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Auditor Choice in Indonesia Listed Family Firms

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Abstract: This study aims to empirically examine the auditor choice in family firms. The study investigates the relationship between family firms, family ownership, and the family identity of the CEO with auditor choice. The research sample consists of 931 firm-year observations non-financial listed companies on the Indonesia Stock Exchange in 2015-2021. A company is considered to use a high-quality auditor if it is audited by one of the BIG 4 Firms. Logistic regression analysis results indicate that family firms are less likely to hire high-quality auditors compared to non-family firms. Besides, the percentage of family ownership is negatively related to auditor choice, where companies with higher family ownership less likely to hire high-quality auditors. In terms of the family identity of the CEO, companies with a descendant CEO are less likely to hire high-quality auditors. However, the presence of a founding family CEO and a professional CEO is not related to auditor choice.

Keywords: Auditor Choice; Family Firm; Family Ownership; CEO Family Identity

Introduction

The COVID-19 pandemic has had not only adverse effects on public health but also on the economic crisis for all types of businesses. According to (□ukowska et al., 2021), the COVID-19 pandemic has impacted family businesses twofold, as a biomedical threat to the family system and as a business threat to the company system. However, the survey conducted by PricewaterhouseCoopers on 2,801 family business owners, including 75 respondents from Indonesia, showed that family businesses have managed to cope relatively well with the pandemic (PwC, 2021). The survey results also indicate that a majority of respondents feel optimistic about their business's ability to survive and continue growing during the pandemic. Family firms dominate compared to other types of companies because most of the companies originate from family businesses. Family firms contribute 70%-90% of the annual gross domestic product (GDP) worldwide and account for 50%-80% of the workforce in most countries around the world (De Massis et al. 2018). Although family businesses make significant contributions to supporting economic growth in both normal conditions and during a pandemic, research examining the family dimension as a determinant of business phenomena is still limited, particularly in the fields of accounting and auditing (Khan et al., 2015; Schierstedt & Corten, 2021; Trotman & Trotman, 2010). Unlike non-family firms, family firms have a different organizational structure that often characterized by concentrated family ownership and greater involvement of family members in management (Hsu et al., 2018).

Previous studies on auditor choice in family firms can be explained through two possible scenarios. Firstly, in the presence of lower agency problems type I, family firms may demand lower audit quality, leading them to prefer hiring auditors with lower or non-top-tier quality (Ho & Kang, 2013). Secondly, strong incentives for fraudulent activities within family firms can increase audit risks, necessitating auditors with high quality to conduct more extensive audits in order to mitigate these risks (Khan et al., 2015). The existence of these two conflicting argument scenarios makes auditor choice in family firms an interesting research topic to explore. According to (Al-Okaily, 2020), studying family firms is crucial due to their unique prevalence and ownership structure, which give rise to different agency problems compared to non-family firms.

Several studies have extensively examined the phenomenon of auditor choice in family firms. (Ho & Kang, 2013) investigated auditor choice in family firms using data from Standard & Poor's (S&P) 1500 companies from 2000 to 2008. Their findings indicated that family firms tend to avoid hiring top-tier auditors (high-quality) compared to non-family firms due to less severe agency problems between owners and managers. These findings were supported by (Ayadi et al., 2020) and (Hsu et al., 2018), who examined the same issue using samples of French-listed companies in 2016 and companies listed on the Taiwan Stock Exchange between 1996 and 2015, respectively. The research by (Khan et al., 2015) on non-financial companies in Bangladesh from 2005 to 2013 also yielded similar results. However, the research by (Srinidhi et al., 2014) on a sample of family firms in the United States from 2003 to 2010 showed that family firms with strong governance tend to choose high-quality audits in the form of specialized auditors, compared to non-family firms, while family firms with weak governance did not show a preference for specialized auditors. These findings were supported by (Kang, 2014), who stated that family firms are more likely to select industry-specialist auditors compared to non-family firms, indicating that family firms have strong incentives to signal the quality of financial reporting.

This study aims to empirically examine the phenomenon of auditor choice in family firms. It builds upon the research conducted by (Hsu et al., 2018), which explored how family firm characteristics, such as family ownership percentage and CEO identity, influence auditor choice. According to (X. Chen et al., 2013), auditor choice can be influenced differently depending on who is leading the family firm. CEOs who are founders, descendants, or professionals exhibit distinct identities when leading family firms (Hsu et al., 2018). Previous studies on auditor choice in family firms have predominantly focused on advanced economies such as the United States (Ho & Kang, 2013; Kang, 2014; Srinidhi et al., 2014) and Taiwan (Ayadi et al., 2020; Hsu et al., 2018), with limited research conducted in developing countries, such as Bangladesh (Khan et al., 2015). This study aims to address this gap by investigating the topic in the context of another developing country, namely Indonesia. As a developing country, Indonesia is characterized by having a weak legal environment and investor protection. (Francis et al., 2003; Kusharyanti & Kusuma, 2020) state that countries with weak legal environments tend to demand lower audit quality compared to those with stronger legal environments. The presence of such unique institutional arrangements makes the phenomenon of auditor choice in family firms in Indonesia intriguing for further investigation. In this study, the proxy for high-quality auditors is the use of BIG 4 firm as auditors. BIG 4 firm auditors are known to provide superior audit quality compared to non-BIG 4 firm due to their scale, expertise, technical capabilities, and reputation incentives in detecting and uncovering accounting fraud (Barton, 2005; Choi & Wong, 2007; Ho & Kang, 2013; Hsu et al., 2018).

Literature Review

Agency Theory

The phenomenon of auditor choice in family firms can be explained through agency theory proposed by (Jensen & Meckling, 1976). Agency theory states that shareholders as principals delegate decision-making authority in the daily operations of the company to management as agents (Jensen & Meckling, 1976). This theory assumes that the separation of ownership and management in a company can create agency problems. Agency problems arise due to the asymmetry of information between principals and agents. Agency theory suggests that agents will not act in the best interest of the principal unless their behavior is closely monitored (Eisenhardt, 1989). Agency costs incurred to mitigate agency problems can be reduced through credible financial reporting (Jensen & Meckling, 1976). Audit serves as a means to enhance the credibility of financial statements, thereby indirectly fulfilling the monitoring function of the company. Therefore, the tendency of auditors to engage high-quality or low-quality auditors depends on the severity of the agency problems faced by the company (Kang, 2014). (Ho & Kang, 2013) state that family firms tend to experience less severe Type 1 agency problems compared to non-family firms.

There are two conflicting agency perspectives that explain the behavior of family firm owners, namely the alignment effect and the entrenchment effect (Alhababsah, 2019; Hsu et al., 2018; Qawqzeh et al., 2021). The alignment effect predicts that the interests of managers and shareholders are more aligned in family firms compared to non-family firms (Hsu et al., 2018). Family owners, as significant block shareholders, are more motivated to monitor managers. Furthermore, family owners, as controlling shareholders, strive to maintain the family's reputation to sustain their long-term presence in the company (Alhababsah, 2019; Hsu et al., 2018). This concern for reputation creates implicit commitments among family members to uphold the family name and avoid the misuse of power for personal gain at the expense of other shareholders (Alhababsah, 2019).

The entrenchment effect predicts that high family ownership and the dominance of family owners in top executive positions within a company will increase the likelihood of power abuse for the personal interests of family owners, thereby detrimentally affecting the interests of other shareholders (Hsu et al., 2018; Qawqzeh et al., 2021). According to this perspective, controlling family owners will act to restrict the flow of information related to the company's activities in order to conceal their opportunistic behavior (Hsu et al., 2018).

Hypotheses Development

Family firms tend to be characterized by a significant ownership percentage held by the founding family, giving them control to influence and monitor the company. Family owners, as controlling shareholders in a family firm, are more motivated to engage in effective monitoring to protect their wealth and maintain the family's reputation, thereby ensuring the long-term presence of the family dynasty in the company (Hsu et al., 2018; Miller et al., 2013). This effective monitoring results in lower information asymmetry and conflicts of interest among family shareholders, non-family shareholders, and managers within the family firm (Ho & Kang, 2013). From the perspective of agency theory, this condition leads to alignment of interests between shareholders and managers (alignment effect) in family firms, consequently reducing Type 1 agency problems (Ayadi et al., 2020). Consequently, family firms tend to be less likely to hire high-quality auditors.

The research findings of (Ho & Kang, 2013) and (Ayadi et al., 2020) indicate that family firms tend to not engage high-quality auditors. This is attributed to the relatively less severe agency problems in family firms (Ho & Kang, 2013). Family firms tend to have effective monitoring mechanisms in place because family owners have a vested interest in safeguarding their wealth and reputation. This alignment of interests among family shareholders, non-family shareholders, and managers leads to reduced reliance on auditor monitoring, thereby lowering the demand for high-quality auditors. Therefore, the first hypothesis of this study is as follows:
H_1 : Family firms tend to be less likely to hire high-quality auditors.

Family ownership can play a significant role in mitigating agency problems between family owners as controllers and other shareholders (Darmadi, 2016). Based on the alignment effect perspective, high family ownership fosters alignment of interests between family owners and other shareholders. High family ownership provides incentives for owners to employ effective monitoring mechanisms to protect their wealth tied to the family firm (Hsu et al., 2018). (Wang, 2006) states that information asymmetry tends to be lower in the company with high family ownership because concentrated ownership can motivate owners to provide credible financial reports for enhanced monitoring. Companies with high family ownership are inclined to hire auditors from smaller audit firms because investors recognize that family owners lack incentives for opportunistic behavior (El-Ghoul et al., 2007 as cited by Darmadi, 2016). Family owners prioritize the long-term survival and reputation of their family in the firm. The research findings of (Darmadi, 2016) and (Hsu et al., 2018) indicate a negative relationship between family ownership and the appointment of high-quality auditors. The alignment of interests among shareholders and the presence of effective monitoring mechanisms lead companies with high family ownership to be more likely to hire low-quality auditors. Therefore, the second hypothesis of this study is as follows:
H_2 : Family ownership is negatively related to the appointment of high-quality auditors.

The founder of a family firm tends to have long-term investment motivation and a strong intention to pass down the business to their descendants, leading to a high sense of responsibility and careful development of a positive family reputation to ensure the continuity of the family business (Anderson & Reeb, 2003; Gómez-Mejía et al., 2007). Companies led by founders have lower conflicts of interest between controlling owners and other shareholders because founders are motivated to prioritize the long-term interests of the company over their personal interests (Amit et al., 1990). From the perspective of agency theory, this aligns with the alignment effect, which motivates founder CEOs to present more informative and credible information. Consequently, the benefits of appointing high-quality auditors to monitor a family firm managed by a founder CEO become relatively marginal as the dependence of other shareholders on wealth protection decreases (Hsu et al., 2018). Therefore, companies with founder CEOs are less likely to hire high-quality auditors. The research findings of (Hsu et al., 2018) show a negative relationship between the presence of a founder CEO in a family firm and the appointment of high-quality auditors. Hence, the third hypothesis of this study is as follows:

H_3 : The presence of a founder CEO in a family firm is negatively related to the appointment of high-quality auditors.

Founder CEOs and descendant CEOs may have different influences on auditor selection. (Villalonga & Amit, 2006) found that the presence of descendant CEOs is negatively related to firm value, indicating that when descendants served as CEO, the firm value declines. When founders pass down the CEO position to the next generation, family ownership tends to become more dispersed. This leads to high conflicts of interest because it can be challenging for descendant CEOs to share control with other family members based on a shared vision, suggesting that descendant CEOs are more likely to maximize their own interests over those of other shareholders (Hsu et al., 2018). From the perspective of agency theory, this condition aligns with the entrenchment effect. Descendant CEOs are more likely to exploit their power by appointing low-quality auditors to avoid close monitoring of their opportunistic actions. The fourth hypothesis of this study states that:

H_4 : The presence of a descendant CEO is negatively related to the appointment of high-quality auditors.

Family firms sometimes also choose professional CEOs to run the company. (Mullins & Schoar, 2016) state that professional CEOs in family firms have fewer explicit or implicit control rights compared to other types of CEOs. The presence of professional CEOs can sometimes trigger increased conflicts of interest. However, based on agency theory from the alignment effect perspective, family firms can use control mechanisms such as executive compensation schemes to ensure that the interests of managers and the family are aligned (Y. M. Chen et al., 2016). These executive compensation schemes will prevent opportunistic behavior by professional CEOs and ensure that the interests of family shareholders remain protected (Y. M. Chen et al., 2016). This condition indicates that agency conflicts are lower in family firms with professional CEOs due to the control mechanisms exercised by family owners over professional CEOs, which helps maintain the quality of financial reporting. As a result, the demand for high-quality auditors from other shareholders may be reduced. The research findings of (Hsu et al., 2018) show that the presence of professional CEOs in family firms is negatively related to the appointment of high-quality auditors. The fifth hypothesis of this study states that:

H_5 : The presence of a professional CEO is negatively related to the appointment of high-quality auditors.

Methods

This study uses a sample of non-financial companies listed on the Indonesia Stock Exchange from 2015 to 2021. Based on purposive sampling, the sample size of this study consists of 133 companies with a total observation period of 7 years, resulting in a final observed sample of 931 company-years. Winsorization is applied to all research variables above and below 1% of their distributions to mitigate the influence of extreme values (Hsu et al., 2018). This study employs the size or reputation of the Public Accounting Firms as a proxy for auditor choice (AUDCHOICE). The study uses BIG 4 firm as a proxy for high-quality auditors and Non-BIG 4 firm as a proxy for low-quality auditors. BIG 4 firm is considered to have higher audit quality compared to other types of firm because they possess better human and material resources, attract competent and experienced staff, and enable the development of employee skills (Ayadi et al., 2020). The auditor choice variable is dichotomous, with 1 if the company is audited by a high-quality auditor, i.e., one of the BIG 4 firms (PricewaterhouseCoopers, Deloitte, Ernst & Young, or KPMG), and 0 otherwise. This measurement approach is consistent with prior research (Darmadi, 2016).

Family firm (FAM) is a dichotomous variable, with a value of 1 if the company is classified as a family firm, and 0 otherwise. This study defines a firm as a family firm if (1) the founder or their descendants continue to hold positions in top management or the board, or (2) their family collectively holds more than 5% of the company's shares. This measurement approach is consistent with prior research (X. Chen et al., 2013; Hsu et al., 2018). Family ownership (FAMOWN) is measured by the percentage of shares owned by the family within the company. This measurement approach is consistent with prior research (Alhababsah, 2019). Founder CEO (FFCEO) is measured as a dummy variable, with a value of 1 if the CEO position is held by the founder of the family firm, and 0 otherwise. Descendant CEO (FDCEO) is also measured as a dummy variable, with a value of 1 if the CEO position is held by a descendant of the family firm's founder, and 0 otherwise. Professional CEO (FHCEO) is measured as a dummy variable, with a value of 1 if the family firm has a professional CEO, and 0 otherwise. This measurement approach is consistent with the methodology used in previous studies (Hsu et al., 2018). This study also includes several control variables in the research model. The control variables consist of complexity (COMPLEX), firm size (FSIZE), leverage (LEV), return on assets (ROA), and loss (LOSS). Hypothesis testing in this study is conducted using logistic regression analysis with the STATA software. Three logistic regression models are employed to test the research hypotheses. Model 1 is used to test the first hypothesis, Model 2 is used to test the second hypothesis, while Model 3 is used to test the third, fourth, and fifth hypotheses.

Model 1

$$AUDCHOICE_{i,t} = \beta_0 + \beta_1 FAM_{i,t} + \beta_2 COMPLEX_{i,t} + \beta_3 FSIZE_{i,t} + \beta_4 LEV_{i,t} + \beta_5 ROA_{i,t} + \beta_6 LOSS_{i,t}$$

Model 2

$$AUDCHOICE_{i,t} = \beta_0 + \beta_1 FAMOWN_{i,t} + \beta_2 COMPLEX_{i,t} + \beta_3 FSIZE_{i,t} + \beta_4 LEV_{i,t} + \beta_5 ROA_{i,t} + \beta_6 LOSS_{i,t}$$

Model 3

$$AUDCHOICE_{i,t} = \beta_0 + \beta_1 FFCEO_{i,t} + \beta_2 FDCEO_{i,t} + \beta_3 FHCEO_{i,t} + \beta_4 COMPLEX_{i,t} + \beta_5 FSIZE_{i,t} + \beta_6 LEV_{i,t} + \beta_7 ROA_{i,t} + \beta_8 LOSS_{i,t}$$

Findings

Descriptive statistics of the research data are presented in Table 1. The average value of the auditor choice variable (AUDCHOICE) is 0.407 with a standard deviation of 0.492. This indicates that, on average, 40.7% of the sampled companies in this study use high-quality auditors (BIG 4 firm), while the remaining 59.3% use low-quality auditors (Non-BIG 4 firm). The average value of the family firm variable (FAM) is 0.356 with a standard deviation of 0.479. This means that, on average, 35.6% of the sampled companies in this study are family firms. The average value of the family ownership variable (FAMOWN) is 0.047 with a standard deviation of 0.149. This indicates that, on average, family ownership in the sampled companies of this study is 4.7%.

Table 1. **Descriptive Statistics**

Variable	Obs	Mean	Std. Dev.	Min	Max
AUD CHOICE	931	.407	.492	0	1
FAM	931	.356	.479	0	1
FAMOWN	931	.047	.149	0	.81
FFCEO	931	.027	.162	0	1
FDCEO	931	.201	.401	0	1
FHCEO	931	.449	.498	0	1
COMPLEX	931	5.566	5.437	0	25
FSIZE	931	29.249	1.472	25.535	32.454
LEV	931	.499	.261	.077	1.692
ROA	931	.037	.098	-.354	.382
LOSS	931	.226	.418	0	1

The average value of the founder CEO variable (FFCEO) is 0.027 with a standard deviation of 0.162. This indicates that, on average, founder CEOs in the sampled companies of this study is 2.7%. The average value of the descendant CEO variable (FDCEO) is 0.201 with a standard deviation of 0.401. This means that, on average, descendant CEOs in the sampled companies of this study is 20.1%. The average value of the professional CEO variable (FHCEO) is 0.449 with a standard deviation of 0.498. This indicates that, on average, professional CEOs in the sampled companies of this study is 44.9%.

A good regression model should be free from multicollinearity issues. A correlation matrix analysis and variance inflation factor (VIF) calculations were conducted to test for multicollinearity in the research model. Table 2 presents the results of the correlation matrix analysis and VIF calculations for the independent variables in this study. Based on Table 2, the correlation coefficient values among the regression variables in this study range from 0.001 to 0.669, indicating moderate correlation strength. Furthermore, all VIF values for the explanatory variables are less than 3, indicating no multicollinearity issues among the variables in this research model.

Table 3. **Sample Distribution**

	Non-Family Firm	Family Firm	Total Observations
Low-quality auditors	326	226	552
High-quality auditors	274	105	379
Total Observations	600	331	931

Table 2. **Correlation Matrix and Variance Inflation Factors Value**

Variables	**(1)**	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**(7)**	**(8)**	**(9)**	**(10)**	**(11)**	**VIF**
(1) AUDCHOICE	1.000											
(2) FAM	-0.136*	1.000										2.46
	(0.000)											
(3) FAMOWN	-0.110*	0.414*	1.000									1.28
	(0.001)	(0.000)										
(4) FFCEO	-0.029	0.224*	0.174*	1.000								1.36
	(0.369)	(0.000)	(0.000)									
(5) FDCEO	-0.208*	0.669*	0.372*	-0.083*	1.000							2.93
	(0.000)	(0.000)	(0.000)	(0.011)								
(6) FHCEO	0.114*	-0.161*	-0.157*	-0.150*	-0.447*	1.000						1.49
	(0.001)	(0.000)	(0.000)	(0.000)	(0.000)							
(7) COMPLEX	0.073*	0.076*	0.005	-0.078*	0.009	0.045	1.000					1.36
	(0.025)	(0.020)	(0.880)	(0.017)	(0.773)	(0.173)						
(8) FSIZE	0.315*	-0.141*	-0.175*	-0.125*	-0.191*	0.185*	0.480*	1.000				1.58
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)					
(9) LEV	-0.127*	-0.058	-0.093*	0.008	-0.080*	0.051	0.078*	0.202*	1.000			1.23
	(0.000)	(0.076)	(0.004)	(0.801)	(0.015)	(0.124)	(0.017)	(0.000)				
(10) ROA	0.230*	-0.055	0.019	-0.001	-0.025	-0.084*	-0.006	0.131*	-0.332*	1.000		1.78
	(0.000)	(0.094)	(0.558)	(0.979)	(0.450)	(0.010)	(0.861)	(0.000)	(0.000)			
(11) LOSS	-0.097*	0.034	0.040	-0.026	0.025	0.040	-0.033	-0.195*	0.232*	-0.622*	1.000	1.69
	(0.003)	(0.300)	(0.220)	(0.427)	(0.455)	(0.224)	(0.314)	(0.000)	(0.000)	(0.000)		

*** $p<0.01$, ** $p<0.05$, * $p<0.1$

Table 3 presents the sample distribution regarding the difference in auditor choices between family firms and non-family firms. The number of family firms is 331 or 35.55% of the total observations, while the remaining 600 firms or 64.45% of the total observations are non-family firms. Among the family firms, 105 firms, or 31.72%, hire high-quality auditors, while the remaining 226 firms, or 68.28%, hire low-quality auditors. This indicates that family firms tend to hire low-quality auditors. Among the non-family firms, 274 firms, or 45.67%, hire high-quality auditors, while the remaining 326 firms, or 54.33%, hire low-quality auditors. This indicates that non-family firms also tend to hire low-quality auditors.

The results of the logistic regression analysis are presented in Table 4. Based on the results of the regression analysis, Model 1 shows that the coefficient value for FAM is -0.421 with a significance level below 0.01 or 1%. This result indicates that family firms are negatively related to auditor choice, implying that family firms less likely to hire high-quality auditors (i.e., BIG 4 firm auditors). Therefore, Hypothesis 1 is supported. Examining the value of the dy/dx (marginal effect) for the FAM variable, which is -0.083, it can be inferred that the probability of family firms choosing high-quality auditors is 8.3% lower than that of non-family firms. This finding suggests that family firms less likely to hire high-quality auditors compared to non-family firms. These results are consistent with previous studies (Ho & Kang, 2013), (Khan et al., 2015), (Hsu et al., 2018) and (Ayadi et al., 2020). The effect of Type I agency problems dominates Type II agency problems on the choice of auditors for family firms (Ho & Kang, 2013). The alignment of shareholder and managerial interests reduces Type I agency problems, resulting in a decreased demand for high-quality auditors (Ayadi et al., 2020). These findings support the alignment effect perspective within agency theory concerning auditor choice in family firms.

Table 4. **Regression Analysis Results**

Variables	**Model 1**		**Model 2**		**Model 3**	
	Coeff.	**Marginal Effect**	**Coeff.**	**Marginal Effect**	**Coeff.**	**Marginal Effect**
FAM	-0.421***	-0.083***				
FAMOWN			-1.569**	-0.308**		
FFCEO					0.131	0.025
FDCEO					-1.035***	-0.199***
FHCEO					0.067	0.013
COMPLEX	-0.039**	-0.008**	-0.041***	-0.008***	-0.036**	-0.007**
FSIZE	0.641***	0.126***	0.639***	0.125***	0.617***	0.119***
LEV	-1.766***	-0.347***	-1.773***	-0.348***	-1.856***	-0.357***
ROA	5.857***	1.150***	6.17***	1.212***	6.126***	1.177***
LOSS	0.894***	0.176***	0.935***	0.184***	0.909***	0.175***
Constant	-18.384***		-18.418***		-17.69***	
R^2 (Psd R^2)	0.149		0.149		0.166	
Observations	931		931		931	

Significance levels: *** p<0.01, ** p<0.05, * p<0.1

The results of the regression analysis of model 2 in Table 4 reveal that the coefficient value for FAMOWN is -1.569 with a significance level below 0.05 or 5%. This finding indicates that the percentage of family ownership is negatively related to the appointment of high-quality auditors. Companies with high levels of family ownership is less likely to hire high-quality auditors. The dy/dx (marginal effect) value for the FAMOWN variable is -0.308, suggesting that the probability of companies with high family ownership hiring high-quality auditors is 30.8% lower than companies with low family ownership. Therefore, Hypothesis 2 of this study is supported. These results are consistent with previous studies (Darmadi, 2016) and (Hsu et al., 2018), and support the alignment effect perspective within agency theory. (Hsu et al., 2018) state that the alignment effect holds in family firms with higher levels of family ownership.

Based on the results of the regression analysis, Model 3 in Table 4, the coefficient value for FFCEO is 0.131 with a significance level above 0.1 or 10%. This finding indicates that the presence of a founder CEO is not related to the appointment of high-quality auditors. The coefficient value for FDCEO is -1.035 with a significance level below 0.01 or 1%. This finding suggests that the presence of a descendant CEO is negatively related to the appointment of high-quality auditors. The coefficient value for FHCEO is 0.067 with a significance level above 0.1 or 10%. This result indicates that the presence of a professional CEO is not related to the appointment of high-quality auditors. Therefore, Hypothesis 4 of this study is supported, while Hypotheses 3 and 5 are rejected. These findings contradict the results of previous studies (Hsu et al., 2018).

The results of this study indicate the presence of an entrenchment effect in firms with descendant CEOs, which affects the appointment of low-quality auditors. Looking at the marginal effect value of the FDCEO variable, which is -0.199, it can be inferred that the probability of firms with descendant CEOs hiring high-quality auditors is 19.99% lower than firms with CEOs who are not descendants. This finding strengthens the argument that firms with descendant CEOs tend to hire low-quality auditors to avoid strict monitoring of their opportunistic actions. Furthermore, the results of this study also suggest that alignment effect or entrenchment effect does not occur in firms with founder CEOs or professional CEOs, indicating that the presence of these CEOs is not related to auditor choice.

Regarding the control variables, the logistic regression analysis results of Model 1, Model 2, and Model 3 in Table 4 consistently show the relationship between the control variables and auditor choice. Company complexity and leverage ratio are negatively related to the appointment of high-quality auditors. However, company size, return on assets, and company losses are positively related to the appointment of high-quality auditors.

Conclusion

Auditor choice is a crucial decision that is closely related to the quality of a company's financial reporting. Family firms, characterized by unique characteristics, play a significant role in supporting the country's economy. Therefore, studying their behavior can provide insights into understanding the efficiency of corporate governance mechanisms in that company. This study examines auditor choice in family firms. The findings indicate that family firms tend to prefer lower-quality auditors compared to non-family firms. In terms of the percentage of family ownership, this research reveals a negative relationship between family ownership percentage and the appointment of high-quality auditors, suggesting that companies with higher levels of family ownership are less likely to hire high-quality auditors. Additionally, the study also finds that the presence of a descendant CEO is negatively related to the appointment of high-quality auditors, whereas the presence of a founder CEO or a professional CEO is not related to the appointment of high-quality auditors.

This study has theoretical implications regarding the different agency effects resulting from variations in family ownership and the family identity of the CEO. The alignment effect occurs in family firms, leading them to be less likely to hire high-quality auditors due to the alignment of interests among shareholders. However, the presence of a descendant CEO can trigger the entrenchment effect, which tends to result in a lower likelihood of hiring high-quality auditors with the aim of concealing opportunistic behaviors of the family shareholders. The practical implications of this research provide insights for policymakers and practitioners regarding the differences in auditor choice criteria between family and non-family firms, depending on the severity of the agency problems they face.

This study has several limitations. Firstly, it focuses solely on family firms listed in the Indonesian stock market due to data availability considerations, while the majority of family firms are typically unlisted. Therefore, the findings of this study may not be generalizable to all types of family firms, particularly those that are not listed in the stock market. Secondly, the scope of this research is limited to one country. Future research would be more compelling by utilizing cross-country data to examine the phenomenon of auditor choice in family firms.

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