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Atlantis Press publishes proceedings in all major STM disciplines including Physical Sciences, Life Sciences, Health Sciences and Social Sciences. We offer conference, symposium and workshop organizers a unique service which is not only fast and personalized, 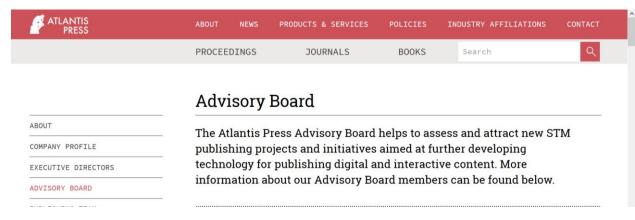but which also ensures maximum visibility for their conference and workshop proceedings. All proceedings on the Atlantis Press platform are **open access** and hence freely accessible for all to read. For a complete list of all published and forthcoming proceedings, please click here.

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The effect of good corporate governance on dividend policy

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Abstract
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The effect of good corporate governance on dividend policy

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University of Surabaya, Surabaya, Indonesia

ABSTRACT: This study aims to determine the effect of good corporate governance on dividend policy. The study used a sample of all non-financial companies listed on the Indonesia Stock Exchange. This research also used control variables of firm size, profitability, leverage, firm growth, and free cash flow. The results show that the variables of good corporate governance, firm growth and free cash flow had a positive significant effect on the dividend payout ratio. Meanwhile, the variable firm size, leverage, and profitability had a significant negative result on the dividend payout ratio.

Keywords: good corporate governance, dividend payout policy, growth, free cash flow

1 INTRODUCTION

After the monetary crisis that hit Indonesia in 1998, issues regarding good corporate governance (GCG) were increasingly highlighted, especially by the government. The topic of GCG is one of the important discussion topics because agency conflict will arise due to the nature of people who tend to be selfish, and conflicts will arise when there are several different interests within the same activity. This conflict occurs between the principal (shareholder) and the agent (manager) so that it can trigger the emergence of agency cost problems (Jensen and Meckling, 1976). Some examples of agency costs are the cost of supervision, incentives for managers, and other costs. Supervision that arises from external parties like capital market investors can be a tool to help reduce the characteristics and habits of opportunistic managers. GCG implementation within the company can also be an action to reduce the occurrence of information asymmetry and agency costs in the company.

La Porta et al. (2000) argue that external shareholders tend to prefer the return of investment in the form of cash dividends compared to an increase in the value of shares due to the reinvestment of profits in earnings withheld. According to Shleifer & Vishny (1997), the main purpose of corporate governance is to protect the rights of minority shareholders because dividend payments can be a tool to reduce conflicts between

corporate insiders (e.g. overseeing shareholders and managers) and outsiders (e.g. minority shareholders) to reduce conflict agency. Another study by Hussein and Byung-Seong (2016) shows that there was a positive effect of GCG combined with the size of firms and profitability on Dividend Payout (DP). In contrast, the financial distress and global financial crisis have a negative effect on dividend policy. The positive effect of this governance includes weak growth opportunities, strengthened firms free cash flow, and franked dividend policy. Benjamin and Zain (2015) conclude the results of the existence of "substitution arguments", which indicates companies with corporate governance were weak to shape the reputation and image of the company by paying high dividends. This shows that the proportion of independent commissioners and directors who meet more often will result in lower dividend payments. Meanwhile, Yarram (2015) shows the results of a significant positive relationship between GCG and dividends. Yaram's research concludes support for the signaling hypothesis where profitability has a significant positive result and a loss dummy has a significant negative effect on the company's dividend payout decisions in Australia.

Research on the effect of implementing the GCG mechanism on dividend policy has not been widely implemented in Indonesia. Generally, the research only examines the effect of profitability and the size of the company only on dividend policy. On the other hand, it should be realized that dividend policy is also influenced by other factors that will be the

topic of discussion in this study. Therefore, this study will discuss further the effect of good corporate governance (GCG) on dividends. In addition, other variables of company size, profitability, leverage, firm growth, and free cash flow will be the variables to be examined in relation to the effect on dividend policy in all company shares of the non-financial sector on the Indonesia Stock Exchange (IDX).

2 RESEARCH METHODS

This study used a sample of the non-financial sector company shares listed on the Indonesia Stock Exchange (IDX) over the period 2012-2016. The independent variable used was GCG; the control variables used were firm size, profitability, leverage, firm growth, and free cash flow, and the dependent variable used was dividend payout.

Dividends in this study were measured by the Dividend Payout ratio. GCG according to Hussein and Byung-Seong (2016) can be measured by doing calculations related to the GCG Index of each company. The entire index was added up so that it has a scale from one to thirteen, where the higher the GCG index, the stronger the company's GCG. Based on research, the GCG Index was calculated by considering thirteen variables which include: Board size, measured by calculating the number of commissioners in each company, then compared to the average number of directors of all companies in the same year. If it is greater than the average, it is given a value of one; if it is smaller, it is given a value of zero. Independence of the directors on the board, calculated by looking at the proportion of non-executive commissioners from each company, then compared to the total number of commissioners. If more than fifty percent, it is given a value of one, if less than fifty percent, it is given a value of zero. Number of board meetings, the total meeting of commissioners for one year compared to the average meeting of commissioners of all company objects. If it is more than the average, the value is one, but if it is less than the average, it is given a value of zero. Chairman and CEO separation, the role of the Chairman and CEO (Chief Executive Officer) that should not be carried out by the same person is given a value of one, if the second role held by the same person then it is given a zero value. Directors' shareholding, measured by the total number of shares held by the company commissioner, if more than five percent of the total

outstanding shares is given a value of one and if less is given a zero value.

CEO's shareholding, measured by the total number of shares held by the company's directors, if more than five percent of the total outstanding shares is given a value of one and if less is given a zero value. The existence of an audit committee, if there is an audit committee in the company; it is given a value of one, if not zero. The audit committee meeting, if it is held at least once a year, it is given a value of one; if there is no meeting, it is given a value of zero. Engagement of big four auditors has an involvement relationship with the big four. If there is a relationship, it is given a value of one, if not, it is given a value of zero. Remuneration committee, if there is a remuneration committee in the company and/or the task of the committee is carried out by other parties within the company, then it is given a value of one, if not zero. The remuneration committee meeting, if it is held at least once a year, it is given a value of one; if there is no meeting, it is given a value of zero. Nomination committee, if there is a nomination committee within the company and/or the task of the committee is carried out by another party within the company, then it is given a value of one, if not zero. The nomination committee meeting, if it is held at least once a year, it is given a value of one; if there is no meeting, it is given a value of zero.

Control Size variables were measured by calculating in from total assets. Profitability was measured using the ratio of return on assets (ROA). Leverage was measured by dividing total debt with total equity in the company. Growth was measured based on the percentage of increase in company sales. FCF was obtained from the operating cash flow in various total assets (Benjamin and Zain, 2015). The samples used in this study were 310 companies or 1,550 years of observation. The study used panel data and based on the results of the Chow and Haussmann test, the fixed effect model was selected.

3 RESULTS AND DISCUSSIONS

In table 1, it can be seen that the good corporate governance variable coefficient is 0.000573, with a significance level of 0.0017 which means that the variable of good corporate governance had a significant positive effect on dividend payout. This significant positive relationship is in accordance with the Outcome model, namely the better corporate governance; the company will tend to pay

more dividends. Strong shareholder rights tend to make agents unable to use cash flow according to their interests due to strong supervision. The relationship between GCG and dividend policy is complementary and not the substitution. Companies with good governance can have an impact on the company's performance that increases operationally so that the company can make a larger dividend payment in accordance with the expectations of shareholders. This is consistent with the research conducted by Yarram (2015), La Porta et al (2000) and Mitton (2004).

Table 1. Regression Test Result

Independent Variable	Coefficient	Significance
GCG INDEX	0.000573	0.0017***
SIZE	-0.002580	0.0114**
PROFIT	-0.012968	0.0373**
LEV	-0.003142	0.008***
FIRM GROWTH	0.000539	0.0262**
FCF	0.001156	0.0745*
R-Squared		0.954089
Adjusted R-Squared		0.942369
Prob (F-Statistic)		0.000000

*Significant at the 10% level; ** Significant at the 5% level; and *** Significant at the 1% level

In table 1, it can be seen that the good corporate governance variable coefficient is 0.000573, with a significance level of 0.0017 which means that the variable of good corporate governance had a significant positive effect on dividend payout. This significant positive relationship is in accordance with the Outcome model, namely the better corporate governance; the company will tend to pay more dividends. Strong shareholder rights tend to make agents unable to use cash flow according to their interests due to strong supervision. The relationship between GCG and dividend policy is complementary and not the substitution. Companies with good governance can have an impact on the company's performance that increases operationally so that the company can make a larger dividend payment in accordance with the expectations of shareholders. This is consistent with the research conducted by Yarram (2015), La Porta et al (2000) and Mitton (2004).

Based on table 1, it can be seen that the firm size variable coefficient is -0.002580, with a significance level of 0.0114 which means that the firm size variable had a significant negative effect

on the dividend payout ratio. Company size shows the direction of a negative and significant relationship. This finding can be explained that small size companies in Indonesia are relatively less publicized. It is in contrast to large companies that relatively receive high attention from both investors and the mass media. In fact, large companies normally have large-scale information available in the public, so the role of dividends to inform the company's conditions is reduced. Meanwhile, small size companies which lacks public attention need to communicate the company's condition with higher dividend payments. This is supported by the condition of the capital market in Indonesia, where the majority of companies listed on the stock exchange are large companies. The bigger the company, the more information available. Large companies that are relatively often discussed make it better known, thereby reducing the role of dividends as a signal about the company's condition (Murhadi & Wijaya, 2011).

In table 1, it can be seen that the profitability variable coefficient is -0.012968 with a significance level of 0.0373 which means that the profitability variable had a significant effect on the negative direction of the dividend payout ratio. This negative result indicates that the greater the profitability of the company, the smaller dividends the company will share with shareholders. Conversely, the smaller the profitability of the company, the greater the amount of dividends distributed. This is because the management of companies that are able to achieve profits focused more on their income compared to changing the dividend payout ratio with the aim of ensuring the stability of dividends and avoiding uncertain dividend payments. Furthermore, companies with uncertain levels of profitability do not reduce dividends until company management believes that the prospect of corporate recovery is difficult (to avoid uncertain changes in the ratio of payments). The results of this study are in accordance with the pecking order theory which states that profitable companies have an incentive to pay a relatively low dividend in order to have more internal funds to finance their investment projects. Even for a growing company, an increase in dividends can be bad news because it is suspected that the company has reduced its investment plan.

In table 1, it can be seen that the coefficient of the leverage variable is -0.002580 with a significance level of 0.008 which means the leverage variable had a significant negative effect on the dividend payout ratio. Farinha (2003) in Abor & Fiador (2013) explained that debt would reduce

dividend payments on the basis of agreed debt agreements and related to the limits provided by debt holders. The use of debt will have an impact on the low free cash flow and can reduce the amount of dividends that are distributed because the company must make payments for debt to debt-holders. Jensen (1986) found that, the existence of debt can be used as a tool to reduce agency costs. Thus, there is a substitution effect between debt and dividends.

In table 1, it can be seen that the firm growth variable coefficient is 0.00000539 with a significance level of 0.0262 which means that the firm growth variable had a significant positive effect on dividend payout. Growth in the company shows the direction of a positive and significant relationship. Growing companies will spend a lot of money. The money includes a fund to pay dividends to shareholders. The more the company grows, the company needs a signal that the company has good prospects in the future. This is in accordance with the signaling theory which states that dividend payments can be a signal for outside investors about the company's future prospects, so that companies that grow more will pay dividends to provide a signal to shareholders regarding the company's future prospects.

In table 1, the variable of Free Cash Flow coefficient of is 0.001156 with a significance level of 0.0745 which means that the Free Cash Flow variable had a positive significant effect on the dividend payout ratio. Free Cash Flow is defined by Jensen (1986) as an excess cash fund after it is used to fund all projects that provide a positive net present value discounted at the level of relevant capital costs. White et al. (2003: 68) revealed that the greater the free cash flow available in a company, the healthier the company is because it has cash available for growth, debt payments, and dividends. It can also be interpreted that the smaller the FCF value the company has, the more it can be categorized as unhealthy. Companies with high free cash flow values tend to experience high agency costs, therefore companies will use dividends to be a tool that can help reduce agency costs. (Adjaoud & Ben-Amar, 2010). High free cash flow in a company will tend to result in the company not making profit manipulation, because in this case, most investors are transient investors who will act to oversee the company's performance so that they are more focused on the company's free cash flow information which shows how the company's ability to distribute dividends.

4 CONCLUSION

Based on the results of the study, it was obtained that the variables of good corporate governance (GCG), firm growth and free cash flow had a positive significant effect on the dividend payout ratio. Furthermore, the variables of firm size, leverage, and profitability had a significant negative result on the dividend payout ratio. The variable of good corporate governance (GCG) had a significant positive effect on the Dividend Payout Ratio. This is because the better corporate governance, the company will tend to pay more dividends according to the outcome of the model. Strong shareholder rights tend to make agents unable to use cash flow according to their interests due to strong supervision. Thus, investors who expect dividends will invest in companies that implements good corporate governance. Firm size variable had a significant negative effect on the Dividend Payout Ratio. This is because large size companies tend to get high attention from investors so that it has an impact on the availability of greater public information, thereby the role of dividends to inform the company's condition is reduced. Likewise, small-size companies rarely get public attention, so the role of dividends as a signal to inform the company's conditions is essential. Thus, investors who expect dividends will invest in small size companies. The profitability variable had a significant negative effect on the Dividend Payout Ratio. This is in accordance with the pecking order theory, profitable companies have the drive to pay relatively low dividends so that the company will have more internal funds with the aim of being able to finance its investment projects. Thus, investors who expect dividends will invest in companies with low profitability.

Variable leverage had a significant negative effect on the Dividend Payout Ratio. This is because the use of debt is considered to trigger conflict between shareholders and creditors, and the use of debt will have an impact on the low free cash flow that can reduce agency costs which cause lower dividends paid. Thus, investors who expect dividends will invest in companies with small debt levels. Firm growth variables had a significant positive effect on the Dividend Payout Ratio. This is because a growing company will spend a lot of money. The money includes fund to pay dividends to shareholders. Dividends for companies to grow will be a signal (signaling theory) that the company has a good prospect in the future. Thus, investors who

expect dividends will invest in companies with high growth rates.

The variable of free cash flow had a significant positive effect on the Dividend Payout Ratio. This is because companies with high free cash flow tend not to manipulate earnings, because in this case most investors are transient investors who will act to oversee company performance so that they are more focused on free cash flow information companies that demonstrate the company's ability to distribute dividends. Thus, investors who expect dividends will invest in companies with high free cash flows.

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