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Corporate governance and dividend payout ratio in non-financial firms listed in Indonesian Stock Exchange

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Abstract: Dividend payout policy has proved to be a complicated issue in the financial management literature that leads to the issuance of different arguments and theories explaining the facts about dividend ratio. The prime objective of the current study is to explore the impact of corporate governance on dividend payout ratio. In order to investigate the linkage between corporate governance and dividend payout ratio, data of four fiscal years (2013-2016) was extracted from annual reports of Indonesian publicly listed companies. The study examines the impact of ownership structure and corporate governance mechanisms on dividend payout ratio using panel data regression model. The findings of the study indicate that board independence, board size, institutional ownership, size and earnings before interest and tax are positive; whereas the CEO duality, managerial ownership, ownership concentration and leverage are in negative relation with dividend payout ratio.

JEL Classifications: G30, G32

Keywords: Corporate governance, dividend payout ratio, Indonesia, non-financial firm

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1. Introduction

The dividend payout ratio has been the subject of debate since long ago. A dividend is defined as the amount that is paid to shareholders from profit after tax. There are several factors that affect dividend decisions of a firm (Agyei & Marfo-Yiadom, 2011; Abobakr, 2017; Har & Visvanathan, 2018). Researchers have used different statistical techniques to predict the factors which affect the dividend decisions in a firm. However, the impact of dividends on shareholders wealth, stock valuation, as well as on the future expectations of shareholders for cash flow from dividend payout ratio, still remains a controversial issue among financial management scholars (Kania & Bacon, 2005; Handa, 2018).

Corporate governance has emerged as a significant determinant of dividend payout ratio. The decision with regard to dividend payout policy is often made by companies' management and can be influenced by its board of directors (Abdullah, Ahmad, & Roslan, 2012; Ajanthan & Kumara, 2017). The board of directors has fiduciary powers to make decisions with regard to how to finance the company operations and expansion, how to make an investment for the company, and distribute dividends to shareholders. However, the agency problems that may exist among managers and shareholders as a result of conflicting of interests in a company; up to some extent they can probably be solved by distributing the available funds in the form of dividend. Accordingly, the conflict of interest may occur because shareholders seek to get dividend while managers prefer to

retain earnings for the purpose of sustaining higher control over company resources (Jensen, 1986).

Corporate governance is also used as a mechanism for mitigating agency cost, though it can also influence the firms' dividend payout. Corporate governance is also regarded as the pool of processes, guidelines and regulations; it directs and controls both individuals and organizations to achieve the ultimate goal of improving organizational performance. Besides, it strives to minimize the agency cost of protecting the right of shareholders and those that are affected by the firms' dividend ratio (Afzal & Sehrish, 2011; Li-Hui & Ching-Chun, 2017). The bodies that are responsible for the good conduct of corporate governance practices are management, board of directors, and shareholders (Bebczuk, 2005; Kowalewski et al., 2007). Thus, the main reason that necessitates for the need of corporate governance is to restore investors' confidence with regard to the business activities through transparency, accountability, and responsibility of the managers due to the agency relationship (Mansourinia, Emamgholipour, Rekabdarkolaei, & Hozoori, 2013; Azam, Haseeb, & Samsudin, 2016; Huynh & Cong, 2017).

Therefore, examining the relationship between dividend payout ratio and agency problems is regarded as the controversial issue in the financial literature as to how such payment could be used as a tool in mitigating the agency cost. The agency theory, promulgated by Ross (1973) and extended by Jensen & Meckling (1976), describes the conflict of interest between managers who serve as agents and shareholders who are the ultimate owners of the business. The disclosures and dividend payments often act as incentives to managers in order to decrease costs related to agency relationship. Moreover, in a company, the top management or directors who hold a significant number of shares can influence the firm's dividend payment decision through the use of their power. Another argument is given by Easterbrook (1984) who observed that the payment of dividends would subject the firms to be scrutinized by the capital market in order to secure more capital for expansion.

Hence, in the light of these determinants and arguments, the prime objective of the current study is to explore the impact of corporate governance on dividend payout ratio.

2. Literature review

Dividend payout policy has proved to be a complicated issue in the financial management literature that leads to the issuance of different arguments and theories explaining the facts about dividend ratio. Dividend payout is primarily concerned with decisions on dividend payout and retention ratio of a company. According to Lasher (2000), managers decide on what portion of a company's earnings should be given to shareholders in the form of dividend and what portion should be retained for further investment.

According to Bokhari & Khan (2013), Hapsoro & Suryanto (2017) and Kakanda & Salim (2017) agency problems could be controlled through the use of both internal and external mechanisms. The internal mechanisms comprise of roles played by board of directors, while the markets for corporate control and shareholder activism serve as external mechanisms. Mansourinia et al. (2013) claim that there is no significant impact of board independence on firm dividend ratio. This is in line with the result of Abdelsalam, El-Masry, & Elsegini (2008) that there is no significant relation between board composition and dividend payout. Furthermore, a study of Abor & Fiador (2013) on company's dividend ratio of Sub-Saharan Africa countries confirms a significant negative influence on board composition of Nigerian firm's divide.

Corporate boards often play significant roles of monitoring and maintaining discipline of corporate management, especially when the board comprises a greater percentage of nonexecutives directors selected on the basis of their expertise and independence (Basheer, 2014). Abdelsalam et al. (2008)) indicate that board size has an insignificant positive relationship with a dividend payout ratio. Similarly, Ajanthan (2013) examines the impact of corporate governance mechanisms and dividend payout ratio in a study of hotel and restaurant business in Sri Lanka from 2008 to 2012 using multiple regressions and descriptive analysis method to analyze the data. The findings show that there is insignificant relationship[between board size and dividend payout in hotel and restaurant firms in Sri Lanka. Similarly, Bolbol (2012) uses samples of 50 Malaysian construction companies to determine the impact of board characteristics on dividend payout ratio through the use of regression analysis method. The results show an insignificant and negative impact of board size on firm's dividend payout. The relationship between board size and dividend payout has been established by many researchers, such as Afzal & Sehrish (2011), Arshad, Akram, Scholar, Amjad, & Usman (2013), Ling et al. (2016), and Kachouri & Jarboui (2017).

The CEO duality as a proxy for leadership also appears in a significant relationship with dividend payout ratio in many prior researchers (Arshad et al., 2013; Mansourinia et al., 2013; Abor & Fiador, 2013). The study of Arshad et al. (2013) uses samples of Pakistani companies to show that CEO duality has a significant impact on company's dividend payout. The study of Obradovich & Gill (2013) uses 296 samples of American service listed companies to show that decision to pay dividends is a positive function of CEO duality in a firm. But results of Mansourinia et al. (2013) find that relationship between CEO and dividend payout ratio is insignificant.

Bolbol (2012) finds a significant negative relationship between CEO duality and dividend payout among Malaysian listed companies. Similarly, Ajanthan (2013) finds that CEO duality is negatively associated with dividend payout.

The relationship between director's ownership and dividend payout has been established by many researchers (e.g., Huda & Abdullah, 2013; Abdullah et al., 2012). Huda & Abdullah (2013) examine the impact of ownership structure among the sample firms listed on Chittagong Stock Exchange from 2006 to 2010 period on dividend payout. The results show a significant and positive impact of managerial ownership on the firms' dividend payout. Abdullah et al. (2012) examine the influence of firm ownership structure on dividend payout ratio among 70 listed companies in Karachi Stock Exchange (KSE) for years 2003 to 2010. The results of the study show that managerial ownership has negatively influenced the firms' dividend payout in Pakistan. Similarly, Al-Gharaibeh et al. (2013) examine the relationship between ownership structure and dividend payout among 35 sample companies from Jordan. The result shows that there is a negative relationship between managerial ownership and firm's dividend payout ratio.

Institutional ownership is referred to as the proportion of shares held by institutions in the form of pension funds, insurance companies, and financing companies holding total number of company's shares. The relationship between institutional ownership and dividend payout has been observed in several studies (e.g., Al-Gharaibeh et al., 2013; Al-Najjar, 2010; Abdelsalam et al., 2008). Al-Gharaibeh et al. (2013) report a positive relationship between institutional ownership and corporate governance. On the other hand, the studies of Afzal & Sehrish (2011) and Huda & Abdullah (2013) show the contrary results. Similarly, Obradovich & Gill (2013) find that the decision to pay dividends is negatively affected by institutional ownership among American service

companies. The study of Al-Najjar (2010) indicates that there was no significant relationship between institutional ownership and dividend payout ratio.

Thanatawee (2012) shows that there is a significant positive relationship between concentrated ownership and firms' dividend payout ratio, while Khan (2006) and Harada & Nguyen (2011) show a negative relation. Bolbol (2012), using a sample of 50 Malaysian construction companies to determine the impact of board characteristics on dividend payout ratio, shows insignificant negative relation between board size, board composition, family linked company and dividend payout ratio. According to this researcher, the managerial ownership shows insignificant positive relation with the dividend payout ratio; this, however, is contrary to the study by Nor & Sulong (2007) who demonstrate the significant positive relation with dividend payout. Subramaniam & Devi (2011) also show a significant negative relation between board size, board composition and firm dividend ratio among Malaysian listed companies from 2004 to 2006.

The size of the firms has been considered in many studies as a control variable in order to determine the impact of corporate governance mechanisms on firms' dividend payout ratio (e.g., Abor & Fiador, 2013; Al-Gharaibeh et al., 2013; Bolbol, 2012; Afzal & Sehrish, 2011; Ramli, 2010; Adjaoud & Ben-Amar, 2010). Abor & Fiador (2013) study the dividend payout ratio in Sub-Saharan Africa countries and find that firm size is significantly and positively related to dividend payout among Nigerian companies. Similarly, Al-Gharaibeh et al. (2013), Afzal & Sehrish (2011), and Adjaoud & BenAmar (2010) confirm the positive and strong influence of firm size on dividend payout. Bolbol (2012) examines the impact of board characteristics on dividend payout among Malaysian construction companies, and the result shows that firm size has a positive insignificant impact on dividend payout.

Profitability measures the ability of firms to generate profit and is considered to be an important factor that can affect firm's dividend payout ratio. This is because the firm that generates more profit can distribute higher dividends to shareholders. Thus, there is positive expectation between the profitable firm and dividend payment (see e.g., Huda et al., 2013; Arshad et al., 2013; Bolbol, 2012; Afzal & Sehrish, 2011; Abdelsalam et al., 2008). Huda et al. (2013) show that return on equity has a significant positive impact on firms' dividend payout ratio. Arshad et al. (2013) indicate that return on equity is significantly and positively related to firms' dividend payout ratio among the sample firm in Karachi. Similarly, Afzal & Sehrish (2011) and Abdelsalam et al. (2008) confirm a significant positive impact of profit on the firm's dividend payout decision. On the other hand, Bolbol (2012) finds a positive and insignificant impact on dividend payout.

Ajanthan (2013) show an insignificant association between leverage and dividend payout among hotels and restaurant firms in Sri Lanka. Moreover, the study of Bolbol (2012) also shows that leverage has an insignificant negative effect on Malaysian construction companies' dividend payout. Abdullah et al. (2012) examine the possible impact of the ownership structure of Malaysian public listed companies on dividend payout ratio for the year 2010 using Lintner model. Their findings suggest that the ownership concentration is in positive and significant relation with dividend payout ratio. The results of the study show that concentrated ownership has a positive impact on firms' dividend payout.

The above review of prior literature leads to hypothesize that corporate governance shows a significant and positive relationship with dividend payout ratio.

3. Data and methodology

3.1. Data source

In order to investigate the linkage between corporate governance and dividend payout ratio, data of four fiscal years (2013-2016) was extracted from annual reports of Indonesian publicly listed companies. We targeted the entire population of listed firms. However, because of unavailability of data and resource issue, the final sample comprised of 90 firms.

3.2. Description of data

Table 1 gives information about sample of the study. The mean value of dividend payout ratio is 18 percent. The 41 percent of Indonesian firms are owned by managers and 52 percent of ownership is concentrated in the hands of few individuals or families. The average board size is 6.1.

TABLE 1. DESCRIPTIVE STATISTICS

	N*	MINIMUM	MAXIMUM	MEAN	STD. DEVIATION
<i>DPR</i>	360	0	1	0.18	0.078
<i>LEV</i>	360	0	1	0.62	0.202
<i>EBIT</i>	360	0	1	0.39	0.287
<i>SIZE</i>	360	11	20	14.62	1.462
<i>MO</i>	360	0	1	0.41	0.255
<i>OC</i>	360	0	1	0.52	0.188
<i>INTO</i>	360	0	1	0.13	0.152
<i>BS</i>	360	1	6	6.85	1.7884
<i>BI</i>	360	2	13	0.62	0.8420
<i>CEOD</i>	360	0	1	0.24	0.445

Note: * Valid N (listwise) - 360. *DPR* - ratio of dividend paid to total asset of the firm; *SIZE* - natural log of total assets in the firm; *LEV* - ratio of total liabilities to total assets; *EBIT* - ratio of earnings before interest and tax to total assets; *MO* - managerial ownership; *OC* - total shares held by shareholders with shareholding 10% or more to total shares; *INTO* - institutional ownership; *BI* - the ratio of non-executive directors to total directors in the firm; *BS* - the total number of directors in the firm; *CEOD* - dummy variable - institutional ownership in the firm.

3.3. Methodology

In the current study, we have adopted the panel data methodology. In this methodology, we have pooled the observations into small cross-sectional unit over several time periods. This methodology has provided more comprehensive results which were not possible from simple time series or cross-sectional analysis.

The general form of panel data model can be specified more compactly as

$$Y_{it} = \alpha_{it} + \beta X'_{it} + \varepsilon_{it} \quad (1)$$

The error vector is given by

$$\varepsilon_{it} = v_{it} + u_{it} \quad (2)$$

Where v_{it} the individual is the effect of each of the industrial companies and u_{it} is the error which assumes a normal distribution.

3.4. Model specifications

To measure the impact of corporate governance on dividend payout we have used the following models

$$DPR_{it} = \alpha_0 + \alpha_1 OC_{it} + \alpha_2 MO_{it} + \alpha_3 INTO + \alpha_4 SIZE_{it} + \alpha_5 EBIT_{it} + \alpha_6 LEV_{it} + \varepsilon_{it} \quad (3)$$

$$DPR_{it} = \alpha_0 + \alpha_1 BS_{it} + \alpha_2 BI_{it} + \alpha_3 CEOD + \alpha_4 SIZE_{it} + \alpha_5 EBIT_{it} + \alpha_6 LEV_{it} + \varepsilon_{it} \quad (4)$$

$$DPR_{it} = \alpha_0 + \alpha_1 OC_{it} + \alpha_2 MO_{it} + \alpha_3 INTO + \alpha_4 BS_{it} + \alpha_5 BI_{it} + \alpha_6 CEOD + \alpha_7 SIZE_{it} + \alpha_8 EBIT_{it} + \alpha_9 LEV_{it} + \varepsilon_{it} \quad (5)$$

Where:

DPR_{it} is the ratio of dividend paid to total assets for the i^{th} firm in the time t ;

$SIZE_{it}$ - natural log of total assets for the i^{th} firm in the time t ;

LEV_{it} - the ratio of total liabilities to total assets;

$EBIT_{it}$ - the ratio of earnings before interest and tax to total assets;

MO_{it} - managerial ownership;

OC_{it} - ownership concentration, the total shares held by shareholders with shareholding 10% or more to total shares for i^{th} firm in the time t ;

BI_{it} - the ratio of non-executive directors to total directors;

BS_{it} - the total number of directors for i^{th} firm in the time t ;

$CEOD_{it}$ - dummy variable for CEO duality which gives value 1 if CEO and Chairman for the i^{th} firm in the time t is same and 0 otherwise;

$INTO$ - institutional ownership;

ε_{it} - random error term for the i^{th} firm in the time t .

4. Analysis, results and discussion

4.1. Pre-test specifications

The study examines the impact of ownership structure and corporate governance mechanisms on dividend payout ratio using panel data regression model. At the initial stage, both the fixed effect model regression and the random effect model were run using STATA version 11. All variables under this study were tested in accordance with Pallant (2007). According to Pallant, the calculated *t*-value above 1.96 or less than -1.96 is significant at Cronbach's coefficient alpha $\alpha = 0.05$, while calculated *t*-value should be significant above 2.56 or less than -2.56 for two-tailed tests at $\alpha = 0.01$. Consistent with the preceding, the significance of variables for this study was determined using statistical significance of the calculated *t*-value compared with the *t*-distribution table at $\alpha = 0.05$ for this study.

4.2. Correlation analysis

Table 2 shows result on bivariate statistical correlation among all relevant variables. The correlation table shows that dividend payout ratio *DPR* is positively correlated with ownership concentration *OC* ($p < 0.010$) and managerial ownership *MO* ($p < 0.05$). *DPR* is negatively correlated the institutional ownership *INTO*, the company's total assets *SIZE* ($p < 0.005$), and board independence *BI* ($p < 0.001$).

TABLE 2. CORRELATION ANALYSIS

	<i>DPR</i>	<i>OC</i>	<i>MO</i>	<i>INTO</i>	<i>BS</i>	<i>CEOD</i>	<i>BI</i>	<i>SIZE</i>	<i>EBIT</i>	<i>LEV</i>
<i>DPR</i>	1									
<i>OC</i>	0.4089*	1								
<i>MO</i>	0.1766**	0.1354*	1							
<i>INTO</i>	-0.2037	-0.2167	0.086	1						
<i>BS</i>	-0.0037**	0.1059**	-0.0117*	-0.2914*	1					
<i>CEOD</i>	-0.0023**	0.2043*	-0.0711*	-0.1492*	1	1				
<i>BI</i>	0.2454***	0.1442**	-0.2745*	-0.001*	0.0100	-0.1200	1			
<i>SIZE</i>	-0.2343**	0.1342*	-0.2341*	0.0213**	0.1120*	-0.3110	0.3451*	1		
<i>EBIT</i>	0.3132*	0.1432*	0.1234*	0.0312**	0.3110*	0.1120	0.1345*	0.2311	1	
<i>LEV</i>	-0.4324**	0.2134*	0.06123*	0.1032**	0.0214*	0.1120	0.1534*	0.1010	0.1021	1

4.3. Results and discussion

To achieve the research objectives, we have used a widely used statistical technique known as the ordinary least square.

The results of regression equations are discussed in Table 3. According to the findings, managerial ownership and ownership concentration are in a negative relationship with dividend payout ratio. The negative relation indicates that firms where a manager holds more stock prefer to retain earnings than paying them in the form of dividend. Similarly, firms with concentrated ownership also prefer retained earnings to paying them out to shareholders. However, the relationship between institutional ownership and dividend

payment is positive; this confirms the view that institutional investor reduces information asymmetry and forces managers to act in the best interest of shareholders. *EBIT* and size are also in positive relation which indicates that the growing firm with stable earning pays out their earnings to shareholders. However, the relationship between leverage and dividend payout ratio is negative, this indicates that firms which are paying their debt obligation retain cash to avoid any unanticipated contingency.

TABLE3. THE RESULTS OF REGRESSION ANALYSIS

DEPENDENT VARIABLE: <i>DPR</i>	(1)	(2)	(3)
<i>EBIT</i>	0.239*** (0.019)	0.21*** (0.019)	0.236*** (0.019)
<i>LEV</i>	-0.258*** (0.018)	-0.299*** (0.020)	-0.297*** (0.019)
<i>SIZE</i>	0.077** (0.003)	0.082** (0.003)	0.081** (0.002)
<i>MO</i>	-0.531*** (0.062)	-0.500*** (0.062)	-0.538*** (0.062)
<i>OC</i>	-1.048** (0.226)	-0.882** (0.229)	-1.071** (0.226)
<i>INTO</i>	0.676* (0.177)	0.624* (0.170)	0.682* (0.177)
<i>BI</i>		0.884 (0.026)	
<i>BS</i>		0.122 (0.006)	
<i>CEOD</i>		-0.200 (0.006)	-0.200 (0.006)
R^2	0.659	0.661	0.660
Adjusted R^2	0.647	0.646	0.646
<i>F</i> -statistic	22.553	19.334	20.749
Prob.(<i>F</i> - Statistics)	0.000	0.000	0.000
S.E of Regression.	0.087	0.088	0.088
Number of firms	90	90	90

The relationship between board independence, board size, and dividend payout is positive. The positive relation confirms the view that the large board with more independent directors prefers paying out their earning than retaining them. However, the relationship between the CEO duality and dividend payout ratio is negative and indicates that board and management prefer to hold a bulk of earning to exploit any unanticipated investment opportunity.

5. Conclusion

The main objective of this study was to examine the relationship between corporate governance variables with a dividend payout ratio in Indonesian publicly-listed companies during the period 2013-2016. To achieve the research objectives, we have used a widely used statistical technique known as the ordinary least square. The findings of the study indicate that board independence, board size, institutional ownership, size of the company and earnings before interest and tax are in positive relation, whereas the CEO

duality, managerial ownership, ownership concentration and leverage are in negative relation with the dividend payout ratio.

Future studies could cover more time period by using panel data analysis to take into consideration of short and long-term effects. The future studies could also take into consideration more variables from both board characteristics and ownership structure, such as government ownership, and foreign ownership because of the uniqueness of ownership structure in Malaysia and to see how such government/foreign ownership can influence the dividend payout ratio among the Malaysian companies.

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