

Political Connection, Tax Avoidance, and Firm Value during Kabinet Kerja Reign: The Case in Jakarta Islamic Index

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Abstract

This study aims to determine the effect of political connection on firm value through tax avoidance as a mediating variable on companies listed in the Jakarta Islamic Index during Kabinet Kerja reign. This research includes quantitative research and the data used are secondary data from the company's annual report. With the purposive sampling method, obtained 103 companies that are used as research samples. Path analysis test was used to analyze data and hypothesis test. The results of the study show that the political connection and tax avoidance partially or simultaneously affect the value of companies listed in the Jakarta Islamic Index during Kabinet Kerja reign. Meanwhile, the political connection has no effect on tax avoidance, so it can be ascertained that tax avoidance does not mediate (unmediated) the effect of political connection on firm value in companies listed on the Jakarta Islamic Index during Kabinet Kerja reign.

Keywords: Political Connection, Tax Avoidance, Firm Value, Jakarta Islamic Index

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1. INTRODUCTION

The development of stock prices in Indonesia, especially on companies listed in the Jakarta Islamic Index (JII), continues to increase in line within economic growth. This phenomenon can be seen from the increase in the average of JII's stock price in each period. At the end of 2015, the JII's value was at 603.35 points. One year later, at the end of 2016, the value of JII became 694.13 and at the end of 2017, the value of JII increased to 759.07 (finance.yahoo.com). The increase in the average of JII's stock price value was also accompanied by an increase in tax revenues. Based on the realization of tax revenues, the Indonesian state government has increased every year. In 2015 the total realized tax revenue was Rp.1,013.18 Trillion, in 2016 the total realized tax revenue was Rp.1.071.88 Trillion, and in 2017 the total realized tax revenue was Rp.1.102.72 Trillion (www.pajak.go.id).

Realization of tax revenue increases every year, but the effectiveness of tax revenue decreases due to the non-fulfillment of the target of tax revenue every year. The decrease in the effectiveness of tax revenue

shows that there is a lack of awareness and interest of taxpayers in carrying out their tax obligations, as many as efforts made by companies in carrying out tax avoidance actions.

Every company wants maximum profit with minimum expenses. One of the expenses component that is often minimized by companies is tax payments. Taxes for companies are seen as a charge that must be minimized. One way to minimize is by implementing tax avoidance. Wang (2011) argues that tax avoidance is considered as a tax-saving effort by transferring resources that should be received by the state, but instead deposited with shareholders so that the after-tax value of the company increases.

The existence of political connections in the business also influences the company's decisions regarding tax payments. Kim & Zhang (2016) link the influence of political connections with aggressive tax actions through tax avoidance schemes. Companies with political connections tend to receive privileges from the government, for example in terms of easy access to capital loans and low risk at a tax audit,

which makes companies more aggressive in carrying out tax avoidance practices.

This research is a development of the previous studies results regarding the effect of political connection on firm value by adding tax avoidance as an intervening variable which is expected to have an indirect effect on the relationship between political connections and firm value in companies listed on the Jakarta Islamic Index during Kabinet Kerja reign. In Indonesia, reflecting on the events after the presidential election which was won by Joko Widodo, it is important to know whether the political connection with Kabinet Kerja reign led by President Joko Widodo affects tax avoidance actions from companies will affect firm value.

2. REVIEW OF LITERATURE

Agency Theory

Agency theory explains the existence of a cooperative relationship between the owners of capital or shareholders as principals and management as agents. Agency relationship exists when the principal has an employment contract with the agent. This contract causes the delegation some authority of the principal (shareholders) to the agent (management) to make decisions in carrying out the company's operational activities. In line with the implementation of the employment contract, the principal must supply the necessary funds and other facilities to support the company's operations. Meanwhile, the management is obliged to manage the funds and the facilities properly according to the mandate of the owner. As a reward, the manager will be given a salary, bonus, and various other compensation benefits (Jensen, 1986).

The principal wants additional wealth and prosperity for the given investment. On the other hand, the agent also wants to improve his welfare. This is what often triggers a conflict of interest between the principal and the agent for the welfare of each other. Therefore, the principal will be more intense to monitor the management so that it will added the cost for monitoring. The basis of agency theory in this study is the difference in interests between the owners (principal) and the management (agent) to maximize their respective welfare.

Political Connection, Tax Avoidance, and Firm Value

Success of a company can be seen based on the value of the company (firm value) as illustrated by the

company's stock price. Firm value is identified as the market value of the company's share price. Share price is directly proportional to firm value, meaning that the higher share price of a company, the higher firm value. The value of the company can also increase welfare of its shareholders, with higher share price the welfare of shareholders also increases. High firm value will make the market believe in the company's performance and create a positive impression for investors regarding the company's future prospects. Theory of the firm proposed by Jensen & Meckling (1976) in principle is a process of maximizing firm value by considering managerial behavior, agency costs, and ownership structure within the firm. In this study, to minimize costs for increasing the value of the company, the company makes political connections with the government and carries out tax planning through the tax avoidance.

Political connection involves the company and the government. Companies with political connections if at least one of the major shareholders (owns at least 10% of the total shares) or one of the company's leaders is part of the parliament, ministers, or people who have close relationship to the government (Faccio, 2006). In addition, companies that are indicated to have political connections can also be seen based on direct ownership by the government of the company. Maulana & Wati (2019) concluded that there is a positive and significant relationship between political connection and firm value. This is reinforced by research conducted by Niessen & Ruenzi (2010) regarding several reasons why companies that are politically connected have better performance than companies that are not politically connected to the local government. The existence of political connections with the government can provide a competitive advantage for companies such as getting easy access to funding (loans or bailouts) and lower tax rates paid by companies. Study on political connection and firm value states the same results as research by Qouch-Anh et al., (2015), Coulomb & Sangnier (2014), and Bandiyono (2019) which concludes that the existence of connections has a significant effect on increasing firm value.

Study about the effect of political connection and tax avoidance has been proposed by several researchers. Butje & Tjondro (2014) suggest that political connection has a positive and significant effect on CETR which is a proxy for measuring tax avoidance. Based on the research, political

connections can also help companies reduce tax payments through tax avoidance schemes. In context of the company, the practice of tax avoidance is to reduce the level of tax payments and at the same time to increase the company's cash flow. It can be concluded that the benefit of implementing tax avoidance is to increase tax-saving which has the potential to reduce tax payments so that it will increase cash flow (Budiman, 2012). The results of this study are in line with research by Adhikari et al. (2006), Christensen et al. (2015) and Utari & Supadmi (2017) which concluded that the existence of political connections with the government has a significant effect on tax avoidance.

Meanwhile, research related to the effect of tax avoidance with firm value was conducted by Ilmiani & Sutrisno (2015) who suggested that tax avoidance and firm value had a significant relationship, or in other words, the higher practice of implementing tax avoidance, the higher firm value. Similar research by Chasbiandani & Martani (2012) concluded that tax avoidance has a positive effect on firm value. This certainly indicates that the less tax paid by the company cause the higher firm value due to tax saving.

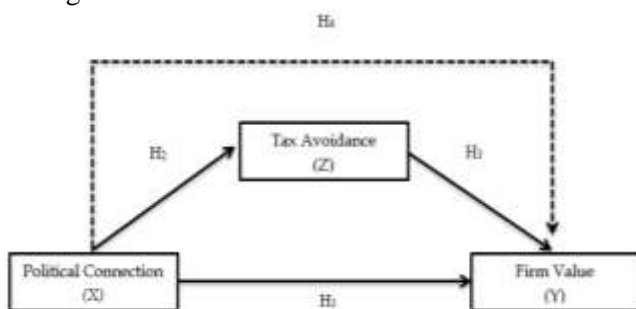


Figure 1. Research Model

Based on the existing research model, the hypothesis in this study is formulated as follows:

- H₁: Political connection has an effect on tax avoidance in companies listed on the Jakarta Islamic Index during the Kabinet Kerja reign.
- H₂: Political connection has an effect on firm value in companies listed on the Jakarta Islamic Index during the Kabinet Kerja reign.
- H₃: Tax avoidance has an effect on firm value in companies listed on the Jakarta Islamic Index during the Kabinet Kerja reign.
- H₄: Tax avoidance mediates the effect of political connection on firm value in companies listed on the Jakarta Islamic Index during the Kabinet Kerja reign.

3. RESEARCH METHOD

Based on its characteristics, this research is included in quantitative research. In this study, we will analyze the effect of the political connection variable on firm value through tax avoidance as a mediating variable in companies listed on the Jakarta Islamic Index during Kabinet Kerja reign. The population of this study is all public companies listed in the Jakarta Islamic Index (JII) for the 2014-2018 period. The sample was selected using the purposive sampling method with the following criteria.

Table 1. Criteria of Sample

No	Criteria	Total
1	Companies listed on JII in 2014-2018	138
2	Companies that are not delisted from JII during the observation period	(12)
3	Companies with incomplete data	(7)
4	Companies with extreme data	(16)
Total Sample		103

Source: Processed data (2021)

Secondary data was used in this study, namely data published by companies in the form of financial reports and annual reports of companies listed on the Jakarta Islamic Index (JII) during 2014-2018. The source of the data was obtained through searches on the company's official website or through the Indonesia Stock Exchange (IDX) website. The data analysis method uses path analysis.

4. RESULT AND DISCUSSION

4.1. Results

Substructure Analysis I

Substructure Analysis I is described as follows.



Figure 2. Substructure Analysis I

Substructure Equation I : $Z = \beta X + \epsilon_1$

Table 2. Statistical Test Results for Substructure Analysis I

Variabel	Koefisien (β)	t value	Sig.
Constant	0,240		
PC (X)	0,009	0,324	0,747
R Square	0,001		

Source: Processed data (2021)

Based on table 2 above, it can be seen that the level of significance for the political connection variable is 0.747, which is greater than 0.05. It means hypothesis 1 is rejected, that the political connection has no effect on tax avoidance. The magnitude of R square value (R^2) is 0.001. This figure illustrates that only 0.1% of tax avoidance variables in companies listed on the Jakarta Islamic Index during the 2014-2018 period of Kabinet Kerja reign can be explained by the political connection variable.

Substructure Analysis II

Substructure Analysis II is described as follows.

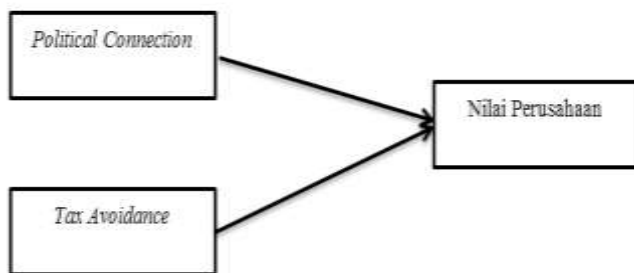


Figure 2. Substructure Analysis II

Substructure Equation II : $Y = \beta X + \beta Z + \varepsilon_2$

Table 3. Statistical Test Results for Substructure Analysis II

Variabel	Koefisien (β)	t value	Sig.
Constant	1,542		
PC (X)	0,254	2,548	0,012
CETR (Z)	-0,726	-2,063	0,042
Sig (F- value)		0,007	
R Square		0,094	

Source: Processed data (2021)

Based on table 3, first, the significance level for the political connection variable is 0.012, which is smaller than 0.05. It means hypothesis 2 is accepted, that the political connection partially has an effect on firm value. Secondly, the significance level of the tax avoidance variable is 0.042, which is smaller than 0.05. It means hypothesis 3 is accepted, that tax avoidance partially has an effect on firm value. Then, simultaneously, the significance level of the political connection and tax avoidance variables shows a value of 0.007 which is smaller than 0.05. This indicates that political connection and tax avoidance simultaneously have an effect on firm value. The magnitude of R square value (R^2) is 0.094. This figure illustrates that only 9.4% of the firm value variables in companies listed on the Jakarta Islamic Index during the 2014-2018 period of Kabinet Kerja reign can be explained by the political connection and tax avoidance variables, 91.6% is explained by other variables outside the research.

Table 4. The Result of Research

No	Hypothesis	Result
1	H ₁ : Political connection has an effect on tax avoidance in companies listed on the Jakarta Islamic Index during the Kabinet Kerja reign.	H ₁ is rejected. Political connection has no effect on tax avoidance in companies listed on the Jakarta Islamic Index during the Kabinet Kerja reign.
2	H ₂ : Political connection has an effect on firm value in companies listed on the Jakarta Islamic Index during the Kabinet Kerja reign.	H ₂ is accepted. Political connection has an effect on firm value in companies listed on the Jakarta Islamic Index during the Kabinet Kerja reign.
3	H ₃ : Tax avoidance has an effect on firm value in companies listed on the Jakarta Islamic Index during the Kabinet Kerja reign.	H ₃ is accepted. Tax avoidance has an effect on firm value in companies listed on the Jakarta Islamic Index during the Kabinet Kerja reign.
4	H ₄ : Tax avoidance mediates the effect of political connection on firm value in companies listed on the Jakarta Islamic Index during the Kabinet Kerja reign.	H ₄ is rejected. Tax avoidance does not mediate (unmediated) the effect of political connection on firm value in companies listed on the Jakarta Islamic Index during Kabinet Kerja reign.

Source: Processed data (2021)

4.2. Discussion

The Effect of Political Connection to Tax Avoidance

Statistical result show that political connection to tax avoidance has a significance value of 0.747,

greater than 0.05, which means hypothesis 1 is rejected. Political connection does not have a significant effect on tax avoidance in companies listed on the Jakarta Islamic Index during Kabinet Kerja reign for 2014-2018 period. This study is in line with research by Lestari & Putri (2017) which states that

political connections have no effect on tax avoidance. In this research, political connection has no effect on tax avoidance, presumably because the companies categorized as having political connections with the government indexed in the Jakarta Islamic Index during 2014-2018 period were mostly state-owned enterprises (BUMN). Based on Regulation of the Minister of Finance in Indonesia Number 71/PMK.03/2010, state-owned enterprises is a low-risk taxpayer. The determination indicates that the Directorate General of Taxes trusts that state-owned enterprises as a taxpayer will not take tax avoidance actions. In addition, the government-owned companies (state-owned enterprises) will conflict with the government itself, namely in terms of the government's role as the owner and its role as the organizer of state activities.

The government as owner of the company has an interest to improve the company's performance in the form of return on investment, one of the ways is by suppressing the tax payable. The government also acts as the executor of state activities which is obliged to increase state revenues used for infrastructure development and provide social services to the public. It can be concluded that the companies in the Jakarta Islamic Index that have political connections with Kabinet Kerja reign are minimal to carry out tax avoidance because most of them are state-owned enterprises under the direct control of the government, so these companies will have moral responsibility to carry out government programs in maximizing state tax revenues.

The Effect of Political Connection to Firm Value

Based on the statistical results, it can be seen that the political connection, proxied by a dummy variable (category 1 if the company has a political connection with the government and category 0 if it does not have a political connection), has a significance value of 0.012, smaller than 0.05 which means hypothesis 2 is accepted. It shows that political connection has a significant effect on firm value in companies listed on the Jakarta Islamic Index during Kabinet Kerja reign for 2014-2018 period.

The results of this study strengthen research by Faccio (2006), Fisman (2001) and Wati et al. (2016) which have proven that there is a positive relationship between political connections and firm value, both in countries with weak and strong legal systems. One of the reasons why companies with political connections

make it possible to have better corporate value is the competitive advantage for companies with political connections, such as easier access to funding from loans, lower tax rates, contracts with other companies, or reduce regulatory requirements.

The Effect of Tax Avoidance to Firm Value

The CETR value which is a measurement proxy for the tax avoidance variable has a significance value of 0.042, smaller than 0.05, which means hypothesis 3 is accepted. It shows that tax avoidance has a significant effect on firm value in companies listed on the Jakarta Islamic Index during Kabinet Kerja reign for 2014-2018 period. This study is in line with research conducted by Ilmiani & Sutrisno (2015) and Panggabean (2018) which states that tax avoidance has a significant negative effect on firm value.

Tax avoidance actions taken by the company show that tax aggressiveness can increase or decrease the value of the company's shares. If tax aggressiveness is seen as an effort to carry out tax planning and tax efficiency, then the effect is positive on firm value. However, if viewed as an act of non-compliance, it will increase the risk thereby reducing the value of the company (Hanlon & Slemrod, 2009). The results of statistical tests in this study prove that the market reacts negatively. Management's actions to carry out tax aggressiveness activities through tax avoidance schemes will be able to increase the firm value, but the resulting of financial statements can mislead investors because they do not describe the actual state of the company.

The Effect of Political Connection to Firm Value through Tax Avoidance

A variable is called a mediator if the variable influences the relationship between the predictor (independent) and criterion (dependent) variables. The mediation model has a hypothesis that the independent variable affects the mediator variable, which in turn affects the dependent variable (Baron & Kenny, 1986). In this study, the independent variable had no significant effect on the mediating variable. In other words, after the process of analyzing data on the existing sample, the political connection variable does not have a significant effect on tax avoidance, so the assumption that tax avoidance is a mediator variable between political connection and firm value is not fulfilled. It means that tax avoidance does not mediate (unmediated) the effect of political connection on firm

value in companies listed on the Jakarta Islamic Index during Kabinet Kerja reign.

As it is known that most companies that have political connections in this study are state-owned enterprises, where that state-owned enterprises is a company with majority ownership of shares owned by the government, then the company should comply and always carry out policies initiated by the government, including tax revenue policy. The existence of maximizing tax revenue policy from the government, like it or not, must be supported by state-owned companies under government so that state-owned enterprises will think again to do tax avoidance scheme.

The results of the statistical test of substructure equation II, through the t-test, it appears that tax avoidance has a partially significant effect on firm value, then through the F-test, tax avoidance and political connection have a simultaneous significant effect on firm value. as an independent variable, it would be more appropriate if tax avoidance is used as an independent variable.

5. CONCLUSION

Based on the results and discussions, it can be concluded that political connection and tax avoidance partially or simultaneously affect on firm value in companies listed on the Jakarta Islamic Index during Kabinet Kerja reign. Meanwhile, the political connection variable has no effect on tax avoidance, so it can be stated that tax avoidance does not mediate (unmediated) the effect of political connection on firm value in companies listed on the Jakarta Islamic Index during Kabinet Kerja reign. Companies that have political connections in this study are mostly state-owned enterprises so that they will be encouraged to comply and carry out policies initiated by the government, including the tax revenue policy. This is what causes causes state-owned enterprises do not have the courage to take risks doing tax avoidance activities.

This study implies that most state-owned enterprises are not willing to do tax avoidance scheme because the demands of government regulations. It can be used as positive information for investors who will invest in the capital market. Further research can choose a wider research sample with diverse industrial sectors so that it is better to describe the phenomenon of political connection, tax avoidance, and firm value.

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