

# THE ROLE OF POLITICAL CONNECTIONS, CASH HOLDINGS, AND PUBLIC OWNERSHIP IN IMPROVING LQ45 COMPANY PERFORMANCE ON THE INDONESIA STOCK EXCHANGE

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**Abstract:** Successful companies would manage their performance very well. Previous research found that there are many factors affecting the company's performance such as dividend policy, financing policy, investment policy, size of the firm, intellectual capital and so on. This study aims to determine the effect of political connections, cash holdings, and public ownership on the performance of companies incorporated in the LQ45 index on the Indonesia Stock Exchange. The sample used is all companies that are members of the LQ45 index on the Indonesia Stock Exchange during 2018-2021. The results show that cash holdings and public ownership have a positive effect on company performance, while political connections do not affect the performance of companies incorporated in the LQ45 index.

**Keywords—** *Company Performance, Political Connections, Cash holdings, Public Ownership*

## I. INTRODUCTION

In general, the goal of the company is to maximize its corporate performance by maximizing the wealth or the prosperity of its shareholders. To achieve this goal, the company has to maximize its profitability as measured by Return on Assets (ROA). Company performance is defined as the total value created by the company through its activities in generating profits [1]

According to [5], the support of political parties is one of the success key of the company. Business people are very aware that they tend to take advantage of their business related to the government or politicians to provide benefits to the companies, such as the provision of government subsidies, debts, tax amnesties, market power, and so on [2]. Based on previous research, political connections have negative impacts on company performance [15] [17]. On the other side, [18] found that political connections lead to positive impact on performance.

Cash holdings also plays an important role in affecting the company's performance. Cash holdings are assets that are held in the form of cash which are available to fund the company's operational needs or to be distributed as dividends. The cash holdings policy has many benefits that

can improve the company's performance. Maintaining sufficient cash, the company could conduct transactions smoothly, and enhance its investment activities when other funding sources are not available or too expensive [3]. According to previous research, cash holdings has positive impact on company performance [19] but it has negative impact on performance [16].

The third factor detected to be able to affect the company's performance is public ownership. The high level of the proportion of public ownership implies that public control over the behavior of managers tends to increase to maximize shareholder wealth [4]. Following this strategy, managers will act following the company goals and decrease their desire to behave outside of their authority. Such procedures will ultimately improve the company's performance in the future. Referring to previous findings, public ownership has positive impact on company performance [13] and other research shows that public ownership does not have any impact on company performance [14].

Following previous research, it can be drawn that there is no conclusive result regarding such relationship between political connection, cash holdings, public ownership and the company performance. In other words, there are many research gaps that the researchers would like to prove whether this research would confirm to one of those findings. Therefore, based on the background and the phenomena described above, the researchers are interested in conducting a study entitled "The Role of Political Connections, Cash Holdings, and Public Ownership in Improving LQ45 Company Performance on the Indonesian Stock Exchange".

## II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### A. Political Connection

A political connection to a company occurs when at least one of the company's major shareholders or a high-ranking official (CEO) of the company is a member of parliament, a minister, or a head of state, and is a party member [5]. Politically connected companies are found to enjoy several benefits, including easy access to financing through banks,

tax subsidies, market power, and accepting government contracts. Political relationships can benefit companies in a number of ways. Politically connected companies may find it easier to access debt, but the impact is that companies have higher leverage ratios than other companies that are not politically connected. In addition, politically connected companies also benefit from the large number of investors who look to these companies because investors only need to pay less for politically connected companies because of the easy access to their sources of funds. This indicates that they generally perceive connected companies as having lower risk when compared to other companies with political connections. [12]. Referring to the previous explanation, the proposed hypothesis is as follows:

Hypothesis 1: Political connections significantly affects the company performance

#### B. Cash Holdings

Cash holdings are assets that are held in the form of cash (cash) needed for the company's operational needs. Holdings a certain amount of cash is important for the company because it becomes easier for the company to carry out daily transactions. By holding a certain amount of cash reserves, company managers consider that this can make it easier for managers to finance investments that benefit the company [6]. On the other hand, holding too much cash also delivers bad news to the investors since this message shows that the company fails to distribute idle cash to profitable investment opportunities leading to bad future income. Referring to the previous explanation, the proposed hypothesis is as follows:

Hypothesis 2: Cash holdings significantly affects company performance

#### C. Public Ownership

Public ownership is the large portion of outstanding shares owned by the public or the public. This public ownership shows how investors could supervise and control the management to achieve good corporate governance in such a way following the investor considerations. The higher the public ownership, the higher the investors' control over how well the manager or CEO runs the company. Based on the previous explanation [4,11], the proposed hypothesis is as follows:

Hypothesis 3: Public ownership significantly affects company performance

### III. RESEARCH METHODS

#### A. Population and Research Sample

The population in this study is all companies incorporated in the LQ45 Index listed on the Indonesia Stock Exchange (IDX) as many as 45 companies. The sample size and selection technique will be carried out using the census method.

#### B. Variable Analysis and Operationalization Tool

This research takes advantage of a multiple linear regression method as the main analysis tool. The research model used for analyzing the data is as follows.

$$Y = + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e$$

where :

- $\alpha$  : Intercept
- $\beta$  : Regression coefficient (beta)
- $X_1$  : Variable of political connection
- $X_2$  : Variable of cash holdings
- $X_3$  : Variable of public ownership
- $Y$  : Company performance as the dependent variable
- $e$  : Error

#### C. Research measurement

The following is the measurement of the variables used in this study.

- Return On Assets

ROA is used to measure the level of management efficiency in generating profits based on the value of assets owned. ROA can be calculated using the following formula [1]:

$$ROA = \frac{\text{Net Profit}}{\text{Total Asset}} \times 100\% \quad (1)$$

- Political Connection

The criteria for political connection in this study are carried out based on the following arguments:

- a) Company owners or shareholders are politicians and Government officials.
- b) Directors or members of the board of commissioners hold concurrent positions as ministers of the president's working cabinet.
- c) Directors or members of the board of commissioners hold concurrent positions as politicians affiliated with political parties and government officials.

Political connection is measured by a dummy variable, with a value of 1 if the company meets one of the criteria above and a value of 0 if it does not meet the criteria.

- Cash Holdings

Cash holdings is a ratio of cash obtained from the amount of cash to net assets designed to show how much cash is available from the total company assets [7]. Cash holdings can be calculated by the following formula:

$$\text{Cash Holdings} = \frac{\text{Sum of Cash and Cash Equivalent}}{\text{Total Asset}} \times 100\% \quad (2)$$

- Public Ownership

Public shareholders are one of the structures of the company's share ownership whose ownership status is as a minority shareholder. The proportion of public ownership ranges from less than 30% so can't do much company control [4]. The amount of share ownership by the public is calculated as follows [4]:

$$\text{Public Ownership} = \frac{\text{Outstanding Public Shares}}{\text{Total Shares}} \times 100\% \quad (3)$$

#### D. Classic Assumption Test

A classical assumption test should be conducted in regression analysis to obtain a good, linear, and unbiased regression coefficient (Best Linear Unbiased Estimated-BLUE) [8]. Data testing consists of autocorrelation, multicollinearity, heteroscedasticity, and normality test.

#### E. Test Model

Before testing the hypothesis, the partial t-test should be taken first. The regression model above will be tested with the F-Fisher test and the coefficient of determination ( $R^2$ ). The test is used to find out how much the dependent variable is explained by the independent variables. The coefficient of determination ( $R^2$ ) ranges from zero to one ( $0 \leq R^2 \leq 1$ ), where the higher  $R^2$  (closer to 1) means that the independent variables provide almost all of the information needed to predict the variation of the dependent variable and if  $R^2 = 0$  indicates independent variables as a whole cannot explain the dependent variable.

#### F. Hypothesis testing

This study uses a significance level of  $\alpha$  value of 5% to determine whether there is a real effect of all independent variables on the dependent variable [9]. The criteria for this test are:

- a) If the level of significance ( $\alpha$ ) > 00.05, then  $H_0$  which states that there is no effect of the independent variable partially on the dependent variable is rejected. This means that partially the independent variable has a significant effect on the dependent variable.
- b) If the level of significance ( $\alpha$ ) < 0.05 then  $H_0$  is accepted, which means partially the independent variable has a significant effect on the dependent variable

### IV. RESULTS AND DISCUSSION

#### A. Results

##### 1. Descriptive statistics

This study begins by examining the financial statements of sample companies, namely companies that are members of the LQ45 index in 2018-2021, and then proceeds to calculate and analyze company performance, political connections, cash holdings, and public ownership. Descriptive statistics calculates the value of the four variable studied in the sample of companies in the period 2018 to 2021 are shown in Table 1 below.

**Table 1. Descriptive Statistics**

Descriptive Statistics					
	N	Minimum	Maximum	mean	Std. Deviation
Company performance	180	.1322	9.8724	4.6852	2.3756
Political connection	180	.00	1.00	.7777	.4895
Cash_Holdings	180	.0758	.5472	.1964	.0974
Public_Ownership	180	.0113	.0424	.0342	.0235
Valid N (listwise)	180				

Source: SPSS 23 output

Table 1 shows that among 180 observations, PT. Kalbe Farma Tbk. has the highest company performance based on

ROA with a value of 9.8724 in 2020, while PT. XL Axiata Tbk. with the lowest company performance in 2018 with a value of 0.1322. The average firm value is a value of 4.6852 showing that the average performance can be categorized as a good company since the average interest rate is around 3,5%. In other words, on average, the companies that are members of the LQ45 index can manage the existing resources effectively and efficiently. According to ROA measurement, the higher the Return on Assets (ROA), the higher the net profit generated from each rupiah of funds embedded in total assets. Thus, ROA would tell whether the company has been efficient in using its assets to generate profits.

Based on the political connection in Table 1, among 180 observations, the result shows that the minimum value is 0.00, the maximum value is 1.00, and the average value is 0.7777 with a standard deviation of 0.4895. The average value of 0.7777 shows that there are quite a lot of companies have political connections. Specifically, 35 companies have massive political connections and the remaining 10 companies do not have any political connections at all.

Based on cash holdings in Table 1, it can be observed that among 180 observations, in 2021 PT. Bank Central Asia Tbk. allocated cash and cash equivalents at the highest proportion of 0.5472 or 54.72% of total assets, while PT. Telekomunikasi Indonesia (Persero) Tbk. Allocated its cash and cash equivalents at the minimum level in 2020, which is 0.0758 or 7.58% of its total assets. On average, the company places its cash and cash equivalents at 0.1964 or 19.64% of its total assets. The average value of cash holdings tends to be moderate showing that the company places available funds in working capital accounts, equipment, and machinery for production purposes.

Public share ownership is the proportion of share ownership owned by the public. Based on Table 1, among 180 observations, the minimum value of public ownership was 0.0113, the maximum value was 0.0424, and the average was 0.0342. These figures show that the presence of a composition of public shareholders is too small that would reduce the number of elected boards from outside. In this situation, it is hard for the shareholders to control the manager's policy.

##### 2. Classic Assumption Test

Based on the classical assumption test, the data in this study has met the requirements to use multiple linear regression models.

##### 3. Test Model

- *F test*

**Table 2. F Test Results**

ANOVA					
Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	.072	3	9,024	60,538	.000b
Residual	.027	64	.092		
Total	.099	67			

a. Dependent Variable: Company\_Performance

b. Predictors: (Constant), Public\_Owners, Political\_Connections, Cash\_Holdings

Source: SPSS 23 output

Referring to Table 2, the F value is 60.538 with a significance level of 0.000 which is less than 0.05 ( $\alpha$ ). Thus, the regression model is significant meaning that the independent variables are significant to predict and explain the dependent variable. In other words, the independent variables of political connections, cash holdings, and public ownership have a joint effect on the Rate of Return on Assets of companies incorporated in the LQ45 index for the 2018-2021 period.

- *Coefficient of Determination Test*

**Table 3. Results of the Coefficient of Determination Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.854a	.198	.705	.02811	1,940

a. Predictors: (Constant), Public\_Owners, Political\_Connections, Cash\_Holdings

b. Dependent Variable: Company\_Performance

Source: SPSS 23 output

Based on Table 3, the value of the coefficient of determination (Adjusted R Square) is 0.705 or 70.5%. This figure shows that 70.5% of the Company's Performance (ROA) can be explained by the variables of Political Connections, Cash Holdings, and Public Ownership, while the remaining 29.5% is explained by other factors outside of this research model.

#### 4. Hypothesis testing

The following Table 4 shows the result of multiple linear regression.

**Table 4. Results of Multiple Linear Regression Analysis**

Model	Coefficients				
	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.025	.110		.224	.824
Political connection	.009	.011	.077	.759	.453
Cash_Holdings	.039	.010	.441	4.061	.025
Public_Ownership	.021	.004	.539	5.540	.048

a. Dependent Variable: Company\_Performance

Source: SPSS 23 output

Based on Table 4, the multiple linear regression equation can be generated as follows:

$$\text{Company Performance} = 0.025 + 0.009 \text{ PC} + 0.039 \text{ CH} + 0.021 \text{ PO}$$

Referring to Table 4, the coefficient of the Political Connection variable has a positive sign of 0.009 with a significance value of 0.453, which is greater than 5%. This result indicates that the political connection variable does not affect the company's performance. This result means that as political connection increases by any size then it does not affect the company's performance.

Furthermore, the coefficient of the cash holdings variable has a positive sign of 0.039 with a significance value of

0.025 which is smaller than 5%. This finding shows that the cash holdings variable has a positive effect on the company's performance significantly. Thus, when the cash holdings variable increases by 1%, the company performance would raise by 0,039%

The next result reflects that the coefficient of the public ownership variable has a positive sign of 0.021 with a significance value of 0.048 which is smaller than 5%. This result indicates that the public ownership variable has a positive impact on the company's performance significantly. This finding reflects that as the public ownership variable increases by 1%, the company performance will increase by 0.021%

#### B. Discussion

- *The Influence of Political Connections on Company Performance*

The first result of this study is that the political connection variable does not affect company performance. Political connection is defined as the existence of political power in a company that can be owned by individuals or groups. Politically connected companies will usually receive many benefits such as bank loans and loan installment convenience leading to high market power which can be reflected in rising stock prices. However, this connection will hurt company performance when it is implemented improperly or misused for personal interest. The negative impact will be detected when long debts have consequences on the high and risky debt installment, and expensive interest expenses leading to the difficulty of paying those obligations. Therefore, this research found that even though those companies have high political connections, they tend not to take advantage of this opportunity to improve their performance because they do not want to face any problems dealing with it in the future. It implies that all decision are taken based on the professional and rational business considerations reflecting the blue chip companies. In addition, those companies are not only controlled by their shareholders, but also the Finance Service Authority (Otoritas Jasa Keuangan\_ OJK) so that the involvement of political connectionis could be reduced.

- *The Influence of Cash Holdings on Company Performance*

The second result shows that the Cash Holdings variable has a positive and significant effect on company performance. The significant effect reflects that when the value of cash holdings increases, the company's performance will also increase. Cash holdings are defined as cash and cash equivalents that can be easily converted into cash that is available for investment in physical assets and dividends [10].

The constant increase in cash holdings will improve the company's performance because the presence of such reasonable amounts of cash reflects its sufficient amount of cash holdings indicating its good liquidity. Each company will manage its cash holdings properly to provide the ideal amount of cash which means neither too much nor too little. If the company maintains too much cash, it will decrease its efficiency because the embedded funds in the form of cash are unproductive which will disrupt the profitability,

whereas if the company implements too little cash, it will also disrupt the company liquidity. Thus, this research found that all companies could maintain the cash holdings properly in term of holdings sufficient amount of cash such that they could free themselves from any problem of excess cash or shortages cash. By maintaining sufficient cash, the companies implying that they are well managed.

- The Effect of Public Ownership on Company Performance

The third result shows that the Public Ownership variable has a positive and significant effect on company performance. Significant influence in this study shows that when the value of Public Ownership increases by 1%, the company performance will increase by 0,021%. The interesting result of this research is that according to the descriptive statistics, the mean of political connections is relatively small around 3,4%, but it could affect the company performance. This phenomena shows that the quality of any suggestion coming from this small public ownership is so good reflecting their competence and their experience. Thus, the quality of the member of the public ownership is the most important point to achieve the company goal. In addition, the greater percentage of shares held by the public is still needed to accomplish greater involvement of the community in the share ownership structure.

## V. CLOSING

### A. Conclusion

Based on the above analysis and discussion, the conclusions can be drawn as follows:

- 1) The political connection variable has a positive coefficient of 0.009 with a significance value of 0.453 which is greater than 5%. The result of this test indicates that the political connection variable does not affect the company's performance. Thus, Hypothesis 1 stating that political connections affect the company's performance is rejected.
- 2) The cash holdings variable has a positive sign of 0.039 at a significant value of 0.025 which is smaller than 5%. Based on this result, the cash holdings variable has a positive effect on the company's performance. Thus, Hypothesis 2 stating that cash holdings affects the company performance is accepted.
- 3) The public ownership variable has a positive sign of 0.021 with a significance value of 0.048 which is smaller than 5%. The result of this test indicates that the public ownership variable has a positive effect on company performance, eventhough this public ownership is relatively small reflecting their competence and their experience. Thus, Hypothesis 3 stating that public ownership affects significantly company performance is accepted.

### B. Suggestion

- 1) It is recommended for companies to pay attention to political connections because it tends to harm their profitability. The company should limit this connection

so that all decisions will be made based on professional and rational business considerations.

- 2) The recommendation for the companies is that if they want to pursue improving company performance, they should pay more attention to the level of cash holdings and public ownership because these variables are proven to affect the company performance.
- 3) It is recommended for the company to increase the proportion of the public ownership appropriately to reduce agency problem.

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