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ANALYSIS THE EFFECT OF POLITICAL CONNECTIONS AND OWNERSHIP STRUCTURE ON QUALITY CORPORATE GOVERNANCE

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ABSTRACT

The purpose of this study is to analyze the effect of quality corporate governance on political connections and ownership structures. In this research, quality corporate governance is measured by indicators. The independent variables used in this study are political connections, company size, leverage, diffuse ownership, and sales growth. The target of this research is companies listed on the Indonesia Stock Exchange, provided that they have an annual report from 2016 to 2020. The method used in this study is objective sampling, and the method used is panel data regression analysis. The conclusion of this study is that changes in company size, proliferation of ownership, and political ties have a significant positive impact on quality corporate governance.

Keywords : *Quality Corporate Governance, Political Connection, Firm Size, Diffused Ownership, Leverage, Sales Growth*

INTRODUCTION

RESEARCH BACKGROUND

Companies are the center of our economic system. Because they are involved in all levels and areas of society and create wealth, their actions can have impact through the life on entire population. As a social institution, companies must strict with governance rules and ethics. However, financial crisis and accounting scandals are increasing in the business world Dicko (2016a). The quality of corporate governance helps to assess whether a company is practicing to get good quality or bad quality. A company that has high profits may not apply good corporate governance, for example the case of "Enron" is an company owned by the United States that commits accounting fraud by recording financial statements stated that the company earning a huge profit, which in fact the company is experiencing loss. The purpose is to keep investors interested in their shares. Haji & Mubaraq (2015) also find that some companies in Malaysia doesn't apply a good corporate governance code as well. After the global financial crisis in general, it can be realized that companies with low governance have the potential to have long macroeconomic and distributional consequences (Claessens & Yurtoglu, 2013).

The relationship link political connections and quality corporate governance has attracted the attention of various companies, because it is believed that the two have a strong relationship in business. Previous research on politically connected firms tended to check their financial performance and found that politically connected firms performed better than those non- political ties (Li & Xia, 2013). A company is considered to have political relations if one of its members or shareholders has been a member of the government, an exclusive officer, and a member of the board who has contributed to politics. (Dicko & Breton, 2013a; Dicko & Breton, 2013b; Dicko & El Ibrami, 2013). In a market economy system, corporate governance is one of the issues observed by organizational regulators.. Good governance can add value to the company by improving company performance, asset allocation, and efficient company management (Claessens & Yurtoglu, 2013). However, from the research of Houston *et al* (2014), politically connected firms can create value because they are mostly receive a number of benefits, including contracts, loans, and looser oversight associated with implementing their regulatory requirements. Therefore, researchers are interested in conducting research with the title "**Analysis the Effect of Political Connections and Ownership Structure on Quality Corporate Governance**".

RESEARCH PURPOSES

The research objectives achieved in this study include the following :

a. To determine the effect of political connections on quality corporate governance.
b. To determine the effect of diffused ownership on quality corporate governance.
c. To determine the effect of firm size on quality corporate governance.
d. To determine the effect of leverage on quality corporate governance.
e. To determine the effect of sales growth on quality corporate governance.

LITERATURE REVIEW

The definition of quality of corporate governance is a code of governance, rules, regulations, and best practices related to governance to assess whether the company is managing well or poorly. The quality of corporate governance must also consist of the demands of a public ethos, good decision making, giving reasons according to legal regulations, efficiency, stability, and the principle of expediency. Corporate governance is a system that regulates, control and oversees the business process to increase share value, as well as a form of concern for shareholders, employees and the surrounding community (Tunggal, 2013). Corporate governance helps to stabilize company performance, ensure accountability and transparency (Faruqi *et al*, 2019). Governance frameworks are in place to promote the efficient use of resources and equally demand accountability for the management of these resources. Good corporate governance can improve an organization's ability to attract financial resources and increase citizens' trust in the organization (Wang & Sarkis, 2017). Most shareholder organizations use corporate governance mechanisms to manage conflicts that may arise between managers and shareholders.

Effect of Firm Size on Quality Corporate Governance

Firm size is a method that been used a lots in corporate finance research (Belghitar *et* al, 2019). There are several company sizes related to corporate finance. Large companies have multiple stakeholders, so the policies will have a greater effect on large companies than small companies. For investors, the company's policy will have connections for cash flow prospects in the future. From the research Dicko, (2016) firm size, is very significantly associated with the overall governance index, showing that larger firms bear a higher governance risk. The research of Franck & Sundgren, (2012) also found that there was a significant positive relationship between size and IGQS. This relationship can be attributed to the fact that governance mechanisms consume corporate resources, while large corporations have better investment capacity and ensure the quality of corporate governance.

H1: Firm size has positive significant on quality corporate governance.

Effect of Leverage on Quality Corporate Governance

Lots of studies have assuming the empirical evidence on the effect of financial leverage on firm performance (Graham *et al*, 2015; *Fosu et al*, 2016; Ellul & Pagano, 2019) and evidence related to corporate governance (Doan & Nguyen, 2018). Companies with good corporate governance are unlikely to be leveraged and may have good financial performance. Corporate governance influences a company's performance and leverage. Obviously, companies with weak or low governance may need higher or lower leverage, while companies with good corporate governance can reduce agency costs and leverage. A company's leverage can change by looking at changes in governance indicators. In another sample, well-managed (well-managed) corporate profits and leverage are positive (negative) correlated. This is further enhanced by the consequences of using interaction variables to control feedback from under-regulated companies (Butt, 2020).

H2: Leverage has positive significant on quality corporate governance.

Effect of Sales Growth on Quality Corporate Governance

Large companies with relatively complex structures and high sales growth require Large companies and companies with high sales growth have relatively complex structures that require clear and well-functioning corporate governance. This means that companies need to ensure a high degree of internal control, thereby achieving high IGQS in order to continue operating and increase sales and dollars over the years. Based from the research, there is a positive relation between a firm’s sales growth and quality corporate governance (Adane *el* at, 2018).

H3: Firm size has positive significant on quality corporate governance.

Effect of Diffused Ownership on Quality Corporate Governance

Aggarwal *et al*, (2009) other experts argue that need more stable external funding than companies with dispersed ownership, which are heavily funded by major shareholders, so only companies with dispersed ownership are interested in good governance practice. In this case, the quality of governance also depends on the structure of ownership. The dispersed ownership structure is arguable, but economists believe that some developed markets such as the European continent and Japan and companies listed on the Chinese framework are very concentrated. (Abdallah & Ismail, 2017). In fact, generally speaking, the ownership structure of a company is an important element of its governance. In companies with concentrated ownership, conflicts of interest are different because there is no separation of ownership and control. Research conducted by Kusumawati (2006) that dispersed ownership influences the disclosure of corporate governance. The finding Adane *et al*, (2018) shows that, among the Ethiopian sample companies, those with more widespread ownership have taken more action that could improve the quality of internal governance. Therefore, the measurement of distributed ownership has a negative sign.

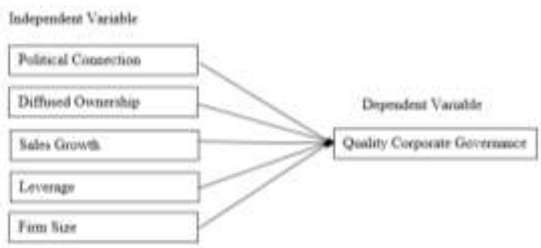
H4: Diffused ownership has no significant on quality corporate governance.

Effect of Political Connections on Quality Corporate Governance

Few studies have focused on the relationship between political connections and corporate governance mechanisms. Claessens & Yurtoglu (2013) explicitly acknowledge the impact of corporate political relationships on the mechanisms and effectiveness of corporate governance. By identifying the impact of political ties on firm and national performance indicators, the literature explains why developed countries have made little progress on firms. Corporate governance reforms include changes in control and power structures, and the resulting loss of wealth. This means that politically connected companies have sufficient resources to avoid good governance practices without negatively impacting their economies. studied the relationship between political relations and corporate governance, particularly in the areas of corporate finance and accounting. It was revealed by Shen *et al*, (2015) that political connections are more than prevalent in poor governance firms. Several papers look at the interaction between ownership structures and political connections (Al *et* al, 2016).

Shen *et al*, (2015) using a sample of companies listed on the Taiwan Stock Exchange from 1997 to 2009, the relationship between corporate governance and corporate governance, and whether corporate governance and political relationships are mutually alternative or complementary. I investigated. I looked it up. They found that companies with strong corporate governance were less interested in developing political ties, and companies with political ties were more likely to show poor governance practices. These results show that political parties are adversely affecting the quality of corporate governance. The result of Neselevska (2013) research show that political connections do not affect corporate governance in Ukraine, which is influenced by several factors such as the majority of corporate governance is not well regulated, foreign ownership is not significant (which can be a source of implementing good corporate governance practices), the alternation of corporate governance practices with political connections at all levels and finally the significant measurement error associated with political connection data may bias the results. Dicko, (2016) political connections significantly influence the overall governance index (with a positive sign). This indicates that being politically connected is associated with a higher index and thus with greater levels of governance quality risk.

H5: Political connections has a positive significant on quality corporate governance.



Picture 1. Research Model

RESEARCH METODOLOGY

The type of data tested is quantitative data using SPSS application to perform panel data regression testing. The data tested are quantitative and secondary data from the company's annual reports from 2016 to 2020 on the Indonesia Stock Exchange website and from the respective company websites. The dependent variable that being research is quality corporate governance. The independent variables studied are political connections, firm size, leverage, diffused ownership, and sales growth.

Quality corporate governance is the dependent variable in this research, the variable is measured by using the governance quality score by (Adane *el* at, 2018). The measurement of the independent variables used in this study is presented in the following table:

Variable	Measure
Firm Size	Natural logarithm of the total sales.
Leverage	this represents total debt/total assets.
Sales Growth	Measure by sales of this year minus sales of laste year divided by sales of last year.
Diffused Ownership	Dummy Variable 0 = individual shares < 20% 1 = individual shares > 20%
Political Connections	Dummy Variable 0 = non-political connection 1 = political connection

Picture 2. Variable Measurement

Data Analysis Method

Panel regression data analysis is a method in which research is used to test the effect of the hypothesized variables that have been formulated The research is to explain the relationship between research variables where the independent variables in this study are firm size, leverage, sales growth, diffused ownership and political connections. Quality corporate governance is the dependent variable used in this study. The object of research used in this study are companies listed as public companies and listed on the Indonesia Stock Exchange and the sampling criteria are (1) public companies listed on the Indonesia Stock Exchange for banking between 2016 and 2020, and (2) financial statements annually on December 31. The collected data was tested using the Statistical Product and Service Solution software version 25 for Windows.

RESULTS AND DISCUSSION

Statistic Descriptive

Variable	Min	Max	Mean	Std. Deviation
QUALITYCG	0,33	1,00	0,68	0,16
FIRMSIZE	10,80	14,55	12,48	0,69
SALESGROW	-0,56	0,68	0,03	0,18
LEVERAGE	0,04	1,02	0,45	0,21

Source: Data processing, 2021.

The results of the statistic descriptive whose data were sourced from the recording of the company's annual report documents that obtained 526 data were as follows. Descriptive statistical test results value that the governance quality variable has a minimum value of 0.33, namely from Intanwijaya Internasional Tbk, PT Citra Tubindo Tbk and PT Tempo Scan Pacific Tbk, the maximum value is 1, namely from Sido Muncul, PT Mandom Indonesia, Lotte Chemical Titan Tbk, PT Multi Bintang Indonesia Tbk, Barito Pacific Tbk and Fajar Surya Wisesa Tbk the average value is 0.6836 and the standard deviation value is 0.16. The company size variable has a minimum value of 10.80, namely Gudang Garam Tbk, a maximum value of 14.55, namely from PT Astra Internasional Tbk, the mean value of 12.48, and the standard deviation of 0.68906. The sales growth variable has a minimum value of -0.56 from Trias Sentosa, a maximum value of 0.68 from Alakasa Industrindo Tbk with a mean of 0.03, and a standard deviation of 0.18. The leverage variable has a minimum value of 0.04 from PT Tunas Alfin Tbk, a maximum value of 1.02 from Siantar Top, a mean value of 0.45, and a standard deviation of 0.21.

Statistic Descriptive – Dummy Variable

	Frequency	Percentage	Percentage Valid	Percentage Cumulative
NON-POLC	317	70,5	70,5	70,5
POLC	155	29,5	29,5	100.0
Total	526	100.0	100.0	

Source: Data processing, 2021.

According to the results of the political connection variable test, as an independent variable in the form of a dummy, it shows that from the 526 sample data used, there are 317 sample data or 70.5% non-political connection data, where a company has no political relationship, while 155 data others or as much as 29.5% proven that the company has political connection.

	Frequency	Percentage	Percentage Valid	Percentage Cumulatif
NON-DIFO	136	25,9	25,9	25,9
DIFO	390	74,1	74,1	100.0
Total	526	100.0	100.0	

Source: Data processing, 2021.

According to the test results of the distributed ownership variable, as an independent variable in the form of a dummy, it shows that of the 526 sample data used, there are 136 sample data or 25.90% of data that are non-diffused ownership, where a company whose individual ownership shares exceed 20%, while the other 390 data or as much as 74.10% proved companies with individual ownership shares of 20% or <20%.

Outlier Test

The outlier test is a test carried out to find out if there is a deviation from the average value of each data per variable by using the z-score value. Elimination of z-score points with values greater than 3 and less than -3. The results obtained from the outlier test are as many as 39 observational data that do not meet the reasonable limits.

Multilinearity test

This multicollinearity test is a linear relationship between the independent variable X in the Multiple Regression Model.. If the VIF value is less than 10, it can be stated that the related data is free form multicorrelation. The following is a table of the results of the multicollinearity test.

Description	VIF	Result
FIRMSIZE	1,31	Free from multicorrelation
LEVERAGE	1,03	Free from multicorrelation
SALESGROWTH	1,02	Free from multicorrelation
DIFFUSEDOWN	1.04	Free from multicorrelation
POLCON	1.28	Free from multicorrelation

Source: Data processing, 2021

Coefficient Determination Test

Model	R	*R Square*	*Adjusted R Square*	*Std. Error of the Estimate*
1	0,434[a]	0,188	0,180	0,14427

Source: Data processing, 2021.

The coefficient of determination test (R2) is a test that serves to show the level of influence of the independent variable on the dependent variable. The test results show the R2 value of 0.188. This shows that the independent variable has an effect of 19% on the dependent variable while 81% is influenced by other variables that are not included in the linear regression model.

T Test

Model		*t*	*Sig.*
1	*(constant)*	-4,610	0,000
	FIRMSIZE	9,502	0,000
	LEVERAGE	0,080	0,936
	SALESGROWTH	0,777	0,437
	DIFFUSEDOWN	4,140	0,000
	POLCON	-4,591	0,000

Source: Data processing, 2021.

To determine the effect of political connection, leverage, firm size, diffused ownership and sales growth on the quality of corporate governance, a t-test must be performed. Based on the table below, the results of the t-test are as follows. (1) the firm size variable has a t-test significance value of 0.000, because the value is <0.05, then H1 is accepted. The result is that firm size has a significant influence on the quality of corporate governance. (2) the leverage variable has a t-test significance value of 0.936, because the value is > 0.05 then H2 is rejected. The result is that firm size does not have a significant effect on the quality of corporate governance. (3) the sales growth variable has a t-test significance value of 0.437, where the value is > 0.05 so H3 is rejected. The result is that sales growth does not have a significant effect on the quality of corporate governance. (4) the diffused ownership variable has a t-test significance value of 0.000, where the value is <0.05 so H4 is accepted. The result is that diffused ownership has a significant positive effect on the quality of corporate governance. (5) the political connections variable has a t-test significance value of 0.000, where the value is <0.05 so H5 is accepted. The result is that political connections have a positive and significant influence on the quality of corporate governance.

F Test

Model		*Sum of Squares*	*df*	*mean Square*	*F*	*Sig.*
1	*Regression*	2,508	5	0,502	24,099	0.000[b]

Model		***Sum of Squares***	***df***	***mean Square***	***F***	***Sig.***
	Residual	10,823	520	0,021		
	Total	13,331	525			

Source: Data processing, 2021.

To find out whether the independent variable has an overall effect on the dependent variable, an f test will be carried out and the results of the research test show that the independent variable has a significant influence on the dependent variable because it has a value <0.05 and it is also known that quality corporate governance can be predicted with firm size, leverage, sales growth, diffused ownership and political connections.

CONCLUSION

The conclusions from the tests that have been carried out are as follows. (1) Firm size has positive significant effect on quality corporate governance. (2) The leverage has no significant effect on quality corporate governance. (3) sales growth has no significant effect on quality corporate governance. (4) Diffused ownership has positive significant effect on quality corporate governance. (5) Political connections have a positive and significant impact on quality corporate governance,

Based on the test results and the conclusions that have been drawn, the researchers recommend that: (1) Expand the scale of the sample studied so that the results obtained are more accurate. (2) Adding variables that have an influence on the dependent variable. (3) Expanding the object of research to include companies outside Indonesia.

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