Political connections and firm performance in an emerging market context: the mediating effect of sustainability disclosure

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Abstract

Purpose – This study examines the mediating effect of sustainability disclosure on the relationship between political connections and firm performance from the resource-based view.

Design/methodology/approach – The sample of this study was sourced from 888 public companies listed on the Indonesia Stock Exchange (IDX) from 2016 to 2017. Path analysis and Sobel tests were used to determine the mediating effect of sustainability disclosure.

Findings – The results show that political connections have a positive and significant influence on firm performance. Furthermore, sustainability disclosures mediate the relationship between political connections and firm performance.

Research limitations/implications – In the context of developing countries such as Indonesia, managers can make the existence of parties in politically connected companies as a medium to demonstrate their adherence to external stakeholders through the disclosure of sustainability information.

Originality/value – This study is the first to investigate the mediating effect of sustainability disclosure on the relationship between political connections and firm performance, especially in emerging markets. The parties of the politically connected companies use a social responsibility mechanism as a medium that can sustain their operational sustainability whilst gaining long-term economic benefits.

Keywords Political connections, Firm performance, Sustainability disclosure, Indonesia

Paper type Research paper

1. Introduction

Currently, a company's sustainability issue is an important concern that has always been part of its long-term goals. One of the typical efforts to ensure a company's sustainability is to undertake corporate social responsibility (CSR) activities (Reimsbach *et al.*, 2018). Clarkson (1995) suggests the necessity of considering efforts to increase a company's value through the sustainability programme disclosure. Disclosing sustainability information can increase the value of company by improving transparency and accountability, as well as stakeholder confidence (Li *et al.*, 2018). Disclosure of sustainability will provide non-financial information to businesses, such as how the production process is executed (use of raw materials and labour) and stakeholder engagement (suppliers, employees, government). Consequently, companies

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with greater disclosure of sustainability could be more attractive to investors and stakeholders and that the enhanced relationships that will result between companies and their multiple stakeholders will benefit financially in the long term (Velte, 2017). However, debates on whether the disclosure of sustainability information generates a positive impact on a company's performance have continued amongst academics. Previous studies have found varied relationships between sustainability disclosure and firm performance (Limkriangkrai *et al.*, 2017; Moore, 2001). For example, some studies have shown that the more companies disclosed sustainability information, the better their financial performance (Al-Tuwaijri *et al.*, 2004; Bodhanwala and Bodhanwala, 2018; Velte, 2017). In comparison, Nekhili *et al.* (2017) found a negative relationship between sustainability disclosure of non-family firms and firm value. Consistent with Nekhili *et al.* (2017) and Fatemi *et al.* (2018) also found that environmental, social and governance (ESG) disclosure can decrease firm value.

The inconsistent evidence of prior studies motivates the current study to further investigate this topic. The inconsistency of past results may be caused by institutional context differences given that the majority of these works have been conducted in developed countries (Kuzey and Uyar, 2017). Therefore, the results of these studies are difficult to generalise in the context of emerging countries with different levels of regulatory enforcement, stakeholder pressure, societal awareness and political environments, which can influence companies to provide sustainability disclosure (Amran and Haniffa, 2011; Zaini *et al.*, 2018).

The existence of political powers may provide significant benefits by creating specific regulations to a specific group of a business, industry or a company (Faccio, 2006; Gray *et al.*, 2014). The relationship between political power and the regulation of an industry is crucial when the market reacts to the issue of political power in a company (Carboni, 2017). On the other hand, political relations can also harm the value of the company (Ang *et al.*, 2013). For example, when political control is high, certain individuals appointed to political positions may have contradictory objectives, such as maximising work, minimising social costs or securing loans on concessionary terms without penalties (Banerji *et al.*, 2018). Additionally, insiders of connected companies may choose to defer disclosure of benefits received for the purpose of intentionally misleading investors, making financial statements more opaque (Chaney *et al.*, 2011). Moreover, politically connected directors have weak incentives to conduct their monitoring role (Zhang and Truong, 2019). One type of political power is the political connection between a company and the government. Issues related to political connection are a kind of information that can be considered by investors in making investment decisions. Thus, political connections exert considerable influence on sustainability disclosure (Bianchi *et al.*, 2019; Muttakin *et al.*, 2018) and firm value (Goldman *et al.*, 2009; Maaloul *et al.*, 2018; Ovtchinnikov and Pantaleoni, 2012; Wong and Hooy, 2018). As suggested by Zhang (2017), political connections have a positive impact on sustainability disclosure, and such an impact is more pronounced for state-owned enterprises (SOEs).

Indonesia presents an interesting case for exploring the business and political environments in relation to this topic. First, most large companies belonging to business groups have direct connections with the president, state officials and military officers (Joni *et al.*, 2020). Second, Indonesia has a long history of corruption, patronage, clientelism and cultural norms of reciprocity with SOEs traditionally dominating the economy (Apriliyanti and Kristiansen, 2019). Third, the level of mandatory disclosure amongst public listed firms in Indonesia is low. Hence, the results of the study are expected to contribute to the literature by providing a new explanation for the mediating role of sustainability disclosure in defining firm performance based on the political and business environments.

By using the resource-based view (RBV), the current study predicts that sustainability disclosure may be a mediating factor that can facilitate the interaction between the political connections and firm performance. Political relationships can help companies obtain valuable key resources and address external uncertainties (Ang *et al.*, 2013), have the power and discretion to allocate resources (Apriliyanti and Kristiansen, 2019), influence the electoral process to achieve positive results and then let them influence their competitive advantage (Boubakri *et al.*, 2012). The parties of the politically connected companies use a social responsibility mechanism as a medium that can sustain their operational sustainability whilst gaining long-term economic benefits. Consequently, sustainability efforts and the pursuit of CSR are intrinsically linked and work together to create economic growth and wealth creation (Bodhanwala and Bodhanwala, 2018). The role of mediating sustainability disclosure between the political relationship and the value of the firms stems from the optimising the resource mechanism to gain a competitive advantage. Disclosure of sustainability is seen as one of the actions that can influence the financial performance of the company due to the high synchronisation with political connections. As such, sustainability disclosure activities are not just a means of providing non-financial information between the company and stakeholders but may also improve performance through the effective use of politically connected parties that can be beneficial for company.

Studies testing the role of sustainability reporting as mediating and moderating variables on the relationship between political connections and firm performance are limited, especially in emerging markets (Leuz and Oberholzer-Gee, 2006). This study is different from Faccio (2006). Faccio (2006) only documents political connection practices in 47 countries based on the types of connections and he also does not directly test political connections to company values. Moreover, previous studies have only partially tested the relationship between political connections and sustainability disclosure (Huang and Zhao, 2016; Lin *et al.*, 2015; Luo and Wang, 2021; Muttakin *et al.*, 2018; Reimsbach *et al.*, 2018; Wang *et al.*, 2018; Zhang, 2017) and the relationship between political connections and firm value (Ang *et al.*, 2013; Banerji *et al.*, 2018; Boubakri *et al.*, 2012; Goldman *et al.*, 2009; Haris *et al.*, 2019; Liu *et al.*, 2018; Maaloul *et al.*, 2018) and the relationship between sustainability disclosure and firm performance (Ahsan and Qureshi, 2021; Qureshi *et al.*, 2020) The study also differs from He *et al.* (2019) in several ways. First, He *et al.* (2019) examine the relationship between political connection and financial distress. Second, they do not take into account other variables that may influence the direct relationship between the political connection and financial distress, such as disclosure activity. This study developed prior studies by re-examining the relationship between political connection and firm value, also testing the mediated effect of sustainability disclosure. By jointly considering the mediating effect of sustainability disclosure, the findings of this study can better explain the political connections and their effects on firm performance. The mediating model can provide more details and benefits when the researcher needs to capture when, how and why a particular relationship exists between the independent and dependent variables (Namazi and Namazi, 2016). Moreover, the purpose of mediation analysis is to see whether the influence of the mediator is stronger than the direct influence of the independent variable (Baron and Kenny, 1986, p. 1,174). Therefore, our study contributes to the growing body of business and accounting literature by providing insights, which reveal that the relationship between sustainability disclosure and firm performance may be different and that such a difference depends on the context of the connections of the company with related parties. The findings may also be useful for regulators, such as financial services authorities, government bodies and investors, in understanding the companies' performance. Based on the problems that have been presented above, the research questions are as follows:

RQ1. Does political connection affect firm performance?

RQ2. Does political connection affect sustainability disclosure?

RQ3. Does sustainability disclosure mediate the relationship between political connection and firm performance?

2. Literature review and hypothesis development

2.1 The political connections in Indonesia

In various literature related to political connection practices, there have been many previous studies using companies in Indonesia. However, studies linking the effects of the political link to the value of the company mediated by the disclosure of sustainability have never been carried out. Thus, this study contributes to the literature of political connection by testing the relationship of political connection, sustainability disclosure and firm value. "Political connections" are defined as a condition whereby a politician works in a company and/or an entrepreneur is involved in political activity (Faccio, 2006). For example, a director, commissioner or shareholder of a company engages in political activities by being a member of the parliament, a minister or a state official. A company is categorised to be politically connected if a politician who serves as a member of the board of directors and commissioner of the company has a relationship or network with a particular company and/or political affiliation (Carretta *et al.*, 2012), has entrepreneurs having a political background, if the firm contributes to political activity and/or if a person has close relations with political parties (Carboni, 2017).

The phenomenon of political connections in Indonesia is an issue that has long existed for many years. As part of efforts to prevent the practice of political connection in a company, in the year 1974, the Government of Indonesia issued Government Regulation No. 6, which prohibits public officials to have all or part of the shares of private companies and/or engage in the management of private enterprises. However, in the era of President Susilo Bambang Yudhoyono, Government Regulation No. 6/1974 was revoked and replaced with Government Regulation No. 53/2010. Regardless of whether the revocation of government regulation No. 6/1974 has a direct influence on the rise of political connection practices in Indonesia companies, the survey results of Indonesian Corruption Watch (ICW) in 2015 indicate the effects of the revocation of such a government regulation. The results of the ICW survey found that 52.3% of the members of the People's Representative Council of the Republic of Indonesia during the period 2014–2019 have backgrounds as businessmen (https://nasional.kompas.com). Furthermore, the current phenomenon on political connections was highlighted due to the case of the PT Garuda Indonesia, Tbk. The country's flag carrier is known to be politically connected, because its majority shareholder (>50%) is the Indonesian government, and several structural office holders were appointed directly by the government. However, the company sustained 2.88 trillion rupiahs in losses, thus indicating its bad financial performance.

2.2 Resource-based view

In the 1990s, a resource-based approach was developed in a business environment. This approach emphasises the importance of corporate resource excellence as a capital to acquire a sustainable competitive edge. This resource-based approach was introduced by Wernerfelt (1984), Rumel (1984) and Barney (1986). The main premise of this theory is that companies compete on the basis of their resources and abilities (Peteraf and Bergen, 2003). Resource-based theory strives to explore the internal and external factors facing the company (Peteraf and Barney, 2003).

According to Barney (1991), the resources intended in this theory are a collection of tangible and intangible assets, which include management skills, organisational processes and routines as well as certain information and knowledge that the company can control to help it select and implement effective strategies. If the resources and capabilities are valuable, scarce and inimitable, these cannot be easily substituted; hence, the company can achieve a competitive edge over others in the same market (Barney, 1991). One form of resource excellence is the political connection in business (Sun *et al.*, 2010). Political relations are considered to be relational assets, which can facilitate a company's acquisition of major government resources and support (Boubakri *et al.*, 2012; Faccio, 2006). This connection is a rare, intangible resource and can be a key factor that allows a company to obtain government support in order to gain competitive edge (McWilliams *et al.*, 2002). Political connections can facilitate the acquisition of resources through loans, contracts and government grants, which can positively affect the value of the company (Maaloul *et al.*, 2018).

Lee *et al.* (2014) argue that corporate officials may consider alternatives to using political connections in order to increase the likelihood of winning subsidies (aid) from the government. In resource-based theory, political connections are viewed as a competitive advantage and valuable resources that are not easily available for all companies. In addition, this theory implies that political connections can help improve the performance and value of the company (Maaloul *et al.*, 2018).

RBV is considered a useful foundation in sustainability because it emphasises the importance of intangible resources and a company's ability and considers them to be the most important source of company success (Dominguez, 2011). The implementation of CSR disclosure will signify that the company has leverages resources, which can either be used for internal projects in order to increase the company's value or be refunded to shareholders (Friedman and Miles, 2001). Resources and capabilities are used by companies to develop and implement their strategies. Hart (1995) was one of the first to implement studies on RBV, focussing exclusively on environmental social responsibility. He argues that CSR can be a resource or capability that leads to a sustainable competitive edge.

2.3 Political connections and firm performance

The value of the company is the long-term market value of the company that is expected as a profit to meet the expectations of stakeholders. To meet the expectations of their stakeholders, companies can use their ability and resources to realise such expectations. According to RBV, political access is one of the sources of decision-making power within the organisation (Cheema *et al.*, 2016). In turn, the ability to control the organisation can drive the market to produce high wealth and standard of living worldwide (Jensen, 2002).

In the business and accounting literature, empirical evidence showing the relationship between the practice of political connection with the company's financial performance is still being contested. Fisman (2001), for example, has investigated the relationship between political connections and firm values in Indonesian and Chinese companies. His results showed that, on the one hand, political connections can contribute positively to the firm's value by 25–33%. On the other hand, in China, political connections have a negative influence on the value of the company. Fisman's result is consistent with the findings of Li *et al.* (2007) who reported that the politically linked financial performance of Chinese-connected companies is 37% lower than that of a non-politically connected company.

Recent studies also provide empirical evidence stating that the practice of political connection has a positive impact on a company's value increase (Ang *et al.*, 2013; Banerji *et al.*, 2018; Maaloul *et al.*, 2018; Wang *et al.*, 2018). A politically connected company can have a strong connection with the ruling government, either through state ownership or through a network connection. Therefore, they may have better access to government resources (Liu *et al.*, 2018). With the existence of its political relationship with the government, there is an investor's tendency to invest in companies that are politically connected to gain such benefits. Thus, the first hypothesis is presented as follows:

H1. The performance of politically connected firms is higher than that of non-politically connected firms.

2.4 Political connection and sustainability disclosure

Politically connected companies have better access to government resources; however, these companies are often highly supervised, especially in terms of carrying out their social responsibilities (Reimsbach *et al.*, 2018). Such companies are encouraged to publish their social responsibility report as a form of compliance pursuant to LAW 40/2007 of the limited liability companies in Indonesia (Rosser and Edwin, 2010). Political connections can assist the company in minimising environmental uncertainties, reducing transaction costs and increasing their long-term sustainability (Hillman and Hitt, 1999). McWilliams *et al.* (2002) explained that social responsibility practices supported by political strategies can be used to create a sustainable competitive advantage. In order to achieve such an advantage, the company's managers often use corporate sustainability as a way to manage the position of power and establish the legitimacy of the company in the eyes of the key stakeholders (Muttakin *et al.*, 2018). Companies with a reputation of good social responsibility can improve relations with external actors. They can also attract better employees or increase the motivation, morale, commitment and loyalty of current employees to the company (Branco and Rodrigues, 2006). Nevertheless, Fitriani *et al.* (2020) found that political connections have no influence on sustainability disclosure.

As mentioned earlier, McWilliams *et al.* (2002) argued that social responsibility practices backed by political strategies can be used to create a sustainable competitive edge. Generally, both politically and non-politically connected companies will choose to satisfy certain stakeholders in accordance with the interests of those stakeholders. However, companies with political connections are significantly better than those without political connections in terms of carrying out community-oriented responsibilities and satisfying customers (Huang and Zhao, 2016; Reimsbach *et al.*, 2018). Based on RBV, sustainability activities can provide internal or external benefits, or both. Investing in socially responsible, sustainable activities can have internal benefits by assisting the company in developing new resources in the form of corporate knowledge and culture. Meanwhile, the external benefits of sustainability relate to its influence on the company's reputation, which is understood to be a fundamental intangible resource and is a consequence of the decision to engage/not engage in the activities and disclosures of sustainability activities. Thus, on the basis of the previous explanation, the second hypothesis is proposed as follows:

H2. Politically connected firms disclose higher sustainability disclosure than non-politically connected firms.

2.5 Mediating role of sustainability disclosure on the relationship between political connection and firm performance

RBV explains that the presence of political connections can be a source of competitive advantage, which originates from the ownership of tangible and intangible resources that cannot be easily obtained by competitors (Barney, 1991). As mentioned earlier, political connections and all related activities can assist the company in minimising environmental uncertainties, reducing transaction costs and increasing long-term sustainability (Hillman and Hitt, 1999). Sustainability practices supported by political strategies can be used to create a sustainable competitive edge (McWilliams *et al.*, 2002). Previous studies on the relationship between political connection and disclosure of corporate sustainability information showed that politically connected companies may use the disclosure of information related to CSR activities to influence key stakeholders such as investors and the public (Bodhanwala and Bodhanwala, 2018; Branco and Rodrigues, 2006). The objectives of engaging in sustainability disclosure are to meet the expectations of key stakeholders, maximise economic returns and to increase the value of the firm. The higher the level of sustainability disclosure the better the response from investors which in turn will increase the firm value (Fatemi *et al.*, 2018; Gregory *et al.*, 2014; Li *et al.*, 2018). Diantimala (2018) tests the relationship between financial performance, sustainability disclosure and firm value. Furthermore, she argued that better financial performance would encourage companies to disclose more detailed sustainability information that could ultimately increase the value of the firm. Consequently, sustainability could be mediating the relationship between political connection and firm value. On the basis of the explanation presented above, the third hypothesis is proposed as follows:

H3. Sustainability disclosure mediates the relationship between political connections and firm performance. The mediated effect is stronger than direct effect.

3. Research method

3.1 Data collection and sample selection

The sustainability disclosure and political connection data were sourced from the 2016–2017 annual reports of public listed companies, while the financial and accounting data were collected from the *Bloomberg* database. The political data were obtained from the annual reports, corporate websites and other sources, such magazine and newspaper articles. The sample used in this study consisted of 888 firm-year observations. The purposive sampling method was used to select the sample. Table 1 presents the sample selection. There were 576 public companies listed on the Indonesia Stock Exchange (IDX) during 2016–2017. Of the 576 companies, there are 65 annual reports that are inaccessible and 67 companies do not have complete data. Thus, the final sample is 444 companies for each year.

3.2 Variable measurement

According to the Global Reporting Initiative (GRI), 'sustainability disclosure' is defined as a disclosure of the economic, environmental and social impacts caused by the activities of a company or organisation. It also presents the organisation value and governance model, which demonstrates the link between a company's strategy and commitment to a sustainable global economy (Global Reporting Initiative, 2016). Content analysis was used to extract the information related to sustainability information. The measurement of sustainability disclosure was based on GRI G4 (2016) and was done by using an unweighted index. This approach is considered less subjective and relevant to all companies (Cooke, 1989). Following Faccio (2006, p. 369), a company is considered politically connected if "at least one of its large shareholders (anyone controlling at least 10% of voting shares) or one of its top officers (CEO, president, vice-president, chairman or secretary) is a member of parliament, a minister, or is closely related to a top politician or party." Consistent with previous studies, we used four control variables, namely, profitability, firm size, sales growth and leverage. Table 2 summarises the measurement of variables.

Criteria	*N*
Number of companies listed on the Indonesia Stock Exchange	576
Number of companies whose annual reports cannot be accessed	(65)
Number of companies with incomplete data	(67)
Number of sample per year	444
Final sample (2 year × 444)	888
Percentage sample to total listed company (444/576) = 77%	

Table 1.
Sample selection

Variable	Measurement
Sustainability disclosure (SD)	Using 91 indicators of the GRI G4 standards (Global Reporting Initiative, 2016). A value of 1 is assigned if a company disclosed the items and 0 otherwise (Faisal *et al.*, 2018; Reimsbach *et al.*, 2018). The formula of the index follows that of Haniffa and Cooke (2005) $SD_j = \frac{\sum_{t=1}^{n_j} X_{ij}}{n_j}$
Political connections (PC)	A value of 1 is assigned for politically connected firms and 0 otherwise (Boateng *et al.*, 2019; Boubakri *et al.*, 2012; Faccio, 2006)
Firm performance (FP)	Market value of equity (MVE) = stock price × number of outstanding shares (Maaloul *et al.*, 2018)
Profitability (PROF)	Return on assets ratio (ROA) = total assets divided by total liabilities (Velte, 2017; Wang *et al.*, 2018)
Firm size (SIZE)	Total assets (Boateng *et al.*, 2019; Faisal *et al.*, 2018; Goldman *et al.*, 2009; Shi *et al.*, 2018)
Sales growth (SG)	Sales for the year t divided by sales for the year $t-1$ (Wang *et al.*, 2018)
Leverage (LEV)	Liability divided by total assets (Faisal *et al.*, 2018; Shi *et al.*, 2018; Velte, 2017; Wang *et al.*, 2018; Zhang and Truong, 2019)

Table 2.
Variable measurement

3.3 Econometric equations

This study employed multivariate regression analysis, which is used to examine the influence of independent variables on a dependent variable. This analysis also measures the strength of a relationship between these variables and shows the direction of the relationship. The regression equations used to test H1 and H2 are respectively given by

$$\text{FP} = \alpha + \beta_1\text{PC} + \beta_2\text{PROF} + \beta_3\text{SIZE} + \beta_4\text{SG} + \beta_5\text{LEV} + e, \tag{1}$$

$$\text{SD} = \alpha + \beta_1\text{PC} + \beta_2\text{PROF} + \beta_3\text{SIZE} + \beta_4\text{SG} + \beta_5\text{LEV} + e. \tag{2}$$

Finally, to test the mediating effect of SD on the relationship between PC and FP, path analysis and Sobel test were used. Path analysis was used to investigate patterns of effect within a system of variables. By using the path analysis, the effect of multiple predictors (political connection and sustainability disclosure) on a criterion variable (firm value) can be assessed. In addition, the Sobel test was used to test the significance of a mediating effect. In mediation, the relationship between the independent variable and the dependent variable is hypothesised to be an indirect effect that exists due to the influence of a third variable (the mediator). As a result, when the mediator is included in a regression analysis model with the independent variable, the effect of the independent variable is reduced and the effect of the mediator remains significant. The Sobel test is a method of determining whether the reduction in the effect of the independent variable after including the mediator in the model is a significant reduction and, as a result, whether the mediation effect is statistically significant.

The respective regression equations are expressed as

$$\text{SD} = \alpha + p_2\text{PC} + e_1, \tag{3}$$

$$\text{FP} = \alpha + p_1\text{PC} + p_3\text{SD} + e_2, \tag{4}$$

where

FP = financial performance,

SD = sustainability disclosure,

PC = political connection,

PROF = profitability,

SIZE = firm size,

SG = sales growth,

LEV = leverage,

p_2 = path coefficient SD and PC and

p_1 = path coefficient FP and PC,

p_3 = path coefficient FP and SD,

$e_{1,2}$ = Error or residual.

4. Results

4.1 Descriptive statistics and correlation

Table 3 presents the descriptive statistics of politically connected firms based on the industry classifications. As can be seen, out of 888 public listed firms, 231 (26%) have political connections with various parties. This finding is consistent with the studies of Harymawan and Nowland (2016), Harymawan *et al.* (2017) and Harymawan *et al.* (2020), who reported that 34% of Indonesia's public listed companies are politically connected. In terms of the industries, trade, services and investment and financial industries are the most politically connected firms. This finding can be explained by the fact that these companies are mostly SOEs wherein the majority of the stocks are owned by the government and controlled by the Ministry of State-owned Enterprise/Badan Usaha Milik Negara (BUMN). For instance, in the financial sector, the three largest banks in term of assets, namely, Bank Mandiri, Bank Negara Indonesia and Bank Tabungan Negara, are almost 100% owned by the Indonesian government. Thus, it is not surprising that the Directors nor the Board of Commissioners of these companies would come from the ranks of government officials and political parties.

Table 4 presents the comparison performance and level of disclosure between politically and non-politically connected firms. As can be seen, the average market value for all sectors is 28.53 for politically connected firms and 27.17 for non-politically connected firms. In terms of sustainability disclosure, the average disclosure of politically connected firms is higher (20.40%) than that of non-politically connected firms (11.00%). In addition, the sustainability

Sector	Industry classification	*N*	%	Politically connected firms	%
1	Agriculture	32	3.60	4	0.45
2	Mining	68	7.67	28	3.15
3	Basic industry and chemicals	112	12.61	23	2.59
4	Miscellaneous industries	68	7.67	10	1.13
5	Consumer goods industries	62	6.98	14	1.58
6	Property, real estate and building constructions	106	11.94	25	2.82
7	Infrastructure, utilities and transportation	82	9.23	29	3.26
8	Financial	150	16.88	40	4.50
9	Trade, services and investment	208	23.42	58	6.53
Total		888	100.00	231	26.01

Note(s): The industry is classified into nine sectors according to the provisions of the Indonesian Stock Exchange (IDX); political connection = a value of 1 is assigned for politically connected firms and 0 otherwise

Table 3. Descriptive statistics of political connections by industry

Table 4. Comparing firm performance and sustainability disclosure by industry

Sector	Industry classification	Mean of *logarithm natural* of market value of equity		Mean of sustainability disclosure (%)	
		PC	Non	PC	Non
1	Agriculture	29.53	29.38	15.70	14.10
2	Mining	23.41	23.33	21.50	20.01
3	Basic industry and chemicals	26.28	26.36	14.60	14.5
4	Miscellaneous industries	25.30	25.27	10.00	9.80
5	Consumer goods industries	29.64	29.46	15.00	14.90
6	Property, real estate and building constructions	28.87	28.27	13.20	12.70
7	Infrastructure, utilities and transportation	25.49	25.31	14.40	14.10
8	Financial	30.03	29.94	15.00	14.60
9	Trade, services and investment	27.81	27.80	9.40	9.30
All sectors		28.53	27.17	20.40	11.00

Note(s): PC = political connection = a value of 1 is assigned for politically connected firms and 0 otherwise; market value of equity = stock price × number of outstanding shares; sustainability disclosure = a value of 1 is assigned if a company disclosed the items and 0 otherwise

disclosure rates of the mining and agriculture sectors are the highest. This finding may be due to the regulations (Law No. 40/2007 and Government Regulation No. 47/2012) requiring all the sectors related to natural resources to report their sustainability activities to the government.

Table 5 presents the results of the Pearson correlation matrix amongst the variables. As can be seen, the coefficient of correlation of independent variables is under 0.50, suggesting that there is no multicollinearity problem. We also conducted additional tests by using the variance inflation factor (VIF), and the results showed that the VIF value ranged between 1 and 1.5. This means that the model does not contain multicollinearity. The results further indicated a significant and positive link between PC and SD and between SD and FP. However, only two control variables, namely, firm size and profitability, correlate with the dependent variables (SD and FP).

Table 5. Pearson correlation matrix

	FP	PC	SD	PROF	SIZE	SG	LEV
FP	1	0.158**	0.174**	0.086*	0.941**	0.023	−0.040
PC	0.158**	1	0.34**	0.150**	0.150**	−0.040	−0.019
SD	0.174**	0.342**	1	0.164**	0.164**	−0.052	−0.008
PROF	0.086*	0.009	0.111**	1	0.069*	0.006	−0.052
SIZE	0.941**	0.150**	0.164**	0.069*	1	−0.049	−0.031
SG	0.023	−0.040	−0.052	0.006	−0.049	1	−0.008
LEV	−0.040	−0.019	−0.008	−0.052	−0.031	−0.008	1

Note(s): FP, firm performance = market value of equity (stock price × number of outstanding shares; PC, political connections = a value of 1 is assigned for politically connected firms and 0 otherwise; SD, sustainability disclosure = a value of 1 is assigned if a company disclosed the items and 0 otherwise; PROF, profitability = total assets divided by total liabilities; SIZE, size of the firm = total assets; SG, sales growth = sales for the year t divided by sales for the year $t-1$; LEV, leverage = liability divided by total assets. **statistically significant at 0.01; * statistically significant at 0.05

4.2 Results of the regression analyses

Table 6 presents the results of the regression analyses. Based on these results, it can be seen that PC has a direct effect on FP and SD. Therefore, H1 and H2 are accepted.

Table 7 presents the results of the path analysis. The results indicate that PC has a direct effect on FP and an indirect effect via SD. Therefore, H3 is supported.

Variable	Coefficient	t	p-value
Panel A. $FP = \alpha + \beta_1 PC + \beta_2 PROF + \beta_3 SIZE + \beta_4 SG + \beta_5 LEV + e$			
Constant	1.050	3.428	0.001**
PC	0.193	2.056	0.000**
PROF	2.076	2.984	0.000**
SIZE	0.956	5.917	0.000**
SG	0.158	6.193	0.000**
LEV	0.371	0.6.786	0.000**
Adj $R^2 = 0.994$; $F = 15472.652$; p-value $= 0.000$**; $N = 888$			
Panel B. $SD = \alpha + \beta_1 PC + \beta_2 PROF + \beta_3 SIZE + \beta_4 SG + \beta_5 LEV + e$			
Constant	0.020	0.672	0.502
PC	0.090	9.742	0.000**
PROF	0.122	2.964	0.003**
SIZE	0.003	2.904	0.004**
SG	−0.003	−1.129	0.259
LEV	0.003	0.586	0.558
Adj $R^2 = 0.158$; $F = 19.069$; p-value $= 0.000$**; $N = 888$			

Note(s): All the regression assumptions have been met; hence, there are no multicollinearity, heteroscedasticity and autocorrelation problems. Panel A presents the results of regression analysis with dependent variable is financial performance. Panel B presents the results of regression analysis with dependent variable is sustainability disclosure. FP, firm performance = market value of equity (stock price × number of outstanding shares; PC, political connections = a value of 1 is assigned for politically connected firms and 0 otherwise; SD, sustainability disclosure = a value of 1 is assigned if a company disclosed the items and 0 otherwise; PROF, profitability = total assets divided by total liabilities; SIZE, size of the firm = total assets; SG, sales growth = sales for the year t divided by sales for the year t−1; LEV, leverage = liability divided by total assets; **statistically significant at 0.01; * statistically significant at 0.05

Table 6.
Results of the regression analyses

Variable	Coefficient	t	p-value	Adjusted R^2
Panel A. $SD = \alpha + p_2 PC + e_1$				
Constant	0.105	22.818	0.000**	0.109
PC	0.086	9.454	0.000**	
Panel B. $FP = \alpha + p_1 PC + p_3 SD + e_2$				
Constant	27.854	301.170	0.000**	0.268
PC	0.902	6.090	0.000**	
SD	7.015	12.316	0.000**	

Note(s): Panel A presents the results of path analysis with dependent variable is sustainability disclosure. Panel B presents the results of path analysis with dependent variable is financial performance. FP, firm performance = market value of equity (stock price × number of outstanding shares; PC, political connections = a value of 1 is assigned for politically connected firms and 0 otherwise; SD, sustainability disclosure = a value of 1 is assigned if a company disclosed the items and 0 otherwise; **statistically significant at 0.01

Table 7.
Path analysis results

Figure 1 presents the coefficients of the path analysis. The total effect of the relationship can be calculated as follows: the coefficient of the direct effect (p_1) is 0.902, and the coefficient of the indirect effect ($p_2 \times p_3$) is 0.604 (0.086 × 7.015) and the total effect ($p_1 + (p_2 \times p_3)$) is 1.506, where the value of *t-statistics* (7.532) > *t-table* (1.965). Therefore, SD acts as a mediating variable on the relationship between PC and FP. To test the consistency of the path analysis results, we also run the *Sobel tests*. The results of the path analysis are consistent with those of the *Sobel tests* provided in Table 8.

4.3 Sobel tests results

Table 8 presents the results of the Sobel tests. As can be seen, the coefficient of the direct effect of PC on FP is 0.902 ($p < 0.001$). Regarding the mediating effects of PC on SD and of PC

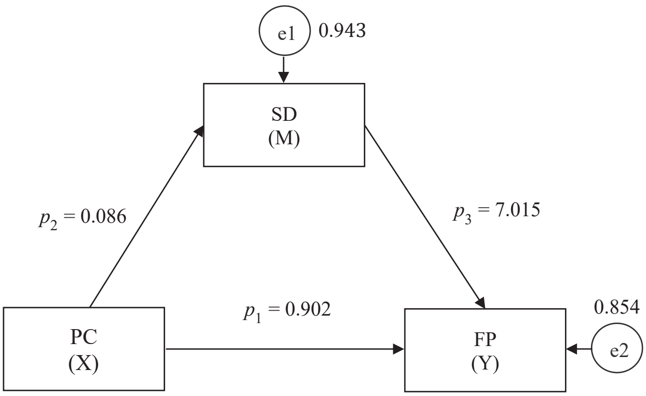

Figure 1.
Path analysis diagram

Table 8.
The Sobel test results and effect size

Panel A	Coefficient	p-value
Direct effect		
PC → FP	0.902	0.000**
Mediated effect		
PC → SD	0.086	0.000**
PC → FP	7.015	0.000**
Total effects		
PC → FP	1.506	0.000**
Indirect effect	0.604	0.000**

Panel B

	R2 with mediator – R2 without mediator (A)	1 – R2 with mediator (B)	f^2 = A/B	Effect size
PC → SD → FP	0.160	0.730	0.210	Moderate[1]

Note(s): Panel A presents the results of Sobel test. Panel B presents the effect size test. FP, firm performance = market value of equity (stock price × number of outstanding shares; PC, political connections = a value of 1 is assigned for politically connected firms and 0 otherwise; SD, sustainability disclosure = a value of 1 is assigned if a company disclosed the items and 0 otherwise; **statistically significant at 0.01. [1]Cohen (1988) categorised the effect of size into three types: weak (0.02–0.15), moderate (0.15–0.35) and strong (>0.35) correlation on FP, these are found to be significant, with coefficients of 0.0086 and 7.015, respectively, ($p < 0.001$). In addition, Sobel test result (Panel A) showed that the coefficient of mediation effect (7.015) was greater than the direct effect coefficient (0.902). Likewise, the coefficient of determination of mediation effect (Panel B, Column B) is higher than the direct effect (Column A). Finally, the coefficient of the indirect effect of PC on FB is 0.604, which is also significant. Overall, the results demonstrate that the relationships amongst PC, SD and FP are consistent with the prediction. The magnitude of the mediating effect of SD on the relationship between PC and FP is moderate (0.210).

5. Discussion

This study investigates the relationships between PC and FP and between SD and FP as well as the mediating effect of SD on the relationship between PC and FP using RBV. The result shows that SD has a mediating effect on the relationship between PC and FP. This indicates that SD should be considered by decision-makers in designing strategies to increase the performance of a company. Such findings may also help the decision-makers realise the importance of disclosing information about their sustainability activities, which may benefit the key stakeholders of a company.

Regarding the direct causal relationship between PC and FP, we found that political connection can have a significant positive effect on a company's improved performance. The positive effect of political connection and firm value is consistent with the literature arguing that in general PC contributes to the value of the firm (Ang *et al.*, 2013), increase the loan's collateral value (Banerji *et al.*, 2018), improve companies' performance and value (Maaloul *et al.*, 2018; Wang *et al.*, 2018). This result is consistent with RBV, which assumes that political connections are intangible resources (Barney, 1991) that can increase the value of a company if utilised properly. Political connection is also a relational asset, which enables a company to acquire major government resources and support. Thus, it is reasonable to assume that political connections can help increase the value of a company.

In addition, politically connected companies have better access to the government in power, thus strengthening the decision-making power within the organisation (Ang *et al.*, 2013). Having such a decision-making power means that organisations can align with government-defined regulations and gain access to more government resources. Politically connected people are thought to be able to control the organisation, thus generating a certain effect upon the company in the market and capitalism system, and producing a certain wealth and standard of living for the company. Therefore, it is not surprising that politically connected entities will utilise the skills and political resources they have to achieve success in managing and influencing public policy processes. In turn, this gives them greater competitive advantage compared to companies without political connections. Despite the fact that large companies in Indonesia have political connections with various parties, however, the results of this study show that efficient political connections able to contribute positively to firm value (Faccio, 2010). The positive contributions made by politically linked parties within the business are made through political legitimacy. A board of directors or commissioners that have a good relationship with the government can help companies easily access funds and regulations. In fact, the board of directors (commissioners) has an extensive network and relatively long experience to reduce uncertainty about sources of financing and to be able to manage the business efficiently. The existence of patronage and clientelism facilitates the access of government-related parties to resources to improve corporate performance (Harymawan *et al.*, 2020).

In the subsequent examination of the relationship between PC and SD, the result is consistent with our prediction that politically connected firms tend to disclose more sustainability activities. This is consistent with the findings of previous studies, which stated that politically based companies, and in particular those that are politically centralised, are more likely to issue CSR reports (Reimsbach *et al.*, 2018; Wang *et al.*, 2018), significantly better than the ones without political connection in society-oriented and customers-oriented responsibility (Huang and Zhao, 2016). From a resource-based perspective, SD is seen as providing internal or external benefits, or both (Branco and Rodrigues, 2006). Sustainability disclosure activities have a significant impact on the creation or depletion of fundamental intangible resources, including those associated with employees. The external advantages of SD are linked to its effect on the company's reputation. The company's reputation can be understood as a fundamental intangible resource that can be created or diminished by decisions about whether to engage in sustainability disclosure activities.

This finding can be explained by the fact that the politically connected companies are visibly supervised by the stakeholders (Al-Tuwaijri *et al.*, 2004). For a company that is linked to the government, reporting its sustainability activities demonstrates compliance to the government as mandated in the Law No. 40/2007 and Government Regulation No. 47/2012. By following these regulations, a company can improve its position in the eyes of the stakeholders, thus creating sustainable competitive advantage (Bianchi *et al.*, 2019). In addition, the positive contribution of the board (commissioners) or other politically related parties will have an impact on the low level of disclosure of sustainability information. By disclosing higher information sustainability, it will be an indicator of the company's adherence to government regulations. Thus, political linkages can be a mechanism of good governance, as a means of oversight of government.

Finally, our analyses on the role of SD in mediating the relationship between PC and FP confirm our hypotheses. The result corresponds to the notion that political connection of the company with the government through the relationship with the Board of Directors and/or Board of Commissioners can explicitly maintain the relationship in business operations (Wong and Hooy, 2018). This can help demonstrate the benefits of a company's value as expected by the stakeholders. The presence of political connections as a relational asset can also be a source of competitive advantage in terms of increasing the value of a company through long-term sustainability improvement (Nekhili *et al.*, 2017). The implementation of social responsibility through certain strategies is a known tactic employed by companies to increase long-term sustainability. When companies engage in social activities, they are essentially intent on meeting the expectations of key stakeholders and maximising future economic returns. Sustainability disclosure can also positively affect the reputation and value of the company (Bianchi *et al.*, 2019).

Furthermore, a company's ability to disclose sustainability information may affect its value. SD quality can certainly have a significant influence on the relationship between political connection and the company's value, thus becoming an indirect relationship. This is because the higher the quality of sustainability information disclosure, the higher the stakeholder (e.g. the government) trust. As explained in the literature, SD helps a company communicate or convey important non-financial information to the stakeholders.

6. Conclusions

This study investigates the relationship between PC and FP, specifically examining the role of SD in mediating the relationship between the two. First, we found that PC positively affects FP. Politically connected firms show higher market value than non-politically connected firms. Second, in relation to the PC–SD link, PC has a significant and positive impact on SD. Politically connected companies are driven to improve the quality of social responsibility disclosure as a way to manage their position and gain a good reputation in the eyes of their stakeholders. Companies can maintain long-term sustainability by taking advantage of their intangible resources in the form of good relations with the government. Finally, we found that

SD plays a mediating role in the relationship between PC and FP. This finding indicates that SD should be considered thoroughly by managers when coming up with strategies to improve company performance. Such a finding may also encourage decision-makers to report high-quality sustainability information in the media in order to communicate non-financial issues to stakeholders. In this way, investors can assess and evaluate company performance.

This study has several implications. Theoretically, the findings of this study expand literature by providing empirical evidence related to political connection, sustainability disclosure and company performance in the context of emerging markets. From the perspective of RBV, stakeholders can consider the benefits of having politically connected people in maintaining a company's competitive advantage. The practical implications of these findings, in the context of developing countries such as Indonesia, managers can make the existence of parties in politically connected companies as a medium to demonstrate their adherence to external stakeholders through the disclosure of sustainability information. Higher disclosure of sustainability information will help the company to improve its reputation while building a corporate image that will ultimately be responded positively by market participants through improved stock performance. For policy makers, PC can play an important role in encouraging companies to become more involved in sustainable development activities, particularly in Indonesia where the level of sustainability disclosure remains low.

The limitations of this study should be noted. First, as in many studies on the sustainability disclosure, there may be a high level of subjectivity from the researchers in terms of interpreting and scoring the information from the annual reports, even though they have attempted to reduce the bias by using two expert coders in validating the disclosure index. Further analyses can improve the scoring method by using secondary data, such as those from the *Bloomberg* database or other rating sources. Second, our study also only measures political connections based on the presence or absence of links between members of the company and the government or political parties without differentiating them according to the type of link. Additionally, future studies could test details on whether or not there are difference in the extent of disclosure and firm performance amongst the types of political connections (Board of Directors vs. Board of Commissioners, professional vs. political party members). The results of the current study can provide more insights into this topic.

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