

Political Connection and Corporate Performance: A Research Library

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Abstract

This study aims to review various literatures and get an overview related about political connection and corporate performance from a research library. This type of research is library research. This research uses various written sources such as articles, books, and other relevant documents. The main sources of information for articles used in this study are in the last 10 years, namely 2011 to 2020. This study uses online journal databases such as Scopus, Google Scholar, and Emerald to obtain literature from previous studies that are relevant to the topic of this research. The keywords used in the literature search process include political connection, firm performance, politically connected board, political connected in boardroom, and political connection and firm performance. Researchers conduct an analysis of how the relationship between the board of directors is connected to politics and the resulting company performance. The results show that companies that have political connections will receive a number of benefits and can help companies to improve their performance. These advantages include a lower cost of equity, much lower borrowing costs and interest, lower tax rates, and much better stock market performance.

Keywords

political connection; corporate performance; firm performance



I. Introduction

Indonesia is a unitary state in the form of a republic based on the 1945 Constitution Article 1 paragraph (1). Indonesia runs a government system that upholds democracy, namely from the people, by the people, and for the people. Based on Law No. 42 of 2008 concerning General Elections for President and Vice President, Indonesia will hold general elections for president and vice president every 5 years. Therefore, the political conditions in Indonesia will experience changes in line with changes in the regulations set by the government. As a result, these conditions can have an impact on all business sectors. The stability of political conditions in Indonesia and changes in regulations have become factors that affect corporate governance.

Indonesia is a country with high political influence in the business context (Harymawan, 2018). This is because most companies in Indonesia are quite dependent on changes in political stability and the effectiveness of the government in running the government. In particular, companies that are politically connected either through the board of directors, board of commissioners, or other management departments, tend to provide quality financial reporting in accordance with the level of political stability and government effectiveness. This shows that political connections in Indonesia play an important role in business decision making and can affect company performance.

Economic conditions in Indonesia have undergone an economic transformation from State-Owned Enterprises, an economy dominated by Small and Medium Enterprises, and traditional to modern private companies since the late 1970s (Harymawan, 2018). However, in reality this transformation marks the emergence of an era in which political connections in business are growing. This was marked by the leadership of President Suharto as its center at that time. The success of these politically linked companies largely depended on the company's ability to acquire and maintain relations with the regime of President Soeharto at the time. This is of course to get special rights from the state during the leadership of President Soeharto. The Suharto government has also given full support to these politically connected companies by offering government contracts to these companies and providing investment capital to preferred companies at low interest rates (Sakti et al., 2020).

The relationship between political and business connections in Indonesia has been investigated by previous studies. As in Fisman's (2001) research which examines the relationship between politically connected companies and market reactions based on stock prices in Indonesia. Fisman (2001) conducted a study using President Soeharto's health condition during his leadership. The results of Fisman's research (2001) show that the market reaction as proxied by using the stock prices of companies with political connections in Indonesia decreased significantly when bad news spread about President Soeharto's health. Vice versa, the market reaction increased significantly when good news circulated about President Soeharto's health condition. In addition to the influence of political connections on business in the era of President Soeharto (Fisman, 2001), political connections have also been shown to increase the relationship between family companies and company performance (Harymawan, 2018). Earnings quality for politically connected companies in Indonesia depends on the level of political stability and government effectiveness. Previous research has also shown that political connections can provide distinct advantages for connected companies (Harymawan, 2018).

This study aims to review various literatures and get an overview related about political connection and corporate performance from a research library.

II. Research Method

This type of research is library research. Library research is research carried out using literature, both in the form of books, notes, and reports of previous research results (Octiva et al., 2018; Pandiangan, 2018). The purpose of library research is to find out a more in-depth discussion of a topic or theme. This topic is adapted to the topics raised in the writing (Asyraini et al., 2022; Octiva, 2018; Pandiangan, 2015).

Written sources are historical sources obtained through written relics, records of events that occurred in the past, for example inscriptions, documents, manuscripts, charters, newspapers, diaries, and so on (Octiva et al., 2021; Pandiangan et al., 2021; Pandia et al., 2018). This research uses various written sources such as articles, books, and other relevant documents. The main sources of information for articles used in this study are in the last 10 years, namely 2011 to 2020. This is useful in keeping the information presented in this study up to date and relevant to the development of the business world (Jibril et al., 2022; Pandiangan et al., 2018; Pandiangan, 2022). This study uses online journal databases such as Scopus, Google Scholar, and Emerald to obtain literature from previous studies that are relevant to the topic of this research. The keywords used in the literature search process

include political connection, firm performance, politically connected board, political connected in boardroom, and political connection and firm performance.

In addition to literature obtained from online journal databases, this study also adds information obtained from books, government regulations, and information from other sources as supporting information in this study.

Researchers conduct an analysis of how the relationship between the board of directors is connected to politics and the resulting company performance. The researcher draws conclusions from various information that has been obtained from various sources which can then be used as a proposal to the relevant regulators in considering policies and laws on limited liability companies and corporate governance in Indonesia. Drawing conclusions is intended to explain whether the proposed hypothesis can be accepted or rejected (Pandiangan et al., 2022; Tobing et al., 2018).

III. Discussion

The results show that companies that have political connections will receive a number of benefits and can help companies to improve their performance. These advantages include a lower cost of equity, much lower borrowing costs and interest, lower tax rates, and much better stock market performance.

The phenomenon of political connections in a company has become a common thing, especially in developing countries. Companies build political connections by placing people who have ties or closeness to the government or political parties. This phenomenon is also common in Indonesia, especially in State-Owned Enterprises. This phenomenon has occurred since the era of President Soeharto until the era of the current leadership of President Joko Widodo. Currently, President Joko Widodo has placed several commissioners of State-Owned Enterprises who are connected to the government. The president assigns positions to volunteers and members of political parties to occupy positions in the company's organizational structure, for example the positions of commissioners and directors (Wicaksono, 2017). This indicates that the phenomenon of political connections in companies (especially developing countries) is still common.

In running a business, companies can take advantage of opportunities that exist in the business environment in order to plan the best strategy. One of the opportunities that companies can use is to take advantage of political connections. Political connections can be leveraged to enhance and expand profitable connections.

In general, companies with political connections will receive some special benefits from these relationships. These advantages include lower cost of equity, much lower bank borrowing costs, lower tax rates, and enjoying lower loan interest rates from unaffiliated companies or political connections (Harymawan, 2018). In addition, politically connected companies are also shown to have a much better stock market performance than unconnected companies. Based on several advantages obtained by companies that have political connections, the company hopes that political connections can help companies to improve their company's performance. In addition, when an economic crisis occurs, the government will provide replacement funds through the granting of special rights due to political connections, especially in State-Owned Enterprises (Lestari and Putri, 2017). The political experience of members can also give banks special treatment, help open new markets, and provide various benefits that are reflected in the company's performance.

Political connections in a company are considered a valuable asset. Political connections will affect the decision-making process and company performance. This political connection can be obtained and built-in various ways, for example by recruiting the board of directors, the board of commissioners, as well as the company's management who are

currently serving or have served as members of parliament, ministers, heads of state, as well as those who have close relationships with politicians and/or top party.

In a politically connected company, there is an agency problem. If in general agency problems occur because of differences in interests between shareholders as principals and management as agents, then politically connected companies occur because there are differences in interests between owners and minority shareholders. This is supported by the statement of Sakti et al. (2020) which states that in Indonesia, agency relations tend to be less significant because many companies are closely owned by a small group of family shareholders and are closely connected politically.

To achieve good financial reporting quality and better company performance (Shahzad, 2016). In the internal governance mechanism of a company, there is a board of directors as the party holding the highest and most powerful position in the company's decision making. Therefore, the appointment of a new board of directors will be very important because the management together with the shareholders will appoint the right people to be able to bring prosperity to the company. In fact, some companies prefer to appoint someone with political power and connections to be appointed as director. This is because these companies view that person as a resource for the company and become one of the ways to gain profits from the government (Azmi et al., 2020).

Based on the theory of resource dependency, companies are more interested in appointing a politician as a director of the company because it is considered a resource for the company. With the appointment of politicians as directors, the company hopes to be able to enjoy the benefits of these political connections and is expected to bring resources into the company. Several previous studies have proven that there is a positive relationship between political connections and company performance (Yeh et al., 2013). This means that politically connected companies will have increased company performance. This is due to several factors, such as the existence of loan contracts with low interest rates, favorable government policies, low tax rates, competitive advantages, and others. Yeh et al. (2013) argue that political connections can replace weak corporate governance to achieve better corporate performance.

Politically connected companies do not fully benefit from these relationships. However, there is a possibility that companies will have a negative perspective where the quality of accounting information is worse for companies that have political relations than companies that do not have political relations (Azmi et al., 2020). Several studies have proven that politically connected companies have decreased company performance. This is due to several factors, including higher labor costs, decreased company profitability, increased risk from expropriation of company assets for political or campaign purposes, and worsening of the controlling role of company boards (You and Du, 2012). In addition, greater transparency and accountability from better corporate governance will help prevent irresponsible actions that can create agency conflicts. In this case, political connections and good corporate governance add more value to the company, which leads to a complementary effect on the company's performance. This detrimental effect occurs mostly in companies in highly regulated industries (Pang and Wang, 2020). In Indonesia, the existence of political connections also has a negative impact on several companies due to corrupt acts involving directors of politically affiliated companies.

On the one hand, the existence of political connections within a company can bring various benefits that can support and facilitate the company to achieve better company performance. However, there needs to be strict supervision from the government regarding political connections within the company. This is necessary so that the negative effects of political connections can be minimized so as not to harm the company or other parties. One of the policies that can reduce the negative effects of political connections is to pay attention

to the rights of minority shareholders. This is intended so that minority shareholders can still use their votes to oversee the running of the company.

IV. Conclusion

The results show that companies that have political connections will receive a number of benefits and can help companies to improve their performance. These advantages include a lower cost of equity, much lower borrowing costs and interest, lower tax rates, and much better stock market performance.

This research did not escape from the limitations experienced during carrying out the research. The limitation of this research lies in the effect that we want to see only on the company's performance. Therefore, further research can conduct research on the impact of political connections in a company from another point of view, for example the influence of political connections on the company's dividend distribution policy.

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