THE IMPACT OF INSIDER OWNERSHIP TO DIVIDEND POLICY IN INDONESIA 2013-2016

CHAPTER I

INTRODUCTION

1.1 Research Background

Investors make investment decisions in a company to earn revenue (return) towards their investment. According to the news in Beritasatu.com (22/11/2017) the most profitable investment in Indonesia is share investment. Share investment is considered as the most profitable investment because the tax is very low, only 0.1% of the sales value, compared with interest tax of the bank that reached 20%. Moreover, there is also high potential return and growth of the issuers (companies) in Indonesia.

Revenue (return) from share investment can be dividend and also capital gain (the difference between selling price and purchase price of the shares). According to Brigham, E.F and Houston (2009) dividend policy is a decision about the allocation of profits earned by the company, in which it will be distributed to shareholders as dividends and the remaining profit will be retained as retained earnings for future investment activities. The dividend distribution that are expected by investors is likely to be stable or even increase from one period to another period. This stable dividend policy will reduce the uncertainty of investor and increase investor's confidence level in making investment decisions.

Dividend policy in one company may be different with other companies. It can be different because the nature of market and the ownership structure of company. Adjaoud and Ben-Amar (2010) argue that emerging markets differ from developed markets in many aspects. Particularly, they suggest that emerging markets have specific corporate governance and ownership structure characteristics.

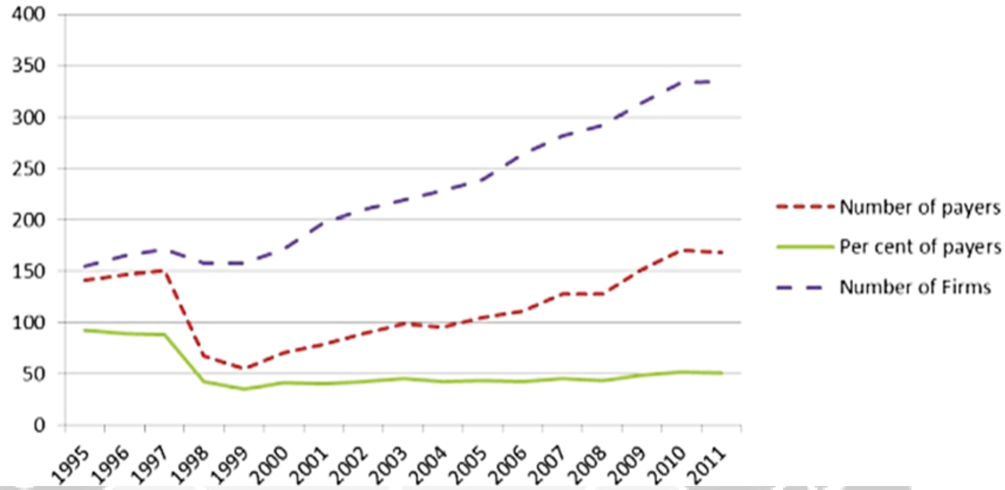
La Porta et al. (1999) examined the ownership structures of large firms in 27 different countries and suggested that relatively a few of these firms are widely held; rather they are heavily concentrated and are commonly controlled by families or the states. Claessens et al. (2000) reported that single shareholder controls more than two-thirds of publicly listed East Asian firms and families dominate about 40% of all listed companies. Furthermore, Faccio et al. (2001) found that families, which often supplied a top manager, are the main players in East Asia and Western Europe.

Mitton (2004) suggests that emerging markets provide low legal protection for investors and weak governance mechanisms compared to firms operating in developed countries. In emerging market, ownership structure is highly concentrated among institutional investors that hold the management of their firms, even when they become listed, while institutional play an important role in decision making, regardless of their official status. The boards of these companies operate as an advisory committee rather than focusing on control. Due to these special ownership structures, expropriation of minority shareholders therefore appears more problematic in developing countries.

As an emerging market, Indonesia has poor governance (Nys et al., 2015). As a result, minority shareholders may obtain lower dividends because of the expropriation of resources by insider owner. Faccio et al. (2001) found that shareholders receive lower dividends when the ratio of ownership rights to cash flow rights is lower. Thus, firms with a higher probability of engaging in expropriations pay lower dividends to keep their resources inside businesses.

Research that was done by Wardhana (2014) showed that the number of companies listed in Indonesia Stock Exchange (IDX) increase year by year and number of companies that pay dividend also increase. The fluctuation of companies number that paid dividend can be seen through picture below.

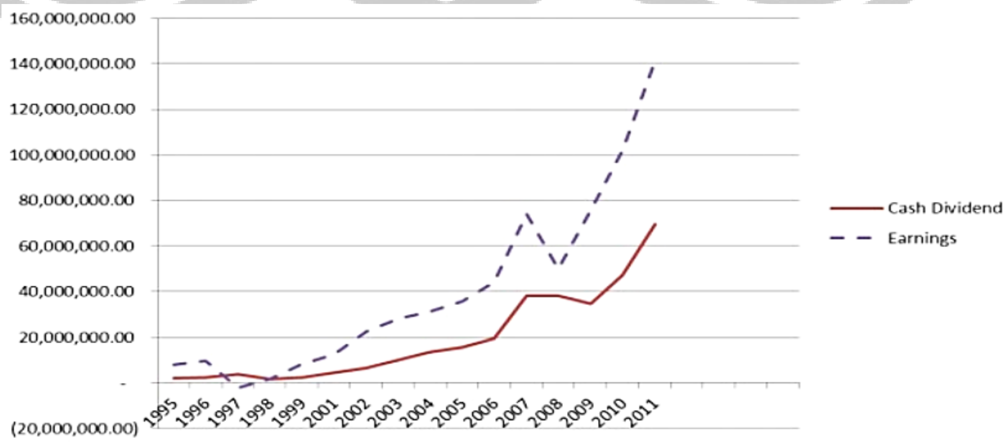
Picture 1.1 Dividend Payers in 1995-2011



Source: Wardhana (2014) "Dividend Policy in Indonesia: A Life-Cycle Explanation"

The graph showed that since 1999 up to 2011 under 50% of non-financial companies paid dividend and retained the remaining profit as retained earnings even when their financial position is in a good condition. The phenomenon becomes more interesting to be researched because in crisis period (Asia financial crisis in 1997 and Global financial crisis in 2008) the earning of companies decreased significantly but the amount of dividend that was distributed by the company did not decrease, it increased instead. That phenomenon can be seen through table below.

Picture 1.2 Dividend Payout in 1995-2011



Source: Wardhana (2014) "Dividend Policy in Indonesia: A Life-Cycle Explanation"

Based on financial report data in 2005 and 2006 from IDX, a mature company like PT. Unilever Indonesia Tbk. had an increasing profit after taxes from 1.440.485 (in million rupiah) in 2005 to 1.721.595 in 2006. In the other hand, the dividend payout ratio decreased from 63,56 in 2005 to 55,40 in 2006. It showed that in 2006 PT. Unilever Indonesia Tbk. decided to retain the profit more than in 2005 for making a future investment decision. In 2007, the profit after taxes of PT. Unilever Indonesia Tbk. increased as 1.962.147 (in million rupiah) but the dividend payout ratio also increased as 64,94.

Table 1.1 Profit After Taxes And Dividend Payout Ratio Of PT. Unilever Indonesia Tbk.

Year	**2005**	**2006**	**2007**
Profit after tax (in million rupiah)	1.440.485	1.721.595	1.962.147
Dividend Payout	63,56	55,40	64,94

Source : www.idx.co.id (had been processed)

Moreover, government of Indonesia also has an issue related to dividend income. According to Tempo.com (06/05/2014) income from dividend targeted in 2013 Rp 40 trillion was not achieved. As the realization, state-owned companies can only deposited approximately Rp37.5 to Rp38.5 trillion. The targeted income from dividend were not achieved due to bad economy condition in the previous year that made some state-owned enterprises got losses, for instance PLN that did not distribute dividend because they suffer losses in that period. Furthermore PT. Freeport Indonesia also did not distribute dividend because they needed funds to expand the business. Government of Indonesia already asked PT. Freeport Indonesia to pay dividend but due to small ownership of Indonesia government in PT. Freeport Indonesia, as minority shareholders, government did not have enough control compare with the majority shareholders in which decide not to pay dividend for that year. The inconsistency and uncertainty of dividend payment towards company's profit makes this topic is very interesting to be researched.

The proxy of dividend policy in this study is dividend payout ratio (DPR). Dividend payout ratio (DPR) determines the portion of profits distributed to shareholders as dividend rather than retained as retained earnings. Dividend payout ratio shows the preference of manager in managing profits, whether it will be distributed or reinvested. Company with higher dividend payout ratio is more attractive for investors because it indicates that the managers had commitment in prioritizing higher portion of dividend payments rather than portion for reinvestment.

The company's decision in determining dividend policy sometimes creates problems between managers and shareholders. This is happened due to the conflict of interests towards the use of profits generated by the company. On the management side, profits earned are expected to be retained in order to make future investment decisions. On the other hand, investors may judge that the investment that's done by management does not give significant advantage for them. Shareholders give their trust to managers to manage the company in order to increase company's value and the welfare of shareholders. Therefore, the manager should not only consider about their own interests, but they also have to consider about shareholders interest.

Conflict between shareholders and managers is called agency conflict. Agency conflict makes shareholders have to oversee manager behavior. These monitoring costs are called agency costs. To reduce agency costs, shareholders can increase their investment by having insider (managerial) ownership in the company. Jensen and Meckling (1976) argue that agency cost will be low in companies with high insider ownership because the interests of shareholders will be in line with the interests of managers since managers will act both as an agent and as a principal. By increasing managerial ownership, managers can feel directly the benefits or losses for every decision taken by them.

Taswan (2003) argues that the more shares hold by insider ownership the more tendency of management to hold the dividend payment. A high level of insider ownership makes the managers pay lower dividends because internal funding are more efficient than external funding. While a low level of insider ownership makes the manager distribute large amounts of dividends in order to attract investors. This was in line with the research done by Kilincarslan (2016) that provides the empirical evidence by doing research in Turkey that ownership structure has a negative relationship on dividend policy. Harada and Nguyen (2011) studied the link between ownership structure and dividend policy in Japan. The result showed that the presence of controlling shareholders has a negative effect on dividend payouts. Controlling shareholders compensate minority shareholders with low dividend payouts.

Berzins et al. (2012) investigated the effect of controlling ownership by studying private firms in Norway. It was argued that agency problems should generally be worsened for private firms, as they have no external (public) monitoring mechanisms. They also found that minority shareholders receive higher dividends when agency conflict is higher. Mollah (2007) by doing research in Bangladesh argues firms pay higher amount of dividends as monitoring and bonding package when insiders hold a lower percentage of common stock and or greater number of common stock held by outsiders to reduce agency cost. Al-Kuwari (2009) shows that dividend policy is significantly related to firm size and firm profitability. He notes that, in the GCC (Gulf Cooperation Council) region, firms pay dividends to resolve agency problems and to preserve firms' reputation.

In the other hand, Shah, Ullah, and Hasnain (2010) provide an empirical evidence by doing research in Pakistan that show a positive influence between ownership structure and dividend policy. Moreover, Nuringsih (2005) provides an empirical evidence by doing research in Indonesia that shows there is positive and significant impact of ownership structure to dividend policy in Indonesia. Nuringsih (2005) stated that the more involvement of manager as insider ownership, make the assets of manager are not optimally diversified and they will require high dividend payment as the return from their investment. Moreover, ownership structure in Indonesia is relatively concentrated or owned by family so that they tend to pay higher dividend.

If the manager's behavior likes low dividend payment, then the manager will relatively choose higher retained earnings and making new investment. If the manager's behavior likes high dividend payment, then the behavior of managers will lead to "Bird in The Hand Theory". This theory states that investors prefer dividend payouts likened to "one bird in hand is worth more than two birds in the forest". According to this theory, income that can be gained through dividend distribution has more definite value than expected income from capital gains. This is happened because dividend distribution are controlled by the firms while capital gains are controlled by the market.

According to the research background and the inconsistence result from previous researches, it brings curiosity for author to conduct this research. Author used 148 samples from all companies listed in IDX that had insider (managerial) ownership which paid dividend from year 2013 to 2016. Data of dividend payout ratio was obtained from annual report provided in Indonesia Stock Exchange website year 2013-2016 and data of insider ownership was obtained from Indonesia Capital Market Directory. Moreover author used two control variables, return on equity (ROE) and firm size.

1.2 Research Problem

The main problem in this research is the determination of company's dividend policy. There is inconsistency relationship between the profits earned by the company towards the amount of dividend paid to shareholders. For instance, a mature company like PT. Unilever Indonesia Tbk. had a rise in profit after taxes in 2006 but in the other hand, the dividend payout ratio decreased. In 2007, the profit after taxes of PT. Unilever Indonesia Tbk. increased but the dividend payout ratio also increased.

There were some phenomenon showed that lots of non-financial companies did not pay dividend and retain the profit as retained earnings even their financial position is in a good condition. Moreover, government of Indonesia also has an issue related to dividend income. The income from dividend targeted in 2013 Rp 40 trillion was not achieved. As the realization, state-owned companies can only deposited approximately Rp37.5 to Rp38.5 trillion.

One of possible factor that can affect dividend policy is ownership structure. Ownership structure in Indonesian firms are heavily concentrated and commonly controlled by families. Moreover, families are often supplied as manager and also become the investors of the company. If the manager's behavior likes low dividend payment, then the manager will relatively choose to retain the earnings, give low dividend, and make new investment. In contrast, if the manager's behavior likes high dividend payment, then the behavior of managers will lead to "*Bird in The Hand Theory*". According to this theory, income that can be gained through dividend distribution has more definite value than expected income from capital gains. This is happened because dividend distribution are controlled by the firms while capital gains are controlled by the market. Based on the facts above, author can formulate research problem as follows:

"Does insider ownership impact dividend policy in Indonesia?"

1.3 Research Objectives

The objective of this research is to give empirical evidence about the effect of insider ownership to dividend policy in Indonesia using sample of all companies listed in Indonesia Stock Exchange year 2013-2016.

1.4 Research Contribution

This research has three main contributions. First, the study provides update research about the impact of ownership structure to dividend policy in Indonesia.

Second, the result of this study can give insight to investors in analyzing information related to financial statements of company especially about investments decision making.

Third, for managers of a company, the result of this study can be an additional information for managers in setting dividend policy.

1.5 Writing Structure

This research was prepared systematically as follows:

CHAPTER I	**INTRODUCTION** Chapter I is an introduction of the research that consists of research background, research problem, research objectives, research contribution and writing structure.
CHAPTER II	**LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT** Chapter II consists of theoretical framework, existing researches and conceptual framework used to construct hypothesis development.
CHAPTER III	**RESEARCH METHODOLOGY** Chapter III consists of related data used on the research, it includes population and sample, sample criteria, data collection method, measurement variable, data analysis techniques, and hypothesis testing method.
CHAPTER IV	**DATA ANALYSIS AND DISCUSSION** Chapter IV contains the result and discussion after processing the data. This chapter provides information whether the data fulfill the regression

	requirements and hypothesis is accepted or rejected.
CHAPTER V	**CONCLUSION** Chapter V contains conclusions, limitations and suggestions for future research.