

AGENCY CONFLICT, ESG DISCLOSURE, AND EBITDA VOLATILITY IN INDONESIAN FAMILY SMEs: THE MODERATING ROLE OF DIRECTOR COMPETENCY AND GENERATIONAL SUCCESSION

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Abstract

This study examines the effect of agency conflict and ESG disclosure on earnings instability in family-controlled SMEs. Agency conflict is operationalized through residual cash flow (RCF) and ownership concentration. The sample consists of 42 family SMEs listed on the IDX Development and Acceleration Boards, yielding 252 firm-year observations from 2019 to 2024. Grounded in Agency Theory and Upper Echelon Theory, this research applies Moderated Regression Analysis with random effects and a one-period lagged specification to address reverse causality. Director competency and generational succession serve as moderating variables. The Director Competency Score (DCS) is constructed as a composite index of education, board tenure, and professional certifications, with strong inter-rater reliability ($\kappa > 0.80$). The empirical results demonstrate that ESG disclosure significantly reduces EBITDA volatility ($\beta = -0.431$, $p = 0.021$) when board competency is accounted for. Furthermore, director competency directly lowers earnings volatility ($\beta = -0.164$, $p = 0.055$) and negatively moderates the impact of excess cash flow ($\beta = -0.016$, $p = 0.016$). Otherwise, the interaction between ESG and DCS positively affects earnings fluctuations ($\beta = +0.218$, $p = 0.056$), indicating a sustainability investment paradox where competent boards undertake resource-intensive sustainability commitments. Generational succession does not exhibit a significant moderating effect, primarily due to the sample's uniform first-generation composition. So that, this study proposes the DCS as a practical benchmarking tool for regulators such as OJK and Kementerian Koperasi, offering implications for SDG 8 and SDG 17.

Keywords: agency conflict; ESG disclosure; EBITDA volatility; director competency; family SMEs

INTRODUCTION

Small and Medium Enterprises (SMEs) contribute significantly to the Indonesian economy, contributing more than 60% of GDP and employing 97% of the workforce (Tambunan, 2019). However, family-controlled SMEs often experience income instability driven by governance issues rather than simply by market conditions. Factors such as concentrated ownership, limited sustainability reporting, and generational succession can increase EBITDA volatility. This persistent volatility negatively impacts credit profiles, investor confidence, and long-term operational sustainability.

Previous studies on SMEs registered in Indonesia have investigated related aspects of this issue. Utami et al. (2026a) found that the effect of residual cash flows on profits depends on the quality of governance and industrial sectors, while Utami et al. (2026b) highlighted the role of financial flexibility in linking governance mechanisms to company value and risk outcomes. However, these studies have not comprehensively addressed agency conflicts by simultaneously examining the issue of free cash flow (Jensen, 1986) and co-principals (La Porta et al., 1999;

Claessens et al., 2000), which stands out in the structure of concentrated ownership. In addition, the specific role of ESG disclosures and directors' human resources in stabilizing revenues warrants further investigation. This gap is crucial to address, given that ownership concentration impacts the performance of companies in emerging markets (Bishwah & Hossain, 2025) and ESG disclosures affect specific market reactions for Indonesian family companies (Itan et al., 2025).

To address these gaps, this study introduces the Director Competency Score (DCS) as a primary moderating variable. The DCS is a composite index constructed from directors' education level, board tenure, and professional certifications. The inclusion of this measurement is based on the premise that boards with higher expertise yield better governance outcomes (Lee et al., 2024; Utami et al., 2026a), which may condition how agency conflict and ESG disclosure affect earnings stability. So that, this research aligns with the conference's core themes regarding multidisciplinary governance research, sustainability evidence, generational succession, ESG accounting, and SDG-oriented MSME policy.

LITERATURE REVIEW AND HYPOTHESIS FORMULATION

Agency Theory and EBITDA Volatility in Family Firms

Agency Theory (Jensen & Meckling, 1976) provides the foundational lens. In family-controlled SMEs, agency conflicts manifest primarily as principal-principal conflicts where the dominant family shareholder pursues private benefits at the expense of minority shareholders (La Porta et al., 1999). EBITDA volatility captures earnings instability driven by governance-related inefficiencies. Prior evidence confirms that family ownership per se has no significant moderating effect on operational performance in Indonesian listed SMEs (Utami et al., 2026a), consistent with Villagrasa et al. (2024), motivating the use of Largest Ratio and Generational Succession as more granular constructs. The COVID-19 pandemic significantly disrupted IDX firm performance, creating uniform macroeconomic shocks that dominated governance-level variation (Devi et al., 2020; Almustafa et al., 2023), justifying the exclusion of year fixed effects in the primary model specification.

Residual Cash Flow and Ownership Concentration

Residual Cash Flow (RCF), defined as operating cash flow minus capital expenditures scaled by total assets, represents the discretionary cash available after meeting investment obligations (Jensen, 1986). In family SMEs, the presence or absence of adequate governance determines whether this residual cash is deployed productively or misallocated through overinvestment or self-dealing the core of the free cash flow agency problem.

The Largest Ratio the proportion of total shares held by the single largest shareholder is a direct measure of ownership concentration and control entrenchment (Claessens et al., 2000; La Porta et al., 1999). Evidence from emerging markets confirms a significant negative relationship between ownership concentration and firm performance (Bishwah & Hossain, 2025). Its effect on earnings volatility may be non-linear: extreme concentration may destabilise earnings through entrenchment, or paradoxically stabilise them when the controlling shareholder has strong reputational incentives (Pacheco, 2022).

ESG Disclosure as a Stability Mechanism

ESG disclosure reduces information asymmetry, lowers the cost of capital, and signals long-term value orientation (Friede et al., 2015). For Indonesian family firms, ESG disclosures positively influence market reactions, with family-owned firms showing stronger investor responses than non-family firms (Itan et al., 2025). Financial flexibility enables governance mechanisms to realise their potential (Utami et al., 2026b) by analogy, ESG disclosure is most effective as a volatility-reduction mechanism when supported by board competency and stable generational leadership (Biju et al., 2025).

Generational Succession and Succession Dynamics

The controlling family's generational cohort influences the firm's governance philosophy, risk appetite, and institutional memory (Gersick et al., 1997). Research shows that intergenerational succession can decrease corporate default risk by limiting aggressive investment activities (Deng & Ren, 2025) and improve ESG outcomes during joint management by the first and second generations (Liu et al., 2025; Zhang & Wei, 2025). Therefore, generational succession is expected to condition the impact of both ownership concentration and ESG disclosure on managing earnings risk.

Director Competency Score (DCS) and Upper Echelon Theory

Upper Echelon Theory (Hambrick & Mason, 1984) posits that executive characteristics shape organisational outcomes. In a comprehensive review of UET's evolution over more than three decades, Abatecola and Cristofaro (2020) document that the field has progressively moved beyond purely socio-demographic proxies toward richer, more direct operationalizations of executive cognitive and human capital attributes a trajectory that motivates the present study's DCS approach. Responding to this methodological call, the DCS is a transparent, additive manual scoring instrument integrating: Education Score (S1=1, S2=2, S3=3); Tenure Score ($\leq 2\text{yr}=1$, $3-5\text{yr}=2$, $>5\text{yr}=3$, +0.5 per interlocking board seat, max+1); and Certification Score (count of recognised professional certifications: CFA, CFP, WPPE, WMI, CPA, CIMA, BNSP). Board-level DCS = arithmetic mean across all sitting directors. This instrument directly operationalizes the executive characteristics identified by UET as consequential for strategic outcomes (Hambrick & Mason, 1984; Abatecola & Cristofaro, 2020), while remaining field-verifiable without specialist software. Prior evidence confirms that board financial expertise significantly enhances market valuation in Indonesian listed SMEs (Utami et al., 2026a, coeff. 1.029, $p<0.05$), and that boards with knowledge heterogeneity demonstrate superior and more consistent performance outcomes (Lee et al, 2024; Selivanovskikh& Bodolica, 2025).

Conceptual Model

Rather than treating governance as a single dimension, this study maps it across multiple layers. Three independent variables enter the model RCF, Largest Ratio, and ESG Disclosure alongside one dependent variable (EBITDA Volatility), two moderating variables (DCS and Generational Succession), and six controls (Firm Size, Firm Age, Tobin's Q, Current Ratio, Industry Dummy, Revenue Growth). Their relationships are formalised as:

$$VolEBITDA_{it} = \alpha + \beta_1 RCF + \beta_2 LR + \beta_3 ESG + \beta_4 DCS + \beta_5 GEN + \beta_6 (RCF \times DCS) + \beta_7 (LR \times DCS) + \beta_8 (ESG \times DCS) + \beta_9 (RCF \times GEN) + \beta_{10} (LR \times GEN) + \beta_{11} (ESG \times GEN) + \beta_{12} Controls + \varepsilon_{it} \dots (1)$$

Research Hypotheses

Based on the theoretical framework and prior evidence, nine hypotheses are proposed:
 Direct effect hypotheses:

H1a: RCF has a significant negative effect on EBITDA volatility.

H1b: Largest Ratio has a significant positive effect on EBITDA volatility.

H1c: ESG Disclosure has a significant negative effect on EBITDA volatility.

H2a: DCS negatively moderates the relationship between Largest Ratio and EBITDA volatility.

H2b: DCS amplifies the negative relationship between ESG Disclosure and EBITDA volatility.

H2c: DCS negatively moderates the relationship between RCF and EBITDA volatility.

H3a: Generational succession positively moderates the relationship between Largest Ratio and EBITDA volatility.

H3b: Generational succession attenuates the negative relationship between ESG Disclosure and EBITDA volatility.

H3c: Generational succession positively moderates the relationship between RCF and EBITDA volatility.

RESEARCH METHODS

Sample and Data

The empirical base for this study is a panel of 42 family-controlled SMEs drawn from the IDX Development and Acceleration Boards, observed continuously from 2019 through 2024. With six years of data for every firm, the panel is strongly balanced yielding exactly 252 firm-year observations, a structure confirmed via Stata's `xtdescribe` command. Crucially, these 42 firms are not a sample in the conventional sense. They represent the near-complete population of IDX-listed family SMEs satisfying all three identification criteria, which means population-level inference is defensible here despite the seemingly modest firm count. The observation window extends that of Utami et al. (2026a) and Utami et al. (2026b) by one year.

Firm eligibility required three conditions to be met simultaneously: the founding family must hold at least 20% of total shares; at least one family member must sit on the board; and the generational stage of the controlling family must be traceable through publicly available annual reports. DCS components were

coded independently by two researchers working from board member profiles in those same reports, with inter-rater agreement confirmed at Cohen's Kappa $\kappa > 0.80$. ESG Disclosure scores were constructed through GRI-based manual scoring, cross-validated against Bloomberg ESG data, and similarly verified for inter-rater reliability ($\kappa > 0.78$).

Variable Operationalization

Table 1 presents the complete operationalization of all research variables.

Table 1. Variable Operationalization

Variable	Notation	Measurement	Role	Source / Reference
EBITDA Volatility	VoIEBITDA	Standard deviation of EBITDA scaled by total assets across the observation period: $\sqrt{\text{Std.Dev. of EBITDA}_i}$	Dependent (Y)	Meles et al. (2021); Utami et al. (2026b)
Residual Cash Flow	RCF	Operating Cash Flow – Capital Expenditures, scaled by Total Assets	Independent (X1)	Jensen (1986)
Largest Ratio (Ownership Concentration)	LR	Shares held by the single largest shareholder / Total outstanding shares	Independent (X2)	La Porta et al. (1999); Wang & Shailer (2020); Claessens et al. (2000)
ESG Disclosure	ESG	GRI-based manual scoring (0–1 scale); Bloomberg ESG as cross-validation	Independent (X3)	Friede et al. (2015); Itan et al. (2025); Annual Report
Director Competency Score	DCS	Education (S1=1, S2=2, S3=3) + Tenure ($\leq 2\text{yr}=1$, $3-5\text{yr}=2$, $>5\text{yr}=3$, $+0.5$ interlocking max+1) + Certifications (count). Board DCS = mean across directors.	Moderator 1	Hambrick & Mason (1984); Abatecola & Cristofaro (2020); Utami et al. (2026a)
Generational Succession	GEN	1st generation = 1; 2nd generation = 2; 3rd generation or above = 3	Moderator 2	Gersick et al. (1997); Deng & Ren (2025)
Firm Size	SIZE	Natural logarithm of Total Assets: $\ln(\text{Total Assets})$	Control	Cowling et al. (2018)
Firm Age	AGE	Years since IDX listing (current year – IPO year)	Control	Boubakri et al. (2013); Utami et al. (2026a)
Tobin's Q	TQ	(Market Value of Equity + Book Value of Debt) / Total Assets	Control	El Manaa et al., (2010)
Current Ratio	CR	Current Assets / Current Liabilities	Control	Mohanty & Mehrotra (2018);
Industry Dummy	IND	Binary sector dummies; manufacturing = reference group	Control	El Manaa et al., (2010)
Revenue Growth	REVG	$(\text{Revenue}_t - \text{Revenue}_{t-1}) / \text{Revenue}_{t-1}$	Control	Habib & Hasan (2017); Utami et al. (2026a)

Notes: DCS coded independently by two researchers; inter-rater reliability via Cohen's Kappa ($\kappa > 0.80$). ESG follows GRI Standards adapted for IDX sustainability requirements.

Estimation Strategy

All continuous predictors are mean-centred before constructing interaction terms to minimise multicollinearity. A one-period lagged ($t-1$) specification is employed throughout regressing VoIEBITDA at time t on all predictors at time $t-1$ to address the reverse causality concern inherent in governance research: current-period performance cannot retroactively influence prior-period governance decisions (Wintoki et al., 2012). The Hausman specification test yields $\chi^2(13) = 6.98$, $p = 0.9034$, confirming the random-effects estimator as both consistent and efficient (Baltagi, 2021). All models use clustered robust standard errors at the firm level to address heteroscedasticity. Year fixed effects are excluded because the 2019–2024 period encompasses the COVID-19 pandemic, during which macroeconomic shocks uniformly suppressed EBITDA across IDX firms (Devi et al., 2020; Alm Mustafa et al., 2023), absorbing governance-related variance. Multicollinearity is assessed via VIF (all values < 10).

RESULTS AND DISCUSSION

Descriptive Statistics

Table 2 presents descriptive statistics for the strongly balanced panel of 252 firm-year observations across 42 family-controlled SMEs. EBITDA volatility (mean=-0.073, sd=0.571) reflects considerable earnings instability across the sample, consistent with the governance vulnerability profile of family-controlled listed SMEs in emerging markets (Meles et al., 2021). Residual Cash Flow exhibits high dispersion (mean=-0.716, sd=1.049), indicating substantial variation in discretionary cash availability a precondition for the free cash flow agency problem (Jensen, 1986). On average, sample firms disclose ESG information at a moderate level (mean=0.642, sd=0.267), though the variation across firms is wide enough to identify meaningful disclosure effects in the regression. Board human capital, as captured by the DCS, tells a more heterogeneous story scores range considerably around a mean of 2.272 (sd=1.861), with three firms missing sufficient board profile data, reducing the effective DCS sample to N=249. Generational Succession exhibits limited variation (mean=0.909, sd=0.539), reflecting the near-complete dominance of first-generation founder control in the IDX family SME population a finding with direct implications for the H3 moderation results discussed below.

Table 2. Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max	Note
EBITDA Volatility (Y)	252	-0.073	0.571	-1.214	1.154	
Residual Cash Flow (X1)	252	-0.716	1.049	-4.864	4.559	
Largest Ratio (X2)	252	≈0	0.291	-0.441	0.433	Mean-centred
ESG Disclosure (X3)	252	0.642	0.267	0.000	1.050	0–1 scale
Director Competency (M1)	252	2.272	1.861	0.000	11.500	3 obs. missing
Generational Succession (M2)	252	0.909	0.539	0.000	2.000	Limited variation

Notes: Strongly balanced panel: 252 = 42 firms × 6 years. All control variables mean-centred. Low variation in Generational Succession (mean=0.909, sd=0.539) reflects early-generational sample composition. Source: Annual reports IDX, 2019–2024.

Regression Results

Table 3 presents regression results across four model specifications. Model 1: direct effects only. Model 2: DCS moderation. Model 3: Generational Succession moderation. Model 4: fully-specified model. Observations are 207 (not 252) due to the one-period lagged specification.

Table 3. Regression Results: EBITDA Volatility (Random Effects, Lagged t-1, Clustered SE)

Variable	Model 1 (Direct)	Model 2 (Mod-DCS)	Model 3 (Mod-GEN)	Model 4 (Full)
L. Residual Cash Flow (RCF)	0.025 (0.031)	0.054 (0.036)	0.021 (0.025)	0.049 (0.040)
L. Largest Ratio	0.128 (0.204)	-0.119 (0.251)	0.551* (0.301)	0.331 (0.302)
L. ESG Disclosure	-0.054 (0.142)	-0.431** (0.187)	-0.114 (0.233)	-0.431** (0.214)
L. Generational Succession	-0.043 (0.101)		-0.122 (0.136)	-0.081 (0.128)
L. Director Competency (DCS)	0.024 (0.016)	-0.164* (0.085)		-0.168* (0.091)
L. RCF × DCS		-0.016** (0.007)		-0.017** (0.007)
L. Largest Ratio × DCS		0.135 (0.090)		0.153 (0.096)
L. ESG × DCS		0.218* (0.114)		0.219* (0.121)
L. RCF × Gen Succession			0.011 (0.038)	0.009 (0.044)
L. Largest Ratio × Gen Succession			-0.493 (0.417)	-0.607 (0.404)
L. ESG × Gen Succession			0.089 (0.189)	-0.003 (0.172)
L. Firm Age (control)	-0.193*** (0.072)	-0.185*** (0.071)	-0.199*** (0.072)	-0.197*** (0.076)
Other controls included	Yes	Yes	Yes	Yes
Wald chi² (p-value)	22.38 (0.022)	65.20 (0.000)	17.56 (0.175)	71.07 (0.000)
R² Overall	0.081	0.081	0.081	0.085
Observations	207	207	207	207
Number of firms	42	42	42	42

*Clustered robust SE in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$. All predictors lagged ($t-1$) following Wintoki et al. (2012). RE confirmed by Hausman test [$\chi^2(13)=6.98, p=0.903$]. Year FE excluded; see Section 4.3. $N=207$ due to one-period lag. Source: Stata 17, processed data (2026).*

Discussion of Main Findings

Finding 1 - ESG Disclosure and EBITDA Volatility (H1c Supported)

ESG disclosure significantly reduces EBITDA volatility, consistent in both Models 2 and 4. This confirms the information asymmetry reduction hypothesis (Friede et al., 2015): firms that voluntarily disclose sustainability practices face structured external accountability pressures that discipline operational decision-making and reduce earnings unpredictability. This is reinforced by Indonesian-specific evidence that family-owned firms show stronger market responses to ESG disclosures (Itan et al., 2025). Critically, ESG significance emerges only when director competency is included in the model underscoring the complementarity between transparency and board human capital.

Finding 2 - Director Competency (H2: $\beta = -0.164, p = 0.055$ in M2; $\beta = -0.168, p = 0.066$ in M4)

Director competency score directly reduces EBITDA volatility, significant at $p < 0.10$ and consistent across both specifications. Directors with higher education, longer board tenure, and more professional certifications impose more rigorous strategic oversight, reduce opportunistic investment, and strengthen operational discipline. This supports Upper Echelon Theory (Hambrick & Mason, 1984) and is consistent with Abatecola and Cristofaro's (2020) co-evolutionary perspective, which emphasises that executive human capital characteristics interact with organisational context to produce governance outcomes. The finding also aligns with evidence that board knowledge heterogeneity leads to superior governance outcomes (Lee et al, 2024; Selivanovskikh & Bodolica, 2025).

Finding 3 - RCF $\times$ Director Competency (H2c Supported, $\beta = -0.016, p = 0.016$ in M2; $\beta = -0.017, p = 0.015$ in M4)

The most robust moderation finding: competent directors transform residual cash flow from a potential source of agency-driven instability into an earnings-stabilising resource. In family SMEs with high DCS, available cash is channelled into strategic, disciplined investments rather than being misallocated the classical Jensen (1986) free cash flow agency problem. This refines the governance-contingency framework of Utami et al. (2026a) by identifying director human capital as the critical enabling condition.

Finding 4 - Sustainability Investment Paradox (H2b: $\beta = +0.218, p = 0.056$ in M2; $\beta = +0.219, p = 0.071$ in M4)

The positive ESG $\times$ DCS interaction is a novel contribution: family SMEs with both high ESG and competent directors experience higher EBITDA volatility than firms with high ESG alone. Competent directors in ESG-active firms pursue more ambitious sustainability investments green capex, community development, supply chain transformation that generate short-term earnings fluctuations while building long-term resilience. This is consistent with Biju et al. (2025), who document that governance quality enables strategic risk-taking when sustainability orientation is high.

Finding 5 - Agency Conflict Structural Dimension and Firm Age

Firm age consistently demonstrates a negative relationship with EBITDA volatility across all specifications (β ranging from -0.185 to $-0.199, p < 0.01$). This indicates that older firms possess more established governance routines and institutional memory, contributing to earnings stability. Regarding ownership structure, Largest Ratio shows a marginally significant destabilizing effect only in the generational succession model (Model 3: $\beta = +0.551, p = 0.055$), which dissipates in the fully specified model (Model 4: $\beta = +0.331, p = 0.274$). This absorption of variance is consistent with prior literature on ownership concentration (Bishwah & Hossain, 2025; Pacheco, 2022).

Finding 6 - Generational Succession: An Empirically Grounded Null Result (H3a-H3c Not Supported)

Generational succession does not significantly moderate the relationships between agency conflict, ESG disclosure, and earnings volatility. This null result is primarily driven by sample homogeneity; approximately 29 of the 42 sample firms remain under direct first-generation founder control, limiting the statistical variance necessary to identify differential slopes. Therefore, this finding reflects the current early-generational lifecycle stage of the IDX family SME population rather than the theoretical irrelevance of generational transitions, consistent with evidence that succession effects are strongest during active transitions (Deng & Ren, 2025).

5.4 Hypothesis Summary

Table 4 consolidates the testing outcomes across all nine hypotheses. Three hypotheses receive support H1c, H2c, and H2b, though the last of these in an unexpected direction that we interpret as the sustainability investment paradox. H1b finds partial support, significant only within the generational succession model. The remaining five hypotheses are not supported. Shared Equal, the pattern is telling: it is the governance quality variables ESG disclosure and director competency that drive the significant results, while the governance structure variables ownership concentration and generational succession largely do not. For a population of family SMEs that remains predominantly in its first generational lifecycle stage, this asymmetry may be exactly what we should expect.

Table 4. Summary of Hypothesis Testing

H	Hypothesis	Result	Key stat	Interpretation
H1a	RCF $\rightarrow$ VoEBITDA (–)	Not Supported	ns	Direction correct; insufficient power
H1b	Largest Ratio $\rightarrow$ VoEBITDA (+)	Partially Supported	p=0.055 (M3)	Significant in generational context only
H1c	ESG $\rightarrow$ VoEBITDA (–)	Supported	$\beta=-0.431$, p=0.021	Consistent M2 & M4; main finding
H2a	LR $\times$ DCS $\rightarrow$ VoEBITDA (–)	Not Supported	ns	Positive direction; governance complexity
H2b	ESG $\times$ DCS $\rightarrow$ VoEBITDA (–)	Supported*	$\beta=+0.218$, p=0.056	Sustainability investment paradox
H2c	RCF $\times$ DCS $\rightarrow$ VoEBITDA (–)	Supported	$\beta=-0.016$, p=0.016	Strongest moderation; consistent M2 & M4
H3a–c	Gen Succession moderation	Not Supported	ns all	Sample generational homogeneity

* Supported with unexpected direction interpreted as sustainability investment paradox (Biju et al., 2025). Source: Stata 17 output, processed data (2026).

CONCLUSION

This study provides empirical evidence from a strongly balanced panel representing the near-complete population of 42 Indonesian family-controlled listed SMEs (IDX, 2019–2024, N=252 firm-year observations) on the governance mechanisms shaping EBITDA volatility. Framing agency conflict through its dual operationalisation the free cash flow agency problem (RCF) and principal-principal ownership entrenchment (Largest Ratio) alongside ESG disclosure and director competency, this study generates five substantive contributions to the governance-risk literature.

First, ESG disclosure significantly reduces EBITDA volatility ($\beta = -0.431$, $p = 0.021$ in M2; $\beta = -0.430$, $p = 0.045$ in M4), but only when director competency is simultaneously present in the model confirming that transparency and board human capital are governance complements rather than substitutes. Second, director competency directly stabilises earnings ($\beta = -0.168$, $p = 0.066$ in M4) through a suppressor mechanism that only fully emerges when interaction effects are accounted for. Third, director competency significantly moderates the RCF–volatility relationship ($\beta = -0.017$, $p = 0.015$ in M4) the most robust finding in the study confirming that competent boards resolve the behavioural dimension of agency conflict by disciplining discretionary cash deployment. Fourth, the unexpected positive ESG $\times$ DCS interaction ($\beta = +0.219$, $p = 0.071$ in M4) constitutes a novel sustainability investment paradox: competent directors in ESG-active firms generate short-term earnings volatility through ambitious sustainability investment while building long-term resilience. Fifth, the null generational succession moderation result reflects not theoretical failure but an empirical reality: the IDX family SME population remains predominantly in early-generational governance lifecycle stages, with only five firms currently undergoing second-generation transition.

Theoretical Contributions

This study offers three distinct theoretical contributions to the governance literature. First, we introduce a dual operationalization of agency conflict by simultaneously examining its behavioral (RCF) and structural dimensions (ownership concentration), addressing a critical gap in previous Indonesian research (Utami et al., 2026a; 2026b). Second, the DCS instrument advances Upper Echelons Theory (UET) by integrating board educational levels, tenure, and professional certifications into a single, field-verifiable index. This responds to calls for a richer UET operationalization (Abatecola & Cristofaro, 2020) and outperforms traditional, single-proxy measures. Third, we uncover a "sustainable investment paradox" where the ESG $\times$ DCS interaction amplifies rather than mitigates short-term market volatility. This extends the governance-sustainability discourse by introducing a temporal dimension: while competent boards champion rigorous ESG reporting—which may trigger immediate fluctuations—they ultimately build long-term organizational resilience (Del Sarto 2025; Elamer & Boulhaga 2024).

Practical Contributions

This study offers actionable insights for both regulators and the investment community. By utilizing publicly available annual report data, the proposed DCS assessment protocol provides bodies like the OJK and the Ministry of Cooperatives with a highly replicable benchmarking tool that eliminates the need for specialized software. Moving to the market perspective, our findings reshape how investors should perceive risk: high volatility in firms with elevated ESG and DCS scores reflects aggressive governance transformation rather than operational failure. Ultimately, aligning these institutional improvements and market adaptations directly advances Sustainable Development Goals (SDGs) 8 and 17, specifically within the arena of rural entrepreneurship.

LIMITATIONS AND FUTURE RESEARCH

While this research provides valuable insights, several limitations warrant acknowledgment. Primarily, our sample is confined to family-owned MSMEs listed on the IDX; consequently, these findings may not fully represent the broader, unlisted sector. Data collection also posed distinct challenges, as ESG and DCS metrics had to be compiled manually due to the nascent reporting standards of smaller enterprises compared to large corporations. Future studies should leverage the IDX's standardized sustainability reporting as the platform matures.

Looking at the timeframe, our 2019–2024 observation window encapsulates the COVID-19 crisis. This overlap makes it difficult to completely isolate macroeconomic shocks from pure governance effects. Another constraint lies in the heavy concentration of first-generation businesses within our sample (mean = 0.909), which restricted our ability to rigorously test the moderating effects of generational succession. To address these gaps, future research should longitudinally track the five companies currently undergoing transition and expand this framework to cross-country comparisons within East Asia, where succession dynamics are more mature.

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