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Penulis: Joni Joni, Maria Natalia, Leliana Leliana

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2.	Bukti konfirmasi submit revisi pertama, respon kepada reviewer, dan artikel yang diresubmit	13 Apr. 2023
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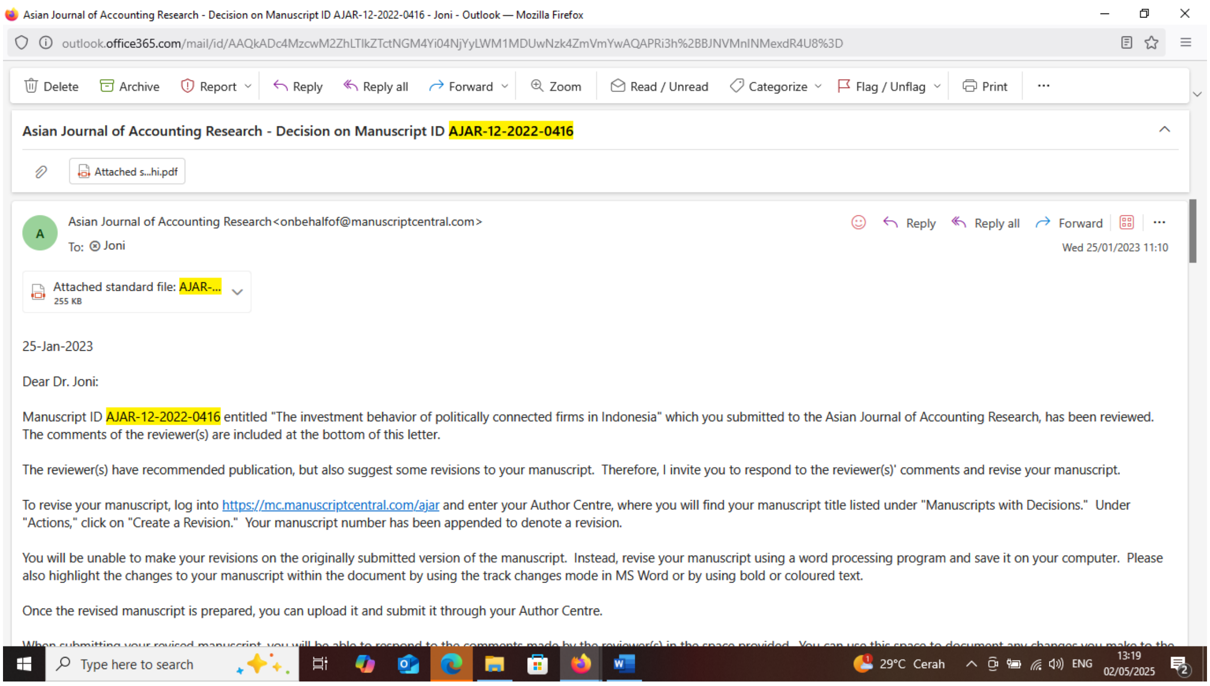

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The investment behavior of politically connected firms in Indonesia

Journal:	*Asian Journal of Accounting Research*
Manuscript ID	AJAR-12-2022-0416.R1
Manuscript Type:	Research Paper
Keywords:	politically connected SBs, emerging market, corporate investment, endogeneity

The investment behavior of politically connected firms in Indonesia

Abstract

Purpose - We examine the effect of the politically connected supervisory board (PV_SVP) on corporate investment behavior in Indonesia in the period of 2015-2019.

Design/methodology/approach – We use Indonesian listing companies as our sample. OLS (Ordinary Least Square) regression is applied to investigate this association. Also, we address the endogeneity problem by using the generalized method of moments (GMM).

Findings - We find that firms with political connections through Supervisory Boards (SBs) are negatively significantly associated with corporate investment. Our results are robust to alternative measures and to test for endogeneity.

Research implications – We contribute to prior research by showing empirical findings on the investment behavior of politically connected firms using an emerging economy context, Indonesia, which has a unique political landscape. We offer practical implications for practitioners and policy makers, such as improving the corporate governance system and promoting better investment opportunities by establishing a transparent and competitive environment.

Originality/value - Our study differs from other studies due to different corporate governance and political connection settings. While most prior studies examine the investment behavior of politically connected firms using the Chinese context, we use Indonesia which has different political and governance landscapes. Indonesia applies a two-tier board system that promotes the strategic role of the political supervisory board.

Keywords politically connected SBs, emerging market, corporate investment, endogeneity.

Paper type Research paper

1. Introduction

Our study aims to investigate how investment behavior is different between politically connected and non-politically connected companies in an emerging economy, Indonesia. Specifically, we examine the effect of political connections through supervisory board members on corporate investment. The research on the effect of political connections on capital market outcomes has been explored around the world, including stock return (Cooper et al., 2010; Faccio and Parsley, 2006), accounting information quality (Chaney et al., 2011), and market valuation (Faccio, 2006). Further, previous studies document that political affiliation is an effective way for companies to obtain easy access to external financing (Claessens et al., 2008; Bliss and Gul, 2012; Boubakri et al., 2012; Houston et al., 2014; Joni et al., 2019; Kamarudin et al., 2021), tax benefits (Wahab et al., 2017), audit pricing (Gul, 2006) which can influence their corporate investment behavior (Pan and Tian, 2017). However, limited studies examine the effect of political connections via supervisory board members on investment behavior in a dual board system context. In addition, the empirical results on the relationship between political connections and corporate investment are inconclusive. While several studies argued that politically connected firms experience better investment efficiency than their counterparts because political connections allow them to have extra external funding (e.g., Pan and Tian, 2017; Phan et al., 2020), other studies confirm that firms with government connections may suffer from government intervention to invest in unfavorable projects, but it is concerned politically (e.g., Chen et al., 2011; Chen et al., 2020; Nasih et al., 2020).

Our study is different from prior studies in terms of institutional background. We examine the investment behavior of politically connected firms in Indonesia, where the capital market is imperfect and semi efficient (Joni et al., 2019). In the context of semi-efficient market, informational asymmetries and agency problems, which have been the most crucial factors in affecting corporate investment efficiency, are more relevant for investment decisions than the efficient market (Xu et al., 2013). Also, most prior studies use China as the setting of their studies, which is very different from Indonesia. While the Chinese government system is communist, the Indonesian government system is a democracy where people have the authority to vote for their legislators and president. Accordingly, the political power in Indonesia is more dispersed compared to China. Unlike the political connection pattern in China, where external resources are controlled by the government and the role of SOEs is important in China (Imamah et al., 2020; Pan and Tian, 2017), political connection in Indonesia depend on various political parties and army power (Joni et al., 2019). Compared to Nasih et al. (2020), our work also promotes another uniqueness of the Indonesian corporate governance system, which implements a two-tier board system. Indonesian dual board system has separated operating and monitoring functions into two different boards called a board of directors and a supervisory board (or board of commissioners). Political connection is mostly developed through elite people appointed to supervisory board, and their roles become very strategic (Joni et al., 2019). Therefore, this institutional context is interesting to investigate whether political connection through the supervisory board effectively influences corporate investment.

Based on 1,523 firm-year observations of Indonesian listed companies from 2015-2019, we find that firms with the politically connected supervisory board have a significantly lower investment expenditure than their counterparts. The results are robust after addressing the endogeneity issue using the GMM (Generalized Method of Moments) model and alternative measure of investment expenditure. Our paper contributes to the literature by providing empirical results on the role of the politically connected supervisory boards in determining corporate investment behavior in the context of Indonesian dual board system. Also, we contribute to the policy makers in terms of the improvement of corporate governance system which can offer better investment opportunities in Indonesia.

The remainder of our paper is reported as follows: in section 2, we provide theoretical background and hypothesis development, followed by research design in Section 3. Next, research findings and discussion are explained in Section 4. The final section is the conclusion.

2. Theoretical Background and Hypothesis Development

The association between political connections and investment behavior has been examined and the results are inconclusive and need more explanation. On the one hand, Resource Dependency Theory (RDT) explain that organization is an open access and use political connection to deal with external uncertainty and its dependency to government bureaucracy in conducting business. A Firm with political connection obtains more external funding and lower cost of finance than non-politically connected firms (Joni et al., 2020; Houston et al., 2014; Boubakri et al., 2012), that cause a better investment efficiency. Xu et al., (2013) test whether Chinese family firms can mitigate their underinvestment problem when they have connections with the government. Using the Shanghai and Shenzhen listed firms in the period of 2000-2007, they show that family firms have difficulty accessing external funding and suffer from underinvestment problem. However, political connections help family firms to mitigate the underinvestment problem. The effect is more substantial in financially constrained companies. Pan and Tian (2017) set up a natural experiment using the recent anti-corruption based on listed firms in China and examined the association between political affiliation and corporate investment from 2003-2014. They find that politically connected firms experience lower investment after the ousting of the corrupt government officers compared to non-politically connected firms. Also, politically connected SOEs obtain more efficient investment than non-politically connected SOEs after the corrupt government officer's ousting. Since the recent anti-corruption campaign, the investment efficiency for politically affiliated firms in China become more significant. Imamah et al. (2020) explore the influence of the anti-corruption campaign on the investment behavior of politically affiliated companies in China from 2007-2016. Their finding indicates that all types of politically connected companies (political connections of non-SOEs/central SOEs/local SOEs) reduced their investment expenditures after the anti-corruption campaign compared to the period before the campaign. Also, political connections between Non-SOEs and local SOEs improve their investment efficiency after the anti-corruption campaign. Phan et al. (2020) examine the relationship between political connections and corporate investment in Malaysia from 2002 to 2016. Based on 631 listed firms, they document a positive influence of political connections on corporate investment. Firm with political connections with top political elites has 2.1%-2.9% more investment than non-political firms in the context of a stable political environment, such as Malaysia.

On the other hand, the Agency perspective argues that information asymmetry between management and shareholders distracts the company from making an efficient investment decision. And political connection worsens it because firms with political connections should invest in unfavorable projects due to political concerns. Using a Chinese sample, Chen et al. (2011) indicate that government intervention in SOEs prevents them from making optimal investments and even lower investment efficiency. Another study using the Chinese context by Chen et al. (2020) also found that regional political favoritism is related to less efficient corporate investment. Next, Nasih et al. (2020) examine the association between political connections and a company's overinvestment in Indonesia. They show a negative association between those variables. It might happen because of mixed economy applied in Indonesia, where both public and private sectors are essential.

In line with the theoretical background and the prediction of the previous empirical studies, the hypothesis is proposed as follow:

H1: Politically affiliated firm through supervisory board connections is associated with corporate investment expenditure, ceteris paribus.

3. Research Design

3.1 Data and sample

We use all listed companies in Indonesia during 2015-2019 as our sample, except financial sectors because they are regulated under different mechanisms. The chosen period is considered as a stable political regime. In our research, we collected all information from several different sources. We first use corporate governance information, including supervisory board connections which is manually collected from company annual report, their website, and google search engine. Next, our financial data is downloaded from the Datastream database.

3.2 Models dan Variables

We use the following regression models to examine the effect of politically connected firms through supervisory boards on corporate investment expenditure in hypothesis 1.

$$INVasset_{it} = \alpha_1 PC\_SPVB_{it} + \alpha_2 SIZE_{it} + \alpha_3 DER_{it} + \alpha_4 GROWTH_{it} + \alpha_5 INDUSTRY_{it} + \alpha_6 YEAR_{it} + \varepsilon_{it}$$

A detailed definition of variables and references are outlined as follows:

Table 1: Variable's definition

Variable	Definition
$INVasset_{it}$	capital expenditure of the company in year t scaled by a 5 year total assets of the company in year t-1 (Phan et al., 2020)
$PC\_SPV\__{it}$	Dummy variable sets to 1 if the company has political connections through the supervisory board in year t and 0 otherwise. We consider our sample as politically connected firms if one of the top management (supervisory board) was a former government officer, such as a minister, a member of parliament, a president, etc. (Faccio, 2006)
Control variables-firm characteristics	
$SIZE_{it}$	the natural log of the company's total assets in year t (Phan et al., 2020; Pan and Tian, 2017)
DER_{it}	total debts scaled by total assets in year t (Phan et al., 2020)
$GROWth_{it}$	sales growth (Phan et al., 2020)
Control variables-fixed effects	
$INDUSTRY_{it}$	a vector of industry indicator variables that categorized using two-digit GICS (Global Industry Classification Standard).
$YEAR_{it}$	a vector of year indicator variables: 2015; 2016; 2017; 2018; 2019.

3.3 Statistical analyses

The objective of this study is to examine the impact of political connections through the supervisory board on investment expenditure, using an OLS (Ordinary Least Squares) regression model. We begin by presenting descriptive statistics to better understand the sample, followed by a pairwise correlation analysis to check the correlation of the key variables. To address the potential issue of multicollinearity, we conduct a variance inflation factor (VIF) test before proceeding with the regression analysis.

3.4 Sensitivity analyses and alternative measure

Endogeneity is a critical issue in corporate governance literature, particularly when investigating the association between political connections and investment efficiency. The possibility of firms with efficient investment connecting with government officials introduces the potential for an endogeneity problem. The independent variable, political connections, may be endogenously determined and influence the dependent variable, investment expenditure. To address this problem, the study employs the Generalized Method of Moments (GMM) to estimate the model. GMM is a widely accepted econometric technique that addresses endogeneity. These methods are consistent with previous research (Phan et al., 2020; Pan and Tian, 2017) and aim to ensure the validity and reliability of our findings. Moreover, the study re-estimates the model using a different measure of investment expenditure, a five-year fixed asset, which represents the long-term investment commitment made by the firm. This alternative measure can serve as a proxy for investment expenditure, offering a more accurate assessment of the relationship between political connections and investment efficiency.

4. Research Findings and Discussion

4.1 Descriptive Statistics

Table 2 reports descriptive statistics for the total sample of 1,523 firm-year observations to examine the relationship between the politically affiliated firm and corporate investment. We winsorized at the 1st and 99th percentiles for continuous variables, except dummy variables. The average of several main variables is presented in Table 2. The average of INV_{asset} is 6.680 and PC_SPV is 15.6%. We find that these values are consistent with prior literature (e.g. Pan and Tian, 2017; Joni et al., 2019). The average firm size (SIZE) value is 22.179 with a maximum of 32.921 and a minimum of 2.607. Next, the value of DER and GROWth are considered reasonable compared to prior literature (e.g. Pan and Tian, 2017; Joni et al., 2019).

Table 2: Summary statistics of main variables

Variable	N	Mean	St. Dev	Min	Max
INV_{asset}	1,523	6.680	6.653	0.070	34.950
PC_SPV	1,523	0.156	0.290	0.000	1.000
SIZE	1,523	22.179	9.362	2.607	32.921
DER	1,523	0.734	0.371	0.000	0.960
Growth	1,523	0.116	0.614	-0.831	5.267

Notes: The table reports the summary statistics of the key variables. The sample includes 1,523 firm-year observations for the period 2015-2019. We use all variables based on calendar year. The variable definitions are available in Table 1.

Next, Pairwise Pearson Correlation is applied to check correlation among key variables in the model, industry and year effects are excluded. In Table 3, it reports that the highest correlation is between firm size and leverage (r=0.131). Then, we run the multicollinearity test using VIF in Table 4 and the result shows that the model is free from the multicollinearity problem.

Table 3: Correlation matrix

	(1)	(2)	(3)	(4)	(5)
(1) INV_{asset}	1.000				
(2) PC_SPV	-0.046[c]	1.000			
(3) FSIZE	0.046[c]	0.009	1.000		
(4) LEV	0.100[a]	0.058[b]	0.131[a]	1.000	
(5) GROWth	0.002	-0.020	-0.026	0.052[a]	1.000

The table reports the pairwise Pearson correlation matrix for the full sample (1,523 firm-year observations). Please see Table 1 for definitions of variables. The superscripts a-c indicate two-sided significance at the 1%, 5%, and 10% levels.

4.2 Politically Connected Supervisory Board and Corporate Investment

Table 4 reports the OLS estimate to examine the effect of the politically connected supervisory board on corporate investment. The result of the model shows that the coefficient of political connection via the supervisory board is negative and significant at the 5% level (the coefficient = -1.116 and t = 1.95), suggesting that the presence of political connections through supervisory reduces corporate investment expenditure. The result is consistent with Agency Theory which explains the reason why politically affiliated companies tend to have lower investment efficiency and avoid optimal investment. It argues that information asymmetry between agent (management) and principal (shareholders) distracts the company from making an efficient investment decision. The leverage is positively and significantly associated with corporate investment. However, firm size and company growth are not statistically significant. Mostly, the results are consistent with prior studies, such as Nasih et al. (2020).

Table 4: Politically Connected SB and Corporate Investment-pooled OLS

	Model
INTERCEPT	5.125[a] (3.59)
PC_SPV	-1.116[b] (1.95)
SIZE	0.069 (1.38)
DER	1.777[a] (3.57)
Growth	0.137 (0.51)
INDUSTRY	Included
YEAR	Included
Average VIF	2.46
Adj. R^2	0.083
F	12.54
Prob > F	0.000[a]
N	1523

The table reports OLS coefficient estimates, and indicator variables are included in the regression to control for year and industry-fixed effects. Please see Table 1 for definitions of variables. The superscripts a-c indicate two-sided significance at the 1%, 5%, and 10% levels, respectively.

4.3 Sensitivity Analysis

It is clearly argued that firms with politically connected SBs are negatively associated with corporate investment. Table 5 reports an alternative analysis using the Generalized Method of Moments (GMM) model to check for endogeneity issues in testing the relationship between politically connected SBs and Corporate Investment. Overall, the result remains similar after applying the GMM model.

Table 5: Politically Connected SB and Corporate Investment-GMM Model

	Model 1
INTERCEPT	-1.976 (1.28)
PC_SPV	-0.011[a] (5.42)
SIZE	0.000 (0.35)
DER	0.018[a] (9.43)
Growth	0.001 (0.75)
INDUSTRY	Included
YEAR	Included
N	1,523

4.4 Alternative Measure

To improve the reliability of our main result, we use a five-year fixed asset to measure capital expenditure as an alternative measure and rerun the regression. As shown in Table 6, the result shows a negative association between politically connected firms through the supervisory board and corporate investment. The result in Table 6 is consistent with the result in Table 5.

Table 6: Politically Connected SB and Corporate Investment-Alternative Measure

	Model
INTERCEPT	24.474[a] (2.00)
PC_SPV	-16.373[a] (3.76)
SIZE	0.381 (0.92)
DER	-7.159[a] (-1.55)
Growth	3.810 (1.55)
INDUSTRY	Included
YEAR	Included
Average VIF	2.71
Adj. R^2	0.022
F	2.76
Prob > F	0.001[a]
N	845

5. Conclusions

Our paper contributes to the literature by examining the relationship between the politically affiliated supervisory board and corporate investment behavior in an emerging market, Indonesia. After controlling several main variables, we find a negative association between political connections through the supervisory board and investment expenditure. Consistent with agency theory, our finding suggests that firms with political connections via supervisory boards make inefficient investment decision-making. Politically connected firms through supervisory board tend to invest in unfavorable projects due to political concerns. Additionally, we conduct robustness tests by addressing endogeneity problem and using an alternative measure of corporate investment, the results remain similar.

This study offers implications for scholars on the cost of having political connections through supervisory boards. We also provide implications for practitioners and regulators to strengthen the corporate governance system in Indonesia. Further, policymakers should establish a transparent and competitive environment to promote better investment opportunities. However, our findings should be interpreted by considering several limitations which can be potential future research. First, we consider firm size, growth, and leverage as control variables in the model, but other control variables (such as free cash flow, firm's age, return on asset, state-owned enterprises, etc.) are not included. Second, the effect of political connections on corporate investment behavior is examined using a quantitative approach. It will be interesting to address this issue using a qualitative approach to obtain a deep and comprehensive understanding of how and why the presence of political connections reduces corporate investment. Third, a firm can establish a connection with the government through several different channels, such as family members, friends, etc. Our paper needs to address these issues, and it raises the need for future studies.

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Responses to Reviewers' comments

Dear Reviewers,

Many thanks for your insightful and suggestions to improve the quality of the paper submitted to Asian Journal of Accounting Research. In this revised version we have made all necessary corrections and undertake additional as suggested and hope this time the revised paper will have positive recommendation from you. Our responses are placed side-by-side to your comments.

Reviewer #1: Manuscript ID AJAR-12-2022-0416

Major Comments and Suggestions

No	Comments and Suggestions	Responses
1	Originality: Does the paper contain new and significant information adequate to justify publication?: It is an interesting topic. However, the originality of the paper does not adequately address. Weak in the write-up - support from the prior literature.	Thank you for the suggestions. We have made a followed up and submitted a revised version. We have done proofread for the revised paper.
2	Relationship to Literature: Does the paper demonstrate an adequate understanding of the relevant literature in the field and cite an appropriate range of literature sources? Is any significant work ignored?: The paper does not adequately cite relevant literature in the politically connected field. Most of the literature considers china and only 1 study from Malaysia. Much significant work was ignored such as Gul et al, Kamaruddin et al, and Abdul Wahab et al.	Thank you for the suggestion. We have added suggested papers in our paper. "The research on the effect of political connections on capital market outcomes has been explored around the world, including stock return (Cooper et al. 2010; Faccio and Parsley 2006), accounting information quality (Chaney et al. 2011), and market valuation (Faccio 2006). Further, previous studies document that political affiliation is an effective way for companies to obtain easy access to external financing (Claessens et al. 2008; Bliss and Gul 2012; Boubakri et al. 2012; Houston et al. 2014; Joni et al. 2019; Kamarudin et al., 2021), tax benefits (Wahab, et al., 2017), audit pricing (Gul, 2006) which can influence their corporate investment behavior (Pan and Tian 2017)."
3	Methodology: Is the paper's argument built on an appropriate base of theory, concepts, or other ideas? Has the research or equivalent intellectual work on which the paper is based been well designed? Are the	We now have added the justification of our sample and clear definition of politically connected firm based on Faccio (2006).

	methods employed appropriate?: Further justification is required for the chosen sample. The definition of politically connected firms from Faccio (2006) does not properly explain in the paper.	It is expressed in section 3 (Research design) as follow: "We use all listed companies in Indonesia during the period 2015-2019 as our sample, except financial sectors because they are regulated under different mechanism. The chosen period is considered as a stable political regime." "dummy variable sets to 1 if company has political connections through supervisory board in year t and 0 otherwise. We consider our sample as politically connected firms if one of the top management (supervisory board) was a former government officers, such as minister, a member of parliament, president, etc. (Faccio 2006)"
4	Results: Are results presented clearly and analysed appropriately? Do the conclusions adequately tie together the other elements of the paper?: - The discussions are weak and require further explanation. - The result does not explain in detail in the writeup - Descriptive, correlation, and multiple regression. - E.g. (in regression), the author only explains the IV in the writeup. What about others control variables. All findings should be supported by the theory and prior studies.	Thank you for the suggestions. We have added further explanations. In descriptive statistics: Table 2 reports descriptive statistics for the full sample of 1,523 firm-year observations to examine the relationship between politically affiliated firm and corporate investment. We winsorised at the 1^{st} and 99^{th} percentiles for continuous variables, except dummy variables. The average of several main variables is presented in Table 2. The average of INV_{asset} is 6.680 and PC_SPV is 15.6%. We find that these values are consistent with prior literature (e.g. Pan and Tian 2017; Joni et al. 2019). The average value of firm size (SIZE) is 22.179 with a maximum of 32.921 and a minimum of 2.607. Next, the value of DER and GROWth are considered reasonable compared to prior literature (e.g. Pan and Tian 2017; Joni et al. 2019). In the result discussions: "Table 4 reports the OLS estimate to examine the effect of politically connected

		supervisory board on corporate investment. The result of the model shows that the coefficient of political connection via supervisory board is negative and significance at the 5% level (the coefficient = -1.116 and t = 1.95), suggesting that the presence of political connections through supervisory reduce corporate investment expenditure. The result is consistent with Agency Theory which explains the reason why politically affiliated companies tend to have lower investment efficiency and avoid optimal investment. It argues that information asymmetry between agent (management) and principal (shareholders) distract company to make an efficiency investment decision. The leverage is positively significant associated with corporate investment. However, firm size and company's growth are not significant statistically. Mostly,the results are consistent with prior studies, such as Nasih et al. (2020). "
5	Practicality and/or Research implications: Does the paper identify clearly any implications for practice and/or further research? Are these implications consistent with the findings and conclusions of the paper?: Lack of research and practical implication on the regulatory or companies.	We have revised the conclusion section and add practical implications. "This study offers implications for the scholars on the cost of having political connections through supervisory boards. We also provide implications for practitioners and regulators to strengthen the corporate governance system in Indonesia. Further, policy makers should establish a transparent and competitive environment to promote better investment opportunities."
6	Quality of Communication: Does the paper clearly express its case, measured against the technical language of the field and the expected knowledge of the journal's readership? Has attention been paid to the clarity of expression and readability, such as sentence structure, jargon use, acronyms, etc.: average	Thank you for your suggestions. We have rechecked and revised it.

Reviewer #2: Manuscript ID AJAR-12-2022-0416

Major Comments and Suggestions

No	Comments and Suggestions	Responses
1	Originality: Does the paper contain new and significant information adequate to justify publication?: The contributions of this paper must be explicitly discussed. It should discuss how this paper is different from other papers (at least highlight two papers that are closely related to this paper. It can be from other countries). For example, compare with Nasih et al. (2020). Political connections, overinvestment and governance mechanism in Indonesia. published in Cogent Economics & Finance.	Thank you for your suggestions, we have included the discussion in the introduction section. "However, limited studies on the effect of political connection via supervisory board members on investment behavior in the context of dual board system. In addition, the empirical results on the relation between political connections and corporate investment are inconclusive. While several studies argued that politically connected firms experience better investment efficiency than their counterparts because political connections allow them to have extra external funding (e.g., Pan and Tian, 2017; Phan et al., 2020), other studies confirm that firms with government connections may suffer from government intervention to invest in unfavorable projects but it is concerned politically (e.g., Chen et al., 2011; Chen et al., 2020; Nasih et al., 2020). Our study is different with prior studies in terms of institutional background. We examine the investment behavior of politically connected firms in Indonesia where the capital market is imperfect and semi efficient. In the context of semi efficient market, informational asymmetries and agency problem which have been the most crucial factors in affecting corporate investment efficiency are more relevant for investment decisions compared to efficient market (Xu et al. 2013). Also, most prior studies use China as the

		setting of their studies which is very different with Indonesia. While Chinese government system is communist, Indonesian government system is democracy where people have authority to vote for their legislators and president. Accordingly, the political power in Indonesia is more dispersed compared to China. Unlike the political connection pattern in China where external resources are controlled by government and the role of SOEs is important in China (Imamah et al. 2020; Pan and Tian 2017), political connection in Indonesia is depend on various political parties and army power (Joni et al. 2019). Compared to Nasih et al. (2020), our work also promotes another uniqueness of Indonesian corporate governance system which implement two-tier board system. Indonesian dual board system has separated operating and monitoring functions into two different boards called board of directors and supervisory board (or board of commissioners). Mostly, political connection is developed through elite people who has been appointed as supervisory board and their roles become more strategic (Joni et al. 2019). Therefore, this institutional context is interesting to investigate whether political connection through supervisory board is effective to influence corporate investment. "
2	Relationship to Literature: Does the paper demonstrate an adequate understanding of the relevant literature in the field and cite an appropriate range of literature sources? Is any significant work ignored?: Limited. Add relevant literature to investment efficiency, for example: Nasih, M. Al-Cholili, A.S., Harymawan, I., Haider, I and Rahayu, N.K. (2020). Political connections, overinvestment and governance	In the revised version, we have added any relevant literature to investment efficiency in theoretical background and hypothesis development section. "On the other hand, Agency perspective argues that information asymmetry between management and shareholders distract company to make an efficiency investment decision. And the presence of political connection worsens it because

	mechanism in Indonesia. published in Cogent Economics & Finance, 8(1), 1790220. Chen, Y., Cui, C, Yang, T. Zhang, X. (2020). Political favouritism and investment efficiency. Pacific-Basin Finance Journal. Vol 61, 101058 Shin, Y.Z., Chang, JY., Jeon, K. et al. Female directors on the board and investment efficiency: evidence from Korea. Asian Bus Manage 19, 438–479	firms with political connections have obligation to invest on unfavorable projects due to political concerns. Using Chinese sample, Chen et al. (2011) indicate that government intervention in SOEs prevents them from making optimal investment and even lower investment efficiency. Another study using Chinese context by Chen et al. (2020) also find that political regional favoritism is related to less efficient corporate investment. Next, Nasih et al. (2020) examine the association between political connections and company's overinvestment in Indonesia. They show a negative association between those variables. It might happen because of mixed economy applied in Indonesia where both public and private sectors are essential."
3	Methodology: Is the paper's argument built on an appropriate base of theory, concepts, or other ideas? Has the research or equivalent intellectual work on which the paper is based been well designed? Are the methods employed appropriate?: Consider to include additional control variables (any three of the following), such as: 1. FREECF is the free cash flow, 2. CFO_SALE is the cash flow from operations (CFO)/sales 3. SD_CFO is the standard deviation of CFO/beginning of year total assets for the past five years 4. SD_INV is the standard deviation of investment in PPE/beginning of the year total tangible assets for the past five years 5. TANGIBILITY is the tangible assets/total assets, 6. AGE is the the firm's age from year listed on the exchange refer to this article: Shin, Y.Z., Chang, JY., Jeon, K., & Kim, Y. (2020). Female directors on the board and	Thank you for the suggestion. Ideally it would be better to add several control variables. However, we are constrained by some factors which we put forward for understanding and consideration. Therefore, we added all the considerations in the limitation of the study. "However, our findings should be interpreted by considering several limitations which can be potential future research. First, we consider firm size, growth, and leverage as control variables in the model, but other control variables (such as free cash flow, firm's age, return on asset, state-owned enterprises, etc.) are not included."

	investment efficiency: evidence from Korea. Asian Bus Manage 19, 438–479	
4	Results: Are results presented clearly and analysed appropriately? Do the conclusions adequately tie together the other elements of the paper?: Appropriate	Thank you for Feedback.
5	Practicality and/or Research implications: Does the paper identify clearly any implications for practice and/or further research? Are these implications consistent with the findings and conclusions of the paper?: Appropriate	Thank you for Feedback.
6	Quality of Communication: Does the paper clearly express its case, measured against the technical language of the field and the expected knowledge of the journal's readership? Has attention been paid to the clarity of expression and readability, such as sentence structure, jargon use, acronyms, etc.: Appropriate	Thank you for Feedback.

Reviewer #3: Manuscript ID AJAR-12-2022-0416

Major Comments and Suggestions

No	Comments and Suggestions	Responses
1	In this study, The investment behavior of politically connected firms in Indonesia has been investigated. In my opinion, the paper is good, and it can be considered for publishing after a minor revision. • Check for typo and grammatical mistakes and improve the usage of English language • Update some new reference • Include some more applications of	Thank you for your highlights, we have considered your suggestions to improve our paper, including check for typo and grammatical mistakes, update some new reference, and discuss more practical implications. We have done proofread for the revised paper.

	the study in the introduction section by using the references.	

Associate Editor #4: Manuscript ID AJAR-12-2022-0416

Major Comments and Suggestions

No	Comments and Suggestions	Responses
1	The topic is interesting, unfortunately, this paper lack of deep discussion in almost every section. I strongly suggest to the author(s) to revamp this article to enrich its discussion in introduction, literature review, and result sections.	Thank you for your highlights, we have considered your suggestions to improve our paper by providing more discussion in introduction, literature review, result sections, and conclusion.

Responses to Reviewers' comments

Dear Reviewers,

Many thanks for your insightful and suggestions to improve the quality of the paper submitted to Asian Journal of Accounting Research. In this revised version we have made all necessary corrections and undertake additional as suggested and hope this time the revised paper will have positive recommendation from you. Our responses are placed side-by-side to your comments.

Reviewer #1: Manuscript ID AJAR-12-2022-0416

Major Comments and Suggestions

No	Comments and Suggestions	Responses
1	Originality: Does the paper contain new and significant information adequate to justify publication?: It is an interesting topic. However, the originality of the paper does not adequately address. Weak in the write-up - support from the prior literature.	Thank you for the suggestions. We have made a followed up and submitted a revised version. We have done proofread for the revised paper.
2	Relationship to Literature: Does the paper demonstrate an adequate understanding of the relevant literature in the field and cite an appropriate range of literature sources? Is any significant work ignored?: The paper does not adequately cite relevant literature in the politically connected field. Most of the literature considers china and only 1 study from Malaysia. Much significant work was ignored such as Gul et al, Kamaruddin et al, and Abdul Wahab et al.	Thank you for the suggestion. We have added suggested papers in our paper. "The research on the effect of political connections on capital market outcomes has been explored around the world, including stock return (Cooper et al. 2010; Faccio and Parsley 2006), accounting information quality (Chaney et al. 2011), and market valuation (Faccio 2006). Further, previous studies document that political affiliation is an effective way for companies to obtain easy access to external financing (Claessens et al. 2008; Bliss and Gul 2012; Boubakri et al. 2012; Houston et al. 2014; Joni et al. 2019; Kamarudin et al., 2021), tax benefits (Wahab, et al., 2017), audit pricing (Gul, 2006) which can influence their corporate investment behavior (Pan and Tian 2017)."
3	Methodology: Is the paper's argument built on an appropriate base of theory, concepts, or other ideas? Has the research or equivalent intellectual work on which the paper is based been well designed? Are the	We now have added the justification of our sample and clear definition of politically connected firm based on Faccio (2006).

	methods employed appropriate?: Further justification is required for the chosen sample. The definition of politically connected firms from Faccio (2006) does not properly explain in the paper.	It is expressed in section 3 (Research design) as follow: "We use all listed companies in Indonesia during the period 2015-2019 as our sample, except financial sectors because they are regulated under different mechanism. The chosen period is considered as a stable political regime." "dummy variable sets to 1 if company has political connections through supervisory board in year t and 0 otherwise. We consider our sample as politically connected firms if one of the top management (supervisory board) was a former government officers, such as minister, a member of parliament, president, etc. (Faccio 2006)"
4	Results: Are results presented clearly and analysed appropriately? Do the conclusions adequately tie together the other elements of the paper?: - The discussions are weak and require further explanation. - The result does not explain in detail in the writeup - Descriptive, correlation, and multiple regression. - E.g. (in regression), the author only explains the IV in the writeup. What about others control variables. All findings should be supported by the theory and prior studies.	Thank you for the suggestions. We have added further explanations. In descriptive statistics: Table 2 reports descriptive statistics for the full sample of 1,523 firm-year observations to examine the relationship between politically affiliated firm and corporate investment. We winsorised at the 1^{st} and 99^{th} percentiles for continuous variables, except dummy variables. The average of several main variables is presented in Table 2. The average of INV_{asset} is 6.680 and PC_SPV is 15.6%. We find that these values are consistent with prior literature (e.g. Pan and Tian 2017; Joni et al. 2019). The average value of firm size (SIZE) is 22.179 with a maximum of 32.921 and a minimum of 2.607. Next, the value of DER and GROWth are considered reasonable compared to prior literature (e.g. Pan and Tian 2017; Joni et al. 2019). In the result discussions: "Table 4 reports the OLS estimate to examine the effect of politically connected

		supervisory board on corporate investment. The result of the model shows that the coefficient of political connection via supervisory board is negative and significance at the 5% level (the coefficient = -1.116 and t = 1.95), suggesting that the presence of political connections through supervisory reduce corporate investment expenditure. The result is consistent with Agency Theory which explains the reason why politically affiliated companies tend to have lower investment efficiency and avoid optimal investment. It argues that information asymmetry between agent (management) and principal (shareholders) distract company to make an efficiency investment decision. The leverage is positively significant associated with corporate investment. However, firm size and company's growth are not significant statistically. Mostly,the results are consistent with prior studies, such as Nasih et al. (2020). "
5	Practicality and/or Research implications: Does the paper identify clearly any implications for practice and/or further research? Are these implications consistent with the findings and conclusions of the paper?: Lack of research and practical implication on the regulatory or companies.	We have revised the conclusion section and add practical implications. "This study offers implications for the scholars on the cost of having political connections through supervisory boards. We also provide implications for practitioners and regulators to strengthen the corporate governance system in Indonesia. Further, policy makers should establish a transparent and competitive environment to promote better investment opportunities."
6	Quality of Communication: Does the paper clearly express its case, measured against the technical language of the field and the expected knowledge of the journal's readership? Has attention been paid to the clarity of expression and readability, such as sentence structure, jargon use, acronyms, etc.: average	Thank you for your suggestions. We have rechecked and revised it.

Reviewer #2: Manuscript ID AJAR-12-2022-0416

Major Comments and Suggestions

No	Comments and Suggestions	Responses
1	Originality: Does the paper contain new and significant information adequate to justify publication?: The contributions of this paper must be explicitly discussed. It should discuss how this paper is different from other papers (at least highlight two papers that are closely related to this paper. It can be from other countries). For example, compare with Nasih et al. (2020). Political connections, overinvestment and governance mechanism in Indonesia. published in Cogent Economics & Finance.	Thank you for your suggestions, we have included the discussion in the introduction section. “However, limited studies on the effect of political connection via supervisory board members on investment behavior in the context of dual board system. In addition, the empirical results on the relation between political connections and corporate investment are inconclusive. While several studies argued that politically connected firms experience better investment efficiency than their counterparts because political connections allow them to have extra external funding (e.g., Pan and Tian, 2017; Phan et al., 2020), other studies confirm that firms with government connections may suffer from government intervention to invest in unfavorable projects but it is concerned politically (e.g., Chen et al., 2011; Chen et al., 2020; Nasih et al., 2020). Our study is different with prior studies in terms of institutional background. We examine the investment behavior of politically connected firms in Indonesia where the capital market is imperfect and semi efficient. In the context of semi efficient market, informational asymmetries and agency problem which have been the most crucial factors in affecting corporate investment efficiency are more relevant for investment decisions compared to efficient market (Xu et al. 2013). Also, most prior studies use China as the

		setting of their studies which is very different with Indonesia. While Chinese government system is communist, Indonesian government system is democracy where people have authority to vote for their legislators and president. Accordingly, the political power in Indonesia is more dispersed compared to China. Unlike the political connection pattern in China where external resources are controlled by government and the role of SOEs is important in China (Imamah et al. 2020; Pan and Tian 2017), political connection in Indonesia is depend on various political parties and army power (Joni et al. 2019). Compared to Nasih et al. (2020), our work also promotes another uniqueness of Indonesian corporate governance system which implement two-tier board system. Indonesian dual board system has separated operating and monitoring functions into two different boards called board of directors and supervisory board (or board of commissioners). Mostly, political connection is developed through elite people who has been appointed as supervisory board and their roles become more strategic (Joni et al. 2019). Therefore, this institutional context is interesting to investigate whether political connection through supervisory board is effective to influence corporate investment. "
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3	Methodology: Is the paper's argument built on an appropriate base of theory, concepts, or other ideas? Has the research or equivalent intellectual work on which the paper is based been well designed? Are the methods employed appropriate?: Consider to include additional control variables (any three of the following), such as: 1. FREECF is the free cash flow, 2. CFO_SALE is the cash flow from operations (CFO)/sales 3. SD_CFO is the standard deviation of CFO/beginning of year total assets for the past five years 4. SD_INV is the standard deviation of investment in PPE/beginning of the year total tangible assets for the past five years 5. TANGIBILITY is the tangible assets/total assets, 6. AGE is the the firm's age from year listed on the exchange refer to this article: Shin, Y.Z., Chang, JY., Jeon, K., & Kim, Y. (2020). Female directors on the board and	Thank you for the suggestion. Ideally it would be better to add several control variables. However, we are constrained by some factors which we put forward for understanding and consideration. Therefore, we added all the considerations in the limitation of the study. "However, our findings should be interpreted by considering several limitations which can be potential future research. First, we consider firm size, growth, and leverage as control variables in the model, but other control variables (such as free cash flow, firm's age, return on asset, state-owned enterprises, etc.) are not included."

	investment efficiency: evidence from Korea. Asian Bus Manage 19, 438–479	
4	Results: Are results presented clearly and analysed appropriately? Do the conclusions adequately tie together the other elements of the paper?: Appropriate	Thank you for Feedback.
5	Practicality and/or Research implications: Does the paper identify clearly any implications for practice and/or further research? Are these implications consistent with the findings and conclusions of the paper?: Appropriate	Thank you for Feedback.
6	Quality of Communication: Does the paper clearly express its case, measured against the technical language of the field and the expected knowledge of the journal's readership? Has attention been paid to the clarity of expression and readability, such as sentence structure, jargon use, acronyms, etc.: Appropriate	Thank you for Feedback.

Reviewer #3: Manuscript ID AJAR-12-2022-0416

Major Comments and Suggestions

No	Comments and Suggestions	Responses
1	In this study, The investment behavior of politically connected firms in Indonesia has been investigated. In my opinion, the paper is good, and it can be considered for publishing after a minor revision. • Check for typo and grammatical mistakes and improve the usage of English language • Update some new reference • Include some more applications of	Thank you for your highlights, we have considered your suggestions to improve our paper, including check for typo and grammatical mistakes, update some new reference, and discuss more practical implications. We have done proofread for the revised paper.

	the study in the introduction section by using the references.	

Associate Editor #4: Manuscript ID AJAR-12-2022-0416

Major Comments and Suggestions

No	Comments and Suggestions	Responses
1	The topic is interesting, unfortunately, this paper lack of deep discussion in almost every section. I strongly suggest to the author(s) to revamp this article to enrich its discussion in introduction, literature review, and result sections.	Thank you for your highlights, we have considered your suggestions to improve our paper by providing more discussion in introduction, literature review, result sections, and conclusion.

3. Bukti konfirmasi submit revisi kedua, respon kepada reviewer, dan artikel yang diresubmit (02 May 2023)

Asian Journal of Accounting Research - Manuscript ID AJAR-12-2022-0416.R2 - Joni - Outlook — Mozilla Firefox

outlook.office365.com/mail/id/AAQkADc4MzcwM2ZhLTlkZTctNGM4Yi04NjYyLWM1MDUwNzk4ZmVmYwAQAP4i1VaNMkDmVOZAyaxawo%3D

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Asian Journal of Accounting Research - Manuscript ID AJAR-12-2022-0416.R2

Asian Journal of Accounting Research<onbehalfof@manuscriptcentral.com>
To: Joni

Thu 13/04/2023 14:46

13-Apr-2023

Dear Dr. Joni:

Your manuscript entitled "The investment behavior of politically connected firms in Indonesia" has been successfully submitted online and is presently being given full consideration for publication in the Asian Journal of Accounting Research.

Your manuscript ID is AJAR-12-2022-0416.R2.

Please mention the above manuscript ID in all future correspondence or when calling the office for questions. If there are any changes in your street address or e-mail address, please log in to Manuscript Central at https://mc.manuscriptcentral.com/ajar and edit your user information as appropriate.

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Asian Journal of Accounting Research - Decision on AJAR-12-2022-0416.R2

Asian Journal of Accounting Research<onbehalfof@manuscriptcentral.com>
To: Joni; Maria Natalia S.E., M.S.AK; leliana.maksi@gmail.com

Tue 02/05/2023 20:21

02-May-2023

Dear Dr. Joni:

It is a pleasure to accept your manuscript AJAR-12-2022-0416.R2, entitled "The investment behavior of politically connected firms in Indonesia" in its current form for publication in Asian Journal of Accounting Research. Please note, no further changes can be made to your manuscript.

This email will be followed by a second message containing a copy of your author accepted manuscript (AAM) which is the version that we will typeset and publish in the journal.

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The investment behavior of politically connected firms in Indonesia

Journal:	*Asian Journal of Accounting Research*
Manuscript ID	AJAR-12-2022-0416.R2
Manuscript Type:	Research Paper
Keywords:	politically connected SBs, emerging market, corporate investment, endogeneity

The investment behavior of politically connected firms in Indonesia

Abstract

Purpose - We examine the effect of the politically connected supervisory board (PV_SVP) on corporate investment behavior in Indonesia in the period of 2015-2019.

Design/methodology/approach – We use Indonesian listing companies as our sample. OLS (Ordinary Least Square) regression is applied to investigate this association. Also, we address the endogeneity problem by using the generalized method of moments (GMM).

Findings - We find that firms with political connections through Supervisory Boards (SBs) are negatively significantly associated with corporate investment. Our results are robust to alternative measures and to test for endogeneity.

Research implications – We contribute to prior research by showing empirical findings on the investment behavior of politically connected firms using an emerging economy context, Indonesia, which has a unique political landscape. We offer practical implications for practitioners and policy makers, such as improving the corporate governance system and promoting better investment opportunities by establishing a transparent and competitive environment.

Originality/value - Our study differs from other studies due to different corporate governance and political connection settings. While most prior studies examine the investment behavior of politically connected firms using the Chinese context, we use Indonesia which has different political and governance landscapes. Indonesia applies a two-tier board system that promotes the strategic role of the political supervisory board.

Keywords politically connected SBs, emerging market, corporate investment, endogeneity.

Paper type Research paper

1. Introduction

Our study aims to investigate how investment behavior is different between politically connected and non-politically connected companies in an emerging economy, Indonesia. Specifically, we examine the effect of political connections through supervisory board members on corporate investment. The research on the effect of political connections on capital market outcomes has been explored around the world, including stock return (Cooper et al., 2010; Faccio and Parsley, 2006), accounting information quality (Chaney et al., 2011), and market valuation (Faccio, 2006). Further, previous studies document that political affiliation is an effective way for companies to obtain easy access to external financing (Claessens et al., 2008; Bliss and Gul, 2012; Boubakri et al., 2012; Houston et al., 2014; Joni et al., 2019; Kamarudin et al., 2021), tax benefits (Wahab et al., 2017), audit pricing (Gul, 2006) which can influence their corporate investment behavior (Pan and Tian, 2017). However, limited studies examine the effect of political connections via supervisory board members on investment behavior in a dual board system context. In addition, the empirical results on the relationship between political connections and corporate investment are inconclusive. While several studies argued that politically connected firms experience better investment efficiency than their counterparts because political connections allow them to have extra external funding (e.g., Pan and Tian, 2017; Phan et al., 2020), other studies confirm that firms with government connections may suffer from government intervention to invest in unfavorable projects, but it is concerned politically (e.g., Chen et al., 2011; Chen et al., 2020; Nasih et al., 2020).

Our study is different from prior studies in terms of institutional background. We examine the investment behavior of politically connected firms in Indonesia, where the capital market is imperfect and semi efficient (Joni et al., 2019). In the context of semi-efficient market, informational asymmetries and agency problems, which have been the most crucial factors in affecting corporate investment efficiency, are more relevant for investment decisions than the efficient market (Xu et al., 2013). Also, most prior studies use China as the setting of their studies, which is very different from Indonesia. While the Chinese government system is communist, the Indonesian government system is a democracy where people have the authority to vote for their legislators and president. Accordingly, the political power in Indonesia is more dispersed compared to China. Unlike the political connection pattern in China, where external resources are controlled by the government and the role of SOEs is important in China (Imamah et al., 2020; Pan and Tian, 2017), political connection in Indonesia depend on various political parties and army power (Joni et al., 2019). Compared to Nasih et al. (2020), our work also promotes another uniqueness of the Indonesian corporate governance system, which implements a two-tier board system. Indonesian dual board system has separated operating and monitoring functions into two different boards called a board of directors and a supervisory board (or board of commissioners). Political connection is mostly developed through elite people appointed to supervisory board, and their roles become very strategic (Joni et al., 2019). Therefore, this institutional context is interesting to investigate whether political connection through the supervisory board effectively influences corporate investment.

Based on 1,523 firm-year observations of Indonesian listed companies from 2015-2019, we find that firms with the politically connected supervisory board have a significantly lower investment expenditure than their counterparts. The results are robust after addressing the endogeneity issue using the GMM (Generalized Method of Moments) model and alternative measure of investment expenditure. Our paper contributes to the literature by providing empirical results on the role of the politically connected supervisory boards in determining corporate investment behavior in the context of Indonesian dual board system. Also, we contribute to the policy makers in terms of the improvement of corporate governance system which can offer better investment opportunities in Indonesia.

The remainder of our paper is reported as follows: in section 2, we provide theoretical background and hypothesis development, followed by research design in Section 3. Next, research findings and discussion are explained in Section 4. The final section is the conclusion.

2. Theoretical Background and Hypothesis Development

The association between political connections and investment behavior has been examined and the results are inconclusive and need more explanation. On the one hand, Resource Dependency Theory (RDT) explain that organization is an open access and use political connection to deal with external uncertainty and its dependency to government bureaucracy in conducting business. A Firm with political connection obtains more external funding and lower cost of finance than non-politically connected firms (Joni et al., 2020; Houston et al., 2014; Boubakri et al., 2012), that cause a better investment efficiency. Xu et al., (2013) test whether Chinese family firms can mitigate their underinvestment problem when they have connections with the government. Using the Shanghai and Shenzhen listed firms in the period of 2000-2007, they show that family firms have difficulty accessing external funding and suffer from underinvestment problem. However, political connections help family firms to mitigate the underinvestment problem. The effect is more substantial in financially constrained companies. Pan and Tian (2017) set up a natural experiment using the recent anti-corruption based on listed firms in China and examined the association between political affiliation and corporate investment from 2003-2014. They find that politically connected firms experience lower investment after the ousting of the corrupt government officers compared to non-politically connected firms. Also, politically connected SOEs obtain more efficient investment than non-politically connected SOEs after the corrupt government officer's ousting. Since the recent anti-corruption campaign, the investment efficiency for politically affiliated firms in China become more significant. Imamah et al. (2020) explore the influence of the anti-corruption campaign on the investment behavior of politically affiliated companies in China from 2007-2016. Their finding indicates that all types of politically connected companies (political connections of non-SOEs/central SOEs/local SOEs) reduced their investment expenditures after the anti-corruption campaign compared to the period before the campaign. Also, political connections between Non-SOEs and local SOEs improve their investment efficiency after the anti-corruption campaign. Phan et al. (2020) examine the relationship between political connections and corporate investment in Malaysia from 2002 to 2016. Based on 631 listed firms, they document a positive influence of political connections on corporate investment. Firm with political connections with top political elites has 2.1%-2.9% more investment than non-political firms in the context of a stable political environment, such as Malaysia.

On the other hand, the Agency perspective argues that information asymmetry between management and shareholders distracts the company from making an efficient investment decision. And political connection worsens it because firms with political connections should invest in unfavorable projects due to political concerns. Using a Chinese sample, Chen et al. (2011) indicate that government intervention in SOEs prevents them from making optimal investments and even lower investment efficiency. Another study using the Chinese context by Chen et al. (2020) also found that regional political favoritism is related to less efficient corporate investment. Next, Nasih et al. (2020) examine the association between political connections and a company's overinvestment in Indonesia. They show a negative association between those variables. It might happen because of mixed economy applied in Indonesia, where both public and private sectors are essential.

In line with the theoretical background and the prediction of the previous empirical studies, the hypothesis is proposed as follow:

H1: Politically affiliated firm through supervisory board connections is associated with corporate investment expenditure, ceteris paribus.

3. Research Design

3.1 Data and sample

We use all listed companies in Indonesia during 2015-2019 as our sample, except financial sectors because they are regulated under different mechanisms. The chosen period is considered as a stable political regime. In our research, we collected all information from several different sources. We first use corporate governance information, including supervisory board connections which is manually collected from company annual report, their website, and google search engine. Next, our financial data is downloaded from the Datastream database.

3.2 Models dan Variables

We use the following regression models to examine the effect of politically connected firms through supervisory boards on corporate investment expenditure in hypothesis 1.

$$INVasset_{it} = \alpha_1 PC\_SPVB_{it} + \alpha_2 SIZE_{it} + \alpha_3 DER_{it} + \alpha_4 GROWth_{it} + \alpha_5 INDUSTRY_{it} + \alpha_6 YEAR_{it} + \varepsilon_{it}$$

A detailed definition of variables and references are outlined as follows:

Table 1: Variable's definition

Variable	Definition
$INVasset_{it}$	capital expenditure of the company in year t scaled by a 5 year total assets of the company in year t-1 (Phan et al., 2020)
$PC\_SPV\__{it}$	Dummy variable sets to 1 if the company has political connections through the supervisory board in year t and 0 otherwise. We consider our sample as politically connected firms if one of the top management (supervisory board) was a former government officer, such as a minister, a member of parliament, a president, etc. (Faccio, 2006)
Control variables-firm characteristics	
$SIZE_{it}$	the natural log of the company's total assets in year t (Phan et al., 2020; Pan and Tian, 2017)
DER_{it}	total debts scaled by total assets in year t (Phan et al., 2020)
$GROWth_{it}$	sales growth (Phan et al., 2020)
Control variables-fixed effects	
$INDUSTRY_{it}$	a vector of industry indicator variables that categorized using two-digit GICS (Global Industry Classification Standard).
$YEAR_{it}$	a vector of year indicator variables: 2015; 2016; 2017; 2018; 2019.

3.3 Statistical analyses

The objective of this study is to examine the impact of political connections through the supervisory board on investment expenditure, using an OLS (Ordinary Least Squares) regression model. We begin by presenting descriptive statistics to better understand the sample, followed by a pairwise correlation analysis to check the correlation of the key variables. To address the potential issue of multicollinearity, we conduct a variance inflation factor (VIF) test before proceeding with the regression analysis.

3.4 Sensitivity analyses and alternative measure

Endogeneity is a critical issue in corporate governance literature, particularly when investigating the association between political connections and investment efficiency. The possibility of firms with efficient investment connecting with government officials introduces the potential for an endogeneity problem. The independent variable, political connections, may be endogenously determined and influence the dependent variable, investment expenditure. To address this problem, the study employs the Generalized Method of Moments (GMM) to estimate the model. GMM is a widely accepted econometric technique that addresses endogeneity. These methods are consistent with previous research (Phan et al., 2020; Pan and Tian, 2017) and aim to ensure the validity and reliability of our findings. Moreover, the study re-estimates the model using a different measure of investment expenditure, a five-year fixed asset, which represents the long-term investment commitment made by the firm. This alternative measure can serve as a proxy for investment expenditure, offering a more accurate assessment of the relationship between political connections and investment efficiency.

4. Research Findings and Discussion

4.1 Descriptive Statistics

Table 2 reports descriptive statistics for the total sample of 1,523 firm-year observations to examine the relationship between the politically affiliated firm and corporate investment. We winsorized at the 1st and 99th percentiles for continuous variables, except dummy variables. The average of several main variables is presented in Table 2. The average of INV_{asset} is 6.680 and PC_SPV is 15.6%. We find that these values are consistent with prior literature (e.g. Pan and Tian, 2017; Joni et al., 2019). The average firm size (SIZE) value is 22.179 with a maximum of 32.921 and a minimum of 2.607. Next, the value of DER and GROWth are considered reasonable compared to prior literature (e.g. Pan and Tian, 2017; Joni et al., 2019).

Table 2: Summary statistics of main variables

Variable	N	Mean	St. Dev	Min	Max
INV_{asset}	1,523	6.680	6.653	0.070	34.950
PC_SPV	1,523	0.156	0.290	0.000	1.000
SIZE	1,523	22.179	9.362	2.607	32.921
DER	1,523	0.734	0.371	0.000	0.960
GROWth	1,523	0.116	0.614	-0.831	5.267

Notes: The table reports the summary statistics of the key variables. The sample includes 1,523 firm-year observations for the period 2015-2019. We use all variables based on calendar year. The variable definitions are available in Table 1.

Next, Pairwise Pearson Correlation is applied to check correlation among key variables in the model, industry and year effects are excluded. In Table 3, it reports that the highest correlation is between firm size and leverage (r=0.131). Then, we run the multicollinearity test using VIF in Table 4 and the result shows that the model is free from the multicollinearity problem.

Table 3: Correlation matrix

	(1)	(2)	(3)	(4)	(5)
(1) INV_{asset}	1.000				
(2) PC_SPV	-0.046[c]	1.000			
(3) FSIZE	0.046[c]	0.009	1.000		
(4) LEV	0.100[a]	0.058[b]	0.131[a]	1.000	
(5) GROWth	0.002	-0.020	-0.026	0.052[a]	1.000

The table reports the pairwise Pearson correlation matrix for the full sample (1,523 firm-year observations). Please see Table 1 for definitions of variables. The superscripts a-c indicate two-sided significance at the 1%, 5%, and 10% levels.

4.2 Politically Connected Supervisory Board and Corporate Investment

Table 4 reports the OLS estimate to examine the effect of the politically connected supervisory board on corporate investment. The result of the model shows that the coefficient of political connection via the supervisory board is negative and significant at the 5% level (the coefficient = -1.116 and t = 1.95), suggesting that the presence of political connections through supervisory reduces corporate investment expenditure. The result is consistent with Agency Theory which explains the reason why politically affiliated companies tend to have lower investment efficiency and avoid optimal investment. It argues that information asymmetry between agent (management) and principal (shareholders) distracts the company from making an efficient investment decision. The leverage is positively and significantly associated with corporate investment. However, firm size and company growth are not statistically significant. Mostly, the results are consistent with prior studies, such as Nasih et al. (2020).

Table 4: Politically Connected SB and Corporate Investment-pooled OLS

	Model
INTERCEPT	5.125[a] (3.59)
PC_SPV	-1.116[b] (1.95)
SIZE	0.069 (1.38)
DER	1.777[a] (3.57)
GROWth	0.137 (0.51)
INDUSTRY	Included
YEAR	Included
Average VIF	2.46
Adj. R^2	0.083
F	12.54
Prob > F	0.000[a]
N	1523

The table reports OLS coefficient estimates, and indicator variables are included in the regression to control for year and industry-fixed effects. Please see Table 1 for definitions of variables. The superscripts a-c indicate two-sided significance at the 1%, 5%, and 10% levels, respectively.

4.3 Sensitivity Analysis

It is clearly argued that firms with politically connected SBs are negatively associated with corporate investment. Table 5 reports an alternative analysis using the Generalized Method of Moments (GMM) model to check for endogeneity issues in testing the relationship between politically connected SBs and Corporate Investment. Overall, the result remains similar after applying the GMM model.

Table 5: Politically Connected SB and Corporate Investment-GMM Model

	Model 1
INTERCEPT	-1.976 (1.28)
PC_SPV	-0.011[a] (5.42)
SIZE	0.000 (0.35)
DER	0.018[a] (9.43)
GROWth	0.001 (0.75)
INDUSTRY	Included
YEAR	Included
N	1,523

4.4 Alternative Measure

To improve the reliability of our main result, we use a five-year fixed asset to measure capital expenditure as an alternative measure and rerun the regression. As shown in Table 6, the result shows a negative association between politically connected firms through the supervisory board and corporate investment. The result in Table 6 is consistent with the result in Table 5.

Table 6: Politically Connected SB and Corporate Investment-Alternative Measure

	Model
INTERCEPT	24.474[a] (2.00)
PC_SPV	-16.373[a] (3.76)
SIZE	0.381 (0.92)
DER	-7.159[a] (-1.55)
GROWth	3.810 (1.55)
INDUSTRY	Included
YEAR	Included
Average VIF	2.71
Adj. R^2	0.022
F	2.76
Prob > F	0.001[a]
N	845

5. Conclusions

Our paper contributes to the literature by examining the relationship between the politically affiliated supervisory board and corporate investment behavior in an emerging market, Indonesia. After controlling several main variables, we find a negative association between political connections through the supervisory board and investment expenditure. Consistent with agency theory, our finding suggests that firms with political connections via supervisory boards make inefficient investment decision-making. Politically connected firms through supervisory board tend to invest in unfavorable projects due to political concerns. Additionally, we conduct robustness tests by addressing endogeneity problem and using an alternative measure of corporate investment, the results remain similar.

This study offers implications for scholars on the cost of having political connections through supervisory boards. We also provide implications for practitioners and regulators to strengthen the corporate governance system in Indonesia. Further, policymakers should establish a transparent and competitive environment to promote better investment opportunities. However, our findings should be interpreted by considering several limitations which can be potential future research. First, we consider firm size, growth, and leverage as control variables in the model, but other control variables (such as free cash flow, firm's age, return on asset, state-owned enterprises, etc.) are not included. Second, the effect of political connections on corporate investment behavior is examined using a quantitative approach. It will be interesting to address this issue using a qualitative approach to obtain a deep and comprehensive understanding of how and why the presence of political connections reduces corporate investment. Third, a firm can establish a connection with the government through several different channels, such as family members, friends, etc. Our paper needs to address these issues, and it raises the need for future studies.

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