**Corporate Governance and Dividend Policy in Indonesia**

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**Introduction**

Corporate governance refers to a set of rules and regulations, mechanisms, relations or even processes that are used in the direction, management and running the corporation’s activities and the stipulated functional roles. This explores the distribution of rights and the responsibilities entitled to all the stakeholders such as: the managers, the share holders, the creditors, the auditing personnel, the regulating bodies, the legal fraternity and the board of directors in a corporation with an aim of over sighting of the corporate governance. More so, the decision making procedures are well stipulated and the roles defined concretely for the proper management of the corporate affairs (Ang, Fatemi & Tourani-Rad, 1997). A critical analysis of the key players and the main function of the corporate governance, need to be taken into review. It includes all the processes that are involved on the setting of the corporation’s objectives and the interrelations that it has to do with the regulation, social aspect and the market environment under which the corporation operates in. The dividend policy refers to the set rules, standards and guidelines under which the corporations share their profits and losses amongst the members. It examines the thresh hold on which the corporation should operate and share their interest among its members. It gives the analysis of the amount or the percentages of the share that all and sundry are entitled to with regard to their total shares in the corporation (La Porta, Lopez-de-Silanes, Shleifer & Vishny, 2000),. This is necessary to ensure that the members gain their share according to the contributions that they have made to the corporation.

This study therefore aims at critical examination of the impacts of the governing criteria of a corporation on the dividend policies amongst the Indonesian companies. In this study, we shall examine the two known theories regarding to the dividend policy which are the substitution theory and the outcome theory. The two theories will be critically reviewed and their impacts to the dividend policy be analyzed. For the success of every corporate society, the set rules and guidelines must play the key role in the success actualization. The report concentrated on two companies within Indonesia and explored through their systems in the dividend policies and the governance structure and strategy (Jensen & Meckling, 1976). The dividend policy is usually developed to avert any conflict of interests between the managers and the shareholders. Mainly, the interests of the two parties do not coincide and this may raise a grave alarm to the continuity of the corporation. To avert this, the two polices that are used are the dividend and the debt policy. The dividend policy necessitates the management to enter into equity market more frequently.

**Literature review**

Corporate governance is derived from the agency theory. The agency theory explores the reason for the existence of the conflict, the essence of the conflict as well as the way in which this conflict can be solved. The agency theory stipulates that there is a clear difference between the ownership of the corporation and the control of the operations of the corporation. As a result of the increased agency problems and complexity of their conflicts which arise from the existence of the free-cash flow in the firm there is a need to apply the corporate governance to avert this problem (Baker & Powell, 2012). The principles under which corporate governance operates are; fairness, accountability, transparency and responsibilities. Through these principles, the corporation is able to exercise its governance effectively and efficiently. The factors that determine the effectiveness of the corporate governance are: the ownership structure, the economical system under which the corporation operates, the law and the enforcement criterion used, the social aspects, the cultural norms attached to the governance strategy, the process involved in carrying out various activities in the corporation and finally the key performance indicators that a company or a corporation has adopted in its activities. The ownership structure dictates the ranks and the roles attached to every individual within the corporation. It gives the roles and the parts that each is entitled to play within the process of the governance. This helps to clear any possibility of clash of roles and powers in the duty performances. The economic state has an impact to the governance in that it helps to strategize for the company so that it can have the most efficient ways and the strategies to invest so as not to incur a lot of losses. The economy determines the earnings of a company (Capulong, Virginita, Webb & Zhuang, 2001). If the company earns very little, then it means that it should have few managers since it doesn’t have a lot of the resources to sustain the salaries of the managerial personnel. The law and the enforcement criterion shows the legal requirements on which the corporation operates. It gives the state of the legal atmosphere, the requirements that the corporation needs to meet in order to be certified by the government to commence operation (Gul, 1999). The enforcement strategy refers to how the corporation enforces the rules and the regulations that are set for the corporation to follow. It explores the monitoring of the activities as well as the oversight function. This is tasked to a certain group within the organization with an aim of ensuring that the corporation doesn’t go against the requirements of the law. Every governing body is subject to law and must have a well stated law that is in line with their strategic plan. Failure to observe the law may stimulate the exercise of favoritisms and corruption within the corporation. Therefore there should be a body tasked to this responsibility to ensure that the law is followed to the letter.

On the social aspects, the corporation must examine its relations with their customers and stakeholders at large. It should ensure that there is a good social platform in which the corporation interacts with the locals. This is realized through managerial tactics. The manner in which a company relates with the customers and others determines whether they are social or not. The company must have a good relationship strategy with its immediate surrounding key players to enhance its performance (Sato, 2004). The other factor is the culture that the company operates on. The culture of a company is determined through its practices. The manner in which the company operates, its roles to the community and above all its responsibility towards the community is the cultural aspect that a company mainly operates on. Secondly, the culture is set through the norms that a company observes. It goes beyond the performance to the corporation to the operation criterion. The manner in which the activities are carried out is defined by the corporation leadership. The leadership determines the strategy or the process implementation (Brown, Beekes & Verhoeven, 2011). The company should implement the strategy in a more cost effective manner to ensure that it is able to meet the demands of the strategic plan of the corporation. If they implement the strategies wrongly, the corporation may lose a lot of its benefits that would come with the plan implementations. Finally, the key performance indicator strategies are an important aspect of the corporation implementations of its plans. The corporation uses various indicators to evaluate its performances in different sectors of its performances. This helps the company to effectively perform its functions. The management uses these indicators to evaluate its performance.

The policies that are used to enhance the corporate governance are the dividend and the debt policies. The increase in the divided can help to reduce the conflicts that may arise from the free cash flow. The report will look into the dividend policy in Indonesia. In every financial institution, dividend policy has always remained a puzzling subject over decades (Gugler, 2003). The dividend policy has combined various aspects such as the market imperfections and understanding their interactions on various aspects. The dividend policy is determined by factors such as the profitability of the business or rather the corporation’s operations, the investment opportunities and the size of the corporation. The study of a dividend trend of a company gives the life cycle that a given company may have gone through. The more the advancement of the dividend share amongst the members the more the company gets to grow. This can be used specially to measure the size of a company and the corporation through the total dividend share (CLSA, 2007). It indicates the profits margins that a company has gained. Looking at Indonesia, which is a developing country within the South East Asia, there is a great lesson that one can learn from its dividend policy. The study will keenly look at the Indonesia stock exchange. The agency theory has been used to explain the dividend policy in Indonesia.

The dividend policy in Indonesia has become a regulatory level issue lately. There has been a set up standard policy and procedure which aims at governing dividend payments. However the payment is not yet a compulsory affair as the regulation greatly depends on the general meeting of the shareholders. During these meetings, the corporations and the companies in Indonesia agree upon the method or the criteria to use in giving out dividends and when they need to issue the dividend to their members (Claessens, Djankov & Lang, 2000). In the past, the stock exchange found that dividend issuance was burdensome to the companies due to their small sizes. However, in the recent times, the IDX committee has found out that most of the companies have recorded a positive net income and has found it necessary that they need to include a dividend share policy as a way of corporate governance. They found it being unfair to the shareholders ads they were not entitled to enjoy a share of the profit that the corporation was getting at that time. They argued that this kind of practice was an indicator of the good corporate governance practice and that it was not only the investor’s interest to earn capital gain but also to be entitled to a dividend share. To enact this, in the year 2013, they proposed to put in place a more strict regulation on the dividend policy so that the companies would give their shareholders the dividends upon realization of a positive profit margin. This included the minimum frequency at which they would be paying their dividends to the members, the minimum amount that would be paid as a dividend was also set and finally the sanction for non-compliance to the policy that was put in place.

Looking into the assumption created by Miller and Modigliani (1961) through their irrelevance theorem where they deduced that the dividend was an irrelevant issue to the firm value, we realize that there had been ensued encouragement on the other scholars in finance to examine their theory (Denis & Osobov, 2008). This theory was built on a number of assumptions which are; rational behavior of the firm, the perfect capital market as well as the perfect certainty. The study of the work done by Black and Scholes shows that there is no permanent effect on the stock prices that is impacted by the changes in the dividend policy which is a support to the theory developed by Miller and Modigliani. Another hypothesis developed in relation to the dividend policy was the relaxing asymmetric information assumption of Bhattacharya in 1979 which introduced the signaling hypothesis. This was used to explain the positive stock price reaction as a result of the outcomes related to the dividends may it be the dividend increase or the initiation of the dividend. As days went by, the signaling hypothesis was however found out not to be consistent in its results. This necessitated the developing of another hypothesis which was developed by Baker and Wurgler in 2004 which is referred to as the catering theory of dividend. This used to relate the dividend payment to the demands by the investor. It says that if the investor demands for the dividend, then the stock valuing will be higher. This makes the manager feel motivated to pay the dividends. On the other hand, it supposes that if there are no demands by the investor to be paid the dividend, then the manager doesn’t pay the dividend and hence no dividend is paid. Dividend smoothening is yet another dividend hypothesis that was formulated (Knyazeva, 2007). This explores through the managements offering of the dividends to its members at all times even when there are crisis in financial state of the company the management would give little amounts of dividends to their shareholders as a way of making them motivated and evade the risk of them withdrawing their shares from the company.

Majoring on the agency theory which has been prominently used to explain the dividend policy in Indonesia, we look into various proposals made by different financial researchers of time. By examination of the proposal made by Easterbrook and Jansen in 1984 and 1986 respectively, we find out that they had the proposal that the dividends reduce the agency costs. This is done through induction of the external monitoring which comes along with an increase in the transaction costs as a result of the raising external funds (Kowalewski, Stetsyuk & Talavera, 2008). The agency theory shows that the dividend share that one is entitled to depends on the laws and regulations that operate within a state. Countries with a better investor protection are seen to be paying better than those that exercise civil laws. A study done on the developing countries shows that the better the corporate governance, the better the dividends policy that are put in place. These countries actually pay a greater ratio of dividend compared to others whose corporate governance is not yet well established (Miller & Rock, 1985).

**Corporate structure and dividend policy**

In Indonesia, the dividend policy is regulated in general terms. The framework that is used for the Indonesian dividend policy is the Indonesia Limited Company Law Number 40 of the year 2007 (Nam & Nam, 2004). This law gave the authorization to all the companies to own an article of Association so as to use it for the dividend payments and the net income valuations. The net income was used to determine the surplus income which was supposed to be shared amongst the shareholders. The dividend share is only done in cases where we have the company experience the positive net income (Gugler & Yurtoglu, 2003). The articles gave the conditions for the public companies but for the privately owned companies there is no limitation that is given to them as they may decide to give dividends or not and no measures would be taken on them. They act in accordance with their own decisions. They have no law that the follow in regard to the dividend shares.

The corporate governance in Indonesia is determined by the ownership of the company. The company has both the major and the minority shareholders (Renneboog & Szilagyi, 2008). The governance has to be done in regard to the ownership structure. These two shareholders are entitled to different privileges in the company. This aspect brings about a conflict of interests amongst the shareholders. There should be guiding policies therefore which will be used as the reference points to solve any form of conflicts that may arise (Knyazeva, 2007). Most of the vital activities to be carried out by companies in Indonesia greatly depend on the majority shareholders’ decision. Unlike in other countries where the dividend share is determined by the managers. The decisions are also made during the general shareholders meetings in Indonesia.

On the taxation, the companies operating in Indonesia use defined regulations on the tax in the dividends. The first regulation is “The 1959 Tax on Dividend Regulation’. This regulation subjects the dividend on 20% tax and the tax for this case is paid in advance. Later, there was an amendment done which was aimed at making some reforms in the year 1983. The act was meant to clearly define and elaborate the regulations along which tax was carried out (Mahadwartha, 2003). Later it was revised in the year 1994. In this regulation, the individual companies and domestic institutional shareholders were entitled to a rate of 15% and for the foreign shareholders the rate applied was 20%. In this tax regulation, the institutional shareholders who owned more than 25% of the shares in the firm were not supposed to be entitled to the tax deduction. This led to Indonesia introducing a double taxation into their system since both the shareholder and the firm was taxed (Leal & Carvarhal-dal-silva, 2007). Later in 2008, the regulation was revised to reduce the tax to 10% which was considered to be final. Later, it was followed by a regulation by the government regulation and by the regulation of the ministry of finance.

The dividend policy is one of the most important things that a company can use in order to implement the corporate governance. The corporate governance is the most crucial thing in the success of a corporation. The set rules and regulations help in the oversight authority. The company has to come up with the dividend regulation policies which should be applied in the cases when there is need to impact taxation and the sharing of the dividends amongst the shareholders (Kumar, 2006). The corporate governance needs to be a very critical part of the governance as it gives the criteria on which all the activities of a company can operate on. The company needs to be well established in terms of revenue sharing and dividend shares.

In every business, the returns that the company gets should be distributed amongst the workers for the purpose of realizing the benefits that are accrued due to their activities. The interests should be equally distributed between the members. The benefits accrued are subject to the shareholders enjoyment (Jiraporn & Ning, 2006). The amount of dividends share determines the company’s size and the age of a company can be deduced from the total amount of dividends that is given to the individual shareholders since it is determined incrementally over years.

**Conclusion and recommendations**

For any success to be realized in any corporation and business there should be a good yet credible leadership system in place. The leadership has the role of governing the way in which the company performs. In Indonesia, it has been found out that the dividend policy has been based on the agency policy. The corporate governance uses the debt policy together with the dividend policy as ways to ensure that they make their governance effective. Indonesia has been found to have had a system of taxation that used to tax both the shareholder and the company. This had introduced double taxation though it was later solved through the inclusion of the regulation that reduced taxation to 10% (Claessens & Yurtoglu, 2013). The companies have been seen to have improved productivity within Indonesia since it is a developmental hub as we found earlier on. The regulatory bodies in a company are the main determinants of the governance criteria that a company adopts. The leadership should be governed by set rules and regulations to prevent them from exercising forceful leadership. They should ensure that they have included all the needs of the shareholders (Mitton, 2004). For the companies that operate on the basis that they have both minor and major shareholders, there should be ways to harmonize their roles to ensure that no party exercises more authority over other. When this is done, even the claims that may come up with the dividend policy will be easy to solve. Moreover, the company should have a dividend sharing policy (Denis & Osobov, 2008). They may decide that the decision is made during the general shareholders meeting or be made by the management. There are different ways to determine the share; there is a share percentage share, there is an equal share of the interests without looking at the total contribution and finally share according to the roles played by various shareholders and their rankings.

Finally, it is important to note that Indonesia has got a stable corporate governance which has enabled it realize major corporation developments of late. The sharing of the dividend has been streamlined to ensure that all the companies give good services to their shareholders. The involvement of the government is aimed at streamlining its policy implementations.

**Recommendations**

To ensure that there is a good system for governance in the corporation leadership in Indonesia, the following recommendations were [proposed.

1. There should be a well set up standards that each corporation should be required to meet
2. Every corporation leadership structure should be certified and well formed to evade the formation of leadership that is not all inclusive
3. Corporations should involve all shareholders in their decisions that are aimed at making their final decision on the sharing of the dividends
4. Any company that doesn’t give its members dividend should be subjected to law so as to encourage them to share their gains to the shareholders
5. Dividend policies should be made in accordance with the shares that one owns in various companies since it will bring about equity
6. The corporations should only share dividends when they have experienced a positive index in the incomes to ensure that they don’t freeze the corporation even when they have no profits.

If these recommendations are taken into consideration, there will be very effective corporate governance in Indonesia as well as a comprehensive yet all inclusive dividend policy.

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