"Political connection status decisions and benefits for firms experiencing financial difficulties in emerging markets"

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POLITICAL CONNECTION STATUS DECISIONS AND BENEFITS FOR FIRMS EXPERIENCING FINANCIAL DIFFICULTIES IN EMERGING MARKETS

Abstract

There is relatively little research exploring the benefits of political connection status decisions for firms experiencing financial difficulties in emerging markets. This paper investigates financially distressed firms that benefit from their political connection status in Indonesia. This study uses three measurements of financial distress as the dependent variables: Altman Z-score, negative working capital, and interest coverage ratio. Firm size, profitability, liquidity, leverage, and operating cash flow are independent variables. Quarterly data for the period from 2012 to 2018 from 327 non-financial companies were obtained from the Indonesia Stock Exchange. To analyze the relationship between financially distressed companies and decisions on the status of political connections as supporters or opponents, the random effects probit model (REPM) was used. The results show that firms with political status as opposition to the government have a strong positive correlation with experiencing financial difficulties. Meanwhile, companies with political connections as government supporters have a strong negative correlation. Companies with politically connected status as opposition experience financial difficulties in terms of negative working capital and interest coverage ratios. Then, debt financing was not found to be a significant problem for financially distressed companies with a political support status of the government. There are indications that they have benefited from political connections, such as more accessible debt financing.

Keywords	financial distress, political connections, bankruptcy, debt financing, random effects probit model
JEL Classification	G32, G33, G38

INTRODUCTION

Profitability, solvency, and liquidity are fundamental indicators in predicting the possibility of a company's bankruptcy. In the theory of bankruptcy prediction, a company can be said to be in a state of financial distress as an early sign of bankruptcy if it has had a negative net income for several consecutive years (Altman, 1968; Whitaker, 1999). Companies experiencing financial difficulties are indicated as companies that are starting to experience financial difficulties and pressure gradually leading to bankruptcy. This financial difficulty and pressure are a situation where the company's cash flow is insufficient to pay the installments or interest on the debt that the company needs (H. Platt & M. Platt, 2006; Mselmi et al., 2017).

Companies with an interest coverage ratio of less than one tend to experience financial difficulties. Then, a company has a negative net operating profit that also indicates financial difficulties. Another sign of a company experiencing financial difficulties is a decrease in its ability to meet its interest payments or debt install-

ments to creditors (Hofer, 1980; Whitaker, 1999). However, politically strong connected firms have preferential access to cheaper debt financing to benefit firms (Faccio et al., 2006).

In developing countries, the activities of corporate leaders in establishing political connections with the government can provide many benefits for the company (Habib et al., 2017). Companies can receive financial, relational, and other benefits by influencing policies. This is one of the company's profitable non-market strategies (Lawton et al., 2013).

Regarding sources of debt financing, politically connected firms gain preferential access to lenders such as low-debt state banks (Khwaja & Mian, 2005; Faccio, 2006; Boubakri et al., 2012). Moreover, apart from the benefits of debt, politically connected companies can usually contract projects and support government regulations that benefit a company. In this way, controls can be softer, such as schemes for paying lower taxes, preferential import licenses, and favorable tariffs (Johnson & Mitton, 2003; Leuz & Oberholzer-Gee, 2006; Goldman et al., 2009; Houston et al., 2014).

Social, political, economic, and cultural environment between companies in developing countries is very different from the environment in developed countries. This study is motivated by the characteristics of the business environment in developing countries such as Indonesia. In developing countries, some problems such as property rights issues are not well defined, weak laws, weak investor protection, and poor financial transparency. In addition, research related to political connections in companies is essential to conduct in developing countries where political activity plays an important role in state policy, such as government-run projects.

1. LITERATURE REVIEW AND HYPOTHESES

The environment, social issues, politics, economy, and culture of companies in developing countries operate very differently from the environment in advanced economies (Khan et al., 2016). La Porta et al. (2000a, 2000b) examined the characteristics of developing country business environments. They found that property rights in developing countries are not well defined. There are also weak legal regulations, weak investor protection, and a low-quality government. Besides, the transparency of financial problems is poor. Therefore, research related to corporate political connections is important to study in developing countries since political activity in developing countries plays a vital role in influencing government policies in carrying out or implementing government-run projects (Fan et al., 2007).

The causes of a company experiencing financial difficulties are quite diverse. They include increased operating costs, overexpansion, technological lags, competitive conditions, economic conditions, weakness in company management, and decreased industrial trading activity. Even in a good economic situation, financial difficulties can occur because of weaknesses in management (Whitaker, 1999). Due to the many interrelated factors that cause financial difficulties, there is no guarantee that large companies will not experience financial difficulties. Financial ratios are widely used in detecting early signs of financial difficulties in a company, such as interest coverage ratios. However, research is still rare to examine the relationship between companies with financial difficulties and decisions on the status of political connections as reflected in the activities of CEOs and boards of directors (Amendola et al., 2015).

The research on financially distressed firms is rarely associated with a firm political connection status decision, especially in developing countries such as Indonesia. Hence, it is crucial to determine why Indonesia's data is very interesting in research relating to political connections. Faccio (2006) shows that of 47 countries, Indonesia has the largest percentage (22.08%) of companies with political relationships with ministers or close relations lie their own biological relatives. Therefore, the main objective of this study is to explore the relationship between

companies experiencing financial distress and the status of their political connections as supporters or opposition using data from Indonesia as a developing country.

Financial distress is a condition where a company cannot pay its financial obligations, such as debts, when they fall due. If this financial difficulty is severe enough, it can cause the company's bankruptcy. Furthermore, in the event of bankruptcy, all of the company's stakeholders will experience financial and social losses. Management of companies experiencing financial difficulties can usually do things detrimental to debtholders and other stakeholders to settle their debts. Financial distress is a negative signal that a company's condition is weaker than competitors, so competitors can take better advantage of opportunities to gain market share (Beaver, 1966; Opler & Titann, 1994).

From the company manager's perspective, if a company experiences financial stress, a company manager can predict that his/her bonuses will be cut or his/her position as manager will be replaced so that he/she will suffer losses. Then, his/her reputation as an executive would be tarnished. Managers can take risky actions that threaten the survival of a company. Therefore, financial distress is an important concern for the government, society, and stakeholders due to a significant decline in the company's financial performance. If it happens continuously, it can eventually lead to a company's bankruptcy. This will make investors and creditors suffer substantial financial losses (Liberty & Zimmerman, 1986; Gilson, 1989; Habib et al., 2013).

The first financial distress prediction model was introduced by Altman (1968), often referred to as the Altman Z-Score model. This model has become the most widely used financial stress prediction model in various countries with different objectives, such as predicting bank bankruptcy (Ooghe & De Prijcker, 2008). The financial distress prediction model becomes the basic model for bankruptcy prediction. Company stakeholders such as managers, stock analysts, bankers, creditors, investors, auditors, bankruptcy attorneys, and the judiciary use the Altman Z-Score model in analyzing corporate bankruptcy cases.

Altman and Narayanan (1997) proposed an improvement on the Altman Z-Score model using data from 22 countries and separating developed and developing countries. The model provides significantly different coefficient differences in the definition of the concept of failure, modeling techniques, and financial variables. Furthermore, Bellovary et al. (2007) examined more than 150 models using company data from 18 countries to test whether the models were significantly different from each other. Thus, the selection of model variables is mostly explicitly sampled from the characteristics of a country and leads to models that are not suitable for generalization in various countries. The Altman Z-Score model is expected to be helpful in providing early warning about financial stress on a company. They are expected to provide a possible alternative for companies experiencing financial pressure to avoid bankruptcy. However, the use of this predictive model cannot always predict bankruptcy accurately because there are various types of companies in different contexts, such as different business, social and political environments in each. Therefore, it is necessary to adjust the specific bankruptcy prediction model according to the conditions of various countries (Balcaen & Ooghe, 2006; Altman & Hotchkiss, 2010).

In addition to financial difficulties in the company's internal environment, the issue of the linkage of political activity affects the value of a company. Pfeffer and Salancik (1978) put forward the theory of resource dependence that states that political issues are related to firm value, including when there is financial difficulty. The theory illustrates that political connections help companies to acquire essential resources that are valuable to companies in the face of external uncertainty. Therefore, political relations are important for a company. This political relationship is considered very valuable if the government has the power to control large amounts of resources. This is especially true when government officials have the power to allocate these resources, such as decisions to approve state-funded projects. Therefore, companies with strong political connections have the opportunity to get projects and funding sources such as debt (Chen et al., 2010; Cheng et al., 2015).

Political connections can give firms access to powerful economic resources and reduce uncertainty. Companies may be able to influence their competitive position by influencing government decisions or policies to benefit their companies, including obtaining funding from state banks (Keim & Zeithaml, 1986; Li et al., 2006; Capron & Chatain, 2008). Political connections can be profitable when market mechanisms are not functioning properly. For example, market mechanisms are hampered by excessive regulation to hinder business, high tax burdens, and poor property rights protection. In this position, political connections help company managers to compete in the market. Thus, company managers with strong political ties to executives in government can receive favorable assistance. For example, companies can secure financial resources, negotiate government policies and influence the political election process to benefit the company (Pfeffer & Salancik, 1978; Hillman & Hitt, 1999; McWilliams et al., 2002; Li et al., 2008; Abelson & Baysinger, 1984; Wu et al., 2012; Ding et al., 2015).

Strongly politically connected firms gain economic benefits from the exchange of profits between firms and politicians. This would include the existence of more business protection support from the government so that companies become more competitive (Li et al., 2006; Faccio, 2006; Chaney et al., 2011; Wu et al., 2012). Political connection status is identified as share ownership and/or directorship positions held by former ministers, former heads of government, former parliamentarians, and politicians who currently count as political connections (Fisman, 2001; Johnson & Mitton, 2003; Faccio, 2006; Leuz & Oberholzer-Gee, 2006; Chaney et al., 2011).

Faccio (2006), using data from 47 countries, found that firms with strong political connections have preferential access to lenders and receive preferential tax treatment. There is a negative relationship between earnings quality and the cost of debt that only occurs in companies that are not politically connected. Companies with strong political connections get a lower cost of debt than companies with political connections. The association is stronger if there is CEO duality, while it is weaker for higher audit committee independence (Chaney et al., 2011; Bliss et al., 2011). However, Bliss and

Gul (2012) found that politically connected firms in Malaysia were associated with higher debt costs. Then, Tee (2018) examined the relationship between political connections and debt financiers in Malaysia, getting different results. It was found that CEO duality was associated with higher costs of debt, while higher audit committee independence led to lower costs of debt.

Firms with strong political connections tend to experience severe agency problems and weak corporate governance. However, they can survive because they are protected by the ruling government (Khwaja & Mian, 2005; Chaney et al., 2011). For example, politically connected firms may report sustained low earnings quality because they are politically connected. The capital market does not penalize them with higher debt costs like other companies. Companies that only have weak political connections must rely on equity as a source of funding because the government can direct banks to provide cheap loans to companies that have strong political connections (Gomez & Jomo, 1997; Boubakri et al., 2012; Guedhami et al., 2014).

Fisman (2001) examined the case of political connections in Indonesia during the Suharto era and found additional benefits or values of politically connected companies during this era. He observed a decline in the profitability of companies with political ties to Suharto, especially when his health condition deteriorated. The study results illustrate that companies directly related to President Suharto at that time suffered losses along with bad news about his health. Therefore, it can be concluded that political connections are very influential on company performance. Generally, companies with political ties tend to have higher market power than those without political ties (Faccio, 2006).

Firms with higher earnings quality are associated with lower costs of debt. Therefore, lenders tend to rate these companies as lower risk, so they provide lower costs of debt. The capital market in developing countries is an example of a capital market dominated by companies with strong political connections. In winning the business competition, companies with strong political connections can transfer property from politicians to companies by offering support through monetary donations

to politicians or political parties. They do this in the hope that a company will receive priority for government projects or be assisted by the government when experiencing financial difficulties such as access to bank loans (Faccio, 2006; Claessens et al., 2008).

Faccio et al. (2006) found that governments are more likely to use the International Monetary Fund (IMF) and World Bank bailouts to help financially troubled politically connected companies in various countries. The study suggests that to lobby good regulatory oversight from governments and banks successfully is likely to offer favorable loan terms to politically connected firms. This result is corroborated by Duchin and Sosyura (2012), who found that politically connected US firms were more likely to receive government bailouts than politically unconnected US firms during the 2008 US financial hardship.

Harymawan and Nowland (2016) researched Indonesian data and found that the institutional environment significantly influences the relationship between political connections and earnings quality. That is, the quality of earnings will increase when the effectiveness of political connections with the government increases, while the quality of income decreases due to political connections when government stability decreases. Meanwhile, companies that do not have political connections with the Indonesian government in power at that time will experience obstacles and difficulties in obtaining access to debt financing. So that one way to get debt is only through foreign debt financing, which has a higher risk of being exposed to exchange rate risk. Then, as lenders, bankers recognize the importance of the value of political connections so that it will reduce credit risk for companies with strong political connections. The guarantee of financial certainty either directly or indirectly reduces the systematic risk of companies with strong political connections. As a result, lenders tend to charge lower costs of debt than firms with low political connections. Thus, the advantage of this political connection is that the cost of debt of politically connected firms tends to be lower than that of politically unconnected firms because of government implicit financial guarantees (Leuz & Oberholzer-Gee, 2006; Houston et al., 2014; Tee, 2018).

Based on the literature review, this study proposes two hypotheses as follows:

H1: *Firms with political connection status as government supporters have a negative correlation with financial distress because there is no significant difficulty in obtaining debt financing.*

H2: *Financially distressed firms with politically connected status as government supporters get financial benefits.*

2. METHODS

2.1. Data and sample

The sample of this study uses quarterly data from 327 non-financial companies on the Indonesia Stock Exchange from 2012 to 2018. The study uses the basic criteria and definitions of political connections from Faccio (2006), Chaney et al. (2011), Guedhami et al. (2014), and Habib et al. (2018). Then, this study modifies these definitions and criteria by adding the status of political connections to the Indonesian political context. The primary data on political connections are obtained from observations of the company's quarterly reports. Then, the political connection data is categorized as a politically connected company if (1) at least one of the major shareholders has 10 percent of the voting rights directly or indirectly or (2) the board of directors or board of commissioners or government officials. What meant by government officials are (1) members of parliament; (2) ministerial officials, heads of local governments; (3) people who are closely related or members of political parties; and (4) former high-ranking military officials who support the government. To identify status as a supporter or opposition to the government or close relationship with political parties, or friendship with government officials, it is done by searching for information on internet news such as kompas.com, tempo.co, and Forbes Indonesia.

2.2. Dependent variable: financial distress

In this study, the measurement of financially distressed firms that had or experienced financial difficulties was represented by three indicators:

1. Altman Z-Score
2. Negative Working Capital; and
3. Negative Interest Coverage Ratio.

These three indicators are dependent variables.

2.2.1. Altman Z-Score (ALTMAN)

Altman (1968) advanced a combined model of several financial ratios consisting of liquidity ratios, continuity, profitability, solvency, and asset turnover to predict financial distress firms. Companies with an Altman Z-Score below 1.81 are declared vulnerable to conditions of financial difficulty. Altman (1968) Z-Score is obtained by:

$$Z = 1.2\ T1 + 1.4\ T2 + 3.3\ T3 + \\ + 0.6\ T4 + 0.99\ T5, \tag{1}$$

where $T1$ = Liquidity Ratio of the firm (Net Working Capital/Total Assets); $T2$ = Continuity Ratio to business expand (Retained Earnings/Total Assets); $T3$ = Profitability Ratio of the firm (Operating Profit / Total Assets); $T4$ = Solvency Ratio as firm leverage (Total Equity/Book Value Liability); $T5$ = Asset Turnover Ratio as sales performance (Sales/Total Assets).

2.2.2. Negative working capital (NWC)

Companies may experience negative working capital conditions. This concept has been tested by Habib et al. (2013). The working capital measurement is obtained from the difference between the total current assets deducted by the total current liabilities. A negative working capital number reflects that a company has current liabilities that exceed the value of its current assets. Hence, it is feared that the company cannot pay its current liabilities by the due date.

2.2.3. Interest coverage ratio

The interest coverage ratio of a company illustrates its ability to repay debt interest. A company can have EBIT (income before interest tax) divided by interest costs (interest coverage ratio) smaller than one that indicates the company is experiencing financial difficulties. If a company has an interest coverage ratio that is less than one, the company's income is smaller than the interest on the debt that must be paid and is dangerous (Asquith et al., 1994).

From the three indicators, the company is identified whether it meets the company criteria as a company experiencing financial distress. Then, companies that experience financial distress are distinguished using a dummy variable. Companies that are considered to be in financial distress will be given a score of 1, otherwise a score of 0 will be given. All financial report data for calculating and financial distress indicators are obtained through Capital-IQ (S&P).

2.2.4. Independent variable: political connection status, profitability, size, leverage, and operating cash flow

To determine the status of political connections as supporters or opposition to the government, names of directors, board of commissioners, and ownership data, the study used data from the Indonesia Stock Exchange, reuters.com, bloomberg.com, company websites, audited financial statements, and company annual reports. The political relationship status variable is an indicator variable that is coded 1 for quarterly observations that meet at least one of the aforementioned criteria and 0 otherwise. For example, the status of a political connection is a supporter of the government, so it is coded 1 and the other is coded 0 (i.e., government opposition, has no political connection), and vice versa.

Profitability is a variable that illustrates the operational efficiency of a company's performance that affects the long-term business continuity of the company. Profitability indicators reflect whether a company will be able to fulfill the going concern principle and reduce the risk of bankruptcy. Low profits will result in companies having a higher likelihood of making earnings management.

If a company has a high profitability performance, then the tendency to conduct earnings management will decrease. In other words, profitability is negatively related to earnings management activities. The return on assets and return on equity have a significant negative effect on the possibility of financial difficulties. However, profitability has a significant positive effect on opportunistic earnings management behavior and financial difficulties (Ghazali et al., 2015).

Company size is an indicator used to classify a company into a large or small category concerning the total value of the company's assets. These assets describe how a company controls the competition in its business lines. It was easier to implement earnings management in small companies. The tendency of small companies to seek capital from investors creates pressure for management to produce good financial reports. Conversely, large companies will obtain more public attention and have stronger internal controls.

Companies in New Zealand that experience financial difficulties with different company sizes have a significant positive relationship with earnings management. However, companies experiencing financial difficulties in Malaysia and found that the company size significantly negatively affected earnings management (Habib et al., 2013; Ghazali et al., 2015). Companies that have high leverage tend to do earnings management by increasing revenue. This is done to maintain the company's performance in the eyes of investors and other stakeholders. However, companies with financial difficulties will find it challenging to get funding from debt. Creditors assess that the risk of default will be higher (DeFond & Jiambalvo, 1994; Dechow et al., 1995).

Therefore, the study uses the independent variables, namely political connection as government supporter or opposition (PCGov, PCGovSUP, PCGovoPP), Return On Assets (ROA) as a measure of company profitability, the total value of company assets as company size (SIZE), and debt ratio of long-term debt divided by total assets as company leverage (LEV). Political connection positively affects company performance, reducing the possibility of financial distress as the dependent variable. Profitability was found to have a significant positive effect on earnings management behavior and financial distress. Financial distress firms with different sizes have a significant positive relationship with earnings management. Then, financial distress firms with high leverage positively correlate with earnings management by increasing revenue.

2.3. Panel data regression: random effects probit model (REPM)

This study uses a panel data regression based on the random effects probit model (REPM) approach to

overcome the initial conditions problem by modeling the shared distribution of results, depending on t_1 or y_1. The REPM used here is the Heckman (1981) model, which proposes a RE model built on static RE estimates. The model uses modeling for a shared distribution for the response variable $y_i = [y_{i1}, \ldots, y_{it}]$, where a separate reduced-form of the REPM for the initial observation y_{i1} is estimated through a linearized index function.

Butler and Moffitt (1982) used a RE probit model based on the corresponding adjusted assumptions of the distribution. The possibility of the log-joint for y_i can be evaluated using the Gauss-Hermite quadrature. The estimation can be made with the maximum likelihood method (ML). The latent variable representation of the REPM is:

$$Y_{i,t} = \propto + X_{i,t} + \varepsilon_{i,t} + \mu_{i,t}, \qquad (2)$$

$$Y_{i,t} = \begin{cases} 1 \ if \ Y_{i,t} \geq 0 \\ 0 \ if \ Y_{i,t} < 0 \end{cases}, \qquad (3)$$

where: $Y_{i,t}$ represents the unobserved latent variable and the observed binary variable, $X_{i,t}$ is a $1 \times K$ vector of the data, β is a $K \times 1$ vector of the marginal effects on the latent variable, i, t is an *iid* idiosyncratic error term, and μ_i is a mean-zero error term specific to the individual level of the panel.

The REPM assumes that i, t is an *iid* standard normal and follows a logistic distribution. In the linear model regression, the study assumes that E[$X_{i,t}$, μ_i] = 0. In the probit model, the study assumes a parametric distribution of μ_i. This probit model specification standard assumes that u is jointly estimated using the maximum likelihood (ML) estimator.

3. RESULTS

3.1. Descriptive statistics

Table 1 shows the descriptive statistics of the political connection status data studies. In this study, the dependent variable is a financial distress variable with three measurement proxies: the value of the Altman Z-Score, negative working capital, and the less than 1 of interest coverage ratio to indicate financial distress. Analysis of Altman Z-Score

(ALTMAN) as financial distress firm indicator by looking at whether the value of the Altman Z-Score is less than 1.81 or not. The average value of this variable is 0.4070, meaning that 40.7 percent of the companies studied have an Altman Z-Score below 1.81, indicating that 40.7 percent of firms are experiencing financial difficulties. The minimum and maximum values of this variable are 0 and 1 because this is a dummy variable where 0 represents the companies that have an Altman Z-Score above 1.81 and 1 if the value is below 1.81.

Political connection (PCGov) as the independent variable in Table 1 shows an average of 0.608 from the total sample of 223 companies. This means that more than 50% of companies in Indonesia have political connections. Political connection status as a supporter of the government (PCGovSUP) is 0.361 and in opposition to the government (PCGovoPP) is 0.248.

The variable financial difficulty indicator for negative working capital (NWC) illustrates the dependent variable as an indicator of financial difficulties using the criteria of working capital. This variable has an average value of 0.2358, which means that 23.6 percent of the companies have a negative working capital number. This is a dummy variable where 0 represents positive working capital and 1 represents negative working capital.

Table 1. Descriptive statistics

Variable	Mean	Median	S.D.	Min	Max
ALTMAN	0.407	0	0.491	0	1
NWC	0.235	0	0.424	0	1
NICR	0.334	0	0.472	0	1
ROA	0.00815	0.00724	0.0733	−2.44	2.12
LEV	0.143	0.082	0.203	0	3.6
PCGov	0.608	1	0.488	0	1
PCGovSUP	0.361	0	0.48	0	1
PCGovoPP	0.248	0	0.432	0	1
SIZE	8350	2240	19000	6.930	262000

Note: SIZE in million Rupiah.

The interest coverage ratio (NICR) is one of the dependent variables that indicate whether or not firms are financially distressed. If it is a negative number, the firms are financially distressed. This variable is a dummy variable. Firms with a negative interest

coverage ratio are given a value of 1; they are given a value of 0 when the companies have a positive interest coverage ratio. The average value of the interest coverage ratio (NICR) is 0.8570, which illustrates that 85.7 percent of the firms in the sample have an interest coverage ratio value below 1.

Variable return on assets (ROA) as an independent variable has an average value of 0.0081. The variable return on assets has a minimum value of –2.4367 and a maximum value of 2.1217. The standard deviation of the variable return on assets is 0.0733. This result shows that the average firm is profitable.

The firm size variable (SIZE) is a control variable obtained from the total value of the company's assets. Firm size variables have an average value of 8.35E+06 and a standard deviation of 1.90E+07. The standard deviation of this company size variable is the highest standard deviation value when compared to the other variables. This illustrates that the diversity and difference in value that exists are quite large because each company has a different amount of total asset values. The maximum value is 19.3833 and the minimum value is 8.8435.

The leverage variable (LEV) is an independent variable obtained from the results of the long-term debt distribution with the total value of the assets of each sample of the firms. The leverage variable has an average value of 0.1425 and a standard deviation of 0.2032. The biggest leverage value is 3.5973, while the smallest is 0, which indicates that there is no loan. This result indicates that the average of the firm uses low debt financing or only 14.25% of its assets.

3.2. Random effects probit model (REPM) regression results

Model 1 regression results of this study are presented in Table 2. The z-statistic test looks at the significance of the independent variables (e.g., political connection, profitability, size, leverage) against the Altman Z-Score as the first indicator of financial distress or the dependent variable.

Table 2 illustrates that the political connections with the government supporting status

(PCGovSUP) have a negative influence on the financial distress Altman Z-Score (ALTMAN), with a statistical significance of p = < 0.0001. This illustrates that the more companies have political connections, the less likely they are to experience financial distress. In contrast, companies with a government-opposition political connection status (PCGovoPP) had a positive influence on the financial distress indicator Altman Z-Score (ALTMAN), with a statistical significance of p = < 0.0001.

Table 2. Model 1, random effects probit model, dependent variable: Altman Z-Score (ALTMAN)

Variable	Coefficient	Std. Error	Z	p-value
const	−0.21287	0.15739	−1.353	0.1759
PCGovSUP	−0.40568	0.04354	−9.318	< 0.0001***
PCGovoPP	0.43285	0.04489	9.641	< 0.0001***
ROA	−4.29952	0.30933	−13.90	< 0.0001***
SIZE	−0.02576	0.01153	−2.235	0.0254**
LEV	3.29986	0.1282	25.74	< 0.0001***
OCF	−2.87405	0.30977	−9.278	< 0.0001***
lnsigma2	−9.00000	6.67823	−1.348	0.1778

Note: (*) (**), and (***) significant at the 10%, 5%, and 1% levels.

The regression results of the second model of studies on negative working capital (NWC) are presented in Table 3 (Model 2). The z-test statistic sees the significance of the negative working capital (NWC) dependent variable influenced by the independent political connection variables, profitability, and leverage, but not the company size.

Table 3 (Model 2) illustrates that the political connection variables with the government supporting status (PCGovSUP) have a negative influence on the negative working capital (NWC) (z = −2.109; p = 0.0349). This shows that political connections negatively affect the company's likelihood of experiencing negative working capital, thus avoiding financial distress. On the contrary, companies with a government-opposition political connection status (PCGovoPP) have a positive effect on those who have difficulty or negative work models (z = + 11.88; p = < 0.0001).

Table 3. Model 2, random effects probit model, dependent variable: negative networking capital (NWC)

Variable	Coefficient	Std. error	Z	p-value
const	−0.884340	0.155647	−5.682	< 0.0001***
PCGovSUP	−0.0972836	0.0461288	−2.109	0.0349**
PCGovoPP	0.539888	0.0454541	11.88	< 0.0001***
ROA	−1.80215	0.262936	−6.854	< 0.0001***
SIZE	−0.00993922	0.0112029	−0.8872	0.375
LEV	1.18352	0.0911608	12.98	< 0.0001***
OCF	0.787098	0.305401	2.577	0.01
lnsigma2	−8.90381	4.44234	−2.004	0.045**

Note: (*) (**), and (***) significant at the 10%, 5%, and 1% levels.

The third model of regression results focus on the interest coverage ratio (NICR) and are illustrated in Table 4 (Model 3). The z-statistic test shows the significance of the dependent variable interest coverage ratio influenced by the independent variable political connection, profitability, and company size. The statistical significance is p = < 0.0001, except for the leverage variable (p = 0.3434).

Table 4. Model 3, random effects probit model, dependent variable: interest coverage ratio (NICR)

Variable	Coefficient	Std. error	Z	p-value
const	1.24034	0.147366	8.417	< 0.0001***
PCGovSUP	−0.213909	0.0423307	−5.053	< 0.0001***
PCGovoPP	0.455403	0.0434162	10.49	< 0.0001***
ROA	−2.87748	0.2278	−12.63	< 0.0001***
SIZE	−0.113942	0.0106565	−10.69	< 0.0001***
LEV	−0.0787013	0.0830682	−0.9474	0.3434
OCF	−2.79563	0.294546	−9.491	< 0.0001***
lnsigma2	−8.98100	5.01555	−1.791	0.0734

Note: (*) (**), and (***) significant at the 10%, 5%, and 1% levels.

Table 4 (Model 3) illustrates that the political connection variables with a government supporting status (PCGovSUP) negatively influence the Interest Coverage Ratio (NICR) (z value = −5.053; p = < 0.0001). This shows that political connections negatively affect companies that experience interest coverage ratios that are smaller than 1. Conversely, companies with a government-op-

position political connection status (PCGovoPP) positively affect those experiencing financial difficulties. The interest coverage ratio is less than 1 (z = +10.49; p = < 0.0001).

The results of the first hypothesis test are accepted with evidence in Tables 1, 2, and 3, which show that companies with political connection status as government supporters (PCGovSUP) have a negative correlation with financial difficulties Altman Z-Score (z = −9.318, p = < 0.0001), net working capital (z = 2.109; p = 0.0349), and interest coverage ratio (z = 5.053; p = < 0.0001). Then, a company does not have significant difficulties in obtaining debt funding, supported by the results in Table 4 that leverage has no significant effect on financial distress (z = 0.9474; p = 0.3434).

The results of the second hypothesis test are also accepted with evidence of significant results for ROA as a measure of profitability and OCF as a measure of company health based on operational cash flows in Tables 1, 2, and 3 are below p = < 0.0001. Then, these results are strengthened by evidence that the ROA (coefficient = 4.29952) and OCF (coefficient = 2.87405) variables have a negative correlation with financial distress.

4. DISCUSSION

The results of this study indicate a positive correlation between the status of political connections with the financially distressed firm. The status of political connections as supporters or opposition affects companies experiencing financial difficulties. Supporters of the ruling government benefit from the procurement of government projects and loans from government banks. This finding reinforces Faccio (2006) and Boubakri et al. (2012), who state that firms obtain financial benefits because they have political connections. Conversely, companies who oppose the ruling government will experience financial difficulties (Fisman, 2001).

The results showed that leverage as a debt ratio had no significant effect on financial distress with the interest coverage ratio indicator in accordance with Hypothesis 1 (H1). This shows that debt is not a problem for companies experiencing financial distress. These results support Tee (2018), who

shows that political connections are negatively correlated with the cost of debt. On the other hand, this finding contradicts the results of Laitinen and Suvas (2016), which state that the solvency ratio or the company's ability to pay debts affects financial distress.

The results also show a significant difference between companies that have political connection status as supporters or opponents of the government. From the two research models, companies with political connections as supporters of the government have a negative correlation with the three indicators of financial distress. However, companies with political connections as government opposition have a positive correlation with financial distress according to the second hypothesis (H2). This finding supports Joni et al. (2020), who state that firms with politically connected supervisory boards experience lower debt costs.

The relationship between the status of political connections as supporters of the government and the interest coverage ratio also shows a significant positive correlation. That is, a company can or is able to pay interest on debt and installments to avoid financial difficulties. This business process reduces the risk of default and bankruptcy on companies that make decisions to become political supporters of the government. This finding supports Tee (2018), who finds that the debt costs of politically connected companies tend to be low. These activities can also assist the company's treasury management regarding debt financing. Treasury management has become more dynamic, adjustments to financial regulations, developments in information technology and overall business operations (Polak et al., 2018).

In terms of risk, this advantage reduces the financial risk of companies making decisions as political supporters of the ruling government. This is in line with Otchere et al. (2020), who investigated the impact of political connections on risk-making decisions in companies from 48 countries. Political connections encourage higher risk-taking by companies that have a political relationship with the government. Conversely, the inability of companies to exploit political connections or as opposition forces them to adopt more conservative strategies.

CONCLUSION

This study aims to explore the status of political relations as supporters of the government or opposition to financial distress companies that use Indonesia as a developing country. The results of the study found a significant positive (negative) correlation between the status of political connections as supporters or opponents of the government and the financial difficulties experienced by the company.

In emerging markets, a company's decisions about the status of its political connections affect the company's ability to cope with financial difficulties. Companies with political connection status as government supporters do not experience significant difficulties obtaining loans and paying interest on their debts. On the other hand, companies with political connections as opposed to the government tend to have problems paying interest on their debts. Regarding debt financing, the leverage ratio of financial distress companies with political connections as government supporters has no significant effect on their financial distress ratios. Financial difficulties based on working capital are not affected by company size because they have political connections as government supporters. Meanwhile, the status of political connections affects the company's ability to cope with the financial distress experienced by the company.

The decision on the status of political connections provides significant benefits in a developing country such as Indonesia. Therefore, the practical implications of this study suggest that companies experiencing financial distress need to prepare a strategy related to political connections, especially regarding the status of these political connections as supporters or opposition. The status of political connections is likely to help with debt financing issues.

Further research related to the sustainability of companies that have political relations with the status of supporting the government is interesting to study for a longer period. For example, if there is a change of government, can companies that previously supported the old government survive? Then, research related to the relationship between political connections and environmental, social, and governance (ESG) values will add to the exploration of research on corporate political connections.

AUTHOR CONTRIBUTIONS

Conceptualization: Arief Rijanto.
Data curation: Arief Rijanto.
Formal analysis: Arief Rijanto.
Funding acquisition: Arief Rijanto.
Investigation: Arief Rijanto.
Methodology: Arief Rijanto.
Project administration: Arief Rijanto.
Resources: Arief Rijanto.
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Supervision: Arief Rijanto.
Validation: Arief Rijanto.
Visualization: Arief Rijanto.
Writing – original draft: Arief Rijanto.
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