

Do ownership structure and corporate governance mechanisms affect dividend payouts? Evidence from Indonesia

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Abstract

This research aims to show how ownership structure and corporate governance mechanisms influence the dividend policies of non-financial companies listed on the Kompas 100 index from 2015–2018. The independent variables are foreign ownership, insider ownership, board independence, board intensity, and board size; the dependent variables are dividend policy measured with dividend payout ratio (DPR), dividend yield (DY), and dividends to total assets (DTA). Six control variables were also considered: leverage, volatility (risk), asset tangibility, age, sales growth, and profitability based on annual data and reports from non-financial registered companies listed on the Kompas 100 Period Stocks Index from 2015–2018 (180 observations). Purposive sampling with balanced panel data was used. The model used in this research is a data panel with a fixed-effect model; random effect model approaches were also utilized. The results show that foreign ownership, insider ownership, board independence, board intensity, and board size do not significantly affect dividend policy, except board intensity significantly affects dividend payout ratio.

JEL classification: G30, G35

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1. Introduction

Dividends can be used as a managerial disciplinary tool to prevent acts of self-interest, such as opportunistic behavior (Al-Qahtani dan Ajina, 2017; Jiraporn, 2011), which may put minority shareholders at a disadvantage due to a lack of legal protection (Xu'nan, 2011). Dividend payments can be used to discipline poor company managerialism even though shareholders are not directly involved in managerial supervision (Kadioglu dan Yilmaz, 2017). Conversely, Lam *et al.* (2012) stated that cash dividend payments can increase tunneling activity, by which only the majority shareholder enjoys the benefits of dividend payments.

Agency conflicts occur when ownership is separated and when there are differences in control. Such conflicts result in differences in expectations and goals between managerial and shareholder ownership (Al-Qahtani dan Ajina, 2017). Dividends must be paid to reduce agency conflicts and the problems associated with them (Fairchild, 2010).

La Porta *et al.* (2000) put forth two hypotheses, namely the outcome hypothesis and the substitution hypothesis, that explain the relationship between agency conflicts and dividend payments. The outcome hypothesis states that companies in countries that provide legal protection for minority shareholders tend to pay higher dividends than companies in countries without such legal protection. According to the substitution hypothesis, dividends are substitutes related to the legal protection of shareholders and governance in some companies. If a company has good corporate governance, directors can reduce agency conflicts, meaning there is less of a need to pay high dividends to shareholders. Conversely, companies tend to pay high dividends to compensate for bad governance.

This study focuses on the relationships of ownership structure and corporate governance with dividend policy. Foreign ownership and insider ownership are used as variables of ownership structure. Meanwhile, board independence, board intensity, and board size are the variables used to represent corporate governance. Finally, there are six control variables: leverage, income volatility (risk), asset tangibility, age, sales growth, and profitability.

2. Literature and hypotheses

Foreign ownership is the share of ownership held by foreign investors in relation to the total shares of a company (Jayanti and Puspitasari, 2017). The lack of information received and foreign investors cannot directly monitor the condition of the company, making dividends a tool for disciplining opportunistic behavior (Ullah *et al.*, 2012). However, in Indonesia, Law no. 17 of 2000 dictates that there is a 20% tax rebate regulation on dividends distributed to foreign investors. This law has encouraged foreign ownership of the companies they invest in to retain profits so that they are not burdened by taxes. This is in line with the tax-preference theory, according to which companies are advised not to share their income because of differences in taxation between capital gains and dividends. In the Indonesian context, this theory prevents foreign shareholders from being taxed when receiving dividends due to the imposition of higher taxes on dividends for foreign investors. Thus, a negative relationship between foreign ownership and dividend policy is expected.

H1: Foreign ownership has a negative effect on dividend payouts.

Insider ownership refers to the percentage of shares of a company owned by its board of commissioners and directors (Afza and Mirza, 2010). Ullah *et al.* (2012) stated that managerial parties understand company information related to company growth opportunities and corporate governance very well. Agency conflicts due to information gaps between insiders and investors can be reduced and prevented by implementing signaling theory, by which shareholders are given signals about improving the company's future performance (Al-Kayed, 2017). For example, an increase in dividends signals the company's ability to increase its cash

flow (Thakur and Kannadhasan, 2018). Thus, insider ownership that implements signaling theory should be positively related to dividend policy.

H2: Insider ownership has a positive effect on dividend payouts.

Board independence is the percentage of external commissioners on a company's board of commissioners (Abdullah, 2016). Board independence protects the rights of minority shareholders from the expropriation of free cash flows by managerial parties (Shahid *et al.*, 2016; Setia-Atmaja, 2010). Agency conflict also decreases as opportunistic behavior is reduced. In line with the impact on dividend payments, the outcome model states that dividend payments can be used to indicate good corporate governance. According to the outcome model, board independence is positively related to dividend policy.

H3: Board independence has a positive effect on dividend payouts.

Board intensity is measured as the number of board meetings (Bokpin, 2011). Regular meetings by a board of commissioners are thought to reduce agency costs and provide transparency to company managers and shareholders (Greco, 2011). Therefore, the substitution model can explain the relationship between board intensity and dividend policy. Regular board of commissioners meetings improve corporate governance. Thus, board intensity and dividend policy are expected to have a positive relationship.

H4: Board intensity has a positive effect on dividend payouts.

Reducing the number of members on the board of commissioners is thought to enhance communication and coordination between members (Setayesh and Ebrahimi, 2012). Regarding board size, the substitution model can explain the relationship between board size and dividend policy. Specifically, the substitution model hypothesis supports the idea that a small board size fosters effective communication and information delivery to shareholders. Thus, agency costs can be avoided, and the company's obligation to pay high dividends can be reduced. Thus, board size is expected to have a negative relationship with dividend policy.

H5: Board size has a negative effect on dividend payouts.

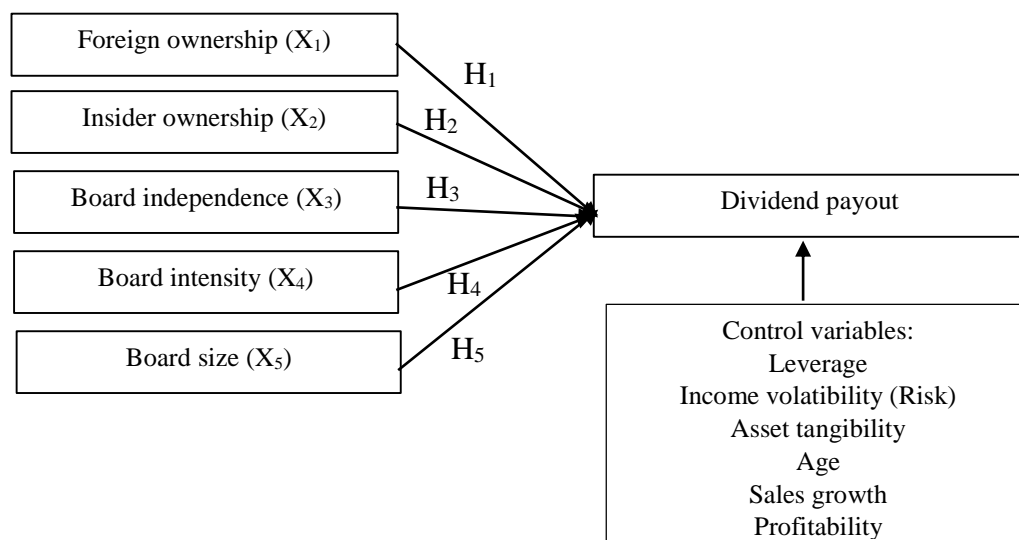


Figure 1. Research model

3. Methodology

The population of this study comprises non-financial companies listed on the Kompas 100 Stock Index from 2015–2018. The samples were determined based on the purposive sampling method, with the following criteria applied: (1) non-financial companies listed on the Kompas 100 Stock Index from 2015–2018, (2) non-financial companies that published annual financial reports in the IDR, and (3) non-financial companies that published annual financial reports consecutively from 2015–2018. A sample of 45 companies that fit these criteria was obtained, which translates to a total of 180 observations. Data were taken from the annual reports of each sample company from the official IDX website and the official website of each company. The collected data were processed in Eviews 10.

The dependent variable in this study is dividend policy, which is measured according to three proxies, namely dividend payout ratio (DPR), dividend yield (DY), and dividends to total assets (DTA). DPR is the ratio of dividends per share to earnings per share, DY is the ratio of dividends per share to market price per share, and DTA is the ratio of total dividends to total assets.

The independent variables considered in this study include foreign ownership (FO), insider ownership (IO), board independence (BOIND), board intensity (BOINT), and board size (BS). FO is proxied by a dummy variable (1 if one of the largest shareholders is foreign and 0 if the largest shareholders are not foreign). IO is the ratio of the number of managerial shares to the number of shares outstanding. BOIND is proxied by the number of independent commissioners and the total number of commissioners. BOINT is proxied by the natural log of the total number of board of commissioners meetings per year. BS is proxied by the natural log of the number of commissioners in the company.

The control variables in this study include leverage, income volatility (risk), asset tangibility, age, sales growth, and profitability. The proxy for leverage is the debt to equity ratio (DER). Income volatility (risk) is proxied by the natural log standard deviation of return on assets (ERVOL). Asset tangibility (TAN) is proxied by the relation between fixed assets and total assets. Age (AGE) is proxied by a natural log of the subtraction of years of research from the year the company was founded. Sales growth (GROWTH) is proxied by sales growth in the previous year. Profitability is proxied by return on assets (ROA).

4. Results and discussion

4.1. Descriptive statistics

DPR as a proxy for dividend policy has a minimum value of 0. The calculations for this variable revealed that several companies decided not to distribute dividends during the study period, such as PT Eagle High Plantations Tbk and PT Gajah Tunggal Tbk. The maximum value of 176.68% is owned by PT Indocement Tunggal Prakarsa Tbk, which, in the 2018 fiscal year, distributed dividends per share of Rp511 and earnings per share of Rp311.29. The standard deviation of 29.11% and the average of 36.49% indicate a small distribution of data, indicating that the data tend to be homogeneous.

The second proxy for dividends is DY, which also has a minimum value of 0. Due to the decision not to distribute for a certain period, this proxy cannot be calculated. The maximum value obtained (from PT Bukit Asam Tbk in 2017) was 12.95%, which indicates an increase in the distribution of dividends and the price of shares. The average of 2.02% and the standard deviation of 1.70% indicate that the data are spread tends to be homogeneous.

The last proxy of dividend policy, namely DTA, has a maximum value of 36.87%, which was reported by PT Unilever Indonesia Tbk in 2015. Again, the minimum value was 0 because there was no decision to distribute dividends during the year. The standard deviation of 6.33%, which is greater than the average of 3.69%, indicates that the distributed data is heterogeneous.

Table 1. Descriptive statistics

Variable	Mean	Maximum	Minimum	Std. Dev
DPR	0.3649	1.7668	0.0000	0.2910
DY	0.0201	0.1294	0.0000	0.0167
DTA	0.0368	0.3676	0.0000	0.0632
FO	0.6388	1.0000	0.0000	0.4816
IO	0.0038	0.0792	0.0000	0.0114
BOIND	0.4136	0.8333	0.2000	0.1108
BOINT	8.9833	31.0000	0.0000	5.8676
BS	5.6833	11.0000	2.0000	1.7796
DER	1.3636	13.5433	0.1534	1.6546
ERVOL	1773102	21113411	5324.902	3173116
TAN	0.5392	0.9305	0.0522	0.21077
AGE	40.677	112.0000	11.0000	18.5670
GROWTH	0.0895	0.9947	-0.2640	0.1710
ROA	0.0836	0.4666	-0.0572	0.0883

4.2. Multicollinearity test

As shown in Table 2, there is no correlation data exceeding 0.8. Therefore, it can be concluded that none of the variables have high multicollinearity.

Table 2. Correlation matrix

	FO	IO	BOIND	BOINT	BS	DER	ERVOL	TAN	AGE	GROWTH
FO	1	-	-	-	-	-	-	-	-	-
IO	-0.022	1	-	-	-	-	-	-	-	-
BOIND	-0.268	0.089*	1	-	-	-	-	-	-	-
BOINT	0.327	-0.209	-0.262	1	-	-	-	-	-	-
BS	0.274	-0.274	-0.178	0.234	1	-	-	-	-	-
DER	0.054*	0.149	0.131	-0.085	0.025**	1	-	-	-	-
ERVOL	0.198	-0.133	-0.105	0.349	0.199	-0.058	1	-	-	-
TAN	-0.173	-0.005	-0.020	-0.144	0.050**	0.209	-0.285	1	-	-
AGE	-0.034	-0.144	-0.091	0.292	0.318	-0.238	0.249	-0.265	1	-
GROWTH	0.104	-0.093	-0.134	0.360	-0.036	0.065*	0.242	-0.129	0.097*	1
ROA	-0.019	-0.040	0.261	-0.096	-0.001	-0.131	-0.030	-0.132	0.122	-0.014

Significance is indicated at the 10% (*) and 5% (**) levels.

4.3. Hypothesis tests

For the DPR proxy FO, the probability is greater than 10% ($0.1578 > 0.1$), which indicates that high or low FO has no significant effect on DPR. This result supports the research of Khalfan and Wendt (2020) in Norway, as well as that of Jayanti and Puspitasari (2017) and Al-Najjar and Kilincarslan (2016). It also supports the tax-preference theory, which states that foreign ownership encourages companies to retain profits rather than pay taxes on dividends distributed. Due to the establishment of a higher tax rate for foreign investors in Indonesia (which is 20% as stated in Law no. 17 of 2000), foreign investors tend to prefer for companies to hold their profits or pay dividends in small amounts, as this reduces investors' tax burdens when receiving dividends. However, these results are not in line with those reported by Jeon *et al.* (2011) and Ullah *et al.* (2012), who found that foreign investors tend to choose to receive dividends (dividend clienteles) and monitor incentives to prevent opportunistic behavior.

The results of the IO effect test show that the probability is greater than 10% ($0.5401 > 0.1$), meaning that high or low IO does not significantly affect DPR. These results are in line with the research of Aristanto and Prasetyono (2015), who found that the board of commissioners and directors, as company managerial parties, understand the condition of the

company and can project the need for funds for company development or reinvestment in the coming period. Therefore, the company needs internal funds in the form of retained earnings to finance operational needs in the next period. Thus, the amount of dividends distributed to shareholders is reduced to support the company's operational needs, even if the company has decided not to distribute dividends for a certain period.

Table 3. Regression results

Y	DPR	DY	DTA
Model approach	Model A FEM	Model B REM	Model C FEM
FO	(1.4213) 0.1578	(0.7590) 0.4489	(-0.9949) 0.3217
IO	(0.6143) 0.5401	(1.1289) 0.2606	(0.9065) 0.3665
BOIND	(-1.5796) 0.1168	(-0.9298) 0.3538	(0.7573) 0.4503
BOINT	(-2.6721) 0.0086***	(0.3702) 0.7117	(-0.8725) 0.3847
BS	(0.2895) 0.7727	(0.5597) 0.5765	(0.3441) 0.7313
DER	(-0.3283) 0.7433	(-1.2095) 0.2282	(-0.5449) 0.5868
ERVOL	(-0.5715) 0.5687	(1.0113) 0.3134	(-0.9921) 0.3231
TAN	(-0.4421) 0.6592	(-0.8861) 0.3768	(-1.6902) 0.0936*
AGE	(2.3100) 0.0226*	(-0.3876) 0.6988	(0.6803) 0.4976
GROWTH	(1.3625) 0.1756	(1.4816) 0.1404	(0.3382) 0.7357
ROA	(-3.0954) 0.0024***	(4.3080) 0.0000***	(5.1582) 0.0000***
Adjusted R ²	0.6758	0.1027	0.9388
Observation	180	180	180

Significance is indicated at the 10% (*) and 1% (***) levels.

Regarding BOIND, the probability is greater than 10% ($0.1168 > 0.1$), indicating that high or low BOIND does not significantly affect DPR. These results are in line with the findings of Elmagrhi *et al.* (2017), Mehdi *et al.* (2017), Sanan (2019), and Sener and Selcuk (2019). Because there are fewer independent commissioners than the total members of the board of commissioners (Bangun *et al.*, 2018), the voting rights of the independent commissioners do not significantly affect the company's dividend policy. The number of independent commissioners tends to reduce dividend payments (Mehdi *et al.*, 2017; Sener and Selcuk, 2019) because independent commissioners also improve corporate governance. Thus, the better the corporate governance, the less the company is obliged to pay high dividends (Elmagrhi *et al.*, 2017; Sanan, 2019).

The results of BOINT's effect on DPR show a probability of less than 1% ($0.0086 < 0.01$), indicating that BOINT affects DPR. This is in line with the results of Mehdi *et al.* (2017), who stated that regular and active board of commissioners' meetings can help managers and shareholders align their interests. Concerning shareholders, the priority interest is the payment of dividends.

BS indicates a probability greater than 10% ($0.7727 > 0.1$). Thus, high or low BS does not affect the DPR. This is in line with the research of Abor and Fiador (2013) in South Africa. It is also in line with the substitution model, which states that the members of the board of commissioners are effective in communicating and reducing agency conflicts, which reduces

the company's obligation to pay high dividends. However, this result contradicts the results of research by Bokpin (2011), who reported a positive relationship between BS and dividend policy.

For the DY proxy, FO has a probability greater than 10% ($0.4489 > 0.1$), which shows that FO does not affect DY. As in the discussion on DPR, this result is in line with the tax preference theory, which states that the high tax on dividends charged to foreign investors makes investors choose not to distribute dividends.

IO has a probability of 0.2606, which is greater than 10% ($0.2606 > 0.1$). This indicates that IO does not significantly affect DY. The absence of this influence can occur when the board of commissioners and directors understand the condition of the company and can project the need for funds for company development or reinvestment in the coming period.

BOIND has a probability of 0.3538, which is greater than 10% ($0.3538 > 0.1$). From these significant results, it can be seen that the size of BOIND does not affect DY. These results are in line with the findings of Elmagrhi *et al.* (2017), Mehdi *et al.* (2017), Sanan (2019), and Sener and Selcuk (2019). This result is likely because independent commissioners also improve corporate governance. Thus, the better the corporate governance, the less the company is obliged to pay high dividends (Elmagrhi *et al.*, 2017; Sanan, 2019).

BOINT has a probability greater than 10% ($0.7117 > 0.1$). From these results, it can be seen that high or low BOINT does not affect DY. This is in line with the results presented by Benjamin and Zain (2017) and Elmagrhi *et al.* (2017). The influence of BOINT on DY might be absent because regular meetings aid the monitoring of company performance and the establishment of good relationships with shareholders; thus, the company views dividends as a substitute (Benjamin dan Zain, 2017; Elmagrhi *et al.*, 2017).

BS has a high probability of 0.5765, which is greater than 10% ($0.6765 > 0.1$). This result indicates that BS does not affect DY. This result is in line with the findings of Ntim *et al.* (2014), who found that having a large number of board members helps a company control opportunistic behavior and reduce agency conflicts. Thus, the company's need to increase dividends is reduced.

For the DTA proxy, FO has a probability greater than 10% ($0.3217 > 0.1$). From these results, it can be seen that high or low FO does not significantly affect DTA. This shows that foreign investors prefer companies to hold their profits instead of distributing them in the form of dividends (in which case they have to pay taxes on the dividends received). Thus, the results of this study are in line with the tax preference theory, which states there is a higher tax rate for foreign investors in Indonesia, namely 20%, as stated in Law no. 17 of 2000.

IO has a probability greater than 10% ($0.3665 > 0.1$). This shows that insider ownership does not affect DTA. High managerial ownership helps managerial parties understand the company's condition and project its operational needs so that they decide to increase retained earnings (Aristanto and Prasetyono, 2015). Thus, the amount of dividends distributed to shareholders is reduced (or dividends are not distributed at all) in a certain period.

BOIND has a probability of 0.4503, which is greater than 10% ($0.4503 > 0.1$), meaning that board independence does not affect DTA. These results are in line with the findings of Elmagrhi *et al.* (2017), Mehdi *et al.* (2017), Sanan (2019), and Sener and Selcuk (2019). The absence of an effect might be because an independent board of commissioners improves corporate governance. Thus, the better the corporate governance, the less the company is obliged to pay high dividends (Elmagrhi *et al.*, 2017; Sanan, 2019). This is because improved corporate governance enables a company to reduce agency conflicts, even though dividend payments are not high.

BOINT has a probability of 0.3847, which is greater than 10% ($0.3847 > 0.1$), indicating that the BOINT does not affect DTA. This is in line with the research results presented by Benjamin and Zain (2017) and Elmagrhi *et al.* (2017). The absence of an influence of BOINT

on DY might be because regular meetings promote effective monitoring of company performance and the establishment of good relationships with shareholders. As such, companies view dividends as a substitute (Benjamin and Zain, 2017; Elmagrhi *et al.*, 2017).

BS has a probability greater than 10% ($0.7313 > 0.1$). Thus, BS does not affect DTA. This result indicates that the number of commissioners is large and effective in preventing opportunistic behavior and reducing agency conflicts. Thus, companies view dividends as a substitute or a form of compensation for bad corporate governance.

5. Conclusion

The purpose of this study was to determine the effect of several independent variables, namely foreign ownership, insider ownership, board independence, board intensity, and board size, on dividend payout among 45 non-financial companies listed in the Kompas 100 Stock Index from 2015–2018 (a total of 180 observations). From the results, it can be concluded that ownership structure and corporate governance mechanisms do not affect the dividend policy. In the future, research should be carried out to examine how the recent COVID-19 pandemic has strengthened or weakened the economy and business (specifically considering its effect on dividend policy). Future research should also involve other independent variables that were not addressed in the present work, such as board tenure and board diversity.

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