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Dividend and Debt Policy as Corporate Governance Mechanism: Indonesian Evidence

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ABSTRACT

This study examines the dividend and debt policies as a corporate governance mechanism to reduce agency conflict between majority and minority shareholders. The most of firms ownership structure in Indonesia are categorised concentrated structure, where its create a conflict between majority and minority shareholders. The sample comprises 200 firms which stocks are listed on Indonesia Stock Exchange until the year of 2006. These samples are selected based on purposive sampling method which are divided into two groups, high and low concentrated ownership structure. To test the hypotheses, this study use two indicators, i.e. market indicator and accounting indicator. Event study analysis is used for market indicator and multiple regression analysis is used for accounting indicator. The results conclude that dividend policy can be used as a corporate governance mechanism to reduce agency conflict between majority and minority shareholders, both at high and low concentrated ownership structure. Debt policy cannot be used as corporate governance mechanism to reduce agency conflict between majority and minority shareholders, both at high and low concentrated ownership structure.

ABSTRAK

Kajian ini cuba untuk menguji polisi hutang dan polisi dividen sebagai mekanisme tadbir urus untuk mengurangkan konflik ejensi diantara pemilikan majoriti dan minoriti. Kajian ini penting kerana hampir keseluruhan struktur pemilikan firma di Indonesia dikelompokkan sebagai pemilikan terpusat yang boleh menciptakan konflik di antara pemilik saham majoriti dan minoriti. Sampel kajian adalah sebanyak 200 firma yang berdaftar di bawah Bursa Saham Indonesia yang dipilih berdasarkan kaedah pensampelan bertujuan. Sampel dibahagi menjadi dua kelompok iaitu sampel yang mengikut struktur pemilikan terpusat yang tinggi dan struktur pemilikan terpusat yang rendah. Untuk mengkaji hipotesis yang dicadangkan digunakan model kajian peristiwa untuk menguji indikator pasar, manakala regresi berbilang digunakan untuk menguji indikator perakauanan. Hasil kajian menunjukkan bahawa polisi dividen boleh digunakan sebagai mekanisme tadbir urus untuk mengurangkan masalah ejensi diantara pemilikan saham majoriti dan minoriti sama ada pada struktur pemilikan terpusat yang tinggi mahupun yang rendah. Manakala polisi hutang tidak boleh digunakan sebagai mekanisme tadbir urus yang boleh mengurangkan masalah ejensi diantara pemilikan saham majoriti dan minoriti sama ada pada struktur pemilikan terpusat yang tinggi mahupun yang rendah.

INTRODUCTION

Modern firms are characterised separation of ownership and control. In these firms, the agency conflict will occur between shareholders and managers or between shareholders and creditors (Jensen & Meckling 1976). Berle and Gardiner (1932) found that the agency cost occurs in the relationship between shareholders and managers. In this relationship, agency problem occurs because the interest of manager and shareholders are not necessarily coincide, managers usually want to satisfy their own objectives, while shareholders want to maximise profits or share value. (Crutchley & Hansen 1989).

Two financials policies are used as corporate governance mechanism to reduce agency conflict between shareholders and manager, these are dividend and debt policies. Rozeff (1982) and Easterbrook (1984) introduced that dividend policy can reduce agency conflict by forcing management into the equity market more frequently. When new equity is raised, managers are monitored by capital market. Debt policy also can be used as corporate governance mechanism to reduce agency conflict (Jensen & Meckling 1976; Faccio, Lang, & Young 2001). The increasing debt will drive a firm to use the cash efficiently, because the cash is used to pay debt interest periodically. Debt generates external monitoring; therefore, the majority shareholders should act to improve the firm's performance. These policies are effective as corporate governance mechanism since market responses to them positively. These will lead to reduce agency cost and increase firm performance (Denis 2001; McColgan 2001).

Agency problem also occurs at concentrated ownership structure, where agency conflict occurs between majority and minority shareholders because the interests of these two groups are not always coincide. Growth and profitability of a firm generally benefit majority and minority shareholders, but in some circumstances, majority and minority shareholders have conflicting interests. The majority shareholders may try to take actions to capture advantages of the business for themselves at the expense of the minority shareholders. Thsese are commonly referred to as private benefits of control (Filatotchev & Tomasz, 2001). When private benefits of control are large, controllers will tend to lock-up control, keeping the ownership of the firm concentrated in their hands even when going public.

The firms in Indonesian are categorized as concentrated ownership structure, so the agency conflict occurs between majority and minority shareholders. Evidence in Indonesia from 2002 until 2006 shows that maximum ownership by institution or individual less than 25% are 9.29%. 9.77%. 7.76%. 7.9%. and 9.64%. But, maximum ownership by institution or individual more than 25% are 90.71%. 90.23%. 92.24%. 92.1% and 90.36% (see table 1).

Based on the above background, this study investigates the influence of corporate governance mechanism on reducing agency conflict using dividend and debt policy at the concentrated ownership structure. This study is difference with the previous study in several conditions. For examples, Jensen and Meckling (1976) found that debt policy and dividend policy can reduce agency problem in the dis-

TABLE 1. Ownership Structure in Indonesia Period 2002-2006

Ownership	2002	2003	2004	2005	2006
< 25%	26(9.29%)	30(9.77%)	25(7.76%)	26(7.9%)	32(9.64%)
≥ 25%	254(90.71%)	277(90.23%)	297(92.24%)	303(92.1%)	300(90.36%)

Source: Indonesian Capital Market Directory

perse ownership, while this study tests that debt policy and dividend policy can use to reduce agency conflict in the concentrated ownership. Gugler and Yurtoglu (2000) only test dividend policy as corporate governance mechanism, so agency conflict can be reduced. Faccio, Lang, dan Young (2001) and Sarkar and Subrata (2005) only examine debt policy as corporate governance mechanism to reduce agency conflict between majority and minority shareholders.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

The concept of corporate governance is derived from agency theory. Agency theory explains the appearance of conflict, the essence of conflict, and also solution to the conflict. Agency theory (Jensen & Meckling 1976) states that there is a separation between ownership and control in modern firms. Agency conflict also appears in the existence of free cash-flow in a firm, referred as free cash-flow hypothesis (Jensen 1986). Nevertheless, since the problem of agency becomes complex, corporate governance is needed.

The definition of corporate governance various, but generally is a system, structure, mechanism or policy, process and also rules explaining the relations among all parts in a firm, so that they are able to carry out the rights and bonds correctly and proportionally. There are 2 paradigms of corporate governance; shareholder paradigm and stakeholder paradigm (Letza & Sun 2002). There are 4 principles of corporate governance (Gregory & Simms 2000), i.e., fairness, transparency, accountability, and responsibility. The effectiveness of corporate governance is determined by some factors: ownership structure, law and enforcement, economy system, social, culture, process, and also clear performance measurement.

Two policies are used as corporate governance mechanism, those are dividend and debt policies (Jensen & Meckling 1976; Agrawal & Knoeber 1996). The increasing of dividend can reduce conflict of free cash flow and show to public that majority shareholders do not use the free cash-flow for their own sake, but it is shared to minority shareholders. This is referred as rent extraction hypothesis. Harada and Pascal (2006) investigate the effect of ownership on the dividend policy of Japanese firms. The results show a negative relationship between ownership concentration and payout rates. Firms with concentrated ownership are less likely to increase dividends when profitability increases and more likely to omit dividends when investment opportunities improve, which is consintent with extraction of

private benefits at the expense of minority shareholders.

Debt policy is used as corporate governance mechanism to reduce agency conflict (Jensen & Meckling 1976; Faccio et al. 2001). The increasing of debt can reduce conflict of free cash flow and show to public that majority shareholders do not use the free cash-flow for their own sake. The increasing of debt will drive a firm to use the cash efficiently, because the cash is used to pay debt interest periodically. Debt generates external monitoring; consequently, the majority shareholders should conduct the best performance. This is referred as control hypothesis (Faccio et al. 2001; Jensen 1986; Sarkar & Subrata 2005).

Concentrated ownership structure causes agency conflict between majority and minority shareholders (Shleifer & Robert 1997; Zhuang et al. 2000). This agency conflict occurs because of the asymmetric information from majority and minority shareholders. Besides, majority shareholders have bigger power to control the managers in decision making, for example, the one related to the firm's free cash flow. It is the reason why dividend policy can be used as corporate governance mechanism to reduce the conflict between majority and minority shareholders, because the increasing of dividend will show to the public that the majority shareholders do not use free cash-flow for themselves and ignores the minority shareholders, but it is shared to the shareholders. This condition is referred as rent extraction hypothesis (Gugler & Yurtoglu 2000; Lee & Xiao 2002). This argument is supported by Faccio et al. (2000) state that the increase of dividend can play a main role in limiting expropriation, because dividend can move the prosperity from insider control to outsider control. From this explanation, this study purpose hypothesis 1a:

Market react positively (negatively) to the increase (decrease) of the dividend per share announcement at concentrated ownership structure

The ownership structure determines the type of agency conflict in a firm. At concentrated ownership the agency conflict that might occur is the conflict between majority shareholders with minority shareholders (Shleifer & Robert 1997; Zhuang et al. 2000). Majority shareholders have the power to control the manager in decision making on free cash flow, therefore the decision made is the one mainly for the majority shareholders' sake rather than for minority shareholders. This complies to Shleifer and Robert's (1997) statement saying that when concentrated ownership comes to a certain limit, the majority shareholders can control the firm and they tend to make policies that give benefit to themselves.

Agency conflict between majority shareholders and minority shareholders is influenced by the level of firm ownership. At high concentrated ownership structure, the agency conflict is higher than it is at low concentrated ownership structure (Gugler & Yurtoglu 2000; Dewenter & Vincenta 1998). This means that at high concentrated ownership structure, the majority shareholders' power to control the managers on free cash flow is bigger than that at low concentrated ownership structure. Therefore, the increase of dividend at high concentrated ownership structure will be positively reacted more than that at low concentrated ownership structure. On the contrary, the decrease of dividend at high concentrated ownership structure

will be negatively reacted more than that at low concentrated ownership structure. From above explanation, this study purposes hypothesis 1b:

"Market react greater positively (negatively) to the increase (decrease) of dividend per share announcement at high concentrated ownership structure to low"

Concentrated ownership structure cannot function as a monitoring tool on management's conduct; rather it will generate agency conflicts, i.e. conflict between majority and minority shareholders (Shleifer & Robert 1997; Prowsen 1998; Zhuang et al. 2000). This conflict occured due to the fact that the sructure of ownership is mainly composed of family or founders' members who have big power in controlling managers in decision making. Therefore, the decision made tends to give benefit only for them on minor shareholders' account. This statement is proven by Mitton (2002) stated that when major shareholders is entangled in management as director or commisariat, they will have an opportunity or bigger incentive to expropriate minority shareholders which eventually decrease the company's performance.

Debt can be used to decrease agency conflict between majority and minority shareholders, because debt allows public investors to notice that majority shareholders do not use the free cash-flow for themselves, but it is used to pay the debt and interest periodically. Debt shifts management monitoring from shareholders to creditors (Jensen and Meckling 1976; Jensen 1986; Faccio et al. 2001). This monitoring forces the management or shareholders to conduct actions which can give benefit to the company. This is called *control hypothesis*. Nevertheless, excessive debt will decrease the firm's performance, because the increase of debt will be followed by the increase of debt expense. From above explanation, this study purposes hypothesis 2a:

"Market react positively to the bond announcement at concentrated ownership structure"

In developing countries, concentrated ownership structure cannot function as a monitoring tool on management's conduct; rather it will generate agency conflicts, i.e. conflict between majority and minority shareholders (Shleifer & Robert 1997; Prowsen 1998; Zhuang et al. 2000). This conflict occurs due to the fact that the structure of ownership is mainly composed of family or founders' members who have big power in controlling managers in decision making. Therefore, the decision made tends to give benefit only for them on minor shareholders' account. This statement is proven by Mitton (2002) stated that when major shareholders is entangled in management as director, they will have an opportunity or bigger incentive to expropriate minor shareholders which eventually decrease the firm's performance.

The debt policy can be used to reduce agency conflict between majority and minority shareholders, because debt allows public to notice that majority shareholders do not use the free cash-flow for themselves, but it is used to pay the debt and interest periodically. Debt shifts management monitoring from shareholders to creditors (Jensen & Meckling, 1976; Jensen, 1986; Faccio et al. 2001). This monitoring forces the management or shareholders to conduct actions which can give benefit to the firm. This is called *control hypothesis*. Nevertheless, excessive

debt will decrease the firm's performance, because the increase of debt will be followed by the increase of debt expense.

Ownership structure determines agency conflict type. At concentrated ownership structure, the agency conflict that might happen is the conflict between majority and minority shareholders (Shleifer & Robert 1997; Zhuang, et al., 2000). Majority shareholders have power to control the manager so that decision made on free cash flow is intended for their own benefit rather than for minority shareholders. This complies to Shleifer and Robert's (1997) statement saying that when concentrated ownership comes to a certain limit, the majority shareholders can fully control the firm and they tend to make policies that give benefit to themselves (Shleifer & Robert 1997).

The level of agency conflict between majority and minority shareholders is influenced by the level of concentrated ownership structure. At high concentrated ownership structure, agency conflict is higher than that at low concentrated ownership structure (Gugler & Yurtoglu 2000; Dewenter & Warther 1998). This means, the higher concentrated ownership structure, the higher the power owned by majority shareholders to expropriate minority shareholders. From above explanation, this study purposes hypothesis 2b:

Market react positively greater toward the bond announcement at high concentrated ownership structure to low concentrated ownership structure

Ownership structure in a firm determines power distribution between all parts in a firm. Therefore, at concentrated ownership structure, majority shareholders have very big power to influence managers in making decision, thus the decision made will give benefit only for them but will gain loss for minor shareholders. Therefore, the agency conflict that might occur is the conflict between majority shareholders and minority shareholders (Shleifer & Robert 1997; Zhuang et al. 2000).

The dividend policy can be used as a mechanism to reduce the agency conflict, because the increase of dividend policy will reduce the amount of free cash flow and it can also show that majority shareholders do not have willingness to use free cash flow for themselves, but it is shared to the shareholders pro-equally; this is called rent extraction hypothesis (Gugler & Yurtoglu 2000). This argument is supported by Faccio et al. (2000) who stated that dividend increase can be the main role to limit the expropriation towards minority shareholders. Dividend payment shows that minority shareholder's right is fulfilled. The effectiveness of dividend policy to lessen the agency conflict between majority shareholders and minority shareholders can be seen from the policy influence towards firm's profitability. From above explanation, this study purposes hypothesis 3a:

Dividend has positive (negative) influences toward the performance of concentrated ownership structure

At concentrated ownership structure, only a few owners and shareholders have large amount of stock ownership. The level of ownership concentration will determine power distribution in a firm (Zhuang et al. 2000). The higher the concentrated

ownership structure, the higher the power owned by major shareholders to control management decision that it tends to give disadvantages to minor shareholders.

Agency conflict between majority shareholders and minority shareholders is influenced by the concentration of firm ownership (Gugler & Yurtoglu 2000). At high concentrated ownership structure, the agency conflict is higher than it is at low concentrated ownership structure (Gugler & Yurtoglu 2000; Dewenter & Vincenta 1998). This is because when the ownership concentration passes a certain degree, majority shareholders can control the firm and they tend to make policy of which gives benefit to themselves, it will harm the minority shareholders (Shleifer & Robert 1997).

Dividend policy can be used to decrease the agency conflict between majority shareholders and minority shareholders, both in high and low concentrated ownership structure. This is called rent extraction hypothesis (Gugler & Yurtoglu 2000). The effectiveness of dividend policy to lessen the agency conflict is shown by its influence to the firm's profitability. Therefore, the increase of dividend at high concentrated ownership structure has bigger positive influence than that at low concentrated ownership structure on the firm's profitability. On the contrary, the decrease of dividend at high concentrated ownership structure has bigger negative influence than that at low concentrated ownership structure on the firm's profitability. From above explanation, this study purposes hypothesis 3b:

Dividend on high concentrated ownership structure influences greater positively (negatively) than low concentrated ownership structure at the firm's performance

The ownership structure determines agency conflict type. At high concentrated ownership structure, the agency conflict that might happen is the conflict between majority shareholders with minority shareholders (Shleifer & Robert 1997; Zhuang et al.,2000). This conflict occurs due to the fact that the structure of ownership is mainly composed of family or founders' members who have big power in controlling managers in decision making. Therefore, the decision made tends to give benefit only for themselves on minor shareholders' account. This statement is proven by Mitton (2002) stated that when majority shareholders is entangled in management as director, they will have an opportunity or bigger incentive to expropriate minority shareholders which eventually decrease the firm's performance.

Debt policy can be used as a corporate governance mechanism to reduce agency conflict in a firm (Jensen & Meckling 1976), because debt can decrease the free cash flow in a firm. Debt also allows public to notice that majority shareholders do not use the free cash-flow for themselves, rather it is used to pay the debt and interest periodically. Debt shifts management monitoring from shareholders to creditors (Jensen & Meckling 1976; Jensen 1986; Faccio et al. 2001). This monitoring forces the management or shareholders conduct actions which do not disadvantage minority shareholders and consequently, it gives positive influence to the firm's profitability. This is called *control hypothesis* (Faccio et al. 2001; Jensen 1986; Sarkar & Subrata 2005). From above explanation, this study purposes hypothesis 4a:

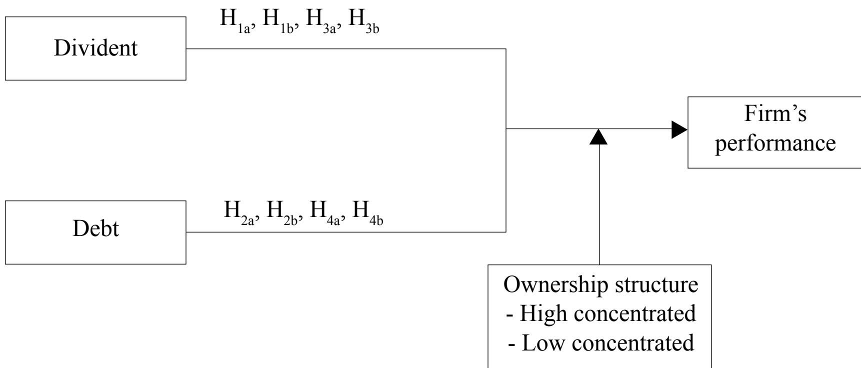
Debt has positive influences toward the performance of concentrated ownership structure

The level of concentrated ownership structure determines the agency conflict in a firm. The higher the concentrated ownership structure, the bigger the agency conflict between major shareholders and minor shareholders. This complies to Shleifer and Robert's (1997) statement saying that when concentrated ownership comes to a certain limit, the major shareholders can control the firm and they tend to make policies that give benefit to themselves (Shleifer & Robert1997). The higher the concentrated ownership structure, the bigger the majority shareholder's power to expropriate minority shareholders. Therefore, debt policy at high concentrated ownership structure has bigger positive influence than that at low concentrated ownership structure on the firm's profitability. From above explanation, this study purposes hypothesis 4b:

Debt on high concentrated ownership structure influences greater positively (negatively) than low concentrated ownership structure at the firm's performance

DATA AND METHODOLOGY

The population of this research is all firms listed in Indonesian Stock Exchange until 2006. The sample is gained through non-probability technique with purposive sampling method which used the following criteria: a) non-financial firms listed in Indonesian Stock Exchange; b) firms which shares are owned by the largest share-



GRAPH 1. Hypothesis scheme

agency problem of free cash-flow occurs when the increasing cash flow is faced with low investment opportunity set. This is simply because the value of free cash-flow is high (quadrant B) in this situation. It matches with the hypothesis of free cash-flow (Jensen 1986).

The low investment opportunity clearly shows that a firm does not have a

holders, with a minimum ownership as high as 25%. This complies to investment law that defines majority shareholders as those who own at least 25 % shares. c) firms that announce dividend and bond.

A method of pooling data is used to give a better analysis result. Based on the above criteria, 200 samples achieved are then divided into two groups; i.e. a) low concentrated ownership structure (low COS), where a firm's shares are owned by the largest shareholders from 25% to less than 50%; b) high concentrated ownership structure (high COS), where a firm's shares are owned by the largest shareholders as many as 50% or more.

MARKET INDICATOR TESTING

Market indicator is measured by abnormal return and cumulative abnormal return (Gugler & Yurtoglu 2000; Riyanto & Gudono 1996). Abnormal return is an excess between actual return with expected return. Average abnormal return is observable when event is announced (t = 0). Cumulative average abnormal return being tested is the one with t = –2 until t = + 2 and t = 0 until t = + 5. Abnormal return is measured by using single index with an estimation period of 21 days, 10 days before the announcement, 1 day at the time of the announcement (t = 0) and 10 days after the announcement (t = –10 until t = +10). The accounting performance is measured by Return on Equity (Murali & Welch 1989).

Based on the testing with accounting indicators, independent variables are dividend and debt. For market indicator, dividend is indicated by dividend per share announcement, debt is indicated by bond right issue announcement. For accounting indicator, dividend is indicated by dividend payout ratio. Debt is indicated by leverage = total debt/total assets. Firm size is used as control variable.

The data used is secondary data consisting of annual report from the year 2002 – 2006, the date of dividend announcement, bond, stock price, daily stock price index, and other information related with this research. The announcement date of dividend and bond are to be announced to public either on media or press conference. The data are compiled from ICMD, JSX Statistics, PRPM, PDBI, Indonesian Business daily, internet, stock market data from PPA-UGM, and other sources related to the research.

To what extent the dividend and debt policies can be used as corporate governance mechanism should be tested through the significance of the values of average abnormal return and cumulative average abnormal return on four groups (Lang et al. 1991), i.e. 1) the cash flow increases as the investment opportunity set is high; 2) the cash flow increases as the investment opportunity set is low; 3) the cash flow decreases as the investment opportunity set is high; 4). the cash flow decreases as the investment opportunity set is low.

The four groupings above explain that in discussing the hypothesis of free cash flow, the starting point is not on how to measure free cash flow, rather on how to make a decision on cash flow when faced with investment opportunity set. The

positive net present value. This condition impels the management to use excessive cash for inefficient things that will give disadvantages to shareholders. The bigger the free cash flow in a firm is, the bigger its flexibility owned by a firm is. This situation can also lead the management to flexibly use the existing cash; where the chances of any interest conflict in using the free cash flow is higher as well. It is the reason as to why it is important to lessen the free cash flow; for instance, by increasing the payment of dividend, debt, and investment. The result will support the research hypothesis, if the median of average abnormal return and cumulative average return on the high cash flow with low investment opportunity is positive or negative and is statistically significant as hypothesised.

THE ACCOUNTING PERFORMANCE TESTING

Diagnostic examination is carried out to test the multicollinierity and heteroscedasticity. Multicollinierity test is carried out to test whether the independent variables have one or more linier relation. To test the multicollinierity problem, tolerance value or variance inflation factors test is conducted. Heteroscedasticity test is carried out to detect whether (σ^2) variant from dependent variable is increasing as a result of the increase in independent variable. To detect the heteroscedasticity test, Glejser testing is conducted (Gujarati 2003).

RESULTS AND DISCUSSIONS

RESULT ON MARKET INDICATOR

Hypothesis 1a states that market reacts positively to the increase (decrease) of dividend per share announcement at concentrated ownership. The result shows that the values of AAR, $CAAR_2$, $CAAR_5$ on dividend increase are positive and statistically significant. This positive reaction shows that when high agency conflict occurs; that is when cash flow increases but investment opportunity is low, dividend announcement increase is positively responded by the market. This positive response shows that majority shareholders do not use the free cash flow for their own sake, rather they give it to the shareholders. The dividend policy can be used as a corporate governance mechanism in the firm. This result supports Gugler and Yurtoglu (2000) and Jensen (1986), but not Faccio, Lang, and Young (2000). This result supports the rent extraction hypothesis.

The same thing applies to dividend decrease announcement as well. The result of empirical testing shows that AAR and $CAAR_2$ are negative and statistically significant. The result shows that the market reaction is negative and statistically significant when dividend decrease is announced. This negative reaction indicates that the majority shareholders use the surplus cash for their own sake and for other unnecessary expenditures at the expense of shareholders. This condition supports rent extraction hypothesis. This result is consistent with the findings from Gugler and Yurtoglu (2000). The dividend policy can be used as corporate governance

mechanism so that any agency conflict in a firm can be minimised.

Hypothesis 1b states that market reacts positively to the increase (decrease) of dividend per share announcement on high concentrated ownership structure greater than that on low concentrated ownership structure. The result indicates that AAR, $CAAR_2$, and $CAAR_5$ value on a high concentrated ownership structure is positive and statistically significant. This result indicates that when a high concentrated ownership structure announces dividend increase, the market reacts positively. Then, the values of AAR and $CAAR_2$, $CAAR_5$ on low concentrated ownership structure are positive and statistically significant.

This result shows that a dividend increase policy can be used as a corporate governance mechanism to minimise any agency conflict between majority and minority shareholders either in high or low concentrated ownership structure. However, the market reaction to the dividend increase on a highly concentrated ownership structure is positively greater compared to that on a low concentrated ownership structure and the difference is statistically significant. The results support the findings from Gugler and Yurtoglu (2000).

Dividend decrease announcement shows the same result. Empirical testing shows that the values of AAR, $CAAR_2$ and $CAAR_5$ after a dividend decrease announcement on a high concentrated ownership structure are negative and statistically significant. This negative reaction indicates that at the time of the increasing cash flow and no interesting investment opportunities are available; the management does not give dividend to shareholders when they should. Accordingly, the market interprets that the majority shareholders have used the surplus cash only for their own sake. The dividend policy can be used as corporate governance mechanism in a highly concentrated ownership structure; *rent extraction* hypothesis is then supported.

The values of AAR and $CAAR_2$ on high concentrated ownership structure are positive and statistically insignificant. This implies that when the cash flow increases at the time of low investment opportunities, the dividend decrease on low concentrated ownership structure is positively responded but insignificantly. The positive and significant response occurs when the cash flow increases at the time of increasing investment opportunities. This indicates that excessive cash flow can be used as investment since the prospect of investment is profitable. Accordingly, it can be concluded that the market response to the decrease of dividend on a high and low concentrated ownership structure is negative. This shows that the result is consistent with the findings from Gugler and Yurtoglu (2000).

Hypothesis 2a states that market reacts positively to bond announcement. The research result shows that the values of AAR, $CAAR_2$ and $CAAR_5$ are negative and statistically significant. This condition indicates that the increase in debt cannot be used as corporate governance mechanism in a firm. Total debt exceed will decrease share price. This result does not support Jensen & Meckling (1976) and Jensen (1986).

The negative response is possibly due to the relatively big amount of debt exceeding the maximum value. The amount of debt below the maximum value can function as a monitoring tool and can also be used to increase a firm's per-

formance. However, once the amount exceeds the maximum value, the debt will lead to high agency expenditures and bankruptcy. In the end, this will diminish a firm's performance.

In general, public firms in Indonesia add more debt without adding their own asset as guarantee. This condition will burden the debt-holders and shareholders since this may lead to bankruptcy. Based on the calculation, it turns out that the comparative ratio between the debt amount and the asset amount increased from 1999 to 2003; i.e. = 0.49216; 0.51162; 0.57432; 0.51730; and 0.57568. This statement corresponds with Taridi (1999) who states that firms in Indonesia have high debt. The capability to expropriate increases at the same time as the debt excessively increases (Harris & Artur 1988).

Hypothesis 2b states that market reacts positively greater on high concentrated ownership structure than that on low concentrated ownership structure. Empirical testing results show that the values of AAR, $CAAR_2$ and $CAAR_5$ at high concentrated ownership are negative and statistically significant. The same result applies to low concentrated ownership structure that shows the negative and statistically significant value of AAR. This condition indicates that debt policy cannot be used as corporate governance mechanism on high and low concentrated ownership structure.

The result is consistent with Faccio et al. (2003), Taridi (1999), Harris and Artur (1988); Faccio et al. (2001); also with Sarkar and Subrata (2005) who state that any debt on concentrated ownership structure will bring about moral hazardous attitudes that endanger negatively on a firm's performance. On this kind of concentrated ownership structure, shareholders have the power to expropriate minor shareholders; referred as expropriation hypothesis. Faccio et al. (2003) state that in developing countries with the characteristics of concentrated ownership structure like Indonesia, debt cannot function as a monitoring tool to lessen any agency conflict; rather it will serve as a tool of expropriating minor shareholders by major shareholders

The reasons as to why expropriating through debt on a concentrated ownership structure is possible are: 1) the protection on the minor shareholders is weak. These are proven by Alba, Claessens, and Djankov (Taridi 1999) who state that Indonesia is among countries in East Asia whose protection on the minor shareholders is weak; 2) Indonesian stock market has not yet so well developed that debt cannot yet function as an effective corporate governance mechanism; 3) the fact that a firm's reputation is still dominated by majority shareholders indicates that the firm still has its intrinsic weakness. This is understandable since once the headquarter files a bankruptcy due to excessive debt, there will be difficulties as to who should be responsible simply because the control system is complicated in a pyramidal structure (Faccio et al. 2001).

Still, the research result shows that market response upon debt announcement from high ownership structure is negatively greater than that of low concentrated ownership, and statistically significant. This result does not support hypothesis 2b.

RESULTS ON ACCOUNTING INDICATOR

The result of diagnostic examination shows that the models have *multicolinearity* problem. Multicolinearity is not a serious problem if the aim of analysis is to predict. It is simple due to the fact that the higher the R^2, the better the prediction will be (Gujarati 2003). The testing result shows that the model suffers some *heteroscedastisity.* This problem can be solved by weighted least square.

Hypothesis 3a states that dividend has positive influence on concentrated ownership structure's profitability. The testing result after its *heteroscedasticity* being eliminated shows that the coefficient value of dividend variable is positive (0.03600), but statistically insignificant. The dividend policy can not be used as corporate governance mechanism in a firm. This result does not support hypothesis 3a.

Hypothesis 3b states that dividend on high concentrated ownership structure influences positively (negatively) greater on a concentrated ownership structure compared to that on low concentrated ownership does. The regression results shows that the value of coefficient $\beta_2 + \beta_5$ is negative (–0.03600 + –0.00200) and coefficient β_2 is positive (0.03600), but statistically insignificant.

The result shows that dividend policy on high concentrated ownership has negative impact on a firm's performance, but statistically insignificant. On the other hand, low concentrated ownership structure has positive impact on a firm's performance, but statistically insignificant. The regression value of this model clearly shows that dividend increase can not be used as corporate governance mechanism either in high or low concentrated ownership structure. This result does not support hypothesis 3b.

The insignificant result of either the decrease or increase in dividend towards a firm's performance—therefore rejects hypothesis 3a and 3b—can probably be traced back by: a) the existence of *clientele effect* phenomenon, which means that any investors in their nonproductive age and who are afraid of taking any risks are likely to choose shares from firms that will pay huge dividend. This indicates that there are firms who shares dividend in spite of their loss. b) the dividend payment in Indonesia is low in average which leads to insignificantly influencing the firm's performance. The contribution of dividend variable in influencing the firm's performance (ROE) is very small, shown by its theoretically proven but not being significant.

Hypothesis 4a states that debt has positive influence on a firm's profitability. The testing result shows that the value of debt coefficient is negative and statistically significant. This means that debt can not be used as corporate governance mechanism in a firm. This result does not support hypothesis 4a.

Hypothesis 4b states that debt on high concentrated ownership structure has bigger effect compared to that on low concentrated structure. The regression shows that the value of debt coefficient on high concentrated ownership structure is negatively smaller than that on low concentrated ownership structure. (–77.58600< –77.58600 + 56.96100) and statistically significant. It means that the influence of debt on high concentrated ownership structure is negatively smaller than that on low concentrated ownership structure on the firm's performance. Hypothesis 4b is not supported.

Debt is proven to have negative impact on a firm's performance either in low or high concentrated ownership structure. This is due to: a) in general, Indonesian firms are funded by debts; moreover, any raise in debt is without any increase in asset as a guarantee. This existing condition will only make debt holders as well as shareholders pay the price of any possible bankruptcy. Based on the calculation during the research, a comparative ratio between the amount of debt and asset is relatively increasing starting from the year 2002 until 2006; i.e. 0.49216; 0.51162; 0.57432; 0.51730; and 0.57568. This statement corresponds to Taridi (1999) who states that firms listed in Indonesian stock market have big amount of debt. The capability to expropriate is increasing as excessive debt increases at the same time (Harris & Artur, 1988). In other words, any debt in certain amount will function as a monitoring tool so as to help increase a firm's performance. However, once the amount of debt is way beyond a maximum level, the debt will only diminish a firm's performance, b) concentrated ownership structure impels major shareholders to expropriate minor shareholders. This is likely to occur since its structure is so pyramidal that minor shareholders will find it difficult to control any conducts of major shareholders, c) Indonesian Stock Market has not yet well developed and enforcement towards *corporate governance* rules is relatively low. This will also impels major shareholders to expropriate the minor shareholders, d) impacts of debts on a firm's performance will be better identified should non linear statistics be used.

CONCLUSION AND IMPLICATIONS

The result can be concluded that dividend policy in Indonesian can be used as corporate governance mechanism to reduce agency conflict between majority and minority shareholders, both on high and low concentrated ownership structure. This result supports Gugler and Yurtoglu (2000) and Jensen (1986), but not Faccio, Lang, and Young (2000), Lee dan Xiao (2002). This result supports the rent extraction hypothesis. Nevertheless, debt policy cannot effectively be used as corporate governance mechanism to reduce agency conflict between majority and minority shareholders, both on high and low concentrated ownership structure. This is because the average debt on high and low concentrated ownership structure is greater than that of industry debt. Greater expropriation exists on high concentrated ownership than that on low concentrated ownership. The result is consistent with Faccio et al. (2003); Taridi (1999), Harris and Artur (1988), Faccio et al. (2001); also with Sarkar & Subrata (2005) who state that any debt on concentrated ownership structure will bring about moral hazardous attitudes that endanger negatively on a company's performance.

This research has some implications. For academic purpose, this research is beneficial as the foundation of conducting further researches, especially for those who want to develop corporate governance in a more comprehensive way, since any previous researches only focused on some variables of corporate governance mechanism. It is worth to note that the success of corporate governance

mechanism depends more on some factors and the existence of relations among variables. Concentrated ownership structure proxy being used in the research is the maximum ownership by an individual or institution with minimum ownership in different concentrated ownership; for instance by using *Herfindal* index, institution, family, and so on. By using different proxies, it is hoped to clearly reveal the role of ownership structure in *corporate governance*. The researcher focuses on the dividend and debt as *corporate governance*, respectively. The following research should be better not only on its secondary data, but also its use of the primary data in order to get better result. Research implications for management; a) can be used as information for decision making in corporate governance mechanism in order to lead the balancing interest among shareholders both majority and minority, b) it will lead to increase firm performance.

BAPEPAM (Badan Pengawas Pasar Modal) or Capital Market Controlling Board in Indonesia and the capital market need to evaluate their regulations and to increase the quality of enforcement related to corporate governance since there are still a lot to do in implementing corporate governance. So far, any practices on corporate governance are just merely acts of practicing the law without any concern on how to make it a necessity for the sake of the firm and the investors. It clearly defines that the existing expropriation conducted by majority shareholders will only reduce minority shareholders' profits. Therefore, the result of this research is expected to give information to BAPEPAM and stock exchange concerning the implementation of corporate governance mechanism in Indonesian capital market, especially for dividend and debt policy. It can be used also as a reference in making or completing corporate governance regulation in correlation with minority shareholders rights and ownership structure in Indonesian capital market. The result of this research is to give information for firms in Indonesian capital market related to the implementation of good corporate governance in order to improve firm's performance.

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