CHAPTER I
INTRODUCTION

A. Research Background

Every company always requires management of funds in order to meet the daily operational needs and to develop the company. According to Weston and Copeland (1992: 2), financial management is one of the areas of functional management in a company, which learns about the use of funds, how to obtain funds and how to share the results of the company's operations. There are several main activities carried out by financial managers, namely the use of funds and fundraising (Wonggo et al. 2016). Based on these two main activities, finance produces functions namely, investment decisions, funding decisions, and dividend policies. These financial functions give birth to the purpose of finance, namely to maximize the value of the company or to add value to assets held by shareholders.

The question mostly arises that why firms pay dividend. It has been the question of consideration and the focus of research since long time. Corporate dividend policy has been an issue of interest and is part of the most controversial topics in the financial literature. According to Weston and Brigham (1990: 198) dividend policy is the decision to share profits or hold them to be reinvested in the company. Dividends are the distribution of profits to shareholders based on the number of shares held paid at the end of each period in accordance with the percentage. Dividend policy is an influential control vehicle to reduce the
conflicting interests of the shareholder and managers because shareholders are interested in getting dividends, but managers prefer to retain earnings. Managers want to retain earnings for maintaining higher control over the resources.

Jensen (1986) and Rozeff (1982) in (Ullah, Fida & Khan, 2012) argued that the firms to alleviate the agency problem could use dividend payout policy. According to them, if dividends are not paid to the shareholders, the managers will start using these resources for their private benefits. In this context, agency theory highlights conflicts of interest arising between the major player while emphasizing the impact of these conflicts on dividend policy. Dividend policy helps the firms to know that how they can control the agency cost by handling the dividend policy. Jensen (1986) in (Ullah, Fida & Khan, 2012) argued that by paying dividends to the shareholders, the managerial control over the resources would reduce. Stouraitis and Wu (2004) suggested that the dividend could be used to squeeze the overinvestment problem of corporation. Based on the agency theories, recent studies have focused on examining the effects of governance standard and ownership structure on corporate dividend policy. For example, La Porta et al. (2000) find that firms in countries with low corporate governance and poor shareholder protection tend to pay low dividends and that firms with high ownership concentration tend to make higher dividend payments. Then, Ullah, Fida, and Khan (2012) said that ownership structure plays an important role in the company's dividend policy by minimizing agency costs associated with agency problems.
Dividend policy will not only assist in reducing the agency cost but will also act as a signal to give information to the shareholders about the firm’s valuation (Ullah, Fida & Khan, 2012). The dividend payout can be influenced by the firm ownership structures. The main focus of this study is to investigate the effect of ownership structure on the dividend policy. Carvalhal-da-Silva and Leal (2004) argued that ownership structure is very important and influential factor in determining the efficiency of the market by giving information about two significant things.

First, it will show the extent of risk diversification of shareholders. Second, it will give information about the possible agency problems in the management of the corporation. They further found that a strong association exists between the dividend policy, governance structure and market valuation. Maury and Pajuste (2002) observed that the firm’s control structure influences the dividend payout policy and that large and leading shareholders in a control structure may generate private benefits that they do not prefer to share these benefits with the minority shareholders. There are different shareholder types, but the institutional shareholders and the managerial shareholders have a greater control over the firm’s policies as compare to other types.

According to Murhadi (2008) institutional ownership is the percentage of company shares owned by institutions or institutions (insurance companies, pension funds, or other companies). Institutional ownership in the company is also expected
to be able to strengthen the supervisory function of management so that deviations made by management within the company can be minimized. The higher the level of institutional ownership will make the external control of the company stronger. According to Scott (2003:191) in Kartikasari and Lasmana (2013), institutional ownership is the majority shareholder that can reduce agency problems in the company because the number of institutional investor ownership is not small and is owned by several individual investors, causing institutional investors will be more careful and provide tighter supervision of management behaviour that is not in line. With the high level of institutional ownership, it can reduce agency costs and allow companies to distribute dividends in low amounts. In the study of Ullah, Fida, and Khan (2012) found that the institutional ownership has positive relationship with the dividend payout and the explanatory power of the model has 23.3% there for it can be concluded that the incremental effect of the institutional ownership in the model has about to 5%. In the research of Fauz and Rosidi (2007) and Ismiyanti and Hanafi (2003), institutional ownership did not affect dividend policy. The results were obtained in the study of Dewi (2008) which showed that institutional ownership did not significantly influence dividend policy. Al-Qahtani and Ajina (2017) in their research have identified a negative relationship between institutional investor ownership and the rate of dividend distribution.

Managerial ownership is a company owner as well as a company manager. The greater managerial ownership, the smaller the difference in interests between shareholders and managers, they will act more carefully because they will share the consequences of the actions taken. Managerial ownership prefers if company
profits are not shared with shareholders because it is used as internal capital used for company expansion. The higher the level of managerial ownership in the company, the higher the likelihood that the dividends to be distributed will be lower, because the managerial party prefers if the dividend is held as retained earnings. So it can be concluded that managerial ownership has a negative relationship to dividend policy. In the study of Ullah, Fida, and Khan (2012) found that managerial ownership has negative relationship with the dividend payout ratio with the explanatory power of 18%. In the research of Al-Qahtani & Ajina (2017) found a different result with Ullah, Fida, and Khan that there is a positive significant relationship between managerial ownership and dividend rate. In the research of Mehrani, Moradi, and Eskandar (2011) have a same result Ullah, Fida, Khan (2012) research that managerial ownership was not significantly associated with dividend payout. It is because managers-owners have a little percentage of ownership in the Iranian firms and they can’t affect on dividend payout.

Foreign ownership plays a significant role in corporate policies, especially concerning the dividend payment policy. Activating foreign ownership can also reduce agency costs. foreign ownership here, namely other institutions outside the company such as financial institutions and other companies that have no affiliation and associate companies with stock issuing companies. With the presence of foreign ownership will increase supervision of managerial performance so that managers will also be more careful in managing the company. In the study of Ullah, Fida, and Khan (2012) found that foreign ownership has a significant positive relationship between dividend payouts and foreign shareholders at 1%, thus be the
dividend payout ratios of the firm. Similar to the research conducted by Mossadak et al. (2016) and Warrad et al (2012) who found that foreign ownership had a positive and significant effect on dividend policy. But it is different from the research conducted by Abdullah et al (2012) and Al-Najjar (2016) who found that foreign ownership had a negative effect on dividend policy.

In this study, researchers chose manufacturing companies as the object of research because manufacturing companies are companies that sell their products starting with uninterrupted production processes starting from the purchase of raw materials, processing of materials to products that are ready for sale. Where this is done by the company itself so that it requires a source of funds to be used on the company's fixed assets. Manufacturing companies need more long-term funding sources to finance the operations of their companies, one of which is stock investment by investors. In addition, manufacturing companies have the largest number of companies on the Indonesia Stock Exchange, so the research results are expected to be more accurate.

Based on the description of the phenomenon and the research gap, the researcher is interested in conducting a study entitled “The Impact of Ownership Structure on Dividend Policy Evidence From Indonesian Manufacture Companies” This research will link to the firm’s dividend payout policies with ownership structure of the firm in Indonesia manufacturing listed companies from 2015 to 2018. Indonesia provides an interesting background to examine that issue as the ownership structure is concentrated and large shareholders are in control. This study
includes replication research and is a development of previous research entitled “The Impact of Ownership Structure on Dividend Policy Evidence from Emerging Markets KSE-100 Index Pakistan” examined by Hamid Ullah, Asma Fida, and Shafiullah Khan (2012). This research will prove to be different because many researchers have been conducted in developed countries to find out the relationship between the ownership structures and dividend policy but Indonesia is emerging economy having different cultural values, traits, norms, beliefs, religion, and lifestyle etc.

B. Formulation of Research Problem

Based on the background described, the authors propose the following problem formulation:

1. Does the institutional ownership affect dividend policy in Indonesian Manufacture companies?
2. Does the managerial ownership affect dividend policy in Indonesian Manufacture companies?
3. Does the foreign ownership affect dividend policy in Indonesian Manufacture companies?

C. Research Objectives

Based on the background and the research problem, the objectives to be achieved from this study are:

1. To find out the effect of institutional ownership on dividend policy in Indonesian Manufacture companies.
2. To find out the effect of managerial ownership on dividend policy in Indonesian Manufacture companies.

3. To find out the effect of foreign ownership on dividend policy in Indonesian Manufacture companies.

D. Research Benefits

In addition to the goals to be achieved, the authors also hope the results will benefit. The benefits that can be taken in this study are as follows:

1. Theoretically

   It is expected to be useful in the field of management as a source of reading and reference that can provide information to parties who will conduct further research on this and can add to the bibliography.

2. Practically

   a. For writers, it is expected to be able to add knowledge about the Effect of Ownership Structure on Dividend Policy.

   b. For company management, it is expected to be beneficial for the management to improve the company's performance in the future so that it can attract investors to invest in the company and become information that can be considered in making decisions regarding the determination of dividends to be distributed.

   c. For investors, it is expected to be able to provide information for consideration of decision making in investing in the company and can
determine which company has a good financial ratio so that it will reduce the loss ratio in investing and embarrassing share sale and purchase transactions.