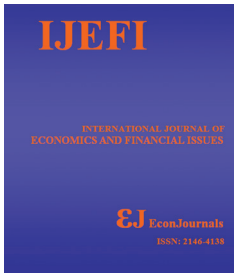

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Dividend Initiation Policy and the Effect on Dividend Sustainability (At Initial Public Offering Companies on the Indonesia Stock Exchange)

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ABSTRACT

This study aims to examine the effects of maturity and agency cost model variables on the behavior of dividend initiation policy, and the effect itself on dividend sustainable. Samples of 93 non-financial companies that have initial public offering (IPO) on the Indonesia Stock Exchange (IDX), 2005-2017. This study uses Structural Equation Modeling with SmartPLS software to test the hypothesis. The test results show: Maturity and capital structure variable have significant and positive effects on dividend initiation policy. Ownership structure does not affect the dividend initiation policy. Dividend initiation variable has a significant and positive effect on dividend sustainable.

Keywords: Agency Cost Model, Dividend Initiation Policy, Dividend Sustainability
JEL Classifications: F12, F30, F39

1. INTRODUCTION

Jain et al. (2003) state that most companies decide to go public at the beginning of their growth in the fast-growing industrial environment. Generally, the funds available in the company are not sufficient to realize their growth needs. Sharma (2001) argues companies that just have implemented an initial public offering (IPO) are not expected to immediately carry out dividend initiation in the early years after IPO, because of the need for substantial funds for investment in the future.

The argument in line with Kale et al. (2011) in his research, state that from 6.588 IPO companies there were 599 companies or 9.09% who initiated dividends during first 5 years after IPO period 1979-2005 on NYSE/NASDAQ. Desai and Nguyen (2015) in their findings, from 7794 samples of IPO companies there were 318 companies or 4.1% who initiated dividends in the first 5 years after IPO, in the period 1975-2007 at Jay Ritter, Florida University. From the two facts above, it can be concluded that only insignificant numbers, companies in America initiated dividends in the early years after IPO.

However, the facts show the opposite condition; the companies' behavior conducting IPO on IDX, in the period 2005-2017 the data was obtained that, from 267 IPO companies, 178 companies or 51.44% initiated dividends in the 1st year after IPO.

From these differences can be conclude that go public companies behavior in developed countries like America, dominated by the managers attitude not to initiate dividends in the early years after the IPO to wait when deemed appropriate to decide initiation dividends, namely when financial conditions as reflected by the company's performance (profitability), adequate free cash flow and supporting stock market conditions Sharma (2001), Dhaliwal

et al. (2003), Bulan et al. (2003), Jain et al. (2003); Kale et al. (2011), Desai and Nguyen (2015).

The behavior of dividend initiation policy commits in Indonesia companies newly go public, show several fundamental questions, especially from the agency cost models perspective, the main model based on the relevance of dividend proposition that needs to be clarified empirically and at the same time be the focus of the study from this research. Is the behavior of dividend initiation policy related commit to monitoring mechanism of management?

This study is intended to examine variables that thought have an influence on dividend initiation policies which consist of ownership structure, capital structure, maturity phase and its effect on dividend sustainability, in the environment of go-public companies in Indonesia.

2. LITERATURE REVIEW

2.1. Agency Cost Model

In agency cost model context developed by Jensen and Meckling (1978), dividend policy is used to minimize agency costs arising from conflicts between agents (managers) and principals (company owners) associated with the same relationship. Agency costs are costs incurred in order to control or support the actions of managers in accordance with the principal interests. The basis of the agency cost model is when the manager aware of act inappropriately with investor/shareholder interests, so the shareholders use a certain mechanism to control the manager. One of these mechanisms is dividend payment with higher dividend payout (Beiner, 2001). However, it is suggested by Easterbrook (1984) that effective dividend as one of the monitoring tools depends on other monitoring facilities, such as ownership structure and capital structure.

2.2. Ownership Structure

Jensen and Meckling (1976) states agency costs in companies will be low with high managerial ownership because this allows the integration of shareholders' interests with managers' interests who in this case function as agents and as principals. The same thing can happen in companies where there are large block shareholders that usually consist of institutional shareholders who have a high ability to control managers (Frankfurter and Wood, 1994). The presence of a large block shareholder indicates the level of shareholders dispersion by the public will be smaller. In this situation, the company does not need to pay a high dividend payout to control agency costs. Rationally, that managerial ownership is high so agency problem will be low between managers and shareholders, whereas with the presence of high large block shareholder so monitoring can be more effective by shareholders. From these explanations, the hypothesis can be formulated as:

"Ownership structure has a negative effect on dividend initiation policy."

2.3. Capital Structure

Related to capital structure variables, Sprenman and Gantenbein (2001) suggest that the greater dependence of the company's on external funds such as long-term debt, so more intensive monitoring conducted by creditors towards management, this also contributes to agency problem control between management with shareholders, so the smaller dependence of the company's on dividends as monitoring mechanism. While monitoring mechanism from Easterbrook (1984) states that the effectiveness of dividends as one of the monitoring depends on the existence of other monitoring facilities, one of which is carried out by creditors.

In addition, the other side of agency cost model explains agency problems that arise between creditors and shareholders, indicate that high dividend payments will increase the firm's fixed burden, causing debt to be riskier and therefore the debt value will be low (Taranto, 2002). The method that can be taken by creditors to protect themselves is to make debt covenants which contain restrictions on management including policy restrictions on dividends to be paid to shareholders.

But Titman and Wassels (1988) state by Mollah et al. (2000) suggests firms have more collateral assets will have a smaller agency problem between creditors and shareholders, because such assets can use as collateral for the debt. Since collateralizable asset has a function to reduce agency problems, it is expected the number of collateralizable assets owned by the company will be positively related to dividends. Alli and Tanbir (1993) by using the net plant to total assets ratio as a proxy for collateralizable assets and also used to represent agency problems between creditors and shareholders, obtained a positive significant relationship between collateralizable assets and dividends. So, the hypothesis can be formulated as follows.

"Capital structure has an effect on dividend initiation policy."

2.4. Maturity

Companies that entered the maturity phase are generally characterized by declining opportunities for profitable investment growth (growth investment opportunities), decreased capital expenditure (CE), and also marked by reduced funding needs. In line with maturity hypothesis of Grullon et al. (2002), the increase in dividends, in this case, is not motivated by the manager's desire to give a signal about the company's performance prospects, as explained by signaling model, but by increasing funds that are not needed to reduced funding in maturity phase. Sharma (2001), Jain et al. (2003), and Bulan et al. (2003) found that companies do initiate dividends will decline in profitability growth after initiation dividends which indicated that they entered maturity phase.

Previous studies base on capital markets in America (Sharma, 2001; Jain et al., 2003; and Bulan et al., 2003) show companies that decide to initiate dividends are proven to enter their maturity phase. However, these findings need to be clarified in different contexts such as the capital market in Indonesia contexts. This is important to consider the behavior of dividend initiation policies in Indonesia go-public companies is very different from the timing of dividend initiation. Based on the explanation, the hypothesis can be formulated as follows:

"Maturity has a positive effect on dividend initiation policy."

2.5. Dividend Sustainability/Stability

Behavioral Model of Dividend from Lintner's (1956) developed based on his findings, indicates the importance of dividend sustainability. Dividend Payout is not sustainable in subsequent periods will result in negative information content which is considered to damage the reputation of managers in investors views. Base on this, the manager will try to set a payout in such way the payout can be maintained in the future.

On the other site, the implications of signaling model explanatory are the manager will not pay a higher dividend payout if the manager does not believe the company will have a better prospect performance in the future. With two arguments above, it can be argued that companies with a higher dividend payout indicate a better prospect performance than companies with a lower dividend payout, so the first group of companies is expected to have greater opportunities to be able to maintain stability or sustainability compared the second group of companies. Empirical findings consistent with Lintner's model include Farrelly et al. (1986), Gail and Baker (1989), Pruitt and Gitman (1991), and Baker et al. (2001). On this basis, the fourth hypothesis can be formulated as follows.

"Dividend initiation policy has a positive effect on dividend sustainability."

3. RESEARCH METHOD

3.1. Population and Sampling

The population in this study are all IPO companies listed on IDX, which amount of 267 companies from 2005 to 2017 (Indonesian Capital Market Directory [ICMD], 2018). The sampling with purposive sampling technique, with certain criteria, so companies in the population are the sample. The first criterion, companies that be sample are companies initiate dividends in period 2005-2014 but not include companies classified as high-regulation industries such as public utilities, banks that have high debt-equity are equivalent to the high risk inherently related industries compared to non-regulated firms, Jensen and Meckling (1976). Determination of sampling period, related to specific data needs. For example, regular dividend data for a period of 3 years after dividend initiation is needed to determine the sustainability level of dividend initiation. For initiate dividend companies in 2014 (the last year in the sample period), data of regular dividend in the 3-year period after dividend initiation is required, obtained in period (2015-2017). At the time of data collection, data of 2017 is publicly available update data, provided by IDX. The second criterion is the issuance of financial statements that are not completed during the observation period. On the basis of some criteria above, 113 companies were obtained as a sample.

This study uses secondary data in the form of financial statements and market data obtained through several documents, especially the ICMD and Indonesian Stock Market Database. With cross-section data, structural equation model is used with the SmartPLS program for hypothesis testing.

3.2. Research Variables and Measurement

The description of the research variable for each indicator is presented in Table 1.

4. RESULT AND DISCUSSION

4.1. Evaluation of Measurement Model (Outer Model)

Based on the testing of outer model for convergent validity as one of the SmartPLS analysis models, the results show that all indicators used to measure variable latent have met the criteria for outer loading, the value is >0.7 (outer loading >0.7), so that is appropriate to use further analysis, except for Debt to Equity indicator from capital structure variable, and size indicator from maturity variable. Base on this, the two indicators are removed from the model. For the results of other Outer Models, all have met the criteria, so it can be concluded that the overall variable has a high level of reliability.

4.2. Evaluation of Inner Model

The test results on inner models (R^2 and GoF) show the model formed is robust, so hypothesis testing can do it. The full results of R^2 and GoF are presented in Table 2.

4.3. Managerial Implication

This variable for test the significance credibility from agency cost model seen from management behavior towards dividend initiation policies from the aspect of owner structure, capital structure and maturity, the effect on dividend sustainable.

Table 1: Variables and measurement

No.	Variable	Indicator and formula
1	Maturity	$CE = \frac{\text{Total Assets}}{\text{Net Fixed Assets t} - \text{Net Fixed Assets t} - 1}$
		IOS = Book Assets to Stock Market + Book Value to Debt
		$SIZE = \frac{\text{Total Assets}}{\text{Offering Size}}$
2	Capital structure	$LTDA = \frac{\text{Long Term Debt}}{\text{Total Assets}}$
		$DE = \frac{\text{Total Debt}}{\text{Total of Owners Equity}}$
		$CA = \frac{\text{Net Total of Fixed Assets}}{\text{Total Assets}}$
3	Owner structure	$IH = \frac{\text{Number of Share holder by the Insiders}}{\text{Total of Company Share}}$
		$INS = \frac{\text{Number of Share Holder by the Institution}}{\text{Total Company Shares}}$
		$DIS = \frac{\text{Number of Shareholder by the Outsiders}}{\text{Total of Company Share}}$
4	Dividend initiation policy	$DPR = \frac{\text{Dividend Per Share}}{\text{Earning Per Share}}$
5	Sustainability dividend	$SDPR = [\sum_{t-1}^{T} Dt - Di] / 3$

4.4. The Effect of Ownership Structure on Dividend Initiation Policy

The analysis results show that ownership structure with Insider's Holding (IH), Institutional Holding (INSTH) and DISP indicators has a positive coefficient but there is no significant effect on dividend initiation policy (t = 0.359; P > 0.05).

This finding indicates that companies with a high portion of IH and INSTH are not proven to reduce dividend delay, because their existence is considered unable to suppress agency problems, as an agency cost model developed by Jensen and Meckling (1976). This is possibly related to the unique characteristics of the publicly owned companies in Indonesia.

These unique characteristics: First, the outsider's holding is mostly dominated in fact that consists of a holding company that is affiliated even the holding company owners still have family relations even with management (Sudarma, 2004). Based on processed data, the researchers show the number of ownership shares (INSTH) was 67.13% and the highest portion of INSTH reached 97.6%. Second, the portion of shareholder ownership by the public is relatively small, which on average of 26% so that it does not have a significant effect on management policy. The hypothesis test results are supported by Imad (2016); Baker and Jabbouri (2016) the result is INSTH had planned dividend policies before making an investment (Figure 1).

4.5. The Effect of Capital Structure on the Dividend Initiation Policy

The test results show capital structures with LTDA and CA indicators have a positive and significant effect on dividend initiation policy (t = 1.911; P < 0.05). The results of this analysis show that with increasing the portion of the debt in capital structure and greater collateral of fixed assets (CA), it will be stronger to start paying dividends.

This finding also shows that the company is not proven with a larger portion of the debt in their capital structure will have a smaller ability to initiate dividends than companies with a smaller portion of the debt. Thus, predictions based on the logical theory in hypotheses development in monitoring mechanism propositions mainly from Easterbrook (1984), Rozeff (1992), Noronha et al. (1996), Sharma (2001), and Jain et al (2003) were not proven.

Findings above indicate that dividend initiation policy on go-public companies in Indonesia does not follow the pattern of monitoring mechanism of dividend, so dividend policy is not related to creditors' interests. This is possibly related to the behavior of creditors who prioritize collateral aspects of CA rather than forms of supervision/monitoring in order to secure funds embedded in the company. Empirical evidence that CA variable has a positive relationship with dividend initiation policy, stated by Alli and Tanbir (1993) and Mollah et al. (2000).

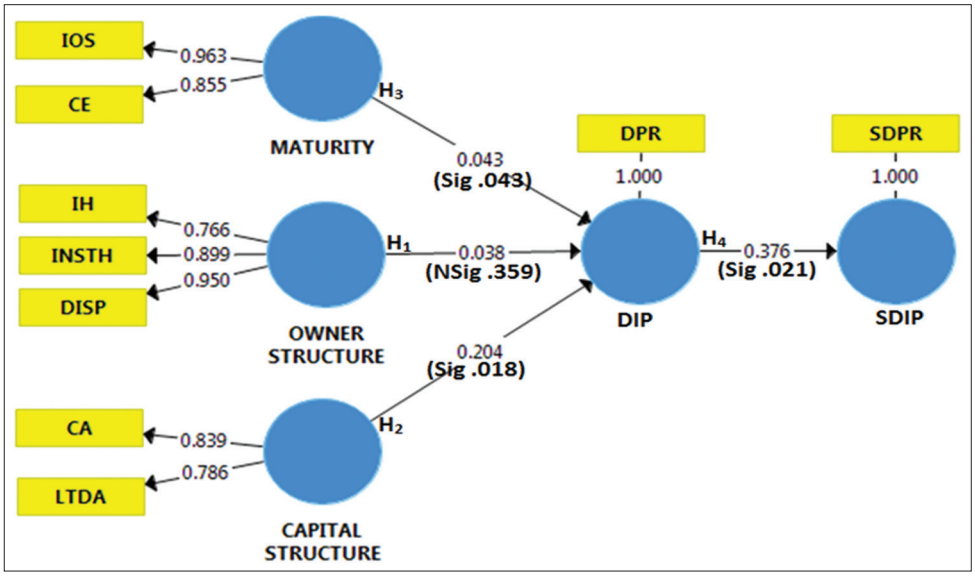
4.6. The Effect of Maturity on the Dividend Initiation Policy

The test results showed that maturity with CE and IOS indicators have a positive significant effect on dividend initiation policy with DPR indicator (t = 2.417; P < 0.05). It means that policies behavior in Indonesia go-public company is carried out in the initial year after IPO, where the maturity level is still low or still in its infancy. In general, CE in the company is not sufficient to realize the investment opportunities potential (IOS) as stated before the behavior of dividend initiation policies in Indonesia was 51.44% a year after IPO.

Table 2: Result of R^2 and GoF

Variable	R square (R^2)	Goodness of fit (GoF)	Q square (Q^2)
DPR	0.367 (Sustainable/moderate)	0.464 (GoF large)	0.6018 (Q^2 large)
SDPR	0.371 (Sustainable/moderate)	0.581 (GoF large)	

Figure 1: Hypothesis Result



But a capital market classified as an emerging market category, the behavior of the capital market in Indonesia may be very different. This seems to be the inconsistent empirical result for hypothesis the effect of maturity on dividend initiation policy, with countries whose capital markets already progressive like America. Overall, the results of hypothesis testing indicate the context of the go-public company in Indonesia; the proposition of maturity cannot provide an accurate predictor of the behavior on the company with dividend initiation policy.

Finding above is not accordance with maturity or over-investment proposition proposed by Grullon et al. (2002) that companies pay or increase dividends because they have entered maturity phase (reduced investment opportunities and CEs). Thus Sharma (2001) state that company at the beginning of the maturity phase is not expected to immediately offer periodic dividend payments, substantial funding needs for investment purposes.

4.7. The Effect of Dividend Initiation Policy on the Dividend Initiation

Hypothesis test results show that the dividend initiation policy variable with DPR indicator is a significant and positive effect on sustainable dividend variable (SDPR) ($t = 2.036$; $P < 0.05$)

This indicates that first dividend payout has been considered, especially with regard to performance perspective so able to maintain the dividend payout that starts for the next periods.

Based on the rational, the urgency of determining initial dividend payout in the extent of stipulation so the payout can be maintained in the future. In other words, payout provision can guarantee consistency or dividend stability in subsequent periods, because inconsistencies dividend can damage the reputation of managers in investors view. The analysis results are in accordance with required by Lintner (1956) which are supported by other findings including Gombola and Liu (1993), Gwilym et al. (2000), Denis and Osobov (2008), and Baker and Jabbouri (2016).

5. CONCLUSION

The empirical results from this study have proven that all relationships between variables in the developed model based on the agency cost model/theory have inconsistency. This indicates that the explanation of the arguments in the agency cost model perspective on dividend initiation policy in Indonesia is not relevant. In terms of ownership structure, which is generally controlled by INSTH in the form of the family holding companies where management is included, alleged causes are not significant, as predicted by existing theories. From capital structure, the behavior of creditors generally relies more on collateralizable assets in securing their funds compared to monitoring management behavior. This is the case from the maturity, that the policy behavior in the go-public companies in Indonesia is carried out in the initial year after the IPO, where the maturity level is still low or still in its infancy. In general, available funds (CE) in the company are not sufficient to realize the potential investment opportunities (IOS). In contrast, the theoretical arguments of the signaling model, there is a positive and significant relationship between the policy dividend policy initiation and the sustainability of dividends, deemed quite relevant to explain go-to companies in Indonesia.

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