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ESG AND DIVIDEND POLICY IN INDONESIA

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ABSTRACT

The purpose of this paper is to determine the effect of environmental, social, and corporate governance (ESG) performance on company dividend policy in Indonesia. This paper uses three controlled variables: firm size, firm age, and firm leverage. The data used in this research are secondary data from Thomson Reuters Eikon Database on 17 companies listed on the Indonesian Stock Exchange from 2011-2020. To analyze the data, this research uses Panel Data Regression Analysis with Common Effect Model aided by STATA 17. The results show that Environmental, Social, and Corporate Governance performance has a positive and significant effect on company dividend policy in Indonesia. This paper adds value to the existing literature as it provides an overview of the impact of Environmental, Social, and Corporate Governance, especially in relation to the performance of companies in Indonesia. It can therefore provide a good basis for understanding how Indonesian companies can be more appealing to investors.

Keywords: *ESG, dividend policy, Indonesia*

INTRODUCTION

One of the indicators used to assess the financial performance of a company is its dividend policy. The dividend policy determines the amount and timeframe for dividend payments made to a company's shareholders. There are two main schools of thought on dividend policy. The first holds that dividend policy is irrelevant to the sentiments of the company's shareholders. The second maintains that dividend policy is important to the company's shareholders. A dividend's significance is usually associated with the belief that the investors value a unit of dividend more than the same amount from an uncertain capital gain.

A dividend is a part of the total gain that is given to shareholders by the company (Khan et al., 2019). Companies with a high dividend payment attract an investor who prefers a guaranteed stable income flow over potential share price growth. On the other hand, companies with low dividend payments reinvest more in their business growth, so the investor will earn more capital gains from their companies' stocks (Khan et al., 2019). According to the 'bird in hand theory' by Gordon (1962) and Lintner (1962), the investor's interest in the cash dividend is higher than their interest in the stock's capital gain. This is because the investor assumes that the cash dividend payment distributed by the company is a form of certainty that can reduce the risk of their investment.

A company's dividend payment is determined by several factors such as earnings after tax and dividend payment in the last period. Therefore, companies must improve their performance and the level of their profitability if dividends are to rise. Companies aim to have enough earnings reserves for future dividend payments, especially when there is an economic crisis. This is because the dividend payment is the key factor to foster investors' trust and increase companies' market value.

Currently, organizations, companies, and humans as individuals have used natural assets much faster than nature's ability to regenerate itself. Most corporate organizations and companies focus only on their financial performance and tend to neglect long-term sustainability for both the natural and social environment in conducting their operational activities. This contradicts the concept of good environmental sustainability in the Principles for Responsible Investment (PRI). PRI is an international investors' association, established at the New York Stock Exchange in April 2006. It aims to increase the application of six principles of sustainable responsible investment. The six principles are based on the assumption that Environmental, Social, and Corporate Governance (ESG) activities can affect the portfolio of an investor. Therefore, investors take ESG into consideration when making investment decisions. The establishment of PRI aims to give investors an understanding of the importance of the application of ESG in making investment decisions and ownership.

The concept of ESG was first introduced in 2006 by the United Nations Global Compact (UN Global Compact) in an initiative called "Who Cares Wins". It sought to focus investors and financial analysts on the importance of integrating those three aspects. ESG is a standard that is applied by companies while running their business and investment activities. If the standards in ESG are applied to business activities and speculation, the companies will also be interested in implementing those elements to their corporate strategy, so that it will be in accordance with the three policies. Up to the first decade of the 21st century, the ESG matrix was not commonly included as the part of a company's annual report; however, nowadays more companies have put it into their annual report (CFA Institute, 2020). The reason is because investors now consider various non-financial factors in making their investment decisions. Through analysis of non-financial investment factors, the investors are able to see the prospects of a company's growth and the risk that it will face.

In 2018, total global management funds for ESG investment reached US$31 trillion with a compounded annual growth rate (CAGR) increase of 15% compared to 2012. Globally, Europe is the largest investor in ESG funds, with 46% of the global total in 2018. Meanwhile, in Australia 63% of total investment in 2018 implemented ESG. In Japan, the investment trend based on ESG significantly increased from 3% in 2016 to 18% in 2018 (Syailendra Capital, 2021).

In Indonesia, the trend of investment based on ESG has also experienced a dramatic increase. In 2017, the total funds for ESG investment were IDR 132 billion and in January 2020 the total funds for ESG had reached IDR 1.8 trillion (Syailendra Capital, 2021). In addition, in January 2021, the Indonesian Stock Exchange established a new index called ESG Leaders. This index lists companies which have high concern toward ESG issues. Towards the end of 2021, the Indonesian Stock Exchange has also launched two new index called ESG Sector Leaders IDX Kehati and ESG Quality 45 IDX Kehati. The launch of these two new ESG indices is also carried out as a form of support of the commitment of the Financial Services Authority (OJK) in encouraging the implementation of sustainable finance in the Indonesian capital market as stated in the Roadmap for Sustainable Finance II for 2021-2025. One of the priority aspects in the roadmap is the Development of Sustainable Products and Services. It is hoped that these three ESG indices can become milestones in the achievement of the roadmap. Consequently, at this time ESG has become one of the main focuses of Indonesian companies.

If these issues are not effectively handled by the companies, it will probably have a negative effect on their financial performance, social trust, and sustainability.

Companies which implement ESG show a more stable dividend payment. Moreover, a high ESG score shows a better long-term alignment with shareholders and stakeholders due to proportionality and more stable profit sharing (Verga Matos et al., 2020). Besides that, there is a positive correlation between ESG scores and dividend payments. In short, a company with a higher ESG score will share higher dividends. Such a score gives additional proof that a company considered several sustainable factors when applying its dividend policy. Despite this trend, research by Niccolò et al (2020) into 181 Chinese companies listed on the Shanghai and Shenzhen Stock Exchange found that ESG practices have had a negative impact on dividend payment policies.

The research for this paper used control variables to clarify the relationship between the dependent and independent variables. The appropriate control variable for this research was based on previous research on dividend policy. As a result, there are three control variables that are used in this research: firm size, firm age, and firm leverage.

According to the explanation above, the sustainability of a company seems to have a connection with the company's financial performance. One of the aspects which are used to assess a company's financial performance is its dividend policy. This connectivity creates the relationship between a company's sustainability and its dividend policy. If a company's sustainability creates value for the company, there comes an interesting question about how this value is distributed since the dividend policy is commonly used as a tool to transfer value to the shareholder. This also raises the question of whether a company's sustainability affects it dividend policy or not. Therefore the title of the research is **" ESG Performance and Dividend Policy in Indonesia"**.

METHOD

Based on the pattern of relationships of the research, this is a type of research that tests hypotheses. Hypothesis testing is testing the relationship that is considered reasonable between several factors which are stated as testable statements (Sekaran & Bougie, 2016). Testing the hypothesis of the research will answer and solve the problems that the research has. Data collection techniques for this research included a documentation study by collecting secondary data from the Thomson Reuters Eikon database, annual reports, and financial reports published by the Indonesia Stock Exchange (www.idx.co.id) or by a company's official website.

The research population for this research is all companies listed on the Indonesian Stock Exchange from 2011-2020. However, not all companies listed on the Indonesian Stock Exchange from 2011-2020 can be used as samples in this study. Therefore, this research uses a purposive sampling technique used for collecting the research's sample. Purposive sampling is a research sampling technique that is non-random and has special criteria. There are several criteria for the research's sample: companies that were listed on the Indonesian Stock Exchange from 2011-2020 which have published an annual report and financial report, and have an ESG score from the Thomson Reuters Eikon database. Based on the criteria above, there are 17 companies that can be used as research samples that shown on Table 1.

Table 1
Samples of the Research

No.	Code	Company
1.	INDF.JK	Indofood Sukses Makmur Tbk PT
2.	KLBF.JK	Kalbe Farma Tbk PT
3.	ADRO.JK	Adaro Energy Tbk PT
4.	ASII.JK	Astra International Tbk PT
5.	AALI.JK	Astra Agro Lestari Tbk PT
6.	SMGR.JK	Semen Indonesia (Persero) Tbk PT
7.	BDMN.JK	Bank Danamon Indonesia Tbk PT
8.	BBCA.JK	Bank Central Asia Tbk PT
9.	BBRI.JK	Bank Rakyat Indonesia (Persero) Tbk PT
10.	UNTR.JK	United Tractors Tbk PT
11.	TLKM.JK	Telkom Indonesia (Persero) Tbk PT
12.	BBNI.JK	Bank Negara Indonesia (Persero) Tbk PT
13.	ITMG.JK	Indo Tambangraya Megah Tbk PT
14.	UNVR.JK	Unilever Indonesia Tbk PT
15.	INTP.JK	Indocement Tunggal Prakarsa Tbk PT
16.	PTBA.JK	Bukit Asam Tbk PT
17.	BMRI.JK	Bank Mandiri (Persero) Tbk PT

Data source: Data processed by researchers from Thomson Reuters Eikon database

The regression analysis used in this research is panel data regression. Panel data regression analysis is a type of analysis used to analyze the combination of cross-section data and time series data. There are three model on panel data regression analysis: Common Effect Model, Fixed Effect Model, and Random Effect Model. This analysis also has three tests that must be passed when choosing a model: Chow test, Hausman test, and Lagrange Multiplier test. Based on the test, the choosen model for this research is Common Effect Model (CEM). After analyzing the model, the next step is to doing hypothesis testing by using T-test, F-test, and R^2 test. The significancy level used for this research is α=0.1. The panel data regression equation for this study is as follows:

$$DPR = \alpha + \beta_1 ENV_{it} + \beta_2 SOC_{it} + \beta_3 GOV_{it} + \beta_4 SIZE_{it} + \beta_5 AGE_{it} + \beta_6 LEV_{it} + \varepsilon$$

DPR = Dividend Payout Ratio
ENV = Environmental Performance
SOC = Social Performance
GOV = Governance Performance
SIZE = Firm Size
AGE = Firm Age
LEV = Firm Leverage
α = Constanta
$\beta_1 - \beta_6$ = Koefisien Regresi
it = Perusahaan i pada tahun ke t

ε = Term Error

This research consists of 7 variables which are divided into 1 dependent variable, 3 independent variables, and 3 control variables. The three independent variables are Environmental performance, Social performance, and Governance performance which are overall measured using the Environmental score, Social score, and Governance score contained in the Thomson Reuters Eikon database. The dependent variable of this research is the company's dividend policy which is measured using the company's dividend payout ratio. This research also has three control variables to clarify the results of the study consisting of company size, company age, and company leverage. Table 2 explain all definition and measurement of research variables.

Table 2
Operational Definition and Measurement of Variables

Variables	Type	Description
DPR	Dependent	Dividend payout ratio from dividend per share (DPS) divided by earnings per share (EPS)
Environmental performance, ENV	Independent	Environmental score from Thomson Reuters Eikon database
Social performance, SOC	Independent	Social score from Thomson Reuters Eikon database
Governance performance, GOV	Independent	Governance score from Thomson Reuters Eikon database
Firm Size, SIZE	Control	Log n (total assets of the company)
Firm Age, AGE	Control	Log n (total age of the company)
Firm Leverage, LEV	Control	Debt to equity ratio from total debt divided by total equity

Data source: Data processed by researchers

RESULTS AND DISCUSSION

This section contains a description of various matters relating to the analysis of research data that has been collected, the results of research data processing, and a discussion of the results of the research data processing. Furthermore, the sequence of data analysis and discussion in this research is systematically starting from descriptive statistics, classical assumption tests, statistical tests, and a discussion of the effect of independent variables on the dependent variable of the research.

The first step in explaining the results of the data analysis of this study is to explain the results of the descriptive analysis. Descriptive statistics is part of statistics that investigates how to collect and present data that aims to make it easier to understand (Iqbal Hasan, 2003). Table 3 below is the result of descriptive analysis of this research.

Table 3
Descriptive Statistics

Variable	Obs	Mean	Std. dev.	Min	Max
DPR	170	0.528	0.272	0.097	1.766
ENV	170	37.821	16.728	10.390	91.644
SOC	170	51.124	15.409	12.970	94.030
GOV	170	54.569	20.189	5.555	98.981
lnSIZE	170	32.351	1.262	29.700	35.700
lnAGE	170	3.862	0.516	2.564	4.828
LEV	170	0.405	0.249	0.004	1.263

Data source: Data processed by researchers by using STATA 17

Table 3 shows that this study consists of 7 variables which are divided into 1 dependent variable, 3 independent variables, and 3 control variables. The three independent variables in this study are Environmental performance (ENV), Social performance (SOC), and Governance performance (GOV) which are all measured using the Environmental score, social score, and Governance score contained in the Thomson Reuters Eikon database. Then, the dependent variable of this study is the company's dividend policy which is measured using the company's dividend payout ratio (DPR). This study also has three control variables to clarify the results of the study consisting Firm size (SIZE), Firm age (AGE), and Firm leverage (LEV). Furthermore, because this research was conducted during the 2011-2020 period and had 17 samples, each variable in this study had the same number of observations, which were 170 observations.

Table 4
Data Panel Regression Result from Common Effect Model

DPR	Coefficient	Std. err.	t	P>|t|	[95% conf. interval]	
ENV	0.0053672	0.0012024	4.46	0.000	0.0029930	0.0077414
SOC	0.0028482	0.0014599	1.95	0.053	-0.0000345	0.0057308
GOV	0.0037119	0.0010420	3.56	0.000	0.0016543	0.0057696
lnSIZE	-0.0064603	0.0147826	-0.44	0.663	-0.0356503	0.0227297
lnAGE	-0.0816352	0.0354496	-2.30	0.023	-0.1516348	-0.0116356
LEV	-0.0867548	0.0734543	-1.18	0.239	-0.2317995	0.0582898
_cons	0.5366836	0.4610370	1.16	0.246	-0.3736914	1.4470590

Data source: Data processed by researchers by using STATA 17

Table 5
T-test Result

DPR	t	P>|t|
ENV	4.46	0.000
SOC	1.95	0.053
GOV	3.56	0.000
lnSIZE	-0.44	0.663
lnAGE	-2.30	0.023
LEV	-1.18	0.239
_cons	1.16	0.246

Data source: Data processed by researchers by using STATA 17

Based on Table 5, it can be seen that the variables of environmental performance, social performance, and governance performance have a significant positive effect on dividend policy. The firm size variable has an insignificant negative effect, while firm age has a significant negative effect. Firm leverage has an insignificant negative effect.

Table 6
F-test Result

F (6,163) = 15.32
Prob > F = 0.0000

Data source: Data processed by researchers by using STATA 17

Table 6 indicates that the value of Prob > F = 0.0000. The research Alpha value is 0.1. This means the value of Prob > F is smaller than the Alpha value of the study. Thus, the overall independent variables, namely environmental performance, social performance, and governance performance, as well as the control variables, namely firm size, firm age, and firm leverage, affect the dependent variable, namely dividend policy, simultaneously.

Table 7
R-squared Result

R-squared = 0.3605
Adj R-squared = 0.3370

Data source: Data processed by researchers by using STATA 17

This study has an R-squared value of 0.3605. This means the dependent variable – dividend policy – which is measured using the dividend payout ratio (DPR) can be explained by the independent variables and the control variables of 36.05%. The remaining 63.95% is explained by other variables outside the study.

Analysis

The effect of environmental performance on a company's dividend policy

The environmental performance (EP) variable in this study has a value of P>|t| of 0.000, which is smaller than the Alpha value of 0.1 and has a positive coefficient of 0.0053672. This means that EP has a positive and significant effect on the dependent variable of this study, namely dividend policy as measured by the dividend payout ratio. This also means that every

1% increase in the EP variable will increase the DPR by 0.0053672, assuming other variables are constant. Thus, the higher the company's environmental score, the higher the dividend payout ratio provided by the company. The results of this study are in line with research conducted by Verga Matos et al (2020), Nguyen & Balachandran (, 2017), and Aziz (2022), which explains that companies with better environmental performance pay greater dividends than companies that have poor or negative environmental performance.

The results of this study are in accordance with the theory used in this study, namely the legitimacy theory. This theory explains that an organization must consistently strive to ensure that its policies and activities are in accordance with the limits and standards that apply in the eyes of the public. Therefore, a company with good environmental performance has implemented various policies and carried out activities that are well accepted by the public. Based on the research results, companies with good environmental performance provide higher dividends. This dividend can describe a form of corporate responsibility that appreciates and respects all stakeholders in the company, in accordance with stakeholder theory.

When viewed from the investor's perspective, based on the bird in hand theory, investors will tend to prefer compensation in the form of cash dividends rather than capital gains from the shares they own. According to investors, receiving cash dividends is a form of certainty that can reduce the risk of their investment. Therefore, investors would choose a company with a high environmental score because it will provide higher dividends. This result is in accordance with the estimation of the Principles for Responsible Investment (PRI), which state that a company's ESG activities can affect the performance of the portfolio owned by investors. Therefore, investors should take ESG as one of their considerations when investing.

The effect of social performance on a company's dividend policy

Social performance (SP) has a value of P|t| 0.053, which is smaller than the Alpha value of the study, which has a value of 0.1. In addition, SP has a positive coefficient value of 0.0028482. This means that this variable has a positive and significant effect on the dependent variable of the study. This also means that every 1% increase in the SP variable will increase the DPR by 0.0053672, assuming other variables are constant. Thus, the higher the company's social score, the higher the dividend payout ratio provided by the company. This study's results are in line with research conducted by Oh & Park (2021), and Trihermanto & Nainggolan (2020), which states that there is a positive and significant relationship between social performance and corporate dividends.

The results of this study are in accordance with the explanation of one of the theories used in this study, namely legitimacy theory. This theory explains that an organization must consistently strive to ensure that its policies and activities are in accordance with the limits and standards that apply in the eyes of the public. Therefore, a company with good social performance has implemented various policies and carried out activities that are well accepted by the public. Based on the results of the study, companies with good social performance provide higher dividends. This dividend can describe a form of corporate responsibility that appreciates and respects all stakeholders in the company, in accordance with stakeholder theory.

When viewed from the investor's perspective, based on the bird in hand theory, investors will tend to prefer compensation in the form of cash dividends rather than capital gains from the shares they own. According to investors, receiving cash dividends is a form of certainty

that can reduce the risk of their investment. Therefore, investors would choose a company with a high social score because it will provide higher dividends. This result is in accordance with the estimation of the Principles for Responsible Investment (PRI), which states that a company's ESG activities can affect the performance of the portfolio owned by investors. Therefore, investors should take ESG as one of their considerations when investing.

The effect of governance performance on a company's dividend policy

Governance performance (GP) has a value of P|t| of 0.000, which is smaller than the research Alpha value of 0.1 and has a positive coefficient value of 0.0037119. This means that this variable has a positive and significant influence on the dependent variable. This also means that every 1% increase in the GP variable will also increase the DPR by 0.0037119, assuming other variables are constant. Thus, the higher a company's governance score, the higher the dividend payout ratio provided by the company. The results of this study are in line with research conducted by Pahi & Yadav (2019), and Verga Matos et al (., 2020), which found a positive and significant relationship between governance performance and corporate dividends.

The results of this study are in accordance with agency theory, which holds that companies that have good governance performance and provide incentives (which in this study are in the form of dividends) for stakeholders can reduce their conflicts of interest. The results of this study are also in accordance with the stakeholder theory, which states that the company is responsible for appreciating and respecting all stakeholders in the company.

When viewed from the investor's perspective, based on the bird in hand theory, investors will tend to prefer compensation in the form of cash dividends rather than capital gains from their shares. According to investors, receiving cash dividends is a form of certainty that can reduce the risk of their investment. Therefore, investors should choose a company with a high governance score because it will provide higher dividends. This result is in accordance with the estimation of the Principles for Responsible Investment (PRI), which states that a company's ESG activities can affect the performance of the portfolio owned by investors. Therefore, investors should take ESG as one of their considerations when investing.

The effect of firm size on a company's dividend policy

Firm size (FS) is the size of the company, which in this study is measured by the formula ln (total assets owned by the company). FS has a value of P|t| of 0.663 and a negative coefficient value of -0.0064603. This means that this variable has a negative and insignificant effect on the dependent variable owned by the study. In addition, this also means that every 1% increase in the FS variable will also increase the DPR by -0.0064603, assuming other variables are constant. Thus, the larger the firm size, the lower the dividend payout ratio provided by the company.

The results of this study contradict research conducted by Benlemlih (Benlemlih, 2019), which states that firm size has a positive influence on a company's dividend policy. However, the results are in accordance with the 'Small Firm Effect Theory', which states that small companies tend to have better performance than large companies. This is because smaller companies have a greater number of growth opportunities than larger companies (Investopedia.com, 2021).

The effect of firm age on company's dividend policy

Firm age (FA) is measured from the year a company was founded. Firm age in this study was measured by using the formula ln (company age). The results of the t-test for the firm age

variable have a value of P|t| of 0.023, which is smaller than the research Alpha value of 0.1, and has a negative coefficient value of -0.0816352. As the value of P|t| is smaller than the Alpha value and has a negative coefficient, this means that firm age has a negative and significant effect on the dependent variable. This also means that every 1% increase in the FA variable will increase the DPR by -0.0816352, assuming other variables are constant.

Thus, the older the company, the lower the dividend payout ratio provided by the company. The results of this study contradict research conducted by Tamimi (2014), which states that firm age has a positive relationship with a company's dividend policy. This means that only a few companies in the sample have a firm age higher than the average firm age value of the sampled company. This also means that the companies in the sample have a small firm age on average.

The effect of firm leverage on company's dividend policy

Firm leverage is used to determine a company's ability to pay all of its obligations. Firm leverage in this study was measured by using the debt-to-equity ratio (DER), which is calculated by dividing total debt by total equity. The results of the t-test for firm leverage have a value of P|t| of 0.246. This value is greater than the research Alpha of 0.1. Meanwhile, the coefficient value of firm leverage is -0.0867548. Thus, firm leverage has a negative and insignificant effect on the dependent variable of the study. Moreover, this means that every 1% increase in FL will decrease the dividend payout ratio (DPR) variable by -0.0867548, assuming other variables are constant.

These results show that the higher the level of debt owned by a company, the lower the dividend payout ratio provided by the company. This is in accordance with research conducted by Benlemlih (2019), which states that a high level of leverage tends to have a negative impact on a company's dividend policy. Companies with a high level of leverage in their capital structure will tend to pay fewer dividends than companies that have a low level of leverage. This is because highly leveraged companies need to protect their creditors and other cash outflows.

CONCLUSION

Environmental performance (EP) has a positive and significant effect on the dependent variable of this study, namely dividend policy as measured by the dividend payout ratio. Thus, the higher the environmental score of the company, the higher the dividend payout ratio provided by the company. The results of this study are in line with research conducted by Verga Matos et al (2020), Nguyen & Balachandran (2017), and Aziz (2022), which explains that companies with a better environmental performance pay greater dividends than companies with a poor or negative environmental performance.

Social performance (SP) has a positive and significant effect on the dependent variable of this study. Thus, the higher the social score of the company, the higher the dividend payout ratio provided by the company. The results of this study are in line with research conducted by Benlemlih (2019), Oh & Park (2021), and Trihermanto & Nainggolan (, 2020), which states there is a positive and significant relationship between social performance and corporate dividends.

Governance performance (GP) has a positive and significant effect on the dependent variable. Thus, the higher the governance score of the company, the higher the dividend payout ratio

provided by the company. The results of this study are in line with research conducted by Odeleye (2017), D. Y. I. S. Pahi (2017), and Verga Matos et al (2020), who found a positive and significant relationship between governance performance and corporate dividends.

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