RE-EXAMINING DIVIDEND PAYOUT, PROPORTION OF OWNERSHIP AND FIRM’S VALUE IN INDONESIA

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Abstrack

We re-examining the impact of dividend policy and proportion of ownership on firm value in the Indonesian Capital Market, which include 2712 firm-year over the period of 2005-2016. Tobin Q measures firm value, dividend payout over net income is a measure of dividend policy, and meanwhile we also include proportion ownership of insider of company, foreign owner and government owner. Panel data regression model is used in our analysis. After controlling with firm specific variables; size of company, liquidity, profitability and leverage, we find that dividend policy is irrelevant in driving the value of firm in Indonesian capital market. This phenomenon might occur in Indonesia because market is characterized by short-term investment prospective from investors. They are less concern on dividend payment, more focus on capital gains. Additionally, it seems that insiders expropriate the firm cash flows for their benefits on the cost of minority shareholders with their control power, consequently value lower by the market. However, the higher the ownership by foreigner impact value higher by the market, positive reaction emerge possibly because the firm perceive applying good corporate governance. Concentrated ownership on government does not have significant relationship with the value of firm.

Key Words: Dividend Payout, Concentrated Ownership, Corporate Governance and Firm Value, the Indonesian Capital Market

1. Introduction

Seminal paper of Miller & Modigliani - MM (1961) answered part of the puzzle on relationship between dividend policy and firm’s value. These authors advocate that firm’s dividend policy does not create additional value for its investors, in frictionless market, only investment policy are matter in determining the value more than normal return create in investment policy in frictionless market. Nevertheless, when there is imperfection in market such as tax differential, trading costs, asymmetric information results in difference magnitude and policy of dividends, which influence the value of the firm. In contrary with MM who assumes that 100 percent of cash flow distribute to shareholder regularly every year, (De Angelo & De Angelo, 2006) allow retention of free cash flow and find that dividend at the same level appreciation of investment policy become a determinant factor of firm value.

Latest empirical study using the cross-section data analysis conducted by Kim, Park, and Suh (2017), suggest non-monotonic (a-J shaped) relationship between dividend policy and value of firm. High payer dividend payment results in higher firm value, however firms that do not pay dividends are not value lower than firms that pay lower dividends. Additionally the authors also find that this J-shaped does not mirror of market mispricing. Fama and French (1998) find dividend positively affect firm value, they argue that there is no effect of tax in pricing dividend, so that this dividend sends valuable information to market about firm’s prospect profitability and cash flow which missed by some other controlled variables (Pettit, 1972).
Aligned with those findings, Asquith and Mullins Jr. (1983) record increase in dividend payment results in upsurge shareholder wealth. More over Pinkowitz et al. (2006) also provide evidence that dividend positively impact firm value in country with poor investors protection. Conversely, different with previous findings, Baker and Wugler (2004) using catering dividend theory find that the size of dividend payments contribute to the firm value at the different direction, could be positive or negative at different time. So managers tend to pay dividend when investors value high for dividend payers and do not distribute dividend when shareholders choose not to have dividend payment.

The main purpose of this paper is to re-examine relationship between dividend and firm value. We also analyse impact of ownership concentration and firm value. As proposed by Claessens et al. (2002) there are two different effect of concentration ownership on firm value, firstly the positive effect appears when increase in cash flow rights or ownership of large shareholder causes of rising of firm's value. Larger shareholders have strong incentive to improve firm value, because they can collect more information and control their appointed managers well, so that this multi coverage could result in lower agency problem between principal and manager. Oppositely, the entrenchment effect occurs when control right or right to control and to vote of larger shareholders outstrip the cash flow rights. When the external control from minority shareholders is weak, often arising in extreme managerial agency problem (Lins, 2003). Managers and majority shareholders that have large control expropriate the firm cash flow for their private benefit. Consequently, this entrenchment effect negatively affects firm value. Additionally, this over control because of concentrated ownership and expropriation of company cash flow mostly occur in the countries with poor shareholder protection (La Porta, De Silanes, Shleifer, & Vishny, 2002).

Large shareholders have an active role in managing better corporate governance (Shleifer & Vishny, 1997). The recent empirical researches study the effect of large shareholder ownership that own by different type of owners such as managers, institutions, and family and its affect to firm’s value. Lin and Fu (2017), Elyasiani and Jia (2010) and Jafarinejad, Jory, and Ngo (2015) find that there is positive associated between institutional ownership and firm value.

Some scholars say that majority of the firm around the world are owned by family (Claessens, Djankov, Fan, & Lang, 2002) (Faccio & Lang, 2002) (Mock, Wolfenzon, & Yeung, 2005). Whether family owner increase value of firm? earlier study argue that family ownership could eliminate agency problem and improve value of firm (Morck, Shleifer, & Vishny, 1988). Meanwhile, (Villalonga & Amit, 2006) confirm that value of firm increase when the founder of family firm serve as CEO or as chairman with outsider professional CEO. Additionally, (Lozano, Martinez, & Pindado, 2016) found that the relationship between family ownership is non-monotonic, varies with their ownership range of control.

Relationship between managerial ownership and firm value is still debatable, as general theory of agency said that higher proportion of managerial ownership act as internal control to alleviate conflict of interest between manager and shareholder. In line with this theory, (Core & Larcker, 2002) confirm positive relationship between manager ownership and firm performance. Some other scholars find positive relationship, but after reaching some level of proportion, higher-level ownership affect negatively to the firm performance (Mc Connel, Servaes, & Lins, 2008)(Benson & Davidson III, 2009). However, (Demsetz, 1983) record that no association between managerial ownership and performance of the company.

The Indonesian capital market is one of the important capital markets in emerging economy, for a decade since 2006-2016 it posted the highest market growth index among leading bourses. Comparing with S&P 500 that grew 59% for the period, Jakarta composite index had 159% growth; meanwhile Kuala Lumpur (KLCI) only grew at 49%. The ownership of the firms are mostly concentrated either on family, individual or government and these owners are active in controlling the firm (La Porta, Lopez-de-
2. Literature Review

This section will explain the relationship between dividend pay out policy and firm value and impact of ownership concentration on value of firm.

2.1 Dividend policy and Firm Value

Investment policy, not dividend payout, is the only determinant factor of firm’s value in frictionless market; meanwhile, the dividend policy does not increase the shareholder wealth when all of firm’s profits are distributed to shareholders (Miller & Modigliani, 1961). (De Angelo & De Angelo, 2006) Relaxing this assumption by allowing retention of profit, result in decreasing the free cash flows available to share holder, then dividend policy is matter in determining the value. This finding support Jensen’s theory (1983) of free cash flows related to positive relationship between dividend policy and value of firm. Meanwhile, if managers use their discretion by disgorging firm’s free cash flows that lead to destroy the value (for example; Jensen, 1986) (Easterbrook, 1984).

Fama and French (1998) analyzed the effect of dividend and debt on firm value for US data, contrary with tax hypothesis, author recorded that the dividend payout positively associated to the firm value meanwhile debt negatively associated to firm value. Additionally, authors suggest that those two variables bring the information to the market about firm prospect future cash flows that are missed by other control variables. Applying Fama and French (1998) regression method, Pinkowitz, Stulz, & Williamson, (2006) used data from 35 countries, they find strong positive relationship between firm value and dividend in the country with poorer shareholder protection, however, this relationship weaken in the countries which have better protection of shareholders.

Hull (2015) expands signaling theory of dividend on prospect firm value, the author theoretically analyses timing of reduction dividend and when should the managers apply that strategy and its impact on the firm value. Timing of dividend reduction depends on the availability external financing and investment opportunity. When firm has relatively expensive external financing and have great investment opportunity earlier reduction of dividend results in higher firm value, oppositely when external financing less costly earlier reduction of dividend causes lower firm value. Time varying of shareholders demand on dividend impacts the share price or catering theory of dividend proposed by Baker and Wugler (2004). Company cater dividend to investors who price the stock higher when the issuer pay dividends, meanwhile, the firms do not pay dividends to those investors who prefer not to receive dividends. Dividend policy depend on the market demand, firms that do not pay dividends will tend to distribute dividend when there is higher demand for, on the other hand company will not pay dividends when the demand is low. Thus, it concludes that the association between dividends and firm value is not linear.

Recent empirical study by Kim et al.(2017) identifies non-monotonic relationship between dividend and firm value. The authors apply clientele dividend hypothesis where group of investors or clientele prefer to have dividend and other clients choose not to received dividend (anti-dividend) probably because of higher taxes on dividends (Miller &Modigliani, 1961). This behavior and demand from both groups create value premium for the stocks, pro-dividend create higher value for stocks that pay high dividends, similarly anti-dividends clients create premium value for the firms that do not pay dividend the study examines data from US firms and 13 other countries from year 1962-2010. In general, it finds that market value of firm higher for higher dividends payer, meanwhile non-dividends payer firms are valued higher than low dividends payers, thus the relationship between dividends and firm value is non linear, and form a J-shaped.

2.2 Concentration ownership and firm value

Increased firm value is the ultimate goal of the corporate finance managers, to achieve this goal managers should align their interests and act in the best interest of
shareholders. However, dispersion of ownership in the company could give a huge control for managers of the company cash flows for their own advantages. Thus probability conflict of interest between managers and owners or agency problems will arise (Jensen, 1986). Corporate governance as separation of ownership and control is used as mechanism to control the managers. It can assure the investors to get the good return on their investment and make sure that the managers invest the investors’ money in the good projects and do not expropriate their money (Shleifer & Vishny, 1997).

Villalonga and Amit (2006) explain that classic agency problem which arises between managers and the shareholder can be mitigated by concentrated ownership that have a power to control managers. Similarly, the concept of corporate governance by Shleifer and Vishny(1997) suggest investors are given a power through both of these ways; firstly legal protection from manager’s discretion and secondly by increasing the ownership by large concentration of shareholders, thus the investors will have a matching between their control rights and the cash-flow rights. Having the control, then investors could oversee the managers as well as control of firm assets in aligning the interest of managers and shareholders to maximize firm profit and value (incentive effect). However, largest concentrated ownership could impact the value of firm negatively where the majority owners without significant control of others might use the firm cash flows for their owned benefit at the cost of minority shareholders. It is said as type II conflict of interest by Villalonga and Amit(2006) or entrenchment effect by Lins (2003).

Empirical studies of the impact of concentrated ownership on firm value in eight East-Asian countries by Claessens et al.(2002) reveals that concentrated ownership increases the value of firms (incentive effect), however when the control right exceed the cash flow right of largest shareholder value of the firm decreases (entrenchment effect). Dispersed institutional ownership among several independent institutions could reduce expropriate behavior of major owners and ultimately increase the value of firm. Elyasiani and Jia (2010) correlate stability of institution ownership and firm value, using US firms’ data; the authors provide evidence that the more stable institutional ownership the better company performance. Following Elyasiani and Jia (2010), Lin and Fu(2017) use Chinese firms sample, they record that there is positive association between firm value and institutional ownership even though not all institutions are active in monitoring the firms. The effect of institutional ownership on diversified firm value was analyzed by Jafarinejad et al. (2015), they find that increasing institutional ownership results in higher firm value.

Family owner have more emotional connection with the firm, sometimes the consider that the continuity of company is family legacy so that it might fewer probability to expropriate firm cash flow (Lozano, Martinez, & Pindado, 2016), however problems such as succession decision among family might create disgorge cash flow out of company which destroy value of the firm (James, Jennings, & Breitkreuz, 2012). Exploring public listed firms from 16 European (Lozano, Martinez, & Pindado, 2016) confirm non-linear relationship between family ownership and firm value. Meanwhile, Morck, Shleifer, & Vishny (1988) and Villalonga and Amit, (2006) record the positive linear relationship between family ownership and company value.

3. Data and Methodology
3.1 Data
We use 226 public listed company data from Indonesian Capital Market, which distribute dividend from year 2005 to 2016, thus totally we have 2712 firm-year. Banking and finance firms are excluded from the data because they have different structure of balance sheets. We also exclude companies that have a missing the main variables data (dividends, firm value) for three consecutive years.

Firm value is measured by Tobin Q as use in several studies such as (Kim, Park, & Suh, 2017), (Claessens, Djankov, Fan, & Lang, 2002). Ownership of firms is divided in to proportion of manager ownership, state ownership and foreign ownership. Dividend payment is proxied from dividend payment over net income.
3.2 Methodology

Static panel data regression is used to analyze the relationship between dividend payment, proportion of ownership and firm value. To overcome part of endogeneity problem that arise from neglected firm-specific factors and time invariant which simultaneously determine explanatory variables and firm value, we apply firm-effect regression in our analysis. The model is

$$ TQ_{it} = \alpha + \beta_1 Div_{it} + \beta_2 INS_{it} + \beta_3 STATE_{it} + \beta_4 FORG_{it} + \beta_5 LIQ_{it} + \beta_6 DER_{it} + \beta_7 Profit_{it} + \beta_8 SIZE_{it} + \epsilon_{it} \ldots (1) $$

Index i and t represent the individual company and the time

- $TQ_{it}$ = Value of each company measured by Tobin's Q
- $Div_{it}$ = the proportion of dividend payment by each company every year
- $INS_{it}$ = proportion of insider ownership or manager ownership
- $STATE_{it}$ = proportion of state owned ownership
- $FORG_{it}$ = proportion of foreign ownership
- $LIQ_{it}$ = measurement of firm liquidity is proxied by current ratio
- $DER_{it}$ = firm leverage ratio measured by debt to equity ratio
- $Profit_{it}$ = firm profit is measured by Return on Asset (ROA)
- $SIZE_{it}$ = the size of firm is measured by ln Assets

4. Results and Analysis

4.1 Descriptive Statistics

Table 1 the descriptive statistics

<table>
<thead>
<tr>
<th>Variables</th>
<th>Mean</th>
<th>Min</th>
<th>Max</th>
<th>Std Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tobin’s Q</td>
<td>4,339</td>
<td>2,486</td>
<td>6,193</td>
<td>2,621</td>
</tr>
<tr>
<td>Dividend Payout</td>
<td>0.161</td>
<td>0.000</td>
<td>0.323</td>
<td>0.228</td>
</tr>
<tr>
<td>Proportion of Ownership</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Insider (INS)</td>
<td>0.848</td>
<td>0.797</td>
<td>0.898</td>
<td>0.072</td>
</tr>
<tr>
<td>- Stated Owned (STATE)</td>
<td>0.002</td>
<td>0.000</td>
<td>0.510</td>
<td>0.001</td>
</tr>
<tr>
<td>- Foreign (FORG)</td>
<td>0.405</td>
<td>0.000</td>
<td>0.810</td>
<td>0.573</td>
</tr>
<tr>
<td>Liquidity (LIQ)</td>
<td>1.329</td>
<td>0.974</td>
<td>1.685</td>
<td>0.503</td>
</tr>
<tr>
<td>Leverage (DER)</td>
<td>0.413</td>
<td>0.023</td>
<td>0.803</td>
<td>0.551</td>
</tr>
<tr>
<td>Profit (ROA)</td>
<td>0.104</td>
<td>-0.039</td>
<td>0.248</td>
<td>0.203</td>
</tr>
<tr>
<td>Size of Assets (SIZE)</td>
<td>13,760</td>
<td>12,543</td>
<td>14,976</td>
<td>1,720</td>
</tr>
</tbody>
</table>

Descriptive statistics reveal that the average payout ratio is 16.1%, meanwhile the maximum number of this profit distribution is quite moderate, it is only 32.3%. Data also shows that the Indonesian public listed firms have more value than its book value, its reflected from the Tobin Q, which has average number 4.339 and minimum 2.486. Proportion ownership by insider is quite high at 84.8%, meanwhile proportion of foreign ownership is only 40.5% with maximum number 81%. There are few firms are owned by state owned enterprises, maximum ownership is 51%.
4.2 Results Analysis

Table 2. Regression results, Tobin's Q as dependent variable.

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend Payout</td>
<td>-0.569</td>
<td>-0.013</td>
</tr>
<tr>
<td></td>
<td>(0.456)</td>
<td>(0.684)</td>
</tr>
<tr>
<td>INS</td>
<td>-225.601 **</td>
<td>-259.084 ***</td>
</tr>
<tr>
<td></td>
<td>(0.076)</td>
<td>(0.007)</td>
</tr>
<tr>
<td>FORG</td>
<td>107.519 **</td>
<td>122.756 ***</td>
</tr>
<tr>
<td></td>
<td>(0.073)</td>
<td>(0.007)</td>
</tr>
<tr>
<td>STATE</td>
<td>134.086</td>
<td>306.326</td>
</tr>
<tr>
<td></td>
<td>(0.633)</td>
<td>(0.512)</td>
</tr>
<tr>
<td>Profitability (ROA)</td>
<td>614.579</td>
<td>-103.776</td>
</tr>
<tr>
<td></td>
<td>(0.270)</td>
<td>(0.566)</td>
</tr>
<tr>
<td>Size ASSET</td>
<td>-355.799 ***</td>
<td>-515.597 ***</td>
</tr>
<tr>
<td></td>
<td>0.000</td>
<td>0.000</td>
</tr>
<tr>
<td>Liquidity (CR)</td>
<td>-216.539 ***</td>
<td>-103.540 ***</td>
</tr>
<tr>
<td></td>
<td>0.000</td>
<td>(0.005)</td>
</tr>
<tr>
<td>Leverage (DER)</td>
<td>-0.139</td>
<td>-0.125</td>
</tr>
<tr>
<td></td>
<td>(0.340)</td>
<td>(0.229)</td>
</tr>
<tr>
<td>Constant</td>
<td>746.290 ***</td>
<td>946.935 ***</td>
</tr>
<tr>
<td></td>
<td>0.000</td>
<td>0.000</td>
</tr>
<tr>
<td>R^2</td>
<td>0.196</td>
<td>0.338</td>
</tr>
</tbody>
</table>

Numbers in parentheses ( ) show probability (p), *, ** and *** indicate significance level at 10%, 5% and 1% consecutively.

Table 2 shows the result of our panel data regression using random effect model. We use random effect model to capture the different characteristics of firm in making dividend policy. We divide the results in to two columns to distinguish that the time of independent variables; the first column has the same level of year between dependent variable and independent variables. Meanwhile the second column investigates the effect of one-year lag value of dependent variables on the firm value.

Our regression result indicates that there is negative relationship between dividend policy and value of firm in The Indonesian Capital Market. However, it is not significant, different conclusion with (De Angelo & De Angelo, 2006), thus our result support theory of (Miller & Modiagliani, 1961), where in frictionless market the dividend is irrelevant, even though there are costs, taxes in doing transaction in Indonesian market. This outcome might occur, because the investors do not value the firm on the dividend basis, probably more investors in this market invest their funds in short term period so that less concern on dividend payment.

Management ownership or insider (INS) negatively affect the value of firm, as Indonesian firm dominantly own by family and the insiders of company, it seems that their control rights outstrip their cash flow rights, thus there is early indication of expropriation of firm cash flows for their benefits. Earlier study from Core and Larcker (2002) confirm positive relationship between manager ownership and firm performance. Some other scholars find inverted U-shaped relationship, positive relationship occur at some proportion of ownership but after reaching some level of proportion, higher-level ownership affect negatively to the firm performance (Mc Connel et al., 2008).

Increased in proportion of foreign ownership consistently have positive relationship with firm value. Investors might perceive good corporate governance on foreign ownership, so that they minority ownership can be protected from expropriate of majority
owners. Meanwhile, government ownership does not significantly affect the value of the firm. This outcome different with the results of Wang (2017), who found that central government in China with quality of their control on company produce premium value, meanwhile the local government owner have opposite results on firm value. We have limited firms that owned by government, so that we suspect that results could occur because of limited data.

This study also include four control variables; size of company (Assets), liquidity (LIQ), profitability (ROA) and leverage (DER). Out of four variables, there are only two specific firm control variable impact on value of firm; Size of company and liquidity. Both of these variables negatively impact value of firm. The larger the size of company the lower firm value, larger company tend to take higher risk and the ownership generally concentrated on larger owner, the minority investors fear on lose of their money, consequently bigger size firm might value lower by the market. The more liquid the company asset the less the value of firm, idle money in current asset grow slowly than investment in riskier project in fixed asset. Additionally, investors perceive that the liquid asset can be used by majority owner for their benefit on the cost of minority shareholder. Thus the probability disgorge of free cash flow could be higher, subsequently lower the market value.

5. Conclusions

There has been long controversial in corporate finance field since Miller and Modigliani (1961) postulate the irrelevance of dividend policy on firm value. By relaxing the friction less market and not all firm profits are distributed to share holder then some scholars find positive relationship between dividend payment and value of the firm (De Angelo & De Angelo, 2006) (Fama & French, 1998) (Pinkowitz, Stulz, & Williamson, 2006). Non-linear relationship between dividend payment then emerge with clientele dividend theory and catering dividend theory by (Baker & Wugler, 2004). Applying this theory then (Kim, Park, & Suh, 2017) suggest that the relationship between proportion of dividend payment and firm value form a J-shaped. Value of firm higher when shareholder receive higher dividend, however, value of non-payer dividends are not lower than value of less payer dividends.

The corporate governance is one of the control mechanisms of the conflict between shareholder and manager. As the common approach to corporate governance when there are disperse ownership and to reduce the power of managers control is giving the investors some power through legal protection and increasing the proportion of ownership. Thus concentrated ownership giving the owner significant control right that could be matched with cash flow right. Theoretically, higher concentrated ownership valuable for investors, where they can control manager from using their discretion, and they could align the interest of manager with those interests.

In this paper we re-examining the impact of dividend policy and proportion of ownership on dividend payment. Our findings suggest that there is no relationship between proportion of dividend payments and the firm value, as postulated by Miller & Modigliani (1961), even though the Indonesian Capital Market far from friction less market and not all profits are distributed to investors. We suspect that investors in this market are characterized by short term investment horizon, subsequently they have less concern on dividend payment and consequently the dividend is not a determinant of firm value.

As insider management or family dominantly owns Indonesian companies, the association between increased in ownership of insider impact negatively firm value. It seems that the owners has more power to disgorge firm cash flows that perceive negatively by the market. Meanwhile foreign firms valued higher by the market, probably because of good perception on corporate governance, thus it is follow the incentive value effect (Claessens et al. 2002).
References


