

The effect of good corporate governance and political connection on firm value

(Study at manufacturing companies listed on the Indonesia stock exchange 2015-2020)

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ABSTRACT

This study aims to examine the effect of good corporate governance and political connections on firm value. The research sample uses 342 observation data of manufacturing companies listed on the Indonesia Stock Exchange. The analytical method used is multiple linear regression. The results showed that simultaneously good corporate governance and political relations have an effect on firm value. Partially, institutional ownership, audit committee, political connections and firm size have no effect on firm value. Independent commissioners and ROA have an effect on firm value.

Keywords: *firm value, good corporate governance, political connection, firm size, ROA.*

INTRODUCTION

This study aims to determine how the influence of good corporate governance and political connections on firm value. Maximizing the value of the company is one of the goals of the establishment of a company, besides that the other goal is to gain profits and prosper the welfare of shareholders. The value of the company can be measured using the market price of the company's stock, with this reflecting the investor's assessment of the barometer of the company's performance (Harefa, 2015). What happened in 2019, several shares of the manufacturing sector companies experienced a decline. From the decline in stock prices, resulting in a decrease in the value of the company.

In addition to the stock market price, Good Corporate Governance is a factor that affects the value of the company. According to Bandiyono (2019) good corporate governance has an important role in increasing company value. Previous research has linked good corporate governance with firm value. However, we found inconsistent results in a number of studies. According to research conducted by Haryati et al. (2021)

good corporate governance through the measurement of public share ownership, shows that the higher the ownership owned by the public, the higher the value of the company. In addition, good corporate governance as measured by the audit committee means that the greater the number of audit committees in the company means the better the audit committee's supervisory function on the performance of company management so as to increase the value of the company. Subsequent research was conducted by Adithya (2016) which showed that good corporate governance as measured by institutional ownership, the composition of independent commissioners, and the size of the board of directors had an influence on firm value. This means that the greater the number of institutional ownership and the board of commissioners, the more effective the monitoring of performance is, so that it affects the value of the company. In addition, the larger the size of the board of directors, the greater the likelihood that the company's strategy will be achieved. A good corporate strategy will affect the company's profit and have an impact on increasing the demand for company shares, which of course will increase the value of the company.

Different from the results above, research conducted by Riana & Iskandar (2017) shows that good corporate governance as measured by the board of directors, independent commissioners and audit committee has no effect on firm value. In this study, increasing the number of the board of directors can cause ineffectiveness in decision making in a company. Then the independent commissioner in this study showed the ineffectiveness of the supervisory function of the independent board of commissioners in reducing the level of manipulation caused by management. In addition, the audit committee in this study shows that the existence of an audit committee does not guarantee that the company's performance will get better.

In addition to good corporate governance, political connections are factors that affect the value of the company. Politically connected companies are companies that are in some way politically connected or seek to be close to politicians or governments. Having political connections within the company can provide benefits that can be used as a way to increase the value of the company.

According to research conducted by Patriarini (2020) that political connections have a significant effect on firm value. This means that companies that have political connections are considered by investors to have advantages that can be used as a way to increase stock prices. Similar research was conducted by Maulana & Wati (2019), that political connections have an influence on firm value. This shows that companies that have political connections allow them to have better performance than other companies, such as can provide a competitive advantage for companies such as better access, easy funding for loans, dan lower tax rates. However, the research above is not in line with research conducted by Dewanti (2019), which shows that political connections have no effect on firm value, because some investors consider politically connected companies to have poor performance, so investors choose not to invest their capital in politically connected company. We try to fill this gap and provide evidence from manufacturing companies listed on the Indonesian Stock Exchange. We also try to answer our primary research question, is there any relation between good corporate governance, political connection and firm value?

This research is expected to contribute in several ways. First, this study provides empirical evidence for the development of literature on good corporate governance, political connections, and firm value. Second, this research is expected to be an input for investors in considering the governance carried out by the company and the political connections that exist in the company, as well as making the right decision on their investment.

LITERATURE REVIEW

Agency theory

This study can be viewed from the perspective of agency theory, to describe the relationship between good corporate governance, political connections, and firm value. The concept of agency theory is that there is a relationship between the principal and the agent, the principal employs the agent to carry out tasks related to the interests of the principal and if the agent does not act in accordance with the interests of the principal,

there will be an agency conflict that causes agency costs (Jensen and Meckling, 1976; Aljana & Purwanto, 2017).

The relationship between good corporate governance and firm value

Previous research has shown that good corporate governance is related to firm value. Haryati et al., (2021) examines the effect of corporate governance and political relations on firm value, in the results of his research that corporate governance as measured by public share ownership and audit committee has a positive effect on firm value. Adithya (2016) examines the effect of good corporate governance on firm value. In his research, good corporate governance as measured by institutional ownership, the composition of independent commissioners, and the size of the board of directors have an effect on firm value. Based on the results of this study, we suspect that good corporate governance has an effect on firm value.

H1 : Good corporate governance with institutional ownership has an effect on firm value.

H2 : Good corporate governance with independent commissioners has an effect on firm value.

H3 : Good corporate governance with an audit committee has an effect on firm value.

The relationship between political connections and firm value

Previous research has shown that political connections are related to firm value. Bandiyono (2019) researched on The Effect of Good Corporate Governance and Political Connection on Value Firm, in his research results political connections have a positive and significant influence on firm value. Pratama & Setiawan (2019) researched about Political Connection and Firm Value in Indonesia, in the results of his research that political connections have a significant effect on firm value in the non-financial sector. Other studies that support the same results are research conducted by Patriarini (2020), examining the Effect of Political Connections on firm value. can be used as a way to increase stock prices, so that it affects the value of the company. Based on the results of this study, we suspect that political connections have an effect on firm value.

H4 : Political connections affect the value of the company.

Research conducted by Riana & Iskandar (2017) shows that the size of the company can be seen from the total assets owned by a company, the greater the total assets owned by the company, the higher the value of the company. Based on this, we formulate the following hypothesis :

H5 : Firm size has an effect on firm value.

Research conducted by Setiawan & Ridwan (2015) shows that a high ROA reflects a good company position so that the value given by the market is reflected in the stock price of the company will also be good. Based on this, we formulate the following hypothesis :

H6 : ROA has an effect on firm value.

METHODS

The study used a sample of manufacturing sector companies listed on the Indonesia Stock Exchange for the period 2015 to 2020. The total number of manufacturing sector companies listed on the Indonesia Stock Exchange until 2020 is 193 companies. After that, we filtered according to the purpose of the analysis using a purposive sampling technique with the need for measuring data used for each research variable and consistently submitting financial reports for 6 consecutive years and presented in rupiah. Based on this, we obtained 57 companies, so our total observations are 342. Data processing in this study using the Eviews 12 application.

Research Model

To answer the hypothesis, the following model is used:

$$Y = \alpha + \beta_1 X_1 + \beta_1 X_2$$

Information :

Y = Firm Value

X₁ = Good Corporate Governance

X₂ = Political Connection

Measurement of good corporate governance

We measure good corporate governance using 3 proxies. The first is institutional ownership, following Riana & Iskandar (2017) we use institutional ownership as a proxy for good corporate governance, with institutional-owned shares divided by outstanding shares. Formulated as follows :

$$\frac{\sum \text{institutional stock}}{\sum \text{outstanding shares}} \times 100\%$$

The second measurement is the independent board of commissioners. Following Riana & Iskandar (2017) we use independent commissioners as a proxy for good corporate governance, by dividing the total independent commissioners by the total board of commissioners. Formulated as follows :

$$\frac{\sum \text{Independent Commissioner}}{\sum \text{board of Commissioners}} \times 100\%$$

The third measurement is the audit committee. Following Riana & Iskandar (2017) we use the audit committee as a proxy for good corporate governance, with a total audit committee. Formulated as follows :

$$\sum \text{audit committee member}$$

Measurement of political connections

We measured political connections using a dummy variable. Referring to the research Haryati et al., (2021) we use a dummy variable by assigning a number 1 for companies that have political connections and 0 for companies that are not politically connected.

Firm value measurement

Referring to research Dewanti (2019), company value can be proxied by price to book value (PBV), namely by dividing the price per share by the book value per share.

Book value per share is obtained from the division between total equity and the number of shares outstanding. Formulated as follows :

$$PBV = \frac{\text{price per share}}{\text{book value per share}}$$

Control variable measurement

To control for certain firm characteristics, we use control variables consisting of firm size and ROA. Following Riana & Iskandar (2017) we use the natural logarithm of total assets as a measurement of firm size. Referring to Setiawan & Ridwan (2015), ROA is a comparison between net income and total assets.

RESULTS

First, we performed a descriptive analysis through the mean, maximum value, minimum value, and standard deviation. The purpose of this analysis is to complete our main test, to see to what extent these variables differ from their mean, maximum and minimum values of each variable. The following table is the result of descriptive statistics.

Based on the table 1, the information obtained on the mean of good corporate governance as measured by institutional ownership, independent commissioners, and audit committees have values of 0.61, 0.39, and 0.30 respectively. With a maximum value of 0.92, 0.52, and 4.00, respectively. The minimum values are 0.01, 0.25, and 2.00, respectively. And the standard deviation of each is 0.76, 0.65, and 0.12. In addition to good corporate governance, we obtained information on political connections, with an average value of 0.017, a maximum value of 1.00 and a minimum value of 0.00, and a standard deviation of 0.13. The average value of the company is 0.32 with a maximum value of 73.85, a minimum value of -0.02, and a standard deviation of 10.99. Other information related to the average firm size and ROA control variables are 28.31 and 0.03 respectively. The maximum values are 33.35 and 0.19, respectively. The minimum values are 25.72 and -0.08, respectively. As well as the standard deviation of 1.61 and 0.16, respectively.

Table 1. Descriptive statistical analysis

	Institutional Ownership	Independent Commissioners	Audit Committee	Political Connections	Firm Size	ROA	Firm Value
Mean	0.619	0.391	0.306	0.017	28.310	0.033	0.326
Max	0.927	0.527	4.000	1.000	33.350	0.197	73,850
Min	0.012	0.258	2.000	0.000	25.720	-0.089	-0,020
Std. Dev.	0.763	0.651	0.122	0.131	1.615	0.167	10.999

The Influence of good corporate governance and political connection on firm value

To test the hypothesis, we conducted a panel test. This test is conducted to determine the extent to which good corporate governance affects firm value. first, we performed the chow test and hausman test to select the right model. Then we analyze the test results to get the right model. The results of the chow test and hausman test obtained a significance of both 0.00. Based on these results, we chose the fixed effect model as the appropriate model.

Table 2. Panel data testing with fixed effect model

<i>Dependent Variable: Firm Value</i>		
Variable	Coefficient	Fixed Effect Model
C	+50.784	0.076
Institutional Ownership	-0.387	0.390
Independent Commissioners	+21.115	0.000
Audit Committee	-0.878	0.303
Political Connections	+2.087	0.377
Firm Size	-1.857	0.064
ROA	+7.945	0.000
F-statistic		0.000
Adjusted R-squared		0.771

Based on the table 2., the p-value of the F-statistic is 0,000000 with a significance level of 0.05, it can be concluded that good corporate governance, political connections, company size and ROA have a simultaneous effect on firm value. Other than that, things that can be concluded from the table above are that the variable of good corporate governance as measured by institutional ownership has no effect on firm value, these results are not in accordance with the theory which says that high institutional ownership can monitor the company's performance in using the assets owned by the company. This is due to the information asymmetry between investors and managers, making it difficult for institutional investors to obtain adequate information and manage manager performance, the results of this study are in line with research conducted by Sofyaningsih, (2011).

Good corporate governance as measured by audit committee has no effect on firm value, based on research, this is because the existence of an audit committee does not necessarily guarantee that the company's performance will increase, this is in line with research conducted by Riana & Iskandar, (2017) which shows that the audit committee has no effect on firm value. Except that good corporate governance as measured by the independent commissioner has a significance of 0.0000 at the 0,05 level with a positive direction. The results of this study are in line with Adithya (2016), the more boards there are commissioners who are in the company, can monitor the company's performance more effectively, and this affects the value of the company. Meanwhile, political connections has no effect on firm value, from the results of research conducted, firm value is not influenced by political relations.

The success of a company does not depend on the existence of political relations between the company and government officials or political parties. This also means that some investors believe that the presence of parties in a company is detrimental to the company's performance, and it is possible that the company will work dishonestly, so investors choose not to invest their shares in companies that have political connections, the results of this study are in line with the research conducted by Haryati et al., (2021) that political connections has no effect on firm value. And the control variable Firm size

shows a significance of 0.0649 with a significance level of 0,05, so firm size has no effect on firm value. In this study, company size is calculated based on total assets. Assets are assets owned and used by a company to carry out its operations. However, total assets can result from an increase in liabilities. If a company spends a lot of debt on its operations, there is a risk of reducing the returns it generates, especially if its debt is higher. This is highly avoided by investors because they expect a return on their invested capital, the results of this study are in line with research conducted by Setiawan & Ridwan, (2015) which states that firm size has no effect on firm value. ROA shows a significance of 0.0000 at the 0,05 level in a positive direction. The results of this study are in line with Hernomo (2017), companies can use their assets effectively and efficiently to increase their value and generate significant profits. High profits, stable company performance and good future prospects attract investors to invest in the company.

Based on the table, the results of the linear regression equation are :

- a. If Institutional Ownership = -0.387, it means that based on this research, if other variables are fixed and institutional ownership has increased by one unit, then the firm value will decrease by -0.387.
- b. If the Independent Commissioner = 21.115, it means that based on this research, if the other variables are fixed and the independent commissioner has increased by one unit, then the firm value will increase by 21.115.
- c. If the Audit Committee = -0.878929, it means that based on this research, if the other variables are fixed and the audit committee has increased by one unit, then the firm value will decrease by -0.878.
- d. If political connection = 2.087, it means that based on this research, if other variables are fixed and political connection increases by one unit, then the firm value will increase by 2.087.
- e. If the size of the company = -1.857, it means that based on this study, if the other variables are fixed and the size of the company has increased by one unit, then the value of the company will decrease by -1.857.

- f. If $ROA = 7.945$, it means that based on this research, if other variables are fixed and ROA has increased by one unit, then the firm value will increase by 7.945.

DISCUSSION

Our study provides evidence of how good corporate governance proxied by independent commissioners affects firm value, namely the more independent commissioners in a company, the more effective and efficient monitoring of company performance will be. Our study aims to determine the effect of good corporate governance and political connections on firm value. For this purpose, we use data from all manufacturing sector companies that consistently publish financial reports for the 2015-2020 period on the Indonesia Stock Exchange. We collected a total of 342 observations to investigate whether good corporate governance and political connections affect firm value. Our test results conclude that Good Corporate Governance, Political Connections, Company Size and ROA have a simultaneous effect on firm value. Other than that, good corporate governance as proxied by institutional ownership and the audit committee has no effect on firm value, but good corporate governance proxied by independent commissioners has a positive effect on firm value. Meanwhile, political connections has no effect on firm value. In addition, the control variable measured by firm size has no effect on firm value, while ROA affects firm value with a significance level of 0,05.

This research is expected to contribute in several ways. First, this study provides empirical evidence for the development of literature on good corporate governance, political connections, and firm value. Second, this research is expected to be an input for investors in considering the governance carried out by the company and the political connections that exist in the company, as well as making the right decision on their investment.

Our research has limitations, namely regarding the time dimension, we only collect data from 2015 to 2020. For further research, we suggest collecting data with a longer time dimension so that it can expand and deepen the study.

CONCLUSION

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