

# **THE EFFECT OF GOOD CORPORATE GOVERNANCE (GCG) MODERATION ON A CORRELATION BETWEEN FUNDAMENTAL FACTORS TO THE DIVIDEND POLICY**

Juwita Agustrisna, Azhar Maksum dan Arifin Akhmad  
Universitas Sumatera Utara

**Abstract :** *The research objective is to analyze the influence of moderation of the Good Corporate Governance (GCG) on the correlation among fundamental factors (liquidity, leverage, profitability, sale growth, firm size, operation of cash flow, profit volatility, capital expenditure, and detained profit) simultaneously and partially on dividend policy in non-financial companies. The population was 376 non-financial companies listed in the Indonesia Stock Exchange from 2009 to 2013. The samples were 20 companies with 100 units of analysis selected based on purposive sampling method. The data were analyzed by using the multiple-linear regression analysis and the residual test with an SPSS software program. The research result proved that simultaneously fundamental factors (liquidity, leverage, profitability, sale growth, firm size, operation of cash flow, profit volatility, capital expenditure, and detained profit) did not influence dividend policy in non-financial companies. Partially, all independent variables did not influence significantly dividend policy. Good Corporate Governance variable was the moderation variable which significantly strengthened fundamental factors with dividend policy of non-financial companies.*

*Keywords: liquidity, leverage, profitability, sale growth, firm size, operation of cash flow, profit volatility, capital expenditure, detained profit, managerial ownership, dividend policy*

## **INTRODUCTION**

Dividend policy is a decision on the amount of profit to be retained for reinvestment and the amount of profit to be distributed to shareholders as dividends. According to Walter (1956), dividend policy aims to maximize the welfare of shareholders. Because the purpose of shareholders is to get a return on what they have invested. Dividends can be a benchmark for a company's credibility. The higher the dividends are distributed by a company, the more credible the company will be. Dividend policy is a major concern for managers and investors. In general, empirical research results indicate that dividend payout is considered good news by investors, while a decrease in dividends will lead to a bad reaction. Dividends can also be used to gain investor interest to invest in a company, and even dividend policy can also affect the value of the company. Several related studies on the relationship of dividend policy and firm value have been done. The Gordon Growth Model explicitly mentions the relationship between firm value and dividend policy. According to Gordon (1963) the current dividend is more important than the present value of future dividends. Gordon also argues that investors always think rationally. They will tend to avoid risk and uncertainty. They will prefer to buy stocks with high prices but with the stock they get a dividend return. On the contrary, they will ignore the value of the company's stock deferring the payment of dividends. Research conducted by Gordon (1963) is not in line with research conducted by Miller and Modigliani (1961). Miller and Modigliani mention that dividend policy is not related to stock prices. They argue that as long as the firm realizes the expected return of the market, it does not matter whether the return will return to shareholders in dividend or to be reinvested. Shareholders can earn cash by selling shares they have when they need cash. But there are

some shortcomings in this study. Miller and Modigliani use the less realistic assumption of no taxes and brokerage fees.

Dividend policy is influenced by many factors. To date, various studies have been conducted in relation to dividend policy and its influencing factors, such as: profitability, cash flow, leverage, sales growth, liquidity, stock prices, capital expenditures, retained earnings, systemic risk, share ownership, firm size, profit volatility and several other factors.

In practice, there are two dividend policies that are often used by the company, namely the residual dividend policy and stable dividend policy. A stable dividend policy is commonly used by companies with low risk levels. Dividends are distributed relatively stable from year to year (Sugiono, 2009: 173). While the residual dividend policy is generally used by considering several factors. At this policy, the amount of dividends distributed is fluctuative.

In carrying out its activities, the company is strongly influenced by its governance system or better known as corporate governance. Corporate governance can determine whether a company is successful or not. With the implementation of good corporate governance system is expected to increase corporate performance. One indicator of increased company performance is an increase in dividends. The variables of good corporate governance are expected to increase the amount of dividends distributed to shareholders. According to Santoso (2008) good corporate governance is a form of investor protection against the dividend payout ratio. Investors who feel protected will be willing to get a lower dividend so that corporate profits can be used for reinvestment. The agency theory explains that corporate governance serves as a tool to give investors confidence that shareholders will receive returns on the funds they have invested. Corporate governance deals with how investors believe that managers will benefit and will not undertake unfavorable "loot" against funds invested by investors (Shleifer and Vishny, 1997).

Non-financial companies are companies that produce non-financial products or services, for example: cars, steel, chemicals, transportation services, and others. Indonesian Stock Exchange (IDX) has set 8 (eight) non-financial industrial sectors consisting of: (1). agriculture, (2). Mining, (3). Industries and chemicals, (4). various industries, (5). industry of consumer goods, (6). property and real estate, (7). Transport and infrastructure, and (8). Trade, services and investment. In total, there are 376 nonfinancial companies listed on the IDX in 2009 - 2013 (source: [www.idx.co.id](http://www.idx.co.id) accessed on September 27, 2014). This research is a replication of research conducted by Mishra *et al* (2010) entitled Dividend Policy Determinant Indian Service Sector: Factor Analysis.

In this study the researchers wanted to see if this study would show the same results as previous research or would get the opposite result, or even would provide a new recommendation. Therefore, researchers are motivated to conduct a further study on the research title "The Effect of Good Corporate Governance Moderation on Correlation between Fundamental Factors to Dividend Policy".

## ***Literature Riview***

### ***Dividen Policy***

Miller and Modigliani (1961) mentioned that theoretically, dividend policy can be explained through two approaches, namely agency cost or contracting model and signaling model. Agency cost is based on the separation between owner and control, especially if ownership is dispersed. This dispersed ownership causes pushing of monitoring managers to be low, and this is where agency issues arise. This Agency problem will be more tapered if the company has a lot of cash but its growth is slow. For this reason, one way to control

managers is to force managers to pay dividends on a periodic basis. Managers who are considered successful are managers who can pay dividends. This will be followed by a positive response from the market (rising stock prices). In signaling models, dividends are used as a positive signal for managers' ability to manage. This is because dividend payments require a lot of cashflow (Asnawi and Wijaya, 2005).

An investor earns a return on investment in stocks in two ways: capital gains earned by an investor if an investor's share is sold at a price higher than the price at which he or she bought it and through dividends distributed by the company. Usually a company distributes dividends with a view to attract potential investors.

According to Fleming *et al* (2010), dividend payout ratio describes the percentage of profits distributed by the company to shareholders. A high dividend payout ratio illustrates that the company is in a "healthy" state financially or it may be considering a reinvestment.

### ***Liquidity***

According to Gupta and Banga (2010), a company with high external financing will require the availability of large cash flows, or in other words, the company must have a high liquidity ratio to pay its obligations. Therefore, to increase its liquidity, the company must lower the amount of dividend payout. On the other hand, the larger the size of the company, the greater the availability of cash flow and the greater the amount of dividends paid to shareholders. A company with large shareholders is expected to pay large amounts of dividends to shareholders feel satisfied.

### **Leverage**

According to Brealy (2001), debt funding will strengthen the effect of changes in shareholder operating income. Debt financing will not affect the operations of the company, but will increase the financial risk. Leverage will increase the return expected by shareholders but also increase the company's financial risk. Rising debt will increase financial risk and end up in high demand by shareholders of their investment. The large amount of dividends paid to shareholders will be very burdensome for companies that do not have sufficient cash flow. There is a condition where the company faces a bad condition and is unable to pay its debts. The company could go bankrupt and shareholders lose all their investment. Therefore, leverage can increase shareholder returns in good financial condition and reduce shareholder returns in times of poor financial condition.

### ***Profitability***

The results of the research conducted by Mehta (2012) states that profitability as measured by Return on Equity (ROE) has a negative effect on dividend policy. This means that the higher the profitability level of the company, the less the dividend will be distributed to the shareholders. This is in accordance with the pecking order theory which states that the company is more dependent on internal funding or retained earnings. This will have an impact on the small amount of dividends distributed to shareholders because the company holds most of its profits.

On the other hand, according to Gupta and Banga (2010), the higher the level of profitability, the higher the dividends will be distributed to shareholders. Companies with a high level of profitability will have a stable profit, so as to pay dividends in large numbers.

### ***Sales Growth***

According to Deitiana (2011) sales reflect manifestation of past successes and can be used as a predictor of future growth. Sales growth is the increase in sales from year to year. According to Weston and Brigham (1991), companies that have high sales growth rates will

require more investment in various asset elements, either fixed assets or current assets. Management needs to consider the appropriate source of funding for the asset's expenditure. Companies with high sales growth will be able to meet their financial obligations.

### ***Firm Size***

According to Machfoedz (1994), firm size can be determined based on sales, total assets, labor, etc., all of which are highly correlated. The size of the firm will affect the company's funding structure. This led to the tendency for companies to require more funds than smaller companies. The need of greater funding has a tendency that companies want growth in profits. The greater the profits generated by the company, the greater the pulses will be distributed to shareholders.

### ***Operating Cash Flow***

The results of the research conducted by Adelegan (2003) give result that significant influence from operating cash flow to dividend policy. The study, conducted by a Nigerian firm, says that most Nigerian companies rely on retained earnings to finance their investment activity on the grounds that funding with retained earnings is considered cheaper. The decision to allocate the available cash flows, whether to invest in a lucrative investment opportunity or used to pay dividends, makes cash flow information important to the company in making decisions related to dividend policy. Because dividends can only be paid when cash is available.

### ***Profit Volatility***

Profit volatility is the level of profit tendency to change. Profit volatility arises due to two main factors, namely volatility caused by economic shocks and volatility caused by accounting problems in determining profit (Dichev and Tang, 2008). Companies that conduct their operations in countries with large economic shocks are more likely to have high profit volatility. The reported volatility of profits also reflects an important aspect of the accounting determination of earnings. Profit volatility also affects the volatility of future cash flows. Companies with high profit volatility are more likely to have uncertain future cash flows (volatile). This of course affects the dividends distributed to shareholders. Therefore the greater the level of profit volatility, the smaller the dividends distributed to shareholders (Bradley et al, 1998). The profit volatility can be measured using the standard deviation on earnings per share.

### ***Capital Expenditure***

Dividends and investments are mutually related and inseparable decisions. The higher the growth opportunity of the company, the lower the dividends will be distributed. According to Pecking order theory (Myer and Majluf, 1984), companies should use retained earnings to finance their investments, not with external borrowings. If the company holds a profit for its investment needs, then the higher the proportion of retained earnings. This of course will have an impact on the low proportion of dividends distributed (Mishra et al, 2010).

### ***Retained Earnings***

Retained earnings negatively affect dividend policy. If the company holds its profits in high proportion for investment or other purposes, the proportion of profits distributed as dividends to shareholders will decrease (Mishra et al, 2010).

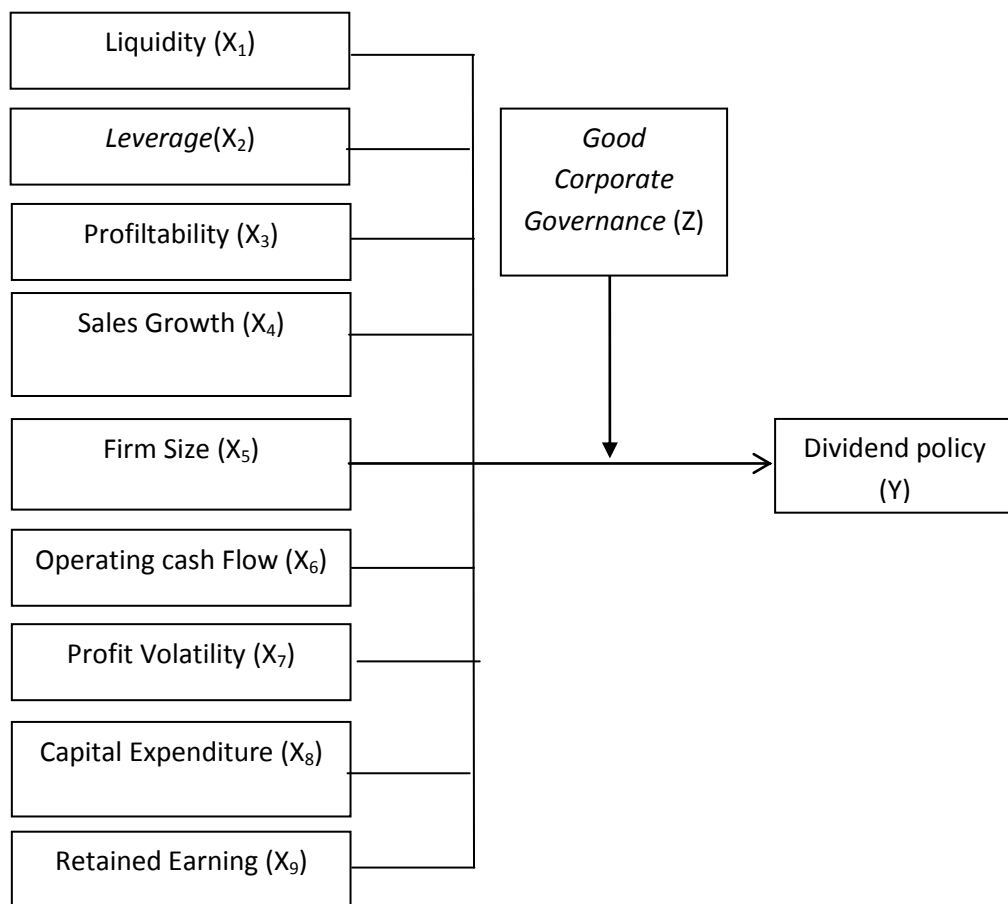
### ***Good Corporate Governance (GCG)***

Due to dividend policy, research conducted by Gugler (2003) mentions that corporate governance is the main determinant of dividend policy. In his research Gugler uses shareholding structure as a proxy of Good Corporate Governnace. Companies that are dominated by institutions tend to pay large amounts of dividends, while firms with high managerial ownership, which means that managers are also owners of firms tend to be reluctant to pay large amounts of dividends. They are more reactive to opportunities to invest and adjust the amount of dividends to be distributed to shareholders.

### ***Managerial Ownership***

According to Gupta and Banga (2010), firms with high managerial ownership are more likely to suggest that the proportion of profits distributed to shareholders is not too great. This is in line with the previously mentioned Gugler (2003) study that managers are more likely to be reactive to opportunities for investment. So the availability of cash tends to be used to expand.

The results of research conducted by Mishra et al (2010) states that service companies do not use dividends as a tool to reduce agency conflict. In other words, the agency conflict on service companies is not too heavy. So it can be concluded that managerial ownership has no significant effect on dividend policy on service companies in India.



***Conceptual Framework***

## Data Source and Methodology

This research is a causal research (causal effect). The design of causal research is a study that has the main purpose to prove the cause or effect relationship influencing and influenced from the variables studied. (Istijanto, 2005). The location of research is at Indonesia Stock Exchange (IDX) which is located at Jalan Jendral Sudirman, Kav. 52-53, Jakarta. Research data obtained by downloading the annual financial statements of nonfinancial companies listed on the official website of the Indonesia Stock Exchange is [www.idx.com](http://www.idx.com). The population in this study are non-financial companies listed on the BEI from 2009 to 2013. Non-financial companies listed on the BEI are divided into 8 (eight) industrial sectors: Agriculture, Mining, Basic and Chemical Industry, Various Industries, Industries consumer goods, property and real estate, infrastructure and transport, as well as trade, services and investment.

The statistical procedure used in this study is a two-step multivariate analysis which will analyze factor on the data, and then the regression analysis will be done on the extracted data. In addition, residual tests will also be performed for moderating variables.

The first step that will be done in this research is to test the classical assumption, followed by factor analysis, multiple regression analysis and residual test to test the moderating variable. Unobservable variables will be measured by connecting them with proxy variables that can be observed by using factor analysis. Then, the relationship between dependent variables with factors obtained from the results of factor analysis will be estimated by using regression analysis. Furthermore, to test the effect of moderating variable on the relationship between dependent and independent variable will be conducted residual test. To test the first hypothesis, used Multiple Linear Regression Model with the following formula:

$$Y = b_0 + b_1X_1 + b_2X_2 + b_3X_3 + b_4X_4 + b_5X_5 + b_6X_6 + b_7X_7 + b_8X_8 + b_9X_9 + e \dots\dots(1)$$

To test the second hypothesis used Residual Test model with the following formula:

$$Z = b_0 + b_1X_1 + b_2X_2 + b_3X_3 + b_4X_4 + b_5X_5 + b_6X_6 + b_7X_7 + b_8X_8 + b_9X_9 + e \dots\dots (2)$$

$$|e| = b_0 + b_{10}Y + e \dots\dots\dots\dots\dots\dots\dots\dots\dots (3)$$

## Empirical Result

### Factor Test

**Table 1** Keiser-Meyer-Olkin *measure of sampling adequacy* (MSA)

**KMO and Bartlett's Test**

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.569
Bartlett's Test of Sphericity	Approx. Chi-Square	199,063
	Df	36
	Sig.	.000

From table 5.1 it can be seen that Kaiser-Meyer-Olkin value measure of sampling adequacy (MSA) is  $0,569 > 0,05$ . Then it can be concluded that factor analysis can proceed and no variables need to be eliminated.

**Table 2 The Determination Coefficient Test Results of the First Hypothesis**

Model Summary <sup>b</sup>				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,436 <sup>a</sup>	,190	,093	2,19377

a. Predictors: (Constant), Arus kas Operasi, Pertumbuhan Penjualan, LnUkuranPerusahaan, PENGELUARAN MODAL, SqrtLabaDitahan, SqrtVolatilitasLaba, SqrtLikuiditas, SqrtLevergae, SqrtProfitabilitas

b. Dependent Variable: SqrtKebijakanDividen

Adjusted R Square value of 0.093. This means that the ability of independent variables (liquidity, leverage, profitability, sales growth, operating cash flow, capital expenditure, profit volatility, retained earnings, and firm size) in explaining the variation of the dependent variable is only 9.3%. While the rest of 90.7% influenced and explained by other variables that are not included in this research model. This small Adjusted R Square value indicates that the ability of the independent variables to explain the variation of the dependent variable is very limited.

**Table 3 F-Test result of the First Hypothesis**

ANOVA <sup>a</sup>					
Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	84,797	9	9,422	1,958	,056 <sup>b</sup>
Residual	360,946	75	4,813		
Total	445,744	84			

a. Dependent Variable: SqrtKebijakanDividen

b. Predictors: (Constant), Arus kas Operasi, Pertumbuhan Penjualan, LnUkuranPerusahaan, PENGELUARAN MODAL, SqrtLabaDitahan, SqrtVolatilitasLaba, SqrtLikuiditas, SqrtLevergae, SqrtProfitabilitas

F value counted of 1.958 while  $F_{table}$  with probability value  $\alpha$  5% of 2.01. It can be concluded that,  $1,958 < 2,01$  which means that  $H_a 1$  is unacceptable. Means that all independent variables do not have a significant effect on the dependent variable.

Partially influence of each independent variable to dependent variable is as follows:

1. The t-value counted on liquidity variable equal to  $-0,180 <$  from value  $t_{table}$  1.99167 with significance level 0,858 bigger than 0,05,  $H_a 1$  is unacceptable and it can be concluded that liquidity variable partially no significant effect to dividend policy.
2. The t-value counted at leverage variable equal to  $-0,829 <$  value of  $t_{table}$  1.99167 with significance level 0,410 bigger than 0,05,  $H_a 1$  is unacceptable and it can be concluded that leverage variable partially no significant effect to dividend policy.
3. The t-value counted on the profitability variable is  $0,575 <$  from the value of  $t_{table}$  1.99167 with the level of significance 0,567 bigger than 0,05,  $H_a 1$  is unacceptable and

it can be concluded that profitability variable partially no significant effect to dividend policy.

4. The t-value counted on sales growth variable equal to 0,187 <from t\_tabel 1.99167 with significance level 0,852 bigger than 0,05, H\_a 1 is unacceptable and it can be concluded that partial sales growth variable has no significant effect on dividend policy.
5. The t-value counted on capital expenditure variable equal to -0,895 <from value t\_tabel 1.99167 with significance level 0,374 bigger than 0,05, h\_a 1 is unacceptable and it can be concluded that the variable of capital expenditure partially has no significant effect on the dividend policy.
6. The t-value counted in variable of profit volatility equal to 0,649 <from t\_tabel 1.99167 with significance level 0,518 bigger than 0,05, H\_a 1 is unacceptable and it can be concluded that variable of profit volatility partially no significant effect to dividend policy.
7. The t-value counted on retained earnings variable equal to -1,601 <from value t\_table 1.99167 with significance level 0,114 bigger than 0,05, hence H\_a 1 is unacceptable and it can be concluded that the retained earnings variable partially no significant effect to dividend policy.
8. The t-value counted on variable of company size is 0,693 <from value of t\_tabel 1.99167 with significance level 0,491 bigger than 0,05, H\_a 1 is unacceptable and it can be concluded that firm size variable partially no significant effect to dividend policy.
9. The t-value counted in the operating cash flow variable is 0.963 <from the value of t\_table 1.99167 with the significance level of 0.339 greater than 0.05, then H\_a 1 is unacceptable and it can be concluded that the operating cash flow variable partially has no significant effect on the dividend policy.

**Table 6 The Residual Results of Variables Moderator**

**Coefficients<sup>a</sup>**

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	,129	,029		4,472	,000
SqrtKebijakan Dividen	-,009	,004	-,243	-2,285	,025

a. Dependent Variable: AbsRes

The residual equality between the dependent variable (dividend policy) to the residual absolute value of the good corporate governance produces the equation of the residual test model as follows:

$$| e | = 0.129 - 0,09 \text{ dividend policy}$$



Based on the result of residual test analysis above is known that the variable value of variable significance Z-score  $0.025 < 0.05$ , means significant GCG variable and negative parameter coefficient value of -0.2243.

## Conclusion

From the results of research and discussion in the previous chapter to produce the following conclusions:

1. Simultaneously liquidity, leverage, profitability, sales growth, firm size, operating cash flow, capital expenditure, profit volatility, and retained earnings have no significant effect on dividend policy on non-financial corporations listed in Indonesia Stock Exchange 2009- 2013. Partially, liquidity, leverage, profitability, sales growth, firm size, operating cash flow, capital expenditure, earnings volatility and retained earnings have no significant effect on liquidity, leverage, profitability, sales growth, firm size, operating cash flow , CAPITAL EXPENDITURES, profit volatility, and retained earnings do not affect dividend policy on non-financial corporations listed in Indonesia Stock Exchange (BEI) period 2009-2011.
2. Good corporate governance variables are moderating variables that significantly influence (strengthen) relationships among liquidity, leverage, profitability, sales growth, operating cash flow, capital expenditures, firm size, profit volatility, retained earnings with corporate dividend policy nonfinancial at the Indonesia Stock Exchange 2009-2013.

## References

- Adelegan, Olantundun. J. 2003. "An Empirical Analysis of the Relationship between Cash Flow and Dividend Changes in Nigeria". *R&D Management* 15(1) : 35-49. <https://www.imf.org/>. (diakses tanggal 25 Agustus 2014)
- Al-Twajjry, Albulrahman Ali. "Dividend policy and payout ratio: evidence from the Kuala Lumpur stock exchange". *The Journal of Risk Finance* 8(4) : 357. [www.emeraldinsight.com](http://www.emeraldinsight.com). (diakses tanggal 14 Maret 2014)
- Al-Khadiri, Ahmed dan Turki SF Alzomaia. 2013. "Determination of Dividend Policy: The Evidence from Saudi Arabia". *International Journal of Business and Social Science*, 4(1) : 181-192. <http://www.proquest.com/>. (diakses tanggal 23 Maret 2013)
- 6(1) : 79-92. <http://www.proquest.com/>.(diakses tanggal 23 Maret 2013)
- <http://www.proquest.com/>.(diakses tanggal 23 Maret 2013)
- El-Gammal, W., and Showeiry, M. 2012. "Corporate governance and quality of accounting information: Case of lebanon". *The Business Review, Cambridge*, 19(2): 310-315. <http://search.proquest.com>.
- Gordon, Myron J. 1959. "Dividends, Earnings, and Stock Prices". *Review of Economics and Statistics* 41(2) : 99-105. <http://www.jstor.org/>. (diakses tanggal 8 September 2014)

- Ghozali, Imam. 2013. *Aplikasi Analisis Multivariate dengan Program IBM SPSS 21 Update PLS Regresi*. Semarang : Badan Penerbit Universitas Diponegoro.
- Gupta, Amitabh dan Charu Banga. 2010. "The Determinants of Corporate Dividend Policy Decisions". *Decision*. 37:2 : 63–77. <http://www.proquest.com/>. (diakses tanggal 23 Juli 2013)
- Igan Deniz *et al.* 2006. "Liquidity and Dividend Policy". *Munich Personal RePec Archive*. <http://mpra.ub.uni-muenchen.de/29409/>. (diakses tanggal 5 Juli 2014).
- Mishra, Sajuta, *et al.* 2010. "Dividend Policy Determinants of Indian Service Sector : A Factorial Analysis". *Paradigm* I 14(1) : 24-41. <http://www.proquest.com/>. (diakses tanggal 23 Maret 2013)
- Kang, Bop Sik. 2001. "Essays on corporate dividend policy: International investigation at the micro and macro levels". Disertasi. Washington DC : Department of bussiness and Economic, The Catholic University of America.
- Lintner, John. 1956. "Distribution of Income of Corporations Among Dividends, Retained Earnings, and Taxes. *The American Economic Review*. 42(2) : 97-113. <http://www.jstor.org/>
- Mehta, Anupam. 2012. "An Empirical Analysis of Determinants of Dividend Policy – Evidence From the UAE Companies". *Global Review of Accounting and Finance*. 3(1) : 18-31. <http://library.imtdubai.ac.ae/>. (diakses tanggal 7 Juli 2014)
- Miller, M. H. And F Modigliani. 1961. "Dividend Policy , Growth and the Valuation of Shares". *The Journal of Business*. 34(4) : 411-433. <http://www.jstor.org/>. (diakses tanggal 21 Juli 2014)