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Determination Of Political Connections and Company Size on Financial Performance in Public Companies in Indonesia

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Abstract

A political connection is a political involvement in the existence of an enterprise, for example, a relationship between government, officials, and shareholders. A politically connected company will gain several advantages, including easy access to bank lending financing, tax relief, market power, and acceptance of government contracts. Previous research has shown that political connections can improve corporate performance both in the short and long term. This research aims to demonstrate whether political connections and corporate size affect corporate financial performance. Political connections are projected with the proportion of political-connected Board of Directors and independent commissioners connected to politics and the size of the company as an independent variable, whereas return on equity as a proxy of corporate finance performance as a dependent variable. This research population is a manufacturer company that goes public on the Indonesian Stock Exchange. The samples were obtained using purposive sampling with the observation period 2021-2022. The analytical technique used is linear regression. The results showed that political connectivity variables did not affect financial performance, while corporate size variables had an impact on financial performance.

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Introduction

Corporate performance is one of the indicators of success in the management of a company. Performance assessment is reflected in the form of corporate responsibility and corporate obligations in performance reporting as well as performance achievement over resource use (Bourne, 2010). Achieving such performance is not easy because the purpose of the company is very important in many aspects, including management aspects within the company. The indicator and variable tools used in performance assessment are also very diverse. However, generally, performance assessments are reflected in financial statements that include financial information and company performance. The success of a company is not independent of the environment around the company itself, both the internal environment and the external environment of the company. The environment around the company covers several aspects, such as the political, economic, social, technological, and ecological aspects. The institutional context has an impact on how businesses function and behave in emerging markets. The degree of PCs is one of the main ways that businesses in emerging nations vary from those in developed markets. Businesses that have PCs can benefit from a variety of special treatments, including government bailouts, favorable laws, tax incentives, priority access to financing, and more (Agrawal & Knoeber, 2001; Faccio, 2006; Johnson & Mitton, 2003; Khwaja & Mian, 2005). The political environment is one of the factors that contributes to the success of a company in developing its business. Political aspects are useful in determining public policies that can support efficiency in the business world and also in the world of business, which can also support the political activities of a country. Habibah (2018) shows that there is a mutual correlation between political relationships and corporations, so the term "company" is politically connected. As seen by the percentage of independent directors with political connections, political ties have no impact on the success of the company (Azizah & Amin, 2020). Corporate value is positively impacted by political ties. Although firm value is not significantly impacted by the management ownership structure (Maulana & Wati, 2020). A company is said to be politically connected if one of its largest shareholders is a member of parliament, a minister, a head of state, or someone who has a close relationship with a politician who directly or indirectly controls 10% of the vote. Faccio (2006) explains that an entity can be said to have a political connection if one of the stockholders or one of the company executives, such as the CEO, commissioner, director, chairman, or secretary, is a member or former member of parliament, a minister, or a person connected with the party. The relationship between business and politics is where politics itself is the process of determining the policy that exists in a country, whereas business is aimed at making profits, and the profits cannot be obtained if the business is established in a region or a country whose policies do not support the existence of the business. Political connections have become commonplace in Indonesia. People who have a good relationship with the government are usually placed in a corporate organizational structure, both as commissioners and board members. Companies that have political connections will essentially have both positive and negative impacts that can even increase or even jeopardize the company's value. Wu et al. (2012) found that companies led by politically connected CEOs tend to have boards inhabited by other bureaucrats with less professional backgrounds. It shows the low quality of corporate governance in these companies and implies the negative effect of political connections on performance sensitivity. A company that has commissioners and directors with political connectivity is considered to have poor corporate governance practices and larger agency problems because it depends on the government. Informal expenses can rise in politically connected enterprises, although it is undeniable that PC firms can gain much from the political establishment (Ha & Frömmel, 2020). Nasih et al., (2020) finds discovers that overinvestment in Indonesia is inversely correlated with political ties. There will be little difficulty in obtaining resources if there are financial problems that ultimately require the use of insufficient accounting conservatism in its financial statements. (Chen et al., 2010). Corporate financial performance is closely related to performance measurement and assessment. Sucipto (2003) explains that financial performance is the determination of certain measures that can measure the success of an organization or company in generating profit. Financial ratio analysis is one of the financial analysis techniques used to find out the relationship between certain positions on the balance sheet and the profit and loss report. Based on the background description, the aim of this study is to test the influence of the political connection and size of companies on the financial performance of public companies in Indonesia.

Political Connections and Financial Performance

Political connection is political involvement in the existence of an enterprise, such as relations between government, officials, and shareholders. This relationship can be defined as two types: direct and indirect. A direct relationship is a relationship of affinity between the board of directors, shareholders, and politicians or officials, whereas an indirect relationship is a relationship of contribution to campaign activities in order to obtain a certain profit. (Bianchi dan Viana, 2014). Political connections are hard or expensive resources for other companies to obtain. Political connections are more pervasive for entities and companies where politics is an important determinant of profitability. Suprihanto (2011) explains that political entrance into business is based on the mutual need between entrepreneurs, political parties, and the government. Entrepreneurs need politics to save and develop themselves, while political parties need the role of entrepreneurs associated with party funding. Besides political parties, governments also exploit their proximity to entrepreneurs by using them as an extension of the government's hand so that entrepreneurs cannot criticize government policies. A few definitions of political linkages are included from earlier studies. "At least one of its large shareholders (anyone controlling at least 10% of voting shares) or one of its top officers (CEO, president, vice president, chairman, or secretary) is a member of parliament, a minister, or is closely related to a top politician or party," according to the definition of a politically connected firm (Faccio, 2006). The definition from Faccio (2006), which only distinguishes political connections when a top officer or shareholder with more than 10 percent shares in the company is a member of parliament, a minister, or someone who is closely related to top politicians, was used by Boubakri et al. (2012) and Harymawan and Nowland (2016). Faccio (2010) found that despite the profits they earned, politically connected companies showed worse accounting performance than non-connected companies. For example, in France, politically connected firms showed lower profits due to higher wage bills; however, political connections would improve bank performance, and with political connections, they would get lower funding costs (Sutopo et al., 2017). If the financial resources and facilities obtained by the company through political connections are not used efficiently, then it can have a negative impact on the company. (Saeed dkk., 2016). If there are political connections in the company but the managerial skills of politicians are still weak, then it can undermine the company's performance (Boubakri, Cosset, & Saffar, 2012). Shleifer & Vishny (1998) argued that politicians connected with corporations tend to be more interested in maximizing political objectives than maximizing corporate value. Rahmawati et al., (2022) finds that political connections have no negative impact on the financial performance of manufacturing companies in Indonesia. The results of the Asquer & Calderoni (2011) research provide empirical evidence that political connections have a negative impact on the performance of companies in Italy. Similarly, Bertrand, Kramarz, Schoar, & Thesmar (2007) explained that corporate affiliation with politics resulted in lower asset returns. Faccio (2010) provides similar evidence that political-connected companies have lower performance rates than non-politically connected companies. Fan et al. (2004) found that firms with politically connected CEOs performed approximately 37% lower than firms that did not have a political connection when measured by their company's stock return three years after the IPO. In this study, political connection is defined when a company has one (one) board of directors who are members of parliament (the Council of People's Representatives), ministers, or former officials and are former members of the military (full officers and police officers). The Board of Directors (BOD) of a company is generally divided into two systems: a one-tier board and a two-tier board. The explanation of each is as follows: (1). Board of Directors The Board of Directors, which serves as the corporate manager, has a very central role in the company, as the board of directors has the authority to determine the direction of the company's objectives. This is because, because of its highly strategic position, the company (shareholders) will elect its members to the board of directors who can raise the value of the company or should be able to prosper shareholders. A study by Agrawal and Knoeber (2001) found that the greater the number of corporate transactions with the government, the more directors have political backgrounds. Suprihanto (2011) explains that political entry into business is based on mutual needs between entrepreneurs, political parties, and the government. (2) Board of Commissioners The Board of Commissioners serves as the overseer of the Board of Directors' performance. Independent commissioners emerged in connection with the independence of board members (BOD) for improving good corporate governance. The independent commissioner is a member of the commissioner who is from outside the issuer or public company; does not have any direct or indirect shares in the issuer or public enterprise; has no affiliation with the issuers or public companies, commissioners, directors, or the principal shareholders of the emitent or the public company; and has no business relationship, either direct or implied, related to the business activities of the issuing or public undertaking. Independent commissioners don't have any ownership of the company; they have a more objective and proportional viewpoint. Therefore, the independent commissioner can act as an intermediary as the coordinator of the interests of shareholders and management. More than that, the role of the independent commissioner is not only related to the monitoring and controlling functions; Agrawal & Knoeber (2001) assess that it can also determine the company's strategy and decision-making. Independent Commissioners who have a political background are used by companies to solve political issues concerning them and not specifically to carry out monitoring and control functions (Agrawal & Knoeber, 2001). When independent commissioners have political relations, it can cause the function of oversight and control to not work optimally; furthermore, independent commissioners with political backgrounds, used by firms to resolve political problems related to companies, can have a positive impact on companies. (Agrawal & Knoeber, 2001). The results of research conducted by Fisman (2001) explain that policies that are not the main activity of a company have a share in shaping the profitability and value of the company. In this study, there are two independent variables: the proportion of outside directors who have political relationships and the ratio of inside directors that have political ties. Independent commissioners who have political relationships can use it to influence parliamentary and government policies that can help companies run their businesses, thereby increasing profitability and ultimately improving the company's operational performance. The variable of political connections in this study is measured by the number of independent commissioners. The size of an enterprise is an indicator of its size, including total sales, average rates of sales, and total assets. The company size used in this study is based on the total assets of the enterpriseBased on this description, the hypothesis in this study is:

H1: The proportion of independent boards of commissioners who are politically connected influences financial performance.

H2: The size of the company influences financial performance.

RESEARCH METHODS

The population in this study is a politically connected company listed on the Indonesian Stock Exchange during the period 2021–2022. Sampling is done using purposive sampling with the following criteria:

1. Manufacturing companies that go public in the years 2021–2022 on the Indonesian Stock Exchange
2. Companies that publish annual reports or financial reports consistently during the observation period, which includes the arrangement of the Board of Directors and Board of Commissioners
3. Companies that have at least one of the two points below: - and/or have members of the board of directors and/or non-independent board of commissioners who have political ties; or have independent board members who have political ties.

The data collection is carried out by the documentation method, i.e., by tracking the annual reports selected as samples. The annual reports are obtained from the publication of the Indonesian Stock Exchange through idx.co.id and the company's web in the period of 2021-2022. On the basis of the above criteria, a sample of 33 manufacturing companies listed on the Jakarta Stock Exchange was obtained.

The independent variable in this study has two independent variables, namely:

1) The proportion of independent commissioners who have political ties. The independent commissioner who has political ties referred to in this research is an independent commissioner who is also a member of parliament and/or a minister, a former official, or an accountant of TNI/Polri who sits as an independent commissioner of the company. And the proportion of managerial ownership that has political links The management ownership that has a political relationship in this study is a member of the board of directors and a commissioner who owns a company's shares and is also a Member of Parliament and/or a Minister, and a former official and/or an accountant of TNI/Polri.
2) Company size. The size of the company is seen on the basis of total assets, i.e., by calculating the natural logarithm of the total assets as of December 31 of each year.

   The dependent variable in this study is the financial performance projected with Return on Equity (ROE).

This research uses data analysis techniques that are regression analysis techniques. This analysis technique will explain the influence between the variables studied.

The analysis of the hypothesis test in this study uses dual linear regression. This multiple linear regression is used to test the influence of political connections on financial performance with the following equation model:

$$\textbf{ROE} = \alpha + \beta 1\textbf{PC1} + \beta 2\textbf{Size2} + \textbf{e}$$

Description:
ROE : Return on Equity
A : Konstanta
B : intercept
X1 : Political connection
X2 : Company size
E : error term

RESULT

Table 1 below shows descriptive statistical results for the period 2020–2022. The independent variables of the Board of Commissioners/Council of Directors that have political connections and the size of the company are shown with the minimum value, the maximum value, the average value (mean), and the deviation standard. The variable of the Board of Commissioners/Conseil of Directors has a minimum value of 0, a maximum value of 1, an average value of 0.61, and a standard deviation of 0.492. The variable size has a minimal value of 5.92, a maximum value of 15.64, an average of 10.1655, and a default value of 2.60221. The ROE variable has a minimum value of -2.23, a maximum value of 1,26, an average of 0.791, and defaults of 0.39762.

Table 1. Descriptive Statistics

Keterangan	N	Minimum	Maximum	Mean	Deviation Std.
PC	66	0	1	.61	.492
SIZE	66	5.92	15.64	10.1655	2.60221
ROE	66	-2.23	1.26	.0791	.39762
Valid N	66				

The results of the classical assumption test can be seen in Table 2, showing that all assumptions are fulfilled so that it can be continued on the hypothesis test and the classical assumption test can be seen in the following table 2.

Table 2. Classical Assumption Test

Test	Financial Performance	Hasil
Multicolinierity test		
a. Tolerance Value		
PC	0.994	no multikolinierity
Size	0.994	
b. VIF		
PC	1,006	
Size	1,006	
Auto correlation test Durbin Watson	2,182	No auto corelation
Heteroscedasticity test (Glesjer test)	1,000	no heteroscedastisity

Hypothesis testing using multiple linear regression analysis. The results of the hypothesis test can be seen in Table 3 below:

Table 3. Hyphotesis Test

Variabel	**β**	**t**	**Sig (*α= 0.05)**
Contant	0,398	1,997	0,050
PC	0,110	1,124	0,265
Size	-0,038	-2,044	0,045
F test 2,560 with Sig 0,085 < alpha α 10%			

The results of the hypothesis test showed that the test F value of 2,560 with a significance value of 0.085 is smaller than the alpha level of 0.10, so the model (goodness of fit) over the regression model is valid. The test result obtained the PC variable value of 1,124 with a significance of 0.265 greater than the alpha level (0,05), so the PC variable does not affect the financial performance projected with return on equity (ROE). Contains the results of empirical research or theoretical studies written in a systematic, critical, and informative manner. The use of tables, figures, etc. is only as support to clarify the discussion and is limited to truly substantial support, for example tables of statistical test results, pictures of model test results, etc. The table presented is not in the form of statistically processed output, but is an informative summary of the results. Figures and

DISCUSSION

The political connection variable has no influence on financial performance. These results do not support the results of the research (Nasih et al., 2020: Maulana & Wati, 2019:) but support the research results (Rahmawati et al., 2022: Kristanto, 2019, Azizah & Amin, 2020). The variable size obtained the test value of -0,038 with a significant value of 0,045 that is less than the alpha level (0.05), then the size variable affects the financial performance projected by ROE. Some of the reasons why an independent commissioner may not affect the company's financial performance are: The primary task of independent commissioners is to ensure that companies operate in accordance with applicable ethical and legal standards. Although they have a responsibility to oversee the company's finances, they do not have direct authority to take financial decisions. Financial decisions are usually made by the management of the company, such as the CEO and CFO, who are responsible for managing the company's finances. Independent commissioners can give advice and recommendations to the management, but ultimately, the financial decisions remain in the hands of the management. Independent commissioners usually do not have direct access to corporate financial information. They only receive financial reports prepared by the management of the company, which can be subject to manipulation or inaccuracy. External factors such as market conditions, competition, and regulatory changes can also affect a company's financial performance, which is not necessarily linked to the role of an independent commissioner. Nevertheless, the presence of an independent commissioner who can give appropriate advice and recommendations can help improve corporate governance and boost investor confidence.

CONCLUSION

In conclusion The purpose of this study is to show how political conection and corporate size impact financial performance. The percentage of independent commissioner with political ties is used to project political connections; total assets is used to project size; and return on equity is used to predict financial performance. 33 manufacturing businesses that were listed between 2021-2022 on the Indonesian Stock Exchange served as samples for the study. The findings demonstrated that corporate size variables had an effect on financial success, but political connectedness variables had no effect.

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