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Institutional Ownership, Newly Appointed CEO, and Dividend Initiation

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A B S T R A C T

The purpose of this study is to examine the effect of institutional ownership on dividend initiation with newly appointed CEO holding a role as a moderating variable in non-financial companies listed on the Indonesia Stock Exchange. This research used a logistic regression model and Moderated Regression Analysis (MRA). The data were obtained from the public company's Financial Report and Annual Report published in the 2012-2017 period. Dividend initiation is the dependent variable measured using dummy variable, and institutional ownership is the independent variable proxied by the percentage of shares held by institutional investors. Newly appointed CEO is the moderating variable. The result shows that institutional ownership has a significant positive effect on dividend initiation and the newly appointed CEO strengthens the positive effect of institutional ownership on dividend initiation. It is advisable that the companies should improve their corporate governance's quality by increasing the degree on institutional ownership.

A B S T R A K

Tujuan penelitian ini adalah menguji pengaruh kepemilikan institusional terhadap inisiasi pembayaran dividen dengan variabel moderasi newly appointed CEO pada perusahaan non-keuangan yang terdaftar di Bursa Efek Indonesia. Penelitian ini menggunakan model regresi logistik dan Moderated Regression Analysis (MRA). Data diperoleh dari laporan keuangan dan laporan tahunan perusahaan yang dipublikasikan pada periode 2012-2017. Variabel dependen dalam penelitian ini adalah inisiasi pembayaran dividen yang diukur dengan menggunakan variabel dummy. Variabel independen yang digunakan dalam penelitian ini adalah kepemilikan institusional yang diproksikan dengan persentase saham yang dimiliki oleh investor institusi, sedangkan variabel moderasi menggunakan newly appointed CEO. Hasil penelitian menunjukkan bahwa kepemilikan institusional berpengaruh positif signifikan terhadap inisiasi pembayaran dividen dan newly appointed CEO memperkuat pengaruh positif kepemilikan institusional terhadap inisiasi pembayaran dividen. Oleh karena itu, perusahaan disarankan untuk meningkatkan kualitas tata kelola perusahaan mereka dengan meningkatkan derajat kepemilikan institusional

1. INTRODUCTION

Technological development and economic integration in the current era of globalization provide investors with easier access to the capital market. This condition could be a catalyst in improving the in-vestment climate in the capital market so that the investors have more widely open opportunities to invest their funds in securities issued by companies. One of the security types that investors can choose as a medium of investment in their portfolio is stocks.

Investors will expect a higher return than the sacrifices that they have incurred when investing their funds. In the perspective of shareholders, a dividend is a form of investment return besides capital gain. According to Ambarwati (2010), dividends are payments made by a firm to the shareholders derived from the firm's earnings. Therefore, a firm's dividend policy is an essential consideration for investors to determine where they have to invest their money.

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In general, shareholders prefer a stable dividend payment because it can reduce the uncertainty they are facing. It will also increase their trust in the company. However, not all companies distribute dividends regularly every year. It is due to there being no rules that stipulate the necessity of dividend distribution. And neither is there specific guidelines regarding the proper amount of dividend which have to be paid by the firms to the shareholders. In addition, each firm management also has its own consideration before distributing their dividends such as the need to withhold profits for reinvestment, firm's liquidity requirements, funding for growth opportunities, shareholder preferences, and various other factors related to dividend policy (Brigham & Houston, 2013).

One crucial explanation about dividend as based on agency theory is that dividends are the result of agency costs and conflicts of interest be-tween the company owner and management (Smith, Pennathur & Marcinciak, 2017). Agency relation arises when one or more individuals as principals employ other individuals (agents) to act on their behalf and delegate power to these agents to make a strategic decision in a company.

Jensen (1986) proposed that management in nature will not share profits in the form of cash to investors without being forced to do so. This is due to the separation between ownership and management of listed companies which makes managers tend to fulfil their own personal interests and override the shareholders' wealth. Dividend payment could reduce excess cash under management's control so it can minimize unnecessary cash expenditure and create disciplinary control over managers (Easter-brook, 1984).

Previous studies such as Hu & Kumar (2004), Bhattacharya, Li & Rhee (2016), and Amina (2015) examined the issue of dividend that generally discusses Dividend Payout Ratio. It is the proportion of net income distributed as dividends to shareholders. This type of issue is relatively common discussed in various literature so that there is a lack of novelty and development on an academic point of view. This research tries to focus on the dividend initiation case that is still rarely studied in Indonesia.

The fundamental difference between dividend initiation and the other types of dividend payment lies on the fact that the firm distributes cash dividends after not paying a dividend in an extended period. In this case, a firm can be classified as dividend initiator if they do not distribute their dividends to its shareholders for the previous three years in a row.

Based on the data on Figure 1 which is compiled and processed from the Kustodian Sentral Efek Indonesia (KSEI) website, it is known that 66 non-financial companies listed on Indonesia Stock Exchange initiate dividend payments during the peri-od of 2013 to 2017. In 2013, it was the year with the highest number of dividend initiators, namely there are 17 companies that did this kind of activity.

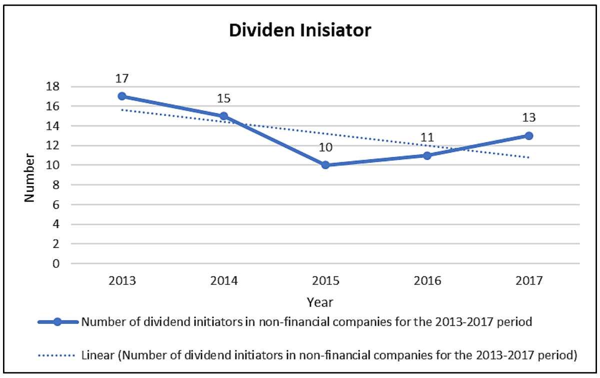

Figure 1.
Number of dividend initiator in non-financial firms listed on IDX for the 2013-2017 period

Institutional ownership is one of the tools that can be used to reduce agency costs and increase the percentage overtime (Aguilar, 2013). Institutional ownership is the ownership of shares owned by investors in the form of institution. High institutional ownership structure will cause more intensive monitoring efforts towards management because institutional investors have adequate professional-ism and resources in analyzing information. Institutional ownership also represents a source of power that can be used to either support or oppose manager's policies (Burns, Kedia, & Lipson, 2010), including policies regarding dividend initiation.

According to the data compiled from the companies' financial statements, the share ownership in Indonesia is still dominated by institutional investors compared to individual investors. This phenomenon shows an increasing trend during the period 2012-2016 with the average percentage of institutional ownership in non-financial companies listed on IDX ranging from 57.50% up to 61.03%.

The relationship of institutional ownership on dividend initiation for a company is also determined by the characteristic of the Chief Executive Officer (CEO). Newly appointed CEO or CEO who is fairly new in occupying his position is associated with low managerial power (O'Reilly III & Main, 2010). Therefore, the new CEO tends to act in accordance with the shareholders' interest because s/he still does not have sufficient power. Based on the research by Smith et al. (2017), conducted in the United States, CEOs who have just been appointed in companies with high level of institutional ownership will have a greater tendency to initiate dividend than those who have had a longer term of tenure.

2. THEORETICAL FRAMEWORK AND HYPOTHESES

Several previous studies tried to explain about the initiation of dividend payments (Jin, 2000; Lee & Mauck, 2016; Officer, 2011; Smith et al., 2017). Smith et al. (2017) describe the issue regarding dividend initiation using logistic regression analysis. This research was held in the United States using samples of non-financial companies that had been gone public in the period 2003-2012. It was stated that the aspects of corporate governance covering institutional ownership, independent commissioners, and shareholder rights had a significant positive effect on dividend initiation.

Another study by Officer (2011) on dividend initiation associated with corporate governance and overinvestment. This study used 1, 283 observations of companies announcing dividend initiation on the NYSE, Nasdaq, or Amex during the period 1963-2008. It was found that companies with high cash flows and low Tobin's Q have a higher return on the announcement of dividend initiation than the other companies. This evidence indicates that the agency cost reduction through dividend initiation is reflected in a higher return. It can prevent the behavior of overinvestment by managers in companies that have low investment opportunities.

Also, a study that reviews the topic of dividend initiation was conducted by Fargher & Weigand (2009). They examined cross-sectional differences in terms of earnings, returns, and risks of market-to-book ratio at the time before and after dividend initiation activities in the United States during the period 1964-2000. This study used parametric and non-parametric statistics and ordinary least squares regression to test the research hypothesis. They found that stocks that had a low market-to-book ratio showed the most favourable price reaction to the announcement of the dividend initiation. However, the firms with high market-to-book ratio characteristics have higher profits, cash levels, and capital expenditure before the dividend initiation compared to after the dividend initiation activities.

Dividend Initiation

Dividend initiation is the first dividend payment activity carried out by the company after not having paid dividends a few years before. This is primarily a firm that can be classified as dividend initiator if they do not distribute dividends to their shareholders for the previous three years in a row (Smith et al., 2017). Asquith & Mullins (1983) stated that dividend initiation reflects a significant shift in the firm's dividend policy because it describes a change in dividends payout from zero to become a positive value.

The policy of initiating dividend taken by a firm has the consequence of financial responsibility that is quite fundamental and sticky. When a company decides to start paying a dividend again, they are required to be able to maintain the consistency of such dividend payments periodically in the future. The dividend initiation can also be used as a signal for investors regarding two things: (i) dividend initiation reflects higher cash flows and profitability in the future; and (ii) dividend initiation indicates lower agency cost at the initiator firms because the manager will have less free cash flow so the probability of expropriation and overinvestment traits can be suppressed (Officer, 2011).

The Effect of Institutional Ownership on Dividend Initiation

Institutional ownership is a condition where the institution participates in the company's share ownership (Widarjo, 2010). This institution can be in the form of government, private, domestic or foreign institutions.

In accordance with agency theory, conflicts between managers and shareholders will cause agency costs that can be detrimental to shareholders. Jensen (1986) stated in the free cash flow hypothesis that dividend payments to shareholders could reduce agency costs because excess cash under management's control becomes limited. Given that managers basically prefer to save surplus cash rather than pay dividends, Fama & Jensen (1983) emphasizes the importance of oversight mechanisms in the firm. One of the oversight mechanisms is by activating the monitoring role through institutional investors.

Institutional investors have advantages in terms of monitoring to create a transparent environment compared to individual investors because they have more adequate resources. Institutional investors are also associated as large institutions with sophisticated skills that make it possible to gather valuable and relevant information. This makes institutional investors able more carefully to invest their funds (Gul, Kim, & Qiu, 2010).

The presence of institutional ownership can reduce asymmetry information between managers and shareholders through the quality improvement of corporate governance. When the level of asymmetry information can be minimized, the potential of opportunistic behavior and the act of expropriation by managers is diminished. As an implication, there will be disciplinary control for the management, so the substantial cash flow, which is actually the right of investors, is also increasingly protected.

Dividend payment can provide more certainty for institutional investors, and it is required as compensation for the monitoring activities they have carried out. Therefore, institutional investors prefer the firms paying dividend compared to those that are not paying a dividend (Grinstein & Michaely, 2005).

Some previous empirical research, such as Short, Zhang & Keasey(2002); Abdelsalam, El-Masry & Elsegini (2008); Rajput & Jhunjhunwala (2019);Al-Najjar & Kilincarlsan (2016); Jory, Ngo & Sakaki (2017); Huda & Abdullah (2013); Liljeblom & Maury (2015); Crane, Michenaud & Wes (2016); Roy (2015); Isakov & Weisskopf (2015), documented the positive relationship between institutional ownership and dividend policy. This study then supports this stream and proposes that a good quality of corporate governance through institutional ownership monitoring activities will lead to a higher propensity of a firm's dividend initiation.

H_1: Institutional ownership has a positive effect on dividend initiation.

Moderating Effect of Newly Appointed CEO on Institutional Ownership—Dividend Initiation Relationship

Chief Executive Officer (CEO) or in Indonesia, well known as the president director, is the highest position in the executive ranks. The CEO is appointed and dismissed by the approval of the shareholders General Meeting SGM). The SGM member who has the authority can propose the CEO candidate who will be appointed to lead the company.

Newly appointed CEO is a CEO who is relatively new in occupying his position in a company. Hambrick & Mason (1984) argue that CEO tenure is one of the critical factors that can explain the results of a CEO's decision making. A source of the power of a CEO could come from the tenure that has been passed. The shorter tenure of the CEO is, the weaker the managerial power is. This makes newly appointed CEOs tend to be more lenient and more easily influenced by shareholders who want the dividend initiation (Smith et al., 2017).

On the contrary, influential owners can influence a firm's strategic policy through their authority in selecting board members and ability to proposing CEO succession. The proportion of institutional ownership has increased over time and plays a vital role in corporate governance (Aguilar, 2013). In general, institutional investors have a large proportion of share ownership in a company. Large amounts of stock ownership make institutional investors able to demand dividend initiation through their influence in determining CEO turnover.

The influence of institutional investors on demanding the initiation of dividend payments is more substantial when the company is led by newly appointed CEOs. This is due to the situation where there is an imbalanced power between institutional investors and newly appointed CEOs as associated with their weak managerial power. This is in line with research conducted by Smith et al. (2017). Therefore, the hypothesis can be proposed as the following.

H_2: Newly appointed CEO strengthens the positive effect of institutional ownership on dividend initiation.

3. RESEARCH METHOD

This study uses a quantitative approach and logistic regression techniques for compiling the prediction models. The sample was chosen by purposive sampling method by applying some specific criteria:

1. Non-financial companies listed on the Indonesia Stock Exchange during the 2012-2017 period.
2. Companies which report their Financial Report using Indonesian Rupiah (IDR).
3. Firms must have complete data regarding the variables used in this research.

Therefore, the samples include 244 non-financial companies listed on IDX during 2012-2017.

The researchers conducted a test for the hypothesis with measurable data to get the general inference. This research uses *IBM SPSS Statistics 25 for Windows* as a statistical tool.

Model Analysis

This research uses a logistic regression model and Moderated Regression Analysis (MRA). To address the research question, the researchers use the following logit model to explain the likelihood of dividend initiation:

Model 1

$$DIVIN_{i,t} = \beta_0 + \beta_1\ INSTOWN_{i,t-1} + \beta_2\ LEV_{i,t-1} + \beta_3\ ROA_{i,t-1} + \beta_4\ SIZE_{i,t-1} + \varepsilon_{i,t}$$

Model 2

$$DIVIN_{i,t} = \beta_0 + \beta_1\ INSTOWN_{i,t-1} + \beta_2\ NEWCEO_{i,t-1} + \beta_3(INSTOWN*NEWCEO)_{i,t-1} + \beta_4\ LEV_{i,t-1} + \beta_5 ROA_{i,t-1} + \beta_6 SIZE_{i,t-1} + \varepsilon_{i,t}$$

DIVIN would be a dummy variable equal to one of the firm initiated dividends in the current year. Following Setiawan & Syarif (2019), *INSTOWN* is the percentage of institutional ownership which measure by the ratio of shares owned by institutional investors-to-total outstanding shares. To test for CEO power, we use *NEWCEO*, a dummy variable equal to 1 if the CEO is in the first or second year of tenure.

To test the moderating role of newly appointed CEO, the researchers use the interaction term, *NEWCEO*INSTOWN* by multiplying *NEWCEO* and *INSTOWN*. The researchers also use firm's characteristics as control variables, i.e. *LEV* was measured with total debt divided by the total assets of the firm, *SIZE* proxied by the natural log of the firm's total assets, and ROA as the proxied of profitability. ROA was measured with net income divided by total assets of the firm.

4. DATA ANALYSIS AND DISCUSSION

The objects of this research for the samples were 244 non-financial companies selected based on the criteria with the number of observations (N) of 774 during the five years of the study. Table 1 shows the descriptive statistics of each variable.

Table 1
Descriptive statistics

	N	Min	Max	Mean	SD
DIVIN	774	0.0000	1.0000	0.0850	0.2790
INSTOWN (%)	774	0.0000	99.6900	59.7650	20.5320
NEWCEO	774	0.0000	1.0000	0.1510	0.3580
LEV (%)	774	0.0300	157.1100	50.6580	21.0130
ROA (%)	774	-71.1300	45.7900	4.1570	8.5930
SIZE	774	23.39000	33.2000	28.3290	1.6140

The dividend initiation variable (DIVIN) has Mean of 0.0853, which means there are 8.53% of firms from all observations that do dividend initiation activity. The institutional ownership variable (INSTOWN) has Mean showing a value of 59.7653%, which means that the average proportion of share ownership held by institutional shareholders in non-financial companies in Indonesia during the study amounted to 59.7653%. This data shows that the percentage of institutional ownership is relatively large. The variable of newly appointed CEO (NEWCEO) has a Maximum value of 1 which means the CEO is classified as new in occupying his/her position because s/he still has tenure for less than two years. Furthermore, this variable has Mean of 0.1512, which means there are 15.12% of the CEOs of the company from all observations classified as newly appointed CEO.

Table 2 describes the correlation matrix be-tween variables.

Table 2
Correlation matrix

	INSTOWN	NEWCEO	LEV	ROA	SIZE
INSTOWN	1.0000				
NEWCEO	-0.1760	1.0000			
LEV	0.1220	-0.4700	1.0000		
ROA	-0.0060	-0.0720	-0.2810	1.0000	
SIZE	-0.0570	0.0820	0.2020	0.1160	1.000

Table 3
Logistic regression analysis

	DIVIN	
	Model (1)	Model (2)
Intercept	-3.0490 (0.2160)	-2.4030 (0.4250)
INSTOWN	0.0230** (0.0010)	0.0170* (0.0660)
NEWCEO		-0.7150 (0.5410)
INSTOWN*NEWCEO		0.0400* (0.0240)
LEV	-0.0170* (0.0160)	-0.0140** (0.0470)
ROA	0.0480*** (0.0040)	0.0560*** (0.0010)
SIZE	-0.0100 (0.9090)	-0.0490 (0.582)
Observation	774	774
Pseudo R-Square	0.0830	0.1860

* Significance at 10% level
** Significance at 5% level
*** Significance at 1% level

Based on Table 3, the results of logistic regression analysis in model 1 and model 2 find that institutional ownership has a significant positive effect on dividend initiation. The result of these two models indicates that higher institutional ownership, the more likely the firm initiates dividend.

Institutional ownership plays a vital role in minimizing agency conflicts that occur between managers and shareholders. The existence of institutional investors is considered an effective monitoring mechanism in the decision-making process by managers (Jensen, 1986). The more substantial institutional ownership in a firm will drive a better supervising on manager's traits, so it will have an impact on the potential reduction of manager's opportunistic behavior.

Institutional investors will also expect incentives in the form of dividend payments for monitoring activities they have carried out. Returns in the form of dividends are preferred because they provide high certainty than capital gains. This result is in line with the first hypothesis that institutional ownership has a significant positive effect on dividend initiation, as also stated by Smith et al. (2017).

The result of logistic regression analysis is about newly appointed CEO as a moderating variable. Table 3 has a significant positive value. The regression result shows that newly appointed CEOs strengthen the positive effect of institutional ownership on dividend initiation. It implies that the positive effect of institutional ownership on dividend initiation will be more substantial when the company is led by a CEO who is still relatively new in occupying his/her position.

The term of tenure provides an opportunity for the CEO to invest his/her power in the company where they lead. Tenure makes it easier for CEOs to create good narratives to pursue personal interests under the pretext that he has a good experience and strong network, understands all resources, well informed about firm's business environment, and knows what is best for the company (Brown & Lee, 2010). Therefore, the newly appointed CEO is associated with lower managerial power. This makes them take action in accordance with the interests of the company owner, and it is easier to influence them.

CEO, as the company's top executive, has a vital role in the company's dividend payment activities. The CEO's involvement in the dividend policy begins when the board of directors proposes interim dividends. According to the Indonesia Limited Liability Company Law (Undang-Undang Perseroan Terbatas) Number 40 of 2007, the distribution of interim dividends is determined based on the decision of the board of directors after obtaining board of commissioners' approval. The interim dividend serves as the basis for determining the final dividend, which will be discussed at the General Meeting of Shareholders.

Institutional investors are generally powerful shareholders because of their large proportion of share ownership. The company owners with a strong characteristic of power can influence the company's strategic policy through their authority in proposing CEO succession. Moreover, the newly appointed CEO is associated with weaker managerial power. Because of this imbalanced power, institutional investors will press the newly appointed CEO to initiate dividend payments by relying on their ability to influence CEO turnover. This is consistent with the results of a study conducted by Smith et al. (2017). It also supports this study's second hypothesis stating that newly appointed CEOs strengthen the positive influence of institutional ownership on the firm's dividend initiation policy. It can also be said that the positive influence of institutional ownership on dividend initiation is stronger for companies led by new CEOs than those led by CEOs with longer tenure.

5. CONCLUSION, IMPLICATION, SUGGESTION, AND LIMITATIONS

This study attempts to highlight the issue of dividend initiation in Indonesia during the period 2012 until 2017. The majority of existing empirical studies only focus on the effect of ownership structure or board composition on a firm's dividend policy as reflected by Dividend Payout Ratio. Unlike the topic mentioned earlier, the relationship explanation be-tween corporate governance and dividend initiation seems has insufficient attention. Besides that, it is still very rarely discussed in the financial management discipline nowadays.

This research objective is to discuss a firm's dividend initiation activity when viewed from the perspective of agency theory by linking it with the corporate governance mechanism and CEO characteristic. This study also proposes an issue development by including the newly appointed CEO as moderating variable on dividend initiation and finally tries to obtain empirical evidence from this research.

This research contributes to the financial management literature through two things: (1) explain the influence of corporate governance proxied by institutional ownership on dividend initiation, in which, this theme still get less attention in the financial sector. (2) provides an element of novelty by presenting the moderating variable of CEO tenure, which portrays one of the CEO's personal attributes. This can affect his/her approach to the decision-making process. Those two contributions are expected to fulfil the research gap from the previous studies and could give a new insight with also a more comprehensive explanation about the firm's dividend initiation activity.

The study showed that dividend initiation mostly occurs in the firm with strong corporate governance. Firms with higher institutional ownership are more likely to initiate dividends because institutional investors could decrease the level of agency cost through its monitoring function. Therefore, institutional ownership has a positive effect on dividend initiation.

The newly appointed CEO variable strengthens the positive effect of institutional ownership on dividend initiation. Newly appointed CEO has a greater tendency to meet shareholders' interest (i.e., in this case, is to initiate dividend). It happened because the new CEO is easier to be influenced by powerful principals so that it will cause an alignment effect.

In terms of the effects, the control variables have some features. For example, leverage has a negative effect on dividend initiation; profitability has a positive effect on dividend initiation, while firm size has no effect on dividend initiation.

It is advisable that the companies should improve their corporate governance's quality by increasing the degree on institutional ownership. By doing so, they can lead to a higher probability of dividend initiation. Moreover, this study is very beneficial for the shareholders on helping them to understand how CEOs would behave according to their attribute in the context of the decision making process. For further research, the researchers can identify other variables (for example, board composition, ownership structure, or other CEO characteristic besides CEO tenure) that influence dividend initiation. This is intended to get a more precise conclusion.

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