



## Political Connections and Executive Remuneration in Indonesia: Does the Role of Institutional Ownership Matters?

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### ABSTRACT

**Purpose :** The study aims to examine the role of institutional ownership in moderating the effect of political connections on executive remuneration in Indonesia.

**Method :** The study uses a quantitative method approach. The population of this study was all companies listed on the Indonesia Stock Exchange from 2015 to 2020. Research data sourced from [www.idx.co.id](http://www.idx.co.id), and OSIRIS. Using the purposive sampling method, 2,275 observations firms were determined. Hypothesis testing was carried out using multiple linear regression for panel data.

**Findings :** The results revealed that only the main effects influenced executive remuneration. Institutional ownership, political connections positively affected executive remuneration. In addition, the interaction effect of institutional ownership was not shown to moderate the relationship between political connection and executive remuneration. These results suggest that political connection and institutional ownership are necessary to determine executive compensation. Therefore, stakeholders must be aware of the political connection misuse possibility in determining the executive compensation package. On the other hand, institutional ownership may be related to incentive-based pay, which needs to be explored further.

**Novelty :** The novelty of this study is a new study that examines the phenomenon of political connections to executive remuneration in Indonesia and includes the role of governance-Institutional ownership as a moderating variable. In addition, this study uses the unbalance panel method, which examines all sectors of companies listed on the Indonesian stock exchange and observed for 6 periods or 2015 - 2020.

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### INTRODUCTION

The corporate board structure in Indonesia adopts a two-tier system, which consists of a board of commissioners and a board of directors, called an executive board. In this case, the remuneration of the executive board becomes a vital issue and is an ongoing discussion in the financial literature (Usman & Akhtar, 2015). The prominent level of remuneration obtained by the executive board is inseparable from their performance achievements in the company. Using agency theory to build a conceptual model, this study, therefore, aims to examine the effect of political connections on the executive remuneration of companies listed on the Indonesia Stock Exchange by considering the role of corporate governance.

In developed and emerging markets, politically connected executives and board members are often found managing listed companies (Dinç, 2005). Specifically, Indonesia is one of the countries with strong political influence in business (Harymawan et al., 2017). It is indicated by a large number of current or former important officials in the government and parliament and political party activists who occupy the seats of directors or commissioners of companies. In state-owned companies (BUMN), 397 commissioners held concurrent positions, and 167 commissioners in subsidiaries were known to hold concurrent positions (Pratama, 2020). Although no law prohibits a person with political connections from being appointed as a commissioner in a company (Pratama, 2020), it opens opportunities for agency problems to arise. Here, abusing executive power to obtain excessive salaries can have negative economic consequences, such as failure of incentive mechanisms and a decline in overall company performance (Bebchuk et al., 2011).

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In this case, companies with political connections get benefits, such as preferential treatment from the government, tax breaks, relaxation of supervision, privileges in government contract competition, and many other forms (Faccio, 2006). Executive boards with political ties also help reduce uncertainty for companies, link companies with governments and other influential politicians, and bring information, skills, and legitimacy to companies (Hillman, 2005). In East Asia, the relationship between business and politics uncovered that political connections are becoming more important than market-based relationships (Gomez, 2014). Companies with political connections also have a better market (Goldman, 2009). It influences investors to put more trust in companies with political connections. Therefore, it is possible for the company to "reciprocate" by providing higher remuneration. Then, it opens up opportunities for agency conflicts, so remuneration policies must be designed to minimize adverse executive actions (Dinç, 2005; Eisdorfer et al., 2013).

Moreover, the determination of remuneration to the executive board is inseparable from the quality and mechanism of corporate governance. Institutional ownership is one of the mechanisms in corporate governance that plays a role in monitoring executive policies. Here, the monitoring role of institutional investors is more effective than individual ownership (Cubbin & Leech, 1983) and has been shown to increase shareholder wealth (Smith, 1996) and align executive compensation with corporate interests (Core & Guay, 1999; Hartzell & Starks, 2003). Other studies have also indicated that institutional investor ownership reduces the compensation of CEOs (Khan et al., 2005; Ozkan, 2011a; Ramadhanti & Indrayanto, 2016) and top management teams (Sanchez-Marin et al., 2011).

Specifically, this study examines the effect of political connections on executive remuneration moderated by institutional ownership as a corporate governance mechanism. This research is vital in Indonesia, given the strong political role of the authorities in determining the ranks of the board in state-owned companies and the strong political and non-governmental business relations in Indonesia. Further, the test results will contribute both theoretically and practically. Theoretically, this study strengthens the opinion that political connections and corporate governance as a monitoring mechanism are critical factors in determining executive remuneration, especially in a country characterized by strong political connections. Practically, the results of this study recommend the importance of monitoring mechanisms, especially from external parties, to prevent abuse of management authority in determining company executive compensation.

The separation of ownership and control between shareholders and management opens opportunities for agency problems to arise, i.e., when management behavior is not in line with the interests of shareholders due to information asymmetry or moral hazard (Jensen & Meckling, 1976). Possibly, managers use company assets to improve their lifestyles (Braendle & Rahdari, 2016). In other words, by leaving costs to the shareholders, they use their power of control to fulfil their personal needs, such as living a life of luxury in expensive cars and personal travel.

Here, agency theory is one of the main frameworks used to describe the design of compensation policies (Pucheta-Martínez & Chiva-Ortells, 2019). To minimize agency costs, the principal seeks to reduce the possibility of misaligning interests by designing an efficient compensation contract. The compensation contract is said to be efficient if the contract is agreed upon by the contracting parties with a certain level of risk sharing and allows direct monitoring by shareholders of all manager's efforts (Scott, 2015).

Faccio et al. (2006) stated that a company is categorized as having political connections if at least one of the top managements (commissioners, directors, and/or executives) or large shareholders (having share ownership of at least 10%) is a political activist and/or hold important positions in government. Benefits for companies with political relations can take the form of getting preferential treatment from the government, tax breaks, relaxation of supervision, getting preferential treatment in government contract competition, and/or any other forms (Faccio, 2006). In a cross-country study of bailouts and political connections, the relationship between business and politics in East Asia (as is the case in Indonesia) showed that political connections are a more important relationship (crony) than market-based relationships (Gomez, 2014).

According to Liang et al. (2015), political constraints affect CEO compensation in two ways. First, they can change certain industries' basic regulatory mechanisms and compensation arrangements. For example, suppose economic regulation reduces the complexity of a CEO's job or limits his ability to influence company performance. In that case, it may be efficient for a regulated company's board to pay CEOs less, tie salaries more closely to the company's financial performance, and hire less affluent CEOs. Second, political constraints can affect CEO compensation by placing direct political pressure on CEO compensation through the regulatory process. It means that boards of directors can consider regulatory and political responses to observed CEO salaries when they make compensation decisions.

Relationship-based capitalism suggests that politically connected firms may serve the private interests of politicians and channel corporate resources to increase executive wealth (Gomez, 2014). Companies with political connections will get preferential treatment from the government, tax breaks, relaxation of supervision, preferential treatment in government contract competition, and/or any other forms (Faccio, 2006). Likewise, companies that run government projects will have stronger bargaining power in the market and greater overcompensation (Hadley, 2016). It indicates that political connections give privileges to the company.

On the other hand, agency problems and weak governance arising from the political affiliation of corporate management allow political affiliates to take political advantage at the expense of different stakeholders, increase

their incentives, and expropriate corporate resources (García-Meca, 2016). Agency theory explains that management has opportunistic behavior and conducts moral hazards, so executives may misuse political connections to get high remuneration. Politically connected CEOs can also leverage politics for their benefit rather than the interests of shareholders. Supported by the power theory of executive compensation developed by (Bebchuk et al., 2002), executive compensation in practice is controlled by manager opportunity. This theory argues that if managers have sufficient power to influence their compensation and use that power to earn bigger salaries, executive power is the ability to influence other top management, including the compensation committee. As a result, executives who have political connections will use their power to get large remuneration.

On the other hand, political connections can bring legitimacy and profit to the company. Consequently, the company provides high remuneration to executives as a return form and can manage political connections well. Chizema et al. (2015) and García-Meca (2016) found that the executive's political activity positively affected the board's remuneration. Thus, this study hypothesized that companies with political connections would provide higher executive remuneration.

**H<sub>1</sub>: Political connections have a positive effect on executive remuneration. Hence, companies with political connections will provide higher remuneration to executives than companies without political connections**

According to Carleton et al., (1998), institutional investors can negotiate with management to influence executives through institutional ownership of shares. The influence of institutional investors is crucial so that management acts following company goals and aligns the interests of management and shareholders. Ozkan (2007) uncovered that institutional ownership had a negative effect on CEO compensation, likewise to the research results of Hartzell & Starks (2002), Khan, et al. (2005), and Ozkan (2011). It indicates the effectiveness of institutional ownership in reducing agency costs, characterized by a decrease in CEO compensation.

Jensen and Meckling (1976) stated that institutional investors are one of the groups that play a key role in the monitoring process to minimize agency conflict. Because institutional investors have more power in monitoring, thereby minimizing executive moral hazard in managing the company, one of which is by reducing the level of compensation to top management (Sanchez-Marin et al., 2011). This reduction in remuneration occurs because of monitoring from institutional investors, opportunistic behavior, and executive moral hazard can be suppressed, such as excessive earnings management to seem to improve company performance, and executives will get more remuneration due to increased company performance. Furthermore, remuneration (Braendle & Rahdari, 2016) and institutional ownership (Jensen & Meckling, 1976) are ways to overcome agency problems. According to this perspective, if the company already has external (institutional) monitoring to supervise executives in carrying out their obligations, it will reduce executive remuneration as a form of agency cost efficiency. It is also supported by research by Braendle & Rahdari (2016), showing that companies with institutional investors in their ownership structure will reduce the remuneration package given to executives as a form of efficiency. Therefore, it can be stated that institutional ownership will negatively affect executive remuneration, so the hypothesis was derived as follows:

**H<sub>2</sub>: Institutional ownership has a negative effect on executive remuneration**

Institutional ownership is one of the essential mechanisms in corporate governance in the form of monitoring (Jensen & Meckling, 1976). This oversight can limit the opportunistic behavior of executives, especially in taking advantage of their political connections. Shen, et al. (2015) revealed that companies with strong governance did not focus on building political connections. In contrast, companies with political connections tended to have poor governance practices. Dicko (2017) also stated that companies with political connections tended not to seek to improve the quality of their governance. From this explanation, it can be concluded that the greater the proportion of institutional ownership, the better it is to support corporate governance practices in monitoring activities. Managers with political connections are also not free to use their power to make policies more profitable for themselves. Agency theory explains that management has opportunistic behavior and conducts moral hazards, so executives may misuse political connections to get high remuneration. Politically connected CEOs also leverage politics for their benefit rather than the interests of shareholders. Supported by the power theory of executive compensation developed by (Bebchuk et al., 2002), executive compensation in practice is controlled by manager opportunity. This theory argues that if managers have sufficient power to influence their compensation and use that power to earn bigger salaries, the executive power is the ability to influence the others top managements, including the compensation committee.

Institutional ownership is a manifestation of institutional monitoring of the company through the shares owned. Institutional monitoring is monitoring from outside the company or external that has strong independence in supervising the executive's performance. Therefore, monitoring by the institution can monitor actions or policies taken by executives that adverse shareholders, including using political connections and executive power to obtain excessive remuneration. Hence, it can be stated that institutional ownership will reduce the negative impact of political connections on executive remuneration, so it was hypothesized:

**H<sub>3</sub>: Corporate Governance-Institutional Ownership weakens the influence of political connections on executive remuneration**

## RESEARCH METHODS

The population of this study was all companies listed on the Indonesia Stock Exchange from January 1, 2015, to December 31, 2020. The data used were secondary, originating from the search for financial statements and annual reports, which could be accessed through the official website of the Indonesia Stock Exchange, the website of the company concerned, the Osiris database, and other published sources related to this research. The sample selection in this study used purposive sampling, with the criteria of companies being the research samples: companies that consistently provided remuneration and/or presentation of financial information using rupiah currency from 2015 to 2020. Companies that presented financial statements in foreign currencies were not included as research samples since not all variables were measured using ratios. In this case, foreign currency translation into rupiah can be a source of variable measurement bias. This study uses panel data regression with EViews 10 software to examine the data. Panel data combines time series and cross-section; the same cross-section unit is measured at different times. The use of panel data can provide many advantages statistically and in economic theory (Gujarati, 2003) such as panel data can take into account individual heterogeneity by explicitly allowing for individual specific variables to make panel data usable for testing and building more complex behavioral models; If the specific effect is significantly correlated with other explanatory variables, the use of panel data will substantially reduce the omitted-variables problem; Panel data is based on repeated cross-sectional observations so that the panel data method is suitable for the study of dynamic adjustment; The high number of observations has implications for more informative, more varied data, decreasing collinearity between variables, and increasing degrees of freedom so that more efficient estimation results can be obtained. In addition, Ye et al., (2018) advantage of panel data is that researchers can control for unobservable heterogeneity.

Based on the sample selection results using the purposive sampling technique, a total of 2,275 samples were obtained. Meanwhile, the sampling of this research can be seen in Table 1. The dependent variable in this study was executive remuneration. Braendle and Rahdari (2016) explain executive remunerations are all compensation in the form of basic salary, bonuses, stock options, limited stock plans (stock grants), pensions, and other benefits (cars, health care, and others) received by executives. The executives (CEO) in the context of companies in Indonesia are the highest paid commissioners and directors in the company and the most attention compared to other positions. In line with top management remuneration research in Indonesia, which uses the term executive (e.g. Maharani and Utami, 2019). For testing, this variable was measured by Ln (natural algorithm) of executive remuneration rupiah, calculated according to the operational definition above.

The independent variable in this study was the political connection. A company is said to have political connections if at least one member of the company leadership, majority shareholder, controlling shareholder, or close relative of the parties mentioned above is currently or has served as a member of parliament, state official, or party administrator who is a representative in parliament and/ or is a high-ranking of TNI (Indonesian National Army), ABRI (Armed Forces of the Republic of Indonesia), or POLRI (Republic of Indonesia Police). The criteria above referred to the modification of the criteria in research by Faccio (2006) and Chaney et al. (2011). For this reason, in this study, political connections were measured by a dummy variable, which is worth 1 if it has political connections and has a value of 0 if otherwise.

The moderating variable in this study was institutional ownership. Institutional ownership is share ownership owned by institutions, such as government institutions, foundations, banks, insurance companies, investment companies, pension funds, limited liability companies (PT), and other institutions, both local and foreign (Lee and Chen, 2011; Nurleni et al., 2018). In this study, institutional ownership was measured by the percentage of total shares owned by the institution.

Then, to increase statistical power, this study added three control variables: firm size, profit margin, and leverage. Firm size is the most significant factor in determining the amount of remuneration (Sigler, 2011) because the variable is closely related to organizational complexity, income level, and the company's ability to pay the salaries of employees and executives. Firm size in this study was measured Ln total assets.

**Table 1.** Research sampling

No.	Description	Total
1.	Companies listed on the IDX, according to the 2019 Factbook	634
2.	Companies that did not consistently provide remuneration and/or presentation of financial information using currencies other than rupiah	(48)
3.	The number of companies used	586
4.	X 6 periods (2015 – 2020)	3,516
5.	Outliers	(306)
6.	Incomplete sample data	(935)
	Number of samples observed	2,275

Source: The Processed Primary Data (2021)

Next, profit margin indicates how much the company can minimize costs and maximize revenue. This profit margin provides an overview of the company's efficiency in running the company's operations. Here, executive remuneration has a positive relationship to the company's financial performance, indicated by the company's profitability; the greater the performance and profitability of the company, the higher the amount of executive remuneration (Pati, 2019). This study measured the profit margin by the net profit ratio divided by total revenue.

The last, leverage or solvency ratio, indicates how much the company depends on creditors to finance the company (Probohudono et al., 2016). The greater the company's debt, the more likely the company will have difficulty paying executive remuneration. The high amount of long-term debt signifies that the company tends to use funding in the form of debt so that the company will bear interest costs and increase the risk of bankruptcy (Russell et al., 2013). Since leverage is measured using equity, the company has large equity, so the company will have a greater ability to provide remuneration, whether remuneration in the form of equity, cash or other company resources (Gande & Kalpathy, 2017). Leverage in this study was measured by the ratio of total equities divided by total assets.

To examine how institutional ownership and political connections affect executive remuneration and how corporate governance can moderate the relationship between political connections and executive remuneration, a research model was developed as in equations 1 and 2.

$$\text{Remn} = \alpha + \beta_1 \text{PolCon}_{it} + \beta_2 \text{InsOwn}_{it} + \beta_3 \text{Size}_{it} + \beta_4 \text{PM}_{it} + \beta_5 \text{LEV}_{it} + \varepsilon_{it} \dots\dots\dots 1$$

$$\text{Remn} = \alpha + \beta_1 \text{PolCon}_{it} + \beta_2 \text{InsOwn}_{it} + \beta_3 \text{PolCon}_{it} * \text{InsOwn}_{it} + \beta_4 \text{Size}_{it} + \beta_5 \text{PM}_{it} + \beta_6 \text{LEV}_{it} + \varepsilon_{it} \dots\dots\dots 2$$

Description:

Remn : Ln (Total remuneration)  
 PolCon : Political connection (Dummy variable)  
 InsOwn : Institutional ownership  
 Size : Firm size  
 PM : Profitability  
 LEV : Leverage

## RESULTS AND DISCUSSIONS

According to Table 2, the number of observations in this study was 2,275. The maximum remuneration value (REM) of 24.96778 represented the executive board remuneration of PT Telekomunikasi Indonesia (Persero) Tbk in 2015. The minimum remuneration value (REM) of 8.478452 represented the executive board remuneration of PT Chandra Asri Petrochemical Tbk in 2020. Meanwhile, the mean remuneration in this study was 16.25800.

In this study, the value of political connections was measured by a dummy variable, where 1 was for companies with political connections and 0 for companies without political connections. The mean value of 23.7% indicates that this study's sample with political connections was 23.7% of the total observations, or 540 samples had political connections.

Furthermore, the maximum number of institutional ownership (InsOwn) of 99% was the number of institutional ownerships of PT BRI Syariah (Persero) Tbk in 2015. Here, the minimum number of institutional ownerships of 0% means that the company did not have institutional ownership.

Then, the maximum firm size (size) of 28.04433 or IDR1,511,811,928,445,000.00 was the total assets of PT Bank Republik Indonesia (Persero) Tbk in 2020. The minimum firm size value of 12.26816 or IDR212,810,000.00 was the total assets of PT Tridomain Performance Materials Tbk in 2017. Meanwhile, the mean firm size in this study was 21.71081 or IDR2,684,633,348,000.00.

While PT Nusantara Properti Internasional Tbk owned the maximum leverage value (LEV) of 99.85% in

**Table 2.** Descriptive statistical test

	REM	POLCON	INSOWN	SIZE	LEV	PM
Mean	16.25800	0.237363	15.72970	21.71081	48.71463	6.589490
Median	16.29224	0.000000	1.180000	21.73082	49.07000	6.130000
Maximum	24.96778	1.000000	99.00000	28.04433	99.85000	99.32000
Minimum	8.478452	0.000000	0.000000	12.26816	-94.75000	-99.24000
Std. Dev.	1.604719	0.425560	25.97736	2.076741	24.75358	22.71366
Skewness	0.043411	1.234586	1.696630	-0.312431	-0.575336	-0.916191
Kurtosis	5.478047	2.524202	4.572617	4.555556	4.762286	6.984643
Sum	36,986.95	540.00	35,785.07	49,392.09	110,825.8	14,991.09
Sum Sq. Dev.	5,855.829	411.8242	1,534,548.	9,807.424	1,393,370.	1,173,180.
Observations	2,275	2,275	2,275	2,275	2,275	2,275

Source: The Processed Primary Data (2021)

2020, the minimum leverage value of -PT Primarindo Asia Infrastructure Tbk owned 99.24% in 2017 because Lev in this study was measured using equity, the result negative showed that the company was having negative equity. Meanwhile, this study's mean leverage value was 48.71%.

In addition, the maximum profit margin (PM) of 99.32% was owned by PT Provident Agro Tbk in 2020, and the minimum profit margin of -94.75% was owned by PT Alam Sutera Realty Tbk in 2018. Meanwhile, the mean leverage value in this study was 6.59%.

The data in this study were processed using panel data regression with EViews 10 software. Before performing regression processing, a model test was first conducted to select the best panel data estimation model and continued with classical assumption tests to obtain BLUE (Best Linear Unbiased Estimator) data. In the model test, i.e., Chow and Hausman, the Fixed Effect Model (FEM) was chosen as the most suitable estimation model. The unbalanced panel fixed effect estimate (Wooldridge, 2006) explained that attrition related to idiosyncratic errors, factors that go unnoticed all the time, can result in biased estimates. However, the benefit of estimating the fixed effect is that the attrition associated with the unobserved factor will be accommodated, thus, the estimation results are still reliable (unbiased). In addition, the classical assumption test of this study only tested the assumption of multicollinearity, carried out through the value of collinearity between independent variables. In contrast, the heteroscedasticity test was tested through the Glejser test. In conclusion, all the data in this study were assessed, and the data were BLUE (Best Linear Unbiased Estimator).

### The Effect of Political Connections on Executive Remuneration

According to Table 3, Hypothesis one (H<sub>1</sub>) results showed that political connections positively affected executive remuneration, statistically significant at  $\alpha < 5\%$ . It indicates that companies with political connections will provide higher remuneration to their executive boards. The results of this study are also in line with Chizema et al. (2015) and García-Meca (2016), who found that political connections positively affected board remuneration. As one of the countries with strong political influence in business (Harymawan et al., 2017), the results of this study strengthen Faccio's (2006) that companies with political connections will get preferential treatment from the government, tax breaks, relaxation of supervision, receive preferential treatment in government contract competition, and/or many other forms. Executive boards with political connections also provide various advantages or privileges for the company; the company offers high remuneration packages to executives for these services. It corroborates with Gomez (2014) that the relationship between business and politics in East Asia, including Indonesia, showed that political connections are more important than market-based relationships. Politically connected executive boards can also help reduce uncertainty for companies, link companies with governments and other influential politicians, and bring information, skills, and legitimacy to companies (Hillman, 2005).

The results of this study reveal that in Indonesia, companies with political connections have higher executive remuneration. According to the previous explanation, companies obtain many privileges because of political connections. On the other hand, management requires a strategy to win the market's competition and maintain the company's survival under all conditions. Political connections were built by the company, which became an added value and opportunity for the company to establish communication with the government regarding the legality and public information. Furthermore, the company needs an executive who can manage these political connections, whether maintaining relations with the government, politicians, or other authorities. Therefore, as a form of reward for the executive who can manage political connections, the executive will receive a larger remuneration.

### The Effect of Institutional Ownership on Executive Remuneration

According to Table 3, institutional ownership had a positive effect on executive remuneration, statistically

**Table 3.** The results of the first equation regression

Variable	Coef.	Std. Error	t-Statistic	Prob
C	4.718931	1.370880	3.442264	0.0003
POLCON	0.332566	0.110208	3.017616	0.0013
INSOWN	0.005236	0.001970	2.658383	0.0040
SIZE	0.520411	0.063396	8.208850	0.0000
LEV	0.001575	0.001526	1.032011	0.1511
PM	0.000383	0.001116	0.343353	0.3657
R-squared		0.853390		
Adjusted R-squared		0.811644		
F-statistic		20.44219		
Prob(F-statistic)		0.000000		

Source: The Processed Primary Data (2021)

**Table 4.** Results of moderated regression analysis

Variable	Coef.	Std. Error	t-Statistic	Prob.
C	4.782861	1.372896	3.483775	0.0003
POLCON	0.380191	0.122937	3.092572	0.0010
INSOWN	0.006098	0.002201	2.770115	0.0029
POLCON*INSOWN	-0.003210	0.003670	-0.874543	0.1910
SIZE	0.517127	0.063510	8.142395	0.0000
LEV	0.001606	0.001526	1.052324	0.1464
PM	0.000392	0.001117	0.350699	0.3630
R-squared	0.853454			
Adjusted R-squared	0.811619			
F-statistic	20.40057			
Prob(F-statistic)	0.000000			

Source: The Processed Primary Data (2021)

significant at  $\alpha < 5\%$ . Thus, hypothesis 2 ( $H_2$ ) in this study, stating that institutional ownership has a negative effect on executive remuneration, was not supported. The results of this test are in line with Feng et al. (2010); Cai et al. (2011); Lee & Chen (2011); Croci et al. (2012); Fernandes et al. (2013); Maharani & Utami (2019) that the greater the shares owned by the institution, the greater the remuneration package received by the company's executive board.

In this regard, institutional ownership is one of the mechanisms in corporate governance (Jensen & Meckling, 1976). Theoretically, institutional ownership will conduct a monitoring function to mitigate management's opportunistic behavior, including in determining excessive remuneration. However, through its share ownership, an institution supervises the company's operations in terms of financial and management performance. Monitoring carried out by the institution motivates management to improve its performance. Thus, with increased executive performance, a higher remuneration package will be given as a form of appreciation (Maharani & Utami, 2019).

Remuneration policies are used to align executive behavior with the interests of the owners to reduce agency problems. Therefore, remuneration is a contract between executives and shareholders. Institutional ownership has a larger share of ownership than individual ownership. Consequently, if the company has large institutional ownership, it will be easier to decide to provide executive remuneration because institutional ownership has significant voting rights. Furthermore, the executive will be motivated to improve its performance and image to institutional investors. Therefore, at the General Meeting of Shareholders (GMS), when discussing executive remuneration, the remuneration committee offers a large remuneration package to executives that institutional investors can approve. The results of this study uncovered that institutional ownership had a significant positive effect on the remuneration received by the executive. Therefore, institutional ownership did not reduce the remuneration package, but institutional ownership motivated the executive board to improve its performance. In addition, supported by the larger remuneration package received, executives will improve and maintain their performance.

### **The Effect of Corporate Governance-Institutional Monitoring in Moderating the Effect of Political Connections on Executive Remuneration**

The coefficient  $R^2$  is the squared correlation of the actual and predicted values and, as such, includes all data used for model estimation to assess the model's predictive power; it represents a measure of the predictive power in the sample (Rigdon, 2012; Sarstedt et al., 2014). The adjusted coefficient of determination (Adj- $R^2$ ) can be used as a criterion to avoid bias toward the model complex (Hair et al., 2017). In addition, the Moderated Regression Analysis regression equation in Table 4 shows that the adjusted R-squared value is 0.811619, meaning that the variables of Political Connection, Institutional Ownership, the interaction of moderating variables, Company Size, Leverage and Profitability can explain executive remuneration of 81.1619 %.

According to Table 4, the results of assessing the third hypothesis ( $H_3$ ) revealed that the interaction between political connection and institutional ownership was not significant (sig. 0.19 > 0.05). Thus, it can be concluded that institutional ownership did not moderate the effect of political connections on remuneration. In this case, corporate governance is a control mechanism against the tendency of managers to behave opportunistically. One of the important mechanisms in corporate governance is institutional ownership (Jensen & Meckling, 1976) in monitoring activities. However, the results of this study did not reveal significant results even though the direction of the coefficient was negative, which means that there is still a possibility that institutional ownership can weaken the influence of political connections. The insignificant effect of institutional monitoring can be caused by not separating institutional ownership by type of institution. Each institution has distinguished characteristics, such as banks, foundations, brokers, etc.

## The Effect of Control Variables of Firm Size, Profitability, and Leverage on Executive Remuneration

According to the test results, firm size was the control variable with a significant effect on remuneration. This result is in line with studies by Murphy (1985), Hartzell & Starks (2003), Hillman (2005), Khan, et al. (2005a), Wahab & Rahman (2009), Ozkan (2011), Braendle & Rahdari (2016), Probahudono et al. (2016), Harymawan, et al. (2017), and Nurfitri (2020). As such, the larger the size of the company, the greater the complexity so that more competent executives are needed to run the business (Agarwal, 1981). In this study, the coefficient of the firm size variable showed the largest value, with the highest significance level. This result indicates that firm size is a key factor in determining the total remuneration level, supporting Sigler's research (2011).

## CONCLUSIONS

The study results showed that political connections positively affected executive remuneration. Thus, companies with political connections will pay their executives higher than those without political connections. However, institutional ownership was not proven to weaken the positive influence of political connections on executive remuneration. The main effect of institutional ownership has been proven to affect executive remuneration positively.

Theoretically, this study adds to the evidence of the importance of considering political and governance connections in determining compensation schemes in countries with two-tier governance structures. From a practical point of view, companies should not focus on building political connections because, in good corporate governance, one is not relying on political connections. In addition, it is feared that politicians will use inefficient political connections as "extortion cows," i.e., using company resources for the benefit of political parties. Therefore, future research may consider using other measures of governance mechanisms, such as independent commissioners or big-4 auditors. The limitations of this study include: Many aspects of corporate governance, and this study only examines aspects of institutional monitoring, as well as political connections that still use dummy variables so that they do not pay attention to the ratio between politically connected executives and the size of the executive board. Based on the limitations, future research can also add the other governance variables to measure corporate governance, and the measurement of political connections can use ratio data, which compares the number of executive members who have political connections with the total board members. In addition, if further research will be still testing institutional ownership, it is recommended that the concentration of institutional ownership be separated according to the type of institution.

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