Delhi Business Review ✠ Vol. 15, No. 1 (January - June 2014)

INFLUENCE OF MANAGERIAL OWNERSHIP, DEBT POLICY, PROFITABILITY, FIRM SIZE, AND FREE CASH FLOW ON DIVIDEND POLICY

A STUDY IN INDONESIAN MANUFACTURING INDUSTRIES

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PURPOSE

THE aim of this study is to analyze how the managerial ownership, debt policy, profitability, firm size, and free cash flow impact the dividend policy on manufacturing industries, and to determine the dominant factors that affect dividend policy.

Design/Methodology/Approach: *Purposive sampling method was used in taking samples of the eight companies listed on the Indonesian stock exchange.*

Findings: *After using multiple linear regression, this research found that only the free cash flow has a significant and positive impact on dividend policy. Managerial ownership has a significant negative effect on dividend policy. Debt policy and firm size did not have a significant negative effect on dividend policy. Profitability did not have a significant positive effect on dividend policy. Dominant factor that affected dividend policy is the company's free cash flow.*

Research Limitation/Implications: *The limitation of the finding of this study was the use of only five variables that affect the company's dividend policy while there are many other variables that affect dividend policy.*

Practical Implications: *The result of this study would help manufacturing industries to better understand the factors that affected dividend policy.*

Originality/Value: *The study offers a beneficial source of information to manufacturing industries because it is one of the dominant sector of capital market at Indonesia Stock Exchange, or IDX.*

Key Words: Managerial Ownership, Debt Policy, Firm Size, Free Cash Flow, and Dividend Policy.

Introduction

Financial management is one of the strategic functions which deals with the management of finances. Financial management is done to make a company capable to increase its value so that the prosperity of the stockholders can be increased as well. A financial manager is responsible for this management and he has to carefully consider the three decisions while managing the financial assets of his company. They are financial decision, investment decision, and dividend policy. By doing so, the financial manager can also improve the value of the company. The dividend policy is an important part that should be considered in financing decision. Dividend payout ratio determines the profit amount that can be endured in a company as a source of funding. However, by enduring the profit in bigger amount in the company would mean that fewer money will be provided for dividend payout. Thus, the major aspect of company

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dividend policy is determining a correct profit allocation and dividend payout with profit endured by the company.

The dividend policy also has connection with the relationship between manager and shareholders. The importance of a shareholder and a manager can be different and perhaps it can also cause a conflict, for instance, a manager wants a small dividend distribution because the company needs much funding to fund an investment, while stockholders wants a big distribution of dividend. The manager's behavior in this situation is interesting to be conducted in a research.

The decision and activity of a manager who has corporate stock certainly will be different from a pure manager. It is caused by a manager who has corporate stock at the same time also play a role as a shareholder and he will treat his importance as same as the importance of a shareholder. However, the manager who does not have corporate stock will only pay attention on his own importance.

Various conditions of the company can affect the value of the company's free cash flow, for example, if the company has a high free cash flow with a low growth rate so the free cash flow is supposed to be distributed to shareholders, but if the company has a high free cash flow and the growth rate is high, this free cash flow can be held temporarily and can be used for investment in the coming period. Due to the above conditions, it indicates that the presence of a large free cash flow in a company does not necessarily indicate that the company will pay dividends in a greater amount than that when companies have little free cash flow.

The use of debt is also expected to reduce conflict of agency; the addition of debt in the capital structure can reduce the use of stock thereby reducing agency costs of equity. The company has an obligation to repay the loan and pay interest charges periodically. In addition, the company as a creditor can use assets as collateral for its debt. The amount of permanent assets used by lender can serve as collateral (collaterizable asset). The greater the assurance of fixed assets, the greater the company's funding which is invested in fixed assets, so that the smaller is the dividend distribution.

Profitability is the net profit level that can be achieved by the company during the operation. Variable ROA (Return on Assets) as a proxy for profitability is used to determine the effect of profitability used by the company in setting dividend policy.

Nuringsih (2005), analyzed the effect of managerial ownership, debt policy, ROA and firm size on dividend policy, with a sample of 60 manufacturing firms in 1995-1996. The results found that managerial ownership and firm size relate positively whereas debt policy and profitability are negatively related.

Review of Literature and the Development of Hypothesis

Dividend is the value of the company's net income after deducting tax and retained earnings (retained earnings which is being held as a reserve in the company). According to Hanafi (2004), the dividend is compensation received by the shareholders, beside the capital gains. This dividend is used to be distributed to the shareholders as profit from corporate profits. Dividends are determined by the general meeting of shareholders and kind of the payment depends on the type of leadership policy.

Dividend policy of the company is reflected in the dividend payout ratio that is the percentage of earnings distributed in the form of cash dividends, means that the size of the dividend payout ratio will affect the investment decisions of shareholders and also the company's financial condition (Marlina and Danica, 2009; Komala and Nugroho, 2013). Considerations about the dividend payout ratio are supposedly related to the company's financial performance. When a company's financial performance is good then the company will be able to determine the amount of the dividend payout ratio in accordance with the expectations of shareholders and of course without prejudice to the interests of the company to stay healthy and grow.

Managerial Ownership and Dividend Policy

Manager has the opportunity to be involved in the ownership of the shares with the aim of gaining equal shareholders. Through this policy, the manager is expected to result in a good performance as well as direct dividends at a low level. With the establishment of a low dividend, the company will have high retained earnings, which in turn would mean high internal sources of funding to fund an investment in the future. If the majority of shareholder like high dividends then it will cause conflicts of interest that required an increase in the dividend. In contrast, in the context of ownership by high managerial, the preference will be similar between the shareholders and the managers and it does not take as dividend increases.

Debt Policy and Dividend Policy

Debt variable is selected as the second independent variable because if the company had retained earning limitations, the company tend to use debt. Based on this effect, when the use of debt is too big it will impact on the financial distress and bankruptcy. In this case, the interests of creditors remain unnoticed as gains are saved for debt repayment. (Nuringsih: 2005).

Pecking order theory establishes a sequence of funding decisions which managers will first choose to use retained earnings, debt, and the issuance of share as a last resort (Hanafi, 2004). The use of debt is preferred as costs incurred for the debt is cheaper than the cost of issuing stock.

Profitability and Dividend Policy

Profitability (ROA) is the third independent variable which indicates that company makes profit. At the high level of profitability, the company allocates a low dividend. This is because most of the companies allocate half of their profits as a source of internal funds. At high ROA, low dividends are paid because profit-making is used to increase retained earnings. In this way, the internal funding is increased so that the company can delay the use of debt or the issuance of new shares. Conversely, if ROA is low, then high dividends are paid. This is done because the company's profit decreased so as to maintain its reputation in the eyes of investors, the company will distribute a large dividend.

Firm Size and Dividend Policy

Company size is used as a fourth independent variable which affects the dividend policy. Size of the company plays a role in explaining the company's dividend payout ratio. Large companies tend to be more mature and have easier access to the capital market. This will reduce their reliance on internal funding, so the company will provide high dividend payments (Vogt, 1994).

Free Cash Flow Against Dividend Policy

Dividend payments are cash outflows. The stronger the financial position of the company, the greater the company's ability to pay dividends to shareholders. Cash usually cause a conflict of interest between managers and shareholders. The manager wants the cash reinvested in the company's assets to increase the incentives that increase earnings and sales, while shareholders want the cash to be distributed as dividends.

According to the free cash flow hypothesis, when the company has extra cash, then the projects that have a positive net present value (NPV) should be funded. But it's better for the manager to return the excess cash to shareholders in the form of dividend payments in order to maximize shareholders, wealth. It shows that dividends may reduce agency cost, because it reduces the free cash flow available to managers (Jensen, 1986).

Based on the background research and theoretical review, the hypothesis of this study are as follows:

H01: There is no significant influence of Managerial Ownership on Dividend Policy

HA1: There is significant influence of Managerial Ownership on Dividend Policy

H02: There is no significant influence of the Debt Policy on Dividend Policy.

HA2: There is significant influence of the Debt Policy on Dividend Policy.

H03: There is no significant effect of Return on Asset on Dividend Policy.

HA3: There is significant effect of Return on Asset on Dividend Policy.

H04: There is no significant effect of the size of the Company on Dividend Policy.

HA4: There is significant effect of the size of the Company on Dividend Policy.

H05: There is no significant effect of the Company Cash Flow and Dividend Policy.

HA5: There is significant effect of the Company Cash Flow and Dividend Policy.

Research Method

The research was conducted at the Indonesian Stock Exchange which is Located at Jl. Sudirman Kav. 52-53, Jakarta 12190. The objective of this study is Managerial Ownership, Debt Policy, Return on Assets, Company Size, and Free Cash Flow of manufacturing companies in Indonesia Stock Exchange by using data from 2008 to 2010.

The population of this study includes all manufacturing companies in Indonesia Stock Exchange from 2008 to 2010, out of which eight companies have been selected as samples in the present study. Purposive sampling is used in taking sample in this study in order to obtain samples in accordance with the criteria specified.

The data used in this study is secondary data. The data collection method used in this study is the method of documentation, i.e., reviewing and recording data of the company's financial report. Research was also conducted by using literature study, namely by learning, understanding, observing, examining and identifying issues related to research problems.

In order to know the influence of the variable OWN, DEBT, ROA, SIZE, and FCF as the independent variable on the dividend policy as the dependent variable then this reseach used multiple linear regression analysis model or Multiple Linear Analysis Regresion which will then be processed by using Statistical calculations through statistical computer software program product and services solution version 19 (SPSS).

The Result of the Study

Multiple Linear Regression

The test results of the multiple linear regression model of the factors that affect dividend policy on manufacturing companies in Indonesia Stock Exchange can be seen in Table 1.

Based on the Table 1, it can be formulated that the multiple linear regression equation of the result of this study is as follows:

$$Y = 0.705 - 1.262\ OWN - 0.032\ DER + 0.344\ ROA - 0.016\ SIZE + 1.663\ FCF$$

Based on the results of the regression calculation, only ROA and FCF have associated direction of the dividend policy while OWN DER and SIZE are in contrast with the dividend policy.

Table 1: Multiple Linear Regression Coefficients[a]

	Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.705	1.420	–	0.496	0.626
	OWN	-1.262	0.441	-0.616	-2.862	0.010
	DER	-0.032	0.030	-0.197	-1.071	0.298
	ROA	0.344	0.270	0.314	1.273	0.219
	SIZE	-0.016	0.050	-0.086	-0.321	0.752
	FCF	1.663	0.648	0.596	2.565	0.019

a. Dependent Variable: DPRSource : The Result of Study, 2012.

(F- Test)

F test is used to test the effect of managerial ownership variables, debt policy, profitability, firm size, and free cash flow simultaneously on dividend policy (DPR). This can be seen by looking at the value of F, if the calculated value of the F-> F-table means that Ho is rejected but if the calculated F d" F-table then Ho is accepted.

Multiple regression analysis showed that managerial ownership variables, debt policy, profitability, firm size, and free cash flow simultaneously have a significant effect on dividend policy. It can be shown from the count value of 2.881 F-> F-table 2.773. It means that Ho1 is rejected and Ha1 is accepted. Because the probability is less than 0.05 then the regression model can be used to predict the dividend policy or it can be said that managerial ownership, debt policy, profitability, firm size, and free cash flow jointly affect dividend policy.

Table 2. Result of F-Test ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	0.801	5	0.160	2.881	0.044[a]
	Residual	1.001	18	0.056		
	Total	1.802	23			

a. Predictors: (Constant), FCF, ROA, DER, OWN, SIZE

b. Dependent Variable: DPR

Source : The Result of Study, 2012.

T-Test

T-test was used to test the effect of variable managerial ownership, debt policy, profitability, firm size, and free cash flow partially on dividend policy. This can be seen by referring to the results of t, if the t-count> t-table, then Ho is rejected but if t-count<t-table then Ho is accepted.

Table 3. T-Test Coefficients[a]s[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t-hitung	t-table	Sig.
		β	Std. Error	Beta			
1	(Constant)	0.705	1.420		0.496	1.734	0.626
	OWN	-1.262	0.441	-0.616	-2.862	1.734	0.010
	DER	-0.032	0.030	-0.197	-1.071	1.734	0.298
	ROA	0.344	0.270	0.314	1.273	1.734	0.219
	SIZE	-0.016	0.050	-0.086	-0.321	1.734	0.752
	FCF	1.663	0.648	0.596	2.565	1.734	0.019

a. Dependent Variabel : DPR

Source: The Result of Study, 2012.

Based on the Table 3, the result of partial test can be expained as follows:

Influence of Managerial Ownership on Dividend Policy

From the calculation OWN significance level that is 0.010 <a = 5% and t-count <t-table, which is -2.862 <1.734, means that partially, managerial ownership is negative and significant on dividend policy of companies in BEI. It shows that the level of ownership of the shares owned by the company's board of directors and commissioners have negative effect on how much dividend will be distributed. If the level of ownership is high, then the companies tend to allocate earnings on retained earnings rather than paying dividends on the grounds of internal financial resources more efficiently than sources of external funding. While at the low ownership level, the company tends to distribute large dividends to provide a good signal about the performance in the future thereby it can increase the company's reputation in front of investors. This description also proves that H1 can be accepted.

Influence of Debt Policy on Dividend Policy

From the calculation, it has been found that the debt policy significance level (DER) that is equal to 0.298> a = 5% and t-count <t-table, which is -1.071 <1.734, means that partially DER has negative effect and is not significant on dividend policy of manufacturing companies in BEI. It shows that if the company has a high debt level then the company will try to reduce agency cost of debt by reducing its debt. The use of debt can be done by paying the investment with internal cash resources so that shareholders will give up their dividend to finance its investment. It is also suitable with a pecking order theory of sequences funding decisions in which managers will first choose to use retained earnings, debt, and the issuance of shares as a last choice. These results suggest that H2 is rejected (Kristianti 2013).

Influence of Profitability on Dividend Policy

From the calculations, the significance level ROA is equal to 0.219> a = 5% and t-count <t-table, i.e., 1.273 <1.734, it means that partially profitability has positive effect and not significant on dividend policy of manufacturing companies on the Stock Exchange. It is proved that if a company has a high profit, it will use the profits for the company's operations or investments that will reduce dividends. Conversely, if ROA is low then high dividends are paid. This is done because the company's profit decreased so that in order to maintain its reputation in the eyes of investors, the company will distribute a large dividend. These results indicate H3 was rejected.

Influence of Firm Size on Dividend Policy

From the calculations, it is found that the significance level of firm size is equal 0.752> a = 5% and t-count <t-table, which is -0.321 <1.734, means that the size of the company partially negative and not significant on dividend policy of manufacturing companies on the Stock Exchange. It can be seen that large companies do not distribute large dividends to shareholders since the company's reputation has been known by investors, so investors trust the company. Large companies tend to use the funds to expand the company. Small companies distribute big dividends in order to provide a good signal to the market. Thus, its stock value will go up, this is in accordance with the signaling hypothesis. These results indicate that H4 is not accepted (rejected).

Influence of Free Cash Flows on Dividend Policy

From the calculations, the significance level of free cash flow is equal to 0.019 <a = 5% and t count> t-table, i.e., 2.565> 1.734, meaning that the partial free cash flow has a positive and significant impact on dividend policy of manufacturing companies on the Stock Exchange. Free cash flow truely affects the dividend policy since the main factor that determines the size of the dividend is the amount of funds available, the greater the funds in the company, more fund will be allocated to the distribution of dividends, and vice versa. This is similar to the free cash flow hypothesis, namely, when the company has excess cash, then projects that have a positive net present value (NPV) are to be funded (Belkaoui 1998). But it is better for the manager to return excess cash to shareholders in the form of dividend payments in order to maximize shareholder wealth. It shows that dividends may reduce agency cost, because it reduces the free cash flow available to managers. These results indicate that H5 is accepted.

Coefficient of Determination

Table 4: The Test of Coeficient Determination

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.667[a]	0.445	0.290	0.23584

a. Predictors : (Constant), OWN, DER, ROA, SIZE, FCF

b. Dependent Variable : DPR.

Source : The Result of Study, 2012.

From the above table, it can be seen that the coefficient of determination (R^2) is 0.445. With a coefficient of determination of 0.445, it means that 44.5% dividend policy can be explained by the five independent variables, managerial ownership, debt policy, profitability, firm size, and free cash flow. Whereas the rest (66.7%) is influenced by other variables which are not included in our research model such as the growth of the company, the level of corporate liquidity, etc.

Conclusion

From the analysis following can be concluded:

1. Simultaneously, the variable of managerial ownership, debt policy, profitability, firm size, and free cash flow significantly influence the dividend policy of manufacturing companies in Indonesia Stock Exchange from 2008 to 2010.
2. In partial, free cash flow and managerial ownership significantly has effect on dividend policy, but the managerial ownership variables negatively affect dividend policy, while the debt policy variable and the size of the company are negative and not significant on dividend policy. Profitability has positive and is not significant on dividend policy of manufacturing companies in Indonesia Stock Exchange during the period of this research is conducted.
3. These results indicate that the dominant factor that determines how much dividend to be distributed to shareholders is the free cash flow, is cash that can be distributed to creditors or shareholders who are not used as working capital or investment in fixed assets (Ross et al., 2000). While the number of shares held by managers and directors, earning level based on its active total, the level of liabilities, and how big the company size does not significantly affect how big dividends declared by the company to stakeholders.
4. Overall, managerial ownership variables, debt policy, profitability, firm size, and free cash flow significantly affect the dividend policy by 44.5%, and for the remaining 66.7% are influenced by other variables which are not included in the research model.

Based on the analysis that has been done, the suggestions that can be given by the authors are as follows:

1. In determining the dividend policy, a company should pay close attention on free cash flow because free cash flow affects the dividend policy.
2. For investors who will invest in Indonesia Stock Exchange with the aim of obtaining the dividend has to be more accurate in analyzing the company and stock companies that will be invested especially at the level of free cash flow that can produce expected profits that can be done by using several analytical instruments like using the factors that have been proved to influence the dividend policy significantly in this study.

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