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THE EFFECTS OF DIVIDEND POLICY AND OWNERSHIP STRUCTURE TOWARDS DEBT POLICY

Marcella Fransisca Santosa
Faculty of Economics and Business
Universitas Kristen Satya Wacana
INDONESIA
SE
E-mail: 232008042@student.uksw.edu

Paskah Ika Nugroho
Faculty of Economics and Business
Universitas Kristen Satya Wacana
INDONESIA
SE., M.Si., CMA
E-mail: paskah@staff.uksw.edu

─Abstract ─

This research used multiple regression methods to examine the relationship between the dividend policy, institutional ownership, and insider ownership with the debt policy. Hypotheses tests of this research used 64 manufacturing companies which were listed in the Indonesian Stock Exchange (IDX) from the year of 2007 until 2010 as the samples. The results of this research show that the dividend policies and the insider ownership had no effects towards the debt policy, while the institutional ownership had a significant negative effect towards the debt policy.

Key Words: *dividend policy, institutional ownership, insider ownership, and debt policy*
JEL Classification: G32

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1. INTRODUCTION

In running a company, the management has an obligation to manage the company which aims to earn profits for the company. In achieving these objectives, there are often some problems between the management as an agent and the shareholders in which the management often has other purposes that are contrary to the shareholders' or company owner's main objective which is not necessarily give benefits to the shareholders but is more concerned with the benefits for the management itself. Such behavior creates a conflict of interest between the management and the shareholders, which is known as agency conflicts. (Jensen, 1986) Agency conflict that often occurs is when the management would rather have a low-risk investments than the shareholders who want a high-risk investment with a high return expectations as well.

In the business for managing and running the company, the management requires funds for the activities of the company. Funding activities that can be done by the company is using the retained earnings or debt. The funding with the use of debt can be used to reduce the agency conflict. It can reduce management's desire to use free cash flow to finance the activities which are not optimal, and also the use of debt. The debt policy is used as a tool to discipline managers because managers have to work harder to pay the debt and its interest. (Jensen, 1986)

Dividend is a part of profits received by the shareholders, the amount of dividends which will be distributed depends on the decisions taken by the shareholders in the general meeting of shareholders. (Wiagustini, 2009) Dividends provide a positive value about the increased cash flow in the future and this information is used by the investor to invest in the company. (Mursalim, 2009) Dividend payment will reduce the company's cash flow. To fulfill its needs, a company will look for a relevant alternative funding, such as debt.

Ownership structure is used to indicate that the variables that are important in the capital structure is not only determined by the debt and equity but also by the insider and institutional ownership. According to Masdupi (2005), the ownership structure may also be an alternative to reduce the agency conflict in which the

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ownership structure represents a source of power that can be used to support or challenge the existence of managers.

The relationship between dividend policy and debt policy has been found in some previous studies, for example Nurfauziah et al., (2007) found a negative but insignificant relationship between dividend policy with and policy. Kim & Sorenson (1986) in Silvi & Bieber (2008) suggested a positive relationship between managerial ownership and debt. While the relationship between institutional ownership and debt policy has a negative relationship.

The results of research conducted by Djabid (2009) is a dividend policy does not significantly affect debt policy. Managerial ownership has no effect towards debt policy. Institutional ownership has no effect towards debt policy. The differences with previous research conducted by Djabid (2009) are (1) replacing the previous study during period 2004-2008 to 2007-2010, (2) adding growth as a control variable in which if the growth rate becomes higher, it will also affect the level of debt in a company.

This study aims to determine whether there is influence between dividend policy and ownership structure towards the debt policy. Contribution of this study would be useful to managers for the decision making in debt policy, to shareholders as additional information for investment decisions, and for other external parties involved.

2. LITERATURE REVIEW

2.1. Agency theory

Agency theory is the relationship between an employer and the employees to carry out the work. In achieving the company's objectives in achieving its profits, generally in public companies the shareholders (principal) appoint management (agents) to manage their business. But in reality, the management and shareholders often have different interests. According to Jensen & Meckling (1976), agency problem may become worse if the management ownership is low.

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One of the agency conflict that often arises is when the shareholders aim to maximize their wealth by looking at the present value of cash flows resulting from the company, while the management often has a different purpose, that is to increase the growth and the size of the firm. (Fadah & Rian, 2007) In addition, the agency conflict that often arises is when the management wants more low-risk investments than the shareholders who want a high-risk investment with a high return expectations as well.

According to Jensen & Meckling (1976), there are several alternatives to reduce agency conflicts that often arise between shareholders and management. Firstly, increasing the stock ownership by management in which the managers will be affected directly if the wrong decisions taken. Secondly, increasing funding by using the debt in which it will lower the excess of free cash flow in the company to reduce waste by management. Thirdly, increasing the monitoring activity by the company, but it can also be done by the institutional shareholders. (Fuad, 2005) In this case, the institutional ownership may increase the optimal monitoring towards the management performances.

2.2. The effects of dividend policy towards debt policy

Djabid (2009) and Yeniatie & Destriana (2010) found evidence that the dividend policy and debt policy have no significant effect. It could be due to the presence of other factors. One factor is the company establish a stable dividend policy in which the company will continue to pay dividends even if the company gets a low profit or the company has debt. In the context of the agency conflict, the dividend payment will reduce the agency conflicts occured. But in reality that relationship often runs ineffectively.

Researches held by Silvi & Lestari (2008) and Putri & Nasir (2006) found an evidence that the dividend policy and debt policy have a positive influence. In this case, when the amount of funds spent to pay the dividend is greater, the company’s retained earning will be smaller. Therefore, the companies need to find other funding sources to look for a loan or debt. Companies that have a high dividend payout are likely to owe more than the ones which have lower dividend payout.

H_1: Dividend policy has a positive effect towards debt policy.

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2.3. The effect of institutional ownership towards debt policy

The use of debt which is too high in a company may cause a bankruptcy in it. The presence of institutional ownership will be able to perform monitoring activities towards the management in the use of funds or corporate debt. If the institutional ownership in a company is higher, it is expected that the company's internal controls will be stronger. (Djabid, 2009) Therefore, it can reduce agency costs on firms and the use of debt by management that may result in the company's financial problems or bankruptcy. With the high control from the institutional management, the management will be more careful in the use of debt and the management tend to use debt at a low level to anticipate the risk of bankruptcy.
A negative influence was found by Masdupi (2005), Sihombing & Riyanto (2001) and Mursalim (2009). Masdupi (2005) stated that the institutional ownership can monitor the management to reduce agency cost which may cause the company's debts. Therefore, the higher institutional ownership will improve the monitoring towards the management, because of that, the agency cost can be minimized and corporate debt will also be lower because the company no longer needs the additional funds due to agency cost.
H_2: Institutional ownership has a negative effect towards debt policy.

2.4. The effect of insider ownership towards debt policy

Insider ownership shows a dual role owned by management in which the management also acts as the company's shareholders. Managerial ownership can also reduce the agency conflict between the shareholders and management because the management that also acts as the shareholders will align their interests as the management and shareholders. (Djabid, 2009) Within the managerial ownership, the management will be more careful in making decisions or managing the company including in determining debt policy. In this case the management who also acts as shareholders does not want the company experience financial difficulties or bankruptcy. Financial difficulties or bankruptcy will make them experience loss as a management of the company as well as the shareholders. Therefore, to reduce risk, they will reduce the amount of the company’s debt.

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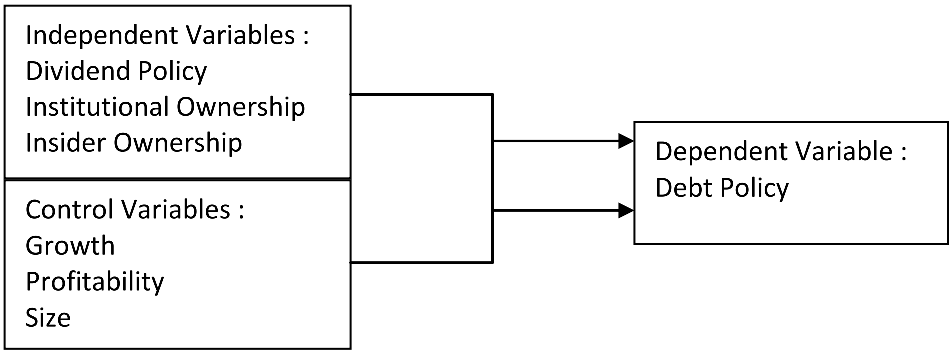
Negative effects found by Christiawan & Tarigan (2007), Tarjo & Jogiyanto (2003) and Hartoro & Atahau (2007). Insider ownership can be used to control the agency costs due to the use of debt because management which acts as well as the owners do not like getting intense monitoring from the creditors and tend to avoid financial distress. The existence of managerial ownership could make the management's decision-making regarding the debt policy more alive. This is because the managers who acts as well as the shareholders take low-risk decisions. (Tarjo & Jogiyanto, 2003) The management is also cautious in making decisions so that the company does not experience any financial difficulties or bankruptcy.

H_3: Insider ownership has a negative effect towards debt policy.

Figure-1: Research Model



3. RESEARCH METHOD

3.1. Population and sample

The population in this study are the manufacturing companies listed on the Indonesian Stock Exchange (IDX) during 2007-2010, which published in Indonesian Capital Market Directory. The sample criteria used in this study are:

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1. The company has distributed dividends during 2008 -2010.
2. The company has an institutional and insider ownership structure.
3. The company has EBIT data during the period 2008 -2010.
4. The company has financial statements ended on 31 Desember.

3.2. Operational definition and measurements of variables

Independent variables

Dividend Policy

Dividend policy is a policy which is related to the payment of dividends by the company in the form of determining the amount of dividends to be distributed to the shareholders. (Rosdini, 2009) According to Djabid (2009), the measurements of dividend policy can be measured by using the dividend payout ratio.

$$\text{Dividend payout ratio} = \frac{\text{Dividend}}{\text{Net profit after tax}}$$

Institutional Ownership

Institutional ownership is an ownership owned by investment firms, banks, insurance companies and other institutional ownerships in the form of companies. (Anggarini & Srimindarti, 2009)

$$\text{Institutional ownership} = \frac{\text{The number of stocks owned by the institution}}{\text{Total outstanding stocks}} \text{ x } 100\%$$

Insider Ownership

According to Djabid (2009), the measurements of managerial ownership can be seen from the percentage of shares owned by management at the end of the year.

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$$\text{Insider ownership} = \frac{\text{The number of stocks owned by the insiders}}{\text{Total outstanding stocks}} \text{ x } 100\%$$

Control variables

1. Growth (the growth of the companies)

   Growth can be measured by using the difference between the assets in the year studied and the assets of the previous year and compared with the total assets of the previous year. (Anggraini & Srimindarti, 2009)

2. Profitability

   According to Djabid (2009), profitability can be measured by the ratio between EBIT and total assets of the company.

3. Size

   According Djabid (2009), size is the size of a company which can be measured by the value of total assets in the company.

   Size = Log of total assets

Dependent variables

Debt Policy

Debt policy is a tool to discipline the managers because managers have to work harder to pay the debt and its interest. (Jensen, 1986) In accordance with research held by Djabid (2009), debt policy is measured by dividing the number of long-term debt with long-term debt plus the equity.

$$\text{Debt ratio} = \frac{\text{Long} - \text{term debt}}{\text{Long} - \text{term debt} + \text{Equity}} \text{ x } 100\%$$

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3.3. Analytical technique

In this study, the technique of data analysis was done by using multiple regression analysis. This study used the classical assumption test that includes tests of normality, multicollinearity, autocorrelation, and heteroscesdastisity. (Djabid, 2009)

The formula of its regression model is as follows:

Debt = bo + b1 (dividends) +b2 (inst) +b3 (management) + b4 (Growth) + b5 (Prof) + b6 (size) + e

Information
Debt: Debt Ratio
Dividend: Dividend Policy
inst: Institutional Ownership
management: Insider Ownership
Growth:the growth of the company
Prof: Profitability
Size: The size of the company
bo: Constants
b1-6: Regression Coefficients
e: Error (error)

4. RESULTS

4.1. Description of research object

The data obtained in the Indonesia Stock Exchange during 2008 - 2010 was from 443 companies in which in 2008 as many as 145 companies, in 2009 as many as 148 companies, and 150 companies in 2010. This study used several criteria to determine the samples so that the samples obtained were 64 companies during 2008-2010.

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Table 1 Sample Selection Criteria

	2008	2009	2010
Manufacturing companies listed in the Indonesian Stock Exchange	145	148	150
Companies that do not pay dividends, have no insider ownership and those which financial statements do not end on December 31	94	105	105
Companies whose data was not found	34	22	19
Total companies that meet the criteria	17	21	26

Source: http://idx.co.id

4.2. Descriptive statistics

In this research, the researcher did a descriptive statistical analysis that is useful to provide a general description about the data that has been obtained, such as the average value (mean), minimum value, and maximum value.

Table 2 Descriptive Statistics Analysis

	N	Minimum	Maximum	Mean	Std.Deviation
DPR	64	.0476	.8151	.3561	.2016
INST	64	.1232	.9973	.6805	.2078
Management	64	.0001	.2561	.0424	.0747
Growth	64	- .2321	.6369	.1146	.1494
Prof	64	.0011	.5221	.1312	.0793
Size	64	8.2800	14.0530	12.1115	0.9836
Debt	64	.0180	.7517	.2324	.1939
Valid N (listwise)	64				

Source: Results of SPSS output

4.3. Multiple regression analysis

In this study, the effects of independent variables towards the dependent variable obtained F value of 5,450 with a significance level of 0.000 which means that the all of the independent variables have a significant effect towards the dependent variable. Adjusted R square of 0.298 shows that the dependent variable Debt was 29.8% influenced by the independent variables which consist of dividends,

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institutional ownership, managerial ownership and control variables, i.e. growth, profitability and size. While 70.2% is influenced by other factors.

In this study, it was found that dividend policy has no effect towards the debt, institutional ownership has significantly negative effect towards debt policy, and managerial ownership has no effect towards debt policy. While the control variables have a significantly negative impacts towards profitability in which the value of beta is -0.378 and its significance value is 0.001 at the 1% significance level. While the other control variables such as growth and size have no effects towards debt policy.

Table 3 Linear Regression Analysis

Variable	Beta	t	Sig
DPR	- .035	- .285	.776
INST	- .340	-2482	.016
Management	- .177	-1366	.177
Growth	.166	1,466	.148
Prof	- .378	-3429	.001
Size	.179	1,545	.128

Dependent variable : DEBT
Adjusted R Square : 0.298
F : 5,450
Sig : 0.000

4.4. Discussion

The result of first hypothesis are consistent with several previous studies such as Djabid (2009) and Yeniatie & Destriana (2010) which found that dividend policy has no significant effect towards debt policy. It could be due to other factors, one of which is the company establishes a stable dividend policy in which the company will continue to pay dividends despite the low profit corporation or company has debt. (Djabid, 2009) In 2010, Selamat PT. Sempurna had 62% DPR and had a debt ratio of 27.24%, while the PT. Sarino Agro Asia had 31.91% DPR and had a debt ratio of 51.31%. From those samples, it can be seen that the companies which distributed higher dividends does not always have higher debt.

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Institutional ownership has a significant negative effect towards debt policy. Therefore, the second hypothesis is accepted. The results are consistent with several previous studies that held by Masdupi (2005), Sihombing & Riyanto (2001) and Mursalim (2009), in which institutional ownership has negative effects towards corporate's debt policy. The companies that have institutional ownership can monitor the company's management to reduce agency cost which can lead to too much debt on the company. Therefore, by increasing institutional ownership, it can increase the monitoring of the company so that the agency cost caused by managers can be minimized, that the company no longer needs any additional funds obtained from debts. Mursalim (2009) stated that investors prefer companies that have a good monitoring in which it will encourage management to manage and use the debts well. In this study, in 2010, PT. AKR Corporindo had 70.82% institutional ownership and 23.75% of the debt policy, while PT.Berlina had less institutional ownership, 51.42% and 52.61% of the debt policy. It proves that high institutional ownership can minimize corporate debt, while companies that have lower institutional ownership have higher debt.

Insider ownership has no effects towards debt policy. The third hypothesis is rejected. This result is consistent with previous studies held by Yeniatie & Destriana (2010) which stated that insider ownership has no effects towards debt policy. This is due to the small number of the managerial ownership compared with the outsider shareholders. Therefore, the management who acts as well as the shareholders can not make decisions based on their own desires which normally the managerial shareholders will take low risk decisions so that their roles as the shareholders do not suffer any losses. The result is not consistent with studies held by Christiawan & Tarigan (2007) and Tarjo & Jogiyanto (2003) which states that managerial ownership has a positive effect towards debt policy, in which if the managers who act as well as shareholders will be more cautious and minimize the debt that the company has no debt which is too high because if there is any financial problems and bankruptcy, the managers who act as well as shareholders will feel the impact as well. (Tarjo & Jogiyanto, 2003) In this study, in 2010, PT. Tunas Baru Lampung had a 0.10% of managerial ownership and 43.26% debt policy, while PT. Lautan Luas had managerial ownership of 3.64% and 51.38% of the debt policy. It can be concluded that greater managerial ownership does not lead to lower debt policy.

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5. CONCLUSION

This study aims to determine whether the dividend policy, institutional ownership and managerial ownership have any effects towards debt policy in manufacturing companies that have been go public in the Indonesian Stock Exchange. The conclusions of this study are as follows :

1. This study found that the dividend payout ratio has no effects towards the debt policy. It could be due to other factors, one of which is the company establishes a stable dividend policy in which the company will continue to pay dividends despite the low profit corporation or company has debt. (Djabid, 2009)
2. Institutional ownership has a significant negative effect towards the debt policy. The companies that have institutional ownership can monitor the company's management to reduce agency cost which can lead to too much debt in the company. Therefore, by increasing the institutional ownership, it can increase the monitor of the company towards the agency cost caused by managers can be minimized, so that the company no longer needs any additional funds obtained from debt. (Mursalim, 2009)
3. Insider ownership has no effect towards debt policy. This is due to the small number of insider ownership compared with the outsider shareholders, so that the management who acts as well as the shareholders can not make decisions based on their own desires in which usually the insider shareholders would take a low-risk decision that their roles as shareholders do not suffer any losses. (Yeniatie & Destriana, 2010)

In this study, it was found that the institutional ownership positively affects the debt policy. It can be used as consideration in investing capitals in the companies, in which the companies that have a high institutional ownership will also have high internal controls. Therefore, investors will feel more secure to invest. For the managers, if the companies have high institutional ownership and high internal controls, the managers will be more careful in the use of debt. Besides that, it can also provide additional information for the creditors to give loans, in which if the companies have high internal control, it is expected that the financial of those companies will be healthier and the payments to creditors will be smoother.

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This study only analyzed the effects of dividend policy, institutional ownership, and managerial ownership towards debt policy. There are still other factors that could affect debt policy, such as the number of foreign shareholders, corporate risk, earnings volatility, and other factors that do not exist in this study. It is also expected that future studies could include other variables that do not exist in this study. This study only took the data from the financial statements of manufacturing companies, while there are many other industries that are can be observed as a comparison and it is expected that future studies can add data from the companies engaged in service or banks.

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