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Challenges in Investment Amid Political Activities in the Province of North Sumatera

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Abstract: The practice of democracy in the province of North Sumatera through political activities meaning via the executive and legislative elections process, both nationally and regionally, constitutes an importance due to the fact that it carries new sense of optimism for the community; with the hope that the new leader will have a breath of fresh for renewal, especially the economic factor. For this political agenda, there are many challenges in investment occurred because of the disturbance in the political stability in the province of North Sumatera that would prompt longer consideration for one to invest. The purpose of this study is to know the challenges in investment amid political activities in the province of North Sumatera. The research methods used primary data with the sample of 400 business enterprises – respondents which were taken from 33 different regencies/cities in the province of North Sumatera. The analysis technique used in this study is Structural Equation Modeling (SEM) analysis. The result of the study shows that challenges in investment often faced by investors amidst the practice of democracy in the form of political activities in the province of North Sumatera are manifested in the less supportive of investment climate. This is visible from numerous investors who sees political activities as cacophonous noises which change the status quo to less safe of an environment to invest their assets.

Keywords: challenges in investments, politics and investment.

I. INTRODUCTION

In efforts to provide more sustainable economic growth, the region needs to have supports from investment activities in the production and service sectors. Investment on private assets is perceived as increasingly important given the limited fiscal capacity of the government (Central, Provincial and District/City), thus complicating the aim of always being its main source of growth. Globalization amplified by increased flow of goods, capital and services between countries and inter-regions creates opportunities for local governments to increase investment activities to be the major source of economic development in the region. The

challenges that shall be overcome by the government is to provide a conducive investment climate by carrying out bureaucratic reforms, fixing license regulations, and eliminating various unnecessary structural obstacles.

Harms (2001) stated that political risks possess a significant effect on the development of foreign investment and portfolios in developing countries. Investors in performing their tasks have to go through many considerations before coming to decision (Sirojuzilam *et al.*, 2016). The factors in consideration include the region's political status quo and institutional leaders.

In recent years, a wide range of political activities have been carried out in the province of North Sumatra, such as the election of President and Vice President, the Governor Election, the Regent/Mayor election and also the legislative members of government election. These political activities bring forth new sense of optimism for the community with the hope that new political leaders will do the best to better the economic reforms. However, these kinds of political activities are also one of varied factors that come to play during the consideration process for investors to make an investment. It is sensible that investors would be concerned that their assets / investments will fluctuate during this election period.

These series of elections in Indonesia – as prominent part of the democratic process – not only brings the political impact for the nation, but also gives impact and influence for the economy. A Political Year can be interpreted as the transitional year of leadership of the executive and legislative bodies of government through elections which in turn affect all areas of life, including its economic growth. During these political years, a condition of uncertainty proves reluctance of investors putting their assets at risk. The recent change within the government may affect investors' confidence in deciding whether or not the region will provide a conducive and supportive investment climate with security guarantee. This is due to the fact that the turnover phase of the leader is considered to trigger conflict disputes within the community.

In investing, it is important to consider the political risks and its effects on the organization. This is worth considering because changes in political policies or political activities in a country can have a major effect on the country's financial and economic sectors. Political risks are generally closely related to the laws and regulations set with in said country; this is related to the bureaucracy process and the policies made by the government which would suggest whether a country is attractive to invest one's asset or not. Political risks are also related to socio-cultural and economic conflicts which might take shape of riots provoked by sensitive social conflicts – takes place on religious, race, and group-based issues – and income inequality that in the long run could put a nation's security at risk. In addition, political conflicts also play an important role when investors consider to make investments in certain region of the country because the policies and activities of political parties within that region can also trigger conflicts that jeopardize its security. Lastly, the most frequent cases in all regions is the abuse of power found in positions as decentralized as local government officials, and also bureaucracy that is no longer considered to represent a public interest but a personal interest. The main purpose of this research is to understand the challenges in investment amidst political activities in the Province of North Sumatra.

II. LITERARY REVIEW

According to Chen (2010), investment, gradually, can improve the economy of a certain region. The development of investment itself, in supporting economic growth is affected by various factors such as;

Economic perspective, Human Resources (HR), and the infrastructure development – which then invites greater investment flows. Nevertheless, the greater influencing factor is the political risk which can be measured by the scale of political wisdom, corruption, the economic freedom, property protection (Jiménez, 2011). Investors will avoid regions and countries with high risk of political conflicts (Aguilar, *et al*, 2016). Political risks in this sense include numerous aspects such as, state sovereignty, legal system, government policy, ideology, interest groups and political parties (Filipe and Moura, 2012). The corruption perception index also has a negative effect on investment (Jimenez *et al.*, 2011).

As a pre-imminent factor, political risk is defined as any event occurring in an area and a country that will negatively affect the success of an investment venture (Agarwal, 2007). Any event occurring in the host country will have a negative effect on the success of an investment venture, this political risk also affects the company's book value (Okizlerli and Ulku, 2012). During these political years, investors tend to be reluctant to invest because the status quo of the set regulations and/or leadership is more uncertain than ever. Haidar, 2012 also stated that foreign direct investment flows are affected by tensions between ethnic groups, internal conflicts, and democracy, but not so much compared to how they are affected by the stability of the government, the bureaucracy, external conflict, law and order, and the military in politics.

III. RESEARCH METHODS

The research methodology is the most important part when it comes to conducting a research. The research type was quantitative. Based on the characteristics of the problems being studied, this research can be classified into comparative causal research. According to Lutfie, *et al* (2016), Lubis, *et al* (2016, 2016), Muda, *et al* (2015, 2016), causal research is those aimed to test the hypothesis and the research to explain the phenomenon in the form of relationship between variables. The main objective of this study is to identify causal relationship among various variables. In addition, it was included as quantitative research (Muda *et al.*, 2017). Quantitative research emphasizes on the theoretical testing through the measurement of research variables using numbers and performing data analysis with statistical procedure (Tarmizi, *et al.*, 2016, 2017). This research pulls the focus on the challenges in investment during the year of political activities in the Province of North Sumatra. Therefore, it is essential to be explored in a more comprehensive manner in the context of regional development of the province of North Sumatra.

The research was conducted in the province of North Sumatra with the object of research business owners based in regencies/cities in the province of North Sumatra. This research utilized secondary data from publications issued by government institutions such as, BPS and Bappeda along with the primary data. The primary data was obtained by conducting field survey in accordance with the object of research, which is business owners in the province of North Sumatra. This study used 400 samples. The sampling method for this research is purposive sampling (intentional) due to the nature of the sample for this research being immeasurable. Meanwhile, the researcher used snowball sampling to be exact. The results of interviews with respondents will be tested using Structural Equation Modeling analysis techniques (SEM).

IV. RESULT AND DISCUSSION

Every entrepreneur or investor will consider the political state of a country including the certainty of the legal system and the regulations, socio-cultural circumstances, socioeconomic conditions, socio-political circumstances and the frequency of abuse of power. Politics (X1) is understood through 5 variables; laws

and regulations (X1.1), socio-cultural conflicts (X1.2), socio-economic conflicts (X1.3), socio-political conflicts (X1.4) and the abuse of power by local government officials (X1.5) in the province of North Sumatra.

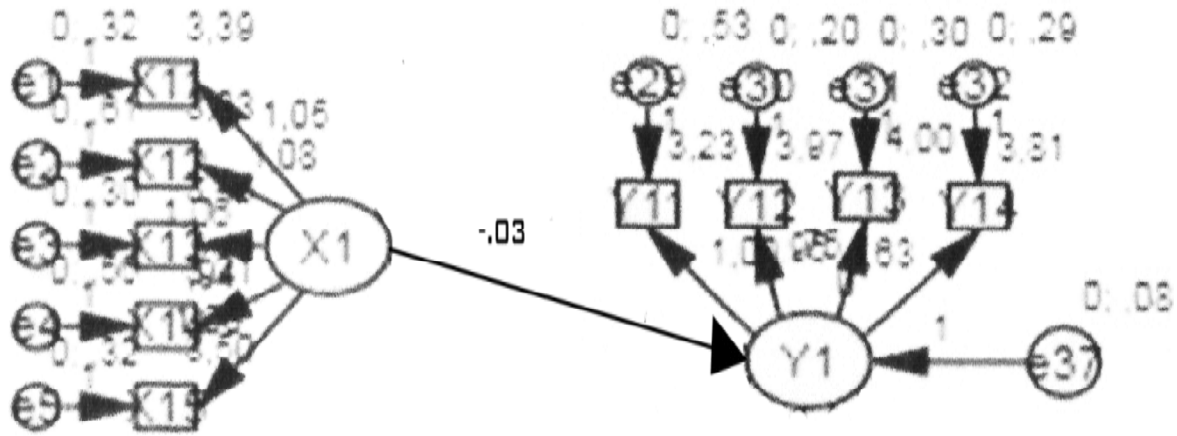


Figure 1: SEM Test Result

Based on the result of the estimation of the structural equation presented in Figure 1 above, hence, 2 equations can be derived as follows:

- Equation 1, toward Politics variable (X_1)

$$X_1 = 1,051 X_{1.1} + 1,082 X_{1.2} + 1,060 X_{1.3} + 0,945 X_{1.4} + 1,000 X_{1.5}$$

- Equation 2, toward investment variable (Y_1)

$$Y_1 = 0,131X_1$$

The result of SEM calculation presented above shows that the political situation (X_1) has a positive effect on investment (Y_1). This is proven by the positive mark on the coefficient of the path by 0.131 with the CR value of 5.872 and, therefore, a significant probability (P) of 0.000 is obtained. This value is relatively smaller than the specified significance level (α), which is 0.05. The value of direct influence of political risk (X_1) on investment (Y_1) is 0.131 which means that a conducive (stable) political risks will increase the actualization of investment in the province of North Sumatra by 0.131.

Table 1

SEM Test Result on Challenges in investment during political activities in the province of North Sumatra

No	Path	Coefficient Regression	Beta	C.R	P	Information
1	Politics (X1) → Legaland Regulations (X1.1)	1,051	0,049	21,321	***	Significant
2	Politics (X1) → Socio-cultural conflicts (X1.2)	1,082	0,059	18,290	***	Significant
3	Politics (X1) → Socio-economic conflicts (X1.3)	1,060	0,049	21,671	***	Significant
4	Politics (X1) → Socio-political conflicts (X1.4)	0,945	0,055	17,194	***	Significant
5	Politics (X1) → The abuse of power (X1.5)	1,000			***	Significant
6	Investment (Y1) ← Politics (X1)	0,131	0,036	5,872	***	Significant

Source: Output Amos (2017).

From the results of the research, one can see that investors' perceptions of challenges in investments during political activities in the province of North Sumatera is less positive. This is due to the fact that the government's commitment and consistency in enforcing legislation has been proven incongruous and idle, including in the certainty of the legal system and the regulations. They are considered unstable and inconsistent in protecting investors. In addition to law enforcement that is considered weak, the factor of socio-cultural conflicts also affect investors' perceptions who feel less secure in deciding to invest in the province of North Sumatera. These social conflicts – conflicts amongst ethnic, racial and religious groups often occur – not to mention conflicts due to economic inequality between Chinese and indigenous groups can disrupt operational activities of a certain company or investors.

In addition to inter-community conflicts that pushed investors to worrisome, mass organization that often use violence and weapons in their actions also potentially cause disturbances on the security and regulations. Labor movement that often went on a strike and took to the streets to protest is also very detrimental to the investors' decision, which resulted in reduced the productivity of company.

The negative responses from local governments in overcoming the problems exist in business based in the region, not to mention the cases of abuse of power by government officials can harm the business both in terms of time-sensitive issue and production issue. This often occurs during the licensing process that indicates the politicization of bureaucracy or government bureaucracy, meaning that a government body should put public's interest first, not biased, though prolonging and complicating the licensing.

The problem of nepotism among stakeholders is not something that investors avoid to consider. The stakeholders' interests should be infrared by assuming that bureaucracy is public's interest, and therefore, the country's priority is public's interest rather than a personal interest. This inconsistent bureaucratic service still has played role in the negative perceptions of investors toward business.

Busse and Hefeker (2007) concluded that governmental stability, internal and external conflicts, corruption, tensions between ethnic groups, law and order, the accountability of democratic government, and the quality of the bureaucratic system were significant determinant factors of foreign capital flows. Political or country risk is associated with the stability of the existing political situation in a country that will be a major determinant on the exchange rate of currency of said country with other countries. Political risk refers to the quality of the institutional environment. That is, political risk is one that the return on investment may be difficult as a result of low quality of institutions and a political instability (Hayakawa, *et. al.*, 2011).

The results of earlier researches indicate that the political situation plays a role in the consideration that affects an investor's decision. Lucas (1990) argued that political risk is an important factor in limiting capital flows. In order to start investing assets in a certain region, an important step one has to take is the issue of business licensing. This initial step becomes the determinant factor for investors to start investing. The problems that often faced in the licensing process is the existence of a discordance between the provisions set in its formal regulations with its actual implementation in the field; regarding the procedures to one has to go through, the timeliness of completion of licensing, and the amount of costs that must be incurred. To obtain this kind of permit, investors go through a long and costly process. The time wasted is caused by the lack of certainty of information from the government that should be stated earlier regarding the period of granting the license.

This research results are in line with research conducted by Aguiar, et. Al., (2016) which argued that investors consider a country with lower political risk to invest, but there are other factors that influence how the government policies in attracting investors to invest, e.g. licensing issuance.

The regulation in the province of North Sumatra is still considered non-enforcing. The weakness of this regulation covers almost all aspects. This regulation leads to legal uncertainty and illegal levies and corruption done by law enforcements, the government, and other interested parties. Laws and Regulations in the province of North Sumatra are considered unprofitable to investors, this is indicated by the results of the respondents who stated that 49.5% of investors were not satisfied with the existing laws and regulations prevailed in the Province of North Sumatra. Strong local leadership should be able to create a conducive investment climate. Heads of local governments can take initiative to create local policies that facilitate the investors that result in the actualization of the transparent and accountable local development policies.

Security is also one factor that needs to be considered in considering to invest one's asset. Investors tend to choose areas with low percentage of risk. The riots that occur due to social inequalities in the community will tend to trigger conflicts within the community, and therefore will disrupt the operations of a certain company or investor. Inequality of income that occurs in the community include:

- *Paramilitary*: Mass organizations that use violence and weapons can potentially cause disturbances in a country's security and order. The country should be able to settle all kinds of issues
- *Political party & Elections*: when it comes to conflict between political parties in the province of North Sumatra, it is still relatively low compared to other regions in Indonesia.
- *Labor movement*: The relationship between the labor and their employers must be improved.

In addition to problems related to illegal levies, there are also cases that the Youth Social Organization (OKP) is the actor. This is often experienced by plantation and property companies in a certain region. Therefore, the participation of local government and Satpol PP/ a security unit is needed to curb these illegal levies. Besides, there are also many illegal levies done by irresponsible individuals such as youth organizations living within the same area of an investment project site.

The security's instability caused by internal conflicts is considered important for investors as it may or may not ensure long-term sustainability of their investments. If the political situation of the regional at the time of elections is less conducive because of the demonstration that protests various issues that could potentially lead to a political crisis, then the security status will be a reasonable arguments for negative perception for market participants, both domestic and foreign investors. High-risk political situations will have a negative effect on investment. The rate of investment will decrease if political risk causes concern to the business owners.

V. CONCLUSION

The challenges in investment has a positive and significant effect toward investment in the province of North Sumatra. One can see this from the political situation measured by using 5 variables such as, state of law and regional regulations, socio-cultural, economic, and political conflicts and the abuse of power that occurs which in turn will be seen as less secure of a condition by investors. Thus, the number of actualization of investments will decrease, if political risk can guarantee a secure condition for investing, only then the realization of investment will increase.

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