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DIVIDEND POLICY AS MEDIATION OF THE INFLUENCE OF MANAGEMENT OWNERSHIP AND INSTITUTIONAL OWNERSHIP ON COMPANY'S FINANCIAL PERFORMANCE

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Abstract

The purposes of this research are: (1) to examine if management ownership influences significantly positive on dividend policy (2) to examine if institutional ownership influences significantly positive on dividend policy, and (3) to examine if dividend policy influences significantly positive on company's financial performance.

This is an explanatory research since it aims to explain the influence among variables after testing research hypotheses based on the underlying theory. The data of this research are financial reports of go public manufacture companies which have been audited at Indonesian Stock Exchange (IDX) from 2003 – 2012. This is a census research that is by using all population, 36 manufacture companies. Since this is a census research by using pooling data technique for 10 years so there were 360 observation data. This research used path analysis technique to test hypotheses.

The research finding shows that management ownership doesn't influence significantly positive on dividend policy, institutional ownership doesn't influence significantly positive on dividend policy, dividend policy doesn't influence significantly positive on company's financial performance,

Keywords : dividend policy, management ownership, institutional ownership, and company's financial performance

1. Introduction

According to Jensen (1986), between managers and shareholders always have different interests, which are called as the agency conflicts. One of the agency conflicts that occurs between managers and shareholders is that shareholders are more interested in dividend payments rather than reinvestment into the company in the form of retained earnings. Meanwhile the manager does not want any payment of dividends to shareholders, but they are more interested to have reinvestment into the company. This statement relates to the agency theory which states that managers and shareholders want to maximize their own prosperity that can lead to the emergence of agency problems within the company.

To reduce the agency problems between managers and shareholders, it can be done in the following ways: (1) monitoring done by institutional shareholders, (2) increasing the proportion of share ownership of company's shares by top management (3) increasing the

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payment of dividend to shareholders , and (4) the policy of financing through having debt (Crutchley et al., 1999).

2. Research Objectives

The purposes of this research are:

1. To examine the influence of management ownership on dividend policy.
2. To examine the influence of institutional ownership on dividend policy.
3. To examine the influence of dividend policy on the company's financial performance.

3. Literature Review

3.1 Management Ownership

Management ownership is ownership of shares of the company by the company's internal parties. Management ownership in this case is the ownership by the Chief Executive Officer (CEO) and director which was also used in research conducted by Schooley and Barney (1994), which examined the relationship between management ownership and dividend policy.

The existence of management ownership in the company has an important role as the management decision control. Management ownership can reduce or minimize the manager's action which is only oriented in short-term interests as well as actions that can decrease the value of the company.

3.2 Institutional Ownership

Institutional ownership is the proportion of shares held by institutions from the number of shares which circulate at the end of the year (Bathala et al., 1994). Institutional ownership are proxied (represented) by institutional shareholders, such as Limited Liability Company (PT.), Pension funds, insurance companies, banks and limited liability, in this case they are not individual shareholders.

Institutional ownership are long-term investments and they oriented to get dividends each year. Institutional ownership is expected to give its role in the form of monitoring so that the manager does not perform actions that can damage the company.

3.3 Dividend Policy

Jensen and Meckling (1976) stated that the financial decision can be sourced from shareholders' capital. Financing through external and internal capital certainly have an influence on the payment of dividend, so companies need to determine the dividend policy, such as increasing dividend payments each period.

Dividend payment is a part of monitoring done by company (Crutchley et al., 1999). It means that when dividend payment is increasing to shareholders , it shows that the company is well managed by the manager, and it indicates the existence of effective monitoring from of institutional shares ownership.

3.4 Company's Financial Performance

Company's financial performance appraisal is important to be conducted either by the management, shareholders or the government, because it involves welfare distribution among them. Companies that have assessed and evaluated the company's financial performance can find out the shortcomings that must be immediately improved in order to make the company be able to realize its goal well. Moreover with investor candidates or shareholders themselves. They need to assess their performance in order to know clearly about how the prospect of the shares later.

The financial performance of the company can be assessed through a variety of variables and indicators of measurement. On the financial aspect, the main source of variables or indicators that become the basis of the company's financial performance assessment is financial report of the company. Based on the report it can be calculated a

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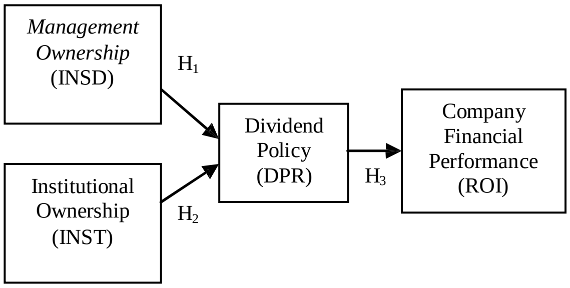
number of financial ratio which becomes the basis of company's financial performance.

4. Research Conceptual Framework

Picture 1. Research conceptual Framework



5. Research Hyphoteses

The hypotheses in this study are:

H1: Management ownership influences significantly positive on dividend policy.

H2: Institutional ownership influences significantly positive on dividend policy.

H3: Dividend policy influences significantly positive on company's financial performance.

6. Technique Analysis

This study used the path analysis technique to test hypotheses. The reasons underlying the use of path analysis technique because all variables used in this study can be measured directly (all variables are measured variables). Analysis of the path used in testing hypotheses using regression.

7. Research Methods

7.1 Research Design

This research is an explanatory research. The secondary data were in the form of the annual financial statements of go public manufacture companies in Indonesia Stock Exchange (IDX) for 10 years consecutively from 2003 to 2012 years. The data collection was done by using data pooling technique.

7.2 Population

The population in this study were 156 companies which were registered in the Stock Exchange from 2003 to 2012 year. Total population that met the criteria were 36 companies.

7.3 Sources and Types of Data

Data source used in this research were financial statements/reports of companies registered in the Stock Exchange in 2003-2012. The types of collected data were;:

1. The financial statements data: total assets, total internal capital, net operating income, dividends per each share, the number of circulated shares and net profit after tax.
2. The percentage of shares owned by managers, directors and commissioners.
3. The percentage of shares owned by institutions.

7.4 Research Variables

The variables in this study were.

1. Exogenous variable, in this study was the management ownership (INSD) and institutional ownership (INST).
2. Endogen variable, in this study was the company financial performance (ROI)

Intervening variable, in this study was dividend policy (DPR).

7.5 Variable operational definition

7.5.1 Management Ownership

Management ownership is defined as the proportion of shares which are owned by manager, director and commissioner divided by the number of circulated shares (Bathala *et al.*, 1994) and symbolized by INSD.

$$\text{INSD} = \frac{\text{The proportion of shares owned by manager, director and commisioner}}{\text{The number of circulated shares}}$$

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7.5.2 Institutional Ownership

Institutional ownership is defined as the proportion of shares owned by institution on the number of shares at the end of the year in the form of percentage (Bathala *et al.*, 1994) and symbolized as INST.

$$\text{INST} = \frac{\text{The proportion of shares owned by institution}}{\text{The number of circulated shares}}$$

7.5.3 Dividend Policy

Dividend policy is defined as the portion determination of how much profit will be given to the shareholders and which will be retained as retained profit (retained earnings) (Hatta, 2002)

$$\text{DPR} = \frac{\text{Dividen of each share}}{\text{Profit of each share}}$$

7.5.4 Company Financial Performance

Financial performance variables as endogenous variables measured by Return on Investment. ROI is the ratio of net profit after tax to total assets.

$$\text{ROI} = \frac{\textit{Net Profit After Tax}}{\textit{Total Asset}} \text{ X } 100\ \%$$

8. Result and Discussion

8.1 Hypothesis Testing Result

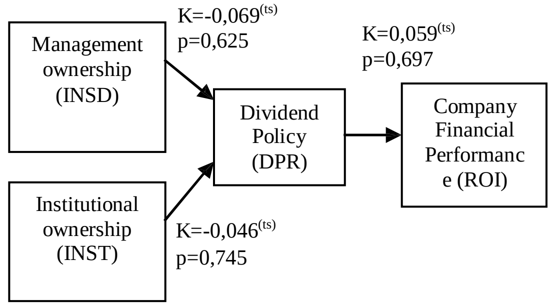
Hypothesis testing was done by t test (t test) partially on the direct influence coefficient.

Tabel 1. Testing Result of Path Coefficient

Relationship among variables		Path Coefficient (p-value)	Note
Independe	Dependen variable)		
Management ownership	Dividend policy	-0,069 (0,625)	Not Significant
Institutional ownership	Dividend policy	-0,046 (0,745)	Not Significant
Dividend policy	Company Financial Performance	0,059 (0,697)	Not Significant

Note: *=significant at α 10 %; **=significant at α 5 %; *** = significant at α 1 %.

Picture 2. Path Diagram of Analysis Result



Note: *=significant at α 10 %; **=significant at α 5 %; *** = significant at α 1 %.

8.2 Research Result Discussion

8.2.1 The Influence of Management Ownership on Dividend Policy

Based on the data used and the testing which had been done, it shows that the management ownership doesn't influence significantly on dividend policy. It means that manager prefers to have dividend paid to shareholders to be reinvested in the company in the form of retained profits in order to add company's capital..

This finding supports the agency theory of declared by Jensen *and* Meckling (1976), who states that one of the agency conflict ; problem which happens between manager and shareholder is that shareholder prefers dividend payment to reinvestment. On the other hand, manager prefers dividend paid to be reinvested in order to add company's capital. The finding of this research is consistent with the research result conducted by Chen and Steiner (1999), and Rozeff (1982) and it doesn't support the research result conducted by Easterbrook (1984) and Moh'd *et al*, (1998).

8.2.2 The Influence of Institutional Ownership on Dividend Policy

Based on the data used and the testing which had been done, it shows that the institutional ownership doesn't influence significantly on dividend policy. It means that institutional shares ownership doesn't do intervention on the dividend policy decision done by manager.

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This research finding hasn't confirmed yet with the agency theory stated by Jensen *and* Meckling (1976). This research finding doesn't support the research finding conducted by Imanda and Nasir (2006), Crutchley *et al*, (1999), Agrawal *and* Mandelker (1990), Han *et al*, (1999), Wiberg (2008) andMursalim (2007).

8.2.3 The Influence of Dividend Policy on Company's Financial Performance

Based on the data used and the testing which had been done, it shows that dividend policy doesn't influence significantly on company's financial performance. It means that the amount of *dividend payout ratio* (DPR) doesn't influence financial performance, but financial performance is determined by *Earning Before Interest Tax* (EBIT) and the level of company's risk.

This research finding hasn't succeeded yet in confirming signaling theory (Leland *and* Pyle, 1977), in which company gives dividend to shareholder is positive signal for investor that the financial performance is good. This research finding is consistent with the research finding done by Jensen *et al.* (1992), Myers *and* Majluf (1984).

9. Conclusion

Based on the analysis of research finding and discussion, it can be concluded as follows:

1. Management ownership doesn't influence significantly on dividend policy. Therefore, hypothesis (1) which states that management ownership influence significantly on dividend policy is rejected.
2. Institutional ownership doesn't influence significantly on dividend policy. Therefore, hypothesis (2) which states that institutional ownership influence significantly on dividend policy is rejected.
3. Dividend policy doesn't influence significantly on company's financial performance. Therefore, hypothesis (3) which states that dividend policy influences significantly on company's financial performance is rejected.

10. Suggestion

1. This research used population who fulfill criteria determined by researcher, as a result this research finding can't be generalized for other industrial group.
2. There wre only 36 companies as the population of the research being observed for 10 years . The number of population needs to be improved for the next research to make it stronger in generalizing research finding.
3. Related to theoretical aspect, especially the one which is related to agency theory, that the existence of monitoring done by institutional ownership , the increasing of management share ownership proportion, doing dividend policy through the increasing of dividend payment to shareholders, if those can be done simultaneously, it can decrease agency problems.

11. Research Limitation

Several limitation in this research are as follows :

1. Data of management ownership and institutional ownership are not reported consistently every year, for example in certain year there is management ownership but next year, the data is not available.
2. There is not complete data of DPR, and ROI every year.
3. This research was conducted in manufactured company which have certain criteria which had been decided. As a result, the research finding can't be used as a guidline to generalize all public companies in Indonesia.

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