MILITARY-CONNECTED BOARDS AND FINANCIAL DISTRESS RISK: THE MODERATING ROLE OF SUSTAINABILITY REPORT DISCLOSURE

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ABSTRACT

This study utilizes rent-seeking and legitimacy theories to investigate the impact of military-connected boards and sustainability report disclosure on financial distress risk. This study's main subject is the non-financial public firms indexed by the Global Reporting Initiative (GRI) and listed on the Indonesia Stock Exchange (BEI) between 2017 and 2022. The findings show a strong positive correlation between the likelihood of financial distress and boards with ties to the military. Conversely, a lower risk of financial distress is significantly associated with higher disclosure in sustainability reports. Additionally, sustainability report disclosure mitigates the adverse effects of military-connected boards on financial distress risk. This study enhances existing knowledge by providing empirical evidence on how military connections and sustainability disclosures influence financial distress risk in a developing country context.

Keywords: Financial Distress Risk; Legitimacy Theory; Military Connection; Rent Seeking Theory; Sustainability Report Disclosure

ABSTRAK

Studi ini menggunakan teori rent-seeking dan legitimasi untuk menyelidiki dampak dewan yang memiliki hubungan dengan militer dan pengungkapan laporan keberlanjutan terhadap risiko kesulitan keuangan. Subjek utama penelitian ini adalah perusahaan publik non-keuangan yang terindeks oleh Global Reporting Initiative (GRI) dan terdaftar di Bursa Efek Indonesia (BEI) antara tahun 2017 hingga 2022. Temuan menunjukkan adanya korelasi positif yang kuat antara kemungkinan terjadinya kesulitan keuangan dan dewan direksi terhubung militer. Sebaliknya, risiko kesulitan keuangan yang lebih rendah secara signifikan dikaitkan dengan pengungkapan yang lebih tinggi dalam laporan keberlanjutan. Selain itu, pengungkapan laporan keberlanjutan memitigasi dampak buruk dewan yang memiliki hubungan dengan militer terhadap risiko kesulitan keuangan. Studi ini meningkatkan pengetahuan yang ada dengan memberikan bukti empiris tentang bagaimana hubungan militer dan pengungkapan keberlanjutan mempengaruhi risiko kesulitan keuangan dalam konteks negara berkembang.

Kata Kunci : *Risiko Kesulitan Keuangan; Teori Legitimasi; Koneksi Militer; Teori Rent-Seeking; Pengungkapan Laporan Keberlanjutan*
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INTRODUCTION

Since the global financial crisis in 2008 that shook the global financial markets, along with a series of financial scandals involving leading companies such as Enron, WorldCom, Lehman Brothers, and American Investment Group, issues related to predicting corporate financial distress have been a primary concern among business stakeholders, including business owners, managers, creditors, and investors (Manzaneque et al., 2016). The global economic crisis triggered by the COVID-19 pandemic has exacerbated this situation, emphasizing the need for a thorough understanding and handling of financial distress risks (Guizani & Abdalkrim, 2023). Financial distress, which occurs when a company fails to meet its debt obligations when due (Farooq et al., 2024), can have detrimental effects on the company, such as damaging reputation, difficulty in obtaining new financing, and the risk of bankruptcy, leading to liquidation or corporate restructuring.

The importance of strategies to prevent financial distress risk underscores the significance of research related to factors that can influence the likelihood of corporate financial distress risk (Ali et al., 2023; Darrat et al., 2016; Farooq et al., 2024; García & Herrero, 2021; Guizani & Abdalkrim, 2023; Leng et al., 2021). Within this framework, rent-seeking theory provides insights into how the relationship between corporate boards and authorities can affect company outcomes, for example, in determining interest rates (Harymawan, 2018), auditor choice (Harymawan, 2020), leverage levels (Lin et al., 2021), etc., however, how the relationship between military-connected boards and financial distress risk within the framework of rent-seeking theory remains an open question.

Furthermore, Indonesia offers an exciting context for investigating the role of military-connected boards in the business world. As a country with a robust political history, military influence has played a significant role in political decision-making since its independence in 1945 (Harymawan, 2018). Even after the military reform in 2004, the military still retains its influence in Indonesian politics. The Indonesian government has regulated Military involvement in business, with regulations supporting and strengthening military participation in economic activities since 1957 (Harymawan, 2018). Indonesia has also been the subject of exciting research regarding the disclosure of sustainability reports. Regulations such as the Law of OJK Number 51/2017 have encouraged the trend of sustainability report disclosure in Indonesia (Theodorus & Rudyanto, 2022). However, there are still challenges in improving its quality and sustainability (Wanqi et al., 2020).

Although previous research has explored the relationship between Corporate Social Responsibility (CSR) and financial distress risk (Boubaker et al., 2020; Farooq et al., 2024; Tarighi et al., 2022; Theodorus & Rudyanto, 2022), studies on how sustainability report disclosure might moderate this relationship are still limited (Anam Ashiq, 2023; Hamad & Cek, 2023; Jiang et al., 2021; Lu et al., 2021). This study fills the knowledge vacuum by examining the effect of sustainability report disclosure on the association between boards with ties to the military and the likelihood of financial distress. The study focuses on publicly listed non-financial companies indexed by the Global Reporting Initiative (GRI) and listed on the Indonesia Stock Exchange (BEI) between 2017 and 2022. The hierarchical regression analysis is utilized to evaluate the hypotheses. Meanwhile, coarsened exact matching (CEM) and Heckman's two-stage regression address endogeneity concerns, such as self-selection bias.

METHOD

This study only examines companies listed on the IDX, excluding financial institutions (SIC 6), that have produced sustainability reports from 2017 to 2022. The ultimate sample consists of 418 observations. Table 1, Panel A, describes the sample selection process, whereas Panel B classifies the research sample according to industry sectors. The Manufacturing sector, which includes food, chemicals, and petroleum refining industries (SIC 2), is the largest group, accounting for 25.4% of the sample and highlighting its significant role. The mining and construction sector (SIC 1) is second with a 20.8% share. These findings underscore the substantial impact of these sectors in the Indonesian business environment. Conversely, the health, legal, educational services, and consulting sectors are less represented, likely due to their slower growth than other rapidly expanding industries in Indonesia (Rizki et al., 2024).

After data collection, various analytical techniques were employed, including descriptive statistics, correlation analysis, independent t-tests, hierarchical regression models, and robustness tests: Coarsened Exact Matching (CEM) and Heckman's two-stage regression.

Table 1. Sample Selection for Firm-Year Observations and Data Distribution

Description	Number of observations	
Panel A. Sample selection		
Total listed company from IDX for 2017 – 2022		5,286
(-) Number of firm years in financial industry (SIC 6)		(1,080)
(-) Number of firm-years without sustainability reports		(3,583)
(-) The company does not present related research variables		(205)
The final amounts of observations		418
Panel B. Industry breakdown		
SIC 0: Agriculture, forestry, and fishing	32	7.6%
SIC 1: Mining and construction	87	20.8%
SIC 2: Manufacturing of food, chemicals, and petroleum refining	106	25.4%
SIC 3: Manufacturing of stone, glass, electrical equipment	63	15.1%
SIC 4: Transportation, communication, and utilities	54	12.9%
SIC 5: Wholesale and retail trade	44	10.5%
SIC 7: Business, hotel, and recreation services	18	4.3%
SIC 8: Health, legal, educational services, and consulting	14	3.4%
Total sample	418	100%

Source: Results from researchers (2024)

The study's dependent variable is financial distress risk, assessed using Altman's Z-score. The study by Agarwal and Taffler (2008) used an international dataset to demonstrate that the Z-Score model outperforms market-based and hazard-based models in predicting bankruptcy. In a more recent longitudinal study, Altman et al. (2017) confirmed the reliability of the Z-Score as a bankruptcy risk predictor. In the research mentioned by Kuzey et al. (2023), the method used for measuring financial risk is Altman's Z-Score. Higher Z-Score values are indicative of less financial risk. The formula for calculating Altman's Z-Score is as follows:

Altman's Z – score (Altman, 1968) = 1.2 (working capital / total assets) + 1.4 (retained earnings / total assets) + 3.3 (earnings before interest and taxes / total assets) + 0.6 (market value of equity/book value of total liabilities) + 0.999 (net sales / total assets)………………………………………………………………………......(Equation 1)

In this study, the independent variable used is military-connected boards. As utilized in previous studies by Fitriani et al. (2022) and Harymawan et al. (2023), the military-connected boards are measured using a dummy variable. This study analyzes the composition of corporate boards to determine the presence of board members with military connections. Indonesia adopts a two-tier governance system, where the board of directors (BOD) is responsible for managerial functions while the board of commissioners (BOC) oversees (IFC, 2018). Within this particular framework, organizations that have at least one person with a military background on their board of directors or board of commissioners are assigned a value of 1, while 0 is assigned if not. Military connection is categorized from the education or experience of board members in the army, navy, air force, or police (Fisman, 2001 in Fitriani et al., 2022).

Furthermore, the moderation variable used is sustainability reporting disclosure (SRQ). Based on previous research by Nasih et al. (2022) and Agustia et al. (2022), sustainability reporting disclosure is measured using scoring based on the Global Reporting Index (GRI G4 Guidelines and GRI Standards). The GRI G4 Guidelines consist of 150 items that should be disclosed. Meanwhile, the GRI Standards consist of core and comprehensive options, where the core option involves varying numbers of items depending on the material topics the company selects. In contrast, the comprehensive option requires disclosure of 147 items. Each item disclosed by the company in the sustainability report is scored as one if disclosed and 0 if not. The total sustainability reporting score for the company is then calculated by summing the scores of each disclosed item, then divided by the total number of items supposed to be disclosed according to the GRI guidelines (Agustia et al., 2022; Nasih et al., 2022).

This research also adds control variables based on previous research (Boubaker et al., 2020; Isayas, 2021), including FSIZE, CURRENT, TANG, and DER. This research includes the constant factors Rizki et al. (2024) proposed to overcome data variations, namely industry-fixed and year-fixed effects.

Furthermore, the hierarchical regression model used in this study aligns with the approach employed in previous research (Oware & Mallikarjunappa, 2023; Xie et al., 2019). In this context, the variable "MCON_SRQ" can be considered a moderation variable if there is a significant interaction between this variable and the dependent variable, financial distress risk. Moderation variables can strengthen or weaken the relationship between other variables in a study (Baron & Kenny, 1986, cited in Oware & Mallikarjunappa, 2023). Therefore, this research aims to test whether the SRQ moderation variable strengthens or weakens financial distress risk with military-connected boards. The following regression equation illustrates this model:

ZSCOREi,t = α + β1 MCONi,t + β2 CURRENTi,t + β3 BTMi,t + β4 FSIZEi,t + β5 TANGi,t + β6 DERi,t + β7 Year FEi,t + β8 Industry FEi,t + ε ……..……..(Equation 2)

ZSCOREi,t = α + β1 MCONi,t + β2 SRQi,t + β3 CURRENTi,t + β4 BTMi,t + β5 FSIZEi,t + β6 TANGi,t + β7 DERi,t + β8 Year FEi,t + β9 Industry FEi,t + ε ....(Equation 3)

ZSCOREi,t = α + β1 MCON_SRQi,t + β2 MCONi,t + β3 SRQi,t + β4 CURRENTi,t + β5 BTMi,t + β6 FSIZEi,t + β7 TANGi,t + β8 DERi,t + β9 Year FEi,t + β10 Industry FEi,t + ε ....(Equation 4)

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RESULT AND DISCUSSION

Descriptive Statistics

Descriptive statistical analysis was used to calculate metrics like mean, standard deviation, median, minimum, and maximum values to summarize the data, and the findings are shown in Table 2. A financial distress risk score of -3.464 denotes the highest level of risk, whereas a score of 29,625 denotes the lowest risk. PT Bakrie Sumatera Plantations saw a notable rise in financial distress risk in 2022, as seen by its lowest ZSCORE compared to 2021. The COVID-19 pandemic's economic effects are to blame for this rise, as government limitations led to supply chain interruptions for palm oil. As a result, PT Bakrie Sumatera Plantations experienced a decline in productivity and revenue, leading to difficulties in covering its operational costs.

Table 2. Descriptive Statistics

	Mean	SD	Median	Minimum	Maximum
ZSCORE	4.209	4.714	2.627	-3.464	29.625
MCON	0.225	0.418	0.000	0.000	1.000
SRQ	0.462	0.223	0.429	0.078	0.929
CURRENT	2.270	2.182	1.638	0.125	13.309
FSIZE	30.008	1.492	30.024	26.545	33.455
TANG	0.571	0.208	0.568	0.151	0.938
DER	1.331	1.703	0.907	-2.177	10.753

Note(s): This table presents the descriptive statistics of the variables utilized in the research. The dataset includes all 418 firm-year observations listed on the IDX, which are accompanied by sustainability reports covering the years 2017 to 2022. This analysis uses data after winsorizing, adjusting all continuous variables to range between the 1st and 99th percentiles.
Source(s): Results from researchers (2024)

Conversely, PT Mitra Keluarga Karyasehat showed strong financial performance with the highest ZSCORE in 2020, indicating that the company had a low risk of financial distress. It was due to their involvement in the healthcare services sector, which was highly needed during COVID-19. The pandemic increased the demand for healthcare services, thereby maintaining PT Mitra Keluarga Karyasehat's revenue and financial stability.

MCON is a dummy variable. The average value of 0.225 indicates that 22.5% of the research sample are companies with military-connected boards. Furthermore, the average SRQ value of 0.462 indicates that companies disclose 46.2% of the items recommended by GRI in their sustainability reports. On the other hand, the maximum SRQ value of 0.929 suggests that PT Vale Indonesia discloses almost all of the items recommended by GRI in its sustainability report for 2022. The mining industry often significantly impacts the environment, so SRQ disclosure helps companies demonstrate their efforts to manage and mitigate these impacts. It will cause PT Vale Indonesia to experience an increasing trend in SRQ scores from 2019 to 2022.

Pearson Correlations

Table 3 shows the Pearson correlation test findings. The findings show a robust negative association between MCON and ZSCORE, suggesting that companies with military personnel on their boards are more likely to face financial distress. On the other hand, a significant positive association between SRQ and ZSCORE implies a decreased risk of financial distress when sustainability report disclosure levels are higher. However, multivariate analysis is needed to test the research hypotheses since

Pearson correlations fail to reflect the possible moderating influence of SRQ in the association between MCON and ZSCORE.

This study also found significant correlations between ZSCORE and all control variables. CURRENT correlates positively and significantly with ZSCORE, while FSIZE, TANG, and DER are negatively and significantly correlated with ZSCORE. It indicates that the study has identified several other factors related to financial distress risk that must be controlled through a multivariate analysis. In additional untabulated findings, this research discovers that all variance inflation factors are below 10, suggesting the absence of problems related to multicollinearity (Harymawan et al., 2023).

Table 3. Pearson Correlation

		[1]	[2]	[3]	[4]	[5]	[6]	[7]
[1]	ZSCORE	1.000						
[2]	MCON	-0.095*	1.000					
		(0.053)						
[3]	SRQ	0.124**	0.054	1.000				
		(0.011)	(0.272)					
[4]	CURRENT	0.408***	-0.117**	0.039	1.000			
		(0.000)	(0.017)	(0.428)				
[5]	FSIZE	-0.161***	0.285***	0.206***	-0.233***	1.000		
		(0.001)	(0.000)	(0.000)	(0.000)			
[6]	TANG	-0.262***	-0.020	0.044	-0.375***	0.225***	1.000	
		(0.000)	(0.689)	(0.366)	(0.000)	(0.000)		
[7]	DER	-0.285***	0.159***	-0.078	-0.330***	0.010	0.067	1.000
		(0.000)	(0.001)	(0.109)	(0.000)	(0.837)	(0.173)	

Note(s): The Pearson correlation coefficients for the study's variables are shown in this table. Four hundred eighteen firm-year observations from firms listed on the IDX with sustainability reports spanning from 2017 to 2022 are included in the collection. All continuous variables in the data have been winsorized to fall between the 1st and 99th percentiles. *, **, and *** denote significance levels of 10%, 5%, and 1%, respectively.
Source(s): Results from researchers (2024)

Independent T–Test

Table 4. Two-Sample Independent T–Test

	Mean			
	The firm with Military-Connected Boards	Firms without Military-Connected Boards	Coef	t-value
ZSCORE	3.381	4.449	-1.068*	-1.940
SRQ	0.485	0.456	0.029	1.099
CURRENT	1.798	2.407	-0.608**	-2.394
FSIZE	30.796	29.779	1.017***	6.066
TANG	0.564	0.573	-0.010	-0.401
DER	1.832	1.185	0.647***	3.277

Note(s): This table shows the results of an independent t-test using 418 firm-year observations. The sample is split into two subgroups using the MCON variable as the treatment variable. The analyzed data has been winsorized, adjusting all continuous variables to fall within the 1st to 99th percentiles. *, **, and *** denote significance levels of 10%, 5%, and 1%, respectively.
Source(s): Results from researchers (2024)

This study employs independent t-tests to investigate potential significant variations in financial distress risk and financial features between companies with military-connected boards and those without it. Based on the test findings shown in Table 4, significant variations have been detected in ZSCORE, CURRENT, FSIZE, and DER. In the case of ZSCORE, it is found that companies with military-connected boards have slightly higher average financial distress risk compared to companies without military-connected boards. Moreover, companies with military-connected boards have lower average liquidity levels, larger sizes, and higher debt levels than those without them. Fitriani et al.'s (2022) conclusions, which indicate that corporations with military connections on their boards typically have greater debt levels, are somewhat indirectly supported by our data.

Hierarchical Regression

MCON and ZSCORE have a negative and significant association, as shown in Model 1 of Table 5. With ZSCORE, MCON (β = -1.008**) has a significance level of 5% (**). According to test results in Model 1 of Table 5, Military-connected boards are positively and significantly correlated with financial distress risk. Consistent with rent-seeking theory, military-connected boards leverage political and/or military influence to garner support from financial institutions and governments, thereby gaining access to more favorable financing for the company. Research conducted by Harymawan (2018) found that military-affiliated companies enjoy lower interest rates than those without military connections. The study by L. Lin et al. (2021) found that executives and directors with military connections tend to underperform by taking higher leverage. This study concludes that despite the benefits of lower interest rates, there is a risk of increased corporate debt that can exacerbate financial distress risk if the company fails to generate sufficient cash flow to meet interest and/or principal debt payments. These results contradict those of Hao et al.'s research (2024), which indicated that businesses run by military leaders were less likely to experience financial distress during the COVID-19 crisis.

Furthermore, Model 2 of Table 5 indicates a significant positive relationship between SRQ and ZSCORE. Thus, SRQ (β = 2.675***) has a 1% (***) significance level with ZSCORE. It means that better disclosure of sustainability reports has a negative and significant relationship with financial distress risk. CSR represents a social contract that brings together companies and society, where companies consistently disclosing sustainability reports expect to receive greater recognition and support from the community as they are perceived to withstand social and economic changes better. It is consistent with legitimacy theory, which asserts that a company's legitimacy, reflected in broad stakeholder acceptance, is a critical factor in its sustainability (Tarighi et al., 2022). This legitimacy not only creates a positive perception of the company in the eyes of the public but can also enhance investor trust, which in turn can lead to increased investment and corporate economic growth (Magnanelli & Izzo, 2017).

In addition to its impact on external perceptions, commitment to CSR has significant internal implications for the company. Sun & Yu's research (2015) indicates that strong CSR practices can increase employee engagement, enhance job satisfaction, and boost productivity. Moreover, adopting CSR can strengthen the company's relationship with consumers because socially responsible behavior increases customer loyalty and trust (Martinez & Rodriguez del Bosque, 2013, cited in Theodorus & Rudyanto, 2022). However, it is essential to remember that stakeholders react to how the company treats them and how it interacts with others in its environment. Therefore, consistency in CSR commitment, even in the face of challenges and crises, can help companies maintain the support and trust of stakeholders crucial for their operational sustainability (Theodorus & Rudyanto, 2022). In this context, the higher the level of sustainability report disclosure by a company, the stronger the legitimacy and support from stakeholders it receives, such as gaining better access to financing, thereby reducing financial distress risk. These findings support the research by Boubaker et al. (2020), which found that companies with higher CSR disclosure tend to have lower financial distress risk.

Table 5. Hierarchical Regression: Military-Connected Boards, Sustainability Report Disclosure and Financial Distress Risks

	(1) ZSCORE	(2) ZSCORE	(3) ZSCORE
MCON_SRQ			-4.141**
			(-2.47)
MCON	-1.008**	-1.041**	0.999
	(-2.08)	(-2.13)	(1.11)
SRQ		2.675***	3.460***
		(2.83)	(3.15)
CURRENT	0.622***	0.609***	0.603***
	(4.91)	(4.83)	(4.74)
FSIZE	-0.070	-0.166	-0.198
	(-0.48)	(-1.11)	(-1.32)
TANG	-2.369**	-2.274**	-2.321**
	(-2.49)	(-2.37)	(-2.41)
DER	-0.452***	-0.431***	-0.462***
	(-4.47)	(-4.26)	(-4.45)
_cons	4.545	6.479	6.712
	(1.03)	(1.45)	(1.50)
Year FE	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes
R^2	0.297	0.311	0.316
R^2_Adjusted	0.267	0.280	0.284
N	418	418	418

Note(s): The findings of a hierarchical regression analysis using 418 firm-year observations are shown in this table. The data has been winsorized, adjusting all continuous variables to fall within the 1st to 99th percentiles. *, **, and *** denote significance levels of 10%, 5%, and 1%, respectively.
Source(s): Results from researchers (2024)

Lastly, the results align with the conditions for a moderating variable predictor (Baron & Kenny, 1986 in Oware & Mallikarjunappa, 2023). Model 3 of Table 5 shows that SRQ strengthens the relationship between MCON and ZSCORE (β = -4.141 at 5% (**) significance level). In other words, sustainability report disclosure strengthens the positive and significant correlation between military-connected boards and financial distress risk. It implies that companies led by military-connected boards with better sustainability report disclosure tend to have higher risk levels of financial distress. Given the results in Models 2 and 3, it can be concluded that SRQ is a type of quasi-moderator, referring to Sharma et al. (1981) in Bryan and Haryadi (2018).

Since the era of President Soekarno, the military has played an important role in Indonesian politics (Harymawan, 2018). In recent decades, political power in this country has shifted from a highly centralized system to a more decentralized one (Selin et al., 2023). In the past, the relationship between companies and the government often involved direct interactions, even reaching the level of the president and their family. However, now, such relationships tend to be indirect, with companies building connections with high-ranking government officials. Although political power has been decentralized, business-government relations remain intact, with companies often benefiting from the government, such as bureaucratic facilitation and tax cuts (Selin et al., 2023). In return, companies are expected to support government policies, including disclosing sustainability reports. The Indonesian government has long shown interest in CSR (Corporate Social Responsibility) issues, as evidenced by the enactment of Law Number 40 of 2007, which encourages public companies to disclose CSR practices voluntarily in their annual reports. Then, in 2017, the Financial Services Authority issued the Law of OJK Number 51/2017, which mandates that all public companies publish sustainability reports. This regulation was later updated with Circular Letter OJK 16/2021.

Government policies regarding sustainability reporting encourage companies with military connections to disclose more sustainability reports as a form of support to the government to gain political benefits in the future. However, this can impact the quality of information disclosed in sustainability reports, focusing more on information desired by the government. Consequently, information needed by other stakeholders, such as investors and the public, needs to be considered. It has the potential to decrease the company's legitimacy in the eyes of stakeholders, thereby affecting the company's image and increasing financial distress risk.

Robustness Analysis

Coarsened exact matching (CEM) and Heckman's two-stage regression are robustness studies used to confirm the findings and address possible endogeneity concerns. Selection bias can arise when the sample is not randomly selected and does not accurately represent the population (Rizki et al., 2024). The study uses CEM, a nonparametric method that balances treated and control groups by adjusting for confounding effects from pre-treatment control variables to address bias from observed variables. On the other hand, Heckman's two-stage regression is employed to resolve selection bias and endogeneity issues related to unobservable variables (Heckman, 1979 in Rizki et al., 2024).

Coarsened Exact Matching Regression (CEM)

The initial robustness checks are carried out using a matching sample approach. This approach can be implemented through propensity score matching (PSM) or coarsened exact matching (CEM). Following the methodology of Harymawan et al. (2022) and Rizki et al. (2024), this study opts for CEM over PSM, as CEM addresses some of PSM's limitations, such as matching multivariate distributions of covariates directly rather than relying on a single scalar. The CEM analysis matches variables across three strata.

Table 6 displays the outcomes of the CEM analysis. Four hundred-five firm-year observations were used in the analysis after the matching sample procedure was applied. The findings of the CEM regression displayed in Table 6 match the baseline regression. According to the study, in both matched and unmatched samples, boards with military ties are linked to a higher likelihood of financial distress. On the other hand, financial distress is linked to a lower likelihood of disclosure in sustainability reports. It also confirms that with CEM regression, sustainability report disclosure strengthens the relationship between boards with military connection and financial distress risk.

Table 6. Coarsened Exact Matching (CEM) Analysis

	0		1
All	324		94
Matched	314		91
Unmatched	10		3
	(1) ZSCORE	(2) ZSCORE	(3) ZSCORE
MCON_SRQ			-4.927***
			(-2.91)
MCON	-1.041**	-1.099**	1.352
	(-2.09)	(-2.17)	(1.46)
SRQ		3.039***	3.977***
		(3.12)	(3.54)
CURRENT	0.795***	0.800***	0.797***
	(5.94)	(6.15)	(6.11)
FSIZE	0.015	-0.089	-0.124
	(0.10)	(-0.59)	(-0.81)
TANG	-2.300**	-2.102**	-2.205**
	(-2.30)	(-2.07)	(-2.15)
DER	-0.394***	-0.360***	-0.392***
	(-2.84)	(-2.62)	(-2.83)
_cons	1.433	3.399	3.543
	(0.32)	(0.76)	(0.80)
Year FE	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes
R^2	0.308	0.326	0.334
R^2_Adjusted	0.278	0.295	0.301
N	405	405	405

Note(s): This table displays the findings of the CEM regression using 418 firm-year observations. The number of observations has been lowered to guarantee a fair comparison between the treatment and control groups by matching the data across all control variables using three-level strata. The data used for the analysis has been winsorized, which means that all continuous variables have been altered to fall between the 1st and 99th percentiles. *, **, and *** denote significance levels of 10%, 5%, and 1%, respectively.
Source(s): Results from researchers (2024)

Heckman Two-Stage Regression

Based on previous research examining the military connection of a company (Harymawan, 2020; Harymawan et al., 2022), this study argues that there may be unobserved variables that can affect both financial distress risk and military connection. Unobserved variables refer to variables not included in the primary regression model but may still be related to the dependent variable. Hiring board members with military experience can also be susceptible to self-selection bias, as companies can choose whether to recruit boards with military connections. The factor influencing financial distress risk might not be the presence of boards with military connections but rather an unobserved variable. To address this issue, the study employs Heckman's two-stage regression analysis to minimize the possibility of undesired relationships arising from the characteristics associated with boards with military connections rather than their presence.

Table 7. Heckman Two-Stage Regression

	First Stage		Second Stage	
	(1.1)	(2.1)	(2.2)	(2.3)
	MCON	ZSCORE	ZSCORE	ZSCORE
AVE_MCON	3.873***			
	(3.20)			
MCON_SRQ				-4.176**
				(-2.48)
MCON		-1.131**	-1.111**	0.944
		(-2.17)	(-2.14)	(1.05)
SRQ	0.233		2.443***	3.227***
	(0.65)		(2.64)	(3.04)
CURRENT	-0.047	0.684***	0.647***	0.642***
	(-0.88)	(4.72)	(4.49)	(4.43)
FSIZE	0.367***	-0.568	-0.452	-0.493
	(6.55)	(-1.48)	(-1.20)	(-1.31)
TANG	-0.975**	-1.140	-1.555	-1.581
	(-2.24)	(-0.93)	(-1.27)	(-1.29)
DER	0.141***	-0.625***	-0.535***	-0.570***
	(3.24)	(-3.76)	(-3.25)	(-3.43)
MILLS		-1.684	-0.997	-1.027
		(-1.28)	(-0.77)	(-0.80)
_cons	-12.640***	20.650*	15.842	16.363
	(-6.85)	(1.67)	(1.30)	(1.35)
Year FE	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes
R^2_Pseudo	0.241			
R^2		0.301	0.312	0.318
R^2_Adjusted		0.270	0.279	0.283
N	418	418	418	418

Note(s): This table shows the results of the Heckman two-stage regression. The test uses AVE_MCON as instrumental variables, posited to be connected solely to MCON and not to financial distress risk. The inverse Mill's ratio (MILLS) is included to capture the strength of the relationship between the instrumental variables. The analysis is conducted on data that has been winsorized, meaning that all continuous variables have been adjusted to lie within the 1st and 99th percentiles. *, **, and *** denote significance levels of 10%, 5%, and 1%, respectively.
Source(s): Results from researchers (2024)

This study employs the industry-year average value of boards with military connections as an instrumental variable in the first-stage regression (Fitriani et al., 2022; Harymawan, 2020; Harymawan et al., 2022). Some industries that intersect with various regulations (such as mining, import, export, etc.) may benefit from employing individuals with military connections to streamline their bureaucratic processes (Harymawan et al., 2022). Employing top managers with military experience is more likely if competitors in the same business use this method because it would provide them with a competitive edge. Only the military link is considered an indirect relationship between this characteristic and a company's financial crisis risk. Table 7 presents the results of the Heckman two-stage regression.

According to the Heckman two-stage regression analysis, in the first stage of the regression, AVE_MCON and MCON have a significant positive connection at the 1%

significance level (β = 3.873***). This finding suggests that, as expected, boards with ties to the military at rival businesses operating in the same sector encourage other companies to appoint veterans to senior management roles. The MILLS ratio was included in the study's second stage to assess the reliability of the primary analysis results. At the 5% significance level (β = -1.131**), it was discovered that there is a positive and significant relationship between boards with military ties and financial distress risk. At the 1% significance level (β = 2.443***), a negative and significant correlation exists between a company's financial distress risk and the disclosure of sustainability reports. At the 5% significance level, the findings of the Heckman regression's second stage further support the idea that the publication of sustainability reports increases the negative correlation between the likelihood of financial trouble and boards with ties to the military (β = -4.176**). Furthermore, the outcomes of every MILLS ratio from the second stage were negligible. As a result, this study's primary regression is reliable and devoid of unobservable bias.

CONCLUSION

This study examined the relationship between financial distress risk and boards of public companies with ties to the military and how disclosure of sustainability reports affects this relationship, taking advantage of Indonesia's particular setting. Indonesia was chosen as the research setting due to its extensive military involvement in business. The study produced three arguments on the relationship between financial distress and boards with military ties and how disclosure of sustainability reports influences this relationship. These arguments drew on theories of legitimacy and rent-seeking. The Hierarchical Regression test results indicate that military-connected boards are significantly and positively associated with financial distress risk. The advantage of low interest rates resulting from military connections encourages companies to use more debt, thus increasing financial distress risk.

Conversely, the research findings show that disclosure of sustainability reports is significantly and negatively related to financial distress risk. Based on legitimacy theory, CSR activities and disclosure serve as a means for companies to legitimize themselves. Corporate commitment to CSR helps maintain stakeholder support, reducing financial distress risk. Interestingly, the study found that sustainability report disclosure strengthens the positive relationship between military-connected boards and financial distress risk in companies with military-connected boards. It suggests that in military-connected companies, sustainability report disclosure is no longer genuinely done for societal legitimacy but instead used to maintain government relationships for future political benefits. As a result, information desired by other stakeholders, including investors and the public, may need to be accurately presented, reducing corporate legitimacy and increasing financial distress risk.

This study's findings contribute to academic literature and industry practice in several ways. Previous research has linked military-connected boards to various company outcomes, such as fraud, lawsuits, audit fees, tax avoidance, innovation intensity, CSR reporting, debt policy, and financial misconduct (Benmelech & Frydman, 2015; Fitriani et al., 2022; Harymawan et al., 2022, 2023; Koch-Bayram & Wernicke, 2018; Law & Mills, 2017; Simpson & Sariol, 2019). Although there has been some research, the relationship between boards with military connections, sustainability report disclosure, and financial distress risk has not been extensively studied. This study builds on previous research using rent-seeking theory and legitimacy theory to explore how military-connected boards impact financial distress risk and how sustainability report disclosure affects this relationship. Consequently, this study reveals the influence of military-connected boards on company outcomes, particularly concerning financial distress risk.

With the possible negative impact of such appointments on financial distress risk, these findings are helpful information for practitioners, investors, and top management considering assigning ex-military people to board or commissioner duties. Conversely, the study recommends that companies adopt sustainability report disclosure practices to help reduce financial distress risk.

However, it is crucial to consider the study's limitations when interpreting the findings. The research does not account for the proportion of management with military experience, which could influence their impact on company policies. Future research could include this aspect to provide a more comprehensive explanation. Additionally, the financial industry was excluded from the study sample due to the unique characteristics of their financial reports. Further research could complement this study by using samples from the financial sector. Lastly, this research uses continuous variables to measure financial distress risk, referring to the study by Boubaker et al. (2020). Further research could expand the measurement of financial distress risk by categorizing companies into healthy company, a grey area, and critically bankrupt categories and employing several proxies, such as the Ohlson and Zmijewski scores, to measure the probability of financial distress to validate the study's findings.

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