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Analysis of The Impact of Political Connections and Ownership Structure on Corporate Performance (A Study on Companies Listed on BEI 2015-2019)

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ABSTRACT

The aim of this study is to understand the differences in the impact of government and political connections, considering various ownership structures, leverage, and company size, on corporate performance. Focusing on political connections during the Jokowi regime, we analyze based on 2843 observations of companies listed in Indonesia. Additionally, we use OLS regression and address endogeneity problems with Robust Standard Error, resulting in new regression outcomes free from endogeneity issues. Our findings indicate that in the Jokowi regime, political connections significantly enhance corporate performance. Furthermore, the business landscape in Indonesia is dominated by conglomerates, family-owned businesses, and politicians. These findings can assist regulators and standard setters in considering future ownership structures, especially in state-owned enterprises, tender restrictions, and good corporate governance supervision, helping to devise the best strategies to improve welfare and reduce the excessive control of conglomerates in Indonesia. Instead of incremental work, this study focuses on corporate performance from a broader dimension of political connections, also examining the influence of other variables central to numerous research studies.

Keywords: Company Performance, Good Corporate Governance, Ownership, Political Connection

1. Introduction

A company is a legal entity formed by a group of people to engage in commercial or industrial business (Kenton, 2019). The type of business conducted will determine the business structure chosen, such as partnerships, sole proprietorships, or corporations. This structure also influences how the company achieves its goals. According to Harjito & Martono (2011), the main objectives of establishing a company include: 1) maximizing profit, 2) enhancing the welfare of owners or shareholders, and 3) maximizing company value as reflected in the stock price. The company's focus on these objectives is reflected in its performance, defined as the total value generated through its activities in generating profits (Harrison & Wicks, 2013). The profit earned becomes an indicator of the company's performance, reflecting past, present, and future performance (Wardoyo & Veronica, 2013).

In this study, financial performance is measured using Return on Assets (ROA) to assess the company's ability to generate profits from its assets (Brigham et al., 2004). Company performance management can be optimized through the application of financial management functions, including investment decisions, funding, and dividend policies (Wijaya & Wibawa, 2010).

However, in financial decision-making, conflicts often arise between owners (principals) and managers (agents) appointed to manage daily operations, as explained in Agency Theory by Meckling & Jensen (1976). This theory outlines the relationship where the principal delegates tasks to the agent, who sometimes acts opportunistically for personal gain. According to (Mallin, 2004), this includes behaviors such as the misuse of power by managers for personal benefit or avoiding risks that should be taken in the interest of the owners.

In Indonesia, many companies are controlled by a small group of shareholders, often with family ties or strong political connections (Rusmin et al., 2012). This leads to conflicts between majority and minority shareholders. Family involvement in management can either enhance or hinder financial performance due to potential internal conflicts or more centralized decision-making (Litz, 2004). However, family involvement can also minimize agency problems since decisions are made by the same family members (Muslimin (2009) dalam Maulida et al., (2023)).

Apart from family conflicts, political connections can also affect company performance. According to (Hill et al., 2013), political connections are covert relationships between senior management and government officials. Companies with political connections often have advantages such as high leverage, low taxes, and large market share (Faccio, 2006). However, these relationships can also lead to corruption cases (Bushman et al., 2004).

This research contributes to understanding the relationship between political connections and company performance. Although previous studies used multivariate regression models to estimate this relationship, we extend the study by examining the role of political connections of the board of commissioners on company performance and comparing it with the role of directors.

2. Literature Review

2.1. Resource Dependence Theory

Resource Dependence Theory (RDT) posits that organizations must engage with external entities to secure necessary resources, influencing their behavior and structure. This dependence on external resources can shape power dynamics within and between organizations. To mitigate risks associated with these dependencies, organizations may form strategic alliances, establish political connections, or incorporate members with influential backgrounds into their boards. Political connections are particularly significant as they help organizations navigate regulatory environments and secure favorable resources, reducing uncertainty and reliance on market mechanisms (Hillman et al., 2009; Pfeffer & Salancik, 1978).

In the context of Indonesia, political connections are a critical aspect of corporate success. Companies with ties to government officials or political parties often find it easier to secure government contracts, favorable regulations, and financial incentives. The first term of President Joko Widodo's administration, for instance, saw a significant positive impact of political connections on corporate performance, measured by Return on Assets (ROA). These connections allow firms to reduce their dependence on uncertain market conditions and enhance their competitive position, demonstrating the practical application of RDT in improving organizational outcomes (Faccio, 2006).

2.2. The Coattail Effect Theory

The Coattail Effect theory describes how the success of a popular political figure can positively influence the performance of other candidates or entities associated with them. In the corporate context, this theory can be adapted to understand how businesses benefit from their association with powerful political figures or parties. When a political leader or party enjoys significant popularity, companies connected to them often experience increased legitimacy, better access to resources, and preferential treatment, enhancing their overall performance.

Empirical studies support the existence of the Coattail Effect in both political and corporate spheres. For instance, Meredith (2013) and Zudenkova (2011) demonstrated that the electoral success of prominent politicians often boosts the prospects of affiliated candidates. Similarly, Perry & Goldman (2009) found that companies with political ties tend to perform better, as they can leverage the influence and networks of their political connections to secure favorable outcomes, demonstrating the practical benefits of the Coattail Effect in enhancing corporate performance

2.3. Corporate Performance

Corporate performance is a multidimensional concept that encompasses various indicators to assess how well a company is achieving its objectives. Key performance metrics include financial indicators such as Return on Assets (ROA), Return on Equity (ROE), and earnings per share (EPS), which provide insights into a company's profitability, efficiency, and shareholder value. According to Brigham et al., (2004), ROA is particularly useful as it measures the ability of a company's assets to generate earnings. Additionally, non-financial indicators like customer satisfaction, employee engagement, and innovation capacity are also essential, as they contribute to long-term sustainability and competitive advantage (Harrison & Wicks, 2013).

Corporate performance is influenced by various internal and external factors, including management practices, ownership structure, market conditions, and regulatory environment. Effective financial management, strategic decision-making, and robust corporate governance are critical internal drivers of performance. External factors such as economic policies, industry competition, and political stability also play significant roles. Studies by Wardoyo & Veronica (2013) suggest that the dynamic interplay between these factors determines a company's success in achieving its financial and strategic goals. Understanding these multifaceted dimensions of corporate performance is vital for stakeholders to make informed decisions and enhance the overall value of the organization..

3. Methodology

3.1. Research Design

Based on type his research so study This including in descriptive quantitative. The variables used in the study are independent variables, namely variables that can influence variable dependent covers connection politics, structure ownership, leverage, and company size. Variable dependence is variable that gets influence from variable another , namely Company Performance. Based on problems and hypotheses that have been stated so framework research depicted as following:

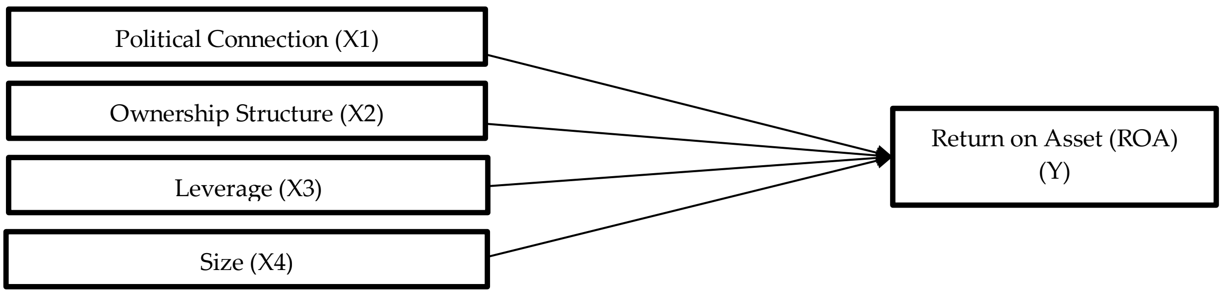

Figure 1. Research Framework

Variable in study this divided of 5 kinds variables, including variable independent, and variable dependent. Variable independent as variable critical is variables that can influence variable dependent namely political connection (X1), ownership structure (X2), leverage (X3), Size (X4). Variable dependent as variable bound is variables that arise Because exists variable independent that is corporate performance (Y) The Research Methods section contains the types of methods or types of approaches used, descriptions of qualitative and/or quantitative data, data collection procedures, and data analysis procedures.

3.2. Data Analysis

Analysis of the data used in the study: This is descriptive data analysis. Descriptive data analysis used for analyzing the data obtained from results validation expert materials, media, and questionnaires from user. As for some technique analysis of the data used in this study.

3.2.1. Multicollinearity Test

Testing multicollinearity addressed for now is There is correlation between variables independent (independent) in the regression model. Mandatory requirements fulfilled in the multicollinearity test according to Ghozali (2013) is based on the Variance Inflation Factor (VIF) and tolerance value. The regression model said multicollinearity if the data in the VIF is more or the same with 10 or less tolerance value from or the same with 0.01. Apart from that, you can analyze matrix correlation between variable independent. If correlation between variable independent above 0.90, then indicated exists multicollinearity.

3.2.2. Heteroscedasticity Tes

Testing heteroscedasticity addressed for now is There is difference variance from residual one observation to observation other. If There is similarity variance from One observation to observation other than the regression model said homoscedasticity, whereas if variance from One observation to observation other different then the regression model said heteroscedasticity good regression model is a model that is homoscedastic and not give rise to heteroscedasticity (Ghozali, 2013). Testing This done with observe scatter plot graphic.

3.2.3. Autocorrelation Test

Testing autocorrelation addressed For now is There is correlation error bully in period t with error confounders in period t-1 (previous) in the liner regression model. If There is correlation, then will give rise to problem autocorrelation (Ghozali, 2013). Problem autocorrelations arise Because observations made throughout time related One each other. This matter is caused by no free of residuals (errors bully) of One observation to observation other. Regression model said Good if regression No give rise to autocorrelation.

3.2.4. Descriptive Data Analysis and Regression

Descriptive data analysis explained results study based on existing data obtained from results regression. In research This use OLS Regression, Fixed Effect, and Random Effect analysis using Stata 14.0. Study This will test three hypotheses with level tolerance error by 10%. Multiple linear regression model equation in study This can formulated as following:

$$ROA = \alpha + \beta_1 PCJKW_{it} + + \beta_2 INSFIX_{it} + \beta_3 FORFIX_{it} + \beta_4 PUBFIX_{it} + \beta_5 Size_{it} + \beta_6 Lev_{it} + \varepsilon_{it}$$

4. Results and Discussion

Descriptive statistics for the full sample of 2843 firm-year observations and all variables used to examine the relationship between political connections and corporate performance that measured with Return on Assets (ROA). The analyzed variables include institutional ownership, foreign ownership, public ownership, firm size, and leverage.

4.1. Results

4.1.1. Descriptive analysis respondents

Table 1. Descriptive analysis

Variable	N	Mean	Min	Max
Political Connections	2843	-	0	1
Institusional	2843	0,660	0	0,999
Foreign	2843	0,208	0	0,998
Public	2843	0,265	0	1
Size	2843	28,651	21,684	34,887
Leverage	2843	0,981	0,0002	973,41

Based on table 1 above we can see that Political Connections, the available values are 0 and 1 because this is dummy variable. Other continuous variables are adjusted at the 1st and 99th percentiles. Institutional ownership has an average value of 0.660, ranging from 0 to 0.999. Foreign ownership has an average value of 0.208, ranging from 0 to 0.998. Public ownership has an average value of 0, ranging from 0 to 1. Firm size is measured with an average value of 28.651, a minimum of 21.684, and a maximum of 34.887. Leverage has an average value of 0.981, with a range from 0.0002 to 973.41.

This analysis shows significant variability in the data for institutional, foreign, and public ownership. Additionally, firm size and leverage also vary substantially. The correlations between the reported variables do not indicate any significant multicollinearity issues. Multicollinearity checks using the Variance Inflation Factor (VIF) values show that all VIF values are less than 10, indicating no multicollinearity problems in the regression model used (Belsley et al., 2005). Below are the regression results and analysis that we made.

4.1.2. Regression Results

The regression results of Political Connection, Institutional Ownership, Foreign Ownership, Public Ownership, Firm Size, and Leverage on Corporate Performance are presented in Figure 2 below:

Table 2. Regression Result

```
11 . reg ROA PCJKW INSFIX FORFIX PUBFIX SIZE LEV, ro

Linear regression                               Number of obs     =      2,843
                                                F(6, 2836)        =      11.74
                                                Prob > F          =     0.0000
                                                R-squared         =     0.0383
                                                Root MSE          =     .15275
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ROA	Coefficient	Robust std. err.	t	P>|t|	[95% conf.	interval]
PCJKW	.0134353	.0058591	2.29	0.022	.0019467	.0249239
INSFIX	-.0109438	.0122849	-0.89	0.373	-.035032	.0131445
FORFIX	-.037184	.013106	-2.84	0.005	-.0628822	-.0114858
PUBFIX	-.095926	.0254404	-3.77	0.000	-.1458095	-.0460425
SIZE	.0121519	.0023662	5.14	0.000	.0075122	.0167916
LEV	-.0005324	.000121	-4.40	0.000	-.0007696	-.0002951
_cons	-.2964213	.0614707	-4.82	0.000	-.416953	-.1758895

Table 2 presents the OLS regression results to examine the relationship between political connections and corporate performance during the first Jokowi administration (2015-2019). The regression model shows that the coefficient for political connections is significantly positive at the 5 percent level, with a significance value of 0.022, indicating that political connections have a positive impact on Return on Assets (ROA). Additionally, institutional ownership is not significant with a significance value of 0.373, foreign ownership has a significantly negative coefficient at the 1 percent level with a significance value of 0.005, and public ownership also shows a significantly negative coefficient at the 1 percent level with a significance value of 0.000. Firm size has a significantly positive coefficient at the 1 percent level with a significance value of 0.000, while leverage shows a significantly negative coefficient at the 1 percent level with a significance value of 0.000.

4.2. Discussion

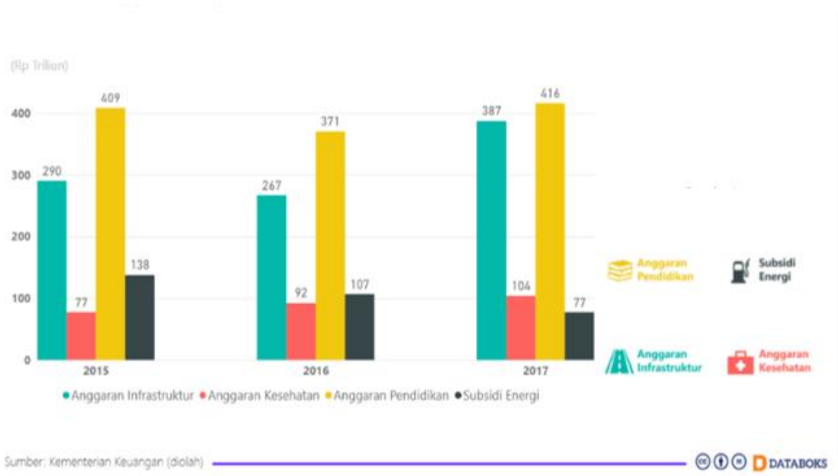

Figure 1. Budget Allocation

The relevance of these results to the budget allocation depicted in Figure 1 can be seen from the differing economic policies between the Jokowi administration and previous administrations. During Jokowi's administration, the budget allocation showed a greater focus on infrastructure, education, and health, with the infrastructure budget significantly increasing from 2015 to 2017. For instance, the infrastructure budget increased from Rp 290 trillion in 2015 to Rp 416 trillion in 2017, while the education and health budgets also saw significant increases.

This focus on massive infrastructure development can help politically connected companies secure government projects and lucrative contracts, which in turn enhances corporate performance as measured by ROA. The increased budget allocation in education and health also reflects the government's commitment to improving human resource quality, which can indirectly support corporate growth and performance in the long term. However, the significantly negative impact of foreign and public ownership on ROA might indicate that foreign investments and public participation in company shares do not directly benefit from these budget policies. Overall, this study's results suggest that political connections can provide competitive advantages for companies during Jokowi's administration, aligning with economic policies focused on infrastructure development and improving the quality of life for the public.

These results align with Social Capital Theory, which posits that relationships between institutions are considered a type of intangible productive asset that can generate information, ideas, and resources, helping to improve markets and overcome institutional constraints, thereby enhancing performance. Additionally, Resource Dependence Theory within Political Connection Theory suggests that companies that build relationships with key sources of interdependency and uncertainty can reduce uncertainty and gain access to information, legitimacy, or resources and information compared to companies that lack such relationships (Hillman et al., 2009). Furthermore, Good Corporate Governance Theory and Agency Theory state that principals or shareholders always expect directors or management to act in the principals' best interests. This research also aligns with the pecking order theory and trade-off theory in Capital Structure Theory, which assert that external funding sources prioritized are in the form of debt rather than equity due to the ease of obtaining financing and lower costs compared to issuing new shares, which are more expensive as they dilute existing shares' value. Companies will strive to increase high profitability through tax savings by increasing the debt ratio, and choosing debt also pressures managers to be prudent in making investment policies to minimize the risk of bankruptcy.

5. Conclusion

Based on the objectives, results, and discussion of the conducted research, it can be concluded that political connections have a significant impact on the performance of companies listed on the Indonesia Stock Exchange during the first term of President Joko Widodo's administration (2015-2019). This study found that companies with political connections tend to perform better, as measured by Return on Assets (ROA). Additionally, foreign ownership and public ownership show a significant negative impact on corporate performance, while company size has a positive impact and leverage has a negative impact.

The research results indicate that political connections, under government policies favoring companies, consistently positively affect corporate performance. This demonstrates the importance of political connections in obtaining resources and information to enhance company performance. Based on the results regarding ownership structure and budget allocation from 2015-2017, it is also revealed that companies with political connections tend to have better access to government projects and other resources that can improve their performance. This supports the hypothesis that political connections play a crucial role in enhancing corporate performance in Indonesia during Jokowi's administration. However, the variables of institutional, foreign, public ownership, and company size show varying results, highlighting the importance of the political and economic context in influencing corporate performance. Overall, this study emphasizes the importance of the relationship between politics and business in Indonesia and the need for policies that support sustainable growth and corporate performance while considering the influence of other factors, such as foreign and public ownership, which can negatively affect corporate performance.

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