
Agency Theory Perspective on Dividend Policy

Mursyidin

Faculty of Economic and Business, Universitas 17 Agustus 1945 Surabaya,
Indonesia
mursyidinsemsi@gmail.com

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Abstract

This study aims to review the literature on dividend policy from the perspective of agency theory with a qualitative approach. The research object used was several research articles published in international journals in 2014–2022, and the sample used was 20 articles. The findings explain that share ownership structure, corporate governance, agency costs, free cash flow, profitability, and other financial performance and debt values are factors in determining dividend policy. A dividend policy can be used as a way to monitor opportunistic behavior and as a tool to reduce agency problems.

Keywords: *Agency Theory, Dividend Policy*

INTRODUCTION

Watts and Zimmerman (1986) suggest that agency theory is a theory that focuses on learning contract design to solve agency problems and agency costs that arise as a result of agency relationships, particularly the delegation of decision-making to agents. Agency theory is part of positive accounting theory, game theory, and organization theory. Positive accounting theory is a theory that tries to explain and predict which companies will not use certain accounting methods and which accounting methods should be used by companies. Game theory aims to understand situations in which decision-makers interact (Osborne, 2000). Meanwhile, organizational theory is a theory that explains the study of structure, function, organizational performance, and the behavior of groups and individuals within them (Howard, 1984).

Furthermore, Panda and Leepsa (2017) explain that in financial accounting theory, agency theory plays a role in explaining and predicting the choice of accounting methods used by managers. Agency theory is also the main thing in inefficient contract theory. In addition, agency theory with contract theory is used in predicting positive accounting theories, such as the bonus plan hypothesis, the debt/equity hypothesis, and the political cost hypothesis. Agency theory is also used as a basis for understanding earnings management. The existence of broad agency problems in various types of organizations has made this theory one of the most important theories in the economics and finance literature (in accounting, economics, political science, sociology, organizational behavior, and marketing).

Agency theory can also be used to generate new theories, such as agency theory and crowding reactance. In addition, agency theory has developed into behavioral agency theory and social agency theory (Liu, 2021).

The agency theory put forward by Jensen and Meckling (1986) explains that there is a separation between the owner (principal) and manager (agent) of a company, which can cause agency problems. Meanwhile, Ramli and Joe (2019) put forward agency theory, explaining that conflicts of interest between principals and agents occur because there are two parties who have different goals. The agent is a party authorized by the principal to carry out the company's operational activities and make decisions on behalf of the principal, but the fact is that the agent does not always do what is in the interests of the principal, causing agency problems.

Pujiantuti (2008) explains that in achieving company goals, stakeholders, or shareholders, surrender the management of the company to professionals who are grouped as managers (agents). The managers appointed by the shareholders are expected to act on behalf of the shareholders by maximizing the value of the company so that shareholder prosperity can be achieved. In carrying out company operations, management (agents) often have other goals that conflict with the company's main goal, namely not to prosper shareholder prosperity but to increase their own welfare or manager opportunism, for example, expansion to increase status and salaries by imposing various costs on the company. Furthermore, Jensen and Meckling (1976) explained that companies that separate management functions from ownership functions will be vulnerable to agency conflicts. Therefore, by ensuring that managers work for the interests of shareholders, shareholders must incur a fee to monitor the activities of managers so that managers can work in accordance with the wishes of shareholders.

The monitoring function is intended as a supervisory mechanism that can align the interests of shareholders. All costs incurred are called agency costs (Brigham, 1997). Agency costs can be in the form of (1) the monitoring expenditure by the principal; (2) expenses incurred by the "principal", namely costs for controlling agents, so that the possibility of unwanted manager behavior is getting smaller (the bonding cost); and (3) residual losses, namely sacrifice due to loss or reduced opportunity to earn a profit because it is limited by authority or there are differences in decisions between "principal and agent" (Brigham, Gapenski, and Daves, 1996).

There are several alternatives for reducing agency costs based on the research results of Ross (1977) and Easterbrook (1984), one of which is that to reduce agency costs, dividend payments are required. Dividend payments are part of company monitoring. Dividend payments to shareholders will reduce the sources of funds that are controlled by managers, thus reducing their power and making dividend payments similar to monitoring capital markets that occur when companies obtain new capital. Rozeff (1982) argues that dividend payments are one way to reduce the agency's cost of equity because the conflict between management and shareholders will be reduced. Dividend payments will show that

management is managing the company well and can be a positive signal for shareholders to invest back in the company.

The Indonesian Institute of Accountants in PSAK No. 23 (2009) describes dividends as the distribution of profits given to shareholders according to their proportions in a certain type of model. A dividend policy is a decision about whether the profits earned by the company will be distributed to shareholders as dividends or will be retained in the form of retained earnings to finance investment in the future. Meanwhile, Lumembang et al. (2022) suggest that dividend policy is a decision made after the company operates and makes a profit. The information contained in the announcement of a company's dividend payment signals investors about changes in share prices. Companies that pay dividends are considered to perform well and generate profits, attracting more investors and increasing demand for the company's shares. Meanwhile, Damayanti and Marwati (2017) argue that dividend policy is very important in managing a company because it has a significant influence on the company, shareholders, creditors, and the public. In addition, an inconsistent dividend policy can pose a risk to investors who can withdraw funds invested.

Sudana (2011: 167) explains that there are three theories about dividend policy, namely: (1) Tax Preference Theory: Based on this theory, dividend policy has a negative effect on the company's market price. This means that the greater the amount of dividends distributed by the company, the lower the market price of the company concerned. This occurs when there is a difference between the personal tax rates on dividend income and capital gains. If the tax rate is higher than capital gains, investors will be happier if the profits earned are retained in the company to finance the company's investments. (2) Bird-in-the-hand theory: This theory was put forward by Gordon and Litner (1997), who explained that dividend policy has a positive effect on stock market prices. That is, if the dividends distributed by the company are getting bigger, the market price of the shares will be higher, and vice versa. This happens because the distribution of dividends can reduce the uncertainty faced by investors. (3) Dividend Irrelevance Theory: This theory was put forward by Modigliani and Miller (1961), which explains that dividend policy does not affect the stock market price or firm value. They argue that the company's value is only determined by the company's ability to generate income and business risk, while the company's value is not affected by how the income stream is divided into dividends and retained earnings. Thus, the company is determined by investment decisions. Meanwhile, the decision about whether the profits earned will be distributed in the form of dividends or retained does not affect the value of the company.

From the perspective of agency theory, it always emphasizes the conflict of interests between managers and shareholders. Purnamasari's (2021) agency theory is one of the theories that underlie dividend policy in companies. Related to this test, it is found in various studies on dividend policy in the context of agency theory, which is still interesting to study because as long as the company continues and its management is handed over to agents, conflicts will continue to be created. Empirically, in non-emerging market countries, research on agency

theory, which is proxied by managerial ownership of dividend policy, has a negative relationship pattern, such as in the research of Rozeff (1982), Jensen et al. (1992), Mollah, Keasey, and Short (2000), Short, Zhang, and Keasey (2002), Maury and Pajuste (2002), Kania and Bacon (2005), as well as in emerging market countries that have a negative pattern, as in the research of Khan and Ramirez (1993), Dickens, Casey, and Newman (2002), Al-Malkawi (2007), Afza and Mirza (2010), Mehrani, Moradi and Eskandar (2011), Ullah, Fida and Khan (2012), and Al-Gharaibeh et al. (2013). Thus, this study focuses on systematically examining the literature on dividend policy from the perspective of agency theory.

METHOD

This research is a literature study with a qualitative approach. The literature study method is a series of activities related to methods of collecting library data, reading and taking notes, and managing research materials (Zed, 2008:3). The literature search process focuses on dividend policy from the perspective of agency theory. The research articles were obtained from research published in international journals from 2014–2022, and the sample used was 20 articles.

RESULTS AND DISCUSSION

Dividend policy is a topic that is often debated and is still hot enough to be discussed in more depth. Several researchers have conducted research related to dividend policy both from a theoretical and empirical perspective, particularly with regard to the determinants of company policy in distributing dividends (Jannah, 2018). The following are some research results obtained from published international and national journals regarding dividend policy from an agency theory perspective:

Auditta et al. (2014), in their research on dividend policy, suggest that institutional ownership has a negative relationship to the dividend payout ratio but has a significant influence, which means that monitoring activities carried out by shareholders become more effective and have an impact on reducing agency costs. This statement is in line with the research results of Chang et al. (2016) and Nurmala and Baskara (2019), which explain that monitoring agencies will use dividend payments as a monitoring tool that can reduce corporate agency problems. In line with Martono et al. (2020), Rodrigues and Matos (2020), and Hussain et al. (2022), who explain that corporate governance indicators determine dividend policy. However, Anggoro and Yulianto (2019) provide that institutional ownership has a significant negative effect on dividend policy. That is, the higher the institutional ownership, the lower the average dividend paid. This result is in line with agency theory, which states that there is a complex mechanism between the determination of dividend policy and the company's ownership structure.

The same thing with collateralizable assets has a negative relationship to the dividend payout ratio but has a significant effect. Companies in Indonesia that have large collateralizable assets will increase financing through debt, thereby increasing the interest expense that must be paid (Auditta et al., 2014). In line

with the research of Lailiyah and Abadi (2021). Meanwhile, insider ownership does not have a significant effect on the dividend payout ratio, which means that there is no clear separation between ownership and management of public companies in Indonesia, where the majority of public companies are still in the family sphere. This result is in line with Lailiyah and Abadi (2021), who explain that insider ownership has no significant effect on dividend policy. However, it is different from the research results of Das et al. (2021), which suggest that there is a positive relationship between managerial and dividend policy at stock exchange companies in Bombay, which indicates that there are rewards for managers who act as promoter controls in dividend payments.

Furthermore, free cash flow has a positive effect on the dividend payout ratio, which means that company management tends to pay their dividends to shareholders to meet shareholder expectations (Auditta et al., 2014). These results are in line with the research of Susilowati (2015) and Lailiyah and Abadi (2021), which suggest that there is a positive and significant relationship between free cash flow, dividend policy, and company performance.

The research conducted by Kilincarslan (2021) shows that there is a positive effect of board independence on dividend decisions. In addition, the findings also detect that family directors show a negative effect, while board size and audit committees have a positive influence, but the Chief Executive Officer (CEO) does not have a significant impact on the dividend policy of family firms in Turkey. Independent directors and dividend policies are complementary governance mechanisms to reduce agency conflicts between families and minority shareholders in Turkey, which is a developing country based on civil law and characterized by a high concentration of family ownership.

Meanwhile, Kuronuma et al. (2022) suggest that there is a positive relationship between the concentration of share ownership and the distribution of dividends; that is, the higher the concentration of share ownership, the greater the distribution of dividends. As a result of high shareholder concentration, agency conflicts do not occur between shareholders and managers. But between controlling shareholders and minority shareholders. In addition, controlling shareholders can influence minority shareholders in various ways, such as by selling assets at below market value for companies belonging to the directors of the same company, hiring personnel who are not qualified, and implementing projects that only benefit company executives.

Awen et al. (2022) explain that ownership structure does not determine dividend policy in the non-financial services sector registered in Nigeria. A tax-based indifference to receiving income as dividends vs. future capital gains may serve to reduce sources of agency problems associated with conflicts of interest between shareholders, thereby providing better alignment between the interests of dominant and minority shareholders. Despite management's right to retain net income and the lack of tax incentives for shareholders to receive income from dividends vs. potential future capital gains, this unwittingly reduces agency costs associated with conflicts between management and shareholders over the use of a company's net profits.

Giriati (2016) suggested in his research that the dividend payout ratio has a positive effect on firm value, which means that dividend distribution can be a positive signal for investors because it shows the value of the company is getting better and the information provided by managers does not occur asymmetrically due to the failures and risks faced by the company as well. In addition, dividends can play an important role in an agency context and can discipline the company. These results are in line with Hitten (2016) and Hailin and Jingxu (2019), which explain that the use of the agency cost model in dividend policy is a mechanism for monitoring management behavior in order to minimize agency costs arising from potential conflicts between agents and principals. In addition, the results of his research imply that agency costs do not fully apply to disclosing the uniqueness of capital market actors from an agency cost perspective. This empirical evidence also strengthens the extreme argument of Frankfurter and Wood (1997), which states that there is no evidence that a dividend policy model can apply to all contexts. Likewise to the results of Driver et al. (2020) and Setiawan and Khajar (2022).

Lin et al. (2016) put forward the results of the study, which showed that the quality of earnings disclosure is positively related to dividend payments. Companies with high agency costs and better disclosure quality are associated with a stronger tendency to pay dividends. Apart from the problem of high agency costs, as long as there is high-quality disclosure, shareholders can protect their interests by demanding higher dividend payments. This result is reinforced by Hussain and Akbar's (2022) explanation that larger dividend payments can reduce managers' involvement in earnings management practices. In addition, the results reveal that agency problems do not have a different effect on the relationship between dividends and earnings management. The agency problem does not provide an adequate solution to the opportunistic behavior of managers.

Jun et al.'s (2017) research results explain that dividends are positively or negatively related to post-dividend net cash flow (performance). In addition, small funds and funds experiencing low inflows have stronger incentives to pay high dividends after controlling for dividend-paying ability.

Berzins et al. (2019) suggest that the potential for conflict between majority and minority shareholders greatly influences how dividends respond to tax issues. When the controlling shareholder owns smaller shares, the incentive to take personal advantage is stronger. A higher decline in dividends triggers the potential for shareholder conflict, which indicates that dividend policy relies on tax and agency considerations.

Tran (2019) explains that companies tend to pay more dividends when there is more severe corrupt behavior, and this relationship is stronger under stronger creditor protection. The research findings also imply that although the environment is corrupt, which can lead to agency problems associated with cash holdings, shareholders can recognize and reduce agency costs by forcing managers to pay more dividends.

Budiarso (2019) explains that the profitability tests on all models carried out show that the goals of managers, for the most part, in paying dividends in

Indonesia are in line with the goals of shareholders in the context of stewardship. This finding implies that most companies that act as payers tend to increase dividends when their profitability increases. In line with the research of Nur and Karnen (2014) and Budiarto and Pontoh (2020), profitability has a significant relationship with dividend policy. Meanwhile, systematic risk has an insignificant relationship with dividend policy. That is, shareholders tend to control insiders in cases of overinvestment. In addition, this study also found that market risk as a systematic risk is not significant for both companies with high and low dividend yields.

Based on the results of the studies described above, it can be explained that there are many factors that influence dividend policy related to agency problems. Auditta, et.al (2014), Nur and Karnen (2014), Susilowati (2015), Giriati (2016), Hitten (2016), Chang, et, al (2016), Lin, et.al (2016), Jun, et.al (2017), Nurmala and Bagaskara (2019), Hailin and Jingxu (2019), Berzins, et.al (2019), Tran (2019), Anggoro and Yulianto (2019), Budiarto (2019), Martono, et.al (2020), Rodrigues, et.al (2020), Budiarto and Pontoh (2020), Driver, et.al (2020), Das, et.al (2021), Kilincarslan (2021), Lailiyah and Abadi (2021), Kuronuma, et.al (2022), Awen, et.al (2022), Hussain, et.al (2022), Hussain and Akbar (2022), and Setiawan and Khajar (2022) factors such as ownership structure, governance corporate governance, agency costs, free cash flow, profitability, and other financial performance and debt are factors in determining dividend policy. Dividend policy is often considered by investors before deciding to invest, but the influence of dividend policy still has pros and cons. Investors have different opinions and perspectives on dividend payments made by the company. Dividend policy is often used as a signal for investors when projecting the future of a company. Companies tend to increase the value of dividends to get a positive market response. An announcement of dividend distribution is often seen as good news that will have a positive effect on the company. Regular and periodic dividend payments, even though the company's condition is not quite good, show that management has a better commitment to providing returns to shareholders.

CONCLUSION

The agency theory perspective can be used as one of the underlying dividend policies within the company. Share ownership structure, corporate governance, agency costs, free cash flow, profitability, and other financial performance, as well as debt values, are factors in determining dividend policy. Dividend policy is very closely related to company management, which determines the size of the dividend that will be distributed. Investors want returns on the funds they invest with a high rate of return on dividends, while the amount of dividends distributed by the company is very dependent on the decisions of the company's management.

The limitations of this study are the use of limited research data from 2014–2022 and only taking a literature study approach. In addition, this research has not used literature study data analysis software such as Nvivo. Suggestions for

further research include expanding the reach of research by increasing the number of observational articles and research variables and conducting tests with a quantitative approach so as to be able to explain the agency theory perspective in dividend policy. In addition, the use of software to process data from literature studies is highly recommended.

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