

## Characteristics of politically connected companies in Indonesia

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**ABSTRACT:** This study examined differences in terms of leverage, taxes, and market share between politically connected companies and non-politically connected companies listed in the Indonesian LQ45 index. Based on previous studies, a company needs political connections to execute its corporate activities. Politically connected companies expect higher leverage, tax reductions, market share than non-politically connected ones.

**Keywords:** leverage, taxes, market

### 1 INTRODUCTION

Political connections can affect a company's business activities. Financial performance is related to the development of existing businesses. Politics is often used by companies to attain certain goals. A company is considered to have a political relationship if one of its leaders, a majority shareholder or board of commissioners member, serves as a state official. As stated by Faccio (2006), a company is considered to have political connections if at least one of its largest shareholders (someone who controls at least 10% of the total shares with voting rights) or one of the company's leaders (CEO, president, vice president, chairman or secretary) is a member of parliament, minister, or someone closely related to political parties. According to Wulandari (2018), various kinds of privileges can be obtained by companies with political connections, even during a financial crisis. Such companies can more easily obtain bailout funds from the government. The political connection that exists between companies and someone who serves in the government or is involved in politics is considered to be beneficial to the companies. Leuz and Gee (2006) explained that the formulation of corporate strategy concerning competition should be able to find and take advantage of opportunities in the business environment, one of which is through political connections.

However, company relations with political members are not always profitable. It can also become a burden for companies, such as declining stock prices affecting their value. Shleifer and Vishny (1994) stated that companies with political relations could influence corporate value, distort incentives, misplace investments, and increase the level of corruption. Political connections have an indirect effect on share price decline in the shares of PT Saratoga Investama Sedaya Tbk (SRTG), a company owned by Sandiaga Uno during the 2019 presidential election. This result is in line with research by Goldman (2009), which analyzed stock price responses to Republican victories in the 2000 US presidential election. It was found that companies connected with Republicans experienced an increase in share value while companies connected with Democrats experienced a decline.

Establishing political relations is still considered a tool for expediting the company's business activities. Even though the existence of a political connection between the company and the government and/or political parties negatively affects the company, the relationship between the two still remains as the company's choice in its preparation for competitive strategies, as the CEO of MNC Group, Hary Tanoesoedibjo, did. Although MNC has been successful with its media business, Hary Tanoesoedibjo participated in

politics and founded the Perindo party that was declared in February 2015. The result then assumes that political connections cause differences between companies. This study, hence, will focus on differences in corporate characteristics based on corporate leverage, tax payments, and market share of companies that are politically connected vs non-politically connected.

## 2 RESEARCH ISSUES

Politics and companies are interconnected. Political party activities require significant funds. The close relationship between business and politics in Malaysia has been proven by Gomez and Jomo (1998), Faccio (2006), and Gomez (2002). Political support in Malaysia has a significant influence on the corporate sectors through restrictions on the listing, direct ownership of shares, and supervision in the banking sector. The government sponsors such restrictions through institutional investors (Gomez & Jomo, 1998).

Furthermore, Chaney, Faccio, and Parsley (2011) found that companies connected through politics had higher leverage, lower taxes, and more significant market power than non-politically connected companies. These results are in line with research by Chaney et al. (2011) and Kim and Zhang (2013), which found that companies with connections would be more willing to make efforts to minimize their taxes because the risk for inspection would be lower and even that they would not be subject to inspection by the tax audit agency. Research carried out by Kamaludin (2010) in Indonesia regarding political support and leverage revealed that only SPI proxy supports the hypothesis that politically connected companies have higher leverage. Following up on the research by Kamaludin (2010), this research also investigates tax and market share variables, and distinguishes between politically connected and non-politically connected companies.

The research question in this study is as follows: Do politically connected companies obtain higher leverage, tax reduction, and market share than those non-politically connected ones?

## 3 LITERATURE REVIEW

Agency problems can be found in politically connected companies. According to Anthony and Vijay (2005), agency theory is a relationship or contract between principal and agent. Agency theory has an assumption that every individual is motivated only by his interests, causing a conflict of interest between principal and agent, as happens between company management and shareholders. Conflict occurs when differences in objectives emerge between managers and shareholders, especially if one of the parties is involved in political activities. If one party decides to be involved in political financing while the other party refuses to do so, a conflict between management and shareholders occurs. Conflicts between management and shareholders become more complicated when alliances emerge in politically connected companies because the parties involved become broader. Hence, agency theory can also be used to explain conflicts that occur between management and shareholders in politically connected companies. Research from Chi, Liao, and Chen (2016) showed that companies with politically connected CEOs are involved in a much lower level of accrual-based earnings management than companies without politically connected CEOs. And research from Harymawan and Nowland (2016) revealed that increased political stability could increase the certainty of political connection benefits, reduce the need for politically connected companies to respond to market pressures, and produce lower-quality earnings.

## 4 METHOD

This study used an analysis of ordinary least squares (OLS) regression to analyze companies listed on the Indonesia Stock Exchange LQ-45 index in the 2014–2018 periods. Samples

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However, company relations with political members are not always profitable. It can also become a burden for companies, such as declining stock prices affecting their value. Shleifer and Vishny (1994) stated that companies with political relations could influence corporate value, distort incentives, misplace investments, and increase the level of corruption. Political connections have an indirect effect on share price decline in the shares of PT Saratoga Investama Sedaya Tbk (SRTG), a company owned by Sandiaga Uno during the 2019 presidential election. This result is in line with research by Goldman (2009), which analyzed stock price responses to Republican victories in the 2000 US presidential election. It was found that companies connected with Republicans experienced an increase in share value while companies connected with Democrats experienced a decline.

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