Political Connections, *Sharia* and M&A Performance: Evidence from Indonesia

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（Abstract）

Political connections play a significant role in creating value for firms. However, political connections are often translated as easier access to government and interpreted similar to bribery and corruption. In contrast, Islamic law prohibits bribery and corruption. Contributing to the literature about the interaction between political connections and *Sharia*, this study investigates the relationship between political connections, *Sharia* and M&A performance. We make use of M&A deals in Indonesia for the period 2010-2016. We find that while political connections can improve market reactions to M&A announcement, *Sharia's* impact on M&A performance is positive but insignificant. We find further that there is a substitution relationship between *Sharia* and political connections. *Sharia* firms with political connections have poorer M&A performance than non-*Sharia* with political connections.

Keywords: political connections, *Sharia*, M&A, Indonesia

Introduction

The literature about the collaboration among political connections and firms has been expanding rapidly (Brockman et al., 2013). Political connections play a significant role in creating value for firms (Fisman, 2001). On the other hand, political connections are like a double-edged sword. While political connections can provide various benefits for firms, especially related to smooth and wider access to the government, political connections are quite risky depending on the conditions of the supporting politicians. For example, Fisman (2001) finds that politically-connected firms lost their values significantly following a bad news about the health of former Indonesian president Suharto. Furthermore, Liu et al. (2016) show that some non-state-owned enterprise (SOE) managers in China have connections with corrupt bureaucrats and that these non-SOEs lost competitive advantage in the M&A market following the arrests of corrupt bureaucrats.

Political connections are potentially associated with bribery and corruption. As revealed by Faccio (2006), political connections generally exist in countries with higher level of corruption and a weak legal system. In contrast, Islamic law forbids firms to engage in bribery and corruption. *Sharia* firms have to carry out their business activities based on Islamic law or

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meet *halal*[1] criteria. This study empirically examines the impact of political connections both in short-term and long-term M&A performance and the role of *Sharia*. We select M&A following previous studies by Gao et al. (2019); Humphery-Jenner & Powell (2014); Liu & Zhang (2013); Liu et al. (2017); Liu et al. (2016); and Zhao et al. (2019). Indonesia is chosen for the purpose of this study. Indonesia is the largest Muslim-populated country and the number of *Sharia* firms in Indonesia has been rising (The Financial Services Authority (OJK), 2019). In addition, Indonesia is one of the most corrupt countries in the world. Based on the corruption perception index (CPI)[2], the corruption score of Indonesia in 2016, 2017 and 2018 were 37, 37, and 38, respectively[3]. As Imamah et al. (2019) point out, the legal system and shareholder protection in Indonesia are weak.

Several studies in the related literature focus on political connection and its impact on the stock market reaction to M&A announcement. Zhao et al. (2019) find that political connections can increase short-term returns after M&A in China. Liu & Zhang (2013), Liu et al. (2017), and Su et al. (2013) suggest that politically-connected non-SOEs in China have better performance. Humphery-Jenner & Powell (2014) examine political connections and M&A performance and show that in weak governance countries politically-connected firms have a higher post-M&A stock return. However, Humphery-Jenner & Powell (2014) focus on political connections at a cross-country level. That is, although their sample included Indonesia, there has been no empirical evidence about whether political connections can improve M&A market response specifically in Indonesia.

In the field of *Sharia*, prior studies show that *Sharia* can improve the value of firms. Saad (2009) shows that *Sharia* compliance can help firms to increase their performance as a result of good market response. Jaballah et al. (2018) find in Muslim countries, firms can get a positive stock market responses through *Sharia* shares due to religious beliefs. Imamah et al. (2019) argue that *Sharia* firms in Indonesia pay higher dividends than non-*Sharia* firms. Furthermore, Kamaludin & Zakaria (2019) show that investors of *Sharia*-compliant firms maintained long-term positive stock returns.

Against this background, to the best of our knowledge, this is the first study that examines the role of *Sharia* on the relationship between political connections on M&A performance. This study contributes to the literature about the relationship between political connections and M&A performance both in the short-term and long-term and fills a gap by introducing the role of *Sharia* in this relationship. Therefore, two research questions arise as follows: 1) Do political connections improve firms' M&A performance? 2) Does *Sharia* play a role in the relationship between political connections and M&A performance?

Specifically, this study makes the following contributions: First, it extends the literature on *Sharia* firms. Previous studies focus on the relationship between *Sharia* compliance and firms profit (Saad, 2009); dividend payout (Imamah et al., 2019); and stock returns (Jaballah et al., 2018; Kamaludin & Zakaria, 2019). Meanwhile, this study focuses on the impact of *Sharia* on

investment decisions, i.e., M&A deals both in the short-term and long-term. Second, this study extends the literature on the effect of political connections on M&A performance. Gao et al. (2019) examine the impact of political connections on M&A performance and use corporate governance as a moderating variable. Other studies, such as Humphery-Jenner & Powell (2014) and Zhao et al. (2019), use political connections as a moderating variable on the relationship between firm size and M&A performance. This study introduces the moderating effect of *Sharia* on the relationship between political connections and M&A performance.

The key empirical findings in this study are worth noting as follows. First, the results show that political connections improve M&A performance both in the short-term and the long-term as politically-connected firms have higher M&A market response compared to non-connected firms. Second, *Sharia*'s impact on both short-term and long-term M&A performance is statistically insignificant. Third, for *Sharia* firms, political connections reduce market reaction to M&A announcement whereas political connections improve the market reaction to the M&A announcement for non-*Sharia* firms. Put differently, there is a substitution relationship between *Sharia* and political connections in their impact on M&A performance.

2. Hypotheses

There are three hypotheses in this research as follows:

2.1. Political Connections and M&A Performance

Firms with political connections can get various benefits, including access to capital, favorable government policies (Chui et al., 2002), and various information related to government policies (Wati, 2017). Furthermore, politically-connected firms have higher corporate investment than non-connected firms (Phan, Tee, & Tran, 2019).

According to Brealey & Myers (1996), M&A is a basic principle of capital investment decision. With regards to M&A, there are several regulations and government agencies in Indonesia. These include government regulation No. 27/1998 about merger, consolidation, and acquisition of limited liability firms and government regulation No. 57/2010 about consolidation of business entities and takeover of firm shares which may result in monopolistic practices and unfair business competition. Indonesia also has government institutions related to M&A, such as the Financial Services Authority (OJK), which oversees the financial services industry in order to protect the interests of consumers and the public, and the Commission for Supervision of Business Competition (KPPU), which oversees business competition. Firms that carry out M&A must provide reports to KPPU in accordance with applicable regulations. Politically-connected firms may have an advantage in M&A because they can have greater access to the government as well as the regulations and bureaucracy.

Previous studies show that political connections could play an important role in fostering M&A performance. Zhao et al. (2019) show that political connections play an economically

significant role in short-term M&A performance. Related to other studies, e.g., Liu & Zhang (2013); Liu et al. (2017); and Su et al. (2013), suggest that political connections increase M&A market response for non-SOEs. The impact of political connections is related to the conditions of the respective countries' governance systems. Brockman et al. (2013) show that politically-connected firms in high-level corruption countries gain more abnormal returns than non-connected peers. Similarly, Humphery-Jenner & Powell (2014) also find that political connections in weak-governance countries bring more benefits to M&A performance than non-connected firms. Indonesia is regarded as a country with a high level of corruption. Although there has been no empirical evidence related to the role of political connections on M&A performance in Indonesia specifically, Fisman (2001) shows that political connections in Indonesia play an important role in determining stock price market response. We argue that political connections of Indonesian firms can enhance M&A market response. Thus, the first hypothesis of this study is as follows:

Hypothesis 1. Political connections increase the market response to M&A announcement.

2.2. Political Connections, *Sharia* and M&A Performance

Firms that issue *Sharia* shares not only have to carry out their business activities according to *Sharia* principles or meet *halal* criteria but also maximize shareholders' wealth (Safieddine, 2009). Imamah et al. (2019) suggest that in Indonesia, investors get higher dividend from *Sharia* firms. As well as in the short term, the issuance of *Sharia* shares also beneficial in the long term. For example, Kamaludin & Zakaria (2019) show that investors of *Sharia*-compliant firms get higher long-term positive stock returns. In addition to a good response from the market, it is also possible for *Sharia* firms to achieve higher performance. Saad (2009) find that *Sharia*-compliant firms have higher performance.

We expect, *Sharia* firms in a Muslim majority country such as Indonesia will have more benefits, as suggested by Jaballah et al. (2018), which find that issued *Sharia* shares in Muslim majority countries lead to gain higher abnormal returns. Due to religious belief, Indonesian investors may be going to react positively following the M&A announcement launched by *Sharia* firms. Thus, the second hypothesis of this study is as follows:

Hypothesis 2. *Sharia* increases M&A market response.

According to Faccio (2006), political connections are closely related to corruption. For example, Liu et al. (2016) show that non-SOEs in China establish political connections through bribery, then they gain access to M&A market and achieve higher abnormal returns. In contrast, Islamic law forbids firms to engage in bribery and corruption. As discussed above, *Sharia* firms have to implement Islamic law well. On one hand, *Sharia* firms may seek to avoid matters that are prohibited by Islamic law and that have the potential to lead to it. Therefore, *Sharia* firms might be more careful in establishing political connections. On the other hand,

compared with *Sharia* firms, non-*Sharia* firms may be tempted to establish political connections actively for the purpose of obtaining more benefits. Thus, the third hypothesis of this study is as follows:

Hypothesis 3. For *Sharia* firms, political connections can reduce the market response to M&A announcement, while for non-*Sharia* firms, political connections can increase the market response to M&A announcement.

3. Research Method

3.1. Data and Sample Construction

This research uses secondary data at the firm level. The list of firms conducting M&A is taken from KPPU. The date of M&A announcement data is taken from the firms' official websites (press release), annual reports, and online newspapers. Stock prices and composite stock index data come from Yahoo Finance, and political connections data are manually sorted from firms' annual reports. *Sharia* share data are obtained from the Indonesian Stock Exchange (IDX). Overall, the sample consists of 48 observations and includes a set of M&A deals during the period 2010-2016. The acquirer firms were selected on the basis of the following criteria:

1) The acquirer firms must be listed on the Indonesian Stock Exchange (IDX).
2) If the acquirer or the acquired firms are from the financial sector, they are excluded.
3) The firms that conducted M&A more than once and less than 3 months are excluded.
4) The firms with missing data are excluded.

3.2. Variables

In what follows, we describe the dependent variable, independent variables and control variables.

3.2.1. Dependent Variable

M&A performance is used as the dependent variable and it measures the value creation of the M&A deal from the acquirer's side. Both short-term and long-term performance of M&A is used in this research. Previous studies generally used cumulative abnormal return (CAR) to measure the short-term market responses around M&A announcements (Gao et al., 2019; Su et al., 2013; Zhao et al., 2019). We use an event study methodology to compute CAR for each firm. The abnormal returns are calculated as the differences between the actual returns and the expected returns. This research uses the estimation window 150 trading days before the event date [-180, -30] and an event window of 5 days (from -4 to +4), i.e., from four days before to four days after the event [-4, 4]. As a supplementary analysis, this research also measures long-term M&A performance using buy-and-hold abnormal return (BHAR) with the event window of 36 months after the M&A announcement.

3.2.2. Independent Variables

There are three independent variables as described below.

3.2.2.1. Political Connections

Our measurement of political connections follows previous studies. According to Faccio (2006); Fu et al. (2017); Habib et al. (2017); and Rusmin et al. (2012), a firm is considered as politically-connected if it is state-owned or the larger shareholders (ownership more than 10%) or the top management are a member or former of a) parliament, b) ministers or heads of state, c) or who have close relationship[4] with top officials. Data to identify political connections are manually sorted from the firm's annual reports.

3.2.2.2. *Sharia*

The measurement of *Sharia* variables in this study is based on Imamah et al (2019), which is simply stated as whether the firm issues *Sharia* shares or not. Data on the issuance of *Sharia* shares by each firm is obtained from several sources. First, it is taken from the Indonesia *Sharia* Stock Index (ISSI)[5] listed on IDX. Second, since ISSI was published on May 12, 2011, we also used data from the *Sharia* Securities List (DES)[6] and the Jakarta Islamic Index (JII)[7] for firms that announced M&A before that date.

3.2.2.3. Control Variables

This study uses five control variables that may have an impact on the M&A market response, namely, firm size, leverage, return on assets (ROA), risk, and growth. We use firm size because Zhao et al. (2019) find that the acquirer firm's size is negatively correlated with the short-term market response of the M&A announcement. According to Ma et al. (2012) and Maloney et al. (1993) M&A performance is influenced by leverage. Therefore, leverage is also used as one of the control variables. Firms with better performance have more ability to conduct M&A (Zhao et al., 2019). Hence, we control firms' ROA to determine the M&A market response. Following Gao et al. (2019), firms' risk is also used in this research, because risk gives a signal about stability or instability of firms. Finally, firms' growth is also used because firms with high potential growth can draw much response from the market (Gao et al., 2019). Data related to firm size, leverage, ROA, and growth are taken from the firms' financial reports or annual reports, whereas risk is estimated as the standard deviation of the daily stock returns.

The list of variables is displayed in Table 1.

Table 1. The list of variables

Variable	Measurement	Title
A. Independent variables		
Political connections	Political connections are a dummy variable, equal to 1 if political-ly-connected firm, and 0 otherwise.	PC
Sharia	*Sharia* is a dummy variable, equal to 1 if firm has *Sharia* shares, and 0 otherwise	SH
B. Dependent variable		
CAR	Cumulative abnormal return (short-term M&A performance) with estimation window [-180, -30] and event window [-4, 4]. Following Brown and Warner (1985) we use OLS market model to calculate abnormal returns: $A_{i,t} = R_{i,t} - \alpha_i - \beta_i R_{m,t}$ where $A_{i,t}$ is abnormal return for security i at day t, $R_{i,t}$ is the observed arithmetic return for security i at day t, α is intercept, β is slope, and $R_{m,t}$ is the return on the IHSG (Composite Stock Price Index) for day t. CAR is the sum of abnormal returns ($A_{i,t}$) between -4 and +4 such that $CAR = \sum_{t=-4}^{4} A_{i,t}$	CAR
C. Control variables		
Firm size	Natural logarithm of total assets	Fsize
Leverage	The sum of total short-term and total long-term debt divided by total assets	LV
ROA	Return on assets, measured as the ratio of net income divided by total assets	ROA
Risk	The daily stock return standard deviation [-60, -1] before the M&A announcement (Gao et al., 2019)	Risk
Growth	The growth rate of the firm's total assets over the last fiscal year	Growth

3.3. Econometric model

We use ordinary least square (OLS) regression analysis to examine the impact of political connections and *Sharia* on M&A performance. We use three econometric models in this research. First, to assess the relationship between political connections and M&A performance, we estimate the following model:

$$CAR = \alpha + \beta_1 PC + \beta_2 Fsize + \beta_3 LV + \beta_4 ROA + \beta_5 Risk + \beta_6 Growth + \varepsilon \tag{1}$$

Second, the econometric model for the impact of *Sharia* on M&A performance is as follows:

$$CAR = \alpha + \beta_1 SH + \beta_2 Fsize + \beta_3 LV + \beta_4 ROA + \beta_5 Risk + \beta_6 Growth + \varepsilon \tag{2}$$

Third, we analyze whether *Sharia* plays a role in the relationship between political connections and M&A performance using the econometric model below:

$$CAR = \alpha + \beta_1 PC + \beta_2 PC \ x \ SH + \beta_3 SH + \beta_4 Fsize + \beta_5 LV + \beta_6 ROA + \beta_7 Risk + \beta_8 Growth + \varepsilon \qquad (3)$$

At the outset, we conduct an analysis to check multicollinearity and heteroscedasticity. The result of the multicollinearity test shows that all variance inflation factors (VIF) are under 10; hence, we conclude that there is no multicollinearity. Furthermore, the Breusch-Pagan heteroscedasticity test result shows that the p-value is more than 5%, which means that the heteroscedasticity problem is not significant in this analysis.

4. Empirical Results

4.1. Descriptive statistics

Descriptive statistics are reported in Table 2. We divide the sample into four sub-samples, namely politically-connected, non-politically connected, *Sharia*, and non-*Sharia*. Subsequently, we conduct independent sample t-tests to check the mean differences between subsamples. The mean value of CAR for the whole sample is -0.005, indicating that the market reaction to the M&A announcement is negative on average. The t-test shows that only CAR for politically-connected firms and non-connected peers are significantly different. This result indicates that politically-connected firms have a higher market response to M&A announcement than non-connected counterparts.

Table 2. Descriptive statistics

Variable	Mean					Difference			
	All sample	Politically Connected	non-Politically Connected	Sharia	non-Sharia	t-test 1	df1	t-test 2	df2
CAR	-0.005	0.007	-0.036	-0.002	-0.015	-2.285**	17.3	-0.778	46
Firm Size	29.904	30.009	29.650	29.847	30.077	-1.317	46	0.794	46
Leverage	0.463	0.476	0.430	0.439	0.534	-0.770	46	1.530	46
ROA	8.535	9.124	7.106	9.471	5.728	-0.625	46	-1.115	46
Risk	0.024	0.023	0.027	0.025	0.022	1.392	46	-0.846	46
Growth	0.442	0.434	0.462	0.506	0.248	0.140	46	-1.255	46
Sample size	48	34	14	36	12				

Note: ** p< 5% (two-tailed). t-test 1 shows the difference between politically-connected firms and non-connected peers on CAR, firm size, leverage, ROA, risk, and growth. t-test 2 is for the difference between *Sharia* and non-*Sharia* firms. df1 is the degree of freedom of t-test 1, while df2 is the degree of freedom of t-test 2.

4.2. Multivariate analysis

The OLS regression results for the relationship between political connections, *Sharia* and M&A market response is exhibited in Table 3.

Table 3. The relationship between political connections, *Sharia* and M&A performance

Variables	(1) CAR [-4, 4]	(2) CAR [-4, 4]	(3) CAR [-4, 4]
Intercept	-0.2584	-0.3570	-0.2276
	(0.2743)	(0.2991)	(0.2555)
Political Connections	0.0478**		0.1235***
	(0.0156)		(0.0320)
Sharia		0.0183	0.0848**
		(0.0178)	(0.0291)
Political * *Sharia*			-0.0925*
			(0.0350)
Firm Size	0.0094	0.0135	0.0057
	(0.0095)	(0.0103)	(0.0089)
Leverage	-0.0992*	-0.0783	-0.0946*
	(0.0430)	(0.0476)	(0.0406)
ROA	-0.0018*	-0.0016	-0.0018*
	(0.0008)	(0.0008)	(0.0007)
Risk	0.0541	-0.5150	0.5339
	(0.6817)	(0.7310)	(0.6717)
Growth	-0.0073	-0.0069	-0.0100
	(0.0122)	(0.0134)	(0.0114)
Observations	48	48	48
R-Squared	0.307	0. 1690	0.4317
F-Statistics	3.0272	1.3900	3.7029
p-value	0.0152	0.2418	0.0027

Note: *** $p < 0.001$, ** $p < 0.01$, * $p < 0.05$, . < 0.1. The figures in brackets are standard errors.

4.2.1. The impact of political connections on M&A performance

Column 1 in Table 3 shows that political connections have a positive and statistically significant impact on M&A market response at the 1% level. This result indicates that politically-connected firms achieve higher CAR than non-connected peers. Political connections play an important role in creating value for firms through M&A. Firms can obtain many advantages through political connections (e.g., wider access to government, easily capital access), hence resulting in positive signal to M&A deals. Thus, hypothesis 1 is accepted.

4.2.2. The impact of Sharia on M&A performance

The OLS regression result of the impact of *Sharia* on M&A market responses is exhibited in column 2 in Table 3. The results show that the coefficient of *Sharia* is positive, but it is not statistically significant. Jaballah et al. (2018) suggest that investors in Muslim countries give positive responses to firms that issued *Sharia* shares. Therefore, we can expect *Sharia* to increase market response post-M&A. However, we do not find evidence *Sharia* firms have higher M&A performance than non-*Sharia* firms. Thus, hypothesis 2 is rejected.

4.2.3. The joint effect of Sharia and political connections

In this section, we examine the moderating impact of *Sharia* on the relationship between political connections and M&A market response. Column 3 in Table 3 displays the regression

results of the interaction between political connections and *Sharia* on M&A performance. The findings show that both political connections and *Sharia* have positive and statistically significant effect on M&A market response. However, the interaction effect (i.e., Political*Sharia) reveals a significantly negative effect. This finding indicates a substitution effect between political connections and *Sharia*. *Sharia* firms bear the burden of this political connections and cannot benefit from the connections. It may be that *Sharia* firms tend to be careful and passive in establishing political connections. *Sharia* firms have to comply with Islamic law, so they may be more careful in establishing political connections to reduce the risk of violating Islamic law. In contrast, non-*Sharia* firms have no obligation to comply with Islamic law, so they can actively make political connections and receive more benefits. In other words, politically-connected *Sharia* firms tend to get a low M&A market response, while politically-connected non-*Sharia* firms get higher market responses. Thus, hypothesis 3 is accepted.

4.3. Supplementary analysis

4.3.1. The long-term M&A performance

In this section, we analyze whether political connections and *Sharia* have an impact on long-term M&A performance. We employ buy-and-hold abnormal return (BHAR) to measure long-term M&A performance. The event window is 36 months after the M&A announcement. We use a formula to calculate BHAR based on Barber & Lyon (1997) and Gao et al. (2019) as follows:

$$BHAR_{i,t} = \prod_{t=0}^{t} (1 + R_{i,t}) - \prod_{t=0}^{t} (1 + R_{benchmark,t})$$

where $R_{i,t}$ is the realized return of security i on day t. Following Gao et al. (2019) we use market return (IHSG) on day t which we denote as $R_{benchmark}$. The mean market-adjusted buy-and-hold abnormal return is defined as:

$$\overline{BHAR} = \frac{1}{n} \sum_{t=0}^{t} BHAR_{i,t}$$

The regression analysis is repeated using BHAR as the dependent variable. There is heteroscedasticity in all regression models, and hence, we use robust standard errors in each model. The results of the impact of political connections and *Sharia* on long-term M&A performance are presented in Table 4.

Table 4. The impact of political connections and *Sharia* on long-term M&A performance

Variables	(1) BHAR (36)	(3) BHAR (36)	(4) BHAR (36)
Intercept	1.0455***	0.9910**	1.0851***
	(0.2696)	(0.3134)	(0.2794)
Political connections	0.0347*		0.0905**
	(0.0158)		(0.0295)
Sharia		-0.0101	0.0391.
		(0.0158)	(0.0228)
Political * Sharia			-0.0685*
			(0.0308)
Firm Size	0.0018	0.0012	-0.0045
	(0.0093)	(0.0111)	(0.0098)
Leverage	-0.0458	-0.0413	-0.0532
	(0.0549)	(0.0575)	(0.0531)
ROA	-0.0018*	-0.0016.	-0.0018*
	(0.0008)	(0.0009)	(0.0008)
Risk	0.8706	0.5657	1.3331.
	(0.6650)	(0.6509)	(0.7099)
Growth	0.0290	0.0314	0.0291
	(0.0201)	(0.0202)	(0.0202)
Observations	48	48	48
R-Squared	0.2698	0.1944	0.3297
F-Statistics	2.5252	1.6485	2.3980
p-value	0.0358	0.1585	0.0330

Note: *** $p < 0.001$, ** $p < 0.01$, * $p < 0.05$, . $p < 0.1$. The figures in brackets are heteroscedasticity-robust standard errors.

The results in Table 4 show that political connections play a significant role in long-term post-M&A performance. Politically-connected firms outperform non-connected firms in long-term M&A abnormal returns. This is mainly because politically-connected firms have more resources and capacity from their connections, which are important in the M&A integration process. Further findings show that *Sharia* has no significant impact on long-term M&A performance. However, there is a substitution effect between political connections and *Sharia* in long-term M&A abnormal returns. Similar to short-term performance, *Sharia* firms with political connections tend to make a passive connection. In addition, politically-connected non-*Sharia* firms make an active connection with the government and receive higher market responses.

4.3.2. Another alternative event window

Following Zhao et al. (2019), in order to check the sensitivity of the M&A market response, we use CAR with another alternative event window, that is, [-3, 3]. Table 5 presents the results.

Table 5. Results of analysis using event window [-3, 3]

Variables	(1) CAR [-3, 3]	(3) CAR [-3, 3]	(4) CAR [-3, 3]
Intercept	-0.3240	-0.3859	-0.2883
	(0.2725)	(0.2851)	(0.2620)
Political connections	0.0323*		0.1008**
	(0.0154)		(0.0328)
Sharia		0.0057	0.0658*
		(0.0170)	(0.0299)
Political * Sharia			-0.0839*
			(0.0359)
Firm Size	0.0117	0.0144	0.0083
	(0.0094)	(0.0098)	(0.0092)
Leverage	-0.0897*	-0.0786.	-0.0905*
	(0.0426)	(0.0454)	(0.0416)
ROA	-0.0015.	-0.0013.	-0.0015*
	(0.0008)	(0.0008)	(0.0007)
Risk	0.2478	-0.1064	0.7326
	(0.6771)	(0.6966)	(0.6889)
Growth	0.0078	0.0087	0.0064
	(0.0121)	(0.0128)	(0.0117)
Observations	48	48	48
R-Squared	0.1916	0.1077	0.2932
F-Statistics	1.6197	0.8244	2.0225
p-value	0.1663	0.5578	0.0691

Note: ** $p < 0.01$, * $p < 0.05$, . $p < 0.1$. The figures in brackets are standard errors. The p-value of the Breusch-Pagan test is more than 5%, implying there is no heteroscedasticity problem in all models.

The additional test results using proxy CAR [-3, 3] are very similar to CAR [-4, 4]. Political connections can increase M&A performance. The coefficient of *Sharia* is statistically insignificant. Furthermore, *Sharia* moderates the relationship between political connections and M&A performance and this interaction has a negative and significant coefficient. That is, *Sharia* mitigates the effect of political connections on M&A performance.

4.3.3. Adding and reducing variables

We conducted additional tests by adding and reducing variables to check for the stability of the main variables. The results reported in Table 6 show that the coefficients of the main variables remain stable even with reduction or addition of the control variables.

Table 6. Additional test by adding and reducing variable

Model 1	(1) CAR [-4, 4]	(3) CAR [-4, 4]	(3) CAR [-4, 4]	(4) CAR [-4, 4]	(5) CAR [-4, 4]	(6) CAR [-4, 4]
Intercept	-0.0356** (0.0130)	-0.0823 (0.2516)	-0.2259 (0.2657)	-0.3168 (0.2513)	-0.3158 (0.2551)	-0.2584 (0.2743)
Political connections	0.0429** (0.0155)	0.0424* (0.0160)	0.0432** (0.0157)	0.0474** (0.0148)	0.0473** (0.0154)	0.0478** (0.0156)
Firm Size		0.0016 (0.0085)	0.0073 (0.0092)	0.0114 (0.0087)	0.0114 (0.0088)	0.0094 (0.0095)
Leverage			-0.0623 (0.0412)	-0.1024* (0.0415)	-0.1022* (0.0424)	-0.0992* (0.0430)
ROA				-0.0019* (0.0007)	-0.0019* (0.0007)	-0.0018* (0.0008)
Risk					-0.0307 (0.6618)	0.0541 (0.6817)
Growth						-0.0073 (0.0122)
Observations	48	48	48	48	48	48
R-Squared	0.1429	0.1435	0.1858	0.3009	0.3009	0.307
F-Statistics	7.6677	3.7707	3.3460	4.6265	3.6157	3.0272
p-value	0.0081	0.0306	0.0275	0.0034	0.0083	0.0152

Model 2	(1) CAR [-4, 4]	(3) CAR [-4, 4]	(3) CAR [-4, 4]	(4) CAR [-4, 4]	(5) CAR [-4, 4]	(6) CAR [-4, 4]
Intercept	-0.0153 (0.0151)	-0.2184 (0.2691)	-0.3321 (0.2851)	-0.4288 (0.2769)	-0.4085 (0.2791)	-0.3570 (0.2991)
Sharia	0.0136 (0.0175)	0.0151 (0.0177)	0.0111 (0.0179)	0.0153 (0.0173)	0.0173 (0.0175)	0.0183 (0.0178)
Firm Size		0.0068 (0.0089)	0.0115 (0.0098)	0.0156 (0.0096)	0.0153 (0.0097)	0.0135 (0.0103)
Leverage			-0.0529 (0.0452)	-0.0872. (0.0461)	-0.0816. (0.0468)	-0.0783 (0.0476)
ROA				-0.0017* (0.0008)	-0.0017* (0.0008)	-0.0016. (0.0008)
Risk					-0.5835 (0.7121)	-0.5150 (0.7310)
Growth						-0.0069 (0.0134)
Observations	48	48	48	48	48	48
R-Squared	0.0130	0.0253	0.0548	0.1504	0.1638	0. 1690
F-Statistics	0.6045	0.5851	0.8498	1.9030	1.6450	1.3900
p-value	0.4408	0.5612	0.4742	0.1273	0.1693	0.2418

Model 3	(1) CAR [-4, 4]	(3) CAR [-4, 4]	(3) CAR [-4, 4]	(4) CAR [-4, 4]	(5) CAR [-4, 4]	(6) CAR [-4, 4]
Intercept	-0.0983*** (0.0267)	-0.0774 (0.2425)	-0.1962 (0.2545)	-0.2969 (0.2374)	-0.3038 (0.2393)	-0.2276 (0.2555)
Political connections	0.11060*** (0.0309)	0.1112** (0.0321)	0.1117** (0.0317)	0.1142*** (0.0293)	0.1220*** (0.0319)	0.1235*** (0.0320)
Sharia	0.0798* (0.0301)	0.0801* (0.0306)	0.0757* (0.0304)	0.0787** (0.0281)	0.0826** (0.0289)	0.0848** (0.0291)
Politic * *Sharia*	-0.0866* (0.0351)	-0.0871* (0.0360)	-0.0868* (0.0356)	-0.0844* (0.0328)	-0.0916* (0.0349)	-0.0925* (0.0350)
Firm Size		-0.0007 (0.0082)	0.0042 (0.0088)	0.0087 (0.0083)	0.0084 (0.0084)	0.0057 (0.0089)

Leverage				-0.0560	-0.0948*	-0.0991*	-0.0946*
				(0.0400)	(0.0393)	(0.0401)	(0.0406)
ROA					-0.0019**	-0.0020**	-0.0018*
					(0.0007)	(0.0007)	(0.0007)
Risk						0.4219	0.5339
						(0.6573)	(0.6717)
Growth							-0.0100
							(0.0114)
Observations	48	48	48	48	48	48
R-Squared	0.2627	0.2629	0.2957	0.4147	0.4206	0.4317
F-Statistics	5.2267	3.8335	3.5272	4.8408	4.1486	3.7029
p-value	0.0036	0.0094	0.0094	0.0008	0.0016	0.0027

Note: *** $p < 0.001$, ** $p < 0.01$, * $p < 0.05$, . $p < 0.1$. The figures in brackets are standard errors. The p-value of the Breusch-Pagan test is more than 5%, implying there is no heteroscedasticity problem in all models.

5. Conclusions

The purpose of this research is to examine the impact of political connections and *Sharia* on M&A performance. We investigate how political connections affect market response to M&A deal announcement and the role of *Sharia* in this relationship. Below, we summarize the main findings.

First, investors give more positive responses to politically-connected firms' M&A deal announcements. Firms with political connections have more resources (e.g., access to capital) and the ability to face government policies. Then, investors might expect politically-connected firms to obtain greater value from the M&A deal. In other words, political connections as a resource for firms bring more benefits through M&A deals.

Second, *Sharia* firms with political connections tend to get low M&A market responses, while politically-connected non-*Sharia* firms get higher market responses. It might be that *Sharia* firms tend to be passive and less flexible in establishing political connections. On one hand, politically-connected firms have politicians in the top management that allow them to have more extensive access to government. On the other hand, *Sharia* firms do not carry out their business activities or transactions contrary to Islamic law. It is possible for *Sharia* firms to be more careful in establishing political connections to reduce the risk of violating Islamic law, and they get lower market responses to M&A deals. In contrast, non-*Sharia* firms can actively make political connections and obtain more benefits.

Third, we also explore the possible role of political connections and *Sharia* on long-term performance post-M&A. Political connections also play a significant role in long-term M&A performance. Politically-connected firms have more resources and capacity from their connections, which are important in the M&A integration process in the long run. Furthermore, similar to the short-term impact, there is also a substitution effect between political connections and *Sharia* on long-term M&A performance. *Sharia* can reduce the positive relationship between

political connections and long-term M&A performance. The results indicate that *Sharia* firms remain consistently cautious in establishing political connections. Political connections of *Sharia* firms tend to be less flexible and do not benefit from their connections.

There are some limitations to this study and addressing them would contribute to future research. First, we measure *Sharia* based on the issuance of *Sharia* shares by firms, which reflects the level of compliance with *Sharia* law. However, we do not measure corporate governance and compliance with government regulations which may also affect M&A performance. Second, the period of analysis in this study covers years after 2010 because KPPU first published a list of firms conducting M&A in 2010. We also examine the long-term M&A performance and use 2016 as final year in our sample. Therefore, the period of analysis spans only seven years (2010-2016). Longer data may be needed for future research to examine the relationship between political connections, *Sharia* and M&A performance further. Third, our sample includes firms in Indonesia, but the results may differ in *Sharia* stock markets in other countries. It would be useful to extend this study to *Sharia* stock markets in other countries.

Note

[1] *Halal* means permissible by Islamic law. Muslims are not allowed to make investments that do not meet *halal* criteria. More specifically, Hayat & Hassan (2017) define the kinds of investments that are prohibited in Islam as investing in companies that sell alcohol, gambling, taking bribes, and paying or receiving interest.

[2] Retrieved from Transparency International (https://www.transparency.org/cpi2018).

[3] The score is from 0 (highly corrupt) to 100 (very clean).

[4] Relationship as relative, friend, or well-known associated with a political party (Faccio, 2006).

[5] ISSI is a composite index of *Sharia* shares listed on the IDX, which is a performance indicator of the Indonesian *Sharia* stock market.

[6] DES is a collection of *Sharia* Securities in the Capital Market launched by OJK.

[7] JII is the first *Sharia* stock index in the Indonesian capital market which consists of only the 30 most liquid *Sharia* stocks listed in the IDX.

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