

The Effect of Firm Location on Corporate Dividend Policy: Study in Indonesia Capital Market

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Abstract

This research explored the effect of firm location in Indonesia on corporate dividend policy. The location variable in this research was represented by firm location in Jakarta, which is the capital city of the state, and firm location on Java, where three largest cities in Indonesia are situated. The empirical results of this research indicated that firms that are situated on Java Island had a tendency to have lower payout ratios than their counterparts off the island. Meanwhile, there were no empirical proofs showing that firms in Jakarta had different payout ratios. This depicts that firms that are situated beyond a financial hub have the drive to pay more dividends to their shareholders, signaling the presence of greater information asymmetry for such firms. The result still consistent after considering several robustness tests include, using alternative proxy for dividend policy, exclude crisis period and exclude upper and lower group in research sample.

Keywords : Dividend payout ratio, Dividend policy, Firm location

JEL Classification : G3, R1

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1. Introduction

Resource-based view theories illustrate that one of determinants of firm success is the physical resources of the firm (Barney, 2001). These resources manifest in relation to, among other things, firm location. Mathias et al. (2020) and Head et al. (1995) described shared firm location as positively influential to firm operations as it exerts an agglomeration effect on both tangible resources such as employees and raw materials and intangible resources such as environment security and workplace culture. Furthermore, a clustered firm location is also able to generate benefits in terms of better innovations for the firms within the location.

A firm's location in a developed area has an impact on easy availability of resources (Kukalis, 2010). Some research in finance has also explored the impact of firm location on financial policy. For instance, Arena and Dewally (2012) described that firms whose locations are in proximity with the financial center of a state derive benefits in terms of low capital expenses to be incurred. Researchers in financial management have attempted to elaborate on this

phenomenon with the assumption that the distance between a firm's location and an external party serve as one of the barriers to the monitoring process in which the firm is engaged (Cornaggia et al., 2015). This becomes intriguing as even today, with the advancements in communications and information technology, firm location may impede intangible soft information from being relayed to other parties (Kuang et al., 2021).

This research explored the effect of firm location on corporate dividend policy. Kose et al. (2011) in the US and Yao et al. (2019) in China have attempted to find answers to such issue abovementioned. However, both research works generated opposite results. While Kose et al. (2011) found that the more isolated the firm the greater the payout ratio, Yao et al. (2019) did the opposite. Therefore, it is expected that the present research may enrich literature in attempt to answer this issue. This research selected Indonesia as research setting due to the state's unique characteristic in terms of gaps in firm location. A study in economics has previously discovered that the ongoing asymmetry in development had brought about gaps in income level across regions (Saliminezhad & Lisaniler, 2018). In addition to economic indicator consideration, Indonesia was also selected in this firm- location-related research due to its uniqueness in its topological conditions: Indonesia is an archipelagic country, but most firms are located on Java Island, on which the economic affairs in the country are centered despite its small size relative to other islands. It was this fact that drove researchers to analyze the impact of these unique characteristics (Rodríguez- Pose et al., 2013).

This research examined the relationship between location variables and the dependent variable payout ratio. The payout ratio is the proportion of dividends paid out per share to earnings per share. In this research location was proxied by Jakarta, if the firm was located in Jakarta, and by Java, if the firm was located on Java. The research results showed that firms on Java Island tended to have lower payout ratios than their counterparts beyond, but there were no empirical proofs showing that firms in Jakarta had different payout ratios. This depicts that firms that are situated beyond a financial hub have the drive to pay more dividends to their shareholders, signaling the presence of greater information asymmetry for such firms. This hypothesis of information asymmetry is consistent with the theories proposed by Hu et al. (2019) and Chen et al. (Chen, 2016), which states that location has a consequence related to information asymmetry.

2. Hypothesis Development

The dividend payout ratio can be defined as the proportion of dividends paid out per share to earnings per share (Ross, 2008). Decisions on dividend payment that subsequently determine the measure of the ratio are part of corporate dividend policy. There are three major views regarding how shareholders perceive the payment of dividends that they receive. The first one, which is known as the dividend irrelevance theory, was expressed by Miller and Modigliani (1961), who stated that dividend policy does not influence corporate value. The second one, which is known as the bird in the hand theory, is based on investors' preference for dividends for the quality of certainty (Lintner, 1962). The last of the three views holds that investors are not in favor of dividend payment because the tax factor that they assume for the dividends paid is greater than the capital gain (Litzenberger & Ramaswamy, 1982; Febrianti & Zulvia, 2020; Kovalev & Drachevsky, 2020; André & Coqueret, 2020; Hakim & Kusmanto, 2020; Nguyen et al., 2021).

Aside from meeting investors' expectations, the most prominent factor that drives the firm to pay dividends is the fact that dividend payment is a mechanism of sending signals to investors (Michaely et al., 1995). This theory maintains that the decision to pay dividends is not only related to the amount of funds available, which is typically used in the residual dividend approach (Miller & Modigliani, 1961). Dividend payment can be explained in reference to the situation the firm is in.

One of the factors that comes into play in the firm's operations is firm location. Theories on the firm portray that firm location in a developed region influences firm success (Kukalis, 2010). A number of studies in finance also discovered the key impacts of location on firm

decisions, such as those on capital cost (Arena & Dewally, 2012) and information asymmetry (Cornaggia et al., 2015). The research by Hu et al. (2019) and Chen et al. (2016) described that location has a consequence in relation to information asymmetry. While location is associated with information asymmetry, firms use dividends for signaling purpose to minimize the impacts of information asymmetry. It is predicted that firms that are situated beyond a financial hub have the drive to pay more dividends to their shareholders, signaling the presence of greater information asymmetry for such firms.

The current empirical research has presented a mixed result on the associations between firm location and firm dividend policy. John et al (2011) research has documented that remotely located firms disburse a higher dividend to signal their prospects to less informed shareholders. On the other hand, Yao et al (2019) empirical research in China presents that firm located in major cities is associated with higher level of dividend payout, they contend lower dividends in remotely located firm is due to the limited access of external market. Therefore, the test in these issues still necessary to resolving the differences in literatures. Based on the explanation above, the following research hypothesis was formulated:

H₁: Firms located in a financial center have smaller proportions of dividends per payout policy than firms located outside the financial center.

3. Methods, Data, and Analysis

In this research, the dependent variable was the dividend payout ratio, which referred to the proportion of dividends paid out per share to earnings per share. The location variables used in this research was Jakarta, which was a dummy variable, where score 1 was assigned if a firm was located in Jakarta and score 0 if otherwise, and Java, which was also a dummy variable, where score 1 was assigned if a firm was located on Java and score 0 if otherwise. Following previous research (Fatemi & Bildik, 2012; Mitton, 2004), in this research we also involved control variables which were important in predicting the dividend payout ratio, namely DTA, MTB, ROE, and size. DTA (debt-to-asset ratio) represented the variable that was related to leverage, MTB (market-to-book value) represented the proportion of share price to equity book value, ROE (return on equity) represented performance, which was a proportion of net profits to equity book value, and size used the logarithm of the firm's total assets. The data used in this research were all firms listed on the Indonesia Stock Exchange (IDX), except financial firms. This research excluded financial firms to avoid management variations in the financial industry that might influence the research empirical results (Fama & French, 1992). The initial sample of the research was composed of 4,325 firm observations, spanning a time period from 2010 to 2020. After removal of observations with no value in research variables, the final sample of the research consisted of 2,434 firm observations. The observations included 591 businesses from various industries.

Each firm's percentage of industry is depicted in Figure 1. The consumer products industry has the greatest number of firm memberships.

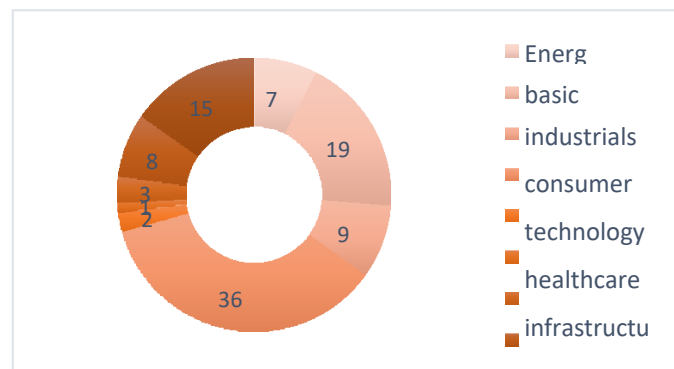


Figure 1. Proportion for Firm Industry Sectors

The table 1 depicts the descriptive values of the research variables. The variables in this research consisted of dummy variables (Jakarta and Java), one dependent variable (payout ratio), and four control variables.

Table 1. Research variables description

Variable	N	Mean	S.D.	Min	Median	Max
Payout Ratio	2,434	0.170	0.230	0.000	0.060	1.000
Jakarta	2,434	0.840	0.370	0.000	1.000	1.000
Java	2,434	0.880	0.330	0.000	1.000	1.000
DTA	2,434	0.520	1.930	-0.020	0.460	94.080
MTB	2,434	1.210	2.380	0.020	0.610	57.230
ROE	2,434	0.400	1.450	-45.060	0.300	27.100
Size	2,434	21.060	1.850	12.760	21.170	26.200

4. Result

In this research, the variables receiving the main attention were location-related variables, namely Jakarta and Java. Estimation using OLS (Ordinary Least Squares) Regression generated varied results. As shown in Table 2, the regression estimation results showed that the variable Jakarta did not have a significant t-statistic value, meaning that there was no relation between the fact that the firm was located in Jakarta and the firm's payout ratio.

Table 2. The effect of location variables on the dividend payout ratio

Variable	(1)	(2)	(2)
	Payout Ratio	Payout Ratio	Payout Ratio
Jakarta	0.005 (0.430)	- -	0.008 (0.720)
Java	- -	-0.031** (-2.40)	-0.033** (-2.460)
DTA	-0.016*** (-6.530)	-0.016*** (-6.490)	-0.016*** (-6.520)
MTB	0.023*** (11.450)	0.023*** (11.470)	0.023*** (11.490)
ROE	-0.001 (-0.300)	-0.001 (-0.270)	-0.001 (-0.320)
Size	0.044*** (18.610)	0.044*** (18.820)	0.044*** (18.620)
Year Fixed Effect	Yes	Yes	Yes
R ²	0.183	0.185	0.185

t statistics in parentheses * p<0.10, ** p<0.05, *** p<0.01

Table 3. Result of Robustness Test

Variable	(1)	(2)	(3)
	Dividend Dummy	DPR	DPR
Jakarta	0,03 -1,11	0,01 -0,63	0,02 -1,27
Java	-0,04* (-1,94)	-0,04** (-2,36)	-0,04** (-2,07)
DTA	-0,02*** (-3,01)	-0,1*** (-3,67)	-0,08*** (-5,82)
MTB	0,01 -1,32	0,03*** -7	0,03*** -10,14
ROE	0,01 -0,47	-0,01 (-0,79)	0,01 -1,34
Size	0,12*** -30,99	0,02*** -4,00	0,05*** -16,29
Year Fixed Effect	Yes	Yes	Yes
N	2330	1321	1915
R ²	0.210	0.079	0.204

t statistics in parentheses * p<0.10, ** p<0.05, *** p<0.01

In this research, we employ several tests to ensure the robustness of the empirical results. The first test is by using dummy dividend variable that equal to 1 if the firm is disburse dividend cash during the period and 0 otherwise. The second test is by exclude firm with 10% upper and 10% lower of dividend Payout ratio to minimize the impact of extremes values of dividend. Lastly, we also employ the test by exclude the firm data in crisis period (between 2020 to 2021). Table 3 shown the result of robustness test. Panel 1 shown the result of estimation for dividend dummy. panel 2 presents the estimation for firm dividend payout ratio for subsample after excluding extremes values, and panel 3 displayed the estimated for firm dividend payout ratio in non-crisis period. The result of robustness is consistent with our primary empirical result that firm located in java is associated with the lower level of dividend payout ratio. Further, we found limited evidence for firm located in Jakarta to be associated with the dividend payout ratio.

5. Dscussion

From the result show that the variable Java had a significant and negative estimated t-statistic value. This estimation result showed that firms that were located on Java Island were associated with lower dividend payout ratios. The research show that firms located in a financial center have smaller proportions of dividends per payout policy than firms located outside the financial center. The empirical result is consistent with the previous research from John et al (2011). Firm that located on Java represent firm that located in the center of capital market industries. Therefore, we could expect that they faced a lesser information asymmetry. Therefore, they faced smaller pressure to convey the market. Line of research has provided the signaling properties of dividend policy to alleviate the information asymmetry. Therefore, firm facing the substantial level of information asymmetry is associated with higher level of dividend payout (Miller & Rock, 1985).

Not all control variables used in this research had significant associations with the dividend payout ratio. Leverage-related DTA had a significant, positive correlation value, meaning that the higher the debt ratio the smaller the amounts of dividends paid. Such is alogical finding since significantly indebted firms would have restrictions in terms of funding to cover dividend payment. This finding is in parallel with earlier research on dividend policy (Karami, 2013). This research also discovered significant positive relationships involving MTB and size. This finding mirrors those of Redding (1997) and Benlemlih (2019), which showed that the larger the firm, as reflected in large MTB and size, the more likeable the firm is to institutional investors, who typically have a greater preference for dividend payment.

In relation to this, Hu et al. (2019) and Chen et al., (2016) described that firms with locations outside a financial center have high levels of information asymmetry, leading to a logical consequence that such firms would attempt to overcome the information asymmetry problem that arises by issuing more dividends in order to compensate investors for the existing information asymmetry. Further, research in financial management has explained the proximity of investor and firm impact on the quality and amount on information for the investor (Carosi, 2016). Based on this notion, since in Indonesian investor mainly located in java island, we could expect that information asymmetry is lower for them.

6. Conclusions, Limitations, and Suggestions

Conclution

This research examined the relationships between location variables and the dependent variable payout ratio. The payout ratio is the proportion of dividends paid per share to earnings per share. The results of this research indicated that firms located on Java Island tended to have smaller payout ratios than their off-Java counterparts. However, there were no empirical proofs showing that firms located in Jakarta had different payout ratios. This depicts that firms that are situated beyond a financial hub have the drive to pay more dividends to their shareholders, signaling the presence of greater information asymmetry for such firms. This research is aligned with previous

research that the firm located in Java is susceptible to a reduced degree of information asymmetry. Consequently, they will encounter reduced pressure to communicate market conditions, particularly through the disbursement of dividends. Moreover, the findings of this study contradict prior research conducted in China, which linked reduced dividend payments to the limited financial accessibility of geographically distant firms.

Limitation and Suggestion

There were two limitations to this research. The first limitation was that the firm location was only determined based on the headquarters, overlooking the possibility of firms with greater operational dispersion to face different consequences than less-dispersed firms. The second limitation was related to the use of dummy variables in the measurement, which according to experts in econometrics carries some drawbacks. Therefore, future research is suggested to consider firms' operational dispersion and use alternative variables as proxies to the location variables.

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