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Article Type: Research Paper

Political turnover and business decision: A study of Indonesian public companies

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Abstract
Research aims: This study aims to explore whether and to what extent political turnover (a change of local government head) is associated with a firm's business decisions, such as tax avoidance and corporate investment.
Design/Methodology/Approach: Using a sample of companies listed in the Indonesia Stock Exchange from 2012-2021, the authors measured the association between changes in local government leaders and business decisions using panel data regression with Driscoll & Kraay's Standard Error. The authors hand-collected data on changes in local government leaders in 183 Indonesian cities to measure political turnover and merged the data with financial variables collected from the Eikon database.
Research findings: This study uncovered that local political turnover in the region of companies' headquarters was negatively associated with tax avoidance decisions. This study also found that local political turnover negatively affected corporate investment decisions during normal/non-crisis periods. Consistent with the Resource Dependence Theory, the results of this study suggest that firms treat relationships with local government as an important resource. Political turnover thus creates uncertainty on the sustainability of the resources, causing firms to adjust their business decisions.
Theoretical contribution/Originality: This study provides an understanding of how changes in political conditions in Indonesia change business strategy decisions. Besides, this research area is still under-studied in Indonesia.
Research limitation: Since this study focused on the uncertainty caused by political turnover, this study did not measure firms' political connections.
Keywords: Political Turnover; Tax Avoidance; Corporate Investment; Business Decision

Introduction

Regional elections are essential to the political condition (Sampe, 2021). In developing countries such as Indonesia and the Philippines, especially after the Indonesian fiscal decentralization, resource mobilization has largely been shifted to locally elected officials (Lewis, 2005; Turner, 2006; Siregar & Badrudin, 2019; Sampe, 2021). Regional elections may result in a change in regional leaders and cause environmental and political uncertainty.

Uncertainty surrounding the business environment is a crucial issue that management must consider because it may impact company decision-making. As environmental uncertainty increases, information asymmetry

increases, and management might not have enough information to predict the situation to make appropriate decisions. Therefore, analyzing the impact of uncertainty surrounding a company's business becomes an important part of managers' consideration of financial strategy and risk (Miller, 1993). Plenty of prior studies have found that political uncertainty, as well as environmental uncertainty, had a significant impact on corporate investment decisions (see, e.g., Gulen & Ion, 2016; Jens, 2017), corporate R&D expenses (see, e.g., Cao et al. 2022), firm innovation (see, e.g., Chen, 2021), and tax avoidance (see, e.g., Huang et al., 2017; Nguyen and Nguyen, 2020).

In this regard, the change of political leadership is commonly used to proxy for the increased political and environmental uncertainty (Jens, 2017; Chen, 2021 Tsai et al., 2021). A change in political leadership causes political uncertainty as it may trigger policy changes and loss of political relations. This political uncertainty will thus make companies act more cautiously in making risky company decisions, such as tax avoidance and investment (Gulen & Ion, 2016; Jens, 2017; Huang et al., 2017; Nguyen and Nguyen, 2020).

Several studies have been conducted to find the impact of political turnover. Tsai et al. (2021) found that a change in local leaders in China led to collusive instability, causing a reduction in tax avoidance behavior. In addition, An et al. (2016) and Julio and Yook (2012) revealed that political turnover caused significant political uncertainty. With the change in local politics, the company's political connections are weakened or even broken, adversely affecting the value of politically connected companies. According to An et al. (2016) and Julio and Yook (2012), political uncertainty makes considerable losses in companies' investment and cash holdings. Yu et al. (2022) also uncovered that investment and corporate financing dropped significantly when the core regional officials were replaced.

Political turnover referred to in this study is a leadership change in a region. This study aims to test whether the change of leadership (political turnover) will be associated with companies' tax avoidance and investment decisions. Some previous research has focused only on China (An et al., 2012; Tsai et al., 2021; Yu et al., 2022), except for Julio and Yook's (2012) research which examined the conditions of political change in 48 countries. There is, however, limited evidence on developing countries in which political uncertainty tends to be higher. Expanding on prior studies, this study analyzes the association between environmental uncertainty caused by a change in political leadership in Indonesia. To complement prior studies that mostly focused on changes in the head office area, this study distinguishes political turnover into two types based on a firm's location. The first type is the change of local government leaders at firms' operational locations (e.g., factories). The second is the change of local government leaders at the company's head office location. Although the company's head office determines most companies' decisions in tax-paying behavior and investment, the operational area also contributes to the firm's overall performance. Thus, the authors postulate that the company's decisions will be associated with political turnover at the head office and the operational area.

The results of this study indicate that local political turnover that occurred in the area where the company's headquarters were located had a negative association with the

company's tax avoidance level. The authors also found that the local political turnover in firms' operational areas (factories, farms, mines, and branch offices) had a significant negative relationship with the level of corporate investment during the normal (non-pandemic) periods. As local officials usually have great influence and control over the development of the local economy, this study's results indicate that political turnover created uncertainty regarding corporate resources, affecting firms' decisions to exercise tax avoidance and make investment decisions. This study's results support prior studies that uncovered a significant association between political uncertainty and investment decision, such as Gulen and Ion (2016) and Jens (2017). This study's results regarding tax avoidance behavior are also consistent with the findings of Nguyen and Nguyen (2020) and Huang et al. (2017).

Further, the authors contribute to the prior literature in several ways. First, there is still limited research on whether and to what extent local political turnover is associated with business decisions in Indonesia, a developing country transitioning into a more decentralized political and public financing system. Second, the authors add an analysis of variations in the company's location. Since prior studies focused on the company's headquarters, the authors separated the company's headquarters from its operational areas in this study. Lastly, the authors analyzed whether there is a difference in the association between political uncertainty and business decisions during and before the pandemic.

Literature Review

Resources Dependence Theory

The Resource Dependence Theory states that an organization's actions will be aligned with its degree of dependence on its various resources (Pfeffer & Salancik, 1978). Organizations act on their environment to reduce dependence on certain resources and maintain independence over others. According to this theory, the power of organizations arises from their ability to cope with and minimize uncertainty and control scarce resources (Pfeffer & Salancik, 1978).

This theory can explain the purpose of political relations in this context, i.e., one of the ways companies reduce the uncertainty of the external environment is by building political relationships (Hillman & Dalziel, 2003; Pfeffer & Salancik, 2003), which will give companies a stronger resource base, such as connections to the government, advisors, advice, experience, resource access, and land permits in the context of the Chinese state (Tsai et al., 2021). This theory also provides support that political relations between companies and governments are indeed very necessary for the sake of the company's ease in managing its business. It makes local governments have a very important role for companies, namely as one of the external resources, resources that will make companies dependent on reducing the risk of uncertainty in the environment in which they operate. With the change of regional leadership, the uncertainty of the company's environment is higher. As environmental uncertainty increases, information asymmetry also increases. It

results in management not having enough information to predict the situation before making the right decision, so management tends to be more careful in considering financial strategies and risks (Miller, 1993).

Political Turnover and Tax Avoidance

In line with the Resource Dependence Theory, the purpose of the political relationships built is as one-way companies reduce uncertainty (Hillman & Dalziel, 2003; Pfeffer & Salancik, 2003). In the Chinese context, local governments can assist companies in various matters, such as tax reductions, tax refunds, facilitating access to state bank loans, selling state property at lower prices, regulatory exemptions, and others (Tsai et al., 2021). Duchin and Soshura (2012) argue that political connections are insurance mechanisms against extreme events. It makes the government, including local governments, have a crucial role for the company as one of the external resources, resources that will make the company dependent on reducing the risk of uncertainty in the environment in which it operates.

Some researchers also argue that a company's survival in the market competition is strongly influenced by its ability to maintain balance and adapt to changes in the external environment and then adapt its internal processes to various elements in the business environment (Kreiser & Marino, 2002). With the change in regional leadership, the uncertainty of the company's environment is higher. Such uncertainty is a problem because management cannot obtain clear and sufficient information about ongoing environmental conditions, so management becomes ambiguous and cannot make the right decisions. As a result, companies will tend to be more cautious in making high-risk operational decisions such as tax avoidance.

Liu et al. (2015) found that corporations showed weaker incentives to engage in tax avoidance activities in the first year of the city's political leaders' tenure. However, over time, they increased tax avoidance rates until the local politicians were replaced again by new ones. Nguyen and Nguyen (2020) revealed that firms tended to be involved in more aggressive tax avoidance activities when economic policy uncertainty heightened. Similarly, Huang et al. (2017) demonstrated that managers tend to avoid tax in a more uncertain environment. A study in China by Tsai et al. (2021) also uncovered that the change of local leaders in China caused collusive instability, causing companies to reduce tax avoidance behavior. Those prior studies indicate political uncertainty during the first year of political turnover. Following the Resource Dependence Theory, which states that the company's behavior will depend on its external resources, it tends to change due to political uncertainty arising from political turnover. Therefore, the first hypothesis proposed in this study is:

H₁: Political turnover has a negative relationship with tax avoidance.

Political Turnover and Corporate Investment

The investment and financing behavior of the company is inextricably linked to political conditions, more particularly the policies made by the government. The impact of government on the allocation of resources is mainly reflected in the different types of business policy interventions (Chen et al., 2011). During the political transition period in Indonesia, the government and local officials had great influence and control over the development of the local economy. Moreover, some important resources, as well as administrative checks and approvals, land acquisition, and various preferential policies, are all held by local governments. Therefore, private companies must establish political connections (Liu et al., 2015. In addition, some companies have more than one area as their operational places, such as areas for farms locations, factories, mines, and branch offices. Thus, companies need to have political connections in each regional location to support operationalization and expand the company's investment.
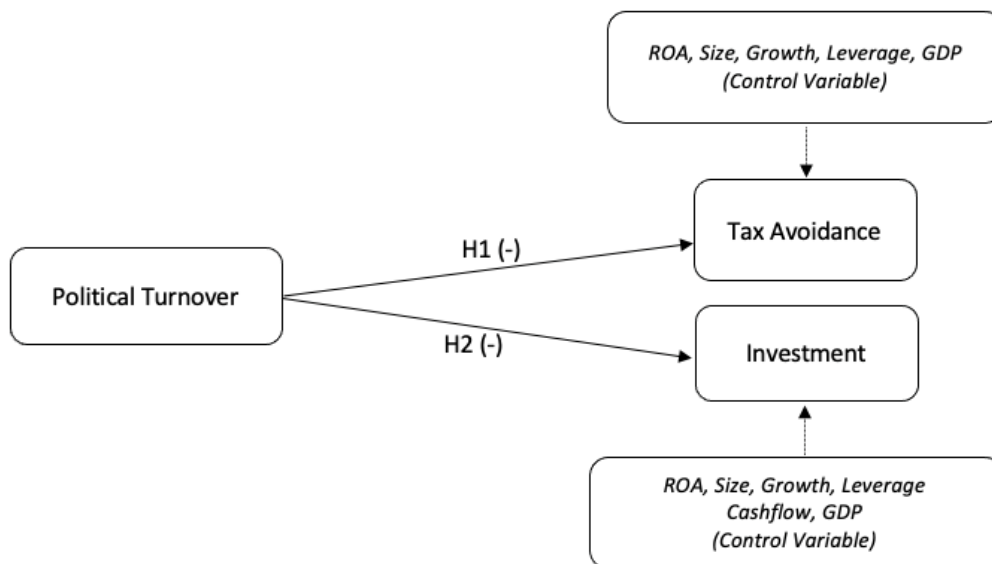

Figure 1 Framework Model

Furthermore, local governments plan local industrial development policies following the national macroeconomic policies and local resources. Local governments entirely determine the allocation of these resources. Consequently, changes in local core officials are usually accompanied by uncertainty over future local government policies and increased external financing costs, leading to uncertainty in future investment project revenues. Therefore, rational entrepreneurs will postpone investment until the uncertainty lessens (Francis et al., 2014; Julio & Yook, 2012). Thus, policy uncertainty influences firm investment decisions (Gulen & Ion 2016; Jens 2017). Pastor and Veronesi (2012) suggests that companies will invest more cautiously in the face of policy uncertainty, usually by reducing investments to deal with these political risks. It is consistent with the Resource Dependence Theory that a company's behavior changes following changes in its external resources. Company behavior tends to change due to the emergence of political uncertainty arising from political turnover. Julio and Yook's (2012)

studies of political elections in Western Countries confirm that corporate investment spending has decreased during elections. Yu et al. (2022) also found evidence that sudden political turns cause investment and corporate financing to drop significantly. Thus, the second hypothesis proposed is:

H_2: Political turnover has a negative relationship with investment.

Based on the hyphothesis development, this research framework can be seen in Figure 1.

Research Method

Data Selection and Data Sources

This study aims to determine the impact of the change in local government leadership on tax avoidance and corporate investment. This study used a quantitative approach with a population of companies listed on the Indonesia Stock Exchange from 2012-2021. This study employed a purposive sampling technique and excluded a sample of; (1) companies controlled by the central government in Indonesia (SOE), (2) financial services and real estate companies, (3) companies without complete data, and (4) companies having a negative ETR value. Financial and banking companies were excluded from the sample because they are highly regulated and have different characteristics than companies in other industries. Real estate companies were also excluded from the sample since this industry has different tax rules than other industries. In addition, state-owned enterprises (SOE) are naturally connected to the government through ownership ties (Calomiris et al., 2010). Appointed by government owners, SOE managers are incentivized to maintain a comfortable relationship with the government. Due to differences in behavior between state-owned and non-state-owned companies, state-owned companies were excluded from the research sample.

This study utilized the secondary data source from Thomson Reuters' Eikon database. The political turnover data were hand-collected. Besides, data on each company's main office and operational location were obtained manually from the annual report, sustainability report, and website. Meanwhile, data on political turnover were attained manually from information on the websites of each city. The final sample used in the analysis was panel data covering 83 firms over ten years.

This research is using political turnover, tax avoidance and corporate investment as the variables and each of variable measurement can be seen in Table 1.

Measurement of Political Turnover

The main variable of this study was political turnover, measured using two proxies. The first proxy was City_Ratio, measured using the average ratio of regent/mayor changes at the company's operational locations other than the headquarters (factories, farms,

mining, and branch offices). After recording all the company's operational locations and using a dummy to determine whether there was a change of regent/mayor change in the area, the next step was to calculate the average occurrence of regent/mayor changes in various operational areas each year. The second proxy was the City_Listed proxy, determined using a dummy; it is 1 if there is a change of regent/mayor in the regency/city in the company's headquarters in that year and 0 otherwise.

Table 1 Variable Measurement

Variable	Measurement
Current_ETR	$\dfrac{Current\ tax\ expense}{pre-tax\ income}\ x - 1$
City_Ratio	The average value of the occurrence of a change of local government leaders in a given year
City_Listed	It is 1 if the area experiences a change of regent/mayor within a given year and 0 otherwise.
CORPINVEST	$\dfrac{Capital\ expenditure}{Total\ Asset\ at\ the\ beginning\ of\ fiscal\ quarter}$
Cashflow	$\dfrac{Total\ operational\ cashflow}{Total\ Asset\ at\ the\ beginning\ of\ fiscal\ quarter}$
ROA	$\dfrac{Earning\ after\ tax}{Total\ asset}$
Size	Natural logarithm of total assets
Leverage	$\dfrac{Total\ debt}{Total\ asset}$
Growth	$\dfrac{(Sales\ t) - (Sales\ t-1)}{(Sales\ t-1)}$
GDP	$\dfrac{(GDP\ t) - (GDP\ t-1)}{(GDP\ t-1)}$

Measurement of Tax Avoidance

The first outcome variable in this study was tax avoidance. The tax avoidance variable was proxied by the current ETR, describing central tax avoidance. The authors postulate that political turnover in both head office and operational area cause political uncertainty, causing changes in overall business decisions.

Current ETR was measured by dividing the current year's tax expense by the accounting income before tax. The current ETR measurement was adjusted yearly to the corporate tax rate. To overcome changes in tax rates during the study period, in hypothesis test 1, the calculation of the current ETR was divided by the applicable statutory tax rate. This model used four control variables: ROA, size, leverage, and growth. The relationship

between political turnover and tax avoidance used the GDP variable to control economic growth conditions.

Measurement of Corporate Investment

The second outcome variable was a corporate investment. This variable was determined using capital expenditure divided by total assets at the beginning of the fiscal period using five control variables: ROA, cash flow, size, leverage and growth. The relationship between political turnover and corporate investment used the GDP variable to control economic growth conditions.

Research Models

To test hypotheses 1 and 2, the authors used different econometric models as below:

$$CURRENT\_ETR_{i,t} = \beta0 + \beta_1 TURNOVER_{i,t} + \beta_2 ROA_{i,t} + \beta_3 SIZE_{i,t} + \beta_4 GROWTH_{i,t} + \beta_5 LEVERAGE_{i,t} + \beta_6 GDP_{i,t} + e \dots (1)$$

$$CORPINVEST_{i,t} = \beta0 + \beta_1 TURNOVER_{i,t} + \beta_2 ROA_{i,t} + \beta_3 SIZE_{i,t} + \beta_4 CASHFLOW_{i,t} + \beta_5 GROWTH_{i,t} + \beta_6 LEVERAGE_{i,t} + \beta_7 GDP_{i,t} + e \dots (2)$$

The dependent variables were tax avoidance (CURRENT_ETR) and corporate investment (CORPINVEST). The main independent variable in both models was the turnover of leadership (TURNOVER). For other explanatory variables, the authors employed the variables suggested by Wang et al. (2014) and Tsai et al. (2021), which are thought to be able to affect each dependent variable. Then, the authors used national GDP to control economic development.

Results and Discussion

Data and Sample

The study samples were taken using purposive sampling techniques with the final panel data sample of 83 companies for ten years so that the total final sample used in this study was 830 observations. Research sample criteria are shown in Table 2.

Table 2 Research Samples

Sample Criteria	Sum
Companies listed on the Indonesia Stock Exchange during the 2012-2021 research year	407
GICS 40 & 60	(111)
ETR is negative.	(201)
State-owned enterprises	(10)
Incomplete data	(2)
Total	83

Statistics Descriptive

Based on Table 3, the average values of City_Ratio and City_Listed were 0.20 and 0.23. In Indonesia, generally, the change of local government leaders occurs once every five years. However, these results showed that the average frequency of changes of local government leaders for ten years in operational areas such as factories, farms, mines, and branches was only 20%, while at the headquarters, it was as much as 23%. It denotes that the change of local government leaders is normal. However, based on existing data during the 10-year observation period, changes in local government leaders more than two times also occurred quite often in some regions. It certainly happened because of various situations, including taking a campaign leave to participate in the next election as stipulated in Law Number 70 on the Election Law. Thus, many local government leaders were temporarily replaced. To avoid bias, temporary local government leaders who served under one year were not included in the research sample and were considered not to have a change of leadership because the term of office was relatively short. It is considered that there will be a change of local government leader if the regent/mayor pins the region for at least one year.

Table 3 Descriptive Statistics

	N	Minimum	Maximum	Average	Std. Deviation
Current_ETR	830	0	3, 59912	0.2914813	0.351558
Corpinvest	830	-1.7	0.97	0.0545904	0.0989975
City_Ratio	830	0	1	0.2067425	0.2968956
City_Listed	830	0	1	0.2337349	0.4234607
ROA	830	0.000282	0.446758	0.0819447	0.0710217
Leverage	830	0	12.15	0.6049759	0.9266141
Cashflow	830	-0.27	0.52	0.1034458	0.104853
Growth	830	-0.96254	3.774502	0.1088898	0.2556574
Size	830	16.821.216	367.311.000.000	14.364.773.006	37.110.422.004
.GDP	830	-0.0249257	0.1079923	0.0810816	0.0374219

Based on the descriptive analysis results, the average amount of the company's current tax burden over ten years in this study was 29% of the total tax burden. The average corporate investment was 0.054, meaning that capital expenditure was 5.4% of total assets, and even the highest amount could reach 97%. It can also be seen that the company's average performance based on the Return on Assets was 8.1%. The company's average leverage ratio or debt level in this study was 60% of total assets and could even reach 1215% of total assets. In addition, the average operating cash flow was 10.34% of total assets. The average company's growth was 10%, and the highest sales growth could reach 377%. The company's size in the study, measured based on total assets, showed that the company with the largest total assets was IDR 367,311,000,000,000 with an average total asset value of IDR 14,364,773,006,997. Meanwhile, this study's total average GDP growth rate was 8% yearly. In the ten years of the study period, there has been a decline in GDP growth by the lowest by 2% and the highest growth of 10%.

Table 4 List of Factories/Farms/Mines/Branches

Area	Number of Factories/Farms/Mines/ Branches
Bekasi	23
Surabaya	22
Tangerang	19
Semarang	16
Bandung	16
Medan	15
Makassar	14
Palembang	13
Banjarmasin	12
Sidoarjo	9
Gresik	8
Other areas	348
Total 183 Regions	516 Factory/Garden/Mine/ Branch

Then, Table 4 shows the company's operational location areas in the form of factories, farms, mines, and branch offices in 83 companies. A total of 516 factories/farms/mines/branches were found in 183 different areas, including regencies/cities and provinces, which would then be used in City_Ratio analysis. Besides, the recording of provincial areas was carried out because some companies had large farms and mining areas, so it was quite difficult to break down and explain the specific areas in their reports. Meanwhile, in recording the location of the headquarters in 83 companies, 16 different regencies/cities would then be used in the City_Listed analysis.

Table 5 List of Headquarters Areas

Area	Sum	%
South Jakarta	22	27
Central Jakarta	13	16
West Jakarta	11	13
Tangerang	7	8
East Jakarta	5	6
Bekasi	5	6
Surabaya	4	5
Sidoarjo	4	5
North Jakarta	4	5
Bandung	2	2
Gresik	1	1
Kediri	1	1
Palembang	1	1
Badung	1	1
Pontianak	1	1
Semarang	1	1
Total	83	100

Based on data collection, Bekasi was an area with the most factories/farms/mines/branches out of the 83 companies studied. It seems reasonable because Bekasi is an area that is quite close to most companies' headquarters operating, so making it a place for factories and branches is a strategic step. Among other big cities, Surabaya, Sidoarjo and Gresik, regencies from East Java, were among the regencies with the greatest number of factories/farms/mines/branches out of the 83 companies studied.

Table 5 indicates that the headquarters of public companies on the Indonesia Stock Exchange were mostly in the capital area of DKI Jakarta. This data was taken directly from Refinitiv Eikon based on the registered city of legal registration. Although the most popular area as the location of the headquarters of a public company was in the DKI Jakarta area, there were also quite a lot of companies located centrally in East Java, such as Surabaya, Sidoarjo, Gresik, Kediri, and Semarang, which reached 13% of the total area.

Cross-Sectional Dependence Test

A targeting test was conducted to determine whether there was cross-sectional dependence in the research model. A model will be identified as having cross-sectional dependence if it has a p-value of < 0.05. From Table 6, it can be concluded that Models 1 and 2 had a cross-sectional dependence. To combat this, models detected by cross-sectional dependence were regressed using Driscoll & Kraay's Standard Error. In addition to addressing the problem of cross-sectional dependence, Driscoll & Kraay's Standard Error regression can also solve the problem of heteroscedasticity and autocorrelation.

Table 6 Cross-Sectional Dependence Test

Model	P value
1	0.0000
2	0.0000

Hypothesis Testing

This study's hypothesis 1 proposes a negative association between the change of regional heads (*political turnover*) and corporate tax avoidance. The higher the value of the current ETR indicates the lower the level of tax avoidance. However, to facilitate interpretation, the value of the current ETR in this study was multiplied by -1, so the higher the current ETR will indicate the higher the level of corporate tax avoidance.

Based on Table 7, Model 1 showed that the *political turnover* proxies measuring the political turnover at the company head office's location (City_Listed) had a coefficient of -0.1178315 with a p-value of 0.079, indicating a significant negative relationship with corporate tax avoidance. However, for the City_Ratio variable, describing the political turnover at the location of factories, plantations, mines, and branch offices, the authors did not find a significant relationship. Thus, only the change of regional heads at the location of the company's head office was shown to have a negative relationship with corporate tax avoidance.

Table 7 Model 1 Hypothesis Testing Results

Variable	Expectations	Coefficient	Probability	Conclusion
City_Ratio	-	0,0027203	0,988	
City_Listed	-	-0,1178315	0,079*	Hypothesis partially accepted
ROA		7,387589	0,004**	
Leverage		0,0457447	0,560	
Growth		0,0481404	0,754	
Size		0,0265498	0,896	
GDP		0,0361447	0,921	
Constant		-2,382555	0,697	
N				830
R^2				4,09%
Prob > F				0,0000
Command	Xtscc, fe			

Notes:

This result was tested using Driscoll & Kraay's Standard Error Fixed Effect. **Current_ETR**= Tax Avoidance Disclosure; **City_Ratio**= The average value of the occurrence of a change of regional heads in a given year; **City_Listed**= It is 1 if the area experiences a change of regent/mayor within a given year and 0 otherwise; **ROA**= Return on Asset by dividing earnings after tax by total asset; **Leverage**= Debt ratio by dividing total debt by total asset; **Growth**= Growth company ratio by dividing the difference between the current sales and the previous sales by current sales; **GDP**= Dividing the difference between the current GDP and the previous GDP by current GDP.

***α = 1%; **α = 5%; *α = 10%

One possible explanation for this study's results is that 67% of the company's headquarters are in DKI Jakarta. DKI Jakarta is a region with privileges in terms of regional autonomy. The specialty of this region is that first, the regent/mayor of DKI Jakarta is not elected through regional election but is appointed directly by the Governor of DKI Jakarta with consideration of the DKI Jakarta Provincial DPRD taken from the group of Civil Servants (PNS) and State Civil Apparatus (ASN) who meet the requirements. Law 29 of 2007 Article 1, paragraph (10), explains that the position of the regent/mayor of DKI Jakarta serves as the head of the city/regency administration in the DKI Jakarta area and as a device of the DKI Jakarta provincial government. Hence, the regent/mayor of DKI Jakarta is directly responsible to the governor. It indicates that companies operating in the DKI Jakarta area have closer political relations with the central government than companies operating in other regions. The relationship between regional heads in DKI Jakarta and the central government is quite close, so there is a possibility that the company also has external resources in the form of political relations that extend to the central government due to its relationship with the regent/mayor of DKI Jakarta. Thus, the change of regional head in the area around the head office has a more significant relationship with tax avoidance than the change of regional head in the area around the location of factories, plantations, mines, and branch offices of the company.

This study's results align with Resource Dependence Theory. The purpose of the political connection is to reduce uncertainty (Hillman & Dalziel, 2003; Pfeffer & Salancik, 2003). Duchin and Sosyura (2012) argue that political connections are insurance mechanisms against extreme events. It makes the government, including local governments, have a very important role for the company, i.e., as one of the external resources. These

resources will make the company dependent on reducing the risk of uncertainty in the environment in which the company operates.

This study's results also support the studies of Liu et al. (2015) and Tsai et al. (2021). Liu et al. (2015) found that corporate incentives for conducting tax avoidance tended to decrease during the first year of regional leadership change. Tsai et al. (2021) also uncovered similar results. Based on Tsai et al. (2021), tax avoidance behavior carried out by companies in China tended to decrease when there was a change of leadership. According to Tsai et al. (2021), it was due to collusion between local governments and companies in China. With the change of leadership resulting in instability and collusion in China, companies tended to be cautious in making tax evasion decisions. This result is also supported by the RDT, stating that there will be changes in the company's behavior when its external resources are disrupted. Given the strong influence of regional heads on the local economy, political turnover can bring changes to economic or fiscal policies that can create significant uncertainty for companies (Tsai et al., 2021). Companies tend to be cautious in taking policies in response to the environmental uncertainty arising from political turnover, especially in tax avoidance behavior.

Additionally, four control variables were used in Model 1: the ratio of Return on Assets (ROA), the ratio of debt levels (leverage), the ratio of revenue growth rate (growth), and the size of the company (size). This study also employed GDP as a variable controlling the level of economic development. The ROA variable describing a company's profitability was calculated based on the profit after tax divided by total assets. The results showed that ROA was positively related to the level of corporate tax avoidance. It indicates that the higher the company's profitability, the company will tend to avoid taxes. The second control variable was leverage, calculated based on the company's total debt divided by total assets. This variable describes the level of corporate debt, but in this study, it is thought not to be related to the level of corporate tax avoidance. It may be because high debt levels are not something companies intentionally do to benefit from *deductible expenses*. The third variable was growth, determined based on this year's revenue minus the previous year's income, then divided by the previous year's income. This variable explains the growth rate of the company. However, this study was not shown to be related to the level of tax avoidance. It denotes that high company growth does not necessarily reflect the company's behavior in avoiding taxes. In addition, the natural logarithm of the total assets measures the size variable. This variable did not show a significant relationship to corporate tax avoidance, so the larger company did not guarantee that the company was likely to do tax avoidance because of the supervision from the public, so companies tended to be cautious. In this study, GDP also did not show a significant number. GDP was used to control the level of economic development and economic structure.

In hypothesis 2, the authors propose an association between the change in local government leadership (*political turnover*) on investments made by companies (*corporate investment*). In this study, it is expected that there is a negative relationship between *political turnover* and *corporate investment*.

Table 8 Model 2 Hypothesis Testing Results

Variable	Expectations	Coefficient	Probability	Conclusion
City_Ratio	-	-0, 014715	0.281	Hypothesis rejected
City_Listed	-	0, 0046094	0.554	Hypothesis rejected
ROA		-0, 1296999	0.633	
Leverage		0, 0171694	0.189	
Growth		0, 0387461	0.221	
Size		0, 0054532	0.871	
Cashflow		0, 0671152	0, 473	
GDP		-0, 0915258	0, 005**	
Constant		0, 0865663	0, 004	
N				830
R²				6,95%
Prob > F				0,0000
Command	Xtscc, fe			

Notes:

This result was tested using Driscoll & Kraay's Standard Error Fixed Effect. **Corpinvest** = Ratios to describe the company's investment decisions by dividing capital expenditure by total assets at the beginning fiscal quarter; **City_Ratio**= The average value of the occurrence of a change of regional heads in a given year; **City_Listed**= It is 1 if the area experiences a change of regent/mayor within a given year and 0 otherwise; **ROA**= Return on Asset by dividing earnings after tax by total asset; **Leverage**= Debt ratio by dividing total debt by total asset; **Growth**= Growth company ratio by dividing the difference between the current sales and the previous sales by current sales; **GDP**= Dividing the difference between the current GDP and the previous GDP by current GDP; **Cashflow**= Dividing total operational cashflow by total asset at the beginning fiscal quarter.

***α = 1%; **α = 5%; *α = 10%

Based on Table 8, hypothesis 2 proposed in this study was rejected. The P-values of City_Ratio and City_Listed were 0.281 and 0.554, indicating that City_Ratio & City_Listed had no significant relationship to the company's investment. In this case, the company's headquarters, factories, farms, mines, and branch offices are spread across different regions. The company needs closer political connections to help streamline its operations, namely political connections with local governments according to their respective operational operations locations. However, many operational areas across various parts of Indonesia may overwhelm companies and be ineffective and efficient if they rely on the local government for their political resources. Instead of relying on local governments, companies may prefer a central government that can protect and support the company's operations in different regions.

This study's finding is consistent with the results of Yu et al. (2022) that when provincial core officials normally change (change of regional heads as scheduled), the impact on investment and financing of local private companies is not visible in the long run. Nevertheless, when the official is investigated for alleged corruption (sudden turnover), the company's investment and financing decline significantly in the short and long term. In Indonesia, changes in regional heads are mostly scheduled (normal changes). It can make companies determine strategies in advance to overcome political uncertainty during the transition period so that it will not have a major impact on their investment during the change of regional heads.

Moreover, five control variables were used in Model 2, including company performance (ROE), debt level (leverage), growth rate (growth), company size based on sales (Size_Sales), and company cash flow (cash flow). However, based on the study, the five control variables did not significantly affect the company's investment. It may be because the company's performance, debt level, growth, cash flow, and size cannot necessarily influence its investment decisions. After all, at the time of the change of local government leader, the company tends to be cautious in taking company policies because there has been a support change, and there is a possibility of policy changes in the operational area.

Sensitivity Test

This test was carried out to ensure that the research results were robust. This research was conducted by issuing the year affected by COVID-19, 2020-2021. Based on Table 9, the results were found to be the same as the main tests carried out earlier. City_Listed and ROA had a significant relationship with corporate tax avoidance, and the significance tended to be higher. It denotes that regents/mayors have a greater impact on corporate tax avoidance decisions during normal years. However, during the transition period, companies will still be cautious in taking tax avoidance actions due to the political uncertainty that arises. Thus, companies tend to reduce tax avoidance actions at the time of the change of local government leaders.

Table 9 Model 1 Sensitivity Test Results

Variable	Expectations	Coefficient	Probability	Conclusion
City_Ratio	-	0, 0768131	0.236	
City_Listed	-	-0, 1206008	0,055*	Hypothesis accepted
ROA		0, 8996627	0,003**	
Leverage		0, 0457447	0,320	
Growth		0, 0481404	0,126	
Size		-0, 0085616	0,534	
GDP		0, 0231036	0,653	
Constant		-0, 7562434	0,387	
N				830
R^2				4,09%
Prob > F				0,0000
Command	Xtscc, fe			

Notes:
This result was tested using Driscoll & Kraay's Standard Error Fixed Effect. **Current_ETR**= Tax Avoidance Disclosure; **City_Ratio**= The average value of the occurrence of a change of regional heads in a given year; **City_Listed**= It is 1 if the area experiences a change of regent/mayor within a given year and 0 otherwise; **ROA**= Return on Asset by dividing earnings after tax by total asset; **Leverage**= Debt ratio by dividing total debt by total asset; **Growth**= Growth company ratio by dividing the difference between the current sales and the previous sales by current sales; **GDP**= Dividing the difference between the current GDP and the previous GDP by current GDP.
***α = 1%; **α = 5%; *α = 10%

Table 10 displays the result for Model 2. The results were quite different from the previous main tests. After excluding years affected by COVID-19, the authors found that City_Ratio, one of the proxies of political turnover, had a significant negative relationship with

corporate investment. It denotes that the change of local government leaders in operational areas other than the headquarters (factories, farms, mines, and branch offices) negatively affected the company's investment. It indicates that local governments are important in making company investment decisions during normal years. Since the company's factories, farms, mines, and branch offices are scattered in different regions, it needs closer political connections to help smooth its operations, namely political connections with local governments according to their respective operational locations. The company's investment, especially in factory construction, expanding land for agriculture, farms and mines, and others, are closely related to the political uncertainty in the operational area. In this case, local governments have the highest authority in deciding local policies. Thus, if the local government leader who had previously helped the company a lot in terms of operational convenience is replaced, there will be political uncertainty when the new local government leader changes. It will result in uncertainty about policy changes. Whether the new local government leader will side with the company or not will cause the company's prudent attitude in carrying out operations, one of them being investment decisions. Based on the results of the study, City_Listed proxies did not have a significant influence on the company's investment decisions. It may be because City_Listed describes the change of local government leaders at the company's headquarters. Meanwhile, most companies' operational areas are not in the capital's center but are spread across various regions in Indonesia.

Table 10 Model 2 Sensitivity Test Results

Variable	Expectations	Coefficient	Probability	Conclusion
City_Ratio	-	-0, 0103638	0.097*	Hypothesis partially accepted
City_Listed	+	0, 0122175	0.113	
ROA		-0, 0247774	0.326	
Leverage		0, 000957	0.819	
Growth		-0, 0393229	0.093*	
Size		0, 0078464	0.029**	
Cashflow		0, 0513201	0, 317	
GDP		-0, 108042	0, 000***	
Constant		1, 6879	0, 000	
N				830
R^2				7,29%
Prob > F				0,0000
Command	Xtscc, fe			

Notes:

This result was tested using Driscoll & Kraay's Standard Error Fixed Effect. **Corpinvest** = Ratios to describe the company's investment decisions by dividing capital expenditure by total assets at the beginning fiscal quarter; **City_Ratio**= The average value of the occurrence of a change of regional heads in a given year; **City_Listed**= It is 1 if the area experiences a change of regent/mayor within a given year and 0 otherwise; **ROA**= Return on Asset by dividing earnings after tax by total asset; **Leverage**= Debt ratio by dividing total debt by total asset; **Growth**= Growth company ratio by dividing the difference between the current sales and the previous sales by current sales; **GDP**= Dividing the difference between the current GDP and the previous GDP by current GDP; **Cashflow**= Dividing total operational cashflow by total asset at the beginning fiscal quarter.

***α = 1%; **α = 5%; *α = 10%

Furthermore, six control variables were used in Model 2, including company performance (ROA), debt level (leverage), growth rate (growth), company size by assets (size), company cash flow (cash flow), and economic growth (GDP). Nonetheless, when the years of economic weakness due to COVID-19 were excluded from the research sample, it was found that the variables growth, size, and GDP had a significant relationship with company investments that did not prove significant in previous tests. The growth and size of the company had a significant positive relationship with the company's investment level because better growth and size will encourage the company to increase and expand its investment. In addition, the GDP variable shows consistent results with previous major tests. GDP had a negative relationship with corporate investment because the better the country's economy, the more the central government will tend to feel satisfied and will not encourage companies to participate in increasing investment.

Conclusion

This study found that political turnover in the area where the company's headquarters was located was negatively associated with the company's tax avoidance decision. In Indonesia, the headquarters of a public company is mostly spread throughout the DKI Jakarta area. Considering that the relationship between the regent/mayor of DKI Jakarta is very close to the central government, companies with political connections with the regent/mayor of DKI Jakarta may also be connected to the central government. It allows the company to get important information from "insiders," thus helping it formulate certain policies. Moreover, companies will be more courageous in showing aggressive behavior because they feel they have politicians' support. Therefore, the change of local government leaders around the company's headquarters increases political uncertainty, and the company will be more careful in taking aggressive policies such as tax avoidance.

The results of this study also indicate that the change of local government leaders in firms' operational areas (factories, farms, mines, and branch offices) had a significant negative relationship with the level of corporate investment during the normal (non-pandemic) periods. As local officials usually have great influence and control over the development of the local economy, this study's results indicate that political turnover creates uncertainty regarding corporate resources, affecting firms' investment decisions.

This research has two implications. First, the results of this study show that the change of local government leaders in locations around the headquarters and other operational surrounding locations has a different impact on company policy decisions. Therefore, this study opens opportunities for subsequent research to learn in more detail about the types of corporate and government political connections in Indonesia (political connections at a higher level, such as the central government) that may have an impact on company policy decisions and other impacts that can result from these relationships and political turnovers. Second, the study gives different results on leadership change in different regions. Thus, it is hoped that the entire community and government will be more vigilant and critical in responding to the economic impact of leadership changes. Considering that this study's results prove the positive and negative impacts of the change of local

government leaders, the government is expected to carry out better monitoring and find solutions to overcome the negative impact on the economy caused by the leadership transition.

This research still has many limitations. With these limitations, it is expected that further research can overcome and correct the limitations in this research. As for the limitations realized in this study and the suggestions, subsequent research is recommended first to enrich the number of samples. Since this study used samples from various sectors, the main causes of the accepted hypothesis were not seen specifically. Subsequent research can use more specific sectors, for example, manufacturing companies, to more clearly know what operational locations are more affected by political turnover (factories, farms, mines, or branch offices). Second, the relationship between political turnover at the head office location has indeed been shown to be related to the reduction of corporate tax avoidance. However, the relationship between political turnover at the location of factories, farms, mines, or branch offices of companies with tax avoidance could not be proven. In addition, due to limitations regarding local tax data, this study used central tax as a measure of corporate tax avoidance. Meanwhile, for regions other than DKI Jakarta, it will be more relevant if researchers connect the change of local government leadership to using regional taxes. Hence, it is advisable for subsequent research to develop other proxies, such as local taxes, to measure the level of tax avoidance. Third, subsequent studies should use political connection variables to capture the political relationships on the board. Because a closer relationship with political connections at the central government level is possible, it will provide variations on the various types of political relations.

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