

Dividend policy of agency cost models in companies listed on the Indonesia Stock Exchange

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ABSTRACT: This study aimed at examining the effect of dividend policy as an agency cost model with an ownership structure in Indonesian companies. The study was conducted to reveal the involvement of family and institutional ownership in dividend decision making in manufacturing companies listed on the Indonesia Stock Exchange (IDX). The hypothesis was tested by using Ordinary Least Square (OLS) analysis. Samples were sorted by simple random sampling based on Slovin's calculations. The samples obtained were 59 manufacturing companies consisting of 16 companies in conventional stock and 43 companies in sharia stock in periods of 2016-2018. Dividend policy is highly important in corporate financial decisions. In several countries, concentrated ownership structures, such as family or individual ownership, institutional ownership, and foreign ownership, have low dividend payments. Thus, the presence of a concentrated ownership structure in Indonesia has the possibility to pay low dividends. Furthermore, sharia shares to develop quite rapidly in Indonesia. However, only a few studies investigated dividend policy in companies listed on the Islamic stock index. Also, no research on the comparison of dividend policy on sharia and conventional stocks had been conducted yet. Hence, this research can be a reference for further research.

Keywords: family ownership, institutional ownership, and dividend policy

1 INTRODUCTION

Dividend policy is a decision on how much income can be paid as dividends and how much can be maintained (Alzomaia and Al-Khadhiri, 2013). The debate over dividend policy remains a controversial issue in company policy. This indicates the difficulty of a company to make a decision on the company's dividend policy. Cash dividends can be used as a tool to reduce agency conflict within the company by reducing free cash flow and encouraging managers to obtain funds from the capital market so that it leads to market monitoring (Rozeff, 1982; Easterbrook; and Jensen, 1986).

Companies listed on the Indonesian Capital Market show inconsistency in paying dividends to shareholders. Statistically, during the 2014-2016 periods, out of 79 financial companies listed on the Indonesia Stock Exchange, only 27 companies paid dividends (Mardani and Indrawati, 2018). The latest data from the Indonesia Stock Exchange on January 31, 2019, revealed that of the 45 companies listed on the LQ45 index in 2014-2018 periods, only 5% of them paid cash dividends consistently while the remainder were inconsistent.

Companies have reasons as to why they have to pay dividends, one of which is learned from the agency cost theory. The theory derives from the problem of ownership separation between management (agent) and shareholders (principal), known as agency conflict (Jensen and Meckling, 1976). Dividends play an important role in reducing agency costs. Agency costs are divided into two types, namely conflicts between shareholders and managers (Type I), and conflicts between majority and minority shareholders (Type II). Type I occurs in the form of widely dispersed ownership, where there is asymmetric information between managers and

shareholders (Jensen and Meckling, 1976). Type II is found in companies with more dominant insider ownership (Claessens and Yurtoglu, 2013).

In developing countries, the form of ownership structure tends to be concentrated. In East Asia, more than half of the existing public companies are controlled by a single shareholder and dominated by family (family ownership) (Claessens, Djankov, and Lang, 2000). In Indonesia, the characteristics of ownership structures tend to be concentrated into institutional ownership and individual ownership or family ownership (Shinta and Ahmar, 2011). The effect of ownership structure in Indonesia on dividend payments provides insight into whether the characteristics of ownership in Indonesia affect the number of dividends paid. Besides, the emergence of Islamic stocks in Indonesia has become an interesting phenomenon due to the majority of Indonesian Muslims and the limited research on dividend policy on Islamic stocks in Indonesia. The development of sharia stock market capitalization is also quite good in this country.

This study focused on the structure of institutional ownership and family ownership of dividend policy as a model of agency costs in sharia stock and conventional stock companies.

2 RESEARCH ISSUE

An empirical study found that during the 2014-2016 periods, out of 79 financial companies listed on the Indonesia Stock Exchange, only 27 companies paid dividends (Mardani and Indrawati, 2018). A concentrated ownership structure should have a role to reduce agency costs between management and shareholders. A study conducted by Faccio, Lang, and Young (2001) on companies in Asia and Europe proved that the distribution of dividends in East Asian companies was lower than that of Western European ones.

Controlling owners in East Asia prefer to hold their resources rather than to distribute them to shareholders in the form of dividends. Thus, an adverse effect has been found between the concentration of ownership and dividend policy. The study by Faccio, Lang, and Young (2001) revealed that the level of dividend payments in Europe was higher than in Asia. Europe has numerous large shareholders indicating that the country is reducing expropriation. However, it was, on the contrary, in Asia.

Claessens, Djankov, and Lang (2000) found that 67% of companies in Indonesia were controlled by family (family ownership). According to Shleifer and Vishny (1986, 1997), when large shareholders, especially family ownership, hold full control, they tend to prioritize personal profit, such as issuing company cash flow, paying extreme salaries, giving the family members top positions. These cases lead to agency conflicts between minority shareholders and majority ones as controlling parties. The questions in this study are: Does the family ownership influence the dividend policy on sharia stock index companies and conventional stock index in Indonesia? Does the institutional ownership influence the dividend policy in the sharia stock index and conventional stock index companies in Indonesia? Can the factors of family ownership and institutional ownership simultaneously influence the dividend policy of sharia stock index and conventional stock index companies in Indonesia?

3 LITERATURE REVIEW

To begin with, agency theory is used to examine the relationship between principal and agent. Jensen and Meckling (1976) stated that agency relationships occur because shareholders (principal) involve in management (agents) to act on behalf of the shareholders. Conflicts of interest between managers and shareholders result in agency costs. Furthermore, agency costs are costs incurred to guarantee and oversee management actions so they can be in line with the interests of shareholders (Jensen and Meckling, 1976). Dividend payments are believed to be a monitoring tool that can reduce agency costs. However, Jensen (1986) argued that dividend payments could create conflicts between managers and shareholders because the management wants to retain their profits compared to shareholders who prefer dividends. Thus, agency problems can occur because managers may not maximize shareholder value.

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