HORIZONTAL LINK, VERTICAL LINK AND MIXED LINK: INVESTIGATION ON MODEL OF BUSINESS STRATEGY DEVELOPMENT IN PUBLIC COMPANIES IN INDONESIA

Nurmala Ahmar, Diyah Pujiati, Soni Agus Irwandi
STIE Perbanas Surabaya (Perbanas Surabaya School of Business and Banking)

ABSTRACT

This research investigates and analyzes the strength of business and corporate elites. Research focuses on approaches that are rooted in social network analysis techniques. Research is based on the same observation in Europe, Japan and Anglo-America. Investigations carried out to double post commissioners and board of directors at public companies in Indonesia. Dual position is often referred to as interlocking Directorate. Such concurrent positions are dual position the board of commissioners and board of directors in the same industry (horizontal link), different industries (vertical link), and both (mixed link). The results showed that the model is dominated by the vertical link. Status link different models significantly during the observation. Based on the analysis of operational performance is affected by link models/interlocking models. Vertical link has the highest performance value compared to other models link. The study is expected to contribute related to the development of organizational patterns in companies and regulators in drafting the rules on dual position.

Key word: Interlocking Directorate, Vertical Links, Horizontal Links, and Mixed Links.


1. INTRODUCTION

This article put focus on the link of companies based on dual positions that they have. Link referred in this journal is interlock model or often also called interlock directorate. Interlock directorate in this journal refers to dual position held by board of directors and board of commissioners in public companies in Indonesia. Based on research done in 10 years, Ahmar, et al (2015) found that 47.5% public companies in Indonesia are interlocked. Extending study
form previous research, this study analyzes interlock status not only in the perspective of dual positions, but also vertical, horizontal and mixed dual positions. Vertical and horizontal interlock as mentioned by Usman (2013: 574-575) are dual positions as stated in article 26 letter a and c Regulation Number 5/1999. Referring to the Bischoff and Buchwald measurement (2015), horizontal link is the link that occurs between companies in the same sector. Vertical link or vertical interlocking directorate occurs when companies in different industries hold dual positions. Mixed link is when the combination of both occurs.

Referring to the regulation of Komisi Pengawas Persaingan Usaha or the Commission number 7/2010 about the Guideline of Dual Positions as stated in the article 26 Regulations number 5/1999 about Prohibition of Monopolistic Practices and Unfair Business Competition, it is stated that one of the monolithic practice indication the dual positions of board of directors or board of commissioners. However, in many empirical studies, interlocking directorate part of competitive strategy (Bischoff and Buchwald, 2015; Omer, et al., 20003; Shi, et al., 2013; Li and Yang, 2012; Silva, et al., 2005). Consistent with Resource Based Theory (RBT), when companies have good resources in corporate governance, they will have better competitiveness. Therefore good human resources with good capability will tend to be used and selected by those companies, even if dual positions are involved. Composition of board of directors or board of commissioner (Kiel and Nicholson, 2003) and interlock status (Addy, et al., 2014) plays an important role in good governance achievement.

Mizruchi (1996) mentioned that interlocking directorate occurs when someone affiliated to one of organization while being a member of board of directors in other organization as well. All aspects that are related to interlocking directorate have important implication for the structure and effectiveness of companies’ board, which in turn play an important role in corporate governance (De, 2003). Study by Phan, Lee & Lau (2003) reveals that low standard of corporate governance and poor law enactment in developing countries must be responsible for crisis that happened, and also responsible for the inability of companies to recover from the crisis. Therefore, interlocking directorate, which considered can be used to prevent uncertainty in the environment become the main approach which is selected by many companies to resolve the problem. This is contributed by the availability of business network horizontally and vertically, which can give certainty and is a part of the strategic mission of the corporation.

Anthony and Govindarajan (2011) reveal 3 important strategies in a corporation, which is clustered into single industry, related diversified and unrelated diversified. The options for the strategies are build, hold, and harvest. The most important thing in strategy formulation and success is goal congruence. Harmony of individual and organization goals becomes an important determinant. The success of a strategy can be measured by looking at the company’s performance. The performance refers to either operational or market performance. Canna, et al. (1999) mentioned that network between board of directors and board of commissioners has important force in companies in Ireland. Specifically, Carbonai (2009) demonstrated the power of competitive network in insurance sector in Italy. Donato and Tiscini (2009) revealed that the interlock status between companies with the financial institution (bank) has impact on the reduced level of risk and cost of debt. The existence of board of directors and commissioners with interlock status is needed by companies that are highly regulated by government to increase performance (Kaczmarek, et al., 2014).

The interlocking directorate has been studied since early of 20th century (Bowman, 1913; Dooley, 1969), in fact it has been associated with the value of management compensation (Hallock, 1997). Dual positions in some of the studies are proven to have impact on companies’ performance. Empirical evidence related with the connection between the link model and the operational performance was found by Shi, et al., (2013), Silva, et al., (2005),
Pomboa and Gutierrez (2011) and Sener, et al., (2011), although not the case with Omer, et al., (2013). The verification of link model and market performance was conducted by Kiel and Nicholson (2003), Silva, et al., (2005), Kacmarek, et al. (2014), Conelly and Slyke (2012), however Omer, et al. (2013) could not verify the connection between market performance and link model. There have not been many researches on link model in Indonesia, which may not be straightforward because name matching model takes time and precision. Ahmar (2015) has done qualitative research on interlock model from 2000 until 2010 by using network analysis. Model Network analysis was chosen to identify interlock status that have been done by Mahdi (2011).

This research is continuing research done by Ahmar (2015) and further developed by testing the link model with strategy development with focus on the operational (internal) and market performance. This research also conduct test of 3 link model classification and no-link group (no dual positions/no interlock). The result of this research is expected to give contribution to regulator in relation to monitoring of dual positions, whether involve violation as indicated by KPPU (the Commission). In the business practices, dual positions provide advantages from the business network created so that management has the power to make many business decisions. Finding in this research become important for reference in setting policies related with the dual positions that lead to monopolistic practices.

2. LITERATURE REVIEW

Resource Based Theory explains that company that uses many intellectual resources will enable the company to gain competitive advantage and added value for the company (Barney, Ketchen & Wright, 2011). Based on that competitive advantage and added value of the company, investor is also a stakeholder who plays an important role that will acknowledge the company that has higher investment value. Resource Based Theory is a growing concept in the strategic management theory and company’s competitive advantage that will ensure companies will have advantage if they have distinguished and competitive resources (Barney, Ketchen & Wright, 2011).

The relation of Resource Based Theory in this research is the dual positions that is held by board of commissiners and board of directors in the company, that will provide someone with high intellectual value and competitive advantage for the company. Board of commissioners and directors is a resource in a company that owns the highest policy in the company. Within the business context, interlocking board of directors network is important and strategic (Simoni & Caiazza, 2012; Battison and Cattanzaro, 2011; Bing, 2004). The competitive advantage will affect company’s performance, the better the quality of the board of commissioners and board of directors who run the company’s policy, the higher the possibility of the company to increase its performance. Contrary, if the board of commissioners and board of directors run the company’s policy poorly, then the company’s chance of improving its performance will be lower.

Interlocking Directorate is a condition when structural dual positions of the board in two or more public companies. That situation usually occurs because of financial relation and co-ownership of shares (article 26 Regulation Number 5 /1999). According to Dwi (2011), financial performance of a company is a description of company’s financial condition analyzed using financial analysis tools, so the health of the company’s financial condition that reflects performance in a certain period can be known. Mahdi, et al., (2012) researched the relation of interlocking company and some characteristic in Kuwait and drew all network using Social Network Analysis (SNA). Social Network Analysis (SNA) reveals that company’s financial is the highest centrality and the most influential actor in the interlocked network.
Several researches about impact of Interlocking Directorate to company’s performance, which study about impact of interlocking board and firm performance for 101 big companies in Netherland by using new panel database (Cai, et al., 2014). Result of the research shows that interlocks have negative effects on company’s performance. Study by Phan, et.al. (2003) has purpose on knowing the function of interlocking directorate between companies and government in the developing countries. The study revealed positive connection between interlocking directorate and company’s performance. Other findings related to the influence of interlock status to company’s performance were also found by some other researchers (Sanchez & Barroso-Castro, 2015; Kim, 2013; Pombo & Gutierrez, 2011; Thorgren, et al., 2010; Milan, 2003). 

Connelly & Van Slyke (2012) revealed that board of directors and commissioners with the interlock status can be important tools for the company to evaluate special strategy. One of the important aspect of interlock status is that it enable companies to observe other companies’ behavior and reduce uncertainty related to the strategic initiative, so that companies’s performance can be monitored well by the board of commissioners.

Market performance is one measurement of companies’ performance from the perspective of long term return of the companies or shares. The level of return can be observed from the market price, which are determined and adjusted by level of yield expected by the investors (Meiza Agmarina, 2011). PBV in this research is a tool to measure ratio between shares market price and its book value. The higher PBV ratio, the higher the company will be valued by the investors, which will have positive impact on the company’s return.

3. RESEARCH METHOD

This research is a quantitative research using secondary data. The data covers names of the board of directors and board of commissioners of public companies in Indonesia, and also the industry type. Model link is measured by matching dual positions between board of commissioners and board of directors. If board of directors or board of commissioners is detected to hold dual positions, value of 1 will be given, and 0 when dual positions are not detected. Vertical, horizontal and mixed link status is done by detecting industry of the company where board of directors and board of commissioners hold dual positions. If dual positions occur in the different industry, value of 1 will be given, if dual positions occur in the same industry, value of 2 will be given, and value of 3 will be given if dual positions occur in the same as well as different industry. Impact on strategy development is measured by company’s performance internally using return on assets (ROA) ratio, and externally using price to book value (PBV).

Research samples are all public companies in Indonesia that have complete data. 1797 data between 2011 and 2014 are collected. The test of model link is done by cross-tabulation analysis. The test is also done by comparing the quantity of companies with the status of vertical link, horizontal link, mixed link and no link/interlock to prove the difference of link/interlock status of public companies in Indonesia with Cramer-V test. The difference in performance based on interlock status is also proved by using Tamhane test. This test tool is used with consideration that the data tested have more than 2 groups and assumed data variance is unequal.

4. RESULT

Based on observation on public companies listed in Indonesia Stock Exchange for the period of 2011 until 2014, the result of model link development is as follow:
Listed companies who hold status of vertical link in 2014 were 43.8%, the highest compared to the other 3 models. Same pattern occurred in 2011. In 2012 and 2013, more than a third of the listed companies have vertical link status. In the observation for those 4 years, listed companies with horizontal link status were the lowest in all the observed years. During the observed years, more than 10% of listed companies in Indonesia Stock Exchange have the horizontal and vertical status. The development of model link in the observed samples can be described as follow.

Test of model link status difference is done by using Cramer-V, and supported by Phi-Test. Test result shows that there is a significant difference of companies quantity based on model link status.

There is a significant difference on quantity of listed companies with status of Vertical Link, Horizontal Link, Mixed Link and No Link/Interlock on public companies in Indonesia. The impact from development of strategy with model link in this research was tested by comparing internal performance and market performance. Description of performance based on model link can be illustrated as follow:
Companies’ ability in terms of asset management to provide profit is reflected in ROA ratio. Internal model link shows that companies with vertical and horizontal statuses have the highest ROA compared to other model link. High market performance is owned by the vertical model link. Interesting fact that was found in this research is that companies that do not have vertical nor horizontal network have performance below average among those in the samples. Lowest market performance was owned by companies with mixed model link, horizontal and vertical.

The important thing that needs to be reviewed is the difference of companies’ performance based on empirical test. The test was done with one way anova test. With the assumption that inter-group variance are different, then an advanced test was done to know whether the 4 groups were different. Below is the test’s result.

### Table 4 Test Result

<table>
<thead>
<tr>
<th>Company’s Performance</th>
<th>F-count</th>
<th>Sig.</th>
<th>Tamhane test (Remarks)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>4.362</td>
<td>.005</td>
<td>Mixed Link : No Link</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Mixed Link : Vertical Link</td>
</tr>
<tr>
<td>PBV</td>
<td>1.834</td>
<td>.139</td>
<td>Not Different</td>
</tr>
</tbody>
</table>

Result of company’s performance based on model link shows that ROA difference exists, while market performance (PBV) was not proven to have significant difference. That difference was due to ROA difference between vertical link group and mixed link group, and between mixed link group and companies not having dual positions of board of commissioners or board of directors.

### 5. CONCLUSION

Resource Based Theory explains that companies utilize several intellectual resources to enable companies to gain competitive advantage and value added. Good corporate governance, especially the setting and development of company’s strategy needs intellectual resource that can be relied on, so that there is a guarantee that the setting of company’s strategy can achieve the desired goal. Therefore, board of directors and board of commissioners that have good quality often found holding dual positions in more than two companies. Dual positions seen from the industry types may occur in the same industry, different industry, or both.
Testing on 1797 data samples during the year of 2011 until 2014 on public listed companies in Indonesia found that vertical link is the model link that dominates public companies in Indonesia. Based on model link status, the quantity difference among 4 status group was proven to be significant, also the operational performance was proven to be influenced by model link. Operational and market performance were proven to be the highest performance in 3 model links that was tested. Although companies that do not have dual positions management also have high performance compared to the companies in the 3 model link categories. Based on 2 status group analyzed, mixed and vertical link have big influence on operational performance. Interesting finding in this research is that mixed link and companies that do not have interlock status also have significantly different performance.

Result of this research is expected to give contribution to the government or regulatory board regarding the prohibition of dual positions in companies, which may result in monopolistic practice. Domination of vertical link in different industry as suggested by this research is related to the Commissions (KPPU) regulation that forbid vertical link in upstream and downstream industry. This research has not identified whether the different industry observed in this research is mainstream and downstream industry or not. Next research can be done related identification as a sub-classification of vertical link. On many research, interlock model can influence on several aspects and accountant behaviours (Omer, et al., 2014), management compensation (Wong, et al., 2015), private capital (Stuart & Yim, 2010), level of financial statement disclosures (Braam & Borghans, 2014; Cai, et al., 2014; Addy, et al., 2014).

REFERENCES


