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Research Article

Corporate Governance and Dividend Policy in Indonesia

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Abstract.
Corporate governance and dividends go hand in hand. But are dividends an outcome of, a supplement to, or a substitute for governance practices? That is, high dividends show that the mechanisms for decent returns to investors are in place, and governance is a set of mechanisms for that. Examining the findings and competing models of dividend-corporate-governance relationships is the overarching goal of this research. Listed on the Indonesia Stock Exchange from 2017 to 2021, the sample company is a manufacturer. Control variables include size, beta, return on investment (ROI), and corporate governance proxies such as the governance index score and dividend policy proxies such as the dividend payout ratio (DPR). The method of data collection involves accessing the IDX web for financial and annual reports of manufacturing companies. Data analysis procedures are based on panel regression analysis. According to the outcome model, there is a positive correlation between corporate governance and dividends during the COVID-19 pandemic, and a negative correlation between governance and dividends. Dividends are a result of internal and external processes meant to safeguard the interests of minority shareholders, proving that governance at the firm and national levels is crucial in determining the nature of investor protection.

Keywords: corporate governance, dividend policy, manufacture

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1. Introduction

Corporate governance and dividends go hand in hand. The relation's exact nature remains a mystery: Do dividends serve as a supplement, a replacement, or the end product of corporate policy? There is a system in place called corporate governance that ensures shareholders get good returns and high dividends, and it's doing its job. To be sure, investors do make money from dividends and capital gains, but as the seminal work of [1] demonstrates, investors couldn't care less about either.

Since Miller and Modigliani's model does not account for frictions like information asymmetry, we must wonder what role these factors play in agency conflicts. Investors confronted with a takeover situation might benefit from the Lintner-Gordon bird-in-the-hand theory. Companies with weak leadership may discover that paying dividends

boosts value by, among other things, preventing insiders from frittering away free cash flow.

In order to prevent corporate insiders from acquiring minority shareholders, certain control and monitoring practices serve as governance mechanisms. We don't yet know how effective it is, particularly in nations where property rights are not strongly protected and institutions are weak. The effect of both internal and external corporate governance can be seen through dividend payments.

Research has proven that dividends are a crucial component of good corporate governance. Early on in the study, the authors [2] modelled dividends according to growth, beta, and agency costs. The model is built upon the transparency that dividend payments provide. Since it becomes more difficult to oversee and manage managers when owners are spread out, Rozeff argues that agency costs are better measured by ownership concentration. His findings corroborate the significance of payout policies for management by showing a negative correlation between dividends and concentration. [3] back this up by utilising an equation system that captures the determination of ownership structure, debt, and dividend policy all at once. Recent work by [4] confirms that dividends are more generously doled out by poorly governed companies, and that this correlation is even more pronounced for those with robust free cash flow. There is a negative correlation between ownership concentration and dividends in Asia as well [5]. Nevertheless, agency conflict, rather than a convergence of interests, was deemed to be the cause of this. The aforementioned instances occur within the framework of dispersed ownership, which is common in American and British businesses, where agency issues manifest as the result of long-standing disputes between managers and shareholders. In nations where state and family ownership are prevalent, however, a different perspective is more important: outsiders have access to cash flows but limited control. Preventing a takeover by controlling shareholders is their top priority. Investors from outside the country and controlling shareholders, who have control over the managers, are at odds in these nations [6].

La Porta et al. [6] provide the yield model and the replacement model, both of which can shed light on dividend policy in developing economies. The yield model states that dividends are paid out when minority shareholders put enough pressure on insiders to make them pay out their profits. To safeguard minority shareholders, governance practices include the ability to remove directors, demand payouts, sue directors, or even liquidate the company and keep the money. Companies with strong governance and a lack of managerial entrenchment are less likely to ignore shareholder demands

for the distribution of surplus funds. In this perspective, a company's governance regime determines whether dividends are paid out when the company's fundamentals call for them. This is because managers at companies with strong governance are more inclined to maximise value for shareholders and act in their best interests.

Conversely, larger dividends are predicted by the substitution model in conjunction with diminished minority shareholder rights. Based on this model, insiders can establish a good reputation for treating minority shareholders fairly through dividend payments. Dividends serve as a binding mechanism to precommit in this situation. The necessity of the company's access to capital market funding is a key component of this perspective. An incentive to earn the respect of minority shareholders is the possibility of reduced funding costs in the future. Since there are no other safeguards in place for foreigners in nations with lax legal protection, payments in such cases are more valuable. There is less of an incentive to establish credibility through dividends when shareholder protection is more important. The surrogate model predicts, therefore, that compensation is inversely related to the quality of government.

How is the influence of minority shareholders defined precisely? Legal regimes, including laws and the efficacy of their enforcement, are the subject of [7-9]. When rules (like voting rights for shareholders) are properly implemented, minority shareholders feel safe and are more likely to invest in the company. Takeovers and tunnelling can happen to minority shareholders when rules and enforcement are lax. La Porta et al. [6] data that backs up the results model. Minority shareholders get smaller dividends in nations with lax investor protection compared to those with more robust investor protection.

Corporate governance practises and national governance both play a role in safeguarding minority shareholders. La Porta et al. [6] on a national level by contrasting the dividend payment systems put in place by various legal regimes. They fail to account for variations in firm-level governance. This article extends the investigation by utilising their framework to analyse scenarios where shareholders in companies operating under different legal regimes have varying degrees of influence over corporate governance, influenced by the quality of governance practices employed by those companies.

Specifically looking at manufacturing companies listed on the IDX from 2017 to 2021, this study intends to investigate the relationship between corporate governance and dividends in Indonesia. A large portion of Indonesia's GDP and employment are supported by the manufacturing sector. On the other hand, poor governance practices

are a known cause of delisting for manufacturing companies. The research in this study includes observations made both before and during the COVID-19 pandemic, specifically in 2017 and 2018.

2. Literature Review and Hypotheses

2.1. Corporate governance and dividend policy

The findings of empirical research on corporate dividend policies and corporate governance are quite promising. Managerial stock incentives reduce agency costs for companies experiencing surplus cash flow issues, according to research [9] that examined the impact of stock incentives on dividend payout policies. Management stock options are inversely related to the dividend policy of the company, according to their research. Using a panel data set from the United Kingdom, [10] also discovered an inverse correlation between dividend payment policies and managerial ownership. Based on data from over 600 UK companies, [11] concludes with high confidence that the insider ownership coefficient turns positive once the level of insider ownership is estimated at approximately 30%. A favourable effect of shareholder dispersion on dividend policy was also discovered by him.

How institutional ownership relates to dividend policy is another area covered in the empirical research. Research by [12] and [10] on the topic of institutional shareholders and dividends revealed a positive correlation between the two. German companies' ownership and control structures, dividends, and other financial metrics were also studied in [13]. A considerably larger negative wealth impact of about two percentage points was observed in companies whose ownership and control structures made minority shareholder takeovers more likely when analysing 736 announcements of dividend changes in Germany from 1992 to 1998. It turns out that when the biggest owner has a lot of shares, dividends are cut, but when the second biggest owner has a lot of shares, dividends are increased. The findings of their study demonstrate that dividends are an indicator of how contentious the dispute is between big controlling owners and smaller outside shareholders.

La Porta et al. [6] examined dividend policies and agency issues on a global scale. They differentiated between two dividend agency models using data from a sample of companies in 33 different countries. They discovered that dividends paid by companies

are higher in nations that provide better protections for minority shareholders. Additionally, they demonstrated that, compared to slow-growth firms, fast-growth firms in nations with strong legal protections pay lower dividends. This lines up with the theory that shareholders who are adequately insured will patiently await dividend payments when investment opportunities present themselves. Nonetheless, unprotected shareholders will grab dividends at any cost, regardless of the quality of the investment opportunity.

Gugler [13] looks at how the ownership and control structure of Austrian companies relate to dividends. He finds that, between 1991 and 1999, a panel of companies participated in dividend smoothing, but firms controlled by families did not. A substantially lower target payout rate was selected by the second group. When it comes to cutting dividends, companies controlled by the state are always hesitant while those controlled by families are always willing to do it. In line with the anticipated "ranking" of information asymmetry and managerial agency costs, the dividend behaviour of firms controlled by banks or foreign entities falls somewhere in the middle of the spectrum compared to firms controlled by states or families. Further, he discovered that regardless of ownership, cash would be optimally spent by companies with low growth prospects.

Consistent with the agency model of dividends, [14] uses a sample of 365 companies from 19 countries and finds that dividend payments are higher from companies with stronger corporate governance. Among companies with strong governance, he discovers a strong inverse correlation between dividend payments and growth prospects. Also, more robustly governed companies tend to be more profitable, though that doesn't fully explain why dividend payments are higher. Additionally, in nations that have protectionist policies, the correlation between good corporate governance and dividend payments is stronger.

H1: Corporate governance influences dividend policy

2.2. Dividend policy and corporate governance

The corporation must carefully consider its dividend policy. First, there will be the shareholders and second, there will be the management company, both of whom have competing interests in this policy. Nett income and earnings after taxes are two ways that management can look at the company's financial situation. Two options are retained earnings, which are invested back into the business, and dividends, which are paid out to shareholders. Management should establish a dividend policy regarding the distribution of earnings after taxes, taking into account the shareholders' entitlement to

receive dividends and the amount that is withheld from earnings after taxes, since this is how most companies typically distribute their earnings after taxes, with some going into investments [15]. In return for shareholders' promises to reinvest their wealth in the business, companies often distribute a portion of their profits to them in the form of dividends [16]. This practice not only benefits the owners of the company but also has an impact on the value of the business, giving shareholders a special position [17]. Investors would rather get their money back in the form of dividends than the anticipated gains from capital appreciation, which is why dividend payments can have an effect on stock prices. According to the "bird in the hand" theory, shareholders would rather have a large dividend payment than a capital gain [18]. Due to the higher return on shares held, shareholders will benefit more from a higher dividend payout ratio [19]. Participants in the capital markets expect returns on their investments, specifically dividends and capital gains [20]. Shareholders who are risk averse would rather get dividends than capital gains. The present value of dividends is greater than the future value of a capital gain. Therefore, dividends, not capital gains, would be a better option for shareholders who are risk averse [21, 22].

H2: Dividend policy influences corporate governance

3. Methods

For 2017–2018 and 2020–2021, the sample is a manufacturing company that was listed on the Indonesia Stock Exchange. As proxies, we have corporate governance (as measured by the governance index score) and dividend policy (as measured by the Dividend Payout Ratio, or DPR). As control variables, we have return on investment (ROI), beta, sales growth, and size. Manufacturing company financial and annual reports sourced from the IDX web are utilised in the data collection method. Data analysis procedures based on panel regression analysis.

The equation reads as follows:

$Div = \beta 0 + \beta 1Gov + \beta 2Profit + \beta 3Beta + \beta 4\ Grow + \beta 5Size + e$ .... (1)

$Gov = \beta 0 + \beta 1Div + \beta 2Profit + \beta 3Beta + \beta 4\ Grow + \beta 5Size + e$ .... (2)

4. Results and Discussion

Consistent with a well-established inverse relationship between risk and payout, beta is consistently negative and statistically significant in all tests. ROI is just barely noticeable. The fact that successful businesses have more money to pay out in dividends explains other research showing a positive correlation between the two variables [23, 24]. Many of the companies in this sample had this metric's volatility throughout the period, which could explain the outcome. In the COVID-19 pandemic, the growth coefficient is negative, which is in line with the theory that high-growth firms hold onto cash for future expansion, as supported by other research. After the crisis, there was a positive correlation. This could be because there weren't many opportunities to invest in the future at the time, or it could be because the best-governed companies are solid businesses that can afford to pay dividends and grow their assets. Payouts were higher for smaller firms prior to the crisis, suggesting a negative relationship between size and payout.

This may have occurred in the Thai and Indonesian economic bubbles because smaller, less-established businesses were more likely to share their profits freely during the period's euphoria and optimism. But just because companies have easy access to funding doesn't mean they'll be generous with payouts. Even though there are plenty of investment opportunities, companies will still prefer to hold on to their earnings rather than pay the fees associated with raising fresh capital. Poorly governed firms utilise dividends to build trust, which is crucial for raising future equity, according to the substitute theory, which is supported by the negative relationship between governance and dividends. Firms must access the market in order to acquire external capital, according to the substitute view. The need to 'assure' investors grows for smaller firms with higher growth expectations and lower reinvested earnings, resulting in a negative relationship between size and payout. Even after accounting for the country, the positive pandemic size coefficient for COVID-19 remains insignificant.

There has been a lot of research looking at the link between dividend policy and corporate governance, and different studies have found different things. Certain aspects of corporate governance have been shown to be negatively correlated with dividend payment, according to research. The research carried out by [25] On the other hand, there is conflicting evidence from some studies that suggests corporate governance has a positive effect on dividend distribution decisions [26]. There is a positive and

robust relationship between corporate governance and dividend propensity and payout amount, according to some research [27].

In conclusion, there is a complex relationship between corporate governance and dividend policy, with studies showing both positive and negative effects. The results highlight the multifaceted nature of corporate governance and its impact on dividend policy, indicating that additional factors should be considered when analyzing this association.

Corporate governance is positively impacted by dividend policy. Thus, good corporate governance is influenced by dividend policies. The findings support the bird-in-the-hand theory, put out by [28] and cited in [29], which states that a high dividend payout ratio will maximize a company's value. This is because investors prefer dividend profits over capital appreciation gains because they believe the risk of a dividend is lower compared to the rise in the cost of capital.

The effect of dividends on corporate governance has been the subject of much research. Dividends are a good way for shareholders and managers to align their interests in an information asymmetry situation, and they also send a message about the company's future prospects [30]. Companies with stronger corporate governance are more likely to have lower dividend payments, according to the research [31]. However, other research shows that dividend payments are positively correlated with corporate governance, meaning that companies with stronger governance policies tend to pay out more dividends [32]. Additionally, evidence suggests that better corporate governance leads to higher cash dividends [33]. Finally, many factors, such as ownership structure, governance quality, and specific firm attributes, influence the complex and variable nature of the relationship between dividends and corporate governance.

5. Conclusions

For companies without other means of establishing their credibility, dividend payments are an obvious and effective mechanism. During this time, there is a negative correlation between size and dividends, which lends credence to this interpretation. Companies with fewer employees and a smaller market presence would have a harder time winning over minority shareholders and would likely seek outside funding again in the near future. There was a marked improvement in governance, and dividends dropped dramatically at the start of the COVID-19 as a result of the urgent need to conserve cash

to deal with the shortage of both capital and liquidity. Although dividends may no longer serve as a boom-era substitute, this does not automatically mean that the relationship between dividends and governance will reverse. The results show that dividends and corporate governance are positively correlated in the COVID-19 pandemic, which is in line with the outcome model. This confirms that governance at both the firm and national levels is critical in determining the character of investor protection, since dividends are the product of internal and legal processes that safeguard the interests of minority shareholders.

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