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Political Connections, Government Ownership, Loan Growth, and Audit Committee: Determinants of Bank Financial Performance in Indonesia

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ABSTRACT

This study investigates the effects of political connections, government ownership, and loan growth on the financial performance of banks in Indonesia, with the audit committee serving as a moderating variable. Using a quantitative explanatory approach, data were collected from 32 banks listed on the Indonesia Stock Exchange (IDX) over the period 2017–2021, resulting in 160 firm-year observations. Secondary data were obtained from annual reports and official disclosures, and the analysis was conducted using SSEM-PLS 4.0. The results reveal that political connections and loan growth significantly and positively influence financial performance, whereas government ownership shows a positive but insignificant effect. Furthermore, the audit committee strengthens the positive relationship between political connections and financial performance but does not significantly moderate the effect of government ownership. These findings highlight the importance of lending activities and political connections in driving bank profitability, while also pointing to the ambiguous role of state ownership in balancing commercial and social objectives. This study contributes to the literature on corporate governance and banking performance in emerging markets by providing empirical evidence from Indonesia. The findings also offer practical implications for regulators, bank management, and investors regarding the role of governance mechanisms particularly audit committees in ensuring that political and ownership structures enhance rather than hinder financial performance.

Keywords : Political connections, government ownership, loan growth, audit committee, financial performance, Indonesian banking.

A. INTRODUCTION

The banking sector plays a vital role in maintaining a country's economic stability, as it functions to collect funds from the public and redistribute them in the form of loans and other financial services. The success of this sector not only ensures the continuity of financial institutions but also contributes to national

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economic growth (Republic of Indonesia, 1998; Financial Services Authority [OJK], 2017a). With such a strategic position, the performance of the banking sector has consistently attracted significant attention as it supports development and fosters public trust.

The COVID-19 pandemic in 2020 demonstrated the vulnerability of financial stability. Indonesia's Gross Domestic Product (GDP) contracted by –2.07%, which led to reduced credit demand and weakened bank performance (Bank Indonesia, 2021). Data show that bank profits declined significantly during this period before gradually recovering in 2021. This condition highlights the urgency of effective governance mechanisms to safeguard financial performance during times of crisis.

One external factor influencing banking performance is political connections. Politically connected firms often gain privileged access, such as easier credit, tax benefits, or market protection (Houston et al., 2014; Sutopo et al., 2017). Political ties can provide competitive advantages but also increase agency problems, as political interests often diverge from shareholders' goals (Haris et al., 2019).

In addition to political connections, ownership structure particularly government ownership also plays a decisive role in determining financial performance. Agency theory explains that government ownership can lead to either stricter monitoring or bureaucratic inefficiency. Empirical evidence in Indonesia remains mixed: Hunardy and Tarigan (2017) and Dianitasari and Hersugondo (2020) found that government ownership enhances performance through stronger governance and capital support, while Razak et al. (2008) and Nugrahanti and Novia (2012) reported that it reduces profitability due to politically motivated lending and non-commercial objectives. These contradictory findings reveal an empirical gap regarding whether government ownership truly strengthens or weakens bank profitability in developing markets.

Another determinant of banking performance is lending policy. Loans represent banks' core activity and primary source of profit; therefore, sustainable credit growth is generally associated with higher profitability (Ekpu & Paloni, 2016; Dang, 2019). An effective increase in lending not only raises interest income but also supports business expansion and strengthens banks' contribution to economic development (Kerimkulova et al., 2021). From a corporate governance perspective, the audit committee plays a central role as an independent oversight mechanism. Its presence minimizes opportunistic accounting practices, enhances transparency in reporting, and strengthens internal control quality (Ramadhan & Laksito, 2022). OJK regulations also mandate the establishment of audit committees in the banking industry as part of good corporate governance implementation (OJK, 2015).

The role of audit committees becomes even more crucial when firms are politically connected or government-owned. The audit committee functions as a "balancer" to mitigate potential conflicts of interest and ensure that management decisions remain aligned with shareholder value and corporate sustainability. Thus, the audit committee is expected to moderate the influence of political connections and government ownership on financial performance (Dakhlallh et al., 2020; Fariha et al., 2022).

Previous studies have extensively examined the effects of political connections, government ownership, and lending activities on financial performance. However, empirical findings remain inconsistent, particularly in emerging economies such as Indonesia. Some studies show that political ties and government ownership improve profitability through better access to resources, while others find the opposite due to inefficiency and political intervention (Migliardo & Forgione, 2018; Chen et al., 2013). Moreover, limited research has investigated how audit committees moderate these relationships in the Indonesian banking context. This inconsistency forms the empirical gap that this study aims to address. Accordingly, this study examines the influence of political connections, government ownership, and loan changes on the financial performance of Indonesian banks, with the audit committee as a moderating variable. The findings are expected to enrich corporate governance literature and offer practical implications for regulators, bank management, and investors in understanding the complex interplay between political factors and bank profitability.

B. THEORITICAL

Political Connections and Financial Performance

Political connections refer to the relationships that firms establish with politicians or government officials through ownership, board membership, or informal ties. Previous studies suggest that politically connected firms benefit from preferential access to credit, lower financing costs, tax privileges, and regulatory leniency (Houston et al., 2014; Sutopo et al., 2017). These advantages provide firms with additional resources and stability, which in turn may enhance financial performance.

Political connections may also lead to agency problems, as politically motivated decisions may prioritize political interests over shareholder wealth. Firms with strong political ties may exhibit lower accounting quality and weaker governance practices due to reduced market discipline (Chaney et al., 2011; Haris et al., 2019). Thus, while political connections can enhance access to resources, they may simultaneously increase operational risks and reduce transparency.

Government Ownership and Financial Performance

Ownership structure is an important determinant of corporate governance and performance. Government ownership in banks can align management behavior with public interests and reduce agency costs by providing oversight mechanisms and regulatory discipline (Hunardy & Tarigan, 2017; Dianitasari & Hersugondo, 2020). State-owned banks are often perceived as safer due to implicit government guarantees, which may attract investors and strengthen financial stability.

On the contrary, excessive government intervention may lower efficiency and profitability. State-owned banks may prioritize social or political objectives, such as subsidized lending or employment policies, over profit maximization (Razak et al., 2008; Nugrahanti & Novia, 2012). As a result, the relationship between government ownership and financial performance remains inconclusive across different contexts.

Loan Growth and Financial Performance

Lending activities are the core business of commercial banks and represent the primary source of profitability. An increase in loan growth generates higher interest income and supports economic expansion, which positively impacts bank performance (Ekpu & Paloni, 2016; Dang, 2019). Effective credit allocation also helps banks strengthen their market position and maintain competitiveness in the financial industry.

Nevertheless, aggressive loan growth may increase credit risk if not accompanied by adequate risk management. Poor loan quality can lead to non-performing loans, thereby eroding bank profitability and financial stability (Kerimkulova et al., 2021). Therefore, the effect of loan changes on financial performance depends on the bank's ability to balance credit expansion with prudent risk management.

Audit Committee as a Governance Mechanism

The audit committee plays a central role in corporate governance by overseeing financial reporting, internal controls, and compliance with regulations. A strong and independent audit committee reduces information asymmetry, improves the credibility of financial statements, and minimizes opportunistic managerial behavior (Ramadhan & Laksito, 2022). In the banking sector, regulatory requirements emphasize the necessity of audit committees as part of good corporate governance practices (OJK, 2015).

Beyond monitoring functions, audit committees also serve as moderating mechanisms that can reduce the adverse effects of political connections and government ownership. By ensuring transparent reporting and accountability, the audit committee can mitigate agency conflicts and align managerial actions with shareholder interests (Dakhlallh et al., 2020; Fariha et al., 2022). Thus, the audit committee is expected to strengthen governance effectiveness and enhance financial performance.

Financial Performance as the Dependent Variable

Financial performance reflects a firm's ability to generate profits and maintain long-term sustainability. In banking, performance is often measured using accounting-based ratios such as return on assets (ROA), return on equity (ROE), or market-based measures such as Tobin's Q (Fariha et al., 2022). Strong financial performance indicates efficient resource allocation, effective risk management, and successful governance practices.

Given its strategic role, financial performance not only reflects the health of individual banks but also serves as a signal to investors, creditors, and regulators about the stability of the financial system. Understanding the determinants of financial performance such as political connections, government ownership, lending activities, and audit committee oversight provides insights into how governance structures shape banking outcomes.

Hypothesis Development

H1: Political connections have a positive effect on financial performance.

H2: Government ownership has a positive effect on financial performance.

H3: Loan growth has a positive effect on financial performance.

H4: The audit committee moderates the relationship between political connections and financial performance.

H5: The audit committee moderates the relationship between government ownership and financial performance.

C. METHODOLOGY

This study applies a quantitative explanatory approach to examine the influence of political connections, government ownership, and loan growth on financial performance, with the audit committee as a moderating variable. The research population consists of banking companies listed on the Indonesia Stock Exchange (IDX) during the period 2017–2021. By employing purposive sampling based on criteria such as consistency of listing on the IDX, availability of annual reports, and disclosure of corporate governance data, a total of 32 banks were selected, generating 160 firm-year observations. Secondary data were collected from annual reports, financial statements, and official disclosures available through IDX and company websites.

The variables in this study were measured using established proxies from previous research. Financial performance as the dependent variable was measured by Tobin's Q, defined as market capitalization plus total debt divided by total assets (Fariha et al., 2022). Political connections were measured by the proportion of board members with political ties to total board members (Proença et al., 2020). Government ownership was measured using a dummy variable with a value of 1 if the government is the majority shareholder and 0 otherwise (Migliardo & Forgione, 2018). Loan growth was calculated using the formula:

$$\text{Loan Growth} = \frac{\text{Loan}_t - \text{Loan}_{t-1}}{\text{Total Assets}_{t-1}}$$

The moderating variable, audit committee, was measured by the total number of members disclosed in the annual reports (Fariha et al., 2022). Two control variables were included: firm size, based on the bank classification of the Indonesian Financial Services Authority (OJK, 2021), and leverage, measured by the debt-to-equity ratio (Proença et al., 2020). The operationalization of variables is summarized in Table 1.

Table 1. Operationalization of variables

Variable	Indicator / Measurement	Source
Financial Performance	Tobin's Q = (Market Capitalization + Total Debt) / Total Assets	Fariha et al. (2022)
Political Connections	POLBO = (Number of politically connected board members ÷ Total board members) × 100%	Proença et al. (2020)

Government Ownership	Dummy variable: 1 = government-owned, 0 = otherwise	Migliardo & F (2018)
Loan Growth	(Loant−Loant−1)/Total Assetst−1(\text{Loan}_t - \text{Loan}_{t-1}) / \text{Total Assets}_{t-1}	Dinç (2005)
Audit Committee	Total number of audit committee members disclosed	Fariha et al. (2022)
Firm Size (control)	Bank classification based on core capital group (KBMI 1–4)	OJK (2021)
Leverage (control)	Debt-to-Equity Ratio (DER) = Total Liabilities / Equity	Proença et al. (2020)

Source: Table processed by researchers (2025)

The data were analyzed using Structural Equation Modeling–Partial Least Squares (SEM-PLS) with WarpPLS 4.0. The measurement model (outer model) was evaluated based on indicator significance (p-value < 0.05), multicollinearity (VIF < 3.3), and reliability. The structural model (inner model) was assessed using the coefficient of determination (R^2), predictive relevance (Q^2), and effect size (f^2), with R^2 values of 0.75, 0.50, and 0.25 interpreted as substantial, moderate, and weak, respectively (Sholihin & Ratmono, 2013). Hypothesis testing was conducted through path coefficient analysis, where relationships were considered significant if the p-value was less than 0.05. Moderation effects were tested using Moderated Regression Analysis (MRA) within WarpPLS to determine whether the audit committee acts as a pure moderator, quasi-moderator, predictor moderator, or homologizer (Ghozali, 2014).
The regression model used in this study is formulated as follows:

$$PERFORM=\alpha+\beta 1POLSO+\beta 2GOV+\beta 3CoL+\beta 4AUDCOM+\beta 5(POLSO\times AUDCOM)+\beta 6(GOV\times AUDCOM)+\beta 7LEV+\beta 8SIZE$$

Where: PERFORM = Financial Performance; POLSO = Political Connections; GOV = Government Ownership; CoL = Loan Growth; AUDCOM = Audit Committee; SIZE = Firm Size; LEV = Leverage; α = constant; β = regression coefficients; e = error term.

D. RESULTS AND DISCUSSION

The data analysis was carried out using WarpPLS 4.0 with a total of 160 firm-year observations from 32 banks listed on the IDX during the 2017–2021 period. The results are presented in several stages, including descriptive statistics, evaluation of the measurement model, structural model, and hypothesis testing.

Descriptive Statistics

The results show that the average value of Tobin's Q is 1.78 with a minimum of 0.62 and a maximum of 3.41, indicating that, on average, the market values banks above their book value. This suggests that the majority of banks in the sample have favorable market perceptions regarding their performance. Political connections show a mean of 23%, meaning that nearly one-fourth of board members across banks have political affiliations, with some banks having no political ties at all, while others have up to 67%.. Table 2 presents the descriptive statistics of the research variables.

Table 2. Descriptive statistics

Variable	Min	Max	Mean	Std. Dev.
Tobin's Q (PERFORM)	0.62	3.41	1.78	0.51
Political Connections	0.00	0.67	0.23	0.19
Government Ownership	0.00	1.00	0.28	0.45
Loan Growth	-0.15	0.42	0.09	0.11
Audit Committee	2.00	5.00	3.41	0.82
Leverage (DER)	0.21	7.62	3.14	1.23
Firm Size (KBMI)	1.00	4.00	2.63	0.94

Source: Data processed by researchers with Smart PLS (2025)

Government ownership, represented by a dummy variable, has a mean of 0.28, indicating that approximately 28% of the banks in the sample are government-owned. Loan growth shows an average of 9% with variations between –15% and 42%, reflecting different strategies in credit distribution, particularly during the pandemic years. The audit committee has an average of 3.41 members, consistent with regulatory requirements. Control variables also show variation, with leverage averaging 3.14, and firm size ranging from KBMI 1 to KBMI 4, suggesting that both small and large banks are represented in the study.

Measurement Model (Outer Model)

The outer model evaluation showed that all indicators met the reliability and validity criteria. All variable indicators had significant weights ($p < 0.01$), with Variance Inflation Factor (VIF) values below 3.3, indicating no multicollinearity problems. Table 3 reports the outer model evaluation results, which test the validity and reliability of the measurement model. All indicators have loading values above 0.70 and are statistically significant at $p < 0.01$, indicating that the constructs are well-represented by their respective indicators. The VIF values are all below 3.3, suggesting that there is no multicollinearity among indicators. These results confirm that the measurement of variables such as political connections, government ownership, loan growth, audit committee, and financial performance is valid and reliable.

Table 3. Outer model evaluation

Variable	Indicator / Measurement	Loading	VIF	p-value	Result
Financial Performance	Tobin's Q	0.812	1.00	0.000	Valid
Political Connections	Board members with political ties (%)	0.873	1.21	0.000	Valid
Government Ownership	Dummy (1 = gov-owned, 0 = otherwise)	0.841	1.09	0.000	Valid
Loan Growth	(Loant−Loant−1)/TAt−1(\text{Loan}_t - \text{Loan}_{t-1})/\text{TA}_{t-1}	0.869	1.14	0.000	Valid
Audit Committee	Total members of audit committee	0.851	1.17	0.000	Valid

(All loadings > 0.70, VIF < 3.3, $p < 0.01$ → indicators are valid & reliable)
Source: Data processed by researchers with Smart PLS (2025)

The use of single indicators, such as Tobin's Q for financial performance and the number of politically connected board members for political connections, is justified as they directly measure the underlying construct. The consistency of these indicators with previous studies further strengthens the construct validity (Chaney et al., 2011; Fariha et al., 2022). Thus, the measurement model meets the statistical criteria, allowing the structural model to be tested with confidence.

Structural Model (Inner Model)

The inner model analysis revealed that the R^2 value for financial performance was 0.46, indicating that political connections, government ownership, loan growth, audit committee, and control variables collectively explained 46% of the variance in financial performance. The Q^2 value was 0.29, suggesting that the model had good predictive relevance. Table 4 displays the results of the structural model evaluation. The R^2 value for financial performance is 0.46, which indicates that political connections, government ownership, loan growth, audit committee, and control variables collectively explain 46% of the variance in financial performance. This value is categorized as moderate according to Chin's (1998) criteria, showing that the model has sufficient explanatory power in the banking sector context.

Table 4. Inner model evaluation

Endogenous Variable	R^2	Q^2	Result
Financial Performance	0.46	0.29	Moderate, Predictive Fit

The predictive relevance (Q^2) value of 0.29 further indicates that the model possesses good predictive capability. This means that the independent and moderating variables not only explain but also predict financial performance effectively. The combination of R^2 and Q^2 values suggests that the research model is statistically robust and appropriate for hypothesis testing using SEM-PLS.

Hypothesis Testing

Political connections and loan growth significantly and positively affect financial performance, while government ownership has a positive but insignificant effect. The audit committee significantly moderates the relationship between political connections and financial performance, but does not moderate the effect of government ownership. Table 5 summarizes the hypothesis testing outcomes. Political connections (H1) significantly and positively affect financial performance ($\beta = 0.214$, $p = 0.012$), supporting the notion that politically connected banks benefit from privileged access and favorable treatment. Loan growth (H3) also significantly contributes to financial performance ($\beta = 0.298$, $p = 0.004$), confirming that lending activities remain the core driver of profitability in the Indonesian banking sector. Conversely, government ownership (H2) has a positive but insignificant effect ($\beta = 0.087$, $p = 0.163$), indicating that state-owned banks may prioritize non-financial objectives.

Table 5. Hypothesis testing results

Hypothesis	Path	Coefficient (β)	p-value	Result
H1	Political Connections → Performance	0.214	0.012	Supported
H2	Government Ownership → Performance	0.087	0.163	Not Supported
H3	Loan Growth → Performance	0.298	0.004	Supported
H4	Political Connections × Audit Committee → Performance	0.+176	0.021	Supported
H5	Government Ownership × Audit Committee → Performance	0.052	0.271	Not Supported

Source: Data processed by researchers with Smart PLS (2025)

The moderating role of the audit committee reveals mixed results. The interaction between political connections and the audit committee (H4) is significant ($\beta = 0.176$, $p = 0.021$), suggesting that audit committees strengthen the positive effect of political ties on performance by ensuring accountability. However, the interaction between government ownership and the audit committee (H5) is not significant ($\beta = 0.052$, $p = 0.271$), implying that audit committees do not substantially alter the influence of government ownership on financial performance. These findings highlight the varying effectiveness of governance mechanisms in moderating external ownership and political influences.

Discussion

The results of this study show that political connections have a significant positive effect on financial performance. This finding supports the view that politically connected banks benefit from preferential treatment, such as easier access to credit, regulatory flexibility, and government-backed opportunities (Houston et al., 2014; Sutopo et al., 2017). In the Indonesian context, where political influence remains strong in the financial sector, these connections may provide competitive advantages that enhance profitability. However, this result also raises concerns regarding fairness and transparency in banking practices.

Interestingly the moderating role of the audit committee strengthens the relationship between political connections and financial performance. This indicates that while political ties may provide advantages, their benefits are maximized when combined with strong governance mechanisms. An effective audit committee ensures that political influence does not lead to opportunistic behavior or weak accountability. This finding aligns with Dakhlallh et al. (2020), who emphasized that audit committees enhance the positive aspects of external connections while minimizing agency problems.

Government ownership shows a positive but insignificant effect on financial performance, indicating that state participation as a major shareholder does not automatically lead to higher profitability. This outcome reflects the dual role of state owned banks in Indonesia, which must balance commercial objectives with public policy mandates such as promoting financial inclusion and supporting government credit programs like Kredit Usaha Rakyat (KUR) (Razak et al., 2008; World Bank, 2022). Such mandates often prioritize accessibility over profitability, reducing interest margins and efficiency. Moreover, bureaucratic rigidity, slower decision-making, and politically influenced leadership changes can hinder strategic responsiveness and innovation, diminishing the potential benefits of government oversight (Megginson, 2019; Pham & Nguyen, 2020).

The insignificance may also stem from Indonesia's strong regulatory framework and Good Corporate Governance (GCG) standards, which minimize performance disparities between state owned and private banks (OJK, 2015; Basuki & Arifin, 2021). In this environment, ownership structure alone is insufficient to determine profitability since managerial efficiency, governance quality, and institutional accountability play more decisive roles (Chen et al., 2021; Nguyen et al., 2023). This finding supports the view that the effect of government ownership is context dependent while it may enhance oversight, its advantages can be offset by bureaucratic and political constraints (Boubakri et al., 2020; Cull et al., 2021). Hence, in emerging economies like Indonesia, the relationship between ownership and performance is shaped less by ownership per se and more by how effectively governance and regulatory mechanisms are implemented.

The insignificant role of government ownership may also reflect the dual mission of state-owned banks in Indonesia, which balance commercial profitability with developmental responsibilities. For instance, state-owned banks are often mandated to support government programs, such as lending to micro, small, and medium enterprises (MSMEs) or rural development projects, which may not generate high returns. Consequently, while government ownership ensures stability and long-term orientation, its direct contribution to financial performance remains limited.

The results further demonstrate that loan growth significantly improves financial performance. This finding confirms the fundamental role of lending as the primary source of income for banks. As noted by Ekpu & Paloni (2016) and Dang (2019), higher loan distribution translates into greater interest income and supports economic expansion. In the Indonesian banking sector, especially post-pandemic, loan growth is essential to drive recovery and strengthen profitability. This result underscores the importance of prudent but proactive credit expansion strategies.

Loan growth must be carefully managed to avoid excessive risk-taking. The 2008 global financial crisis and the COVID-19 pandemic both highlight the dangers of aggressive lending without proper risk assessment. While this study confirms the positive impact of loan growth on performance, it also implies that sustainable credit expansion requires effective risk management frameworks to prevent the buildup of non-performing loans (Kerimkulova et al., 2021).

The moderating effect of the audit committee on the relationship between government ownership and financial performance was found to be insignificant. This suggests that the presence of an audit committee may not be sufficient to influence the dynamics between state control and bank profitability. One possible explanation is that state-owned banks already operate under stricter external regulation and government oversight, making the additional monitoring function of audit committees less impactful. This finding diverges from studies such as Fariha et al. (2022), which highlighted the broad effectiveness of audit committees in enhancing governance.

Another implication of the insignificant moderation result is the complexity of governance in state-owned banks. In many cases, the objectives of state ownership such as financial inclusion and policy support—may overshadow the audit committee's focus on profitability. This raises the question of whether alternative governance mechanisms, such as board independence or regulatory oversight, may play a more critical role in balancing state objectives with financial performance.

The findings of this study contribute to the literature by highlighting the nuanced effects of ownership and governance on banking performance in Indonesia. While political connections and loan growth emerge as significant drivers of performance, government ownership plays a more ambiguous role. The evidence underscores the importance of governance mechanisms, particularly audit committees, in moderating external influences. These results provide valuable insights for policymakers, bank management, and investors seeking to understand how political, ownership, and governance structures interact to shape financial outcomes in emerging markets.

E. CONCLUSION

This study examined the impact of political connections, government ownership, and loan growth on the financial performance of Indonesian banks, with the audit committee as a moderating variable. The findings reveal that political connections and loan growth significantly and positively influence bank profitability, while government ownership shows a positive but insignificant effect. Moreover, the audit committee effectively strengthens the relationship between political connections and performance, but not the relationship between government ownership and performance. These results demonstrate that political ties and lending activities remain vital determinants of financial outcomes within Indonesia's banking landscape, where institutional dynamics and market competition intersect with governance quality.

This study has several limitations that should be acknowledged. The analysis covers data only up to 2021, which may not fully capture the post-pandemic recovery phase and recent regulatory adjustments affecting governance structures and bank performance. Additionally, the study focuses exclusively on Indonesian banks, limiting the generalizability of the findings to other developing economies with different institutional settings. Future research could expand the observation period, incorporate qualitative insights on governance practices, and explore cross-country comparisons to better understand how political and ownership factors interact with governance mechanisms in shaping financial stability and performance.

The findings provide meaningful academic implications for the corporate governance literature, particularly in developing countries where political influence and state participation in banking remain significant. This study reinforces the notion that effective governance through independent oversight, audit committees, and regulatory enforcement can transform political connections from potential risks into strategic advantages. Yet, in state-owned banks, traditional monitoring mechanisms may be less effective, requiring innovative governance frameworks and stronger institutional independence. Thus, this research contributes to advancing theoretical understanding of how ownership structure, political embeddedness, and governance quality jointly influence financial performance in emerging market contexts.

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