INTERNATIONAL JOURNAL OF
CREATIVE RESEARCH AND STUDIES
www.ijcrs.org ISSN-0249-4655

DOES SOCIO EMOTIONAL WEALTH ENHANCES FINANCIAL PERFORMANCE?: MEDIATED BY STRATEGIC INNOVATIVENESS IN FAMILY BUSINESS

Santi Yopie, Itjang D. Gunawan & Willy Arafah

Abstract

This research is focus on family business development. This study aims to analyze whether social emotional wealth is directly improving the family company financial performance or indirectly mediated by Innovativeness in improving the family company financial performance. This study uses primary data with cencus that is at 41 private rural bank in Riau Islands province in Indonesia. In addition, this research also uses secondary data from the financial statements of private rural bank in Riau Islands province. The research method used is quantitative research methods that are explanatory. Model analysis technique and causal relationship between variables using partial least square (PLS) with Smart PLS 3.0 application. The final results of this research show that social emotional wealth is not directly influence significant to financial performance. However, social emotional wealth have a significant effect on innovativeness. Innovativeness can significantly influence positively on financial performance. The effect of the innovativeness strategy succeeded in providing a positive significant effect in the mediation between socio emotional wealth on financial performance in family business. This research contributes theoretically to the study of specialized companies with the expected development of socio emotional wealth. The mediating effect of innovativeness makes a special theoretical contribution to research on the strategies adopted by family companies in obtaining financial goals. This research also has managerial implications for family company owners who are included in the application of strategies and regulators in developing good family governance guidelines.

Keywords: *Emotional social wealth, innovativeness, financial performance, family firm, family governance*

Introduction

Family companies are identical to the characteristics of inheriting their companies from one generation pass to the next generation. The average family company is only able to survive and inherit to the third generation (Wahjono, Wajoedi & Idrus, S, 2014). However, there are also family companies, especially in the field of estate in Scotland that can survive up to 400, 600 and even 800 years (Belmonte, Seaman, & Bent, 2016). The characteristics of family companies are very unique, because they tend to be more focused on achieving long-term goals in maintaining business continuity. Local companies in Indonesia 95% are family companies and produce a growth rate in national gross income of 5.8% - 6.4% (Global Business Guide Indonesia, 2016). In Indonesia, there are 3 (three) out of 10 (ten) family companies that can survive up to the second generation and only 1 in 10 family companies can survive up to the third generation (Wahjono, Wajoedi & Idrus, S, 2014). But if it has passed that time, it is likely that the business will run smoothly in the future. The obstacle to continuing a family company to the next generation is creating a professional company leader so that it can develop sustainably, especially in family companies. There is contestation between family interests and business interests in a professional manner. This contestation must be managed so that it goes hand in hand with business needs to grow. This proves that family companies can look for a successor to a company that is professional and has educational qualifications and experience not only seen from the criteria of blood relations only (Belmonte, Seaman, & Bent, 2016).

The purpose of family companies is generally different from other companies. Family companies tend to pursue non-financial goals rather than financial goals (Berrone, Cruz, Gomez-Mejia & Larraza-Kintana, 2010). Non-financial achievement goals are the key difference between family companies and non-family companies. This non-financial goal is aimed at socio emotional wealth (SEW). Socio emotional wealth is a multi-dimensional approach to assessment that is associated with family behavior in making corporate strategic decisions (Gómez-Mejía, Haynes, Núñez-Nickel, Jacobson & Moyano-Fuentes, 2007). The application of socio emotional wealth is an approach that covers all endowment affective that comes from family owners including the desire of family to exercise their authority, enjoy family influence, maintain family membership in the company, appoint trusted family members to important positions or positions, retain strong family identity, and the continuation of the family dynasty to achieve non-financial goals, namely maintaining the sustainability of the family business (Gómez-Mejía, et al., 2007). Family companies tend to prioritize their non-financial goals as reflected in socio emotional wealth. However, over time, the company will be faced with financial problems in carrying out its operations (Berrone, Cruz & Gomez-Mejia, 2012). Therefore, family companies will also refocus and emphasize the firm's financial performance. This is a unique thing to examine regarding the relationship of non-financial goals, namely socio emotional wealth and financial goals, namely firm financial performance of family companies. The relationship between non-financial goals (socio emotional wealth) and financial goals (financial firm performance) will be influenced by various strategies implemented. The basic preservation logic of socio emotional wealth is the main key to be used in explaining the selection of different business strategies between family companies and non-family companies (Berrone, Cruz & Gomez-Mejia, 2012). In general, family companies tend to be dilemmas with the selection of company strategies in the form of whether to maintain socio emotional wealth or pursue an increase in the company's financial performance (Berrone, Cruz & Gomez-Mejia, 2012). This study specifically examines the effect of non-financial goals of family companies, namely the socio emotional wealth approach to family firm performance. The socio emotional wealth approach reflects the benefits and value received by the owner's family from owning a family company. The owner of a family company participates in socio emotional wealth as a strategic reference framework when leading a family company. The socio emotional wealth model includes of 5 (five) dimensions which are family control & influence, the identification of family members, binding of social ties, family members' emotional attachments, and transgenerational control (Berrone, Cruz & Gomez-Mejia, 2012). Family companies tend to be long-term oriented by prioritizing goals and investments that bring results over a long period of time (Miller & Breton-Miller, 2006) this actually inhibits the development of innovation (Chrisman, Kellermans, Chan & Liano, 2010). Many previous studies used agency theory to state that the overlap between management and ownership in family companies would hamper risk-taking and eventually tend not to innovate (Naldi, Nordqvist, Sjoberg, and Wiklund, 2007; Robin & Amran, 2016). Innovation activities create substantial corporate value, but innovation activities are difficult to manage because of agency risks, and therefore lack investment in innovation. However, agency risk can also make inefficient allocation of resources between innovation activities (Jia, Huang & Zhang, 2018). However, there are also those who say that family companies wishing to survive and be able to inherit to the next generation are even more risk-taking and more innovative (Aldrich & Cliff, 2003; Zahra, Hayton, & Salvato, 2004). Therefore, the results of previous studies address different results, so this becomes a gap regarding the relationship between innovativeness to family firm performance that will be examined in this study.

Research Framework and Hypothesis Development

The soul of family business is explained by theory of socio emotional wealth. The ability to sustain for facing nowdays competitive condition is equipped by innovativeness. Based on previous literatures that stated in above, this study proposed four hypothesis as shown in Figure 1 below as the research framework.

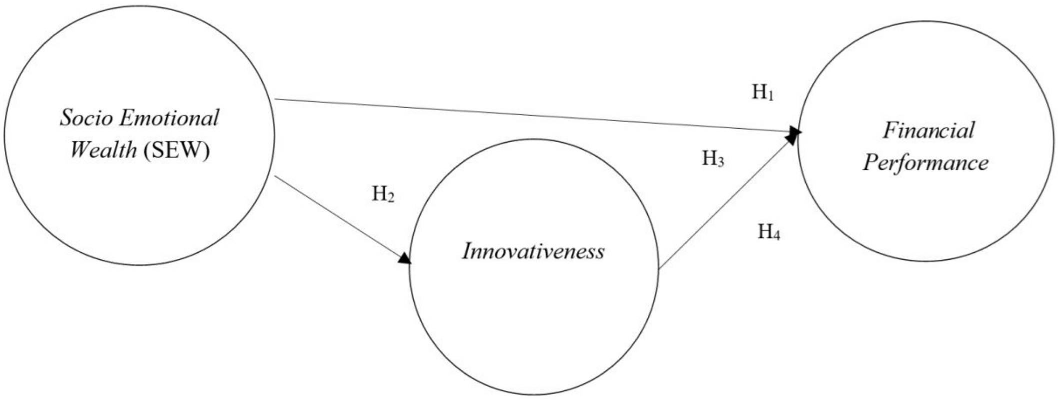

Figure 1: Research Framework

Family companies tend to obtain socio emotional wealth (SEW) from other sources including being controlled by family members, having surnames related to their company, emotional attachment to the company, strong social ties and intentions and goals to maintain business continuity (Gomez-Mejia , et al., 2011). This is one thing that greatly influences the decision making of business between family owners and company managers. Meanwhile, a seemingly unprofessional decision for outside observers, such as appointing inexperienced family members as company CEOs, can be implemented for family owners because they provide non-financial benefits. Therefore, the family's desire to preserve emotional social wealth affects the long-term performance of family companies both positively and negatively (Kalm, Luis & Gomez-Mejia, 2016). The SEW approach shows that, in strategic decision making, family owners tend to prioritize family interests and the presence of risk preferences (Michiels, Voordeckers, Lybaert & Steijvers, 2012). The involvement of family members in management that is high in a family company tends to have strategic goals towards a long-term business continuity (Miller & Breton-Miller, 2011). The emotional attachement between family and company influences how family owners manage the company (Baron, 2014). Corporate family members often identify their company by surname and respect the company's image in public because it reflects on the family (Dyer & Whetten, 2006). In other words, the positive public image of the company increases the socio-emotional wealth that comes from the company. Family members will usually be very strong in maintaining the company's success because it is based on a strong sense of ownership (Zellweger, Kellermanns, Eddleston & Memili, 2012).

Companies owned by families tend to be very careful in interacting with customers, suppliers, local communities and the general public, this is because it will associate family names with company products and services. Therefore, family members tend to maintain good communication with their stakeholders. The reputation of a good family company will attract and retain skilled employees so that employee turnover is lower. This will have a positive effect in storing valuable knowledge within the company. In addition, a high family reputation can positively influence suppliers in terms of increased cooperation, which in turn will encourage increased financial performance of family companies (Sharma & Manikutty, 2005; Berrone et al., 2010). Thus, the following hypothesis were developed:

H_1: Socio emotional wealth has a positive effect on the financial performance of family companies

Inovativeness is an effort to renew the company, increase the company's competitive advantage, spur growth and create new employment opportunities and ultimately generate wealth (Hayton & Kelley, 2016). Thus, innovativeness represents a strategic approach to preserving the economic and non-economic wealth of the company but there are still risks that may not always lead to successful results. Family companies tend to retain SEW because it has the potential to influence family company decisions that will lead to strategic orientation for the company (De Massis, Kotlar, Chua & Chrisman, 2014). Family-controlled companies tend to choose to avoid the risk of failure, so that they rarely want to endanger financial and non-financial interests for innovativeness (Gast, Filser, Rigtering, Harms, Kraus & Chang, 2018). Family companies have a strong relationship between family and company, so that if there is a loss arising from innovativeness, it will damage the reputation of the family and the company. Therefore, family companies tend to be less innovative. However, nowadays small and medium-sized family enterprises (SMEs) actually want to develop and add external resources, capabilities and skills to be more innovative in their business. Inovativeness is a backbone for a company in the present era to survive. Changes in market trends that are increasingly fast encourage the necessity of a company must maintain competitiveness and innovativeness. Therefore, innovativeness will improve financial performance. (Yap, Cheng, Hussain & Ahmad, 2016; Zafar & Kantola, 2018), the following hypothesis were developed:

H_2: Inovativeness has a positive effect on the financial performance of family companies

SME family companies get higher scores in network activities that lead to high levels of community and customer connections (Miller, Breton-Miller & Scholnick, 2008). Close relations with stakeholders from both external and internal will harmonize the openness of sharing knowledge. This gives family companies tend to prefer to take risks associated with innovation, because they have greater access to resources, experience, expertise, and information that increases the chances of innovation success (Gast, et al., 2018). Therefore, family companies that use the SEW approach will increase innovativeness. Therefore, the following hypothesis were developed:

H_3: Socio emotional wealth has a positive effect on innovativeness.

Family companies will be able to increase SEW's goals and financial performance if they are more innovative in their business. Family firms can have greater access to resources, experience, expertise, and information that increases the likelihood of innovation success (Gast, et al., 2018). Therefore, the following hypothesis were developed:

H_4: Socio emotional wealth can have a positive effect on the financial performance of family companies with mediated by Inovativeness

Research Methodology

The research method used in this study is a quantitative method with survey techniques. This study examines the hypothesis of the influence of Socio Emotional Wealth (SEW) variables on corporate financial performance which is mediated by innovativeness strategies. The data studied were cross sectional data. Respondents in this study are owners / shareholders who are in a family company originating from 41 of private rural bank in Riau Islands province in Indonesia, and the financial report is based on end of September 2018.

Financial performance is measured by two indicators, there are return on assets and return on equity (Gill & Obradovisch, 2012). Socio emotional wealth is measured by five components namely family control and influence, family members 'identification with the firm, binding of social ties, family members' emotional attachments, and transgenerational control (Berrone, Cruz & Gomez-Mejia, 2012). All questions are measured by 5 points Likert scale (1 = strongly disagree and 5 = strongly agree to questions 1, 2 and 3. The answers to all items will be added and divided into the number of questions to get the average value. Innovativeness is measured by 5 points Likert scale (1 = strongly disagree and 5 = strongly agree to questions 1, 2 and 3. The answers to all items will be added which adopted from Eggers, Kraus, Hughes, Laraway dan Snycerski (2013). The demographic distribution were as follows: 98% male and 2% female; while based on the education, it was shown that 98% of the owner of private rural bank is graduated from bachelor degree and 2% is graduated from master degree. Based on city location, it was shown that 62,79% is from Batam city, 20,93% is from Tanjungpinang city, 9,30% is from Karimun city, 2,33% from Natuna city, 2,33% from Bintan city, and 2,33% from Lingga city

Result and Discussion

The result of hypothesis significance testing analysis found that there were 3 hypothesis supported while other 1 hypothesis were rejected in the study as showed in Table 1.

Table 1: Results of The Hypothesis Significance Testing

Variable	*Coefficient*	*P Values*	Result	Decision
Socio Emotional Wealth (SEW) -> FinancialPerformance	-0,2748	0,3288	Not significant	Rejected
Innovativeness -> FinancialPerformance	0,8116	0,0007	Positive Significant	Accepted
Socio Emotional Wealth (SEW) -> Innovativeness	0,8671	0,0000	Positive Significant	Accepted
Socio Emotional Wealth (SEW) -> Innovativeness-> FinancialPerformance	0,7045	0,0012	Positive Significant	Accepted

Based on table 1 is the result of the hypothesis testing in this study. The value of P Value of socio emotional wealth variable on finansial performance shows 0.32> 0.05. This shows that socio emotional wealth does not have a significant influence on financial performance but has a negative effect. Therefore, H_1 is rejected. Financial performance of private rural bank in Riau Islands province is not directly influenced by socio emotional wealth. Rural bank is a financial institution supervised by the Financial Services Authority (OJK). There has strictly governance which focus more on profesional management instead of family interest. Private rural banks tend to pursue more towards financial goals than non-financial goals reflected in socio emotional wealth. So socio emotional wealth will not directly affect firm financial performance, but it really depends on the company's strategy. So, efforts to improve company financial performance are highly dependent on the business strategy applied not only based on socio emotional wealth. The P value of the innovativeness variable on financial performance shows 0.00> 0.05 and the coefficient value is 0.8116. This shows that innovativeness has a significant positive effect on financial performance. Therefore, H_2 is accepted. Inovativeness is a backbone for a company in the present era to survive. Changes in market trends that are increasingly fast encourage the necessity of a company must maintain competitiveness and innovativeness. Therefore, innovativeness will improve financial performance. (Yap, Cheng, Hussain & Ahmad, 2016; Zafar

& Kantola, 2018). Rural bank is facing tightly competition and strongly encourages the need for innovation in products to offer to the public. Product innovation is very sensitive in response to market demand. Rural bank in province of Kepulauan Riau often issue products with competitive loan interest rates and funding products that share gifts. Each new product issuance will raise a lot of funds as well as credit distribution. It can be seen that product innovation greatly affects the financial performance of rural banks. The p value of socio emotional wealth variable towards innovativeness shows 0.00> 0.05 and coefficient value is 0.8671. This shows that socio emotional wealth has a significant positive effect on innovativeness. Therefore, H_3 is accepted. Family companies tend to prefer to take risks associated with innovation, because they have greater access to resources, experience, expertise, and information that increases the likelihood of innovation success (Gast, Filser, Rigtering, Harms, Kraus & Chang, 2018). The rural bank of family company has been overseen by the Financial Services Authority (OJK), which is very strict in corporate governance regulation that must be adhered to. This encourages shareholders to participate in professionals in the position of directors of company management. Therefore, awareness of the selection of innovation strategies is also increasing. The p value from socio emotional wealth variable to financial performance mediated by innovativeness shows 0.00> 0.05 and the coefficient value with 0.7045. This shows that socio emotional wealth mediated by innovativeness has a significant positive effect on financial performance. Therefore, H_4 is accepted. Family firms can have greater access to resources, experience, expertise, and information that increases the likelihood of innovation success (Gast, et al., 2018). The owners of rural bank in Riau Islands province have achieved socio emotional wealth goals that have driven the implementation of innovativeness strategies which ultimately contributed positively to the financial performance of their companies.

Conclusion and Implications

This research was conducted to obtain empirical evidence about the influence of socio emotional wealth on financial performance either directly or indirectly through innovativeness. The results of this study found a uniqueness in family companies, especially in the private rural bank in province of Kepulauan Riau, Indonesia. Private rural bank in Riau Islands province in Indonesia is a family company which in its management is very active in involving non-family parties who are actually professionals in managing their business and have high innovative strategies. Private rural bank is a family company that participates in professional and qualified members in controlling operational management because Private rural bank is a financial institution overseen by Financial Services Authority (OJK). Financial Services Authority (OJK) has set various very strict criteria regarding the corporate governance of rural bank. This is different from other family companies that are still traditional in nature, which only wants that all management be controlled by the family and tend to be less innovative.

This research provides several contributions. First, many previous studies examined family companies using the agency theory approach, the theory of stewardship which ultimately only focused on the company's financial goals. However, in this study, it was revealed that family companies actually have non-financial objectives, which can be seen using the socio emotional wealth approach derived from the development of the behavioral agency model theory. Socio emotional wealth measurements used in this study are based on Berrone et al. (2012). This is still very new in Indonesia, and can make theoretical contributions specifically on the topic of developing specific research on family companies. Second, in family corporate governance must pay attention to the quality of management controllers. The shareholders of family companies can participate professionals in company management both from family members and non-family members. Qualifications and professionalism in managing the company will contribute positively to the company's financial performance. So, the owner of family business can be alert of this point. Third, this research also provides managerial implications for regulators regarding companies such as BAPEPAM and OJK. Financial institution companies supervised by the OJK are very strict in their corporate governance. One that is regulated by OJK regulations on rural bank financial institutions is that the director must have a Certified

Rural Banking (CRBD) certification. This shows that professionalism in serving a position in running the company's operational management is very important. While in the regulation of BAPEPAM it still has not regulated the director's qualifications. This can be taken into consideration by BAPEPAM in drafting regulations regarding companies listed on the IDX in order to improve its corporate governance and indirectly will improve the company's financial performance which will contribute to the Indonesian economy.

References

Aldrich, H. E., & Cliff, J. E. (2003). The pervasive effects of family on entrepreneurship:toward a family embeddedness perspective. *Journal of Business Venturing*, *18,* 573-596.

Baron, R. a. (2014). The Role of Affect in the Entrepreneurial Process. *The Academy of Management Review*, *33*(2), 328–340.

Belmonte, S. D., Seaman, C., & Bent, R. (2016). Keeping it in the family: family priorities and succession in scottish landed estates. *Journal of Family Business Management 6*(3), 350-362.

Berrone, P., Cruz, C., & Gomez-Mejia, L. R. (2012). Socioemotional Wealth in Family Firms: Theoretical Dimensions, Assessment Approaches, and Agenda for Future Research. *Family Business Review*, *25*(3), 258–279.

Berrone, P., Cruz, C., Gomez-Mejia, L. R., & Larraza-Kintana, M. (2010). Socioemotional Wealth and Corporate Responses to Institutional Pressures: Do Family-Controlled Firms Pollute Less? *Administrative Science Quarterly*, *55*(1), 82–113.

Berrone, P., Cruz, C., Gomez-Mejia, L. R., & Larraza-Kintana, M. (2010). Socioemotional Wealth and Corporate Responses to Institutional Pressures: Do Family-Controlled Firms Pollute Less? *Administrative Science Quarterly*, *55*(1), 82–113.

Chrisman, J. J., Kellermanns, F., Chan, K., & Liano, K. (2010). Intellectual foundations of current research in family business: An identification and review of 25 Influential articles. *Family Business Review*, *23*(1) , 9 -26.

De Massis, A., Kotlar, J., Chua, J. H., & Chrisman, J. J. (2014). Ability and willingness as sufficiency conditions for family-oriented particularistic behavior: Implications for theory and empirical studies. *Journal of Small Business Management*, *52*(2), 344–364.

Dyer, W. G., & Whetten, D. a. (2006). *Family firms and social responsibility: Preliminary evidence from the S&P 500*.

Eggers, F., Kraus, S., Hughes, M., Laraway, S., & Snycerski, S. (2013). Implications of customer and entrepreneurial orientations for SME growth. *Management Decision, 51(3), 524–546.*

Gast, J., Filser, M., Rigtering, J. P. C., Harms, R., Kraus, S., & Chang, M. L. (2018). Socioemotional Wealth and Innovativeness in Small- and Medium-Sized Family Enterprises: A Configuration Approach. *Journal of Small Business Management*, *56*(00), 53–67.

Gill, A., & Obradovisch, J. D. (2012). The impact of corporate governance and financial leverage on the value of american firms. *International Research Journal of Finance and Economics*. ISSN 1450-2887 Issue 91.

Global Business Guide Indonesia. (2016). Family-Owned Businesses in Indonesia | GBG. Retrieved July 27, 2018, from http://www.gbgindonesia.com/en/main/why_indonesia/2016/family_matters_a_guide_to_family_owned_businesses_in_indonesia_11459.php

Gomez-Mejia, L. R., Cruz, C., Berrone, P., & de Castro, J. (2011). The Bind that ties: Socioemotional wealth preservation in family firms. *Academy of Management Annals*, *5*(1), 653–707.

Gómez-Mejía, L. R., Haynes, K. T., Núñez-Nickel, M., Jacobson, K. J. L., & Moyano-Fuentes, J. (2007). Socioemotional Wealth and Business Risks in Family-controlled Firms: Evidence from Spanish Olive Oil Mills. *Administrative Science Quarterly*, *52*(1), 106–137.

Hayton, J. C., & Kelley, D. J. (2016). A Competency Based Framework For Promoting Corporate Entrepreneurship. *Human Resource Management*, *45*(3), 407–427.

Jia, N., Huang, K. G.-L., & Zhang, C. M. (2018). Public Governance, Corporate Governance, and Firm Innovation: An Examination of State-Owned Enterprises. *Academy of Management Journal*, *62*(1), 220–247.

Kalm, M., & Gomez-Mejia, L. R. (2016). Socioemotional wealth preservation in family firms. *Revista de Administração*, *51*(4), 409–411.

Michiels, A., Voordeckers, W., Lybaert, N., & Steijvers, T. (2013). CEO Compensation in Private Family Firms: Pay-for-Performance and the Moderating Role of Ownership and Management. *Family Business Review*, *26*(2), 140–160.

Miller, D., & Breton-Miller, I. I. (2006). Family governance and firm performance: agency, stewardship and capabilities. *Family Business Review*, *19*(1), 73-87.

Miller, D., Le Breton-Miller, I., & Scholnick, B. (2008). Stewardship vs. stagnation: An empirical comparison of small family and non-family businesses. *Journal of Management Studies*, *45*(1), 51–78.

Naldi, L., Nordqvist, M., Sjöberg, K., & Wiklund, J. (2007). *Entrepreneurial Orientation, Risk Taking, and Performance in Family Firms. Family Business Review, 20*(1), 33–47.

Robin & Amran, N. A. (2016). Implementation of good corporate governance mechanisms on family firm performance in Indonesia. *Advance science letters, 22*(5-6), 1435-1438.

Sharma, P., & Manikutty, S. (2005). Strategic divestments in family firms: Role of family structure and community culture. *Entrepreneurship: Theory and Practice*, *29*(3), 293–311.

Wajhono, S. I., Wahjoedi, Idrus, S., & Nirbito, J. G. (2014). Succession Planning As An Economic Education To Improve Family Business Performance In East Java Province Of Indonesia. *Journal of Asian Scientific Research*, *4*(11), 649–663.

Yap, C. S., Cheng, B. L., Mohamad Hussain, N., & Ahmad, R. (2016). Innovativeness, market intelligence practices, and firm performance of small- and medium-sized tour operators. *Tourism and Hospitality Research.*

Zafar, A., & Kantola, J. (2019). Relationship Between Firm ' s Performance and Factors Involved in the Selection of Innovation Providers. *Springer International Publishing*, 194–205.

Zahra, S. A., Hayton, J. C., & Salvato, C. (2004). Entrepreneurship in Family vs. Non-Family Firms: A Resource-Based Analysis of the Effect of Organizational Culture. *Entrepreneurship Theory and Practice, 28*(4), 363–381.

Zellweger, T. M., Kellermanns, F. W., Eddleston, K. A., & Memili, E. (2012). Building a family firm image: How family firms capitalize on their family ties. *Journal of Family Business Strategy, 3*(4), 239–250.