Role of Political Connections and Family Ownership to Related Party Transactions in Indonesia

Fuad Hudaya Fatchan¹, Ilham Nuryana Fatchan²
¹Faculty of Economics and Business, Universitas Muhammadiyah Surakarta, Surakarta – Indonesia
²Faculty of Economics and Business, Universitas Muhammadiyah Purwokerto, Purwokerto - Indonesia

Abstract:- A related party transaction is a transfer of resources, services or obligations between the reporting entity and related parties, regardless of whether a price is charged. There are several factors that can influence abusive or efficient related party transactions, namely family ownership and political connections. This study discusses the effect of family ownership and political connections on related party transactions with control variables, namely audit quality, firm size, profitability and firm age. This research focuses on mining companies listed on the Indonesian stock exchange in 2016-2020 with a research sample of 170 companies. Data analysis used Eviews 9 with the Random Effect Model test. The results of the study show that family ownership and political connections have an effect on related party transactions. Control variables are audit quality, company size, company age effect on related party transactions. Profitability has no effect on related party transactions.

Keywords:- Related Party Transactions, Family Ownership, Political Connections, Audit Quality, Company Size, Profitability, Company Age.

I. INTRODUCTION

The company's financial statements aim to provide information regarding the financial position, financial performance and cash flows of entities that are useful to most users of financial statements in making economic decisions (statement of financial accounting standard/PSAK No. 1, 2018, Paragraph 09). Information contained in a company's financial statements can be useful if it is presented in a transparent, accurate and timely manner when needed by shareholders/creditors and potential investors/creditors to assess the company's financial condition, as well as the company's going concern, as a basis for decision-making. One of the information presented in the report corporate finance is information about related party transactions or related party transactions (RPT).

In Indonesia, RPT is based on statements of financial accounting standards number 7 of 2014 concerning disclosure of related parties. A related party transaction is a transfer of resources, services or obligations between the reporting entity and related parties, regardless of whether a price is charged. According to IAS 24, the RPT relationship is activity normal activities of commerce and business. For example, an entity often carries out some of its activities through subsidiaries, joint ventures and associates. In such circumstances, the entity has the ability to influence the financial and operating policies of the investee through the presence of control, joint control or significant influence. Kang, Lee, Lee & Park (2014) state that RPT is a transfer of resources, services, or obligations from a reporting entity to related parties, which usually refers to executives, boards of directors, and major shareholders.

Kohibeck & Mayhew (2010) stated that RPT can categorized into 2 namely RPT which has a positive impact or efficient transaction if RPT can be used as an efficient and profitable contract mechanism for companies to achieve shareholder value maximization by reducing transaction costs thereby achieving good economies of scale for the company. RPT can be a management effort to improve company performance (Williamson, 1975; Stein, 1997).

Conversely, the second RPT is detrimental (abusive RPT) if the related party transaction is used to manipulate the company's operating results for economic gain which only benefits the company's majority shareholder. Yeh, Shu & Su (2012) state that a detrimental RPT is the appropriation of wealth from minority shareholders by majority/controlling shareholders.

The ownership structure in Indonesia is the same as other Asian countries which have a concentrated ownership structure in one group such as the family or the state. In Indonesia with a concentrated ownership pattern and the main owner The dominant (ultimate control) is the family (Arifin, 2003). Previous research in Indonesia found that RPT transactions are in line with family ownership (Barokah, 2013; Dyanty et al. 2013). According to a survey conducted by Price Waterhouse Cooper (PWC) in 2014, more than 95 percent of companies in Indonesia are family businesses. Claessen et al. (1999) found that more than 50% of companies in Indonesia are controlled by families.

Company impact family control on RPT can be explained by entrenchment or alignment effects. The entrenchment effect is defined as the ability of the ultimate controlling shareholder to determine the company's operational policy in accordance with his personal interests, even if he has to sacrifice the interests of the shareholders and other stakeholders. When the entrenchment effect dominates, family ownership encourages related party transactions to strengthen motivation to expropriate through related party transactions because control is in the hands of one family controller (Dyanty, 2013). Hu et al (2012) state that there is a lot of information owned by family ownership as the controlling
shareholder. Transactions carried out by controlling shares can be used as a means to carry out expropriation of company resources which can harm minority shareholders due to tunneling carried out by controlling shareholders.

Furthermore, the alignment effect occurs when low family ownership encourages related party transactions to increase firm value through low costs and effective control so that these transactions can provide benefits for business development (Fan & Goyal, 2006). Anderson and Reeb (2003) emphasize that family firms pay more attention to reputation than non-family firms because families expect a continued presence in the companies they start.

Previous research on RPT with family ownership, Cheyoong et al (2015) examined Malaysian companies using panel data stating that RPT in family firms reduces firm value, expropriation through RPT is stronger in family firms compared to non-family firms. Azim et al (2018) examined the main shareholders of Pakistani family-owned companies who took over resources through RPT. The results of the study concluded that there is a relationship between the concentration of family shareholders and the exploitation of the interests of minority shareholders. This is supported by the research of Mohammed (2019) and Dyanty et al (2013) which state that RPT will be stronger with family ownership. In Bertó's research (2019) ownership was reported to have a positive effect on tunneling. That is, the more concentrated the shareholders are in accordance with indications of expropriation. Likewise Abdullatif et al (2019) stated that companies with high concentration of ownership can use RPT in tunneling activities to take over funds to dominant shareholders.

In contrast, Bansal & Thenmozhi (2020) find that concentrated founder ownership in India is more likely to drive RPTs that are beneficial to minority shareholders compared to RPTs that lead to takeovers. Alhadab et al (2020) which showed that there was no effect of family ownership on the RPT relationship.

Majority share ownership has an interest in carrying out RPT activities with political connections to get protection in these activities. Agency theory is the theory that underlies the linkages between connections policies and related party transactions. This theory leads to the linkage of the relationship between majority shareholder and minority shareholder. Having political connections exacerbate type II agency conflict in which the majority shareholder takes advantage position in the company for their own interests without prioritizing the shareholders minority shares (Villalonga & Amit, 2006). According to (Ling et al, 2016) stated from the perspective of agency theory, companies that are politically connected have the potential to be RPT.

Several previous studies have examined the influence between political connections and related party transactions. Ismail et al (2022) researched that many Egyptian companies are still connected to political boards of directors and political relations have a significant effect on RPT. Supatmi et al (2021) stated that political connections strengthen the effect of RPT on firm value. Habib et al. (2017) found that there was a positive effect political connections to related party transactions. Connected company politics will do RPT. In contrast, Abdullatif et al.’s research. (2019) stated Jordan found that there was no influence between political connections and related party transactions.

II. RESEARCH METODS

The population of this study are mining sector companies listed on the Indonesia Stock Exchange (IDX) in 2016-2020. Selection of the sample using purposive-sampling with criteria:
- Researchers obtain the complete annual reports of mining sector companies from 2016 to 2020 through the official websites of each company and on the official website of the Indonesia Stock Exchange (www.idx.go.id)
- Companies that include information related to research variables in their annual reports.

A. Research variable

- Related Party Transactions (RPT)
  In this study, the dependent variable used is related party transactions (RPT) as seen from the sum of the total RPT sales, RPT purchases, RPT debt and RPT receivables divided by total assets. The use of these transactions has contributed significantly to the business operations of companies in Indonesia.

This measurement was chosen because, related party transactions have been regulated in PSAK 7 and OJK regulations through Regulation number VIII.G.7 concerning guidelines for presenting financial statements, one of which has points, namely (a) The company provides details of total assets, liabilities, sales, and purchase of RPT; (b) The company assigns a percentage value in point (1) to total assets, liabilities, sales and purchases; (c) The company provides debt/receivable values from RPT that are not related to the company's main business activities (Nuritomo et al, 2020).

\[
\text{RPT} = \frac{\text{RPT Sales} + \text{RPT Purchases} + \text{RPT Debt} + \text{RPT Receivables}}{\text{Total Assets}}
\]

- Family Ownership
  The family ownership structure is defined as share ownership owned by the family, or the family has an important role in the management of the company, so that the aims and interests of the family are. Bertnard and Schoar (2006) suggest that family firms are characterized by concentrated ownership, control and the presence of one or several family members occupying executive positions. For measuring family ownership using a dummy by looking at the percentage according to PSAK No. 15 whose measurement uses a percentage of 20% share ownership.

- Political Connections
  The political connection variable will use 2 indicators, namely aspects of political ownership owned by independent commissioners and independent commissioners, with criteria, namely concurrent positions as politicians affiliated with...
political parties, concurrent positions as government officials, concurrent positions as military officials, and former officials government or former military officials (Fan, 2007 in Pranoto Ari, 2014) in. Political connection is measured by a dummy variable. A dummy variable is an artificial variable or dummy variable created to quantify qualitative data by giving a code of 0 (zero) or 1 (one) (Main, 2007 : 97 in Dharma and Putu, 2016) in (Purwanti & Sugiyarti, 2017).

- **Audit Quality**
  Audit quality is the size of the Public Accounting Firm used by the company in examining the company's financial statements. The measurement of the Public Accounting Firm size variable in this study uses a dummy variable with the provision that companies that use big four Public Accounting Firms are given a score of 1 and companies that use non-big four Public Accounting Firms are given a score of 0 (Abdullatif et al, 2019).

- **Size**
  This research includes size or company size as a control variable. Company size is an important factor indicating that large companies are relatively more stable and able to provide benefits compared to companies with smaller sizes. The natural logarithm value of the converted total assets. Size has been widely used in disclosure research as a control variable (Hamid et al, 2016). In this study everything was converted into rupiah and in accordance with the rupiah currency that has been widely used in disclosure research as a control variable (Main, 2007 in Dharma and Putu, 2016).

- **Company Age**
  According to Lee and Choi (2015) the longer the period of time a company is registered, the higher the possibility that the company has long-term investment decisions and high corporate value. Through the age of the company, investors can see whether a company is able to continue to survive and is able to compete in getting business opportunities (Sembiring, 2012). In addition, the age of the company also affects the efficiency of the company in carrying out its operational activities. In this study, the age of the company will be calculated from the year the company was founded until the year the observations were made. Company Age = year of observation - year of company establishment

- **Profitability**
  Profitability in this study is proxied by return on assets (ROA). Return On Assets (ROA) used to measure management's ability to earn overall profits. The higher the ROA owned by a company, the more efficient use of assets will be increase profits (Madli, 2014). Return on total assets (ROA) is calculated by comparing the net profit after interest and taxes with total assets with the following formula:

\[
ROA = \frac{\text{Net Profit after Interest and Tax}}{\text{Total Assets}}
\]

### III. RESULTS AND DISCUSSION

#### A. Research Sample

<table>
<thead>
<tr>
<th>No</th>
<th>Criteria</th>
<th>Samples</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Number of mining companies period 2016-2020 (38 mining companies multiplied by 5 years)</td>
<td>190</td>
</tr>
<tr>
<td>2</td>
<td>Number of mining companies in 2010-2020 who do not present financial reports (not found)</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>Number of final sampled used</td>
<td>170</td>
</tr>
</tbody>
</table>

#### B. Descriptive Statistics

<table>
<thead>
<tr>
<th></th>
<th>RPT</th>
<th>POL</th>
<th>FAM</th>
<th>KAP</th>
<th>SIZE</th>
<th>AGE</th>
<th>ROA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>0.063407</td>
<td>0.458824</td>
<td>0.340142</td>
<td>0.476471</td>
<td>20.16222</td>
<td>29.15294</td>
<td>1.790964</td>
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<tr>
<td>Median</td>
<td>0.019613</td>
<td>0.000000</td>
<td>0.317600</td>
<td>0.000000</td>
<td>20.23250</td>
<td>27.50000</td>
<td>0.826000</td>
</tr>
<tr>
<td>Maximum</td>
<td>0.930607</td>
<td>1.000000</td>
<td>0.925000</td>
<td>1.000000</td>
<td>29.05016</td>
<td>52.00000</td>
<td>43.48400</td>
</tr>
<tr>
<td>Minimum</td>
<td>0.000000</td>
<td>0.000000</td>
<td>0.000000</td>
<td>0.000000</td>
<td>14.65477</td>
<td>4.000000</td>
<td>-153.8300</td>
</tr>
<tr>
<td>Std. Dev.</td>
<td>0.124243</td>
<td>0.499774</td>
<td>0.294679</td>
<td>0.509022</td>
<td>2.304949</td>
<td>12.30000</td>
<td>16.05218</td>
</tr>
</tbody>
</table>

N       170  170  170  170  170  170  170

Description: * indicates a significance of 5%; RPT = Accounts payable, receivables, sales and purchases related party transactions; POL = political connections to company directors or commissioners; FAMILY = Percentage of family share ownership; KAP = Audit quality; SIZE = Company size; AGE = Age of the company; ROA = company profitability level.
Related party transactions (RPT) as measured using the sum of related party transactions of sales, purchases, payables and receivables divided by total assets in this study have an average of 0.063 with a maximum and minimum value of 0.930 and 0, respectively. Related party transactions with a maximum value of 0.930 indicates that the level of related party transactions practiced is high, around 93%. This indicates that the sample firms in this study, the practice of related party transactions is carried out from several aspects of transactions such as debts and receivables to achieve certain goals. However, there are also those who do not conduct transactions with related parties in certain years.

Family ownership of mining companies in Indonesia is 34.0%. As is known according to PSAK No. 15 regarding share ownership, that investors are considered to have influence significant if owning either directly or indirectly through the company's shareholding 20% or more of the investee 's voting rights. It can be concluded that the majority of mining companies in Indonesia are owned by families.


Family ownership has proven to be more encouraging for the magnitude of related party transactions. Family ownership of the controlling shareholder has proven to strengthen motivation to engage in related party transactions. This is very reasonable because if there are several companies (company groups) in the hands of one family controller, the family's wealth is spread over many companies. These conditions will allow for expropriation through related party transactions (Dyanty et al, 2012). Family controlled companies have low motivation to engage in related party transactions. This is very reasonable because if there are several companies (company groups) in the hands of one family controller, the family's wealth is spread over many companies. These conditions will allow for expropriation through related party transactions (Dyanty et al, 2012).

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The influence of political connections on the RPT
The test results in table 3 show that political connections have a positive effect on RPT with a value of 0.0118, which means that it has a significant effect on RPT. The research results are consistent with research conducted by Ismail et al. (2022), Supatmi et al. (2021), Habib et al. (2017) and Rahman & Nugrahanti (2021)

Ismail et al. (2022) stated that many Egyptian companies are still connected to political boards of directors and political relations have a significant effect on RPT. Supatmi et al. (2021) state that political connections strengthen the RPT effect on company value. Habib et al. (2017) and Rahman & Nugrahanti (2021) state that there is a political connection that can be used to practice RPT through related party transactions committed by the majority shareholder against the minority shareholder.

The effect of family ownership on RPT
Table 3 shows the results statistical test that the value of family ownership is 0.0329 which means family ownership has a significant positive effect on related party transactions.
Effect of Public Accounting Firm, Size, Company age and Profitability on RPT

Table 3 shows that the audit quality control variable has an effect on RPT with a value of 0.012. Company size has a probability value of 0.027 which means it has an effect on RPT. The age of the company has a value of 0.000, so it affects the RPT. Conversely, the profitability variable measured using ROA has no effect on RPT because it has a value of 0.9436 which is above 0.05

IV. CONCLUSION

A. Conclusion

This study aims to examine the relationship between political connections and family ownership of related party transactions in mining companies in Indonesia. The data analysis conducted shows that the average family ownership of mining companies in Indonesia is 34.0%. As is known according to PSAK No. 15 regarding share ownership, that investors are considered to have influence significant if owning either directly or indirectly through the company's shareholding 20% or more of the investee's voting rights. It can be concluded that the majority of mining companies in Indonesia are owned by families.

The results of the study show that family ownership has a significant positive effect on related party transactions. Ali et al. (2007) stated that family firms suffer less from type I agency problems than type II agency problems as a consequence of highly concentrated ownership which gives them strong incentives and the ability to maximize their interests at the expense of minority shareholders. Furthermore, the results of the study show that political connections have a positive effect on RPT. The results are consistent with research conducted by Ismail et al (2022), Supatmi et al (2021), Habib et al (2017) and Rahman & Nugrahanti (2021).

B. Suggestion

This research has several limitations. First, this research only focuses on mining companies in Indonesia. Based on this, further research needs to explore more broadly by taking samples of other corporate sectors in Indonesia. Second, it is hoped that future research will focus on the sample data that will be examined, namely family ownership, because in this study the researchers did not focus on family ownership of mining companies in Indonesia, but used data on all mining companies in Indonesia.

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