CORPORATE GOVERNANCE ON CONGLOMERATES POLLITICALLY CONNECTED

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ABSTRACT

The paper aims to explain literature review and phenomenon about relationship between political connection and commissioner board effectiveness with conglomerates performance listed at Indonesia Stock Exchange. Strong political connections on conglomerates in Indonesia become an indication of poor corporate governance. Many officials active and non-active sitting as commissioners board on conglomerates indicated that political connections with the authorities in order to obtain benefit political connections among various facilities, such as the ease of access to funding, access gained government procurement contracts, obtaining large subsidies and waivers tax rates, access to the licensing trade, security guarantees on investment companies and other conveniences. They ignore good corporate governance which the board of commissioners as monitoring functions for management act as a political rent-seeking. Based on literature study and phenomenon, this paper result a model about the relationship of political connection and commissioners board effectiveness with conglomerates performance.

Keywords : Political Connection, Commissioner Board Effectiveness, Conglomerates Performance.

1. Introduction

Conglomerates position in developing countries is very strong. This is due to the concentration of economic power in the hands of a small group of large conglomerates (Claessens et al., 1999). The same conditions occurred in Indonesia, where the company's contribution to GDP Indonesian conglomerate is huge. With a small number (only 0.01%) of the total companies in Indonesia, conglomerates contributed enormously to the GDP of Indonesia at 44.4% (BPS, 2009). In fact, of the total 510 companies listed on the Stock Exchange in 2014, there were 116 conglomerate companies listed in the Indonesia Stock Exchange that controls more than 70% of the total market capitalization of the Stock Exchange (Data processed: IDX, 2015).

Table 1. Market and Conglomerates Capitalization on IDX

Year	Amount of Companies in IDX	Market Capitalization (Billion IDR)	Δ% Market Capitalization	Amount of Conglomerates	Conglomerates Market Capitalization (Billion IDR)	Δ% Conglomerates Market Capitalization	Conglomerates Market Capitalization (%)
2005	339	801,253	-	70	571,759	-	74,43
2006	344	1,249,075	78,32	74	952,449	66,58	76,25
2007	383	1,988,326	77,62	81	1,543,407	62,05	77,62
2008	396	1,076,491	-59,08	86	819,174	-46,92	76,10
2009	398	2,019,375	115,1	89	1,592,975	94,46	78,88
2010	420	3,247,097	77,07	101	2,443,101	53,37	75,24
2011	440	3,537,294	11,88	107	2,421,675	-0,88	68,46
2012	462	4,126,995	24,35	109	3,072,352	26,87	74,45

2013	483	4,219,020	3	115	3,052,272	-0,65	72,35
2014	510	5,228,043	33,06	116	3,744,046	22,66	71,61%

Source: Data IDX Processed, 2015

Based on table 1 above, in 2005 from 339 listed companies on the Indonesia Stock Exchange there are 70 conglomerates which controls 74.43% of the total market capitalization. For more details, graph 1.1 below describes the fraction conglomerate that controls the amount of market capitalization in Indonesia.

Chart 1. The Comparison of Company on IDX and Conglomerates

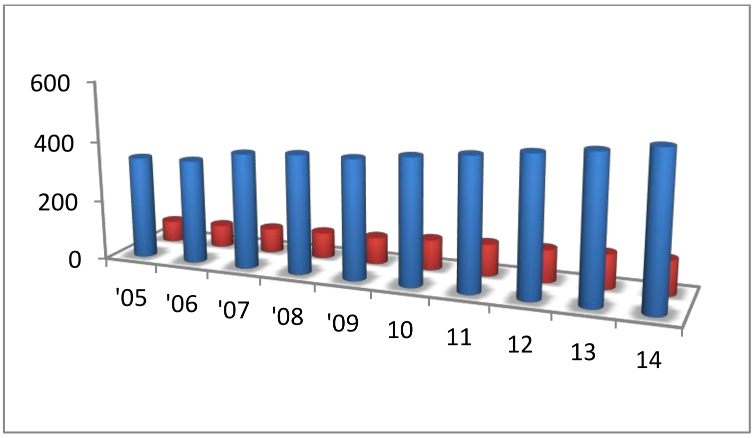
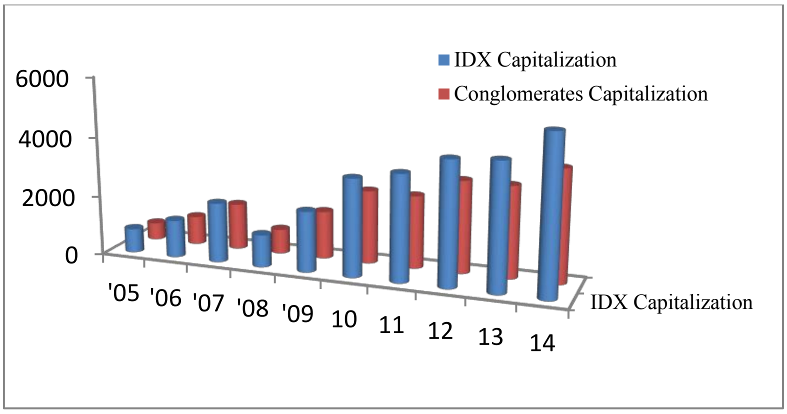


Chart 2. The Comparison of Market Capitalization on IDX and Conglomerates



Source: Data IDX Processed, 2015

In 2005, from 339 listed companies on the Indonesia Stock Exchange there are 70 conglomerates which control 74.43% of the total market capitalization. In 2006-2014 conglomerates dominate the market capitalization consecutively amounted to 76.25%, 77.62%, 76.10%, 78.88%, 75.24%, 68.46%, 74.45%, 72,35% and 71.61%. In 2008, the total market capitalization and conglomerate capitalization in Indonesia decreased very significantly, as a result of the global crisis (sub-prime mortgages) which also have an impact on the Indonesian economy in particular sectors of finance (capital markets). The market capitalization conglomerate dropped from Rp 1543.4 trillion in 2007 to Rp 819.2 trillion in 2008, down by 46.92% (data processed: IDX, 2015). The phenomenon of declining capitalization of the company in 2008 when the global crisis reinforces the findings of Claessens et al. (2001) in which when a crisis occurs, diversified company has a poor performance.

In 2009, the conglomerate capitalization increase into 1592.97 trillion from 819,17 trillion, or increased 94.46%. In 2014 conglomerate capitalization of Rp. 3744.05 Trillion increased 22.66% from the previous year and the highest value for the whole year of observations. The increment of conglomerate capitalization in 2009 is attributed to the economic recovery after the global crisis and also supposed caused by the legislative and presidential elections in Indonesia, as well as a significant increase in 2014. There is an indication of increasing market value of conglomerates have political connections with the winner of the election party and the President, especially in large companies and State-owned firms. Table 1.2 below illustrates the increase in the market capitalization of companies connected to politics:

Table 2. Market Capitalization on Politically Connected Firm

Firms	Market Capitalization (Million IDR)			Market Capitalization (Million IDR)		
	2008	2009	Δ%	2013	2014	Δ%
ASII	42.710.148	140.477.929	228.91	275.288.161	300.590.382	9.19
BBCA	80.128.782	119.576.798	49.23	236.688.096	323.597.006	36.72

BBNI	10.386.279	30.242.402	191.18	73.662.193	113.756.804	54.43
BBRI	56.388.245	94.323.371	67.27	178.851.424	287.395.737	60.69
BMRI	42.517.901	98.683.525	132.10	183.166.666	235.666.666	28.66
DILD	1.243.902	1.990.243	60.10	3.265.244	6.737.805	106.35
KIJA	689.043	1.639.923	137.88	3.883.424	5.969.407	53.72
KLBF	4.062.405	13.202.818	225.01	58.593.902	85.781.473	46.40
LPLI	52.219	160.349	207.69	561.807	702.259	25.00
MEDC	6.231.684	8.164.506	31.02	6.998.148	11.996.825	71.43
PGAS	42.718.965	94.541.881	121.31	108.480.749	145.449.049	34.08
PLIN	8.520.000	8.875.000	4.17	6.816.000	13.312.500	95.31
PTBA	15.898.509	39.746.274	150.01	23.502.144	28.801.648	22.55
RAJA	63.194	118.235	87.30	703.296	1.376.015	95.65
SMDR	450.329	622.272	38.22	474.892	2.431.776	412.07
SMGR	24.764.096	44.782.976	80.84	83.931.008	96.090.624	14.49
TLKM	135.719.030	185.876.064	36.96	208.766.835	281.273.820	34.73
UNVR	59.514.000	84.311.500	41.67	198.380.000	246.449.000	24.23

Sources: IDX Processed, 2015

Based on the data in table 2 above the value of conglomerates market capitalization increased significantly of the post-election either in 2009 or in 2014. The increased in the company's share price indicates that the entrepreneurs and corporate leaders in developing countries such as Indonesia with the level of corruption is still high, it is believed that the political connections provide lubrication to achieve the objectives of the company, so they do significant efforts to foster political connections in order to achieve the company's growth, they realized that the connection politics is a valuable resource for the company (Fisman, 2001; Li et al., 2012).

The entrepreneurs competing hunt political rents to build a business empire, so do not be surprised if a lot of entrepreneurs in Indonesia are turning to politics and even became the top leaders of political parties. Besides, as a businessman, they were ambitious to become the ruler of this country. They ignore good corporate governance which the board of commissioners as monitoring functions for management act as a political rent-seeking, it is seen by many among the state officials who served as an independent commissioner, commissioner, or even as the president commissioner concurrently independent commissioner.

Strong political connections in Indonesia become an indication to poor corporate governance, so it is no wonder if many people have attributed the crisis in Indonesia and several other Asian countries in 1997 with poor corporate governance (Johnson et al., 2000). The global financial crisis is beginning to be felt in the US in the summer of 2007 and the impact spread to other countries in the world in mid-2008 (sub-prime mortgage crisis), also touted as evidence of disruption of the stability of the financial system as a result of weak implementation of corporate governance (Kirkpatrick, 2009).

This study was an extension of previous research to formulate new research propositions based on theories, previous research and phenomenon. The purpose of this study was to produce a new model that was more complete, thorough and wide-ranging in conglomerates.

The rest of this paper is structured as follows. In section 1 we describe introducing, in section 2 we describe theoretical study including a discussion of the events we study. Section 3 and 4 describe the propotition and research model and section 5 concludes.

2. Theoretical Study

2.1. Conglomerate Performance

According to Weston and Mansinghka (1971: 921), conglomerate are companies that perform broadly diversified program which achieved more by external mergers and acquisitions as compared to the internal development of the Company. While Kerr & Darroch (2004: 21) defined conglomerates or a multi-industry company (unrelated diversification), as a company which consists of businesses that does not have a relationship with each other.

Various studies and opinions on the conglomerates still continues to be debated, whether the conglomerate can increase firm value or actually reduce it. On the one hand, a lot of empirical research, starting with the research Reid (1968), a breakthrough Rumelt (1974) is a breakthrough learning (ground-breaking study), strategy, structure and economic performance, Melicher and Rush, 1973; Ferris et al., 2003; Walker, 2003; Yan, 2006; as well as including several studies that followed up, more commonly found poor performance and conglomerate value. But, on the other hand a number of multi-industry companies, such as General Electric and 3M, are often used as examples of the best company management in the world (Kerr & Darroc, 2004). Weston and Mansinghka (1971) proves that not all the conglomerates have a poor performance, the results of the research indicate that companies are called conglomerate is an efficient and rational organization. This is supported by Keister (1998) which documented that the group affiliation in China linked to performance and better productivity in the latest of 1980s, other evidence supported by Hoshi et al. (1991) and Kerr & Darroch (2004). Kerr and Darroch find a group of companies that are clearly identified indicating superior performance in medians, means, measurements of upper quartile, and the average market-to-book ratio.

Performance of conglomerates in this paper uses a market-based approach (market performance) and profit-based approach (accounting performance) (Niessen & Ruenzi, 2007; Deng et al., 2012). Accounting performance is a calculation of the effectiveness and efficiency of a company within a certain time to achieve optimal results. If the performance is good, then the company has to run its operations effectively and efficiently, while market performance indicators reflect the company's expectations and the manifestation of long-term performance (Deng et al., 2012). Market performance indicators (market performance) is proxied by Tobin's Q, and profit-based approach (accounting performance) is proxied by Return on Assets (Niessen & Ruenzi, 2007; Deng et al., 2012).

2.2. Political Connection

Indonesia and President Soeharto has become popular in the development political connections literature. There is strong evidence that Soeharto sought to protect companies that have political connection with the regime, especially the conglomerates. Fisman (2001) showed that at the end of the Soeharto government and bad news about the health of President Soeharto hit the Indonesian stock market, and companies are close to Soeharto suffered a negative return. As well as the performance of the company is closely connected to Soeharto experiencing deteriorating performance during the financial crisis (Leuz and Gee, 2006).

The company has political connection if one of the shareholders or the top management of the company is a member of parliament, ministers or heads of state, or who have a close relationship of them as political party officials (Faccio, 2006: 370). In countries with weak legal system and the high level of corruption, political connections are very valuable to the company; even political connections did not escape from the country that has a strong legal system such as in the USA (Goldman et al., 2009). Goldman et al. found that political connections have a broad effect on the value of the firm in the United States Presidential election of 2000 and a parliament member who won by Republican party.

Faccio (2006) supports the findings of Goldman et al. (2009), using a sample of 47 countries, Faccio documented that political connections are very common in countries with high levels of perceived corruption, even companies in Indonesia ranks first as a sample that has the largest political connections with members of parliament (DPR), minister, president, and relations relatives. Strengthening results of Faccio (2006), Transparency International Institute survey documented that Indonesia is one of the 15 most corrupt countries in the 146 countries that are ranked in 2004 through Perception Corruption Index (CPI). In 2007, Indonesia ranked number increased to 145 out of 180 countries, ranked 110 out of 178 countries in 2010, ranked 100 out of 183 countries in 2011, ranking 118 out of 176 countries in 2012, and ranks 114 out of 177 in the year 2013.

The findings of the Global Corruption Barometer 2013 (GCB, 2013) puts the parliament and political parties as corrupt institution in the perception and experience of the peoples. Parliament was ranked the second most corrupt (after Police department) of 12 public institutions are assessed, while political parties is ranked 4th most corrupt. The phenomenon of political connections that occur in Indonesia at this time due to the political reform that occurred in 1998. After the reform, the number of parties increasing of the three political parties in the elections of 1997 (PPP, Golkar and PDI) to be 48 political parties at the time of the 1999 elections, 24 political parties in the elections of 2004, 38 national political parties and 6 local parties in 2009, and 12 political parties in 2014 (Indonesia Election Commission, 2014). The increasing of the number of political parties have led to a vacancy to fill the position of party leader/official.

The increasing need for political figures in political parties and the absence of a ban for members of parliament (DPR/DPRD) concurrent positions as directors, commissioners and shareholders of the company (Law No. 32/2004 and Law No. 27/2009) resulted in many employers and top management companies compete to go into the politics. The businessmen still believe that political connections are still considered as a way to enable them to obtain the privileges of the executive, legislative, and judicial.

2.3. Board of Commissioners Effetiveness

Corporate governance control mechanism can be done through internal and external mechanism. External control mechanism is a control of company based on market mechanism (the market for corporate control) (Walsh and Seward, 1990), while the internal mechanism is a control performed by the board of commissioners, including committees under it, the board of directors, management and shareholders, or through an incentive scheme that is attractive and competitive for the management (Fama and Jensen, 1983).

The effectiveness of the implementation of commissioners tasks are proven to be influenced by several characteristics, namely independence, activities, size and competence of the board of commissioners (Zhou and Chen, 2004). Several previous studies have supported the effectiveness of the role of the board of commissioners that is influenced by their own characteristics.

Board of Commissioners have a very important role in the implementation of good corporate governance. Board of Commissioners in carrying out its duties are required to be independent and always pay attention to the company’s interest and other stakeholders above personal or group interest. In Indonesia, practically members of board of commissioners do not often carry out their oversight role which is very essential to the board of directors. Commissioners are often considered to have no benefit, it can be seen in the fact that many members of board commissioners do not have ability and can not demonstrate their independences. In many cases, board of commissioners also failed to represent the interests of other stakeholders other than the interests of the majority shareholder. This condition occured because the selection process of board of commissioners tend to be less democratic where commissioners candidates are often selected by the management so they do not dare to give criticism to the management. Even some commissioners in companies in Indonesia have background as active and inactive state and government officials.

2.4. Control Variable

Control variables are variables that are used to support research but not hypothesized, the function of this variable is to increase the level of accuracy of the research to be conducted. In this paper, will be used as control variables are firm size, growth and firm age. Firm size is one of the forces that affect the company's ownership structure. This view is based on the fact that the size of the company is generally related to the resources used in the operation of the company. The larger the company the greater the company's capital resources and greater market value (Demsetz and Lehn, 1985). Investors saw that sales growth is a sign that the company has increased profits, it can attract investors to invest in the company and enhance shareholder value. Firm age showed that the company survive and compete, as well as take advantage of business opportunities in an economy. By knowing the age of the company, it will note the extent to which the company can survive in the business world. The longer or older the company, the more experience the company's business and the company know more the challenges and conditions of the real business world, so any policies implemented by the company would be more optimal and by itself can improve the performance or value of the firm.

3. Research Propositions

3.1. The Effect of Board Effetiveness to Conglomerate Performance

The effectiveness of task of the board of commissioners is shown to be affected by several characteristics, namely independence, activities, size and competence of the board of commissioners (Zhou and Chen, 2004). Lefort and Urzua (2008) documented that the independence and professional of the board has positive effect on firm value. These results are supported by Vania and Supatmi (2014) who examined the financial institutions in Indonesia, where a growing number of independent directors, the company's value in the proxy by Tobin's Q is higher. Likewise Ma and Tian (2009), an independent board will able to improve the company's performance effectively.

Ramos and Olalla (2011) found that board meetings have positive effect to the company’s performance, but this effect will be weakened when the family business is run by its founder. Brick and Chidambaram (2010) found that the activity of the board through board monitoring has increased the firm value.

Chtourou et al. (2001) documented that the board of commissioners with a large number is able to monitor financial reporting more effectively. This indicates that a large board size can monitor the financial reporting process more effectively than the small board size. Ramos and Olalla (2011) found a positive effect between the size of the board with the company's performance in the family company which not led by its founder, and found a negative effect between the size of the board on the performance when the company is run by its founder.

Beasley (1996) showed that the competence of the board members is affected by the experience, knowledge, and understanding of the financial statements and the financial information of other companies. The competence will affect the ability of the board of commissioners in performing its control function optimally. Jeanjean and Stolowy (2009) found that accounting expertise which average has negative effect to type of board (two-tier versus one-tier) and growth opportunity, but positively effect to the independence of the board, ownership concentration and institutional ownership.

Based on the literature review and previous studies of the mechanism of corporate governance that have been stated above, there is no researcher which focuse to examine the role and influence the effectiveness of the board of commissioners to the conglomerate performance, and based on the explanation of empirical mentioned above, it can be made Proposition 1 as follows:

"More effective board of commissioners that measured by independent commissioners, board activity, board size and competence of the board of commissioners, then conglomerate performance will be greater".

3.2. The Effect of Board Effetiveness on Political Connected Firm to Conglomerate Performance

Political connections proved capable of providing preferential treatment and services in a variety of access, namely: access to funding (Khawaja and Mian, 2005; Leuz and Gee, 2006; Faccio, 2006; Yeh et al., 2010; Boubakri et al., 2012; Tian & Cheung, 2013), access to government procurement contracts (Goldman et al., 2009), public policy (Bunkanwanicha and Wiwattanakantang, 2009), trade Licensing (Mobarak & Purbasari; 2005), as well as access to the company's IPO (Francis et al., 2009). The literature also showed that political connections affect the performance and value of firms (Faccio, 2006; Leuz and Gee, 2006; Fisman, 2001; Goldman et al.; 2006; Boubakri et al., 2008; Fan and Wong, 2007; Wong, 2010; Do et al., 2013; Ang et al., 2013).

Political connections would be more valuable in conditions of high levels of corruption and weak regulation, both small companies and large companies (Faccio, 2006; Do et al., 2013). Wong (2010) proved that the company experienced an increase in ROE and MBV ratio after joining the Election Committee. This means that political connections were able to improve the company's performance as measured by ROE and MBV Ratio. Do et al. (2013) supports research Wong (2010), where political connections were able to increase the value of the firm at the state level.

Deng et al. (2012) examined the effect of diversification in the companies that have political connection and its influence on companies in China. Deng et al. (2012) found that political connections have a positive and significant impact on the performance of the company. The influence of political connections on conglomerate (unrelated diversification) is stronger than the related diversification. But conglomerate (unrelated diversification) connected politics will have a negative impact on the performance of the company in the future (long-term) that can damage the company. The company which has a market value of political connection tend to diversify in unrelated field (unrelated diversification).

Reinforce the findings of Deng et al. (2012), Ang et al. (2013) examined the companies connected to politics in Singapore. Ang et al. found that within three years after the IPO, mostly found companies that are independent of political connections. But after the sample is broken down into several categories of industry, found the director of the company which has political connection and positive and significant impact on the value of the firm.

Based on literature review and previous researches, which found more positive influence of political connections on firm value (Johnson and Mitton, 2003; Faccio, 2006; Goldman et al.; 2006; Boubakri et al., 2007; Wong, 2010; Cooper et al., 2010; Ang et al., 2013; Do et al., 2013). Supported by the results of Li et al. (2012) which showed a strong positive correlation between political connections and the company diversification. Political connections can be more valuable for the company diversified in unrelated fields (conglomerate). Deng et al. (2012) supports the findings of Li et al. (2012), where the performance of conglomerate (unrelated diversification) which has political connection is greater than the performance of the company which has political connection with related diversification. These results indicated that political connections to the conglomerate are more valuable than non-conglomerate.

Many officials active and non-active sitting conglomerate as board of commissioners on conglomerates indicated that political connections with the authorities in order to obtain benefit political connections among various facilities, such as the ease of access to funding, access gained government procurement contracts, obtaining large subsidies and waivers tax rates, access to the licensing trade, security guarantees on investment companies and other conveniences. All these conveniences will ultimately affect the firm value.

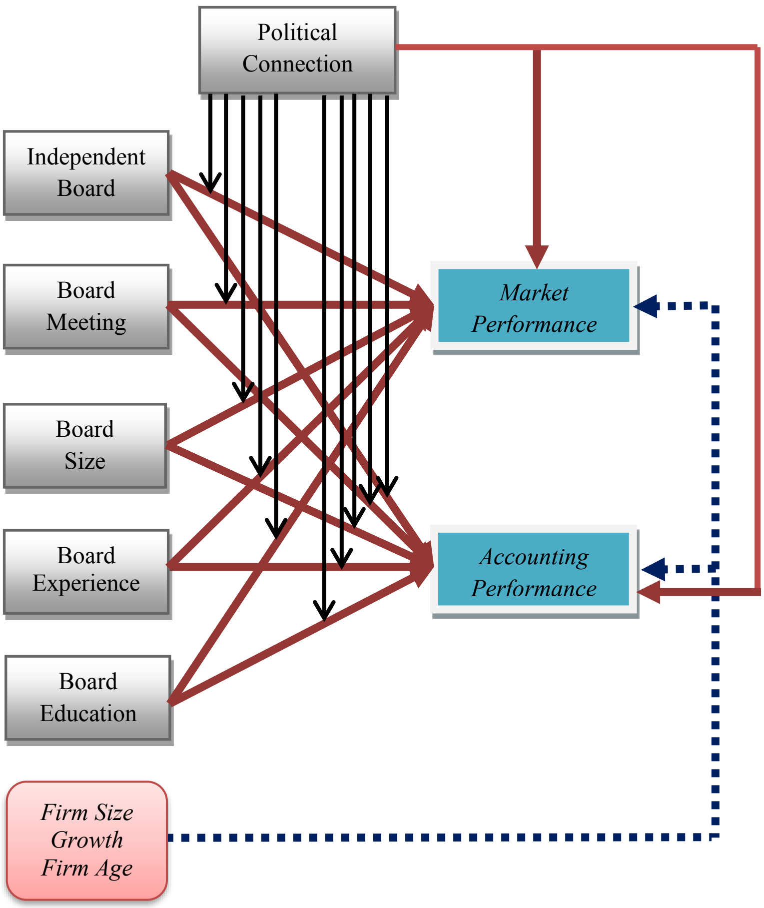
The existence of the government officials as independent commissioner, commissioner or even as president commissioners concurrently as independent commissioner in the company have at least a benefit as a source of information for companies in getting information about government policies, especially during the change of regime that led to the insider trading.

Based on empirical explanation of the foregoing, it can be made Proposition 2 and 3 as follows:
"The more political connection of the company then the higher performance of conglomerate"
"The effectiveness of the Commissioners Board on conglomerates Politically Connected more Effective than non politically connected"

4. Research Model

Based on literature studies, phenomenon and propositions are built on, it can be made a research model as follows:

Figure 1. Research Model



Source: Based on the Theoretical Concept Development

Based on the model of the research and development of a conceptual model of the above proposition, then proposed some research hypothesis in this paper. The filing of this hypothesis used as a basis in preparing the empirical model of research based on the results of research conducted by previous researchers.

H_1 : There is positive affect on the board of commissioners effectiveness consisted of independence, board size, board meeting, board experience and board education on conglomerate value

H_2 : Political connections affect positively to the conglomerates value

H_3 : Board of commissioners effectiveness on Conglomerates Pollitically Connected more affect on the conglomerate value than Conglomerates non politically connected.

To test the hypotheses of the study, we used regression model as follows:

$$Tobin'sQ_{it} = \alpha_1 + \beta 1 Pol_{it} + \beta 2 Indep_{it} + \beta 3 Actv_{it} + \beta 4 BdSize_{it} + \beta 5 Exprc_{it} + \beta 6 Educ_{it} + \beta 7 Pol * Indep_{it} + \beta 8 Pol * Actv_{it} + \beta 9 Pol * BdSize_{it} + \beta 10 Pol * Exprc_{it} + \beta 11 Pol * Educ_{it} + \beta 12 Size_{it} + \beta 13 Growth_{it} + \beta 14 Age_{it} + \varepsilon_{it1} ...(1)$$

$$ROA_{it} = \alpha_2 + \beta 15 Pol_{it} + \beta 16 Indep_{it} + \beta 17 Actv_{it} + \beta 18 BdSize_{it} + \beta 19 Exprc_{it} + \beta 20 Educ_{it} + \beta 21 Pol * Indep_{it} + \beta 22 Pol * Actv_{it} + \beta 23 Pol * BdSize_{it} + \beta 24 Pol * Exprc_{it} + \beta 25 Pol * Educ_{it} + \beta 26 Size_{it} + \beta 27 Growth_{it} + \beta 28 Age_{it} + \varepsilon_{it2} ...(2)$$

5. Conclusion

Entrepreneurs and corporate leaders in developing countries such as Indonesia with the level of corruption is still high, it is believed that the political connections provide lubrication to achieve the objectives of the company, so they do significant efforts to foster political connections in order to achieve the company's growth, they realized that the connection politics is a valuable resource for the company, It was supposed by the increment of conglomerate capitalization in 2009 and 2014 caused by the legislative and presidential elections in Indonesia. There is an indication of increasing market value of conglomerates have political connections with the winner of the election party and the President, especially in large companies and State-owned firms.

Strong political connections of the conglomerate in Indonesia become an indication of poor corporate governance. Many officials active and non-active sitting conglomerate as commissioners board on conglomerates indicated that political connections with the authorities in order to obtain benefit political connections among various facilities, such as the ease of access to funding, access gained government procurement contracts, obtaining large subsidies and waivers tax rates, access to the licensing trade, security guarantees on investment companies and other conveniences. Their presence in the conglomerate as an independent commissioner, commissioner, or even as the president commissioner have at least one benefits as a source of information for conglomerates to obtain information about government policies, especially during the regime change of leadership that led to the insider trading. All these conveniences will ultimately affect the firm value. They ignore good corporate governance which the board of commissioners as monitoring functions for management act as a political rent-seeking.

This studies presented above were a theoritical examination and that still needs further verification. Therefore, for further research were expected to conduct empirical research in order to prove whether the proposition and hypotheses can be accepted or rejected.

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