CORPORATE GOVERNANCE, PROFITABILITY AND DIVIDEND POLICY

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Abstract: This study aims to determine the relationship of Corporate Governance and Profitability on Dividend Policy on pharmaceutical subsector companies listed on the Indonesia Stock Exchange in 2015-2017 either partially or simultaneously. The relationship will be used to identified…. The method used in this research is descriptive method, using ratio analysis of the proportion of the Board of Commissioners, Return On Equity, and Dividend Payout Ratio, descriptive analysis, significance test, correlation test, determination test, classic assumption test, linear regression analysis. The results showed that there was a significant influence between Good Corporate Governance and Dividend Policy which can be seen from the significant value of 0.016 <0.05 so that Ho is rejected and Ha is accepted, and there is a significant influence between Good Corporate Governance and Profitability on Dividend Policy with F count 4,834 significant level of 0.016 <0.05

Keywords: Good Corporate Governance, Profitability, Dividend Policy

Introduction

One of the important objectives of the establishment of a company is to improve welfare and maximize the wealth of its shareholders through maximizing the value of the firm. Damodaran (2015) summarize three decisions throughout the process of maximizing the value of the firm and aside from the investment decision, the financing decision, the dividend decision also one important decisions to be made by the firm. Modigliani and Miller (1961) under the irrelevance propositions of dividend policy to value of the firm since the shareholders could eliminate undesirable dividend cash flow by “rationally” and “arbitrarily” buying and selling shares and that current cash flow of dividend or increase in value are indifferent as long as they get wealthier. On the other hand, Walter (1963) state that “*efforts by investors to negate the effects of policy changes are frequently of limited avail*” (p. 290). One of the questions in dividend decision is how much the business need to give back to the owners, this is dividend policy. Dividend policy is a decision taken at a general meeting of shareholders (GMS) on the net income obtained to be shared with shareholders or otherwise retained. The dividend has a very important impact both on investors and companies, as it is inevitable to disregard this in the manager-shareholder contract. Smith and Watts (1992) state that higher dividends can be perceived as the way to “*dicipline*” the firm’s managers (p. 273). According to According to Ross et al (2015), "*the company will employ management to represent* *the interests of the owners of the company and make decisions on behalf of the owners of the company*" (p. 2). One of them is the distribution of decisions for dividend distribution. Easterbrook (1984), shareholders use dividend as cost efficient mechanism to monitoring cost through capital market funding where the managers, in order to get highest possible price of new stocks, need to maintain company's performance to appeal prospective investors. While the terms dividend and dividend policy seem to be used in parallel, the fundamental meaning of the two need to be fully understood. Ross, Westerfield, and Jordan (2008 p. 595) define dividend policy as "*the time pattern of dividend payout*" including the amount of dividend to be paid back to shareholders for the capital that they provide, this is more than mere dividend. The payback is distributed because "*shareholders have an interest in dividends given by the company*" (Brigham & Houston, 2013, p. 393). Despite the controversy around dividend policy and its relevancy to value of the firm, we can conclude that dividend is important and relevant to the shareholders.

Stock returns to shareholders are the duty of financial management to determine and consider whether the company will share the proceeds of profits with shareholders or be temporarily held for future company development. According to Halim (2015), financial management in carrying out its functions as a dividend policy decision maker in principle concerns the decision whether the profits obtained by the company will be distributed to shareholders in the form of dividends or held in the form of retained earnings for investment financing in the future" (p. 80). The managers (agents), in the pursue of their own interests (agency problem) and not being the residual claimants need to be monitored on shareholder's behalf as dividend will reduce the amount of fund under their control.

According to Walter (1963), "*the greater the profitability, the more likely is management to retain a substantial percentage of earnings*" (p. 31). On the other hand, the company with

World Health Organization (2019) states that spending on health in low- and middle-income countries grows 6% annually and is growing faster than the rest of global economy. In addition to that, Herawati (2019) states that pharmaceuthical industry in Indonesia grew 7.65% annualy and the number was higher than economic growth of 5.06% in the first quarter of 2018. The government of Indonesia plans to establish government-owned holding company in 2019 and this will contribute to higher growth of the industry.

According to Arvirianty (2018) as cited from CNBS Indonesia that PT Kalbe Farma (Persero) Tbk distributed dividends of Rp. 1.17 trillion to shareholders which is equivalent to Rp. 25 per share of Kalbe or with a payout ratio of 48.75 percent for 2017 net income which is greater than the 2016 dividend ratio. The net profit that was achieved was Rp. 2.4 trillion. or up 4.8 percent from the previous year and the reason was to please its investors. On the other hand, H (2018) as cited in Kontan.co.id reported that PT Merck Tbk revised the amount of interim dividend from Rp. 3,260 per share or Rp. 1.46 trillion to Rp. 2,565 per share or Rp. 1,14 trillion.

Based on the above case, draw conclusions to examine what factors influence dividend policy. In this case the author will discuss about "**GOOD CORPORATE GOVERNANCE (GCG) AND PROFITABILITY ON DIVIDEND POLICY IN PHARMACEUTICAL SUBSECTOR COMPANIES LISTED ON THE IDX**".

Significant of the Study

This study seek to find the relationship between Corporate Governance, Profitability and Dividend Policy from at least two broad perspectives; intrinsic and extrinsic influence, while most of the research done based on agency theory, under one perspective, we will employ four underlying theories to give a broader picture on dividend policies and run the test to see how the empirical data will support the theories.

Literature

Corporate Governance (CG) has been used widely, specifically, in many researches and highly related to agency theory where CG is present to solve the agency problem which is the problem between firm management and its owner. Board, as tools of CG, has three roles as identified by Zahra and Pearce (1989), which is service, strategic contribution and control. The three roles show that different perspective should be employed to understand CG as first role of board is related to the institutional perspective and the last two roles come from a different perspective—contigency (Hung, 1998 p. 105). Studies such as ……. seek to find the role of CG through the perspective of agency theory, yet other perspective could be utilized as mentioned by Hung (1998) to help us to understand the complex role of CG which are identified as six school of thoughts: resource dependency theory, stakeholder theory, agency theory, stewardship theory, institutional theory and managerial hegemony (p. 101). The first four theories come from the internal influence perspective and the last two theories come from intrinsic influence perspective. Another study by L'Huillier (2014) compile the definition of CG through several perspectives based on agency theory, stewardship theory, resource dependency theory, stakeholders theory, managerial hegemony theory, multi-governance theory—all but agency and multi-governance theory will be utilised in this study.

Theoritical framework

Resource dependency theory. Boards of directors to act as link to business environment.

Stakeholders theory. The stakeholders, despite of competing interest, need to be taken care of in the pursue of company's goal.

Stewardship theory. Trust of organization and/or owners will empower the manager and not being deemed as self-interest individual.

Managerial hegemony theory. Professional manager will overrule the boards of directors through professional arrangement.

According to Cadbury, CG is here to give direction and control of a company so that a balance between strength and victory of the company occurs. Furthermore, the Center of European Policy Study (CEPS) concluded that CG is an entire system formed from rights, processes and controls through all parties outside or in management (Sutedi, 2011). (Sedarmayanti, 2012) sees Corporate Governance as a system, process, and set of rules that regulate relations between various interested parties, especially in a narrow sense, the relationship between shareholders, board of commissioners and board of directors in order to achieve organizational goals. Therefore, it can be concluded that good corporate governance is a system formed from rights, which is used to direct, control, run, develop a company honestly, obey the law and care about the environment in order to achieve organizational goals. In the practice of Good Corporate Governance there are several principles that are used or applied. According to International Finance Corporation (2010) corporate governance is based on four values which consist of: fairness, responsibility transparency, accountability and which the first two emphasizing on protecting the rights of shareholders.

According to Octavia (2017), a measure of corporate governance can be seen from proxies, namely: independent commissioners, institutional ownership, managerial ownership, audit committee (p. 130). The purpose of independent commissioner is to balance the board of commissioners' decision making, the good proportion of the board of commissioners, according to IA's listing rules regarding General Provisions for Equity Securities Listing at the Exchange is the minimum number of independent commissioners of 30% according to Siallagan and Macfoeds (2006) in Sarafina and Saifin (2017) to measure the proportion of independent commissioners to the total of the commissioners.

Finance manager will face two major decisions regarding the capital budgeting and financing and afterwards the third decisions will rise regarding the distribution of the profits, all or partially, to the shareholders and the rest to stay in the business? (Al-Malkawi, Rafferty, & Pillai, 2010)

Rozeff (1982) argue that firms with higher growth, lower financial and operating leverage pay a higher dividend. According to Damodaran (2015), the dividend policy has the tendency to follow the life cycle of the firm which also defined by the profitability of the firm. In high growth stage the firm will have many of good projects to be funded thus the internal financing will be highly needed, which ultimately affect the dividend policy. On the other hand, the mature and declining stage firm, where the company only have few or none of good projects at hand, will prefer to disburse their earnings through dividend. Profitability ratios are needed for recording financial transactions usually assessed by investors and creditors (banks) to assess the amount of investment profits that will be obtained by investors

and the company's profitability to assess the ability of companies to pay debts to creditors based on the level of use of assets and other resources company.
According to Brigham & Houston (2013), "The profitability ratio reflects the end result of all financial policies and operational decisions". With the existence of profitability, the company will know how much its ability to generate profits. In general, there are four main types of analysis used to assess the level of profitability, which consists of: Net Profit Margin (NPM), Gross Profit Margin (GPM), and Return on Assets (ROA).

Based on the contracting theory in Godfrey et. al (2010) describe the firm with its partakers are governed through contracts including the relationship between principles and agents. Moreover, the agency problem rises whenever the agents make decisions in contrast to the interest of shareholders. Dividend policy is one of the decisions that the managers (agents) will have to take regarding the earnings earned by the firm throughout the performance period. (Sartono, 2008). According to Van Horne et al (2009: 215) there are several factors that influence dividend policy, these factors are as follows: Company's liquidity; repayment of debt; company's growth; opportunities in the capital market and supervision of funds.

Hypotheses of the Study

The hypotheses of this study will be based on the theories mentioned earlier as follow:

Stewardship hypotheses

The theory emphasizes on the empowerment of the manager rather than monitoring and controlling and dividend policy can be seen as one of the monitoring activities to the manager. The theory suggests no defined relationship between the GCG and Dividend Policy as supported by Grinstein and Michaely (2005).

Under the theory, the trust between the manager and principal in the highlight and that retained earnings are the manifestation of "trust" in the relationship. Implicitly, the theory suggests that there is a negative relationship between the Profitability and Dividend Policy.

Stakeholders hypotheses

In the light of stakeholders' theory, the contracts between the board of directors and stakeholders, including competing interest i.e. shareholders and debtholders, suggest that there should not be a significant and positive relationship between corporate governance and dividend policy—shareholders benefit. This is supported by Grinstein and Michaely (2005) that there is no robust relationship between GCG and Dividend Policy.

In regard to profitability, the theory suggests there should not be any positive relationship between profitability to dividend policy since Return on Equity (ROE) being utilized in the study will neutralize the financing inclination among debt and equity.

Managerial hegemony hypotheses

The role of board of directors as “cameo” and that managers have the “real” control suggest that there should be no defined relationship between corporate governance to dividend policy as supported by Grinstein and Michaely (2005).

In regard to profitability, the theory suggests that there will be a negative relationship since the higher the profitability the more management will choose to fund “good” investment through retained earning which ultimately defined the dividend policy.

Resources dependency hypotheses

The theory posits a relationship between resources’ providers and users, and that relationships is built upon the interdependency of parties. The theory suggests that there should be a positive relationship between CGC and Dividend Policy as supported by Francis, Hasan, John, and Song (2011).

In the light of this theory, profitability can be seen as the source of income to shareholders and that managers should consider their well-being since shareholders are also the source of financing to the company. The theory suggests that there is a positive relationship between Profitability and Dividend Policy as supported by Anjathan (2013).

Method of the Study

The method used in the study is descriptive, using quantitative data derived from Annual report of companies at Pharmaceutical sub sector listed at Indonesian Stock Exchange. This study aims to test hypotheses and explains phenomena in the form of relationships between variables. The purpose of this study is to examine whether the independent variables influence the dependent variable, namely Good Corporate Governance, Profitability and Dividend Policy. The data used is secondary data from variables Good Corporate Governance, Profitability and Dividend Policy and there were 30 data samples from the study. Statistical analysis used in the study are descriptive statistic, significant study, correlation analysis, determination analysis and regression analysis.

Result of the Study

Descriptive Statistic

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
GCG	30	.33	.67	.4058	.10486
ROE	30	.01	.63	.2008	.15238
DPR	30	.00	11.54	1.1451	3.24887

Based on the table above the result shows that the variables of the study has a good mean results. The mean results for GCG is 40.58% which is above 30% standard. ROE mean result is 20.08% which is above standard of 20% which shows that pharmaceutical companies has good ability to gain profit. And the mean result for Dividend Payout Ratio is 1.1451.

Correlation Analysis

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.513[a]	.264	.209	2.88929

Table above shows that there is a moderate relationship between Good Corporate Governance, Profitability and Dividend Policy at r = 0.513.

Significant Study

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	80.704	2	40.352	4.834	.016[a]
	Residual	225.396	27	8.348		
	Total	306.100	29			

a. Predictors: (Constant), X2, X1

b. Dependent Variable: Y

Table above show that there is a significant relationship between Good Corporate Governance, Profitability and Dividend Policy with F-test 4.834 and $\rho = 0.016$ at $\alpha = 5\%$.

Classical Assumption Test

Autocorrelation

Table 1. Autocorrelation

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.513[a]	.264	.209	2.88929	.264	4.834	2	27	.016	.719

a. Predictors: (Constant), X2, X1

b. Dependent Variable: Y

Based on the table above, it is known that the autocorrelation test is accepted, the Durbin-Watson value between -2 and 2 is 0.719 in other words there is no autocorrelation.

Multicollienarity

Table 2. Multicollienarity test

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
1 (Constant)	-.482	2.750		-.175	.862		
GCG	-1.223	5.623	-.039	-.217	.829	.828	1.208
ROE	10.572	3.870	.496	2.732	.011	.828	1.208

a. Dependent Variable: Y

Based on the table above, it can be seen that multicollinearity occurs because VIF is above 10 which is 1.208 and the Tolerance value is above 0.1, which is 0.828.Uji

Normality Test

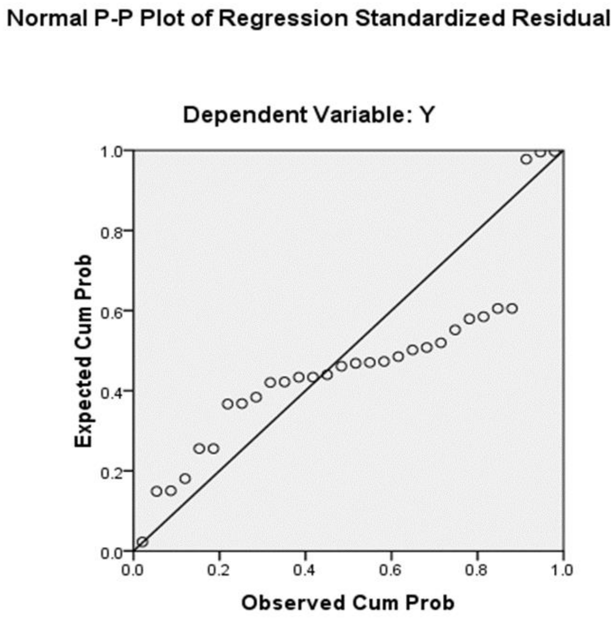

Figure 1. P-Pot

The picture above shows that the plot points are between diagonal lines and therefore the test is accepted that is normally distributed.

Heterocedasticity

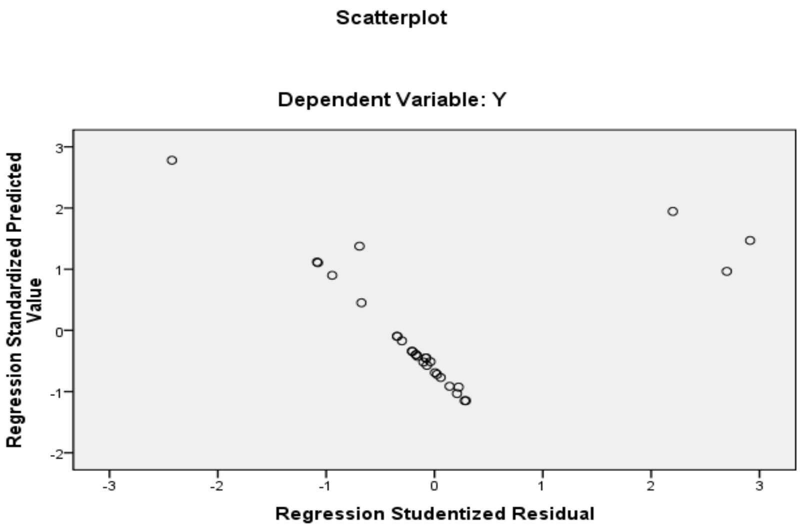

Figure 2. Scatterplot

Based on the picture above, it is known that heteroscedasticity tests are accepted because plot points are scattered and do not form patterns.

Analisa Regresi Linear Berganda

Tabel 3. Analisa Regresi Linear Berganda

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	-.482	2.750		-.175	.862
	X1	-1.223	5.623	-.039	-.217	.829
	X2	10.572	3.870	.496	2.732	.011

a. Dependent Variable: Y

The table above shows that the regression models in this study are as follows:

Y= -0,482 - 1,223X1 + 10,572X2

DPR= -0,482 – 1,223 PDKI + 10,572 ROE

The above equation is not significant where p = 0.829 in Good Corporate Governance is greater than 0.05 and the value of p = 0.011 on profitability is greater than 0.05. The value of constant (a) is -0.482; this can be interpreted if the value of Good Corporate Governance and Profitability is 0, then the Dividend Policy is -0.482. Good Corporate Governance variable regression coefficient value is negative, namely -1,223; this can be interpreted that every increase in Good Corporate Governance is -1 unit, it will increase Dividend Policy by -1,233 units assuming other independent variables remain.

Conclusion

This study aims to determine the effect of Good Corporate Governance and Profitability on Dividend Policy in the pharmaceutical sub-sector listed on the Indonesia Stock Exchange in 2014-2017. Based on the results of the research in the previous chapter, conclusions can be made as follows:

1. Overall, in term of dividend policy, pharmaceutical subsector companies tends to pay dividends.

2. There is a significant influence between X1 and Y on pharmaceutical subsector companies listed on the Indonesia Stock Exchange (2015-2017). can be seen from the significance value of 0.016 <0.05, which means that Ho is rejected and Ha is accepted and found a regression model is DPR = -0.482 - 1.223 PDKI.

3. There is a significant influence between X2 and Y on pharmaceutical subsector companies listed on the Indonesia Stock Exchange (2015-2017). Can be seen from a significant value of 0.016 <0.05 which means that Ho is rejected and Ha is accepted and found a regression model is DPR = -0.482 + 10.572 ROE.

4. There is a significant influence between X1, X2 and Y on pharmaceutical subsector companies listed on the Indonesia Stock Exchange (2015-2017). Can be seen from a significant value of 0.016 <0.05 which means that Ho is rejected and Ha is accepted and found a regression model is DPR = -0.448 - 1.223 PDKI + 10.572 ROE.

Recommendation

Based on the conclusion and discussion of the results of the study, the researcher would like to offer advice to the pharmaceutical subsector listed on the Indonesia Stock Exchange regarding dividend policy that in determining the dividend payout ratio the company must make decisions based on the owner's wishes, the commissioner who represents the owner, and the profit if the company the owner, the commissioner decides that to provide dividends or not, management must follow them. Of the ten companies in the study, all pay dividends at prices that are not much different and there are 3 companies that do not pay dividends. Thus management needs to follow the owner and commissioner in determining dividend payments. And at the same time pay attention to the risks if investors sell shares if investors sell shares if they don't get dividends that can drop stock prices.

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