ROA	Model 1 Coefficient	P-value	ROA	Model 2 Coefficient	P-value
RPT_TTL	-0.31396	0.831	RPT_OPS	-0.02850	0.709
			RPT_FIN	-11.38590	0.025 **
			RPT_OTH	-2.32463	0.008 ***
SIZE	0.82795	0.133	SIZE	0.81452	0.137
DER	-0.00279	0.176	DER	-0.00267	0.182
GROWTH	-0.14477	0.069*	GROWTH	-0.14245	0.072*
YEAR 2016	1.14306	0.126	YEAR 2016	1.15200	0.152
YEAR 2017	1.17402	0.151	YEAR 2017	1.30294	0.050**
YEAR 2018	1.40725	0.083*	YEAR 2018	1.51098	0.034**
Intercept	-22.19635	0.047*	Intercept	-21.68891	0.171
R-squared	0.04210		R-squared	0.05520	
Prob > chi2	0.04330 **		Prob > chi2	0.00000 ***	

Notes: This table presents the regression results of RPTs on ROA. Model 1 and model 2 use the random effect model and the robust standard error with 1,515 observations. *, **, *** denote significance at 10%, 5%, 1% levels, respectively.
Source: Stata (2020)

The results in model 2 suggest that on average, RPT_OPS which represents related party operational transaction such as sales RPT, purchase RPT, cash RPT, accounts receivable RPT, and short-term debt RPT produces an insignificant effect on ROA. These results are in line with Cheng and Leung (2014) which states that the RPTs have no significant effect on the performance of companies registered in China. They use the sales RPT and the purchase RPT in defining the RPT variables. This may be based on the Arm's Length Principle which states that the price charged to each related company must be the same as the price charged to non-related companies for each similar item in comparable circumstances (Choe & Matsushima, 2013). This might also explain why the RPT_TTL in model 1 is insignificant because the largest proportion of total RPTs consists of operational RPTs.

Furthermore, because the coefficients of both RPT_FIN and RPT_OTH are significantly negative at 1-5% levels, these results suggest a strong negative association between these types of related party transactions and the company financial performance. This finding indicates that related party transactions which deal with firms' financing and other activities are more likely to be used for tunneling purposes (Riyanto & Toolsema, 2008; Shleifer & Vishny, 1997; Lim & Yen, 2011). For instance, banks might charge higher interest rates on long-term loans that were extended to related parties. This transaction enables the largest controlling shareholders to extract private benefits by tunneling the resources among companies that belong to the same business groups and controlled by the same owner. In this case, the affiliated banks extract benefits to maximize the wealth of the largest controlling shareholders but at the expense of minority shareholders of the corporate borrowers. As a result, from the perspective of borrowing company, RPTs in financing activities are costly compared to "arm's length" or transactional lending and might result in the decline in the borrowing company's financial performance.

Our findings are in line with Weinstein and Yafeh (1998) research in Japan, where companies that have close relations with banks pay higher loan interest rates than comparable companies. Moreover, Tambunan (2017) concludes that debt RPTs have a significant negative effect on firm value. Bansal and Thenmozhi (2020) also prove that loans from related parties have a significant negative relationship to ROA. The result of Jiang et al. (2010) in a company in Hong Kong states that companies can use internal financing such as inter-group loans to do tunneling from related party funds. Furthermore, Habib et al. (2017) prove that the credit RPTs, consist of lending and borrowing transactions, are used by politically connected companies in Indonesia to tunnel resources. This can occur because there is a possibility that the largest controlling shareholders try to get private benefits of control, in line with the type II agency theory that predicts conflicts of interests between the controlling shareholders and the minority shareholders (Claessens et al., 2002; Nenova, 2003).

We also find that RPT_OTH or RPTs other than operational and financial transactions, have an inverse and significant relationship with ROA, consistent with the type II agency theory. Other RPTs consist of, but are not limited to, expenses and other income, profits from the sale of long-term assets, purchase of fixed assets, investment in associates, and salaries and benefits. For example, a company buys fixed assets from related parties at prices higher than market value. This decision can provide private benefits to the largest controlling shareholders and in turn, reduce the company performance. This is in line with the finding of Bertrand, et al. (2002) suggesting that tunneling among firms are conducted through non-operating items. Moreover, the negative relationship is also in line with Lee et al. (2014) which concludes that non-operational transactions such as the purchase or sale of long-term assets tend to involve relatively large amount of money and occur irregularly, in contrast to operational transactions that occur and might be monitored more frequently.

This causes difficulties for regulators and auditors to monitor non-operational RPTs because they are not part of the company's main business. Bertrand et al. (2002) states that tunneling in business groups in India mainly occurs through non-operational RPTs. Piotroski and Wong (2013) also confirm that non-operational RPTs are associated with a declining company performance.

4.3. Robustness Tests

4.3.1. Samples that Perform and Report RPTs

To ensure robustness, we conduct several additional analyses. First, we exclude observations that did not conduct RPTs or have a total RPTs of zero to eliminate the possibility that the company does not report instead of actually not conducting any RPT during that particular fiscal year. Therefore, by excluding those observations we are able to determine the impact of the RPTs on the performance of companies that do not only perform but also report their RPTs on financial statements. The samples used in this test are 1,459 observations in 380 companies from 2015-2018. The variables and periods used in this test are the same as the previous test.

After performing all of the classic assumption tests and research estimation model tests, the results show that there is a heteroscedasticity problem that can be overcome with the robust standard errors and the right model used in this test is the random effect model.

As shown in Table 6, the regression results are consistent with previous analysis. Overall, the R-squared is 3.14% and 4.52% with a p-value of 0.0000 in models 1 and 2, respectively, which indicates that together all independent variables on both models have a significant effect on ROA. Besides, the results of the partial significance test also show consistent results. RPT_TTL and RPT_OPS have p-values of 0.768 and 0.675 which show insignificant negative effects. Furthermore, variables that have significant influence are RPT_FIN and RPT_OTH which have significant negative effects with p-values of 0.021 and 0.000, respectively.

Table 6.

Robustness Test Result with Samples that Perform and Report RPT

	Model 1			Model 2	
ROA	**Coefficient**	**P-value**	**ROA**	**Coefficient**	**P-value**
RPT_TTL	-0.43255	0.768	RPT_OPS	-0.03321	0.675
			RPT_FIN	-11.43992	0.021 **
			RPT_OTH	-2.82852	0.000 ***
SIZE	0.87656	0.139	SIZE	0.86433	0.143
DER	-0.00226	0.189	DER	-0.00211	0.194
GROWTH	-0.06919	0.000 ***	GROWTH	-0.06549	0.003 ***
YEAR 2016	1.34809	0.101	YEAR 2016	1.35747	0.102
YEAR 2017	1.10248	0.110	YEAR 2017	1.24416	0.066 *
YEAR 2018	1.45629	0.044 **	YEAR 2018	1.56829	0.032 **
Intercept	-23.61906	0.164	Intercept	-23.16229	0.175
R-squared	0.03140		R-squared	0.04520	
Prob > F	0.00000 ***		Prob > F	0.00000 ***	

*Notes: This table presents the regression results of RPTs on ROA with samples that perform and report RPT. Model 1 and model 2 use the random effect model and the robust standard error with 1,459 observations. *, **, *** denote significance at 10%, 5%, 1% levels, respectively.*
Source: Stata (2020)

4.3.2. Other Dependent Variables

As a second robustness test, we use two alternative dependent variables as a proxy for company performance. The first alternative for the dependent variable is EBITDA/ TA (hereinafter referred to as EBITDA), which is the ratio between earnings before interest, tax, depreciation, and amortization with total assets. EBITDA is a measurement of a company's ability to generate cash from its operations and is often used as a proxy for available cash flows to meet financial obligations (Ross et al., 2016). The second alternative for the dependent variable is the average monthly stock return (MSR) obtained by calculating the average of the company's monthly closing stock prices.

The purpose of the robustness test with EBITDA as the dependent variable is to determine the effect of RPTs on income before reducing accounting and financial costs. These costs are incurred in order to produce EBITDA which focuses on the operating decisions of a business because it sees the business benefits from its main operating activities. In the classical assumption tests, we find that there are autocorrelation and heteroscedasticity problems. So, the robust standard error will be used in hypothesis testing. Furthermore, the most appropriate model for this test is the fixed effect model in model 1 and the random effect model in model 2.

The results presented in Table 7 show the overall R-squared for model 1 and model 2 are 1.06% and 2.36% with p-values of 0.0398 and 0.0000, respectively. Therefore, together the independent variables on both models have a significant effect on EBITDA. Furthermore, the RPT_TTL shows p-values and regression coefficients of 0.230 and 0.25012 which identify that the relationship between RPT_TTL and EBITDA is not significant.

Interestingly, if we use EBITDA as the dependent variable, we detect a significant negative association between RPT_OPS or operational RPTs and firm performance at 1% level, which is consistent with the tunneling hypothesis (Riyanto & Toolsema, 2008; Shleifer & Vishny, 1997; Lim & Yen, 2011). In line with previous results in this study, we also find a significant negative association between RPT_FIN and firm financial performance measured by EBITDA at 1% levels. RPT_OPS and RPT_FIN present the results of p-values of 0.001 and 0.000 with regression coefficients of -0.00096 and -0.12478, respectively. However, the coefficient of RPT_OTH variable is only significant at 10% level (p-value of 0.056) and with a positive coefficient of 0.02723 which weakly supports the propping hypothesis (Rasheed et al., 2019; Shin et al., 2019).

In additional robustness test presented in Table 8, we use the average monthly stock return (MSR) as the dependent variable to examine the effect of RPTs on the market-based firm performance. If we use MSR as the dependent variable, we find that the common effect model is the most appropriate model. Furthermore, based on the classical assumption tests, we also find that there is a heteroscedasticity problem. Thus, similar to previous tests, robust standard error is used in this robustness test.

Table 8 shows that the overall R-squared for each model is 7.63% (model 1) and 8.37% (model 2). Furthermore, the F test shown by p-value 0.0000 in model 1 and model 2 indicates that the overall independent variables in both models have a significant effect on MSR. In partial significance tests, we find that in model 1, the regression coefficient of RPT_TTL is 0.00535 with a p-value of 0.109 which suggests that there is a positive but not significant impact of RPT_TTL on MSR.

Table 7.
Robustness Test Result with EBITDA as the Dependent Variable

	Model 1			**Model 2**	
EBITDA	**Coefficient**	**P-value**	**EBITDA**	**Coefficient**	**P-value**
RPT_TTL	0.25012	0.230	RPT_OPS	-0.00096	0.001 ***
			RPT_FIN	-0.12478	0.000 ***
			RPT_OTH	0.02723	0.056 *
SIZE	-0.05939	0.528	SIZE	0.01672	0.017 **
DER	-0.00006	0.316	DER	-0.00003	0.159
GROWTH	-0.00087	0.074 *	GROWTH	-0.00095	0.000 ***
YEAR 2016	0.00420	0.845	YEAR 2016	0.00342	0.878
YEAR 2017	0.01224	0.675	YEAR 2017	0.00992	0.663
YEAR 2018	0.01563	0.662	YEAR 2018	0.00525	0.821
Intercept	1.70547	0.517	Intercept	-0.39456	0.070
R-squared	0.01060		R-squared	0.02360	
Prob > F	0.03980 **		Prob > F	0.00000 ***	

*Notes: This table presents the regression results of RPTs on EBITDA. Model 1 and model 2 use the fixed effect model and the random effect model, respectively and the robust standard error with 1,515 observations. *, **, *** denote significance at 10%, 5%, 1% levels, respectively.*
Source: Stata (2020)

Table 8.
Robustness Test Result with MSR as the Dependent Variable

	Model 1			**Model 2**	
MSR	**Coefficient**	**P-value**	**MSR**	**Coefficient**	**P-value**
RPT_TTL	0.00535	0.109	RPT_OPS	-0.00024	0.117
			RPT_FIN	-0.01196	0.071 *
			RPT_OTH	0.02872	0.000 ***
SIZE	-0.00102	0.113	SIZE	-0.00118	0.070 *
DER	2.68E-07	0.867	DER	1.04E-06	0.438
GROWTH	-0.00002	0.847	GROWTH	-0.00006	0.298
YEAR 2016	0.03686	0.000 ***	YEAR 2016	0.03694	0.000 ***
YEAR 2017	0.02705	0.000 ***	YEAR 2017	0.02687	0.000 ***
YEAR 2018	0.02188	0.000 ***	YEAR 2018	0.02213	0.000 ***
Intercept	0.01540	0.408	Intercept	0.02083	0.262
R-squared	0.07630		R-squared	0.08370	
Prob > F	0.00000 ***		Prob > F	0.00000 ***	

*Notes: This table presents the regression results of RPTs on MSR. Model 1 and model 2 use the common effect model and the robust standard error with 1,499 observations. *, **, *** denote significance at 10%, 5%, 1% levels, respectively.*
Source: Stata (2020)

In model 2, we find that although both have negative coefficients, the p-value of RPT_OPS is not significant and RPT_FIN is only weakly significant at 10% level. In contrast to previous finding, we find that the effect of RPT_OTH on MSR is significantly positive which is shown by the p-value of 0.000 and the regression coefficient of 0.02872.

Based on the two robustness tests in which we rerun the regression analysis with EBITDA and MSR as the dependent variables, it was found that the financial RPTs is the only RPT category that shows consistency in the direction of the negative influence on company performance. This is also parallel with the results of our baseline regression analysis and the robustness test with samples that perform and report RPTs.

Research Limitations
We acknowledge several limitations to this study. First, there are differences in the level of transparency of the company in presenting financial statements that might cause incompleteness of the necessary data, thus affecting the accuracy of the results of the study. Hence, the results of this study should be interpreted with care.

Second, although we have mitigated endogeneity concern by using one-year time lag independent and control variables, there is still a possibility that some unobserved variables might affect both RPTs and firm performance simultaneously. This omitted variable bias can be addressed by performing 2SLS or instrumental variable (IV) regression analysis. One of the potential variables that can serve as IV is the firm's ownership structure variable, such as the amount of control wedge, because firms with large control ownership wedge are more likely to conduct RPTs but the control wedge itself might not directly affect the firm performance except through the RPTs themselves. Due to our limitations to obtain this control wedge data, we are not able to perform this IV regression analysis, so we leave this for further research.

Third, although our model can be considered as valid (indicated by high F-test statistics and very low p-values), we acknowledge that the adjusted R-squared in our model is relatively low. We acknowledge this as one of our research limitations and recognize that the impact of RPTs on company performance might also depend on several other factors, such as governance structure, corporate strategy, and other institutional factors that are not discussed in this study. Adding more control variables to our model might add the model's explanatory power and solve the issue of low adjusted R-squared that is encountered in our model.

Fourth, the independent variable in this study is only measured by calculating the amount of RPTs scaled by total assets. Thus, other RPT measurements, such as the frequency of RPTs, the determinant of RPTs amount, and other RPTs measurements are not yet discussed in this study. Therefore, other measures of RPTs beside the amount of RPTs might be implemented in the future research.

Finally, we suggest that future research use data samples with a longer period to see the consistency of the effect of RPTs on company performance or use different data samples categorization to find out a greater effect of RPTs on company performance. Future studies can also consider to use other company performance indicators or industry groupings to analyze the impact of the RPTs in certain sectors.

Conclusions

This study aims to determine the effect of RPTs on the performance of publicly listed companies in Indonesia from all industries except financial industry during the 2015-2018 period. The sample of this study is 388 companies with 1,515 observations in the form of unbalanced panels selected by the purposive sampling method.

This study uses ROA as the dependent variable to measure firm's financial performance. The main variable of interest is the amount of related party transactions scaled to the firm's total assets. The RPTs are further categorized into three main corporate activities, namely the operating, financing, and other company activities. The models are all controlled by firm-level variables, such as firm size, leverage, growth potential, and year-fixed effects.

We test the hypotheses by running panel data regression analysis using random effect models and robust standard errors. The results of the analysis show that total and operational RPTs do not have a significant effect on company performance. However, we find that RPTs that are related to financing and other company activities have significant negative impact on firm's financial performance. This might be due to the fact that these non-operational RPTs are more difficult to monitor and easier to be exploited by the largest controlling shareholders to maximize their own personal well-being. Furthermore, this study proves that the impact of the RPTs in Indonesia is consistent with conflicts-of-interests hypothesis (Jensen & Meckling, 1976; Shleifer & Vishny, 1997; Lim & Yen, 2011) in which the largest controlling shareholders tend to expropriate the minority shareholders through the RPTs. Furthermore, the negative impact of RPTs in financing activities is also robust even after we exclude samples that do not perform and report their RPTs, and use alternative dependent variables, such as EBITDA and MSR as the dependent variables.

Overall, this study contributes to the existing literature by providing additional empirical evidence on the impact of RPTs on firm performance, especially in emerging countries. We also shed more lights on this topic by breaking down RPTs' components and offering additional empirical evidence that among all types of RPTs, only the financial RPTs have been proved to reduce the company performance.

The results of this study suggest some practical implications. Considering that the implementation of good corporate governance related to preparation and audit of financial statements in Indonesia is still in average level (Setin & Amin, 2018), it is paramount important to reinforce legal environment in Indonesia. Regulators and authorities must tighten the reporting standards and disclosure requirements of RPTs, especially RPTs related to firms' financial activities, to prevent the use of this type of RPTs as tunneling channels that can be harmful for companies as well as minority shareholders.

Second, the management also need to implement better corporate governance practices by conducting RPTs to improve, instead of destroy, their overall shareholders' wealth. Finally, this study also suggests investors to carefully consider RPTs as one of the potential risks before making any investment decisions.

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