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performance: Evidence from Indonesia

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Politically connected boards, family business groups and firm performance

Evidence from Indonesia

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Abstract

Purpose – The purpose of this paper is to examine the association between politically connected boards (both supervisory boards [SBs] and boards of directors [BODs]) and firm performance.

Design/methodology/approach – We focus on the political connections of SBs and BODs separately and estimate a quadratic model based on 1,099 Indonesian listed firm-year observations. Additionally, we address endogeneity problem by using sample selection model, generalized method of moments (GMM), propensity score matching\ and lagged variables regression.

Findings – We find that political connections of SBs are more significantly associated with firm performance than that of BODs. Furthermore, such an association is not monotonic, in that the relationship declines after a certain level of political connections. We also find that stand-alone firms with political connections perform better than firms belonging to family business groups. Our results are robust to alternative measures and to tests for endogeneity.

Research limitations/implications – This study contributes to the literature by proposing non-linear model to incorporate the rent-seeking and resource dependence arguments. Although previous studies use regression analysis (linear model) and find mixed results on the association between political connections and firm performance, our non-linear model extends our understanding of the relationship between political connections and firm performance. We extend corporate governance literature by examining the role of political supervisory boards in the dual board system and the role of family business group in Indonesia. Several limitations are addressed to interpret all the findings. We use one period of the presidency (SBY-Susilo Bambang Yudhoyono) in Indonesia as our sample, but other regimes are not considered. We collect political connection and family business group information based on publicly data available. For politically connected firms, we do not have information whether they obtain connections through ruling parties or not.

Practical implications – Practitioners (such as companies and policymakers) can use our models to consider the level of political connections that can improve corporate's performance. Additionally, they can use our findings to design corporate governance policies.

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Originality/value – The paper identifies the use of the non-linear model on the association between political connections and firm performance in Indonesian dual board system.

Keywords Market performance, Curvilinear relationship, Family business group, Politically connected BODs, Politically connected SBs

Paper type Research paper

1. Introduction

Political connections (PCs) of corporate board members are an important determinant of firm performance because government policies exert a profound effect on corporate decision-making and operations (Dinç 2005; Faccio, 2006; Fan *et al.*, 2007; Boubakri *et al.*, 2008; Wu *et al.*, 2012; Ding *et al.*, 2014). In emerging countries, corporations encounter a number of impediments and operate in uncertain environments, and governments exerts control over resource allocations (Faccio *et al.*, 2006). Hence, it has become a prevalent practice in those economies that corporations establish connections with the government by appointing politically connected people on their boards to overcome conflict, challenges, limited resources, market competition and bureaucratic problems (Agrawal and Knoeber, 2001; Kang and Zhang, 2013).

When it comes to the association between politically connected boards and firm performance, the literature documents two competing predictions. Previous studies argue that politically connected boards have negative consequences for firm performance due to their rent-seeking activities arising out of agency conflicts. Fisman (2001), for instance, uses an event study approach to investigate the effect of politically connected firms on firm performance upon receipt of the news about former Indonesian President Suharto's health.[1] He finds that politically connected firms lost more value during that period than did non-politically firms. However, other studies show that firms with politically connected boards perform better than non-connected firms (Boubakri *et al.*, 2009; Wu *et al.*, 2012; Liu *et al.*, 2018). The evidence supports resource dependence theory (RDT), suggesting that firms appoint politically connected boards as a vehicle to mitigate environmental uncertainty and their dependence (Hillman *et al.*, 2009).

Given these conflicting and inconclusive results, we extend the literature by integrating the rent-seeking and resource dependence arguments through a quadratic relationship between politically connected boards and market performance of listed Indonesian firms over a period of four years to 2013. Indonesia provides a unique opportunity to test the role of PCs because most of the previous studies on firm performance have been undertaken in the context of unitary board systems such as those operating in the UK and USA. In some other countries such as China, France, Germany, Indonesia, Japan[2] and the Netherlands, a two-tier corporate board system exists to govern and monitor a corporation. Some studies have examined the role of corporate dual board systems in these countries (Firth *et al.*, 2007; Ran *et al.*, 2015; Xiao *et al.*, 2004; Schilling, 2001; Tran, 2014; Van Ees *et al.*, 2003; among others), but limited knowledge exists on the effect of politically connected boards (supervisory boards [SBs]) on firm performance. This specifically refers to those that have implemented a dual corporate board governance system, particularly the differential role of the two boards and family firms regarding firm performance.

The role of SBs in Indonesia is different from that in other countries with a dual board system such as China and Germany (Joni *et al.*, 2019). For example, the SB in Indonesia does not have employee representatives, and SB members cannot sit on the BOD and vice versa. Schilling (2001) argues that involving employee representatives in German SBs weakens their role and strengthens the role of BODs because SB members cannot discuss critical and

confidential issues in the presence of employee representatives. In the context of China, Tam (1999) shows that SBs are less attractive and are in fact ineffective. Dahya *et al.* (2002) argue that Chinese SBs lack legal power and responsibilities since they do not have authority to employ and dismiss directors and executives and are thus less effective than BODs.

In contrast, the SB position under the Indonesian dual board system is more important and strategic than that of the BOD (IFC, 2014). Since the introduction of the Indonesian Company Law in 1995, the SB has the authority to appoint and dismiss BOD members and other key managers, to do the following:

- firstly, decide long-term strategic planning and remuneration packages; and
- secondly, supervise the BOD.

In particular, IFC (2014) identifies the strategic authority of SBs in Indonesia. For example, SBs have the authority to create development strategies and a business plan for the company, investment projects, solutions for market and technology expansions, and even to approve long-term contracts for purchase, sale, borrowing, lending and other issues.

Another institutional feature of corporate governance in Indonesia is that corporate board members are highly connected with politicians, military and senior government officials (Fisman, 2001; Leuz and Oberholzer-Gee, 2006; Fisman, 2001). Leuz and Oberholzer-Gee (2006) find that 35 per cent of the Indonesian listed companies had direct political connections with former president Suharto and his family members. Later, Chaney *et al.* (2011) in their international study on earnings quality and political connections, document that 22 per cent of companies have links with Indonesia's government[3]. Previous research also finds that Indonesian corporate ownership is dominated by family business groups and government ownership (Sato, 1993; Fisman, 2001; Leuz and Oberholzer-Gee, 2006; Rusmin *et al.*, 2012). Claessens *et al.* (2006) report that 73 per cent firms in Indonesia belong to a family business group[4].

In this paper, we suggest that SBs' political connections will dominate that of BODs, and this is reflected in better firm performance. We use a sample of 1,099 firm-year observations from publicly listed firms on the Indonesian Stock Exchange (IDX) for the period 2010 to 2013 and find empirical evidence supporting that suggestions that firms with politically connected boards, especially politically connected SBs, did better. We further find a curvilinear relationship between politically connected boards and market performance. It indicates that political connections through boards are beneficial at a certain level and beyond that level the benefits decrease. Lastly, the findings show that stand-alone firms with political connections enjoy better market performance compared to firms belonging to family business groups.

We contribute to the debate on the relationship between political connections and firm performance which produced mixed evidence. Although previous studies use multivariate regression models to estimate the associations between firm performance and PCs, we extend PCs and performance relationship by using a quadratic model to determine whether the association is monotonic. We also extend previous studies that only examined PCs and firm performance by examining the role of political connections of supervisory boards in firm performance and compare with that of BODs. Finally, we add to the corporate governance literature concerning the role of family business groups and market performance in the presence of political connections. Claessens *et al.* (2006) argue that the development of corporate governance in emerging markets has been significantly influenced by family business groups. The context of this paper enables us to examine whether firms belonging to family business groups derive more values than stand-alone firms when they appoint politically connected people on their boards.

The remainder of the paper is structured as follows: in Section 2, we review the literature and develop the hypotheses, followed by research design in Section 3. Section 4 presents our empirical results, and Section 5 reports additional tests. In the final section, we provide concluding comments.

2. Literature review and hypotheses development

2.1 Politically connected boards, firm performance, and two-tier board system

Political connections are external dimensions of corporate governance mechanisms that influence the behaviour of an organisation. In the literature, there are two competing arguments on the consequences of political connections. One argument is that political connections might result in poor corporate governance and increase the agency costs due to rent-seeking behaviour (Fisman, 2001). Fan *et al.* (2007) investigate the influence of politically connected executives on long-term stock returns and accounting performance based on IPO firms in China. They show that having politically connected executives is negatively associated with long-term accounting and stock return performance. They also conclude that when executives are more politically connected, they are less professional. Faccio (2010) reports that politically connected firms suffer poorer firm performance and market-to-book ratio. Leuz and Oberholzer-Gee (2006) examine the relationship between political connection and long-term financial performance during the Asian Financial Crisis in three Indonesian regimes (Suharto, Habibie and Wahid). They find that the performance of politically connected firms was inferior than that of non-politically connected firms when Suharto was in power.

A contrasting view is that politically connected firms can extract benefits for themselves, making shareholders better off (Chaney *et al.*, 2011). Agrawal and Knoeber (2001) report that directors with political experience play an advisory role in firms that need to connect with the government. Goldman *et al.* (2009) find that politically connected boards add value to a company in the US as reflected in higher abnormal stock return. Cooper *et al.* (2010) test the association between political connections and firm performance based on US listed firms. They find that political contributions are positively related with future abnormal returns and future earnings. Claessens *et al.* (2008) examine whether political connection is related to market performance in Brazil. They document that abnormal returns around the announcement of election results are positively associated with a firm's contribution to federal deputy candidates. This positive effect is stronger when candidates win the election. Boubakri *et al.* (2009) find that politically connected firms improve their performance after they establish connections with politicians. They also note that politically connected firms are associated with a higher level of risk, but connected firms gain easier access to long-term debt.

The complementary theory to Agency Theory (AT) is Resource Dependence Theory (RDT) which is important to enable us to understand the consequences of politically connected boards. Under the RDT, an organisation experiencing environmental uncertainty and other constraints can act to reduce these constraints and obtain and maintain much needed external resources by connecting with resourceful people on key decision-making bodies (Hillman *et al.*, 2009; Ulrich and Barney, 1984). Pfeffer and Salancik (1978) also document that organisations appoint political board members who have the ability to manage this environmental dependency.

The presence of politicians on company boards has been increasingly investigated in recent times in Asian countries. Bunkanwanicha and Wiwattanakantang (2009) examine the value of politically connected firms in Thailand. They find that firms belonging to large tycoon families experience higher market valuation. Wu *et al.* (2012) test the effect of

political connections on performance of private firms in China, detecting a positive association between the two variables. In contrast, they show that political connections for local state-owned firms is negatively related to firm performance and political connections for central state-owned firms has no effect on how well they perform. Taken together, the findings indicate that political connections enhance firm performance only in private sector companies.

Su and Fung (2013) examine the relationship between political connections and firm performance in Chinese firms from 2004 to 2008 and report a positive relationship between political connections and firm performance after controlling for ownership structure, related party transactions and firm attributes. They also find that state-owned and non-state-owned enterprises use political connections equally effectively to enhance performance. Saeed *et al.* (2016) investigate how politicians serving on the boards of directors influence firm performance in Pakistan. Their results reveal a negative relationship between political connections and firm performance. Specifically, politically connected firms underperform non-connected firms directors by almost 17 per cent and 15 per cent based on return on assets and return on equity, respectively. In contrast, Khwaja and Mian (2005) contend that politically connected firms in Pakistan receive substantial preferential treatment from government banks in the form of softer terms and larger loans. As well, firms with "stronger" politicians on their boards[5] obtain even greater preferential access to credit from government banks.

In Indonesia, one study has examined whether ownership structure and high levels of political connections in Indonesian firm's impact on firm performance (Rusmin *et al.*, 2012). Using both accounting and market measures of firm performance of 419 observations for the years 2006 to 2009, they find that firms with high political connections outperform firms not politically aligned, and that firms with significant foreign ownership performed better than only domestically owned firms. However, they did not consider the differential effect of political connections of SBs and BODs, nor did they examine the effect of PCs on the performance of firms belonging to business groups.

As stated earlier under Indonesia's two-tier board system, SBs are important and more strategic than BODs. SBs influence firm performance through their strategic supervision and monitoring function. Based on the Indonesian Company Law, SBs undertake several general duties:

- conducting supervision over the BOD of the company;
- executing any duty based on laws and regulations, and the resolutions of the GMS;
- acting in the interests of the company and being responsible to the GMS; and
- examining, reviewing and signing financial reports (financial statements and annual reports) prepared by the BOD.

The International Finance Corporation (IFC, 2014) states that SBs play an important role in Indonesian corporate governance mechanisms, such as deciding long-term and strategic planning, making strategic negotiation with creditors, even determining directors' remuneration packages. More convincingly, a study conducted by the Centre for Governance, Institutions and Organisations (CGIO) (2012) at NUS Business School in Singapore found that the most powerful board members of Indonesian listed companies were elder entrepreneurs and senior retired government officials. These people frequently act on the supervisory boards and offer their full experience and connections in a supervisory way.[6] Li *et al.* (2008) suggest that members of the Chinese Communist Party sitting on private firms' boards are considered elite because they come through strict and

merit-based selection processes, and therefore they enjoy stronger political access. Thus, we suggest that although BODs affect firm performance through efficiency, SBs' political connections will outweigh the benefits of efficient operations.

Based on the abovementioned discussion, we propose the following hypotheses:

H1a. Politically connected boards are associated with a firm's better firm performance.

H1b. Politically connected SBs are associated with a firm's better firm performance than politically connected BODs.

2.2 Curvilinear relationship between politically connected boards and firm performance

Prior studies have indicated a monotonic association between PCs and firm performance, suggesting that the more connections a firm has will lead to better business outcomes (Wu *et al.*, 2012; Liu *et al.*, 2018). In contrast, other studies showed a different direction on the association (Fan *et al.*, 2007). Since the AT arguments on the effect of political connections compete against the RDT arguments, we expect a non-linear relationship between politically connected boards and firm performance in Indonesia's two-tier board system. It might be possible that the conflicting results on the relation between corporate governance characteristics and firm's behaviour due to the curvilinear relationship. Specifically, we expect that the RDT arguments outweigh the AT arguments up to a certain level of political connections and beyond that level, the AT will dominate the RDT. This indicates that the level of politically connected boards up to the threshold point may enhance market performance but beyond that point, market performance tends to decline. Empirically, Anderson and Reeb (2003) provide evidence on the non-linear relationship between founding family ownership and firm performance, specifically the relationship is inverted u-shaped. Wang (2006) finds that the relationship between the level of earnings management and family ownership is u-shaped relation in the US context. Particularly, he suggests that firms with 33.72 per cent family ownership have lower abnormal accruals compared to non-family firms. And family firms result lower abnormal accruals up to 67.44 per cent and beyond that level, the abnormal accruals of family firms are higher than non-family firms. Similarly, Razzaque *et al.* (2016) also report that there is a curvilinear relation between family ownership and real earnings management. It appears in their findings that firms with family ownership up to 26.78 per cent have lower real earnings management. Beyond this level, family firms report higher real earnings management than non-family firms. Therefore, we expect similar pattern on the association between politically connected boards and firm performance.

Accordingly, the following hypotheses are proposed:

H2a. There is a curvilinear relationship between politically connected boards and firms' market performance in Indonesia, ceteris paribus.

H2b. There is a curvilinear relationship between politically connected SBs (BODs) and firms' market performance in Indonesia, ceteris paribus.

2.3 Politically connected boards, firm performance, and family business groups

Another internal corporate governance mechanism is ownership structure. The topic of ownership structure has been widely examined in many countries. According to Claessens and Yurtoglu (2013), the structure of ownership influences the nature of principal–agent problems worldwide. In developed countries, the agency problem

between shareholders (principal) and management (agent) exists because the ownership structure is diffuse (Jensen and Meckling, 1979). However, the ownership structure in emerging countries is mostly concentrated (Claessens and Yurtoglu, 2013). With this type of ownership structure, conflicts may not occur between the principal and the agent. Morck *et al.* (2005) and Young *et al.* (2008) suggest that firms with a concentrated structure regularly experience conflict between controlling shareholders and minority shareholders.

In addition, the Indonesian corporate governance is influenced by the presence of family business group as controlling shareholders. The economy of Indonesia is mostly controlled by family business group. Claessens *et al.* (2006) report that 73 per cent of Indonesian listed firms are owned by family business groups. The control and benefits that family business has gain is the result of the political connection they have built (Joni *et al.*, 2019). Therefore, the presence of family business group in Indonesia is important.

The issue of costs and benefits of concentrated ownership has attracted many scholars. The literature suggests that concentrated ownership may lead to decrease in a firm's value. Bae *et al.* (2002) examine whether South Korean firms with business group affiliation (*chaebols*) actually benefit from acquisitions. Further, they test whether this acquisition provides an opportunity for controlling owners to increase their wealth by adding value to other group firms. They use a final sample of 87 non-financial firms (with 107 mergers) that are listed on the Korean Stock Exchange between 1981 and 1997. The results show that the stock price of companies belonging to a business group is lower when they have acquisitions. They find that controlling owners gain benefits from acquisitions via the increased value of other firms in the same group. In contrast, minority owners of affiliated firms suffer during acquisitions.

However, other studies suggest that concentrated ownership has a positive effect on firm value. Claessens and Djankov (1999) investigate the association between concentrated ownership and firm performance of 706 Czech companies from 1992 to 1997. Their findings indicate that concentrated ownership is positively associated with company profitability and labour productivity. Thomsen and Pedersen (2000) examine the consequences of ownership structure on firm performance based on the 435 largest European firms. Their results reveal that concentrated ownership is positively associated with profitability. Perotti and Gelfer (2001) investigate whether firms belonging to a business group generate higher value (with Tobin's Q as a proxy) than independent firms. The sample of the study is 71 Russian listed companies from 1995 to 1996. Perotti and Gelfer (2001) define a business group as "all members of official financial–industrial groups and/or firms owned by a large Russian bank". They provide evidence that a financial business group provides financing benefits to its members.

Khanna and Rivkin (2001) examine the association between firms affiliated with business groups and firm performance in 14 emerging economies: Indonesia, Brazil, Chile, India, Argentina, Israel, Mexico, Taiwan, Peru, the Philippines, South Africa, Turkey, South Korea and Thailand. Members of a business group extract benefits in terms of access to labour, capital and product markets. On the other hand, this business group structure imposes costs related to the obligation to support affiliated companies with inefficient trading and weak performance. In this study, firms belonging to business groups have better performance than non-group firms in six countries (India, Indonesia, Taiwan, Peru, Israel and South Africa) and lower profitability in three countries (Argentina, Chile and the Philippines). For the remaining five countries (Brazil, South Korea, Mexico, Thailand and Turkey), there is no significant difference between performance of group-affiliated companies and non-group-affiliated companies. Their second hypothesis is whether the

performance of companies within a business group will be similar. Overall, the results support the hypothesis in 12 out of 14 countries. Rusmin *et al.* (2012) examined whether foreign ownership plays a substitutive role of corporate governance in Indonesia. They find that firms with significant foreign ownership performed better than domestic owned firms as measured by both accounting and market returns.

Based on this argument and what the above studies concluded, the following hypotheses are proposed:

H3a. Family business groups moderate the association between politically connected boards and firms' performance, ceteris paribus.

H3b. Family business groups moderate the association between politically connected SBs/BODs and firms' performance, ceteris paribus.

3. Research design

3.1 Data and sample selection

We extract financial information and market data from Datastream and Worldscope Databases and hand-collected corporate governance data from company annual reports, company/government websites, and the Google search engine. We identify politically connected boards in our sample firms via three steps. First, we reviewed board profile section on the annual reports. Second, we match board members' names on the government website (www.indonesia.go.id). Third, we check the background of board members by using companies' websites and the Google search engine.

The sample in this paper originates from the firms listed on the IDX during the period 2010-2013. The paper's timeframe encapsulates the second presidential term of Susilo Bambang Yodhoyono (SBY). His first term ran from 2004 to 2009 and the second covered the years 2009-2014. We use data during this period for the following reasons. Firstly, we believe that political connections were well established after the second period of SBY. Secondly, literature states that Indonesia enjoyed better political and economic stability during SBY's period in office compared to previous presidencies (Kimura, 2011). Lastly, this period followed the Global Financial Crisis that erupted in 2008. We also exclude the finance industry because it is fundamentally different from other sectors of the economy. The finance industry is governed by different regulations and methods of operation (Pittman and Fortin, 2004).

After eliminating the financial sector and missing data, the final sample comprises 1,099 firm-year observations. Panel A of Table I summarises the sample selection procedures. Panel B of Table I presents the distribution of firms with politically connected boards across industries. Overall, there are 405 out of 1,099 firm-year observations (36.85 per cent) that have politically connected boards, with the energy (6.55 per cent of sample observations), industrial (6.19 per cent), consumer staples (6.46 per cent), information technology (5.82 per cent) and consumer discretionary (5.00 per cent) sectors being the most heavily represented industries. Other industries have a nominal composition of political connections, such as the materials (3.73 per cent), health care (1.46 per cent), and real estate (1.64 per cent) sectors. Panel C of Table I summarises the distribution of firms with politically connected boards by year. During the sample period, the average proportion of firms with politically connected boards is 36.85 per cent (38.19 per cent in 2010, 40.07 per cent in 2011, 34.80 per cent in 2012 and 35.04 per cent in 2013). Panel D of Table I reports the distribution of politically connected boards by family business groups and non-family business groups. This shows

Panel A: The sample selection

Calendar year	2010	2011	2012	2013	Total
Number of listed companies	424	449	467	494	1834
Number of firms from the finance industry	(119)	(123)	(124)	(134)	(500)
Number of firms with missing data	(72)	(64)	(50)	(49)	(235)
Number of firms in the sample	233	262	293	311	1099

Panel B: Distribution of politically connected boards by industry

Two-digit GICS code	Industry description	Political boards		Non-political boards		Total sample	
		N	(%)	*N*	(%)	*N*	(%)
10	Energy	72	6.55	29	2.64	101	9.19
15	Materials	41	3.73	168	15.29	209	19.02
20	Industrials	68	6.19	149	13.56	217	19.75
25	Consumer Discretionary	55	5.00	104	9.46	159	14.47
30	Consumer Staples	71	6.46	104	9.46	175	15.92
35	Health Care	16	1.46	21	1.91	37	3.37
40	Real Estate	18	1.64	23	2.09	41	3.73
45	Information Technology	64	5.82	81	7.37	145	13.19
50	Telecommunication Services	0	0.00	15	1.36	15	1.36
		405	36.85	694	63.15	1099	100

Panel C: Distribution of politically connected boards by year

Calendar year	2010	2011	2012	2013	Total
Firms with political boards	89	105	102	109	405
Number of firms	233	262	293	311	1099
Percentage of firms with political boards	38.19	40.07	34.80	35.04	36.85

Panel D: Distribution of firm-years by ownership type and politically connected boards

	Political boards		Non-political boards		Total	
	N	(%)	*N*	(%)	*N*	(%)
Family business groups	327	80.74	340	48.99	667	60.69
Non-family business groups	78	19.26	354	51.01	432	39.31
Total firm-years	405	100	694	100	1099	100

Table I. Description of the sample

that firms belonging to family business groups are the most likely to have connections with the government (327 of 405 firm–year observations, or 80.74 per cent).

3.2 Measurement of the variables

3.2.1 Dependent variable. We employ Tobin's Q to measure market performance. The adoption of Tobin's Q to measure the expected growth of the listed company is important for examining the effect of political connection on market performance. Ding *et al.* (2014) argue that future growth opportunities are a significant concern to the shareholders. They also state that:

> [. . .] although market returns do not necessarily shed light on the impact of political connections over time, the market capitalization of equity, which is determined by stock price and the number of shares of common stock, is able to capture investor's expectations about the political connection-future growth relationship (p. 157).

Therefore, estimating Tobin's Q to reflect the expected growth of listed firms is appropriate for investigating the association between politically connected boards and market performance. Following Dahya *et al.* (2008), Tobin's Q is measured as the ratio of the book value of assets minus the book value of equity plus the market value of equity, divided by the book value of assets. The ratio is calculated for the end of years

2010, 2011, 2012 and 2013. Additionally, we use earnings per share (EPS) to estimate accounting performance. This measure is widely use in the accounting and finance literature (Omran *et al.*, 2008).

3.2.2 Experimental variables. We calculate the percentage of SB/BOD members who serve as a current or former minister, member of parliament, other appointed bureaucrat in local or central government or member of the military to measure the presence of political connection (Bertrand *et al.*, 2004; Dinç, 2005; Fan *et al.*, 2007; Goldman, 2013; Boubakri *et al.*, 2008; Ding *et al.*, 2014). To provide politically connected board information, we manually collect them by reviewing published annual reports. Annual reports are collected from the IDX, company websites and via the Google search engine. We mostly review the profile sections of each company's annual report and website. When information on a politically connected board member's background is not available in the profile section, the next step is to check the board member's name on a government website such as www.indonesia.go.id. Finally, we check the background of board members by using company websites and the Google search engine.

3.2.3 Control variables. Following prior studies (Klein, 2002; Xie *et al.*, 2003; Bradbury *et al.*, 2006; Ran *et al.*, 2015), we control for other internal corporate governance mechanisms, including SB characteristics: percentage of SB, proportion of SB independence, average age of SB members, proportion of SB members with a financial and accounting background), audit committee size and ownership structure characteristics (concentrated ownership, government ownership and family business groups). We also incorporate several firm characteristics in the regression models, namely firm size, leverage, firm age, loss, industry and year effects (Claessens *et al.*, 2008; Chaney *et al.*, 2011; Chen *et al.*, 2011; Bliss and Gul, 2012; Wu *et al.*, 2012; Muttakin *et al.*, 2015).

3.3 Regression models

Regression models are developed to test proposed *H1a* and *H1* b, which investigate the relationship between politically connected boards and market performance in the two-tier board structure, particularly for politically connected SBs. Two empirical models are used to test the hypotheses. The first model tests the influence of politically connected boards and firm performance, whereas the second model examines the relationship between politically connected SBs/BODs and firm performance.

Following Anderson and Reeb (2003) and Wang (2006), we apply quadratic modelling to test the curvilinear relationship between politically connected SBs/BODs and Tobin's Q in *H2a* and *H2*b. The variables of interest in the models are the squared politically connected boards (PC_TOT^2) and the squared politically connected SBs/BODs (PC_SB^2/PC_BOD^2) in Models 1a, 1b, 2a and 2b. We expect an inverted U-shaped relationship ($\beta_1>0$, $\beta_2<0$) for performance measures, suggesting that the positive effect of RDT argument outweighs the negative effect of the AT argument. The optimum level of political connection is $0.5\beta_1/\beta_2$.

$$\begin{aligned}\text{TOBIN'S}\quad Q_{it} = {} & \alpha_1 PC_{TOT\,it} + \alpha_2 (PC_{TOT\,it})^2 + \alpha_3 SB_{PCT\,it} + \alpha_4 SB_{AGE\,it} + \alpha_5 SB_{IND\,it} \\ & + \alpha_6 SB_{F\,it} + \alpha_7 AC_{SIZE\,it} + \alpha_8 BH_{it} + \alpha_9 SOE_{it} + \alpha_{10} BG_{it} \\ & + \alpha_{11} LEV_{it} + \alpha_{12} FSIZE_{it} + \alpha_{13} LOSS_{it} + \alpha_{14} FAGE_{it} \\ & + \alpha_{15} INDUSTRY_{it} + \alpha_{16} YEAR_{it} + \varepsilon_{it} \end{aligned} \tag{1a}$$

$$EPS_{it} = \alpha_1 PC_{TOTit} + \alpha_2 (PC_{TOTit})^2 + \alpha_3 SB_{PCTit} + \alpha_4 SB_{AGEit} + \alpha_5 SB_{INDit} + \alpha_6 SB_{Fit} + \alpha_7 AC_{SIZEit} + \alpha_8 BH_{it} + \alpha_9 SOE_{it} + \alpha_{10} BG_{it} + \alpha_{11} LEV_{it} + \alpha_{12} FSIZE_{it} + \alpha_{13} LOSS_{it} + \alpha_{14} FAGE_{it} + \alpha_{15} INDUSTRY_{it} + \alpha_{16} YEAR_{it} + \varepsilon_{it} \quad (1b)$$

$$TOBIN'S\ Q_{it} = \alpha_1 PC_{SBit} + \alpha_2 PC_{BODit} + \alpha_3 (PC_{SBit})^2 + \alpha_4 (PC_{BODit})^2 + \alpha_5 SB_{PCTit} + \alpha_6 SB_{AGEit} + \alpha_7 SB_{INDit} + \alpha_8 SB_{Fit} + \alpha_9 AC_{SIZEit} + \alpha_{10} BH_{it} + \alpha_{11} SOE_{it} + \alpha_{12} BG_{it} + \alpha_{13} LEV_{it} + \alpha_{14} FSIZE_{it} + \alpha_{15} LOSS_{it} + \alpha_{16} FAGE_{it} + \alpha_{17} INDUSTRY_{it} + \alpha_{18} YEAR_{it} + \varepsilon_{it} \quad (2a)$$

$$EPS_{it} = \alpha_1 PC_{SBit} + \alpha_2 PC_{BODit} + \alpha_3 (PC_{SBit})^2 + \alpha_4 (PC_{BODit})^2 + \alpha_5 SB_{PCTit} + \alpha_6 SB_{AGEit} + \alpha_7 SB_{INDit} + \alpha_8 SB_{Fit} + \alpha_9 AC_{SIZEit} + \alpha_{10} BH_{it} + \alpha_{11} SOE_{it} + \alpha_{12} BG_{it} + \alpha_{13} LEV_{it} + \alpha_{14} FSIZE_{it} + \alpha_{15} LOSS_{it} + \alpha_{16} FAGE_{it} + \alpha_{17} INDUSTRY_{it} + \alpha_{18} YEAR_{it} + \varepsilon_{it} \quad (2b)$$

Further, we propose the following models to examine whether firms belonging to family business groups extract more benefits than stand-alone firms from the relationship between politically connected SBs/BODs and firm performance in *H3a* and *H3* b. Our variables of interest are PC_TOT*BG in model 3 and PC_SB/PC_BOD*BG in model 4.

$$TOBIN'SQ_{it} = \alpha_1 PC_{TOTit} + \alpha_2 SB_{PCTit} + \alpha_3 SB_{AGEit} + \alpha_4 SB_{INDit} + \alpha_5 SB_{Fit} + \alpha_6 AC_{SIZEit} + \alpha_7 BH_{it} + \alpha_8 SOE_{it} + \alpha_9 BG_{it} + \alpha_{10} PC\_TOT*BG_{it} + \alpha_{11} LEV_{it} + \alpha_{12} FSIZE_{it} + \alpha_{13} LOSS_{it} + \alpha_{14} FAGE_{it} + \alpha_{15} INDUSTRY_{it} + \alpha_{16} YEAR_{it} + \varepsilon_{it} \quad (3a)$$

$$EPS_{it} = \alpha_1 PC_{TOTit} + \alpha_2 SB_{PCTit} + \alpha_3 SB_{AGEit} + \alpha_4 SB_{INDit} + \alpha_5 SB_{Fit} + \alpha_6 AC_{SIZEit} + \alpha_7 BH_{it} + \alpha_8 SOE_{it} + \alpha_9 BG_{it} + \alpha_{10} PC\_TOT*BG_{it} + \alpha_{11} LEV_{it} + \alpha_{12} FSIZE_{it} + \alpha_{13} LOSS_{it} + \alpha_{14} FAGE_{it} + \alpha_{15} INDUSTRY_{it} + \alpha_{16} YEAR_{it} + \varepsilon_{it} \quad (3b)$$

$$TOBIN'SQ_{it} = \alpha_1 PC_{SBit} + \alpha_2 PC_{BODit} + \alpha_3 SB_{PCTit} + \alpha_4 SB_{AGEit} + \alpha_5 SB_{INDit} + \alpha_6 SB_{Fit} + \alpha_7 AC_{SIZEit} + \alpha_8 BH_{it} + \alpha_9 SOE_{it} + \alpha_{10} BG_{it} + \alpha_{11} PC\_SB*BG_{it} + \alpha_{12} PC\_BOD*BG_{it} + \alpha_{13} LEV_{it} + \alpha_{14} FSIZE_{it} + \alpha_{15} LOSS_{it} + \alpha_{16} FAGE_{it} + \alpha_{17} INDUSTRY_{it} + \alpha_{18} YEAR_{it} + \varepsilon_{it} \quad (4a)$$

$$EPS_{it} = \alpha_1 PC_{SBit} + \alpha_2 PC_{BODit} + \alpha_3 SB_{PCTit} + \alpha_4 SB_{AGEit} + \alpha_5 SB_{INDit} + \alpha_6 SB_{Fit} + \alpha_7 AC_{SIZEit} + \alpha_8 BH_{it} + \alpha_9 SOE_{it} + \alpha_{10} BG_{it} + \alpha_{11} PC\_SB*BG_{it} + \alpha_{12} PC\_BOD*BG_{it} + \alpha_{13} LEV_{it} + \alpha_{14} FSIZE_{it} + \alpha_{15} LOSS_{it} + \alpha_{16} FAGE_{it} + \alpha_{17} INDUSTRY_{it} + \alpha_{18} YEAR_{it} + \varepsilon_{it} \quad (4b)$$

All variables and references are outlined in Table II. We estimate all models using the ordinary least squares (OLS) technique since it is widely used in the literature (Boubakri *et al.*, 2012; Wu *et al.*, 2012; Bliss and Gul, 2012; Houston *et al.*, 2014; Muttakin *et al.*, 2015).

4. Empirical results

4.1 Descriptive statistics

Table III presents descriptive statistics for the full sample of 1,099 (1,050) firm-year observations and all variables to test the relationship between politically connected SBs/BODs and Tobin's Q (EPS). Except for the dummy variables, the continuous variables are winsorised at the 1st and 99th percentiles. Among the key variables, Table III shows that the mean Tobin's Q is 1.791 with a range of 0.501-12.361 and the mean EPS is 0.015 with a maximum value of 1.357 and minimum value of −0.355. These values are consistent with previous studies, for example Muttakin *et al.* (2015). The mean for the independent variable in Tobin's *q* (EPS) analysis, politically connected SB, is 0.122 (0.128) with a maximum value of 1 (1) and minimum value of 0 (0). In addition to the politically connected board descriptions, the average politically connected BOD is only 0.4 per cent (0.5 per cent), and ranges between 0 per cent (0 per cent) and 33 per cent (33 per cent). For total politically connected boards, the average is around 6 per cent (6.3 per cent), with a maximum of 54 per cent (54 per cent) and a minimum of 0 per cent (0 per cent). The statistics confirm that SBs are more politically connected than BODs in the context of the Indonesian two-tier system.

We also conduct pairwise Pearson correlations to test the correlation among key variables in the model, except the industry and year dummies. As shown in Table IV, the highest correlation exists between the audit committee size and the SOE in EPS analysis (r = *0.*414) which is significant at the 1 per cent level. Overall, the correlations reported are below 0.45 and it does not suggest any potential multicollinearity problems (Farrar and Glauber, 1967). When multicollinearity is checked by generating VIF values, all VIF values are less than 10 in the four regression models (Table V), which suggests there is no multicollinearity problem in these models (Belsley *et al.*, 2005).

4.2 Politically connected boards and firm performance

Table V reports the OLS estimates in Models 1a, 1b, 2a and 2b for testing the association between politically connected boards and firm performance. Model 1a and 1b show that the coefficient on PC_TOT is significantly positive at the 1 per cent level, as predicted, with the coefficient = 5.129 (0.188) and t = 3.71 (2.71). This suggests that the coefficient is economically significant enough to improve a firm's performance by around 48 (17) basis points.[7] The adjusted R^2 from the regression analysis is 10.7 per cent (6.9 per cent). This result is consistent with *H1a*, suggesting that politically connected boards are positively associated with firm performance. Model 2 separately tests the effect of PC_SB/PC_TOT on Tobin's Q and EPS. As illustrated in Table V, the coefficient on PC_SB is significantly positive at the 1 per cent level (coefficient = 1.821, t = 2.67); the coefficient for PC_BOD is

Variable	Definition
Tobins Q_{it}	The ratio of the book value of assets minus the book value of equity plus the market value of equity divided by the book value of assets for firm *i* in year *t* (Dahya *et al.*, 2008)
EPS_{it}	Earnings per share (Omran *et al.*, 2008)
PC_{TOTit}	The percentage of the politically connected board members for firm *i* in year *t* (Dinç 2005; Fan *et al.*, 2007; Boubakri *et al.*, 2008; Ding *et al.*, 2014)
PC_{SBit}	The percentage of the politically connected SB members for firm *i* in year *t* (Dinç 2005; Fan *et al.*, 2007; Boubakri *et al.*, 2008; Ding *et al.*, 2014)
PC_{BODit}	The percentage of the politically connected BOD members for firm *i* in year *t* (Dinç 2005; Fan *et al.*, 2007; Boubakri *et al.*, 2008; Ding *et al.*, 2014)
$(PC_{TOTit})^2$	The squared politically connected boards for firm *i* in year *t*
$(PC_{SBit})^2$	The squared politically connected SBs for firm *i* in year *t*
$(PC_{BODit})^2$	The squared politically connected BODs for firm *i* in year *t*
PC_TOT*BG_{it}	Interaction variable between PC_TOT and BG for firm *i* in year *t*
PC_SB*BG_{it}	Interaction variable between PC_SB and BG for firm *i* in year *t*
PC_BOD*BG_{it}	Interaction variable between PC_BOD and BG for firm *i* in year *t*
Control variables-corporate governance characteristics	
SB_{PCTit}	The percentage of SB members for firm *i* in year *t* (Bradbury *et al.*, 2006)
SB_{AGEit}	The average age of SB members for firm *i* in year *t* (Ran *et al.*, 2015)
SB_{INDit}	The proportion of SB independence for firm *i* in year *t* (Klein, 2002; Vafeas, 2005)
SB_{Fit}	The proportion of SB members with a financial and accounting background for firm *i* in year *t* (Xie *et al.*, 2003)
AC_{SIZEit}	The number of audit committee members for firm *i* in year *t* (Xie *et al.*, 2003; Davidson *et al.*, 2005; Vafeas, 2005; Krishnan, 2005)
BH_{it}	The percentage of large shareholders who own at least 10% of outstanding shares for firm *i* in year *t* (Thomsen and Pedersen, 2000; Heflin and Shaw, 2000; Claessens *et al.*, 2000)
SOE_{it}	Indicator variable set equal to 1 if the shareholder is a central or local government for firm *i* in year *t* and zero otherwise (Dewenter and Malatesta, 2001; Eng and Mak, 2003)
BG_{it}	Indicator variable set equal to 1 if the controlling family is the largest shareholder in firm *i* in year *t* and zero otherwise (Claessens *et al.*, 2006)
Control variables-firm characteristics	
$FSIZE_{it}$	The natural log of the total assets of the company at the end of the year for firm *i* in year *t* (Beedles *et al.*, 1988; Fama and French, 1992; Hail and Leuz, 2006)
LEV_{it}	The natural log of the ratio of total long-term debt divided by the total assets at the end of the year for firm *i* in year *t* (Dhaliwal *et al.*, 2006)
$LOSS_{it}$	Indicator variable, 1 if loss reported for firm *i* in year *t*, and zero otherwise (Bliss and Gul, 2012)
$FAGE_{it}$	The number of years since establishment of the firm *i* in year *t* (Bliss and Gul, 2012; Boubakri *et al.*, 2012)
Control variables-fixed effects	
$INDUSTRY_{it}$	A vector of industry indicator variables that are classified based on two-digit GICS (Global Industry Classification Standard)
$YEAR_{it}$	A vector of year indicator variables: 2010; 2011; 2012; 2013

Table II. Definitions of variables

positive but not significantly so (coefficient = 1.029, t = 0.19) in Model 2a. It suggests that economically, one standard deviation increase of PC_SB will increase a firm's performance by 34 basis points (1.821*0.189 = 0.3441) in Tobin's q analysis. The adjusted R^2 for the regression analysis is 10.2 per cent. Additionally, the results in Model 2 b (EPS analysis) are

Variable	*N*	Mean	SD	Min	Max	Variable	*N*	Mean	SD	Min	Max
TOBINS Q	1099	1.791	1.710	0.501	12.361	EPS	1050	0.015	0.083	−0.355	1.357
PC_SB	1099	0.122	0.189	0.000	1.000	PC_SB	1050	0.128	0.192	0.000	1.000
PC_BOD	1099	0.004	0.032	0.000	0.330	PC_BOD	1050	0.005	0.033	0.000	0.330
PC_TOT	1099	0.060	0.093	0.000	0.540	PC_TOT	1050	0.063	0.094	0.000	0.540
SB_PCT	1099	0.471	0.091	0.222	0.769	SB_PCT	1050	0.470	0.091	0.250	0.769
SB_AGE	1099	57.446	6.724	25.750	78.000	SB_AGE	1050	57.662	6.626	25.750	78.000
SB_IND	1099	0.403	0.097	0.200	0.800	SB_IND	1050	0.402	0.095	0.250	0.667
SB_F	1099	0.274	0.239	0.000	1.000	SB_F	1050	0.270	0.237	0.000	1.000
AC_SIZE	1099	3.096	0.543	0.000	7.000	AC_SIZE	1050	3.107	0.500	2.000	7.000
BH	1099	0.645	0.206	0.000	1.000	BH	1050	0.645	0.206	0.000	1.000
SOE	1099	0.062	0.242	0.000	1.000	SOE	1050	0.059	0.235	0.000	1.000
BG	1099	0.606	0.488	0.000	1.000	BG	1050	0.624	0.484	0.000	1.000
LEV	1099	0.123	0.161	0.000	0.800	LEV	1050	0.125	0.160	0.000	0.800
FSIZE	1099	9.296	0.720	6.510	11.330	FSIZE	1050	4.880	1.755	0.131	8.555
LOSS	1099	0.168	0.374	0.000	1.000	LOSS	1050	0.165	0.371	0.000	1.000
FAGE	1099	30.753	16.840	2.000	107.000	FAGE	1050	30.696	16.508	2.000	107.000

Notes: This table presents the summary statistics of the main variables. The sample includes 1,099 (1,050) firm-year observations for the period 2010-2013. All variables are based on calendar year. Variable definitions: TOBINS Q is the market performance measure based on Dahya *et al.* (2008). EPS is Earnings Per Share. PC_SB is the percentage of the SB who is or was a minister, parliament member, other appointed bureaucrat in the local and central government, military. PC_BOD is the percentage of the Board of Director who is or was a minister, parliament member, other appointed bureaucrat in the local and central government, military. PC_TOT is the percentage of the SB and Board of Director who is or was a minister, parliament member, other appointed bureaucrat in the local and central government, military. SB_PCT is the percentage of the SB member. SB_AGE is the age of the SB member. SB_IND is the proportion of supervisory board independence. SB_F is the proportion of SB member with financial and accounting background. AC_SIZE is the number of audit committee member. BH is the percentage of large shareholder who owns at least 10% of outstanding shares. LEV is the natural log of the ratio of total long-term debt divided by the total assets at the end of the year. FSIZE is the natural logarithm of total assets. FAGE is the number of years since the firm was established and zero otherwise. Indicator variables are as follows. SOE is the indicator variable that equals one if the shareholder is central or local government and zero otherwise. BG is the indicator variable that equals one if firm belongs to family business group and zero otherwise. LOSS is the indicator variable that equals one if firm is loss and zero otherwise. The year dummy variables indicate the calendar year from 2010 to 2013. The industry dummy identifies two-digit GICS (Global Industry Classification Standard) code.

Table III.
Summary statistics of main variables

relatively similar with the results in Model 2a. This outcome supports *H1b*, suggesting that firms with politically connected SBs enhance their firm performance. There is strong evidence that politically connected SBs are more valuable than politically connected BODs, as reflected in higher firm performance. In the context of Indonesian dual board system, the SB is responsible for monitoring and supervising the BOD. The SB decides long-term and strategic planning for the company. Additionally, in our sample, we found that mostly SB member hold high level of political connections, including former minister with industry specialization, senior military officer, etc. Given the strategic role of SB and the high levels of their political connections, the presence of politically connected SBs is more beneficial for the company compared to politically connected BOD (Joni *et al.*, 2019).

Table V also presents the results for the association between several control variables (corporate governance mechanisms and firm characteristics) and firm performance. For instance, the coefficient on SB_AGE is significantly negative at the 1 per cent level in Model 1a (coefficient = –0.025, t = –3.02) and Model 2a (coefficient = –0.025, t = –3.09). The coefficient on BG is significantly negative at the 1 per cent level in both Model 1a

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
(1) TOBINS Q/EPS		0.057[c]	−0.008	0.029	0.050	0.002	−0.018	0.008	0.045	−0.011	−0.037	−0.108[a]	0.071[b]	−0.156[a]	0.087[a]
(2) PC_SB	0.051[c]		0.114[a]	0.025	0.245[a]	0.208[a]	−0.135[a]	−0.081[a]	−0.084[a]	−0.167[a]	0.259[a]	0.200[a]	0.167[a]	0.082[a]	−0.087
(3) PC_BOD	−0.011	0.117[a]		0.023	0.063[b]	−0.000	−0.078[b]	−0.025	−0.067[b]	−0.038	0.032	0.047	−0.025	0.051[c]	−0.070[c]
(4) SB_SIZE	0.056[c]	0.043	−0.005		−0.060[b]	−0.038	0.001	0.115[a]	−0.065[b]	0.018	−0.114[a]	0.004	0.003	0.079[b]	0.052[c]
(5) SB_AGE	−0.109[a]	0.254[a]	0.065[b]	0.009		0.038	−0294[a]	−0.070[b]	−0.146[a]	0.054[c]	0.112[a]	0.024	0.158[a]	−0.044	0.138[a]
(6) SB_IND	0.084[a]	0.209[a]	−0.000	0.040	0.039		0.032	0.003	−0.045	−0.038	0.048	0.124[a]	0.038	0.124[a]	−0.065[b]
(7) SB_F	0.100[a]	−0.140[a]	−0.078[a]	−0.008	−0.297[a]	0.046		−0765[b]	0.058[c]	−0.179[a]	−0.021	0.026	−0.063[b]	0.042	−0.033
(8) AC_SIZE	0.019	−0.086[a]	−0.019	0.010	−0.049[c]	0.001	−0.084[a]		−0.023	0.414[a]	−0.147[a]	0.069[b]	0.289[a]	−0.065[b]	0.197[a]
(9) BH	0.061[b]	−0.081[a]	−0.065[b]	0.051[c]	−0.147[a]	−0.030	0.075[b]	−0.029		0.043	−0.124[a]	−0.175[a]	−0.017	−0.000	0.008
(10) SOE	0.013	−0.167[a]	−0.038	−0.026	0.051[c]	−0.036	−0.179[a]	0.389[a]	0.030		−0.323[a]	−0.060[b]	0.241[a]	−0.068[b]	0.306[a]
(11) BG	−0.098[a]	0.272[a]	0.037	−0.113	0.144[a]	0.052[c]	−0.036	−0.138[a]	−0.111[a]	−0.321[a]		0.201[a]	0.197[a]	−0.024	−0.099[a]
(12) LEV	0.046	0.200[a]	0.047	−0.005	0.024	0.118[a]	0.040	0.059[b]	−0.160[a]	−0.054[c]	0.193[a]		0.163[a]	0.186[a]	−0.054[c]
(13) FSIZE	0.017	0.211[a]	0.001	−0.001	0.153[a]	0.060[b]	−0.077[b]	0.254[a]	−0.168[a]	0.247[a]	0.266[a]	0.129[a]		−0.214[a]	0.281[a]
(14) LOSS	−0.058[c]	0.074[b]	0.048	0.054[c]	−0.055[c]	0.124[a]	0.063[b]	−0.075[b]	−0.003	−0.076[b]	−0.036	0.166[a]	−0.119[a]		−0.081[a]
(15) FAGE	0.143[a]	−0.018	−0.067[b]	−0.005	0.135[a]	−0.048	−0.040	0.199[a]	0.031	0.316[a]	−0.079[a]	−0.009	0.215[a]	−0.098[a]	

Notes: The table reports the pairwise Pearson correlation matrix for the full sample. Pearson correlations for Tobin's Q models are below (1,099 firm-year observations) and for EPS models are above (1,050 firm-year observations). Please see Table III for definitions of variables. The superscripts a-c indicate two-sided significance at the 1%, 5%, and 10% levels, respectively

Table IV.
Correlation matrix

Table V.
Politically connected boards and firm performance-pooled OLS

	Estimated Coefficients							
	Panel A: Tobin's Q				Panel B: EPS			
Variables	Model 1a	Model 2a	Model 3a	Model 4a	Model 1b	Model 2b	Model 3b	Model 4b
INTERCEPT	2.924[a] (3.89)	2.973[a] (3.95)	2.984[a] (3.96)	3.051[a] (4.08)	−0.044 (−1.15)	−0.045[a] (−1.15)	−0.043 (−1.13)	−0.046 (−1.20)
PC_TOT	5.129[a] (3.71)		4.019[a] (3.26)		0.188[a] (2.71)		0.376[a] (6.13)	
PC_SB		1.821[a] (2.67)		2.965[a] (4.81)		0.091[a] (2.65)		0.189[a] (6.14)
PC_BOD		1.029 (0.19)		−1.582 (−0.62)		−0.049 (−0.18)		−0.011 (−0.09)
PC_TOT^2	−13.857[a] (−3.09)				−4.439[b] (−1.95)			
PC_SB^2		−1.812c (−1.66)				−0.107[b] (−1.96)		
PC_BOD^2		−1.502 (−0.07)				0.152 (0.14)		
SB_PCT	−0.214 (−0.40)	−0.183 (−0.35)	−0.131 (−0.25)	0.008 (0.02)	0.031 (1.17)	0.034 (1.26)	0.042 (1.58)	0.050[b] (1.90)
SB_AGE	−0.025[a] (−3.02)	−0.025a (−3.09)	−0.024a (−2.97)	−0.025[a] (−3.09)	0.000 (1.32)	0.000 (1.33)	0.000 (1.42)	0.000 (1.46)
SB_IND	1.269[b] (2.37)	1.134[b] (2.10)	1.112[b] (2.08)	0.991[c] (1.86)	1.022 (0.82)	0.022 (0.82)	0.018 (0.70)	0.014 (0.54)
SB_F	0.469[b] (2.12)	0.512[b] (2.30)	0.531[b] (2.39)	0.600[a] (2.70)	−0.003 (−0.34)	−0.003 (−0.32)	0.001 (0.15)	0.002 (0.18)
AC_SIZE	−0.017 (−0.16)	−0.012 (−0.11)	−0.033 (−0.28)	−0.028 (−0.25)	0.000 (0.12)	0.000 (0.10)	−0.001 (−0.23)	−0.000 (−0.08)
BH	0.115 (0.46)	0.159 (0.64)	0.131 (0.53)	0.046 (0.18)	0.016 (1.31)	0.017 (1.34)	0.012 (0.98)	0.009 (0.78)
SOE	−0.205 (−0.79)	−0.211 (−0.81)	−0.129 (−0.48)	−0.027 (−0.10)	−0.016 (−1.19)	−0.016 (−1.18)	−0.000 (−0.01)	−0.000 (−0.04)
BG	−0.560a (−4.56)	−0.556a (−4.51)	−0.377[a] (−2.73)	−0.309[c] (−2.25)	−0.016[a] (−2.61)	−0.016a (−2.56)	0.003 (0.47)	0.003 (0.51)
PC_TOT*BG			−3.497[a] (−2.54)				−0.396[a] (−5.79)	
PC_SB*BG				−2.754[a] (−4.01)				−0.201[a] (−5.86)
PC_BOD*BG				3.758 (1.18)				0.013 (0.09)
LEV	−0.525 (−1.53)	−0.543 (−1.58)	−0.448 (−1.31)	−0.501 (−1.47)	−0.054 (−3.06)	−0.055[a] (−3.11)	−0.050[a] (−2.87)	−0.051[a] (−2.94)
FSIZE	0.042 (1.21)	0.043 (1.22)	0.477 (1.35)	0.041 (1.19)	0.000 (0.40)	0.000 (0.38)	0.000 (0.31)	0.000 (0.26)
LOSS	−0.156 (−1.10)	−0.169 (−1.18)	−0.179[c] (−1.25)	−0.179 (−1.26)	−0.028[a] (−3.96)	−0.028[a] (−3.93)	−0.030[a] (−4.27)	−0.030[a] (−4.21)
FAGE	0.009[a] (2.81)	0.009[a] (2.82)	0.009[a] (2.60)	0.008[b] (2.37)	0.000[c] (1.71)	0.000[c] (1.68)	0.000 (1.18)	0.000 (1.05)
YEAR	Included	Included	Included	Included	Included	Included	Included	Included
INDUSTRY	Included	Included	Included	Included	Included	Included	Included	Included
Average VIF	2.09	3.04	2.11	2.21	2.10	2.95	2.05	2.14
R^2	0.127	0.124	0.125	0.136	0.092	0.091	0.117	0.118
Adj. R^2	0.107	0.102	0.104	0.114	0.069	0.067	0.096	0.094
F	6.27	5.66	6.13	6.24	4.15	3.81	5.45	5.07
Prob > F	0.000[a]	0.000[a]	0.000[a]	0.000[a]	0.000[a]	0.000[a]	0.000[a]	0.000[a]
N	1099	1099	1099	1099	1050	1050	1050	1050

Notes: The table reports OLS coefficient estimates and dummy variables are included in the regression to control for year and industry differences. However, the results are not provided due to space constraints. PC_TOT/SB/BOD*BG are the interaction between total politically connected boards/SB/BOD and family business groups. Other definitions of variables are listed in Table III. The superscripts a-c indicate two-sided significance at the 1%, 5%, and 10% levels, respectively

(coefficient = –0.560, t = –4.56) and Model 2a (coefficient = –0.556, t = –4.51). The coefficients on SB_PCT, AC_SIZE, BH and SOE are not statistically significant. However, the coefficient on SB_F is significantly positive at the 5 per cent level in both Model 1a (coefficient = 0.469, t = 2.12) and Model 2a (coefficient = 0.512, t = 2.30). Tobin's Q is positively and significantly related to SB_IND at the 5 per cent level in the two models (coefficient =1.269, t = 2.37 and coefficient =1.134, t = 2.10). These results reveal that most corporate governance characteristics do effectively monitor and supervise management, in terms of market performance. With reference to other control variables, the coefficient on FAGE is significantly positive at the 1 per cent level in Model 1a (coefficient = 0.009, t = 2.81) and Model 2a (coefficient = 0.009, t = 2.82). The coefficients on this variable support the model specification as they have the expected sign.

4.3 Curvilinear relationship between politically connected boards and firm performance

The results from prior section (Model 1a, 1b, 2a and Model 2b) suggest that the presence of politically connected boards is positively associated with firm performance, especially politically connected SBs. In this section, we test whether the relationship between politically connected boards and firm performance is non-linear. As reported in Table V, the coefficient on PC_TOT is significantly positive (coefficient = 5.129, t = 3.71), whereas the coefficient of PC_TOT^2 is significantly negative at the 1 per cent level (coefficient = −13.857, t = −3.09) in Model 1a. More importantly, in Model 2a of Table V, the association between politically connected SBs and Tobin's q is significantly positive at the 1 per cent level (coefficient = 1.821, t = 2.67) and the coefficient on PC_SB^2 is negatively significant at the 10 per cent level (coefficient = −1.812, t = −1.66), as expected. The negative sign of PC_TOT^2 and PC_SB^2 indicates that the relationship between politically connected boards (SBs) and Tobin's q is non-linear. Initially, with the increase in the percentage of politically connected boards (SBs), market performance begins to improve. Yet after reaching the optimum level, market performance tends to decline. The optimum point of the curve is approximately 18.50 per cent in Model 1a and 50.25 per cent in Model 2a.[8] We also find consistent results using EPS models (Model 1 b and Model 2 b). Taken together, these results support *H2a* and *H2*b, indicating that there is a curvilinear relationship between politically connected boards and market performance. Specifically, there is an inverted U-shaped relationship between politically connected boards and firm performance. Firm performance is increasing until firms achieve a certain level of political connections. Beyond this level, firm performance begins to decline. Since the prior studies show inconclusive direction on the effect of political connection and firm performance, we argue that this relationship is not linear. Our results show that the benefits of political connection outweigh the cost of obtaining the connections when the level of political connections reach certain level.

Since the AT arguments on the effect of political connections compete against the RDT arguments, we expect a non-linear relationship between politically connected boards and firm performance in Indonesia's two-tier board system. It might be possible that the conflicting results on the relation between corporate governance characteristics and firm's behaviour due to the curvilinear relationship.

4.4 Politically connected boards, Tobin's Q, and family business groups

Table V reports the OLS estimates of Models 3a, 3b, 4a and 4b for testing the interaction between politically connected boards and family business group (PC_TOT*BG/PC_SB*BG/PC_BOD*BG). Using Tobin's q measure, model 3a of Table V shows that the coefficient on PC_TOT is positive and significant at the 1 per cent level (coefficient = 4.019, t = 3.26), whereas the coefficient of PC_TOT*BG is negative and significant at the 1 per cent level

(coefficient = −3.497, t = −2.54). In Model 4a of Table V, the coefficient on PC_SB is positive and significant at the 1 per cent level (coefficient = 2.965, t = 4.81), but the coefficient of PC_BOD is negative and not significant (coefficient = −1.582, t = −0.62). The coefficients on PC_SB*BG is negative and significant at the 1 per cent level (coefficient = −2.754, t = −4.01), whereas the coefficient of PC_BOD*BG is positive and not significant (coefficient = 3.758, t = 1.18). We also find consistent results using EPS measure (Model 3 b and Model 4 b). Overall, the results suggest that stand-alone firms with political connections experience more benefits than firms belonging to family business groups as reflected in better market performance. This means that the political connection levels of stand-alone firms are more effective than the political connections in firms with family business groups. Therefore, the benefits of having political connections in stand-alone firms outweigh its costs. In Indonesian context, firms with family business groups have strong connections with government and the costs to obtain this level of connections is also high. This can be another reason why the political connections in family business groups in not effective.

5. Further analysis

5.1 Endogeneity

In corporate governance literature, endogeneity is the main concern. We address simultaneity issue as one of potential endogeneity problem in our paper. It is possible that companies with better firm performance tend to have political connections. We address this issue by using several models, including lagged variables regression, selection model, generalized method of moments (GMM), and propensity score matching. Table VI reports the OLS regression results for lagged variables regression on the association between politically connected boards and firm performance (the lagged Tobin's Q and EPS). As reported in Table VI, the coefficients on PC_TOT and PC_SB are positive and statistically significant at the 1 per cent in Model 1a (coefficient = 3.546, t = 3.25) and 2a (coefficient = 1.421, t = 2.64). Table VI also shows that the coefficient on PC_TOT^2 is significantly negative at the 1 per cent level in Model 1a (coefficient = –9.678, t = –2.75) and the coefficient on the association between PC_SB^2 and lagged Tobin's Q is significant at the 10 per cent level in Model 2a (coefficient = −1.644, t = −1.92). Model 3a and Model 4a of Table VI present the OLS results concerning the effect of the interaction between political connections and family business groups on lagged Tobin's Q. As reported previously, Tobin's Q is negatively associated with PC_TOT*BG at the 1 per cent level (coefficient = −2.340, t = −2.14) and PC_SB*BG (coefficient = −1.887, t = −3.45) in Model 3a and Model 4a. Similar results are presented in EPS models (Model 1 b, 2 b, 3 b, 4 b). Overall, the coefficient regression results are consistent with the OLS regression results reported in Table V.

In terms of sample selection test, Table VII and Table VIII present the results of the first-stage probit model and the second-stage regression model. Model 1a in Table VII uses the first-stage model for politically connected boards as the dependent variable and Model 2a employs politically connected SBs as the dependent variable. For the second-stage results, Model 1a of Table VIII shows that the coefficient on PC_TOT is significantly positive at the 1 per cent level (coefficient = 5.573, t = 4.01) when IMR is controlled. The coefficient on PC_SB is positive and significant at the 1 per cent level (coefficient = 2.016, t = 2.95) in Model 2a.

Model 1a and Model 2a of Table VIII also present a quadratic relationship between politically connected boards and Tobin's Q. After controlling IMR, the results indicate a significant inverted U-shaped relationship between politically connected boards and Tobin's Q. Further, Table VIII shows that Tobin's Q is negatively and significantly associated with PC_TOT*BG at the 1 per cent level (coefficient = −3.709, t = −2.70) in Model 3a. The

Table VI. Politically connected boards and firm performance-lagged variable

	Estimated Coefficients							
	Panel A: Tobins Q				Panel B: EPS			
Variables	Model 1a	Model 2a	Model 3a	Model 4a	Model 1b	Model 2b	Model 3b	Model 4b
INTERCEPT	1.491[a] (2.50)	1.505[a] (2.52)	1.520[a] (2.55)	1.574[b] (2.65)	−0.047 (−1.00)	−0.049 (−1.03)	−0.045 (−0.96)	−0.051 (−1.11)
PC_TOT	3.546[a] (3.25)		2.685[a] (2.75)		0.251[a] (2.96)		0.469[a] (6.26)	
PC_SB		1.421[a] (2.64)		1.969[a] (4.01)		0.111[a] (2.67)		0.226[a] (5.95)
PC_BOD		−1.595 (−0.36)		−2.229 (−1.12)		0.127 (0.38)		0.118 (0.78)
PC_TOT^2	−9.678a (−2.74)				−0.575 b (−2.11)			
PC_SB^2		−1.644b (−1.92)				−0.128 b (−1.94)		
PC_BOD^2		8.001 (0.48)				−0.349 (−0.27)		
SB_PCT	0.037 (0.09)	0.052 (0.13)	0.096 (0.23)	0.177 (0.43)	0.027 (0.83)	0.031 (0.97)	0.039 (1.23)	0.051 (1.60)
SB_AGE	−0.008 (−1.26)	−0.008 (−1.29)	−0.007 (−1.20)	−0.008 (−1.24)	0.000 (1.28)	0.000 (1.31)	0.000 (1.38)	0.000 (1.42)
SB_IND	0.703[c] (1.65)	0.653[a] (1.52)	0.592 (1.39)	0.520 (1.23)	0.027 (0.82)	0.028 (0.84)	0.021 (0.67)	0.018 (0.56)
SB_F	0.277 (1.57)	0.297[c] (1.68)	0.322[c] (1.82)	0.372[b] (2.10)	−0.004 (−0.32)	−0.003 (−0.25)	0.002 (0.17)	0.001 (0.14)
AC_SIZE	0.053 (0.59)	0.055 (0.61)	0.045 (0.50)	0.046 (0.52)	−0.000 (−0.12)	−0.000 (−0.12)	−0.003 (−0.48)	−0.002 (−0.29)
BH	0.132 (0.67)	0.168 (0.85)	0.148 (0.75)	0.076 (0.38)	0.015 (1.00)	0.016 (1.05)	0.009 (0.65)	0.008 (0.57)
SOE	−0.014 (−0.07)	−0.015 (−0.07)	0.034 (0.16)	0.096 (0.47)	−0.010 (−0.62)	−0.010 (−0.65)	0.009 (0.56)	0.007 (0.47)
BG	−0.347a (−3.58)	−0.341a (−3.51)	−0.225 b (−2.06)	−0.183c (−1.69)	−0.019a (−2.56)	−0.019 b (−2.52)	0.004 (0.53)	0.004 (0.54)
PC_TOT*BG			−2.340b (−2.14)				−4.484a (−5.79)	
PC_SB*BG				−1.887[a] (−3.45)				−0.235a (−5.59)
PC_BOD*BG				4.501[c] (1.79)				−0.115 (−0.60)
LEV	−0.423 (−1.51)	−0.441 (−1.57)	−0.360 (−1.28)	−0.389 (−1.39)	−0.045 b (−2.10)	−0.046 b (−2.10)	−0.038 (−1.79)	−0.038c (−1.77)
FSIZE	0.036 (1.29)	0.037 (1.31)	0.040 (1.43)	0.036 (1.29)	0.000 (0.19)	0.000 (0.17)	0.000 (0.08)	0.000 (0.04)
LOSS	−0.092 (−0.80)	−0.103 (−0.89)	−0.114 (−0.99)	−0.107 (−0.93)	−0.032 (−3.58)	−0.032a (−3.55)	−0.034a (−3.92)	−0.034a (−3.92)
FAGE	0.004 (1.56)	0.004 (1.56)	0.003 (1.37)	0.003 (1.17)	0.000 (1.64)	0.000 (1.64)	0.000 (1.08)	0.000 (1.01)
YEAR	Included	Included	Included	Included	Included	Included	Included	Included
INDUSTRY	Included	Included	Included	Included	Included	Included	Included	Included
R^2	0.121	0.120	0.119	0.128	0.093	0.092	0.118	0.117
Adj. R^2	0.100	0.097	0.098	0.105	0.070	0.067	0.096	0.093
F	5.71	5.19	5.58	5.62	4.12	3.75	5.40	4.92
Prob > F	0.000[a]	0.000[a]	0.000[a]	0.000[a]	0.000[a]	0.000[a]	0.000[a]	0.000[a]
N	1055	1055	1055	1055	1027	1027	1027	1027

Notes: The table reports OLS coefficient estimates and dummy variables are included in the regression to control for year and industry differences. However, the results are not provided due to space constraints. PC_TOT/SB/BOD*BG are the interaction between total politically connected boards/SB/BOD and family business groups. Other definitions of variables are listed in Table III. The superscripts a-c indicate two-sided significance at the 1%, 5%, and 10% levels, respectively

Variables	Estimated coefficient Panel A: Tobins Q Model 1	 Model 2	Panel B: EPS Model 3	 Model 4
INTERCEPT	−10.764[a] (−7.57)	−11.451[a] (−7.86)	−10.171a (−7.07)	−10.851[a] (−7.38)
LOCATION	3.859[a] (4.83)	3.923[a] (4.79)	3.494[a] (4.42)	3.539[a] (4.38)
DISTANCE	0.002[a] (3.24)	0.003[a] (3.33)	0.002[a] (3.01)	0.002[a] (3.10)
PC_BOD		8.825[a] (3.33)		8.702[a] (3.30)
SB_PCT	4.582[a] (5.40)	4.556[a] (5.35)	4.529[a] (5.34)	4.511[a] (5.29)
SB_AGE	0.059[a] (4.57)	0.058[a] (4.41)	0.058[a] (4.45)	0.057[a] (4.28)
SB_IND	2.585[a] (3.25)	2.813[a] (3.52)	2.630[a] (3.27)	2.872[a] (3.56)
SB_F	−0.661[c] (−1.91)	−0.623[c] (−1.78)	−0.589[c] (−1.69)	−0.550 (−1.56)
AC_SIZE	−0.464[a] (−2.68)	−0.418[b] (−2.41)	−0.452[a] (−2.61)	−0.412[b] (−2.37)
BH	0.696[c] (1.79)	0.503[b] (2.15)	0.662[c] (1.69)	0.919[b] (2.31)
BG	1.292[a] (7.01)	1.353[a] (7.21)	1.225[a] (6.55)	1.291[a] (6.78)
LEV	2.056[a] (4.02)	2.175[a] (4.19)	1.930[a] (3.71)	2.049[a] (3.87)
FSIZE	0.228[a] (4.29)	0.235[c] (4.36)	0.230[a] (4.24)	0.238[a] (4.32)
LOSS	0.207 (0.92)	0.153 (0.67)	0.230 (1.02)	0.175 (0.76)
FAGE	0.001 (0.36)	0.003 (0.68)	0.002 (0.43)	0.004 (0.79)
YEAR[a]	Included	Included	Included	Included
INDUSTRY[a]	Included	Included	Included	Included
Wald chi^2	362.00	380.00	335.67	353.21
Pseudo R^2	0.250	0.263	0.239	0.252
Log likelihood	−542.31	−531.13	−532.29	−521.63
Prob > F	0.000	0.000	0.000	0.000
N	1099	1099	1050	1050

Notes: The table reports OLS coefficient estimates and dummy variables are included in the regression to control for year and industry differences. However, the results are not provided due to space constraints. PC_TOT/SB/BOD*BG are the interaction between total politically connected boards/SB/BOD and family business groups. Other definitions of variables are listed in Table III. The superscripts a-c indicate two-sided significance at the 1%, 5%, and 10% levels, respectively

Table VII.
IMR – First stage

coefficient on PC_SB*BG is negative and significant at the 1 per cent level (coefficient = −2.854, t = −4.17) in Model 4a. These coefficient regression results are consistent with the OLS results presented in Table V. As for the control variable, the coefficient on IMR is significantly positive, which means that it is important to explicitly control for self-selection bias in these models. Table VII and VIII also present similar results using EPS measure (Model 1 b and 2 b in Table VII; Model 1 b, 2 b, 3 b, 4 b in Table VIII). These results are still consistent with those reported in Table V. Then, the Difference GMM is applied to address the endogeneity issue (Arellano and Bond, 1991). GMM is commonly used as an efficient estimate in the presence of heteroskedasticity, and it is asymptotically normal when there is no heteroskedasticity (Baum *et al.*, 2003). Results of the GMM estimations are similar those reported in Table V.[9] Finally, we employ propensity score matching (PSM). This approach addresses the concern that several non-linear terms of the control variables (such as firm size, leverage) affect the likelihood of constructing political connections and firm performance (Houston *et al.*, 2014). As a result, we removed non-politically connected observations that are systematically different from politically connected observations to ensure that politically connected and non-politically connected firms have similar characteristics. First, we estimate the political connection propensity score for each observation in the sample by using a probit model (Lennox *et al.*, 2013). The dependent variable is the dummy variable for political connection and the independent variables are leverage, firm

Table VIII.
Effect of politically connected boards and firm performance – IMR – second stage

	Estimated Coefficients							
	Panel A: Tobins Q				Panel B: EPS			
Variables	Model 1a	Model 2a	Model 3a	Model 4a	Model 1b	Model 2b	Model 3b	Model 4b
INTERCEPT	1.322 (1.29)	1.135 (1.08)	1.515 (1.48)	1.181 (1.12)	−0.004 (−0.09)	0.002 (0.04)	−0.007 (−0.14)	−0.005 (−0.09)
PC_TOT	5.575[b] (4.01)		4.330[a] (3.51)		0.181[a] (2.58)		0.371[a] (6.05)	
PC_SB		2.016[a] (2.95)		3.143[a] (5.09)		0.087[a] (2.55)		0.187[a] (6.05)
PC_BOD		1.846 (0.34)		−0.089 (−0.03)		−0.072 (−0.26)		−0.044 (−0.34)
PC_TOT^2	−14.897[a] (−3.32)				−0.419[a] (−1.86)			
PC_SB^2		−1.986[c] (−1.82)				−0.103[b] (−1.90)		
PC_BOD^2		−0.694[a] (−0.03)				0.127 (0.12)		
SB_PCT	0.560 (0.88)	0.666 (1.05)	0.586 (0.92)	0.892 (1.41)	0.010 (0.32)	0.010 (0.32)	0.023 (0.72)	0.029 (0.90)
SB_AGE	−0.013 (−1.36)	−0.013 (−1.37)	−0.013 (−1.41)	−0.012 (−1.35)	0.000 (0.57)	0.000 (0.55)	0.000 (0.68)	0.000 (0.72)
SB_IND	1.605[a] (2.89)	1.534[a] (2.73)	1.410[a] (2.55)	1.387[b] (2.50)	0.013 (0.46)	0.011 (0.39)	0.010 (0.38)	0.004 (0.17)
SB_F	0.395 (1.76)	0.443[b] (1.98)	0.467[b] (2.08)	0.527[b] (2.36)	−0.001 (−0.12)	−0.001 (−0.11)	0.003 (0.32)	0.003 (0.34)
AC_SIZE	−0.070 (−0.60)	−0.062 (−0.53)	−0.082 (−0.69)	−0.079 (−0.68)	0.002 (0.43)	0.002 (0.41)	0.000 (0.05)	0.001 (0.18)
BH	0.263 (1.03)	0.358 (1.37)	0.269 (1.05)	0.249 (0.95)	0.013 (1.00)	0.012 (0.90)	0.008 (0.69)	0.005 (0.41)
SOE	−0.195 (−0.75)	−0.199 (−0.77)	−0.115 (0.44)	−0.012 (−0.05)	−0.015 (−1.16)	−0.015 (−1.16)	−0.000 (−0.01)	−0.000 (−0.05)
BG	−0.346[b] (−2.29)	−0.311[b] (−2.00)	−0.169 (−1.02)	−0.048 (−0.29)	−0.021[a] (−2.70)	−0.022[a] (−2.70)	−0.001 (−0.18)	−0.001 (−0.21)
PC_TOT*BG			−3.709[a] (−2.70)				−0.393[a] (−5.75)	
PC_SB*BG				−2.854[a] (−4.17)				−0.199[a] (−5.83)
PC_BOD*BG				3.079 (0.97)				0.026 (0.17)
LEV	−0.246 (−0.68)	−0.233 (−0.64)	−0.187 (−0.52)	−0.177 (−0.49)	−0.061[a] (−3.24)	−0.062[a] (−3.31)	−0.056[a] (−3.04)	−0.058[a] (−3.11)
FSIZE	0.071[c] (1.87))	0.076[b] (1.98)	0.074[b] (1.92)	0.076[b] (2.00)	−0.000 (−0.22))	−0.000 (−0.31)	−0.000 (−0.20)	−0.000 (0.30)
LOSS	−0.133 (−0.94)	−0.153 (−1.08)	−0.159 (−1.12)	−0.165 (−1.17)	−0.030[a] (−4.11)	−0.029 (−4.08)	−0.031[a] (−4.38)	−0.031[a](−4.32)
FAGE	0.009[a] (2.82)	0.010[a] (2.90)	0.009[a] (2.59)	0.008[b] (2.44)	0.000[c] (1.69)	0.000 (1.61)	0.000 (1.16)	0.000 (0.99)
IMR	0.222[b] (2.17)	0.242[b] (2.34)	0.204[b] (2.00)	0.246[b] (2.40)	−0.006 (−1.10)	−0.007 (−1.20)	−0.005 (−0.99)	−0.006 (−1.02)
YEAR	Included	Included	Included	Included	Included	Included	Included	Included
INDUSTRY	Included	Included	Included	Included	Included	Included	Included	Included
R^2	0.130	0.128	0.127	0.140	0.092	0.092	0.118	0.118
Adj. R^2	0.110	0.106	0.107	0.118	0.070	0.068	0.096	0.095
F	6.45	5.86	6.28	6.46	4.19	3.87	5.50	5.11
Prob > F	0.000[a]	0.000[a]	0.000[a]	0.000[a]	0.000[a]	0.000[a]	0.000[a]	0.000[a]
N	1099	1099	1099	1099	1050	1050	1050	1050

Notes: The table reports OLS coefficient estimates and dummy variables are included in the regression to control for year and industry differences. However, the results are not provided due to space constraints. PC_TOT/SB/BOD*BG are the interaction between total politically connected boards/SB/BOD and family business groups. Other definitions of variables are listed in Table III. The superscripts a-c indicate two-sided significance at the 1%, 5%, and 10% levels, respectively

size, loss, firm age, year and industry fixed effects. Second, we re-estimate the political connection models by using a reduced sample of 810 observations. The results (not reported) are consistent with those reported in Table V[10].

5.2 Alternative measure of Tobin's Q

To measure firm performance, we also calculate industry-adjusted Tobin's Q and industry-adjusted EPS to ensure the main findings are reliable. In line with previous studies (Wu *et al.*, 2012; Ding *et al.*, 2014), industry-adjusted Tobin's Q (EPS) is calculated as Tobin's Q (EPS) minus the median value of the industry. Our sample is classified by Jakarta Stock Industrial Classification. The regression models are then re-estimated based on this alternative proxy for firm performance. Accordingly, Table IX reports that politically connected boards are significantly positively associated with adjusted Tobin's Q at the 10 per cent level in Model 1a (coefficient = 5.129, t = 3.71) and the coefficient on PC_SB is significantly positive at the 1 per cent level in Model 2a (coefficient = 1.821, t = 2.67).

Model 1a of Table IX also shows that the coefficient on PC_TOT^2 is significantly negative at the 1 per cent level (coefficient = –13.858, t = –3.09) and the coefficient on the association between PC_SB^2 and adjusted Tobin's Q is significant at the 10 per cent level in Model 2a (coefficient = −1.811, t = −1.66). Further, Table IX shows that stand-alone firms with politically connected boards derive more value than firms belonging to family business groups at the 1 per cent level, as reflected in higher adjusted Tobin's Q (coefficient = −3.498, t = −2.55), especially for firms with politically connected SBs at the 1 per cent level (coefficient = −2.755, t = −4.01). We also find consistent results using EPS measure (Model 1 b, 2 b, 3 b, and 4 b). Overall, these additional tests support the main results. Additionally, we test our models using Cluster Robust Standard Errors as prescribed by Petersen (2009) to control for fixed effects from repeated-observed firms in the panel data. The results (not tabulated) are consistent with our OLS results in Table V.

6. Conclusions

This paper extends our understanding of the association between political connections and market performance. While prior studies have detected conflicting results on this issue (Fan *et al.*, 2007; Wu *et al.*, 2012), we expand the literature by examining whether the relationship between firms with politically connected SBs/BODs and market performance is non-linear. We integrate both rent-seeking and resource dependence arguments through a non-linear model. Further, we identify whether family business groups extract more benefits by exhibiting better market performance than stand-alone firms when they appoint politically connected SBs/BODs. To address these research questions, we focus on the Indonesian setting, in which the level of political influence in conducting business is substantial (Fisman, 2001), the corporate governance system is characterised by a two-tier board system (IFC, 2014), and concentrated ownership where firms are mostly controlled by family business groups (Claessens *et al.*, 2006; Rusmin *et al.*, 2012). The SB position under the Indonesian dual board system is more important and strategic than that of the BOD. Since the introduction of the Indonesian Company Law in 1995, the SB has the authority to appoint and dismiss BOD members and other key managers, to decide long-term strategic planning and remuneration packages and, to supervise the BOD (IFC, 2014).

We find that a politically connected board is positively associated with market performance. Specifically, the relationship between politically connected SBs and market performance is positive and statistically significant, whereas the association between politically connected BODs and market performance is not significant. Thus, the presence of politically connected boards improves firms' market performance and the role of politically

Table IX. Effect of politically connected boards and adjusted firm performance

	Estimated Coefficients							
	Panel A: Tobins Q				Panel B: EPS			
Variables	Model 1a	Model 2a	Model 3a	Model 4a	Model 1b	Model 2b	Model 3b	Model 4b
INTERCEPT	1.690[b] (2.25)	1.739[b] (2.31)	1.751[b] (2.32)	1.817[b] (2.43)	−0.047 (−1.22)	−0.047 (−1.22)	−0.046 (−1.21)	−0.049 (−1.27)
PC_TOT	5.129[a] (3.71)		4.021[a] (3.26)		0.188[a] (2.70)		0.375[a] (6.13)	
PC_SB		1.821[a] (2.67)		2.966[a] (4.81)		0.091[a] (2.65)		0.189[a] (6.14)
PC_BOD		1.025 (0.19)		−1.580 (−0.62)		−0.047 (−0.17)		−0.011 (−0.09)
PC_TOT^2	−13.858a (−3.09)				−0.438 [b] (−1.95)			
PC_SB^2		−1.811c (−1.66)				−0.106 b (−1.95)		
PC_BOD^2		−1.486 (−0.07)				0.147 (0.14)		
SB_PCT	−0.213 (−0.40)	−0.183 (−0.35)	−0.130 (−0.25)	0.008 (0.02)	0.031 (1.16)	0.033 (1.26)	0.042 (1.58)	0.049[c] (1.89)
SB_AGE	−0.025a (−3.02)	−0.025a (−3.09)	−0.024a (−2.97)	−0.025a (−3.09)	0.000 (1.31)	0.000 (1.33)	0.000 (1.41)	0.000 (1.45)
SB_IND	1.269[b] (2.37)	1.134[b] (2.10)	1.112[b] (2.08)	0.991[c] (1.86)	0.022 (0.82)	0.022 (0.82)	0.018 (0.70)	0.014 (0.54)
SB_F	0.469[b] (2.12)	0.512[b] (2.30)	0.531[b] (2.39)	0.600[a] (2.70)	−0.003 (−0.34)	−0.003 (−0.32)	0.001 (0.15)	0.002[a] (0.18)
AC_SIZE	−0.017 (−0.16)	−0.012 (−0.11)	−0.033 (−0.28)	−0.028 (−0.25)	0.000 (0.12)	0.000 (0.10)	−0.001 (−0.23)	−0.000 (−0.08)
BH	0.115 (0.46)	0.159 (0.64)	0.131 (0.53)	0.046 (0.18)	0.016 (1.32)	0.017 (1.35)	0.012 (0.98)	0.009 (0.79)
SOE	−0.205 (−0.79)	−0.211 (−0.81)	−0.129 (−0.48)	−0.027 (−0.10)	−0.016 (−1.19)	−0.016 (−1.18)	−0.000 (−0.01)	−0.000 (−0.05)
BG	−0.560a (−4.56)	−0.556a (−4.51)	−0.377*a* (−2.73)	−0.308 b (−2.25)	−0.016a (−2.60)	−0.016[a] (−2.56)	0.003[a] (0.48)	0.003[b] (0.51)
PC_TOT*BG			−3.498*a* (−2.55)				−0.395a (−5.79)	
PC_SB*BG				−2.755a (−4.01)				−0.200a (−5.85)
PC_BOD*BG				3.757 (1.18)				0.014 (0.09)
LEV	−0.525 (−1.53)	−0.543 (−1.58)	−0.449 (−1.31)	−0.501 (−1.47)	−0.054[a] (−3.04)	−0.055[a] (−3.08)	−0.049a (−2.85)	−0.051a (−2.92)
FSIZE	0.042 (1.21)	0.043 (1.22)	0.047 (1.35)	0.041 (1.19)	0.000 (0.39)	0.000 (0.38)	0.000 (0.30)	0.000 (0.25)
LOSS	−0.156 (−1.10)	−0.168 (−1.18)	−0.179 (−1.25)	−0.179 (−1.26)	−0.028[a] (−3.96)	0.000 (0.38)	−0.030[a] (−4.27)	−0.030a (−4.22)
FAGE	0.009[a] (2.81)	0.009[a] (2.82)	0.009[a] (2.60)	0.008[b] (2.37)	0.000[c] (1.71)	−0.028[a] (−3.93)	0.000[a] (1.18)	0.000 (1.05)
YEAR	Included	Included	Included	Included	Included	Included	Included	Included
INDUSTRY	Included	Included	Included	Included	Included	Included	Included	Included
R^2	0.126	0.123	0.124	0.135	0.092	0.091	0.117	0.118
Adj. R^2	0.106	0.101	0.103	0.113	0.069	0.067	0.096	0.094
F	6.22	5.61	6.08	6.20	4.16	3.82	5.46	5.07
Prob > F	0.000[a]	0.000[a]	0.000[a]	0.000[a]	0.000[a]	0.000[a]	0.000[a]	0.000[a]
N	1099	1099	1099	1099	1050	1050	1050	1050

Notes: The table reports OLS coefficient estimates and dummy variables are included in the regression to control for year and industry differences. However, the results are not provided due to space constraints. PC_TOT/SB/BOD*BG are the interaction between total politically connected boards/SB/BOD and family business groups. Other definitions of variables are listed in Table III. The superscripts a-c indicate two-sided significance at the 1%, 5%, and 10% levels, respectively

connected SBs is critical. In this paper, we shed light on the strategic roles of politically connected SBs to mitigate external interdependency and uncertainty of the organisation. We also document a non-linear relationship between politically connected boards and market performance. Consistent with our predictions, the result shows an inverted U-shaped relationship between politically connected boards and the optimum level of politically connected boards is 18.50 per cent and 50.25 per cent for politically connected SBs. After reaching the optimum level, the value of politically connected boards declines as reflected in poorer market performance. Theoretically, our paper integrates the resource dependence effect and rent-seeking effect through a quadratic model. Further, our results show that stand-alone firms benefit more than firms belonging to family business groups when they appoint politically connected boards, especially politically connected SBs.

However, the results of this paper should be interpreted in the light of the following limitations. First, the research sample was selected during second term of the presidency of SBY, yet previous Indonesian regimes are not addressed in this paper. Second, we identify the presence of family business group and political connections based on publicly data available. We do not have detailed information on other characteristics of family business groups, including information on politically connected boards across generations in the family business groups. Third, we do not have complete information to test whether firms who enjoy connections with the ruling party obtain more benefits than those who have connections with other parties. Given these limitations, further research is needed in emerging countries where politically connected boards and family business groups are prevalent.

Notes

1. He used the Suharto Dependency Index (1995) to represent the degree of closeness to the Suharto regime for the years 1995 to 1998. The index was developed by the Castle Group, a leading economic consulting firm in Jakarta. Based on the 25 largest industrial groups in Indonesia with political connections, they classified political connections into five rating ranges, from one (least dependent) to five (most dependent).
2. Japanese corporations have the option to adopt one-tier or two-tier board systems (Tan, 2011).
3. The total sample is 66 firm-year observations, including 15 firm-year observations with political connections in Indonesia (Chaney et al., 2011).
4. Of the 94 firms in the sample, 37% were listed firms (Claessens et al., 2006).
5. Measured by votes obtained, electoral success of the politician, or political party.
6. For instance, Mr Ciputra and Dr Cosmas Batubara were the most powerful board members and they occupied 7 seats on the supervisory board of Indonesian Listed Companies in May 2012.
7. We calculate the economic significance by multiplying the coefficient estimation by standard deviation (Tobin's q analysis =5.129*0.093 = 0.4769 and EPS analysis = 0.188*0.094=0.0176)
8. The inflection point is calculated as $0.5\beta 1/\beta 2$ (Anderson & Reeb, 2003).
9. All results are available upon request. Using Tobin's q measure, the coefficient on PC_TOT is 5.980 (t= 4.32), PC_SB is 2.166 (t= 3.81) and PC_BOD is −1.219 (t=−0.28). Then, the coefficient on PC_TOT^2 and PC_SB^2 are −15.872 (t=−3.97); −2.145 (t=−2.79), respectively. Finally, the coefficient on PC_TOT*BG is −3.715 (t=−1.97) and PC_SB*BG is −2.780 (t=−2.43).
10. All results are available upon request. Using Tobin's q measure, the coefficient on PC_TOT is 6.101 (t= 4.59), PC_SB is 2.145 (t= 3.28) and PC_BOD is −2.869 (t=−0.57). Then, the coefficient

on PC_TOT^2 and PC_SB^2 are −15.638 (t=−3.74); −2.031 (t=−1.99), respectively. Finally, the coefficient on PC_TOT*BG is −5.479 (t=−4.03) and PC_SB*BG is −3.847 (t=−5.71).

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