Print ISSN: 2288-4637 / Online ISSN 2288-4645
doi:10.13106/jafeb.2021.vol8.no6.0223

The Influence of Related Party Transaction and Corporate Governance on Firm Value: An Empirical Study in Indonesia*

Aulia Fuad RAHMAN[1], Yeterina Widi NUGRAHANTI[2]

Received: February 20, 2021 Revised: April 20, 2021 Accepted: May 02, 2021

Abstract

This study aims to examine the effect of political connections on firm value through related party transaction (RPT) as a mediator in the context of emerging Indonesian economy. This study also aims to investigate the moderating role of corporate governance mechanism on the relationship between political connections and RPT. The theory used as the basis for this research is agency theory. The corporate governance mechanism tested in this study consists of independent board of commissioners, institutional ownership and board of commissioner size. Tobin's Q is used to measure firm value. The population of this study is all companies listed on the Indonesia Stock Exchange in 2015–2018. Purposive sampling was conducted, and 271 non-financial companies (1,084 firm-years) were identified as the samples. For testing the hypotheses, panel generalized least square (GLS) using EViews 10 was used. The findings showed that political connection had a negative impact on firm value. The results also showed that RPT abnormal account receivables and RPT abnormal asset non-account receivable mediate the relationship between political connections and firm value. In addition, it is found that corporate governance mechanism, especially the proportion of independent board of commissioners and institutional ownerships, weakens the positive effect of political connection on RPTs.

Keywords: Firm Value, Political Connections, Related Party Transaction, Tunneling, Corporate Governance

JEL Classification Code: M40, M41, M49

1. Introduction

Research on firm value has received much attention in recent years. This attention is due to firm value becoming one of the main goals and concerns of owners, management and other stakeholders. One important research stream in this field is the investigation of the effect of political connections on firm value (Ang et al., 2013). This research proved that politically-connected firms obtain benefits such as easy access to debt, easy access to government contract, tax relief, increased market shares, and preferential treatment from government (Khwaja & Mian, 2005; Faccio et al., 2006; Benceikh & Taktak, 2017). The benefits of these political connections can ultimately increase performance and value of those firms.

However, political connections can also have negative impacts on company performance and firm value. This is because politically-connected boards undertake a lot of rent-seeking behaviors (Chen et al., 2011; Boubakri et.al., 2008; Ang et al., 2013) and tunneling to expropriate the minority shareholders (Qian et al., 2011; Cheung et al., 2009; Habib et al., 2017). In addition, politicians exacerbate agency problems by forcing managers to prioritize political goals over maximizing shareholder values (Chen et al., 2011; Wu et al., 2012).

Thus, previous empirical evidences regarding the impact of political connections on firm value shows inconsistent results. This gap in the research has become a concern in this study. It is expected that the inconsistency may be caused by the emersion of related party transactions (RPTs) as

***Acknowledgements:**
We are very grateful to Brawijaya University, MT. Haryono Street 165, Malang, Indonesia, for the funding provided for the publication of this article.

[1]First Author and Corresponding Author. Lecturer, Accounting Department, Faculty of Economics and Business, Brawijaya University, Indonesia [Postal Address: Brawijaya University, Jl. MT Haryono 165 Malang, Indonesia] Email: fuad_ub@ub.ac.id
[2]Lecturer, Accounting Department, Faculty of Economics and Business, Satya Wacana Christian University, Salatiga, Indonesia. Email: yeterina.nugrahanti@uksw.edu

© Copyright: The Author(s)
This is an Open Access article distributed under the terms of the Creative Commons Attribution Non-Commercial License (https://creativecommons.org/licenses/by-nc/4.0/) which permits unrestricted non-commercial use, distribution, and reproduction in any medium, provided the original work is properly cited.

mediation. RPTs can be used by politically-connected firms as a means of rent-seeking behavior and expropriation of minority shareholders.

Majority shareholders in family-owned firms tend to conduct RPTs to expropriate the wealth of minority shareholders (Cheung et al., 2009; Wahab et al., 2011). This is increasingly possible in Indonesia due to the weak system of law enforcement and investors' protection in Indonesia as well as the ownership concentration in certain families or individuals (Claessens et al., 2000). Therefore, politically-connected firms can carry out opportunistic RPTs for expropriating minority shareholders. If this happens, it is predicted that the firm value will decrease as politically-connected firms increase.

Although RPTs are often used for rent-seeking behaviors, previous studies have also shown that RPTs can be used to support efficient contracts (Kohlbeck & Mayhew, 2017). Chang and Hong (2000); Wong et al. (2015) found that RPT sales will increase profitability and firm value due to the increased efficiency. RPTs can also reduce information asymmetry between the parties conducting the transactions (Kohlbeck & Mayhew, 2017). In this sense, we predict that corporate governance mechanism plays an important role by means of monitoring function to reduce the opportunistic RPT in politically-connected firms. Corporate governance mechanisms can encourage efficient RPTs to improve firm value (Ryngaert & Thomas, 2007; Wahab et al., 2011).

This study aims at investigating (a) the impact of political connections on firm value, (b) the role of RPTs in mediating the effect of political connections on firm value, (c) the role of corporate governance mechanisms (independent board of commissioners, institutional ownership and the size of board of commissioners) in moderating the effect of political connections and opportunistic RPTs. This study contributes to the literature by adding mediating variable, which is related party transaction, in political connection-firm value relationship. This study also contributes to the literature by adding corporate governance mechanism as moderating variable in the relationship between political connections and opportunistic RPTs.

2. Literature Review and Hypothesis Development

2.1. Agency Theory

The separation between company' ownership and management causes an agency conflict between shareholders and managers (Jensen & Meckling, 1976). This agency conflict is known as type I agency conflict and generally occurs in companies with dispersed ownership structures. The ownership structure in Indonesia tends to be concentrated in certain shareholders and managerial positions that are generally held by the family of shareholders. This condition allows for type II agency conflict, namely, a conflict between majority and minority shareholders (Villalonga & Amit, 2006). Majority shareholders can expropriate minority shareholders, namely, using their control rights to maximize their own welfare by distributing wealth from minority shareholders (Claessens et al., 2000). The expropriation can be done through RPTs (Cheung et al., 2009).

2.2. Political Connections and Firm Value

According to Faccio et al. (2006); Wu et al. (2012); Habib et al. (2017), a company is said to have political connections if at least one of its top officers (board of directors, board of commissioners) or shareholders serves (has served) as: (a) regional head, minister, member of parliament, officer of governmental agency, or involved in political party; (b) has close family ties or close friendship with politicians; (c) has a military background.

This study uses agency theory (Jensen & Meckling, 1976; Villalonga & Amit, 2006) to discuss the effect of political connections on firm value. Political connections encourage majority shareholders (managers) to expropriate minority shareholders due to the following reasons (Qian et al., 2011). First, majority shareholders want to get benefit from political connections, at least it is equivalent with the cost they incur to build those connections. Second, politically connected firms face fewer regulatory constraints than non-politically connected firms. This expropriation will reduce firm value (Berkman et al., 2010).

Politically-connected firms face greater agency conflict than non-politically connected firms (Ling et al., 2016). The government and politicians can intervene firms to prioritize political objectives rather than maximize shareholder value (Wu et al., 2012; Benceikh &Taktak, 2017). Managers and the majority shareholders can expropriate minority shareholders using compensation schemes. Funds that should be paid to minority shareholders in the form of dividends can be transferred by managers (majority shareholders) to pay management compensation (Claessens et al., 1999). Politically-connected managers receive higher compensation, even though these managers and boards do not perform well (Ding et al., 2004).

Politically-connected firms have easier access to government resources. If the resources obtained by politically connected firms from the government are not used efficiently, it will have a negative impact on firms' performance. Intervention of politicians in the management followed by low managerial abilities of politicians will worsen firm' performance (Boubakri et al., 2012) and reduce firm value. Boubakri et al., (2008); Ang et al., (2013); Saeed et al., (2015) found that political connections have negative effects on firm value.

H1: *Political connections have negative effects on firm value.*

2.3. The Effect of Political Connections on Firm Value Mediated by Related Party Transactions

Referring to agency theory, the condition of a concentrated ownership structure in Indonesia allows majority shareholders to expropriate minority shareholders (Claessens et al., 2000). This expropriation occurs more in firms that are connected politically (Qian et al., 2011), which can result in a decrease in firm value (Berkman et al., 2010). One of the means used by politically-connected managers (majority shareholders) to carry out expropriation is related party transaction (RPTs). Politically-connected firms have a leniency preference for government regulations (Correia, 2014). This allows politically connected firms to regulate RPTs for the interests of majority shareholders. Thus, it is possible that RPTs can mediate the effect of political connections on firm value.

The leniency preference of politically-connected firms allows those firms to regulate transactions through tunneling, propping, or earnings management to meet the majority shareholders' interests (Cheung et al., 2009). Tunneling consists of asset acquisition, asset sale, asset swap, sale of goods and services and cash payment by companies listed on the stock exchange to related entities or private companies that are largely controlled by them. Through tunneling, majority shareholders tend to ask for legal protection from politicians (Berkman et al., 2010). Politically-connected firms tend to use opportunistic RPTs for tunneling because the more political connections the more benefits for the firms (Qian et al., 2011). However, these benefits can be enjoyed if a firm incurs large costs to maintain existing connections. This motivates firms to take over the resources of minority shareholders through RPTs (Habib et al., 2017). The tendency of politically-connected firms to perform tunneling will increase in countries with weak investor protection systems (Chen et al, 2011; Qian et al, 2011) , including in Indonesia (Leuz & Gee, 2006). Political connections increase RPTs Indonesia (Habib et al., 2017).

RPTs conducted by a politically-connected firm can decrease the firm's value, one of which the RPTs for providing loans. Banks provide loans to affiliated firms with an interest rate lower than the market rate which 33% of these loans defaulted and had 30% lower recovery rates than loans to unaffiliated firms (La Porta et al., 2002). The low interest rate and the high risk of default can reduce firms' performance and value. Friedman et al. (2003); Cheung et al. (2009) found that RPTs-tunneling had negative effects on firms' performance and value.

H2: *RPTs- tunneling mediates the effect of political connections on firm value.*

2.4. The Effect of Political Connections on Related Party Transactions Moderated by the Corporate Governance Mechanism

Several studies on the effects of political connections and RPTs have produced inconsistent findings. Wang and Lin (2016), Habib et al (2017) found that political connections increase RPTs, while Nodeh and Gerayli (2020) found that political connections decrease RPTs. Political connections increase RPTs in state firms and decrease RPTs in private firms (Ma et al., 2013). The inconsistencies in the results of previous studies are thought to be due to other factor that influences the causal relationship between political connections and RPTs. This factor is the corporate governance mechanism.

The corporate governance mechanism in the context of this study is a mechanism designed to reduce agency conflict between majority shareholders (managers) who are politically connected and minority shareholders. Corporate governance is proven to reduce agency conflict (Tran et al., 2020; Ngo & Le, 2021) and increase firm value (Skare & Hasic, 2016; Achim et al., 2016; Malik et al., 2021; Kanakriyah, 2021). Expropriation of politically-connected majority shareholders toward minority shareholders can be carried out in the form of RPTs. Thus, a corporate governance mechanism is expected to weaken the positive influence of political connections on RPTs. The proportion of independent commissioners, institutional ownership, and board of commissioners' size are forms of corporate governance mechanism (Weir et al, 2002).

The independent board of commissioners supervises management performance and acts independently without pressure from other parties. The more the number of independent boards of commissioners, the more difficult it is for politically connected to dominate decision-making that leads to expropriation of minority shareholders, including abusive RPTs (Jeon, 2019). Institutional investors generally own a large number of shares and have stronger power. The strength of institutional investors is the key to avoid collusion among majority shareholders (Bertin et al., 2012). Optimal oversight by institutional investors can reduce expropriation activities. Institutional ownership has been shown to have a negative effect on RPTs (Hwang et al., 2018).

The greater the size of the board of commissioners is, the less dominance of the politically-connected board in decision-making (Goodstein et al., 1994). The size of board of commissioners is proven to have negative effects on expropriation through tunneling activities because the board tends to choose optimal strategies for long-term interest of its firm (Selcuk & Sener, 2018). The more members of the

board of commissioners are the more networks, information and expertise the firm has (Goodstein et al., 1994). By using this expertise and information, the board of commissioners can suppress the efforts of the politically-connected board of directors to carry out expropriation using RPTs.

The corporate governance mechanism will supervise the majority shareholders and politically-connected directors, so that expropriation activities in the form of RPTs can be reduced. The corporate governance mechanism is expected to weaken the positive influence of political connections on RPTs-tunneling.

H3a: *The proportion of the independent commissioners weakens the positive influence of political connections on RPTs-tunneling.*

H3b: *Institutional ownership weakens the positive influence of political connections on RPTs-tunneling.*

H3c: *The size of the board of commissioners weakens the positive influence of political connections on RPTs-tunneling.*

3. Research Method

3.1. Samples and Data

The population consisted of all firms listed on the Indonesia Stock Exchange (IDX) for the period from 2015 to 2018. The samples were determined using a purposive judgment sampling, with the following criteria: (a) non-financial companies listed on the Indonesia Stock Exchange (IDX) for the period of 2015–2018; (b) companies that present their financial statements in rupiah currency; and (c) companies that have complete data used as a research variable in 2015–2018.

Corporate governance mechanisms, RPTs and financial data are obtained from annual reports published by the Indonesian Stock Exchange. The data related to political connection were collected from annual reports and tracking down the board of directors, board of commissioners, and company secretary' biography from the sites on Google; the Indonesian Republic House of Representative website (www.dpr.go.id); and the party website.

3.2. Variables

For the dependent variable, we use Tobins' *Q* (TOBIN = Equity Market Value + Total Debt) / (Equity Book Value + Total Debt) as the proxy of firm value (Berkman et al., 2009). The independent variable used in this research is political connection (PC). A company is said to have political connection if at least one member of the board of directors, board of commissioners, the shareholders are (former): (a) a president/head of local government/minister/member of parliament/officer in governmental organization/involved in political party; or (b) have close familial relationship with politicians (published in annual report); or (c) have military background (Faccio et al., 2006; Tao et al., 2017; Habib et al., 2017). This study uses the number of board directors, boards of commissioners, and shareholders who are politically connected in order to reflect the strength of the political connections owned by the company (Houston et al., 2014; Nugrahanti & Puspitasari, 2018).

The mediating variable used in this study is RPT-tunneling, consisting of normal RPT-tunneling and abnormal RPT-tunneling. Normal RPT-tunneling consists of RPT account receivable (RPT_AR= Account receivable-RPTs divided by total assets) and RPT non-account receivable (RPT_NAR= RPTs-asset other than account receivables divided by total assets). Abnormal RPT-tunneling consists of RPT abnormal account receivable (RPT_ARES) and abnormal RPT non-account receivable (RPT_NARES). RPT_ARES is the residual values of the RPT_AR regressions with SIZE (the natural logarithm of market capitalization), DEBT (total debt to total assets) and MV (market value of equity divided by book value of equity). RPT_NARES is the residual values of the RPT_NAR regressions with SIZE, DEBT, and MV (Habib et al., 2017).

The moderating variable used in this research is corporate governance mechanism, consisting of (a) proportion of independent board of commissioners (INDEP); (b) institutional ownership (INSTOWN: the percentage of shares owned by the institution divided by the total number of outstanding shares); and (c) the board of commissioners' size (BOARDS: number of personnel on the board of commissioners) (Manzaneque et al., 2016; Udin et al., 2017).

This study uses control variables consisting of firm size (SIZE = log total assets), leverage (LEV = debt to equity ratio), sales growth (GROWTH = $sales_t$ – $sales_{t-1}$ / $sales_{t-1}$), ROA, and audit quality (AUD = dummy variable, 1 when a firm was audited by Big-4 auditor; 0 otherwise).

3.3. Regression Model

Balanced panel data regression using EViews 10 is conducted for hypothesis testing. The testing of mediating variable is carried out by causal step regression (Baron & Keny, 1986; Namazi & Namazi, 2016). The testing of RPTs-tunneling (RPT_AR, RPT_NAR, RPT_ARES, RPT_NARES) as mediating hypothesis requires a significant influence from the political connection toward the firm value in equation 1, the political connection towards the RPTs in equation 2, and the RPTs to the firm values in equation 3.

The acceptance or rejection of mediating hypothesis of RPTs in the effect of political connections on firm value (H2) is as follows: a) If the probability of c1 coefficient in equation 3 remains significant (p-value < 5%) and does not change

compared to a1 coefficient in equation 1, the RPTs does not function as a mediating variable; b) If the probability of c1 coefficients in equation 3 decrease, but remains significant compared to coefficient a1 in equation 1, then the RPTs functions as a partial mediating variable; and c) If the c1 coefficients in equation 3 are lower than the a1 coefficient in equation 1 and become insignificant (p-value > 5%), the RPTs functions as a full mediating variable. The regression model to test the mediating hypotheses (H1 and H2) is as follows:

$$\text{TOBIN}_{it} = a_0 + a_1\text{PC}_{it} + a_2\text{SIZE}_{it} + a_3\text{LEV}_{it} + a_4\text{GROWTH}_{it} + e_{it} \quad (1)$$

$$\text{RPTt}_{\text{unit}} = b_0 + b_1\text{PC}_{it} + b_2\text{SIZE}_{it} + b_3\text{ROA}_{it} + b_4\text{AUD}_{it} + e_{it} \quad (2)$$

$$\text{TOBIN}_{it} = c_0 + c_1\text{PC}_{it} + c_2\text{RPTt}_{\text{unit}} + c_3\text{SIZE}_{it} + c_4\text{LEV}_{it} + c_5\text{GROWTH}_{it} + c_6\text{ROA}_{it} + e_{it} \quad (3)$$

The testing of moderating variables is carried out by interacting independent variable (PC) and the moderating variable (INDEP, INSTOWN, BOARDS). The regression model to test the moderation hypotheses (H3a, H3b, H3c) is as follows:

$$\text{RPTt}_{\text{unit}} = d_0 + d_1\text{PC}_{it} + d_2\text{INDEP}_{it} + d_3\text{INSTOWN}_{it} + d_4\text{BOARDS}_{it} + d_5\text{PC}_{it} * \text{INDEP}_{it} + d_6\text{PC}_{it} * \text{INSTOWN}_{it} + d_7\text{PC}_{it} * \text{BOARDS}_{it} + d_8\text{SIZE}_{it} + d_9\text{ROA}_{it} + d_{10}\text{AUD}_{it} + e_{it} \quad (4)$$

4. Results and Discussion

4.1. Descriptive Statistic

Based on the purposive sampling, this research acquired 271 samples. The period used in this study is four years, so there are 1084 observations.

Table 1 indicates that during 2015–2018, the samples engaged more RPTs-non account receivables than RPTs-account receivable. The average of Tobin's Q value is more than one. It implies that Indonesian companies utilize their capital effectively and investors value these companies higher than their book value. The result also shows that almost 50% of samples companies have political connections. The descriptive statistics indicate that institutional investors control 66.21% of the shares, which means Indonesian companies have a concentrated ownership environment.

4.2. Classical Assumption Test

This study uses panel data as it was the combination between of cross-section data (from 271 companies) and time-series data from the 2015–2018 period (four years). The hypothesis testing in this study was originally designed using structural equation modeling in the form of Ordinary Least Square (OLS). The use of structural equation modeling requires the fulfillment of several basic assumptions to produce the best estimate (Best Linear Unbiased Estimator-BLUE). This assumption includes normality, heteroscedasticity, multicollinearity, and autocorrelation (Gujarati & Porter, 2009).

Overall, the results of the classical assumption test indicate that the research data have problems in relation with heteroscedasticity and autocorrelation. To overcome this, the regression estimation of hypothesis testing uses the Generalized Least Square (GLS) method. The GLS method is an OLS method applied to variables that have been transformed into data that meet the standard least-square assumption. Estimators obtained from the GLS method are BLUE estimation (Gujarati & Porter, 2009).

4.3. The Effects of Political Connection on Firm Value

In order to test hypothesis 1, the testing result of equation 1 using the panel GLS method is presented in Table 2.

The testing result shows that political connections influence firm value negatively. This result is in line with previous study conducted by Boubakri et al. (2008), Saeed et al. (2015). Political connections trigger the majority shareholders to expropriate the minority shareholders in order to recover the costs they have spent in building the connections (Qian et al., 2011). The preference of reduced regulation, which is owned by politically-connected firms (Correia, 2014), enables the firms to expropriate or manage profit to meet the majority shareholders' interests (Cheung et al., 2009). It leads to cause in declining performance and firms values (Benceikh & Taktak, 2017).

Politically-connected firms face bigger agency conflict than non-politically connected firm (Ling et al., 2016). Either the government or politicians can interfere in a company to prioritize political and governmental goals over maximizing shareholders' values (Wu et al., 2012; Benceikh & Taktak, 2017). Those political and social goals will force politically-connected managers to increase their investment, although the investment lead to losses (Wu et al., 2012). As an example, politically-connected firms in Europe and United States are proven not efficient because they were forced by the government to employ more workers than the capacity in order to reduce the number of unemployment (Shleifer & Vishny, 1994). The inefficiency in the employee' paycheck can cause decrease in performance and firm values.

Table 1: Descriptive Statistic

Variables	Maximum	Minimum	Mean	Standard Deviation
TOBIN	87.4469	0.0007	1.9973	4.3895
PC	7	0	1.0461	1.48848
RPT_AR	0.4952	0	0.0174	0.0532
RPT_NAR	0.9206	0	0.0372	0.0908
RPT_ARES	0.4825	–0.0665	6.24E–18	0.0529
RPT_NARES	95.5161	–0.7879	7.38E–6	3.5891
SIZE	33.7349	19.1621	28.1129	2.1731
LEV	8.3708	0.0004	0.4908	0.3968
GROWTH	33.9789	–1	0.1465	1.2353
ROA	0.9209	–0.7213	0.0275	0.1767
INDEP	1	0.2	0.3978	0.1097
INSTOWN	0.9977	0	0.6621	0.2989
BOARDS	12	1	4.2288	1.7722
	N		**Percentage**	
AUD				
• Big 4	388		35.66%	
• Non-Big 4	700		64.34%	
PC				
• Exist	542		49.82%	
• Non exist	546		50.18%	

TOBIN: Tobins Q; PC: Political Connection. RPT-AR: RPTs-Account Receivable; RPT_NAR: RPTs- Non Account Receivable; RPT_ARES: RPTs Abnormal Account Receivable; RPT_NARES: RPTs Abnormal Non Account Receivable; SIZE: Firm size; LEV: leverage; GROWTH: Firm growth; ROA: Return on Assets; INDEP: Independent board of commissioners; INSTOWN: institutional ownership; BOARDS: Board size; AUD: Firm Auditor.

Table 2: Regression Result of Equation 1

Variable	Coefficient	*t*-stat	Decision
Constant	–11.596	–50.237***	–
PC	–0.1983	–20.139***	H1 accepted
SIZE	0.464	53.351***	Positive effect
LEV	0.902	28.822***	Positive effect
ROA	0.489	4.413***	Positive effect
GROWTH	–0.022	–1.329***	Negative effect
R^2: 73.32 %; Adjusted R^2; 73.2%; *F* stat: 592*** Variable dependent: Tobin's *Q*.			

**p-value < 0.05; ***p-value < 0.001. PC: Political Connection; SIZE: Firm size; LEV: Leverage; ROA: Return on Assets; GROWTH: Firm Growth.

The politically-connected boards in Indonesia tend to engage in rent-seeking activities to fulfill the majority shareholders' interests (Habib et al., 2017). The rent-seeking activities are conducted using the firm's asset, while the profit from the rent-seeking activity is used for the boards and majority shareholders' personal interests (Ling et al., 2016). The rent-seeking activities will reduce the firm's performance and value. As an example, a politically-connected board of commissioners forced the manager to bribe the politicians, so that the company could get tax breaks or a loan from the government, then the cash obtained was used to provide low interest loan for the board of commissioner or the affiliate firms (La Porta et al., 2002; Shastri & Kahle, 2003). The low interest level and the high risk of default can cause a decrease in performances and firm value.

4.4. The Effect of Political Connection to Firm Value Mediated by Related-Party Transaction

The mediation hypothesis testing requires a political influence on the RPTs-tunneling in equations 2; also, the effect of RPTs on firm value as in equations 3. The discussion is described as follows.

4.4.1. The Effect of Political Connection on Related Party Transactions (RPTs) Tunneling

The effect of political connection to the RPT-tunneling is presented in Table 3. The presented testing results include regression coefficients, *t*-value (in parentheses), and the level of significance. The testing result show that political connection has positive effect toward RPTs-tunneling, either in the RPTs-account receivables (RPTs_AR), RPTs-asset other than account receivables (RPTs_NAR), RPTs-abnormal account receivables (RPT_ARES), and RPTs-abnormal non-account receivables (RPTs_NARES). The influences of political connections on RPTs indicate that the requirement of the RPT tunneling mediation testing in the relationship between political connection and firm value has met the requirement.

4.4.2. The Roles of RPT Tunneling Mediation in the Effect of Political Connection on Firm Values

The decision-making process on whether the RPTs are a mediator between political connection and firm values requires political connection testing and RPT simultaneously as independent variables. The mediation testing result is presented in Table 4.

From the equations 3, it can be inferred that the RPT variables that meet the mediation testing are RPT_AR, RPT_ARES and RPT_NARES as those three show significant effect on Tobin's Q. The political connection coefficient in equations 1 is 0.1983. The testing result shows that the political connection coefficient decreases when it was tested as an independent variable with the RPT_ARES and RPT_NARES. Therefore, it can be inferred that the RPT_ARES and RPT_NARES partially mediate the effect of political connections on the Tobin's Q. Political connections can directly reduce firm values or through the RPTs-abnormal accounts receivable and RPTs-abnormal non-account receivables. Therefore, H2 is accepted and can be inferred that RPTs-tunneling can mediate the effect of political connection on firm values.

The result of this study supports the agency theory (Jensen & Meckling, 1976; Villalonga & Amit, 2006) that believes that the ownership structure conditions in Indonesia, which is centralized, enables the majority shareholders to expropriate the minority shareholders (Claessens et al., 2000). That expropriation happens more to politically-connected firms (Qian et al., 2011), and can cause reduced firm values (Berkman et al., 2010).

Politically-connected boards used RPTs for expropriating minority shareholders' wealth (Habib et al., 2017). The majority shareholders who implements tunneling tend to ask for law protection from the politicians (Berkman et al., 2010). Politically-connected firms tend to use opportunistic RPTs to conduct tunneling as more politically connected provides many benefits for the company (Qian et al., 2011). However, these benefits can be enjoyed if the company incurs bigger amount of costs to maintain the existing connections. This can motivate the company to take over the minority shareholders' resources using RPTs (Habib et al., 2017). These tunneling activity can reduce performance and firm values (Friedman et al. 2003; Cheung et al., 2009).

4.5. Moderation Effect of Corporate Governance Mechanism on Political Connection – RPT Tunneling Relationship

Some studies about the effect of political connections on RPT indicate inconsistent findings, such as in the studies conducted by Wang and Lin (2016); Habib et al (2017); Nodeh and Gerayli (2020); Ma et al., (2013). These inconsistencies are predicted as the result of corporate governance mechanism effects. The testing result of moderation effect of corporate governance mechanism (proportion of independent board of commissioners, institutional ownerships, and the board of commissioners size) on the relationship between political connection and RPTs is displayed in Table 5.

Table 3: Regression Result of Equation 2

Dependent Variables	Equation 2a	Equation 2b	Equation 2c	Equation 2d
	RPT_AR	RPT_NAR	RPT_ARES	RPT_NARES
Constant	–0.025 (–5.564)***	–0.1917 (–4.362)***	0.0008 (0.182)	1.874 (33.458)***
PC	0.0007 (2.943)***	0.0239 (21.070)***	0.0005 (2.368)**	0.023 (11.342)***
SIZE	0.0012 (7.293)***	0.008 (4.654)***	0.0003 (–2.072)**	–0.073 (–33.181)***
ROA	0.008 (4.705)***	0.059 (3.229)***	0.0003 (1.768)	–0.023 (–0.957)
AUD	0.0003 (0.353)	–0.053 (–6.753)***	0.0002 (0.261)	–0.110 (–11.294)***
Adjusted R^2	18.15%	31.93%	0.6%	92.76%
Nilai *F*	60.86***	127.66***	2.56**	3462***

**p-value < 0.05; ***p-value < 0.001. PC: Political Connection. RPT–AR: RPTs–Account Receivable; RPT_NAR: RPTs– Non Account Receivable; RPT_ARES: RPTs Abnormal Account Receivable; RPT_NARES: RPTs Abnormal Non Account Receivable; SIZE: Firm size; ROA: Return on Assets; AUD: Firm auditor.

Table 4: Regression Result of Equation 3

Mediating Variables	Equation 3a	Equation 3b	Equation 3c	Equation 3d
	RPT_AR	RPT_NAR	RPT_ARES	RPT_NARES
Constant	–11.564 (–46.33)**	–11.564 (–49.92)***	–11.69 (–48.730)***	–11.546 (–49.92)***
PC	–0.2023 (–16.97)***	–0.197 (–20.145)***	–0.196 (–17.29)***	–0.197 (–20.145)***
RPT_AR	2.142 (4.548)***	–	–	–
RPT_NAR	–	0.004 (1.0987)	–	–
RPT_ARES	–	–	1.645 (5.048)***	–
RPT_NARES	–	–		0.006 (2.42)**
SIZE	0.463 (49.57)***	0.457 (52.299)***	0.468 (52.055)***	0.462 (53.046)***
LEV	0.827 (20.218)***	0.896 (28.869)***	0.874 (22.237)***	0.897 (28.695)***
ROA	0.456 (4.473)***	0.457 (4.123)***	0.454 (4.407)***	0.474 (4.273)***
GROWTH	–0.035 (–2.288)**	–0.021 (–1.355)	–0.030 (–1.788)	–0.022 (–1.339)
Dependent Variable: Tobin's *Q*				
Adjusted R^2	71.06%	72.55%	72.64%	73.32%
Nilai *F*	443.8***	477.7***	479.82***	496.78***

**p-value < 0.05; ***p-value < 0.001. PC: Political Connection. RPT–AR: RPTs–Account Receivable; RPT_NAR: RPTs–Non Account Receivable; RPT_ARES: RPTs Abnormal Account Receivable; RPT_NARES: RPTs Abnormal Non Account Receivable; SIZE: Firm size; LEV: Leverage; ROA: Return on Assets; GROWTH: Firm Growth.

Table 5: The Regression Result of Equation 4

Dependent Variables	Equation 4a	Equation 4b	Equation 4c	Equation 4d
	RPT_AR	RPT_NAR	RPT_ARES	RPT_NARES
Constant	–0.014 (–3.12)***	–0.164 (–4.13)***	0.01 (3.19)***	1.77 (32.83)***
PC	0.0007 (0.53)	0.025 (3.31)***	0.0007 (0.52)	0.058 (5.519)***
INDEP	–0.018 (–5.21)***	–0.019 (–1.51)	–0.019 (–5.93)***	0.06 (3.08)***
INSTOWN	0.006 (5.08)***	0.028 (3.766)***	–0.005 (4.32)***	0.06 (6.54)***
BOARDS	–0.0007 (–3.18)***	0.003 (2.42)**	–0.0006 (–2.99)***	0.008 (4.04)***
PC * INDEP	–0.001 (–0.74)	–0.03 (2.42)**	0.0008 (0.462)	–0.07 (–4.801)***
PC * INSTOWN	–0.003 (–2.44)**	–0.011 (–1.69)	–0.003 (–2.53)**	–0.01 (–1.32)
PC * BOARDS	0.0004 (2.78)***	0.001 (1.59)	0.0003 (2.28)**	–0.001 (–1.27)
SIZE	0.001 (6.22)***	0.006 (4.32)***	–0.0006 (–3.82)***	–0.07 (–37.49)***
ROA	0.003 (2.36)**	0.032 (1.89)	0.004 (3.07)***	–0.006 (–0.24)
AUD	–0.00004 (–0.04)	–0.04 (–6.29)***	0.001 (2.152)**	–0.09 (–9.76)***
Adjusted R^2	13.21%	10.19%	9.98%	90.91%
Nilai *F*	17.44***	13.25***	12.98***	1081.63***

**p-value < 0.05; ***p-value < 0.001. PC: Political Connection. RPT–AR: RPTs–Account Receivable; RPT_NAR: RPTs–Non Account Receivable; RPT_ARES: RPTs Abnormal Account Receivable; RPT_NARES: RPTs Abnormal Non Account Receivable; INDEP: Independent board of commissioners; INSTOWN: institutional ownership; BOARDS: Board size; SIZE: Firm size; ROA: Return on Assets; AUD: Firm Auditor.

The testing result of RPT_AR and RPT_NAR shows that the institutional ownership weakens the positive influence of political connections on RPT_AR. Besides, the proportion of independent board of commissioner is proven to weaken the influence of political connections to RPT_NAR. The RPT_ARES testing show that institutional ownership weakens the positive effect of political connections on RPT_ARES. Besides, the proportion of independent board of commissioners weakens the positive effects of political connection on RPT_NARES. Therefore, H3a and H3b are supported and it can be implied that the corporate governance mechanism, especially the proportion of independent board of commissioners and institutional ownerships, weakens the positive effect of political connection on RPTs. On the other hand, the board of commissioners' size is found to strengthen the positive effect of political connection on RPT_AR and RPT_ARES, so H3c is rejected. Overall, it implies that corporate governance mechanism moderates the RPT mediating effect on political connection-firm value relationship.

The corporate governance mechanism is designed to control agency conflict (Tran et al., 2020; Ngo & Le, 2021) between the politically-connected majority shareholders (managers) and the minority shareholders. The expropriation done by politically-connected majority shareholders toward minority shareholders can be conducted using RPTs. The corporate governance mechanism is expected to be able to weaken the positive effect of political connection on the RPTs. The testing result indicates that the proportion of board of commissioners weakens the positive effect of political connection on RPT. The greater the number of independent board of commissioners, the more difficult for the board of commissioners and the politically-connected board of commissioners to dominate in the decision-making process, which is directed to expropriation of the minority shareholders, including to limit abusive RPTs (Jeon, 2019). Generally, institutional investors have a big number of shares and have stronger power. The optimal control that is carried out by institutional investors to the politically-connected board or managers can reduce expropriation activities, including expropriation in a form of RPTs (Hwang et al., 2018).

The board of commissioners' size is proven to strengthen the positive effect of political connection on RPT. The size of board of commissioners implicates on the difficulty to coordinate and communicate among board members, so the supervision function does not work effectively. The minimum supervision on the board of commissioners enable politically-connected managers to conduct opportunistic RPT. Besides, in a concentrated ownership structure like in Indonesia, the firm management in general is carried out by the shareholders and their family. The familial relationship between the politically connected managers and the board of commissioners has made it easier for the managers to make a decision that will give benefits for their family. Therefore, the higher the number of board commissioners, the stronger the positive influence of political connection on RPTs.

5. Conclusion and Limitations

This research aims to prove the effect of political connection on firm values using RPTs as the mediator. This study also aims to evaluate the moderation role of corporate governance mechanism in the relationship between political connection and RPT. Although there are a lot of studies about the effect of political connection on firm values, this study contributes by adding RPT as a mediator variable and corporate governance mechanism as a moderation, which is rarely studied, especially in Indonesia. The hypothesis testing results show that political connections negatively impact firm values, besides RPT is also proven to mediate the effect of political connections on firm values. The testing result also indicates that the proportion of independent board of commissioners and institutional ownership weaken the positive effect of political connection on RPT. It implies that corporate governance mechanism moderates the RPT mediating effect on political connection-firm value relationship.

The limitation of this study is that political connection, in this study, is seen from the board of directors, the board of commissioners, and direct shareholders. It is suggested for future studies to expand the political connection criteria to the ultimate shareholders in a firm, as most corporate ownership structures in Indonesia are the pyramid-like ownership structure (Claessens et al., 2000).

The result indicates that political connection is proven to lower firm values. On the other hand, this study also proves that PRT tunneling mediates the effect of political connection on firm values. Based on those results, actual and potential investors have to be careful when investing in politically-connected firms and have high RPTs, as it can result in the low firm value. In addition, the investors and creditors are suggested to invest on a company that has a high proportion of independent board of commissioners and a company, which has high institutional ownership as that corporate mechanism, can weaken the positive effect of political connection on RPTs tunneling. The investors and creditors are also suggested to be more careful when investing in companies that have a high number of board of commissioners because the size of board of commissioners can strengthen the positive effect of political connection on RPT.

References

Achim, M. V., Borlea, S., & Mare, C. (2016). Corporate governance and business performance: Evidence for The Romanian Economy. *Journal of Business Economics and Management*, *17*(3), 458–474. https://doi.org/10.3846/16111699.2013.834841

Ang, J. S., Ding, D. K., & Thong, T. Y. (2013). Political Connection and Firm Value. *Asian Development Review May*, 1–45. https://doi.org/2139/ssrn.1934346

Baron, R., & Keny, D. (1986). The moderators of variable distinction in social psychological research: conceptual, strategic and statistical consideration. *Journal of Personality and Social Psychology, 51*(6), 1173–1182. https://doi.org/1037//0022-3514.51.6.1173

Benceikh, F., & Taktak, N. B. (2017). The effect of political connections on the firm performance in a newly democratised country. *Mediterranean Journal of Social Sciences, 8*(4), 40–46. www.mcser.org/journal/index.php/mjss/article/view/9992/9625

Berkman, H., Cole, R. A., & Fu, L. J. (2010). Political connections and minority shareholder protection: evidence from securities market regulation in China. *Journal of Financial and Quantitative Analysis, 45*(6), 1391–1417. https://doi.org/1017/S0022109010000608.

Bertin, J. M., López-Iturriaga, F. J., & López-de-Foronda, Ó. (2012). Does the influence of institutional investors depend on the institutional framework? An international analysis. *Applied Economics, 44*(3), 265–278. https://doi.org/1080/00036846.2010.502112

Boubakri, N., Cosset, J., & Saffar, W. (2008). Political connections of newly privatized firms. *Journal of Corporate Finance, 14*, 654–673. https://doi.org/1016/j.jcorpfin.2008.08.003

Boubakri, N., Cosset, J. C., & Saffar, W. (2012). The Impact of Political Connections on Firms' Operating Performance and Financing Decisions. *The Journal of Financial Research, 35*(3), 397–423. https://doi.org/10.1111/j.1475-6803.2012.01322.x

Chang, S., & Hong, J. (2000). Economic performance of group-affiliated companies in Korea: Intra-group resource sharing and internal business transactions. *Academy of Management Journal, 43*(3), 429–448. https://doi.org/10.5465/1556403

Chen, S., Sun, Z., Tang, S., & Wu, D. (2011). Government intervention and investment efficiency: evidence from China. *Journal of Corporate Finance, 17*(2), 259–271. https://EconPapers.repec.org/RePEc:eee:corfin:v:17:y:2011:i:2:p:259-271

Cheung Y. L., Jing, L., Lu, T., Rau, P. R., & Stouraitis, A. (2009). Tunneling and propping up: An analysis of related party transactions by Chinese listed companies. *Pacific Basin Finance Journal, 17*, 372–393. https://doi.org/10.1016/j.pacfin.2008.10.001

Claessens, S., Djankov, S., Fan, J. P.H., & Lang, L. P. H. (1999). Expropriation of minority shareholders: evidence from East Asia. World Bank 1999 Working Paper. https://doi.org/10.1596/1813-9450-2088

Claessens, S., Djankov, S., & Lang, L. H. P. (2000). The separation of ownership and control in East Asian corporations. *Journal of Financial Economics, 58*, 81–112. https://doi.org/10.1016/S0304-405X(00)00067-2

Correia, M. M. (2014). Political connections and sec enforcement. *Journal of Accounting and Economic, 57*(2), 241–262. https://doi.org/1016/j.jacceco.2014.04.004

Ding, S., Jia, C., Wilson, C., & Wu, Z. (2014). Political connections and agency conflict: the roles of owner and manager political influence on executive compensation. *Review of Quantitative Finance and Accounting, 45*(2014), 407–434. https://doi.org/1007/s11156-014-0441-9

Faccio, M., Masulis, R. W., & McConnel, J. (2006). Political connections and corporate bailout. *The Journal of Finance, 61*(6), 2597–2635. https://doi.org/10.1111/j.1540-6261.2006.01000.x

Friedman, E., Johnson, S., & Mitton, T. (2003). Propping and tunneling. *Journal of Comparative Economics, 31*, 732–750.

Goodstein, J., Gautam, K., & Boeker, W. (1994). The effect of board size and diversity on strategic change, *Strategic Management Journal*, *15*(3), 241–250. https://doi.org/10.1002/smj.4250150305

Gujarati, D., & Porter, D.C. (2009). *Basic Econometric*. New York: The McGraw-Hill.

Habib, A., Muhammadi, A. H., & Jiang, H. (2017). Political connections and related party transaction: evidence from Indonesia. *The International Journal of Accounting, 52*(1), 45–63. https://doi.org/1016/j.intacc.2017.01.004

Houston, J., Jiang, L., Lin, C., & Ma, Y. (2014). Political connections and the cost of bank loans. *Journal of Accounting Research, 52*(1), 193–243. https://doi.org/10.1111/1475-679X.12038

Hwang, C. Y., Zhang, S., & Zhu, Y (2018). Related party transactions and institutional investors in Chinese listed companies. *Advances in Pacific Basin Business, Economics and Finance, 6*, 1–25.

Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: managerial behavior, agency cost and ownership structure. *Journal of Financial Economics, 3*(4), 305–360. https://doi.org/10.1016/0304-405X(76)90026-X

Jeon, K. (2019). The Characteristics of Board of Directors and Related Party Transaction. *Academy of Accounting and Financial Studies Journal, 23*(3), 1–20.

Kanakriyah, R. (2021) The impact of board of directors' characteristics on form performance: a case study in Jordan. *Journal of Asian Finance, Economics and Business, 8*(3), 341–350. https://doi.org/13106/jafeb.2021.vol8.no3.0341

Khwaja, A., & Mian, A. (2005). Do lenders favor politically connected firms? Rent provision in an emerging financial market. *Quarterly Journal of Economics, 120*, 1371–1411. https://doi.org/10.1162/003355305775097524

Kohlbeck, M., & Mayhew, B. W. (2017). Are related party transactions red flags? *Contemporary Accounting Research, 34*(2), 900–928. https://doi.org/10.1111/1911-3846.12296

La Porta, R., Silanes, F. L., & Zamarripa, G. (2003). Related lending. *Quarterly Journal of Economics, 118*(1), 231–268. https://doi.org/2139/ssrn.302128

Leuz, C. & Gee, F. O. (2006). Political relationships, global financing and corporate transparency: evidence from Indonesia. *Journal of Financial Economics, 81*, 411–439.

Ling, L., Zhou, X., Liang, Q., Song, P., & Zeng, H. (2016). Political connections, overinvestment, and firm performance: evidence

from Chinese listed real estate. *Finance Research Letters, 18,* 328–333. https://doi.org/10.1016/j.frl.2016.05.009

Ma, L., Ma, S., & Tian, G. G (2012). *Political connection, founder-manager and their impact on tunneling in China's listed firms*. Working Paper Faculty of Business Wollongong University, Wollongong, Australia. https://ro.uow.edu.au/buspapers/12

Malik, Q. A., Hussain, S., Ullah, N., Waheed, A., Naeem, M., & Manssor, M. (2021). Simultaneous Equations and Endogenity in Corporate Finance: The Linkage between Institutional Ownership and Corporate Financial Performance. *Journal of Asian Finance, Economics and Business, 8*(3), 69–77. https://doi.org/13106/jafeb.2021.vol8.no3.0069

Manzaneque, M., Prigeo, A., & Merino, E. (2016). Corporate governance effect on Financial distress Likelihood: Evidence from Spain. *Spanish Accounting Review, 19*(1), 111–121. https://doi.org/10.1016/j.rcsar.2015.04.001

Namazi, M., & Namazi, N. (2016). Conceptual analysis of moderator and mediator variables in business research. *Procedia Economics and Finance, 36*(2016), 540–554. https://doi.org/1016/S2212-5671(16)30064-8

Nodeh, A. L., & Gerayli, M. S. (2020). Political connections and related party transaction: evidence from Iranian firms. *Advance in Mathematical Finance & Applications, 5*(1), 15–27. https://doi.org/22034/amfa.2019.581375.1154

Ngo, D. N. P., & Le, A. T. H. (2021) Relationship between the audit committee and earnings management in listed companies in Vietnam. *Journal of Asian Finance, Economics and Business, 8*(21), 135–142. https://doi.org/13106/jafeb.2021.vol8.no2.0135

Nugrahanti, Y. W., & Puspitasari, A. 2018. Do audit quality, political connection, and institutional ownership increase real earnings management? Evidence from Indonesia. *Asian Journal of Finance and Accounting, 8*(4), 413–430. https://doi.org/10.1504/AAJFA.2018.095245

Qian, M., Pan, H., & Yeung, B. (2011). Expropriation of minority shareholders in politically connected firms. *Proceeding Finance and Corporate Governance Conference* 2011, 1–37. https://doi.org/2139/ssrn.1719335

Ryngaert, M., & Thomas, S. E. (2007). *Related party transactions: Their origins and wealth effects*. Working paper. http://ssrn.com/abstract=970689

Saeed, A., Belghitar, Y., & Clark, E. 2016. Do Political Connections Affect Firm Performance? Evidence from a Developing Country. *Emerging Market Finance and Trade, 25*(8), 1–16. https://doi.org/10.1080/1540496X.2015.1041845

Selcuk, E., A., & Sener, P. (2018). Corporate governance and tunneling: empirical evidence from turkey, *Economics Bulletin, 38*(1), 1–14.

Shastri, K., & Kahle, K. M. (2003). *Executive loans*. Working Paper University of Pittsburgh.

Shleifer, A., & Vishny, R. (1994). Politicians and Firms. *Quarterly Journal of Economics, 109*(4), 995–1025. https://doi.org/10.2307/2118354

Skare, M., & Hasic, T. (2016). Corporate governance, firm performance, and economic growth – theoretical analysis. *Journal of Business Economics and Management, 17*, 35–51. https://doi.org/3846/16111699.2015.1071278

Tao, Q., Sun, Y., Zhu, Y., & Yang, X. (2017). Political connections and government subsidies: evidence from financially distressed firms in China. *Journal Emerging Markets Finance and Trade, 53*(8), 1854–1868. https://doi.org/10.1080/1540496X.2017.1332592

Tran, Q. T., Lam, T. T., & Luu, C.D. 2020. Corporate governance and earnings management: a study of Vietnamese listed banks. *Journal of Asian Finance, Economics and Business, 7*(12), 389–395. https://doi.org/10.13106/jafeb.2020.vol7.no12.389

Udin, S., Khan, M. A., & Javid, A. Y. (2017). The effects of ownership structure on likelihood of financial distress. *Corporate Governance: The International Journal of Business in Society,* 1–37. https://doi.org/1108/CG-03-2016-0067

Villalonga, B., & Amit, R. (2006). How do family ownership, control and management affect firm value? *Journal of Financial Economics, 80*, 385–417. https://doi.org/10.1108/S1569-3732(2011)0000014009

Wahab, E. A. A., Haron, H., Lok, C. L., & Yahya, S. (2011). Does corporate governance matter? evidence from related party transactions in Malaysia. *Advances in Financial Economics, 14*, 131–164. https://doi.org/1108/S1569-3732(2011)0000014009

Wang, L., & Lin, P. T. (2016). Who benefits from political connections? minority investors or controlling shareholders? Asia-Pacific Journal of Accounting & Economics, 24(1–2), 1–22. http://dx.doi.org/10.1016/j.jfineco.2004.12.005

Weir, C., Laing, D., & McKnight, P. J. (2002). Internal and external governance mechanisms: their impact on the performance of large UK public companies. *Journal of Business Finance and Accounting, 29*(5–6), 579–611. https://doi.org/10.1111/1468-5957.00444

Wong, R. M., Kim, J. B., & Lo, A. W. (2015). Are related-party sales value-adding or value destroying? Evidence from China. *Journal of International Financial Management & Accounting*, *26*(1), 1–38. https://doi.org/10.1111/jifm.12023

Wu, W. F., Wu, C. F., Zhou, C., & Wu, J. (2012). Political connections, tax benefit and firm performance: evidence from China. *Journal Accounting and Public Policy, 31*, 277–300. https://doi.org/1016/j.jaccpubpol.2011.10.005