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MODERATING EFFECT OF GOOD CORPORATE GOVERNANCE TOWARD IMPACT OF FINANCIAL PERFORMANCE ON DIVIDEND POLICY IN INDONESIA MOST TRUSTED COMPANIES 2011–2015

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ABSTRACT

This study's purpose is to prove that Good Corporate Governance can strengthen the impact of financial performance on company's dividend policy. This study was conducted using panel data on four companies that participated in Indonesia Most Trusted Companies research 2011-2015. The results of Moderated Regression Analysis showed that financial performance and Good Corporate Governance have a negative and significant effect on dividend policy, whereby these results are not aligned with theories and hypotheses which might be affected by the declining in the global economy. However, Good Corporate Governance is still proven to strengthen the effect of financial performance on dividend policy as quasi-moderator.

INTRODUCTION

In the perspective of financial management, the goal of a company is to maximize its value for its owners (Karnadi, 1993). By maximizing company's value, managers are contributing in increasing its owners' wealth. Therefore, the company is obliged to provide an appropriate return to the shareholders, either in form of capital gains or dividend yield.

To meet its obligation regarding dividend distribution, such obligation should be supported with an adequate financial performance. An adequate financial performance shows that company managed to generate sufficient net income to be distributed as dividends to the shareholders in order to meet its obligation. Unfortunately, this performance achieved by the company is not always experienced by the owners when performance is not disclosed transparently. Managers may tend to retain its earnings in order to expand its business thus ignoring dividend payment. Therefore, Good Corporate Governance is expected to serve as a mechanism that will provide assurance to the shareholders that they will receive an appropriate return on their investment in the company (Santoso & Shanti, 2009).

Building trust in the world of business is not an easy work, given the Agency Theory reveals that managers have opportunities and motivations to use their discretion to benefit themselves (Waworuntu, Hermawan, & Hokardi, 2012). Financial statement manipulation and falsification will diminish investors' trusts and expectations of their return. Therefore, this will encourage the need for Good Corporate Governance as the best solution to reduce agency conflict in order to make sure that investors' assets are protected from exploitation which can be done by managers, thus a trusted world of business will be achieved (Saragih, Nugroho, & Eko, 2012).

The importance of Good Corporate Governance in doing business encouraged the establishment of an independent institution in 2000, named the Indonesian Institute for Corporate Governance (IICG). IICG conduct assessment of Good Corporate Governance on Indonesian companies using Corporate Governance Perception Index (CGPI). Yet according to Kaihatu (2006), Good Corporate Governance practice in Indonesia is still extremely low. Then, to encourage Good Corporate Governance in Indonesia, IICG along with SWA magazine give appreciation and recognition through Indonesia Most Trusted Companies Award. CGPI score will be used as a reference to determine the rating of the company, namely Most Trusted Company, Trusted Company, or Fair Trusted Company.

Previous studies on Good Corporate Governance, financial performance, and dividend policy have been conducted up until now. Unfortunately, a consistent result has not been obtained yet. Halviani and Sisdyani (2014) found that Good Corporate Governance and Return On Assets have a positive effect on Dividend Payout Ratio. Good Corporate Governance is also proven to moderate the effect. Meanwhile, Setiawan and Lian (2013) showed that Good Corporate Governance negatively affects dividend policy, but Return On Asset still positively affects Dividend Yield. Besides inconsistent results, there are only a few of previous studies that use Corporate Governance Perception Index. Usually, Good Corporate Governance is measured only by ownership structure, board size, the number of independent commissioners, and the external auditor. This can be seen as a gap that we can explore more.

LITERATURE REVIEW

Dividend Policy

Dividend decision is a decision that determines the portion of company's net profit to be distributed to the shareholders (Karnadi, 1993). Dividend policy determination is not an easy work because when managers choose to distribute its earnings as dividends, the amount of retained earnings will be decreased. Thereby, reducing internal financing sources will reduce investment and expansion that can be done by the company.

There are several opinions and theories that have been used up until now as literature concerning dividend policy. First, dividends increase company's value by Gordon (1959) and Lintner (1956). They stated that investors would prefer to receive dividends rather than receive capital gains. This theory is referred to Bird In Hand Theory. Second, Dividend

Irrelevance Theory by Miller and Modigliani (1961) explained that company's value is determined by company's earning power, not by its dividend policy. Clientele Effect Theory also revealed that dividend policy actually has no effect on the value of the company because different groups of investors with different interests are attracted to a particular kind of company's dividend policy depending on how these investors wish to receive their return (Hatta, 2002). Third, dividends reduce company's value by Litzenberger and Ramaswamy (1979) because dividends are taxed at higher rate than capital gains, therefore capital gains are more attractive and dividend distributions will reduce the value of the company. This theory is referred to Tax Preference Theory. However, it turns out that almost all companies, in fact, execute dividend distributions. Dividends are attractive to investors because they consider it as a good commitment by the company to share the earnings with them. They also consider it as information about company's performance which is expected to be better in the future.

Financial Performance

Performance shows the effectiveness and efficiency of a company in achieving its goal (Pertiwi & Pratama, 2012). Financial performance of a company can be measured by market-based measure and accounting-based measure. Financial performance market-based measure assesses the financial performance of company using Market Value or Valuation Ratio, it consists of Price to Earning Ratio and Market to Book Ratio (Karnadi, 1993). While financial performance accounting-based measure uses Profitability Ratio, it consists of Sales On Profit Margin, Return on Assets, and Return on Equity (Karnadi, 1993). According to Pertiwi and Pratama (2012), financial performance measurement is really useful for manager to be used as basic information to improve performance of the next period, to determine reward and punishment, to assess progress that has been made by the company, and to be used for decision making by the shareholders and managers, including dividend policy.

Agency Theory

It cannot be assured that shareholders will also experience the outcome achieved by financial performance of the company, because Agency Theory explained that agency conflict may occur when principal hires agent to manage the company, but manager as agent has more information about the company than the owner as principal of the company (Pertiwi & Pratama, 2012). Thus, asymmetric information enables agency conflict to occur which is triggered by manager's opportunistic behavior. That opportunistic behavior triggers agency conflict to occur which causes agency cost to be settled up by the principal, such as monitoring cost, residual loss, and bonding costs (Mai, 2015).

Corporate Governance

Corporate Governance can reduce agency conflict through mechanism to protect investors' assets from exploitation that can be done by a manager (Saragih et al., 2012). Corporate Governance is a set of processes, habits, policies, and rules that affect the direction, management, and control of a company (Pertiwi & Pratama, 2012). Excellence organizational communicaton will achieve good corporate governance in government public companies and contribute to value added for organization (Yunus, Sari, & Patriana, 2016). There are five main principles of Good Corporate Governance which are also used as main assessment aspects of Indonesia Most Trusted Companies research (Santoso & Shanti, 2009), such as transparency, accountability, responsibility, independence, and fairness. The benefits of Good Corporate Governance are improving investors' trust, raising capital easier, reducing the cost of capital, improving company's performance by a better decision-making process, increasing dividend distributions, and increasing company's stock price (FCGI, 2001).

Corporate Governance Perception Index

Corporate Governance Perception Index (CGPI) is an index which is used to assess the quality of Good Corporate Governance practice of companies in Indonesia which are willing to participate in Indonesian Most Trusted Companies research. Corporate Governance Perception Index uses four mechanisms of assessment, namely self-assessment, document completion, assessment of papers and presentation, as well as observation (Sugiarsono, 2014). Each year the weight of each assessment mechanism varies according to research themes.

Indonesia Most Trusted Companies Research

Corporate Governance Perception Index is used as an assessment in Indonesia Most Trusted Companies research. Indonesia Most Trusted Companies research is an annual research and rating program of Good Corporate Governance practice in Indonesia which is organized every year by SWA magazine cooperates with the Indonesian Institute for Corporate Governance (IICG). IICG established on June 2nd, 2000 as the central institution for development studies, education, training, and popularization of Corporate Governance practice that aims to disseminate concepts, practices, and benefits of Good Corporate Governance to create a trusted world of business (IICG, 2015). This research has been going on since 2001 with four steps of the research, methodology preparation (January-April), publication and invitation distribution (May-June), assessment (July to November), and the announcement of results (December) (Anissa, 2013). Thus, this research takes one year to assess companies based on predetermined Corporate Governance Perception Index. After getting the result of this research, SWA and IICG express their appreciation to the companies by giving them rating such as Most Trusted Company (score 85-100), Trusted Company (score 70-84), or Fairly Trusted Company (score 55-69) (Sugiarsono, 2014).

Indonesian Most Trusted Companies research highlights different theme every year, in 2011 this research highlighted Corporate Governance with ethics (33 companies), in 2012 Corporate Governance with risk management (40 companies), in 2013 Corporate Governance with knowledge management (42 companies), in 2014 Corporate Governance in the perspective of learning organization (31 companies), and the latest research in 2015 highlighted Good Corporate Governance with value creation (23 companies). The number of participants in Indonesia Most

Trusted Companies research is still extremely small and keeps declining, proves that Good Corporate Governance practice in Indonesia is still not optimal yet.

The Previous study conducted by Halviani and Sisdyani (2014) examined moderating effect of Corporate Governance on Return On Assets and Dividend Payout Ratio of real estate companies during 2009-2012. Management ownership, institutional ownership, and composition of independent commissioners are extracted into one to explain Good Corporate Governance variable. The test showed that Return On Assets and Good Corporate Governance have a positive effect on Dividend Payout Ratio. Good Corporate Governance also strengthens the effect of Return on Asset on Dividend Payout Ratio.

While the study conducted by Setiawan and Lian (2013) examined the effect of Corporate Governance, size, profitability, and growth of the company on dividend policy during 2004-2006. This study uses Transparency and Disclosure Index (TDI) to measure Corporate Governance. This study found that profitability and growth of company have a positive effect on dividend policy, the size of the company does not have a significant influence on dividend policy, while Corporate Governance negatively affects dividend policy. Setiawan and Lian also revealed that Corporate Governance practice in Indonesia is extremely weak because the score of TDI only reached to 32.75%. According to them, Corporate Governance can negatively affect dividend policy because companies in Indonesia distribute dividends as compensation for their poor Corporate Governance. Therefore, this study tries to find newer results which will be more precise and more accurate than those inconsistent results from previous studies.

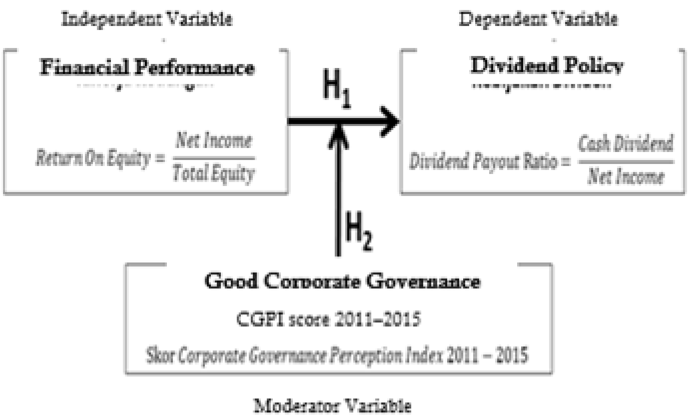

Figure 1. Study Framework

The framework in this study illustrates two hypotheses. First, financial performance is indicated by effectiveness and efficiency of the company in order to achieve its goals (Pertiwi & Pratama, 2012). When the effectiveness and efficiency of the company to accomplish financial performance as measured by Return On Equity rise, then it will reflect a greater income, a greater income will increase the size of income that will be distributed to the shareholders as measured by Dividend Payout Ratio. Thus, this study proposes the first hypothesis as follows:

H1: Financial performance has positive effect on dividend policy

Second, Good Corporate Governance is expected to strengthen the impact of financial performance on company's dividend policy, since Agency Theory suggest that the divergence of interests between managers and owners should be minimized, which is by implementing Good Corporate Governance mechanism. When the company has an adequate financial performance, Good Corporate Governance can avoid abuses of authority to happen and ensure that company will protect investors' assets from exploitation that can be done by managers (Halviani & Sisdyani, 2014). Good Corporate Governance will ensure that shareholders obtain an appropriate return on their investments in the company, one of which is in form of dividends that are distributed to the shareholders. Thus, this study proposes the second hypothesis as follows:

H2: *Good Corporate Governance* moderates the impact of financial performance on dividend policy

MATERIALS AND METHODS

The variables in this study are described in more detail as follows:

Independent Variable

In this study, financial performance is measured by Return On Equity. This variable uses ratio scale and it's taken from financial statements of each company. This independent variable uses data with one year lag to synchronize with other variables. Return On Equity is formulated as follows (Ross, Westerfield, Jordan, Lim & Tan, 2012:64):

$$\text{Return On Equity}_{t-1} = \frac{\text{Net Income}_{t-1}}{\text{Total Equity}_{t-1}}$$

Dependent Variable

In this study, dividend policy is measured by Dividend Payout Ratio. The entire sample of companies in this study set dividend policy based on a percentage of previous year net income. This variable uses ratio scale and it's taken from financial statements of each company with accounting period 2011–2015. This variable is formulated as follows (Marlina & Danica, 2009):

$$\text{Dividend Payout Ratio}_{t} = \frac{\text{Cash Dividend}_{t}}{\text{Net Income}_{t-1}}$$

Moderator Variable

Good Corporate Governance is measured by Corporate Governance Perception Index score. Corporate Governance Perception Index score is valuation given to the participating companies of Indonesia Most Trusted Companies research which are assessed by SWA magazine together with IICG. Scores were acquired based on the research conducted from January through December, therefore Corporate Governance Perception Index score is given based on an assessment of the company which carried out in the previous year. This variable uses ratio scale and weight of each assessment mechanism are formulated as follows:

Table 1. Assessment Mechanism of Corporate Governance Perception Index

	2011	**2012**	**2013**	**2014**	**2015**
Self-assessment	25%	15%	17%	27%	21%
Document completion	23%	20%	35%	41%	27%
Papers and presentation	17%	14%	13%	14%	25%
Observation	35%	51%	35%	18%	27%
CGPI score	**100%**	**100%**	**100%**	**100%**	**100%**

Source: SWA magazine, December 2011–2015.

This study uses secondary data and panel data which combines cross section data (participant companies of Indonesia Most Trusted Companies research) with time series data (2011–2015). Sample selection method used criteria such as; non-bank, go-public company, participated in Indonesia Most Trusted Companies research for 2011–2015 in a row, and has every data that is required as variable used in this study. With these criteria, this study obtains a final sample of four companies for five periods with a total of 20 data; PT Aneka Tambang (Persero) Tbk, PT Bukit Asam (Persero) Tbk, and PT Timah (Persero) Tbk which operate in mining sector, also PT Jasa Marga (Persero) Tbk which operates in infrastructure, utilities, and transportation sector.

After obtaining sample of four companies, secondary data collection starts by collecting data from annual financial statement, then collecting Corporate Governance Perception Index score from the results of Indonesia Most Trusted Companies research 2011–2015 by SWA magazine, perform calculations on Return On Equity and Dividend Payout Ratio, data analysis begins with descriptive statistical analysis, followed by regression analysis including Chow Test and Hausman Test to select panel data regression model, Global Test, Partial Test, Moderated Regression Analysis, also Coefficient Determination Test to determine the significance and size of the effect of variables in the regression model. Therefore, regression model in this study:

$$DPR = \beta_0 + \beta_1 ROE + \beta_2 CGPI + \beta_3 (ROE \times CGPI) + \epsilon$$

Description:
DPR = Dividend policy, is measured by Dividend Payout Ratio
β_0 = Intercept coefficient
$\beta 1$, $\beta 2$, $\beta 3$ = Regression coefficient
ROE = Financial performance is measured by Return On Equity
CGPI = Good Corporate Governance is measured by Corporate Governance Perception Index score
ROE×CGPI = Multiplication of financial performance with Good Corporate Governance as moderating variable
ε = Error term

RESULTS AND DISCUSSIONS

Based on observation, financial performance and dividend policy of four companies continue to decline.

Table 2. Descriptive Statistical Analysis Results

	DPR	ROE	CGPI	ROExCGPI

Mean	0.427017	0.175239	0.833850	0.145121
Median	0.468987	0.169671	0.842100	0.142988
Maximum	0.600243	0.378066	0.891200	0.312093
Minimum	0.000000	-0.061704	0.707300	-0.054991
Std. Dev.	0.158030	0.101916	0.045206	0.085554
Observations	20	20	20	20

Source: EViews 7 Output

Based on Table 2, financial performance as the first independent variable is measured by Return On Equity has a maximum value of 37,8% was achieved by PT Bukit Antam in 2011 and a minimum value of –6,17% was achieved by PT Antam in 2014. The average of Return On Equity is 17,52% indicates that those four companies have an average return of 17,52% for each fund that has been invested in the company by shareholders. For Good Corporate Governance as the second independent variable is measured by Corporate Governance Perception Index score has a maximum value of 89,12% was achieved by PT Antam based on research in 2015 and a minimum value of 70,73% was achieved by PT Timah based research in 2011. The average of Corporate Governance Perception Index score is 83,39% showed that four companies on average are implementing Good Corporate Governance quite high.

The dependent variable in this study is dividend policy and it's measured by Dividend Payout Ratio, this variable has a maximum value of 60,02% was achieved by PT Jasa Marga in 2011 and a minimum value of zero by PT Antam in 2015 because it did not distribute any dividends. PT Jasa Marga is a company which has the highest dividend policy compared to other samples. The average Dividend Payout Ratio is 42,70% showed that companies distribute cash dividends to the shareholders about 42,70% of company's net income.

Table 3. Chow Test Results

	Statistic	**Prob**
Cross-section F	3.727532	0.0392**
Cross-section Chi-square	12.413678	0.0061***

****= significant at α 1%; **= significant at α 5%*

Source: EViews 7 Output

Based on Table 3 Chow Test Results, it shows that $F_{statistics} = 3{,}72753 > F_{table} = 2{,}56$ ($F_{0.10,4-1,20-4-3}$) and p-value = $0{,}0392 < \alpha = 0{,}05$, then H_0 is rejected. It means that Fixed Effect Model is more appropriate than Pooled Least Square model to be used in this study as panel data regression model. Model selection analysis is followed by Hausman Test.

Table 4. Hausman Test Results

	Chi-Sq. Statistic	**Chi-Sq. d.f.**	**Prob.**
Cross-section	11.182597	3	0.0108**

random			

***= significant at α 5%*

Source: EViews 7 Output

Based on Table 4 Hausman Test Results, it shows that $\chi^2_{statistics}$ = 11,182597 > χ^2_{table} = 6,25139 ($\chi^2_{0.10,3}$) and p-value = 0,0108 < α = 0,05, then H_0 is rejected. It means that Fixed Effect Model is more appropriate than Random Effect Model to be used in this study as panel data regression model, as follows:

Table 5. Fixed Effect Model (FEM) Results

Variable	Coefficient	Prob.
C	6.116747	0.0132**
ROE?	-14.89376	0.0523*
CGPI?	-6.761083	0.0170**
ROECGPI?	17.62637	0.0454**
Fixed Effects (Cross)		
_ANTM--C	0.017544	
_JSMR--C	0.068110	
_PTBA--C	0.132518	
_TINS--C	-0.218172	
R-squared	0.767237	
Adjusted R-squared	0.659807	
S.E. of regression	0.092173	
Sum squared resid	0.110446	
F-statistic	7.141785	
Prob(F-statistic)	0.001560***	

****= significant at α 1%; **= significant at α 5%; * = significant at α 10%*
Source: EViews 7 Output

Based on Table 5, it shows that $F_{statistics}$ = 7,141785 > F_{table} = 2,44 ($F_{0.10,3,20-3}$) and prob (F-stat) = 0,001560 < α = 0,01, then H_0 is rejected. It means that at least there is one independent variable (financial performance, Good Corporate Governance, or moderator variable) that has an influence on dividend policy as the dependent variable. Thus, independent variables as together have an influence on dependent variable at the significant level (α) of 1% and this regression model is fit to be used in this study because independent variables have an influence on the dependent variable. Based on Table 4.4, for ROE, it shows that $t_{statistics}$ = |-2,135817| > t_{table} = 1,746 ($t_{0,05,20-3-1}$) and p-value = 0,0523 < α = 0,10, then H_0 is rejected. It means that financial performance as independent variable has negative and significant effect on dividend policy. For Corporate Governance Perception Index score, Table 4.4 shows that $t_{statistics}$ = |-2,736531| > t_{table} = 1,746 ($t_{0,05,20-3-1}$) and p-value = 0,0170 < α = 0,05, then H_0 is rejected. It means that Good Corporate Governance also has negative and significant effect on dividend policy. For moderator variable, Table 4.4 shows that $t_{statistics}$ = 2,213278 > t_{table} = 1,746 ($t_{0,05,20-3-1}$) and p-value = 0,0454 < α = 0,05, then

H_0 is rejected. It means that moderator variable has positive and significant on dividend policy. Therefore, Good Corporate Governance is moderator variable that is proven to strengthen the impact of the financial performance on company's dividend policy.

Table 5 also shows that p-value β_2 = 0,0170 < α = 0,10, then β_2 is significant and p-value β_3 = 0,0454 < α = 0,05, then β_3 is also significant. It means that Good Corporate Governance which is measured by Corporate Governance Perception Index score is quasi-moderator variable, in other words, Good Corporate Governance can become moderator variable and also the independent variable that can affect company's dividend policy.

Adjusted R-squared is 0,659807 shows that 66% of company's dividend policy can be explained by financial performance, Corporate Governance Perception Index score, and moderator variable. While 34% is explained by other factors.

Effect of Financial Performance on Dividend Policy

The result of regression analysis shows that financial performance which is measured by Return On Equity has the negative and significant effect on dividend policy as measured by Dividend Payout Ratio. This result is not aligned with theory by Karnadi (1990) and hypotheses in this study because it can actually happen for two reasons. First, although the company has adequate financial performance, it cannot assure that Dividend Payout Ratio will also increase. Because the company still can decide to retain its income to be reinvested in the company. Retained earnings can be used to enhance company's growth through business expansion.

Second, unfavorable observation time which is caused by unconducive economy condition will affect company's performance and the results of this study. The performance of companies in mining sector continues to weaken due to the declining in China and United States' economic growth. While the performance of companies in infrastructure sector is weak because the investments made by the company have not generated any returns to the company yet. While the performance of the company is extremely low, however, the company is still required to distribute dividends to the shareholders in order to increase company's value by increasing public expectations and trusts through dividend distributions, so the effect of financial performance on dividend policy will be negative.

Moderating Effect of Good Corporate Governance toward Impact of Financial Performance on Dividend Policy

The result of regression analysis also shows that Good Corporate Governance is moderator variable which has a positive and significant effect toward the impact of financial performance on dividend policy. Good Corporate Governance is proven to strengthen the effect of financial performance on dividend policy. This result is aligned with theory and study conducted by Halviani and Sisdyani (2014). It means that high Corporate Governance Perception Index score will avoid abuses of authority to happen and ensure that the company will protect investors' assets from exploitation that can be done by the management (Halviani & Sisdyani, 2014). The result of Moderated Regression Analysis shows that Good Corporate Governance is moderator variable (quasi-moderator).

Besides being a moderator variable, it turns out that Good Corporate Governance can also become the independent variable that affects dividend policy.

However, the result of regression analysis also shows that there is a negative effect of Good Corporate Governance as measured by Corporate Governance Perception Index score on dividend policy as measured by Dividend Payout Ratio. This result is aligned with the study conducted by Setiawan and Lian (2013), but it is not aligned with theory and study conducted by Halviani and Sisdyani (2014). This can occur because of three reasons. First, the company only implements Good Corporate Governance to meet its compliance aspect. Mining companies are just under compulsion to meet laws and regulations of Good Mining Practice. While infrastructure companies only implement Good Corporate Governance to increase investors' trust so that they will increase their investment in the company since this sector needs more funds. Second, besides determination and commitment from the company, basically, implementation of Good Corporate Governance is also costly which may become an obstacle for the company. Thus, income that should be distributed to shareholders actually used to cover the costs of implementation of Good Corporate Governance. Third, to maintain investors' trust in the company, the company tends to distribute dividends as compensation for their poor Corporate Governance (Setiawan & Lian, 2013). Thus, Good Corporate Governance has a negative and significant effect on company's dividend policy.

CONCLUSIONS

Based on the analysis that has been done, this study obtained two conclusions. First, financial performance has a negative and significant effect on dividend policy. Second, Good Corporate Governance can strengthen the impact of financial performance on dividend policy as a quasi-moderator. However, Good Corporate Governance also has a negative and significant effect on dividend policy. Based on those conclusions obtained, these are some suggestions from this study.

For companies, increasing implementation of Good Corporate Governance can reduce dividend distribution of a company. However, this should be highlighted that, although implementation of Good Corporate Governance is costly, it is not an expense, but an investment for companies to create sustainable business success.

For investors, investors need to pay attention to the sector's condition when taking the investment decision. Because sector's condition also influences performance and dividend policy of the company. When investors want to choose a company that has a high level of dividend distribution, investors may consider the company with sufficient governance, because the company with extremely good governance will actually reduce amounts of dividend that will be distributed.

For the government, implementation of Good Corporate Governance needs to be intensified because the number of participants in Indonesia Most Trusted Companies research is fewer year after year, it proves that awareness of the importance of Good Corporate Governance is still weak. First, the government can set rules for go-public companies that they must implement Good Corporate Governance as proof of company's commitment to creating a business that is reliable for investors. Second, the government can offer incentives, such as tax mitigation for companies that implement Good Corporate Governance.

For academics, it is better to use a bigger number of samples that will be more varied for further research and also, academics need to pay attention to the condition of samples at the observation time. So that further research can provide more accurate results.

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