

Political Connections and Characteristics of The LQ-45 Index Companies in Indonesia

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Info Articles

History Article:

Submitted 23 January 2020

Revised 4 March 2020

Accepted 17 May 2020

Keywords:

Political connection, leverage,
tax, profitability.

Abstract

Objective: Political activity relates to the activities of a State. Political activities also can influence decision-making and power. Companies often use politics in executing corporate strategies. The corporate is indicted for having political affiliation or engaging in political activity if one or more of its board of directors, commissioners, or shareholders is involved in political activity. This study aimed to seem at the political connections and characteristics of companies that are politically connected and without political connections within the Indonesia LQ-45 Index. Methodology: The samples during this study were 21 political-connected companies and five companies with no political connections within the Indonesian stock market for 2014-2018. The statistical model went to test the hypothesis is the Ordinary least squares regression (OLS) Method. Results: The results show that the difference between politically connected and non-politically connected companies is apparent within the company's leverage, but does not show any significant impact on the tax and profitability of the LQ-45 Index companies during the amount 2014-2018. Political connections can only support the financing of enterprise debt. Implication: Characteristics of politically connected and non-politically connected companies are only reflected in leverage corporate but have no effect on tax and profitability payments to the LQ-45 Index companies during the period 2014-2018. Political connections can only support the financing of enterprise debt.

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INTRODUCTION

Political activities influence decision-making and power. The economic performance of State-owned Companies is related to the progress and development of the existing business. Companies often use politics in executing company strategies to achieve specific goals. According to Wulandari (2012), businesses can support a country's political activities through funding. Politically connected companies have easier access to corporate operating regulations. Built-in political connections can impact investment decisions and the company's activities. Most companies in Indonesia, especially the LQ-45 index companies, are politically connected companies.

Politically connected companies have more privileges in their business activities than companies without political connections. Politically connected companies have easy access to government-related projects. The closer the company has to the relationship, the more profitable it is to the company, whether it is in the business of obtaining funding or from its policy side.

Faccio (2010) states that politically connected companies have leverage higher, pay lower taxes, and have higher market power; however, they have worse accounting performance than unrelated companies. Research in Indonesia by Kamaludin (2010) on political support for leverage. Kamaludin (2010) found that there is a link between political support for leverage, the case in Indonesia is increasing the size of the company (size) amount of leverage only for informal political support (SPI).

Political connections are considered to have a lower tax payment on companies with political connections. Politically connected companies enjoy lower tax rates of 29.67% for politically connected companies and 32.7% for non-politically connected companies (Faccio, 2010). The difference reached 3.03% between politically connected and non-politically connected companies. Through the political cycle, it is predicted that tax evasion is concentrated among SOEs, especially those closely related to the government (Chen et al., 2015). The papers show that there is a close link between political connections to the reduction of corporate tax payments. Political connections are considered to provide equal benefits to corporations and political actors.

Government-related projects such as State infrastructure development are more likely to be dealt with by political connections. Having a political connection will affect the profits the company generates due to increased sales.

However, would the profits made by the company be comparable to the political investment the company produces? So it is indicated that companies with political connections have lower performance than companies without political connections. The results of the Wulandari (2018) study show that politically connected companies have lower corporate performance than non-politically connected companies where ROA measures corporate performance. This study also uses ROA as a measure of company performance. Selling price factors are thought to play a more significant role in determining the performance of the company. Political connections to the board of commissioners have a significant negative impact on the performance of the Wulandari company (2018). In contrast to the Wulandari (2018), study results of the study of Osamwonyi et al. (2013) found that the composition of the board of commissioners and the political connection does not affect corporate performance had.

This study will look at the political connections and company characteristics of the politically connected and non-politically connected companies from the side of the leverage, tax, and corporate profitability of LQ-45 Index Companies.

Literature Review

Theory of Agency

The managerial and institutional ownership can help to reduce Jensen and Meckling (1976) agency conflict. These are the two main mechanisms in corporate governance. The opportunity for institutional owners to own company shares also needs to be considered by the company owner. In the event of a compromise made by a majority of institutional investors with the management of vulnerable companies neglecting the interests of minority shareholders.

The political connections that companies use to get special treatment compared to others will eventually make their business more accessible. Besides, political connections can also harm the company or even loss. Losses arise when politicians use their influence on corporate decisions for their political gain. It violated the application of Good Corporate Governance and led to the practice of agency theory.

Political Connections and Leverage

The study conducted by Khwaja and Mian (2005) show that connected companies in Pakistan enjoy greater access to debt financing, despite showing a higher default rate, and they do not pay higher interest rates than their counterparts. Nevertheless, those who are not politically connected. Research from Kamaludin

(2010) also shows the impact of political connections on leverage corporate during the new era until 2010 in Indonesia. Kamaludin (2010) also found that there is a link between political support for leverage. The case in Indonesia is that the size of the company's amount leverages greater just for informal political support.

Political Connections and Taxes

Taxes are obligations that citizens must pay to be counted as State income. The company is required to pay taxes on the results of its operations. The higher the profit earned by the company, the higher the taxes that must be paid to the State. Although only a small percentage of corporate income is used to pay taxes, many companies are thinking of lowering or reducing their tax payments by using political connections.

Companies with political connections are considered to be able to minimize tax payments due to their proximity to the State apparatus. Also, tax deductions are obtained by the company by increasing the company's debt. Debt inflation will, therefore, reduce the tax rate as interest payments arising from debt activities can reduce taxable income and thus increase tax savings and increase corporate value (Chandra, 2008). Faccio (2010) explains that companies that are politically connected tend to pay lower taxes than companies that are not politically connected.

Political Connections and Profitability

The role of political connections in the company in generating profits due to increased sales can also play a role in the performance of the company. Faccio (2010) and Wulandari (2018) show that political connections have a significant negative impact on corporate performance. In Habibah's (2018) study, the positive and significant political connections to corporate performance were measured through ROA and ROE. While the results of Ligita and Muazaroh's (2019) study found that there was no effect of political connections on firm performance measured using ROA and ROE. Political connections allow for lower corporate performance.

Hypotheses development and research methods

According to the mentioned theoretical and conceptual framework and based on the study's problem, questions and objectives, our hypotheses are placed as follows:

Hypotheses (1): Companies with political connections have leveraged higher than non-political companies in the Indonesian Stock Exchange LQ-45 Index for the period 2014-2018.

Hypotheses (2): Politically connected companies make lower tax payments than non-politically connected companies in the Indonesian Stock Exchange LQ-45 Index for the period 2014-2018.

Hypotheses (3): Politically connected Return On Assets companies have lower than non-politically connected companies in the Indonesian Stock Exchange LQ-45 Index Company for the period 2014-2018.

Data in this study are financial statements and company ownership reports obtained from the annual report of companies listed on the Indonesian Stock Exchange (BEI) Index LQ45 from 2014 to 2018. Samples at this study was a company that was listed on the LQ-45 Index for the period 2014-2018 and never exited the LQ-45 Index (consistent). The total sample of this study was 26 companies, with 21 politically connected companies and five companies with no political connections.

The political connection criteria are divided into three SPs for Government Support, SF for Formal Support, and SI for Informal Support. The SP criterion is a corporation owned by the government, the SF corporation with its board of directors or its commissioner is either directly involved in the political party or holding office in the government, and the SI is the criterion with political connections seen from the board of directors or commissioners having proximity to the State or politicians like family ties.

This study uses Ordinary Least Squares Regression (OLS). The study was conducted in four regression models to detect better the impact of political connections on the company's Leverage, Tax, and Profitability. The first model of political connections was made in a variable dummy with a sample of all politically connected firms through SP, SF, and SI of 1 and 0 for non-politically connected companies. In model two, political connections are seen from Government Support (SP), model three political connections seen from Formal Support (SF), and model four political support seen from Informal Support (SI).

The way to detect a company by having a political connection is to list the names of the board of directors and board of directors listed on each company, and then search for that name individually in Google search engines. Google's search engine can help to find an individual's electronic track record, especially a ruler or someone who has been in power before. If one or more names in the ranks of the board of commissioners and directors are involved in political relations or are presently serving as state leaders and are active in political party activities, then this political connection belongs to Formal political support.

When it is found that one or more ranks of the board of commissioners and or directors have served as heads of government, have been active in a political party, and have close ties to such authorities as family relations or have previously provided (supportive) leadership currently in office. When a company has one of these criteria, it is said to be politically connected.

This study uses Debt to Asset Ratio (DAR) as a measure of leverage corporate by dividing total corporate

debt by total assets. Company tax payments are calculated by dividing the company's earnings by taxable income. Moreover, the company's profitability is calculated using Return On Asset Ratio (ROA) is the division of a company's net profit by its total assets. Size is used as a control variable calculated using the Log of total assets. The regression equation is as follows:

$$\begin{aligned} \text{Model 1} \\ \text{Leverage/Tax/ Profitability} &= \alpha + \beta_1\text{DConnected} + \beta_2\text{Size} + \varepsilon \\ \text{Model 2} \\ \text{Leverage/Tax/ Profitability} &= \alpha + \beta_1\text{DSP} + \beta_2\text{Size} + \varepsilon \\ \text{Model 3} \\ \text{Leverage/Tax/ Profitability} &= \alpha + \beta_1\text{DSF} + \beta_2\text{Size} + \varepsilon \\ \text{Model 4} \\ \text{Leverage/Tax/ Profitability} &= \alpha + \beta_1\text{DSI} + \beta_2\text{Size} + \varepsilon \end{aligned}$$

DISCUSSION

The focus of this study was to impact of political connections on leverage corporate, tax payments, and profitability. The descriptive statistics table shows the leverage of that the political companies connected with political connections are 56.57% for companies with political connections and 42.48% of companies without political connections. On corporate tax payments, it shows that companies with no political connections pay lower taxes than those with political connections of 23.92% and 25.89% of companies with political connections. Corporate ROA indicates that politically connected companies have lower profitability than firms without political connections of 0.81 and 0.89 owned by companies without political connections.

Table 1. Descriptive Statistics

	Connected Parties		Without Political Connections	
	<i>Mean</i>	<i>Median</i>	<i>Mean</i>	<i>Median</i>
<i>leverage</i>	0.530000	0.424810	0.370000	0.564725
<i>Tax</i>	0.258970	0.243740	0.239241	0.252736
<i>ROA</i>	0.047200	0.089560	0.098900	0.081542
<i>Size</i>	8.083356	7.659762	7.885201	7.790394

Samples are grouped according to the criteria of political connections that support the Government (SP), Formal Support (SF), and Informal Support (SI) and companies with no Political Connection. Companies that have been politically connected with governmental support will dissolve political connections with Formal Support and Informal Support. The rest of the sample is then grouped for Formal and Informal Support political connections. When it is found that the sample has Formal support, it will dissolve Informal Support, though it is implied that Formal Support will also have Informal Support, and the rest is political connections with Informal support.

Table 1 shows the average leverage of companies with higher political connections than those without political connections. Average corporate tax payments indicate that companies with political connections have a higher average payout than companies without political connections, but the differences between them are not significantly different. The average company ROA indicates that companies with political connections have lower ROAs and larger company sizes than companies without political connections.

Table 2. Regression Results of Corporate Characteristics

Variable	Leverage		Tax		Profitability	
	Coefficient	t-Statistic	Coefficient	t-Statistic	Coefficient	t-Statistic
Panel A. Political Connection Across Criteria (Model 1)						
C	0.001	0.164	0.159	2.932	***	-0.389 -1.129
D(DPOL)	0.286	2.209	**			
D(SIZE)	0.019	3.071	***			
DPOL			0.005	0.310		-0.098 -0.737
SIZE			-0.005	-1.031		-0.063 -1.505
TAX (-1)			0.532	7.061	***	
LOGROA(-1)						0.653 9.616 ***
Observasi		130		129		130
R-Squared		0.140		0.326		0.491
Adjusted R-Squared		0.126		0.309		0.479
F-Statistic		10.27		20.014		40.315
Prob. (F-Statistic)		0.000		0.000		0.000
Panel B. Government Support (Model 2)						
Variable	Coefficient	t-Statistic	Coefficient	t-Statistic	Coefficient	t-Statistic
C	-0.025	-0.305	0.235	3.363	***	-0.429 -1.276
DSP	0.085	1.531	0.009	0.293		-0.253 -1.202
D(SIZE)	0.017	1.693	*	-0.012	-1.693	* -0.043 -1.026
DAR(-1)	0.729	9.819	***			
TAX (-1)			0.426	4.343	***	
LOGROA(-1)						0.698 8.437 ***
Observasi		85		84		85
R-Squared		0.696		0.270		0.601
Adjusted R-Squared		0.684		0.242		0.586
F-Statistic		61.153		9.756		40.238
Prob. (F-Statistic)		0.000		0.000		0.000
Panel C. Formal Support (Model 3)						
Variable	Coefficient	t-Statistic	Coefficient	t-Statistic	Coefficient	t-Statistic
C	-0.260	-1.192454	0.134	1.454	0.436	0.601
DSF	0.009	0.291291	-0.005	-0.460	0.156	1.116
SIZE	0.047	1.472015	-0.002	-0.231	-0.167	-1.703 *
DAR(-1)	0.772	8.595050	***			
TAX (-1)			0.519	3.444	***	
LOGROA(-1)						0.664190 5.896017***
Observasi		45		42		45
R-Squared		0.671		0.303		0.624
Adjusted R-Squared		0.646		0.249		0.595
F-Statistic		27.262		5.532		22.137
Prob. (F-Statistic)		0.000		0.002		0.000
Panel D. Informal Support (Model 4)						
Variable	Coefficient	t-Statistic	Coefficient	t-Statistic	Coefficient	t-Statistic
C	-0.063	-0.418	0.156	1.704	0.058	1.218
DSI	-0.009	-0.288	0.024	1.138	-0.005	-0.523
SIZE	0.020	1.070	-0.003	-0.323	-0.003	-0.538
DAR(-1)	0.796	8.082	***			
TAX (-1)			0.464	3.573	***	
ROA(-1)						0.620 5.343 ***
Observasi		50		50		50
R-Squared		0.609		0.323		0.408
Adjusted R-Squared		0.583		0.277		0.368
F-Statistic		23.456		7.157		10.355
Prob. (F-Statistic)		0.000		0.000		0.000

*** Significant at level 1%; **Significant at level 5%; Significant at level 10%

The company with political connections in a research sample of 21 companies and five companies with no political connections. The political support of the government in the research sample of 12 companies, including the three financial institutions, namely Bank Negara Indonesia Tbk, Bank Rakyat Indonesia Tbk, and Bank Mandiri Persero Tbk, formal support of four companies, informal support of five companies and companies without the political support of five company.

Panel A is the result of a political connection with all the criteria using a single model. The results in panel A show that political connections have a significant influence on leverage but do not show significant results on tax and ROA. Panel B, C, and D results show no significant relationship between political connections and specific criteria for leverage, tax, and ROA. The positive coefficient indicates that the leverage of politically connected companies has leverage higher than the non-politically connected companies on the Indonesian Stock Exchange LQ-45 index. The result supports the findings of Kamaludin (2010) and (Faccio, 2010) that firms that are politically connected tend to have easier access to debt.

Judging by the amount of leverage owned by the company, Bank Rakyat Indonesia Tbk holds the highest value. Companies are considered good when they can capitalize on their potential debt. If the total amount of capital-funded assets is too large, then the company is also considered to be wasting potential debt to support the company, but if the debt amount is too much, it will put the financial burden on the company. The assumption in this study is that the higher the value of leverage, then the easier it is to access debt.

The results obtained concerning taxpayer-funded corporate tax returns without any political connection showed insignificant results. These results contradict Ferdiawan and Firmansyah (2017) and Faccio (2010), who state that politically connected companies utilize their political connections to obtain lower tax payments. Taxes are an obligation to be paid to the State. Tax violations will be actionable and subject to sanctions, from both tax administration sanctions to tax evasion sanctions. So there is no bargaining in terms of tax payments for even politically connected companies.

The results show that there is no difference in the ROA of politically connected and non-politically connected companies. This result is in line with the study of Ligita and Muazaroh (2019), who found no effect on political connection to corporate performance (ROA). Any effects of political connection to the company do not give a significant result to the profitability of the company. So there is no difference in corporate profitability between politically connected and non-politically connected.

These results are contrary to Faccio (2010) and Wulandari (2018). Faccio (2010) found that connected companies had lower productivity than unrelated companies in four of the seven Countries, the connected firms showed lower ROA in all countries except Japan; the difference is significant in Indonesia, Italy, Russia, and Thailand. Similar results from the Wulandari (2018) study suggest that political connection within the structure of the board of commissioners harms corporate performance. Although the regression results show a negative impact on the ROA of a politically connected company, the result cannot be used due to insignificant probability

CONCLUSIONS

Characteristics of politically connected and non-politically connected companies are only reflected in leverage corporate but have no effect on tax and profitability payments to the LQ-45 Index companies during the period 2014-2018. Political connections can only support the financing of enterprise debt.

After conducting further analysis and review of the findings, the researchers noted that there are some weaknesses in this study that could be further studied. First, this research focuses only on the Indonesian Stock Exchange LQ-45 Index and has not done a comprehensive study on the entire company on the Indonesian Stock Exchange. Second, The results of this study have not seen the impact of corporate earnings and have not yet compared inter-industry companies on the Indonesian Stock Exchange.

Further research is recommended to look at the effect of political connections on corporate earnings and to compare differences between companies that are politically connected and not, in order to see the difference between corporate and non-politically connected corporate earnings and to add independent variables or controls other than political connections.

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