Political Connections Influence on State-Owned Enterprise Performances in Indonesia

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Abstract

This article examines the role of state-owned enterprises in Indonesia's financial and market performance. The purpose of the study is to see if political ties influence financial performance, and if market performance is influenced by this link, especially in Indonesia, where family culture is dominant. The goal of this research is to look at the connections between government-owned firms' finances, the stock market, and Indonesian industries. The goal of the study is to see if there is a link between political relationships and financial performance of a company, as well as a link between market performance and kinship in Indonesia, where kinship is the norm.

Keywords: Earnings Management, Firm Value, Political Connection, Political Influence

Introduction

The study of political linkages is gaining popularity among academics. A correlation between political issues and corporate success has been discovered in several research. Researchers (Dombrovsky, 2011) discovered that financial relations influence global financial flows and, as a result, the performance of foreign securities. Companies with political ties outperform the competition. (SAKTI et al., 2020) discovered that notifying nominations to the board of directors with political affiliations produces positive stock returns. Furthermore, research has connected political relationships to financial performance. State banks, according to (BASUKI, n.d.), give political support. State banks frequently lend large sums to enterprises with political ties.

(Liu et al., 2018) discovered evidence that Nazi enterprises in Germany earn more money than they do not. Using data from Hong Kong enterprises, (S. Li et al., 2015) There is evidence that political links can help companies perform better. This is also true with Indonesian state-owned firms, where the government controls the majority of management and operations. Although the government owns state-owned firms in Indonesia, several of them are also listed on the Indonesia stock exchange, where investors can buy shares.

Figure 1. Stock Price Movement of IDX-MES BUMN 17

Source: IDX, 2021

The 425 public corporations that have raised cash from the general public include state-owned enterprises (issued companies). The IDX has opened up shares in 19 state-owned firms across nine industries to the general public. Some investors can only buy and sell a certain number of special shares, such as those issued by government-owned companies like BUMN. The impression of security when investing in BUMN shares and private enterprise distrust are two major factors. Another aspect is that state-owned firms frequently pay dividends to shareholders.

Figure 1 shows how external macroeconomic and microeconomic variables affect the volatility of a state-owned enterprise. Market events and policies usually cause a slump or an upturn, but the trend is usually steady. Investors like state-owned companies not only for their sense of security, but also for their ability to generate an average normal return. The goal of this research is to determine how companies listed on the Indonesia Stock Exchange are affected by their political ties. As stated above, the researcher wants to know about the impact of management ownership with political ties, as well as the number of independent commissioners with political ties to the performance firm.

Literature Review

As far as defining and assessing performance is concerned, (Wong & Hooy, 2018) claim that it is a challenging task. to gather all available information, not just one particular piece of data, be it operational or market performance, performance is evaluated on two different measurement axes: operational and market Prior and current accomplishments are used to assess operational performance, whereas future prospects are used to analyze market pessimism.

If (Abubakar, 2016) is correct, adequate and appropriate performance measurements are reliant on researchers' experiences. In order to be able to effectively gauge the company's performance, researchers' performance indicators must be accurate.

Previous academics have frequently used Tobin's q as a performance metric to assess a company's market performance (Garde-Sanchez et al., 2018; Xu et al., 2019). Tobin's is a measurement for determining the performance of a company, particularly its value. In terms of performance, Tobin's q is a better metric (Lin et al., 2020; Malini, 2021a)

According to this study, operational performance is measured using return on equity (ROE). We chose ROE as a proxy performance operation that makes comparisons between alternatives (2011). The return on equity (ROE) is a useful indicator of a company's return on investment (ROI). The shareholders' gain comes to light in the company's return on equity (ROE). A company with a high ROE will put a larger percentage of its own capital to work for shareholders to produce returns.

connections to political parties

A company will be deemed to have political connections if any of the following are true: one or more shareholders has at least 10% of the voting rights, or one or more board members is a member of parliament, a minister, or a high-ranking official; or those individuals are close to politicians and parties (Cherkasova & Ivanova, 2019; Dicko et al., 2019; Malini, 2021b)

These results reveal the degree to which the organization is political. It's indicated in this study if the organization has one board of directors who is a member of parliament ministers, and/or former officials, as well as retired police and the Indonesian National Armed Forces (TNI), which has not been examined before.

Because of a lack of relevant data, no board of directors' affiliation with the country's President and Vice President is included as a sign of political connections. Based on (Chen et al., 2014), the emergence of politics in business is made possible by the mutual dependency among businessmen, political parties, and the government. Political parties depend on entrepreneurs for financial support, while businesses need politics to help them save and grow.

Despite the existence of political parties, the government also works with local businesses in order to make it (entrepreneurs) a part of the government. Policies enacted by the government were justified by businesspeople because the government had used the government to enact them.

(Li & Zhou, 2015; Su et al., 2019) found that politically engaged independent commissioners have a favorable impact on companies. (Latupeirissa & Adhariani, 2020) claims that, while politics is not the primary activity of the company, it has an impact on profit and value. This type of independent commissioner can leverage their position to help companies better manage their businesses and increase their operational performance.

In other words, since it is possible to form the hypothesis that says:

H1a: proportion of independent commissioners who have political ties affect the operational (financial) performance of the company.

H1b: proportion of independent commissioners who have political ties affect the company's market performance.

Because directors with relationships with the company will earn from their affiliation or stockholdings, they will seek to help the firm reach a strong level of performance. It's worth noting that when management is affiliated, relationships will be affected. Political involvement in the firm is based on the concept of mutual respect, according to (Latupeirissa & Adhariani, 2020), while the political parties are looking for businesspeople to fund their campaigns, businesses require funding from those in the political world in order to be saved and developed. The impact of internal and external political interests on corporate policy will have a greater or lesser impact on overall company performance. According to the given description, the hypothesis can be expressed as follows:

H2a: proportion of managerial ownership that has political ties affect the operational (financial) performance of the company.

H2b: proportion of managerial ownership that has political ties affect the company's market performance

Methods

Sample and Population

In this study, the population consists of firms that were listed on the Indonesia Stock Exchange between 2010 and 2012. The research sample was chosen by a panel of experts.

a. Is a government-owned company listed as a public company listed in 2010-2020 on the Indonesia Stock Exchange.
b. Publish the annual report or financial statements consistently from 2010-2020 which contains the composition of the board of directors and the board of commissioners
c. Have at least one of the two points below: -and or have non-independent members of the board of directors and or commissioners who have political ties. -and or have independent members of the board of commissioners who have political relations.

Research variable

The dependent variable in this study is the company's performance measured with Tobin's q as market performance proxy and ROE (Return on Equity) as) proxy of financial performance. Tobins' q formulation (Sudiyatno and Puspitasari, 2010) as follows :

q = (MVS + D)/TA

Where:

MVS : Market value of all outstanding shares.

D : Debt.

TA : Firm’s asset’s

The market value of all outstanding shares (MVS) is calculated by multiplying the number of outstanding shares by the share price (Outstanding Shares * Stock Price) on December 31st. Debt is the quantity of debt that has a market value, which can be computed using the following equation:

D = (AVCL – AVCA) + AVLTD

Where:

AVCL : Accounting value of the firm's Current Liabilities.

: Short Term Debt + Taxes Payable.

AVLTD : Accounting value of the firm's Long Term Debt.

: Long Term Debt.

AVCA : Accounting value of the firm's Current Assets.

: Cash + Account Receivable + Inventories

ROE is calculated by comparing net income and total equity.

ROE = $\frac{Net\ Profit}{Total\ Equity}$

Independent variable

In this study there are 2 (two) independent variables: the proportion of outside directors who have political ties, and the proportion of inside directors who have political ties.

1) Proportion of independent commissioners who have political ties independent commissioner who has the political relationship in question in this study is an independent commissioner who is also a member of parliament and/or ministers, former officials and/or retired TNI/Polri who sit as independent commissioners of the company. Proportion of independent commissioners having a political relationship:

$$\frac{Number\ of\ independent\ commissioners\ who\ have\ political\ ties}{Number\ of\ commissioners}$$

2) Proportion of managerial ownership with political ties Managerial ownership with political ties to research These are members of the board of directors and commissioners who own shares companies and are also members of parliament and/or ministers, and former officials and/or retired TNI/Polri. Proportion of ownership managerial relationship with politics

$$\frac{Number\ of\ non-independent\ directors\ with\ political\ ties}{Total\ board\ of\ directors}$$

Control variable

1) Firm size is used as a control variable because according to Yeh et al. (2010) firm size is positively related to the probability of companies are involved in political relations. Where is getting bigger company, the greater the chance (probability) the company will have political ties. Company size is seen based on total assets. That is, with the natural logarithm of total assets on December 31 each year
2) Type of company. Companies listed on the Indonesian stock exchange are very many kinds of. Company ownership is also very diverse, however If grouped, there are 2 broad lines of ownership, namely, owned by the government in this case BUMN, and also non-government or private. In other words, the degree of political connection for this type of government company expected to have differences compared to non-government companies. The types of companies in question are state-owned and private companies and seen by using dummy variables for each type company

Hypothesis testing

The hypothesis in this study was tested using a linear regression model multiple. The regression model is as follows:

ROE = a + b1 KI + b2 KM + b3 SIZE + b4 BUMND + e

TOBIN = a + b1 KI + b2 KM + b3 SIZE + b4 BUMND + e

Results and Discussion

This study used secondary data, which includes annual financial reports and annual reports. Later on, data was classified by predefined criteria. The data is eligible and adjusted to the requirements. There are 20 government state own companies listed on the Indonesia Stock Exchange from 2010 to 2020. Of these, 18 are extreme data, meaning the sample data for ROE was obtained from 18 companies.

The following are the findings of the company's financial statements based on the results of the descriptive statistics. Results of the descriptive statistics of the company's financial performance, namely ROE (ROE), are as follows: independent commissioners who are politically connected rose (KI), The percentage of politically connected managerial ownership (KM) is inversely proportional to firm size. The size of the business, and the type of business (BUMND). with ROE (ROE), the company's market performance is dependent. The dependent variable is TOBINS'Q (TOBIN). "Number of politically connected independent commissioners as a percentage of all commissioners" (KI), The percentage of politically connected managerial ownership (KM) in small firms, and their small-firm size of company, and type (BUMND).

Table 1. Statistic Descriptive

Research Variable	N	Minimum	Maximum	Mean	Std. Deviation
ROE					
ROE	**18**	0.1411	0.3872	0.0109	-0.0844
KI	**18**	0.4500	0.3700	0.0251	-0.2885
KM	**18**	0.4900	0.4800	0.0322	1.0748
SIZE	**18**	0.0956	0.3300	0.0191	1.0064
BUMND	**18**	0.0426	0.9224	-0.0046	0.6904
Tobin's Q					
TOBIN	**18**	0.0206	0.8608	0.1696	1.8952
KI	**18**	2.3836	3.0325	0.3279	1.7653
KM	**18**	0.1898	1.3592	0.5692	2.3908
SIZE	**18**	0.9094	0.5068	0.2545	1.4775
BUMND	**18**	0.9871	0.0182	0.1239	0.3974

Source: Data Processing

The average ROE is 0.11421 and Tobins'q is 1.45599 in Table 1. When considered alongside the equity's ability to generate profit of 11.42% and Tobin's q, this can be interpreted to mean that the average equity is valued at 11.42% of the company's value. This clearly illustrates that the market values the company over its book value (earnings). For the research sample, the average ROE proportion is 22.7% (Independent Commissioners) and 7.75% (Managers), respectively.

Of the research sample, 22.7% are independent commissioners and 7.86% are the company's managerial owners. Both the ROE research sample and the Tobins' q research sample have a minimum value of 0.00.

Data Validation

From the analysis that has been conducted, it has been determined that the classical assumption test (normality test, test) was carried out for multicollinearity, but not for heteroscedasticity. The data doesn't normally distribute, and therefore can be transformed to normal, according to Ghozali (2009) (Malini, 2020).

In this particular case, the data transformation feature has been applied only to LN (Natural Logarithm). To verify that the observed relationships followed a normal distribution, we performed the normality test on both ROE and Tobins' q. Based on the results of these tests generates transformation of some of the data. In addition, after the data transformation is done, the data is formatted. The data was retested, and the results showed that it is normally distributed.

Financial Performance Hypothesis

Based on the tests that have been performed, here is a table of results from the regression that has been performed using the dependent variable of financial performance (ROE) and the independent variables the proportion of independent commissioners (KI) and the proportion managerial ownership (KM).

Table 2. Regression Table for Hypothesis Testing 1a and 2a

Research Variable	Regression Coefficient	T	Sig.
Konstanta	-0.5163	0.021077	0.00179
KI	-0.6374	0.0332779	(0.00081)
KM	0.1163	0.0410877	[2.222] **
SIZE	0.0140	0.0210669	0.00091
BUMND	1.0432	-0.0210669	(0.00046)
R 2 = 0.111 Adj R2 = 0.096 F =7.563 Sig. F = 0.000*			

Source: Data Processing

The independent variable is only able to account for 9.6% of the variance in the dependent variable, with the remaining 90.4% explained by factors not included in the regression model. The F test value of 7.563 indicates that the number of politically linked independent commissioners, the amount of politically connected management ownership, the size and nature of the company all have an effect on the company's height and low financial performance.

The independent variable explains 9.6% of the dependent variable while additional variables, not included in the regression model, may explain the remaining 90.4%. The proportion of politically linked independent commissioners, the proportion of politically connected managerial ownership, the size and kind of the company all have an effect on the company's height and low financial performance.

The test results reveal, in part, that the percentage of politically linked independent commissioners has an effect on the highs and lows of the company's financial success. On the other hand, managerial control is only indirectly linked to financial success. From the findings, hypothesis 1 is accepted, however hypothesis 2 is denied.

The tests showed that political connections have a big impact on financial performance and are negatively associated. According to (Cherkasova & Ivanova, 2019), political links lead to less competitive enterprises receiving larger investments of money. Due to this, the company's funds are allocated inefficiently.

Additionally, management ownership links to a company's financial performance. This means the director has little control, as the managerial ownership with political relations hovers around 7 percent. In the research of (Su et al., 2019), we see that politically connected enterprises have inferior financial performance.

Political connections drive the company's financial performance.

Firm size and company type affect financial performance. Larger size shows a considerable favorable impact on operational performance. The greater the corporation, the more parties focus on it. Financial reporting and management will increase operational performance. This study reveals that financial performance differs between BUMN/BUMD and private corporations.

Market Performances Hypothesis Testing

The outcomes of various experiments determined the association between the number of politically connected independent commissioners (KI) and market performance (TOBIN).

Table 3. Regression Table for Hypothesis Testing 1a and 2a

Research Variable	Regression Coefficient	T	Sig.
Konstanta	0.0004	-0.0061	-0.0158
KI	0.0089	0.0226	0.0111
KM	0.0617	-0.6711	-0.4949
SIZE	0.6176	3.1044	2.07115
BUMND	0.0403	-0.0109	0.0300
R2 = 0.101 Adj R2 = 0.078 F =6.663 Sig. F = 0.000*			

Source: Data Processing

R2 Value Adjusted

The independent variable has a value of 0.123. explains 12.3% of the dependent variable, however the remaining 87.7% cannot. Other factors not taken into consideration explain the outcome. Test 3.769 F score, with a significance of 0.001, shows a contemporaneous impact. Independent commissioners are 0.008% below the 5% likelihood level. Political connections and the size and type of businesses all have a big impact on management ownership.

The test partially suggests that the independent variable proportion is substantial. political partisans do not have say in the height The degree of significance depicts the organization's poor market performance, and it has been found to have a negative correlation, the more significant the market performance would be lowered by the number of independent commissioners. If the market reacts negatively if you have a political tie, then you have a conflict of interest. Hypothesis 1b was proven to be false because of the inquiry.

Management ownership is the independent variable. The company's market success is influenced by politics at a 5% significance. This results in hypothesis 2b being supported. In higher proportions, management interests suppress company results where political proximity is present, it is difficult to be open with outsiders. Investors use the stock market to guide their investment decisions. Investors will believe that the company is failing and its stock price would drop owing to lack of disclosure. Results are similar to a study by (Aobdia et al., 2018; Gongfu, 2011), which indicated that politically linked CEOs hurt their company's stock return after three years after their IPO.

Independent commission members had no impact on the outcomes. Investors assume the commissioner is involved in the decision to invest because of the lack of progress so far. Only firms who have complete control over the variable size were found to have an impact on market performance. In other words, market performance lags behind the magnitude of the firm. It's a high-stakes undertaking. Company size is linked to risk. The risk is larger for large corporations. Investors will pull their money out of the company, which will negatively impact the company's stock performance.

Conclusion

The following conclusions have been reached as a result of this investigation: To begin with, the percentage of independent commissioners with political ties has a negative impact on financial performance but has no impact on stock market performance. Second, the "managerial ownership percentage" refers to the proportion of managerial ownership that has a negative political impact on stock market performance but has no impact on financial performance. Third, the size and nature of the business have a significant impact on its performance (both financial performance and market performance).

The following sections detail the study's limitations: Members of parliament, government officials, military members, and former officials are all eligible to serve on the proxy political ties committee, which decides whether or not a board of directors should be established. Additional research is recommended to look into the political ties of membership in a political party, proximity to the president, or major family connections with political ties as markers of political ties. Because the data comes just from the annual report, more study should be conducted using a broader range of data sources, including not only annual reports but also other related sources, to obtain a fuller picture.

It can be calculated using data on membership in national and regional legislatures as well as political party membership figures (boards of representatives of the people). According to the conclusions of this study, government-owned businesses outperform their competitors, but they run the danger of being identified with political ties. The data completely contradict the study's theory. Because state-owned firms should be self-contained and free of government interference. This inconsistency must be investigated further.

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