

Political Connection and BPD Performance

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ABSTRACT

The political situation that stable and conducive simplify business activities of a company politics and vice versa can be facilitated by the existence of good business. The relationship is what eventually called a political connection. Business relationship with politics has a very close relationship to harmony of an economy. The sample in this study is board members in 26 Regional Development Banks (BPD) during the year 2010 to 2014. We use political connected as an independent variable, the political connected is the board are coming from government, BPD is owned by government so the board with government background is identified as a political connected. The dependent variables are return on asset, return on equity and non-performing loan. This study uses firm size as a control variable. This study is expected to give a contribution to the topics of political connection and give a recommendation to government how to choice the member of board.

SARI PATI

Situasi politik yang stabil dan kondusif mempermudah aktivitas bisnis suatu perusahaan dan politik sebaliknya dapat difasilitasi dengan adanya bisnis yang baik. Hubungan inilah yang akhirnya disebut dengan koneksi politik. Hubungan bisnis dengan politik mempunyai hubungan yang sangat erat dengan keharmonisan suatu perekonomian. Sampel dalam penelitian ini adalah anggota dewan di 26 Bank Pembangunan Daerah (BPD) selama tahun 2010 hingga 2014. Kami menggunakan koneksi politik sebagai variabel independen, koneksi politik adalah dewan berasal dari pemerintah, BPD dimiliki oleh pemerintah sehingga dewan yang berlatar belakang pemerintahan dapat diidentifikasi sebagai terkoneksi politik. Variabel dependen-nya adalah return on asset, return on equity dan non-performing loan. Penelitian ini menggunakan ukuran perusahaan sebagai variabel kontrol. Kajian ini diharapkan dapat memberikan kontribusi pada topik hubungan politik dan memberikan rekomendasi kepada pemerintah dalam memilih anggota dewan.

INTRODUCTION

Business and political relationships can work alongside each other for the benefit of each other to reach a goal. The political situation that is stable and conducive simplifies business activities of a company politics and vice versa, which can be facilitated by the existence of good business. In Indonesia, the financial resources of political parties regulated in Acts No. 2 of 2011, article 34 and 35, which state that a political party may obtain funds from donations of corporation or business entity. Surely it is an advantage for companies that make donations to political parties because they expect something in return from the contribution. This relationship is what eventually called a political connection. Business relationship with politics has a very close relationship to a harmony of an economy. There must be a stability of the mutual support between policies being undertaken in politics and business. And you as a business person should take care of yourself in order to remain alert to the possibilities that occur so you have all the prepared stuff that may be caused by political conflicts. Political changes will create positive or negative opportunities depending on the business you have and how you take advantage of the situation.

The development of political connection in Indonesia has occurred since the first president, Soekarno: his policy was to nationalize all foreign firms in Indonesia; then the second President of Indonesia, Soeharto: more mixing of business and politics, in which almost all businesses in Indonesia were controlled by the family and friends of Soeharto and the state was held by the military which was an arm of Soeharto. Thus, all major projects in Indonesia fell into the hands of the family and friends of Soeharto. In fact, any policy taken by the government would benefit the businesses of Soeharto's cronies (families and friends). After the Indonesian economy crashed during the monetary crisis in 1997, Soeharto was finally not in power. This was so influential to the businesses of the family and friends of Soeharto because they also fell. Then the reformation era in Indonesia, business

and politics has not changed with each president ruling the country will give benefit to his business associates. It happened until the leadership of SBY where several key figures in Democrat Party involved in corruption and bribery for arrangement of existing projects; as a result, several Democratic Party leaders and ministers were arrested and went to prison. In SBY's leadership there were several campaign team members of SBY who became commissioners in several state-owned companies (SOC) and private companies. Business elite in Indonesia were still the same as in the past when in Soeharto era, but more divided into various powers. Figure 4.1 and Figure 4.2 show the differences of the relationship between business elite and political elite in Soeharto era and the present. It means that the business elite in Indonesia are closely related with politics. Figure 4.1 shows that in Soeharto era, the Cendana family (known as Soeharto Family) was the single power. Business elite got close to Cendana through various foundations. It is apparently still going on in the leadership of the most recent president of Indonesia, Jokowi, where today several successful campaign team members have held several commissioner seats in the state and private companies.

The primary legitimacy of the New Order government was on economic development. Beyond that, the economic success of this regime had no legitimacy whatsoever basis. Development had become the ideology of the regime that spread throughout Indonesia. The parties who opposed were removed and considered subversive. Even the economic crisis also had alerted many parties: solid economic development, as de Tray said, was not able to withstand the global economic downturn. Indonesia was the longest to get out of the economic crisis when compared with neighboring countries that experienced the same crisis. Next, the result of severe monetary crisis is the destruction of economic pillars. Indonesia's modern economy sector such as industry, construction, and finance has been shattered. Its impact is millions of workers have lost their jobs thus increasing the

number of people who fall into unemployment. Capitalism that grows in the form of conglomerates are pampered and cared for by the State. The State and the government in the era are very decisive in economic and political fields. Liddle (1997) even mentions Soeharto deterministic, a term that is not excessive considering the conglomerate that grew from its proximity to the inhabitants of this Cendana. Yosihara (1988) described in the appendix of the brief profile of the conglomerate that grew out of the ruler's womb like Sudono Salim, Sukamdani Sahid, Sudwikatmono, Probosutedjo, Bob Hasan, Ciputra, sons and daughters of the president and so forth. Relating to excessive government interference, it can be seen in the case of national cars in 1996; for example, luxury tax exemption of 35% for PT. Timor Putra Nasional (owned by Tommy – the youngest son of Soeharto) which was the only company that had the privilege of national car. Such an attitude like this had become a portrait of pattern about the business-political relationships in the New Order era. Regulations were adjusted so that they were profitable for other like-minded partnership with government. The hope to see the emergence of the middle class and the capitalist was seriously reduced. The capitalists supported the status quo due to rent seeking.

The reformation era grasped the hope for improvement of Indonesia in the future compared to the previous era. But sometimes expectations are different from the reality. Looking at the concept of reform, it was initiated by John Perkins; corporatocracy feasible for phrased as analysis. Corporatocracy shows that in order to build a global empire, the various major corporations, banks, and government have to join their financial and political powers to unite to force the world community to follow their will. Corporatocracy term can be used to show how a large corporation or company in reality may dictate, sometimes even buy the government to approve their wishes.

Overcast role of the State is due to the public scrutiny that is so big and the current demands for reform

that requires power sharing. The government in power throughout the era of reform is an alliance so when it comes to carrying out the power, it can not necessarily do what they want it. The era of Habibie (the transition era-with the support of Golkar and the military), the period of Abdurahman Wahid (*poros tengah*-shaft Islamic party), the Period of Megawati (PDIP), and the Period of Susilo Bambang Yudhoyono (large coalition; Democratic-7.45% of the national vote, Golkar, PKS, PBB) show how the government should make compromises in running their power.

Reformation period shows how business interests are able to influence the political domain. Conglomerates were raised by New Order, grown by itself, or foreign large corporate were able to influence the government that required the economic pillar to support his leadership. Examples of the corporatocracy can be seen in Presidential Regulation No. 77/2007 concerning the ownership of capital, in which foreigners are allowed to own 95% interest in the field of power generation, oil and gas drilling services, and exploitation of drinking water. This regulation gives the legal rules for foreign companies to take control of the nation's vital joints. This corporatocracy if judging from business and politics is destructive from both views. From a business standpoint, the corporate giant with hit man economical help will make the business to increase the unbalanced of equilibrium. Large corporate will be globalized and hegemonies in terms of the control of capital; in addition, the characteristics of true capitalism in the form of free competition do not happen again. From the political side, the sovereignty of the government is questioned, or simply comprador big corporate. Given the pattern of business relations and politics in the era of New Order and the Reformation period then we have not seen pattern towards common welfare. Prosperity can only be enjoyed by a handful people and it is failed to be distributed to the public as a whole. Reform period up to the presidential election has the political momentum to make a number of improvements in viewing patterns of

business-politics. Populist economic alternative, a third way Giddens, sharia economy is just some of the available options to bring Indonesia into a better direction.

BPD is a company belong to a local area and of course that the election of the board of directors and board of commissioners is determined by the local government which is also supported by the party. No wonder that there was a representative of a government that is in the board of commissioners in 26 BPDs in Indonesia. Table 1 show that 24 of 26 BPDs in Indonesia put the local government envoy to sit as a commissioner, it is very possible because the government wants to control the BPD in order to have good performance, so can generate good revenue also for the region. But there are also few local governments that do things that are not good by providing extended credit to family or business friends, which so often happens averse to bad credit of BPD and the region itself. Therefore, this study wanted to see if the relationship with political connections brings a positive impact to the performance of BPD.

Literature Review

This section describes and illustrates the framework of research. The framework of this study shows the influence of the independent variables in smaller firms, and firms dependent on external finance. Companies connected to the election winner receive more state procurement contracts, invest more, and enjoy a better long-term stock performance. (Political connection) to the dependent variable (value companies). In the long term, the company's goal is to optimize the value of the company. The higher the value of the company described the increasingly prosperous of

the owner. The company's value will be reflected in the market price of its shares (Fama, 1978). Jensen and Meckling (1976) argued that the company is a set of contracts between company managers and shareholders. Friedman (2002) provides an example of the results of his research report that the bankers are often forced to provide loans for projects carried out by companies that connected with politics even though that the project is not profitable. Such action is a transfer of wealth from the citizens or consumers to the company, which led to an increase in the value of the company. In Indonesia, basically political parties more dependent on government assistance and corporate support, when compared to its own members' dues. Expectancy theory is something that can be formed and can be used as a step to change. The cause of the rise of political connection because of the expectation that the company's value increases and can get benefits investments. The presidential election is a great time to connect companies directly related to politics if the company is in accordance with the presidential victory. The investment decision become a consideration for the owner of the company and in line with expectations or measures intended.

Companies that have a political connection are companies in their certain ways having a political bond or proximity to politicians or government. Corporate executives often build personal relationships with public officials (for example, friendship, the same education and experience working with politicians and campaign contributions).

According to Gomez and Jomo (1997), companies with political connections are companies or

Table 1. Background composition on BPD Board of Commissioners

Background	Amount	Percentage
Bankers	26	28.9%
Academicians	22	23.3%
Government	43	47.8%
Total	91	100%

conglomerates that have close relations with the government. Companies that have close ties with the government can be interpreted as a state-owned company. Meanwhile, the owner of a large company has a close relationship with the government or leading political figures (Gomez & Jomo, 1997). The political figure is a board member at the central government or a member of political parties. In other words, political connection is a level of close relationship between company and government. Companies with political connections are risk taker. These companies called risk taker because often use their influence to gain easier access to obtain soft loans (Yoshihara, 1988). This soft loan used by companies to overcome the current crisis because companies with political connections have possibility of having a greater failure (Gul, 2006).

As for the advantages of their political relationship, as expressed in Chaney et al. (2011), it leads to mutual benefits between politicians and value added. Companies even gain benefit, especially in terms of cost reduction competition, reducing regulatory obligations or easier way in getting the contract relating to government projects (Goldman et al., 2011). As an example of what occurred in Indonesia, a company associated with Soeharto regime getting its own convenience in terms of import permits compared with competitors (Mobarak & Purbasari, 2006). Faccio et al. (2006) adds that the government is easier to do the «bail-out» to companies with political connections when it is experiencing financial difficulties. Faccio (2010) finds that the company with political connections pays less tax burden so it will give an impact on the cost of a smaller operation. From the results of some research above, it can be said that companies with political connections have a lower budget constraints and have little competition and market pressures compared to other companies.

However, political relations at the company prove to have its own shortcomings. Although political relations companies can increase the value of the company, research in the perspective of corporate

governance states that companies like this can lead to other managerial problems. As an opinion submitted by Qian et al. (2011) in his research that the activity of expropriation of assets by the majority owner through tunneling and propping more common to be found in companies with political connections. Chaney et al. (2011) also found that firms with political connections put little attention in preparing a good financial reporting. It is certainly simplifying the process of appropriation of the company which would only be beneficial for the majority owner. Other evidence conveyed in several previous studies that firms with political ties reported lower-quality financial reporting to help cover the efforts of appropriation by not conducting inspections efficiently (El Ghouli et al., 2011; Guedhami and Pittman, 2006).

Another deficiency is shown also in terms of market analysts; the results of Chen et al. (2010) stated analyst forecasts for firms with political ties are often missed and inaccurate, one of them is caused by asymmetrical information. Other evidence indicated by Bertrand et al. (2007), in a study of the company in France, which shows the results that companies with political connections have lower returns than companies that do not have political relations, especially in election periods or companies that are in the political area. Research in Indonesia alone conducted by Leuz and Oberholzer-Gee (2006) showed that companies with political connections in Indonesia chose not to cross-listing in the US market because it was feared the requirement for supervision strict market reduces the gain majority owner of control rights in the company. Broadly speaking, this evidence shows that political relations help politicians affiliated to use political benefit at the expense of other stakeholders in the company. As a result, the problem arises from asymmetrical information and potential appropriation by the majority of shareholders that affect the risk of systematic company in terms of delivering a good quality report.

Political connection is about the close relationship between the company and the authorities. A company has a relationship with the rulers gain strategic benefit such as know the rules made by the government earlier. An example is the government removing subsidies on gasoline and diesel, the company at least already knows about the government policy. This is the benefit of politically connected companies. According to Goldman et al., (2011) the company even gain benefit, especially in terms of cost reduction competition, reducing regulatory obligations or easier way in getting the contract relating to government projects. As an example occurred in Indonesia, a company associated with the regime of Soeharto get their own benefit in the case of an import permit compared to its competitors (Mobarak and Purbasari 2006). Faccio (2006) states that if the political connection as the main determinant of distorted investment decisions, it will be resulting in the value of the company become lower without any political connection. Political connection is believed to be an invaluable resource for many companies (Fisman, 2001). As research on the influence of political connection to company value, this study sought to examine further the political connection to BPD performance. So the research question is how do various aspects of political connections, such as monetary ties and shared interests, influence the performance of BPDs?

METHODS

The samples in this study are board members in 26 BPDs during the year 2010 to 2014. Financial performance data can be obtained from annual report provided by each BPD.

We use the political connected as an independent variable; the political connected is the board who are coming from the government. Because BPD is owned by the government, the board with government background is identified as a political connected because he or she brings an interest from the government to the board. We use dummy variable and define 0 as not connected and 1 as

connected. The dependent variables are return on asset (ROA), defined as net income divided by total asset, return on equity (ROE), defined as net income divided by capital, and non-performing loan ratio (NPL), defined as non-performing loan divided by total loan. This study uses firm size as a control variable. The size of the company is usually expressed by the number of assets, income or liabilities of the company. Companies that are large in size are indicated to have big resources and access to the vast resources so as to have sufficient flexibility to make operational processes and ultimately be able to produce good performance. In this study, the size of the company is expressed by the natural logarithm of the total assets of the company. The reason for using the natural logarithm of total assets is that in order to avoid the total number of different variables in an extreme way due to the size of using the absolute amounts of rupiah while other variables using ratios.

RESULTS AND DISCUSSION

Based on the data presented in Table 2, the following key financial indicators were analyzed to provide a comprehensive understanding of their respective descriptive statistics. The sample size consists of 26 observations, which allows for a robust analysis of the data. Let's delve into the descriptive statistics of each financial indicator to gain insights into their central tendency, variability, and distribution.

The mean of the CON variable is 0.92, with a standard deviation of 0.27, indicating a relatively low level of variability in the data. The Prop_con variable has a mean of 0.46 and a standard deviation of 0.25, suggesting a moderate level of variability. The ROA variable has a mean of 3.40 and a standard deviation of 0.85, indicating a relatively higher level of variability compared to the previous variables. The ROE variable has a mean of 26.47 and a standard deviation of 4.87, suggesting a significant level of variability in the data. The NPL variable has a mean of 2.10 and a standard deviation of 1.35, indicating a relatively higher level of variability. Finally, the Log_ta variable has a mean of 6.95 and

Table 2. Descriptive Statistics

Variable	Obs	Mean	Std.Dev	Min	Max
CON	26	.92	.27	0	1
Prop_Con	26	.46	.25	.00	1
ROA	26	3.40	.85	2.21	5.55
ROE	26	26.47	4.87	19.04	35.56
NPL	26	2.10	1.35	.26	5.14
Log_Ta	26	6.95	0.39	6.22	7.80

CON = Connected board by politic
 ROA = return on asset
 Lot_Ta= log total asset
 Prop_con = Proportion board connected by politic

a standard deviation of 0.39, suggesting a moderate level of variability.

These descriptive statistics provide valuable insights into the central tendency and variability of the financial indicators, which can be useful for further analysis, comparisons, and decision-making processes. Overall, the descriptive statistics provide valuable insights into the central tendency and variability of the key financial indicators, which can inform investment decisions and risk assessments (Dutta et al., 2015, Moskovicz, 2019).

The results in table 3 show the coefficient of CON is .138 (ROA), .403(ROE) and .643 (NPL), meaning the connected board by politics is not significant with BPD performance, the similar results also in proportion of board connected to BPD performance in ROA, ROE and NPL. It is not significant with BPD performance with coefficient .418 (ROA), .339 (ROE) and .186 (NPL). This table also shows the

BPD connected by politics is 24 and not connected is 2, so it means that most of the BPD is connected by politics. R-squared for ROA and ROE value is .321 and .243 indicates the level of ROA and ROE is suitability models by considering the number of variables in the model.

While R-squared for NPL is low in .113. The R-squared values for the models predicting ROA and ROE are 0.321 and 0.243, respectively, indicating a moderate level of model fit and suggesting that the independent variables in the model, including political connections, can explain a reasonable portion of the variation in these performance measures (Wibowo et al, 2018, Fatriawati, 2021, Yasmin & Muharam, 2021, Ariesa et al., 2020). However, the R-squared for the NPL model is relatively low at 0.113, indicating that the model has limited explanatory power for this performance indicator (Tulung & Ramdani, 2016, Sari et al., 2020, Putra & Harymawan, 2021).

Table 3. Political Connection and BPD Performance

	ROA		ROE		NPL	
	Coef.	t	Coef.	t	Coef.	t
Political Connection						
CON	.138	-1.54	.403	-.85	.643	-.47
Prop_Con	.418	.82	.339	-.97	.186	1.36
Log_Ta	.085	-1.80	.162	-1.44	.232	1.22
R ²	.321		.243		.113	
Frequency						
N = 26						
	Connected		Not Connected			
	24		2			

Note: * p < 0.1, ** p < 0.05, *** p < 0.01

Therefore, based on these results, the authors conclude that the hypothesis H1, which posits a significant relationship between political connections and BPD performance, is rejected. This finding is consistent with the existing literature suggesting that the impact of political connections on firm performance may be more pronounced in less developed countries with higher levels of corruption (Putra & Harymawan, 2021).

The results presented in this paper contribute to the understanding of the role of political connections in the performance of BPD, particularly in the context of the Indonesian banking sector (Nasih et al., 2020, Harymawan et al., 2020, Putra & Harymawan, 2021, Setiadi & Aryani, 2019). The findings also align with the notion that while political connections can provide certain benefits to firms, they can also increase the risk of conflicts of interest and potential misuse of power. (Harymawan et al., 2019).

MANAGERIAL IMPLICATION

Based on the authors' conclusions, the managerial implications for this research, which posits a significant relationship between political connections and BPD performance, can be summarized as follows, firstly, Strategic Re-evaluation, Managers should reconsider the strategic emphasis placed on cultivating political connections, as the study finds no significant impact on BPD performance. This re-evaluation should shift focus toward more direct performance drivers such as market competitiveness and operational efficiency. Secondly, Enhanced Governance and Ethical Practices, Given the potential risks of conflicts of interest and misuse of power associated with political connections, managers should strengthen governance and ethical practices. This includes implementing rigorous internal controls, transparency measures, and accountability mechanisms to ensure ethical conduct. Thirdly, Operational Focus, focus on improving internal operations and efficiencies. Investments in technology, staff training, and customer service improvements can provide more tangible benefits

than political affiliations. Fourthly, Talent and Leadership Development, invest in developing internal talent and leadership capabilities. By fostering a culture of meritocracy and continuous improvement, managers can reduce reliance on external political connections and build a more resilient and capable workforce. Lastly, Policy Advocacy and Lobbying, while direct political connections may not enhance performance, managers can still engage in policy advocacy and lobbying through transparent and ethical channels to influence favorable business environments and regulations. Seventhly, Stakeholder Engagement and Trust-Building, engage with stakeholders, including employees, customers, and the community, to build trust and credibility. Demonstrating a commitment to ethical practices and transparency can enhance the reputation and long-term success of the bank. By integrating these managerial implications, board of directors of regional development banks can navigate the complex interplay between political connections and firm performance, focusing on sustainable growth, ethical practices, and operational excellence.

CONCLUSION

This study is to examine the relation between political connection and BPD performance, and using the sample of all BPDs in Indonesia, 26 BPDs, the results of this study show that the political connection does not affect BPD performance. This means the presence of government in the board of BPD (24 of 26 BPD boards have been connected to politics, as can be seen in 24 BPDs that have a government representative in the board of commissioners) does not affect BPD performance. This is consistent with the findings of Snyder (2003), Agrawal et al (2007) and Goldman et al (2011) who argue that political power does not affect the firm performance.

This study has a limitation, most of the directors cannot be traced to a political connected because there is no proof of them having connection with the government so not include in this research.

Further research, firstly, should take the historical data from all the board, including commissioners and directors to identify their connection with the government. For example, whether they are an election team campaign from the governor in the election, or perhaps they are friends to the governor

when in college. Secondly, should include historical data of all board members to identify any ties to government, such as involvement in election campaigns or personal connections with the governor. ■

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