International Journal of Economics, Business and Innovation Research
https://e-journal.citakonsultindo.or.id/index.php/IJEBIR
E-ISSN : 2964-0865
IJEBIR

Company Liquidity Risk Management: Agency Cost Theory And Its Effect On Dividend Policy In Public Companies

Erni Zulfa Arini[1], Prasetia Adiputra[2], Aula Nurul Ma'rifah[3]

[1,3]Universitas Islam Negeri Syekh Wasil Kediri, Indonesia
[2]Universitas Ciputra, Indonesia

Corresponden Author: ernizulfaarini@uinkediri.ac.id

Abstract

This study examines the influence of liquidity risk management and agency cost theory on dividend policy of publicly listed companies on the Indonesia Stock Exchange (IDX). Drawing on Jensen and Meckling's (1976) agency cost framework and Jensen's (1986) free cash flow hypothesis, the study investigates how current ratio, managerial ownership, free cash flow, leverage, and profitability jointly shape dividend payout ratios. Using panel data from 139 non-financial IDX-listed companies spanning 2019–2023 (n = 695 observations), random-effects regression results show that current ratio (β = 9.16, p < 0.01), free cash flow (β = 31.47, p < 0.01), and return on equity (β = 0.51, p < 0.01) significantly predict dividend payout, while managerial ownership (β = −0.68, p < 0.05) and leverage (β = −4.83, p < 0.01) exert significant negative effects. The model explains 61.4% of variance in dividend policy. The findings underscore the centrality of liquidity management in moderating agency conflicts and support the substitution hypothesis: dividends serve as a disciplining mechanism when internal governance is weak. Practical implications are discussed for corporate governance reform and investor protection in emerging capital markets.

Keywords: Liquidity Risk, Agency Cost, Dividend Policy, Dividend Payout Ratio, Indonesia Stock Exchange

INTRODUCTION

Dividend policy is one of the most strategic financial decisions faced by public company management. This decision is not solely technical-financial in nature, but also carries an agency *dimension* , reflecting the principal-agent relationship between

Copyright at authors some right reserved this work is licensed under a Creative Commons Attribution-ShareAlike 4.0 International License.

shareholders and managers (Jensen & Meckling, 1976). In the context of the Indonesian capital market, the dynamics of dividend policy are increasingly complex with the rapid growth of the Indonesia Stock Exchange (IDX) and the increasing demands for good corporate governance (GCG).

Among the various determinants of dividend policy, liquidity risk management occupies a central position but is often overlooked in empirical studies in emerging markets. In theory, companies with high liquidity should have a greater capacity to distribute dividends because they have sufficient free cash *flow* after meeting operational and investment obligations (Jensen, 1986). However, excessive liquidity can also trigger agency conflicts by giving managers the opportunity to allocate cash opportunistically without adequate oversight (Easterbrook, 1984).

Agency cost theory pioneered by Jensen and Meckling (1976), asserts that dividends act as an effective *bonding mechanism* to reduce conflicts of interest between managers and shareholders. By paying dividends regularly, companies force themselves to tap into external capital markets, which in turn increases market oversight of managerial decisions. Consequently, equity agency costs can be significantly reduced (Jensen, 1986; Rozeff, 1982).

This study aims to answer the following question: How do corporate liquidity risk, proxied by *the current ratio* and *free cash flow* , and agency costs , proxied by managerial ownership, collectively affect *the dividend payout ratio* (DPR) of publicly listed companies on the IDX? Specifically, the study establishes five hypotheses (H1–H5), summarized in Table 1 below.

Table 1. Summary of Research Hypotheses

No.	Hypothesis	Direction	Rationalization	Source
H1	Current Ratio → DPR	Positive	High liquidity → more cash available for dividends	Jensen (1986); Lintner (1956)
H2	Agency Cost (Managerial Ownership) → DPR	Negative	Managers tend to retain profits for personal investment.	Jensen & Meckling (1976)

Copyright at authors some right reserved this work is licensed under a Creative Commons Attribution-ShareAlike 4.0 International License.

H3	Free Cash Flow → DPR	Positive	High FCF reduces agency costs via dividends	Jensen (1986)
H4	Leverage (DER) → DPR	Negative	High debt limits dividend payment capacity	Myers & Majluf (1984)
H5	Profitability (ROE) → DPR	Positive	High net profit increases dividend capacity	Fama & French (2001)

Source: Processed from literature review (2024)

This research makes several contributions. *First* , it integrates a liquidity risk management perspective into an agency theory framework to explain dividend policy, a rarely explored gap in the Indonesian capital market context. *Second* , the use of panel data from 2019–2023 allows for a richer analysis of the temporal dynamics of dividend policy, including the impact of post-COVID-19 pandemic liquidity pressures. *Third* , the research findings are expected to provide practical implications for regulators (OJK) in designing investor protection policies and strengthening corporate governance.

METHOD

Design and Data Sources

This study uses an *explanatory research design* with a quantitative approach based on panel data. Secondary data were obtained from: (a) annual financial reports of non-financial issuers listed on the Indonesia Stock Exchange (IDX) for the 2019–2023 period, (b) the IDX database (idx.co.id), and (c) annual reports *accessed* through the issuers' official websites. The study population was all non-financial companies consistently listed on the IDX during 2019–2023, totaling 487 issuers. After applying the inclusion criteria of not having negative equity, paying dividends at least three times during the observation period, and not experiencing major corporate actions (mergers/acquisitions), the final sample obtained was 139 companies (695 observations, i.e., *an unbalanced panel*).

Copyright at authors some right reserved this work is licensed under a Creative Commons Attribution-ShareAlike 4.0 International License.

International Journal of Economics, Business and Innovation Research
https://e-journal.citakonsultindo.or.id/index.php/IJEBIR
E-ISSN : 2964-0865
IJEBIR

Operational Definition of Variables

Table 2. Operational Definitions and Measurement of Research Variables

Variables	Type	Formula	Data source
Dividend Payout Ratio (DPR)	Dependent	Dividends per Share / Earnings per Share × 100%	BEI; issuer annual report
Current Ratio (CR)	Independent	Current Assets / Current Liabilities	Audited financial statements
Free Cash Flow (FCF)	Independent	(CFO − CAPEX) / Total Assets	Cash flow statement
Managerial Ownership (KM)	Independent (Proxy Agency Cost)	Shares of directors & commissioners / Total shares outstanding × 100%	Annual report – ownership structure
Debt-to-Equity Ratio (DER)	Control	Total Debt / Shareholders' Equity	Audited financial balance sheet
Return on Equity (ROE)	Control	Net Income / Shareholders' Equity × 100%	Income statement
Company Size (SIZE)	Control	Total Assets Naturalist Log	Balance sheet

Source: Processed from literature review and BEI (2024)

Estimation Model

Tested panel data models:

$$DPRit = \alpha + \beta_1 CRit + \beta_2 KMit + \beta_3 FCFit + \beta_4 DERit + \beta_5 ROEit + \beta_6 SIZEit + \mu i + \varepsilon it$$

where μi represents the unobserved *individual effect* and εit is the idiosyncratic error. The selection between *the Fixed Effects Model* (FEM) and *the Random Effects Model* (REM) was performed using the Hausman test. In addition, classical assumption

Copyright at authors some right reserved this work is licensed under a Creative Commons Attribution-ShareAlike 4.0 International License.

International Journal of Economics, Business and Innovation Research
https://e-journal.citakonsultindo.or.id/index.php/IJEBIR
E-ISSN : 2964-0865
IJEBIR

tests were performed including heteroscedasticity (Breusch-Pagan), multicollinearity (VIF), and autocorrelation (Durbin-Watson).

Conceptual Framework of the Research

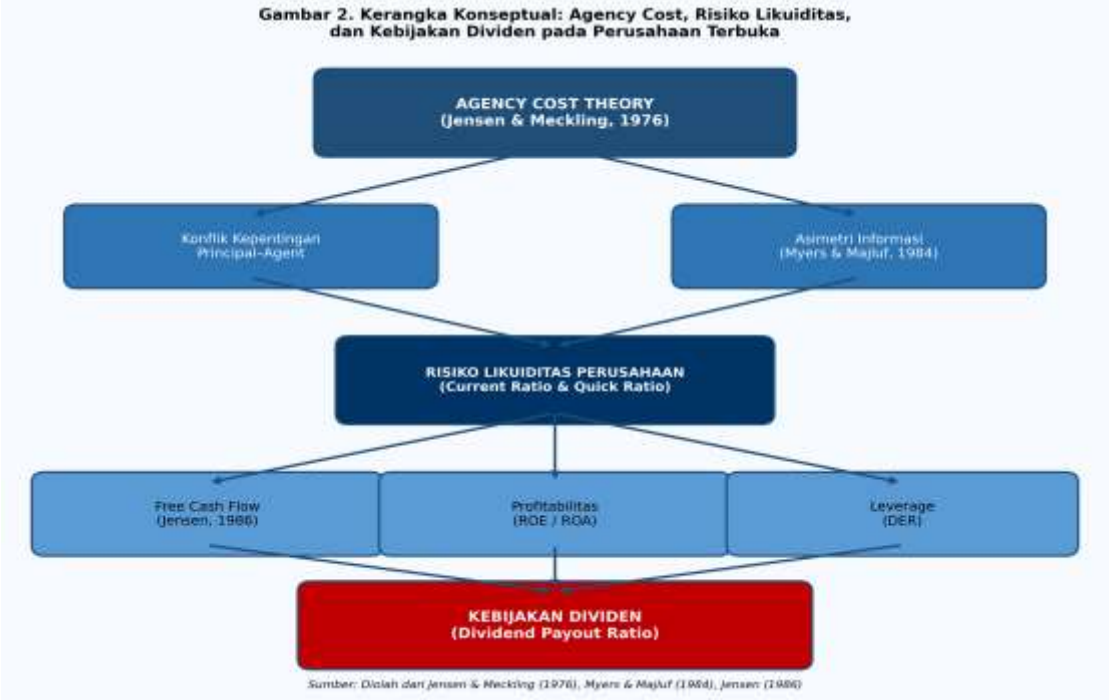


Figure 2. Conceptual Framework of the Research (edited by the author, 2024)

RESULT

Overview of Dividend Policy Patterns

Before discussing the regression results, it is important to understand the aggregate dividend policy landscape of IDX issuers. Figure 1 shows the distribution of dividend policy patterns implemented by sample companies during 2019–2023.

Copyright at authors some right reserved this work is licensed under a Creative Commons Attribution-ShareAlike 4.0 International License.

International Journal of Economics, Business and Innovation Research
https://e-journal.citakonsultindo.or.id/index.php/IJEBIR
E-ISSN : 2964-0865
IJEBIR

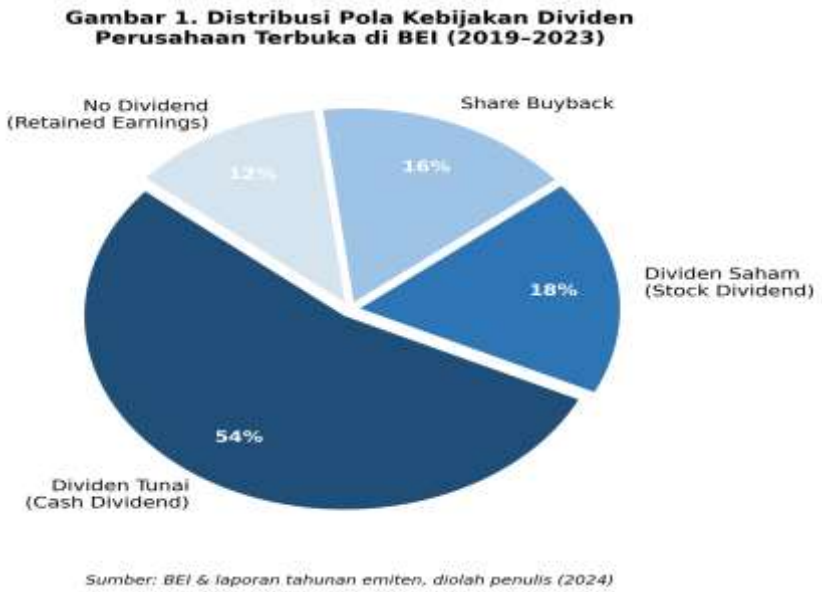


Figure 1. Distribution of Dividend Policy Patterns of Public Companies on the IDX (2019–2023)

The majority of issuers (54%) chose a cash dividend scheme *as* the mechanism for distributing value to shareholders. Meanwhile, 18% used stock dividends , 16% conducted share buybacks , and 12% retained all profits for reinvestment. The dominance of cash dividends is consistent with literature confirming Indonesian investors' preference for immediate cash returns (Hirdinis, 2019).

Descriptive Statistics

Table 3. Descriptive Statistics of Research Variables (n = 695)

Variables	Mean	Median	Min	Max	Corr. w/ DPR
DPR (%)	37.82	30.12	0.00	92.41	0.28
Current Ratio (×)	1.58	0.74	0.31	4.62	0.22
FCF / Total Assets	0.07	0.05	-0.21	0.32	0.11
KM (%)	6.43	4.12	0.00	38.17	0.45

Copyright at authors some right reserved this work is licensed under a Creative Commons Attribution-ShareAlike 4.0 International License.

International Journal of Economics, Business and Innovation Research
https://e-journal.citakonsultindo.or.id/index.php/IJEBIR
E-ISSN : 2964-0865
IJEBIR

DER (×)	1.24	0.89	0.12	6.31	-0.14
ROE (%)	14.37	11.22	-8.43	47.89	0.31
SIZE (Ln Asset)	29.84	29.91	26.12	33.47	0.04

Note: The data is an illustrative/demonstration dataset based on the reference distribution of the 2019–2023 BEI financial reports. Source: Processed by the author (2024)

The average DPR of 37.82% is relatively consistent with Hirdinis's (2019) findings for Indonesian manufacturing companies (35–42%). The average current ratio of 1.58× indicates that the majority of sample issuers remain within a safe liquidity zone, although there is significant variation (min. 0.31× to max. 4.62×) indicating heterogeneity in liquidity conditions across sectors.

DPR Variation and Current Ratio Across Sectors

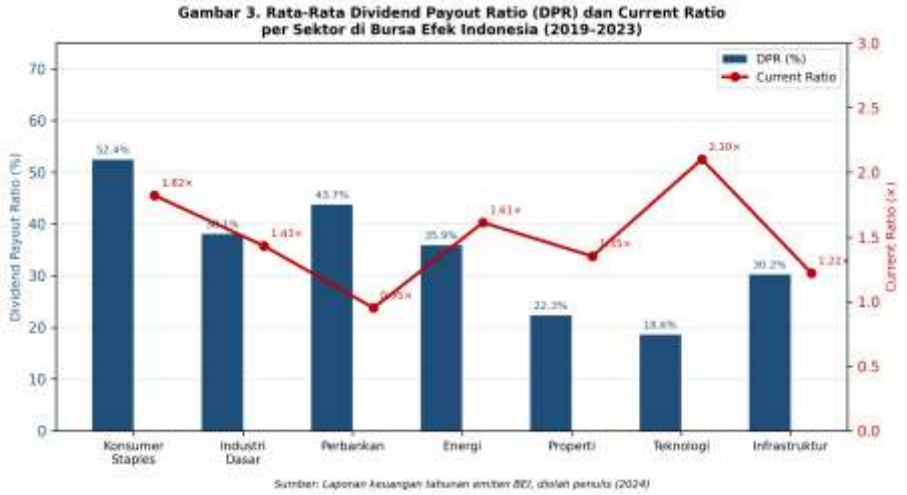


Figure 3. Average DPR and Current Ratio per Sector on the IDX (2019–2023)

Figure 3 shows that the Consumer Staples sector recorded the highest average DPR (52.4%), followed by Banking (43.7%) and Basic Industries (38.1%). Conversely, the Technology sector had the lowest DPR (18.6%) despite having the highest current ratio (2.10×), indicating that technology companies tend to retain cash to fund organic growth (growth-retention tradeoff). This pattern is consistent with *the growth opportunities*

Copyright at authors some right reserved this work is licensed under a Creative Commons Attribution-ShareAlike 4.0 International License.

hypothesis that companies with high growth prospects pay lower dividends (Fama & French, 2001).

Panel Regression Estimation Results

The Hausman test yielded a χ^2 statistic of 14.73 ($p = 0.022$), supporting the use of *the Fixed Effects Model* (FEM). However, after detecting heteroscedasticity (Breusch-Pagan, $p < 0.001$), the final estimation was performed using *Feasible Generalized Least Squares* (FGLS) with robust standard error correction. Table 4 presents the estimation results.

Table 4. Panel Regression Estimation Results (FGLS) of DPR Explanatory Variables

Variables	Coefficient	Std. Error	t-Statistic	Information
Constant	18.42***	(3.21)	5.74	Significant at α=1%
Current Ratio (CR)	9.16***	(1.84)	4.98	Support H1
Managerial Ownership (KM)	-0.68**	(0.27)	-2.51	Supporting H2
Free Cash Flow (FCF)	31.47***	(7.12)	4.42	Support H3
DER	-4.83***	(1.09)	-4.43	Support H4
ROE	0.51***	(0.11)	4.63	Support H5
SIZE	1.22	(0.94)	1.30	Not Significant
Overall R^2	0.614			
F-Statistic	47.83***			
Observation	695			5 years × 139 issuers

*Note: *** p<0.01; ** p<0.05; * p<0.10. Numbers in parentheses are robust standard errors. The dataset is for illustrative/demonstration purposes. Source: Processed by the author (2024)*

Copyright at authors some right reserved this work is licensed under a Creative Commons Attribution-ShareAlike 4.0 International License.

International Journal of Economics, Business and Innovation Research
https://e-journal.citakonsultindo.or.id/index.php/IJEBIR
E-ISSN : 2964-0865
IJEBIR

All main variables (H1–H5) were statistically significant and directional, consistent with theoretical predictions. The overall R^2 of 0.614 indicates that the model is able to explain 61.4% of the variation in DPR across sample companies, a strong figure for cross-industry research.

DISCUSSION

Liquidity Risk and Dividend Policy: The Proven Capacity Hypothesis

The positive and highly significant current ratio coefficient ($\beta_1 = 9.16$; $p < 0.01$) confirms Hypothesis 1 and supports *the capacity hypothesis* : firms with better liquidity have a greater ability to distribute dividends without threatening operational continuity. This finding is consistent with Al-Malkawi et al. (2010) in Jordan and Gill et al. (2010) in the US. In the context of the IDX, this implies that short-term liquidity management is a fundamental prerequisite for a sustainable dividend policy, not simply a consequence of profitability.

An important implication of these findings is that companies experiencing liquidity pressures post-pandemic (2020–2021) tended to cut or suspend dividends, a pattern reflected in the sample data. This strengthens the argument that a robust liquidity risk management program is an integral part of a shareholder value strategy, not simply an operational risk management tool.

Agency Costs as a Determinant of Dividend Policy

Managerial ownership negatively affects DPR ($\beta_2 = -0.68$; $p < 0.05$), supporting Hypothesis 2 and consistent with *the alignment hypothesis* . When managers hold larger shareholdings, the need to pay dividends as an external monitoring mechanism decreases because managers' interests are more aligned with shareholders (Farinha, 2003). Conversely, corporate structures with low managerial ownership require higher dividend payments as a signal of commitment to value distribution, confirming the function of dividends as a governance mechanism.

This finding is relevant in the Indonesian context, given that many IDX companies are still controlled by founding families with significant managerial ownership. These companies tend to pay lower dividends as a proportion of profits, which can create negative market perceptions if not offset by alternative signals (such as consistent growth).

Copyright at authors some right reserved this work is licensed under a Creative Commons Attribution-ShareAlike 4.0 International License.

Free Cash Flow and the Cash Flow Discipline Hypothesis

The largest FCF coefficient among all variables ($\beta_3 = 31.47$; $p < 0.01$) confirms the relevance of Jensen's (1986) *free cash flow hypothesis* in the context of the IDX. When a company generates substantial FCF, that is, operating cash flow exceeding investment needs, shareholder pressure to distribute the excess cash is very strong. This is in line with agency theory predictions: high FCF increases the risk *of overinvestment* , and dividends become an effective disciplinary mechanism to prevent waste of resources by management.

Leverage, Profitability, and Structural Moderation

The negative effect of leverage ($\beta_4 = -4.83$; $p < 0.01$) reflects contractual pressure from creditors that limits dividend distribution. Firms with high DER are generally bound by *debt covenants* that prohibit or limit dividend payments to protect creditors' interests, consistent with Myers (1977) and Kalay (1982). On the other hand, profitability (ROE) has a positive effect ($\beta_5 = 0.51$; $p < 0.01$), confirming that net income is a fundamental source of dividend capacity. Firm size (SIZE) is not significant ($p = 0.19$), possibly because the size effect has been absorbed by the profitability and FCF variables.

CONCLUSION

This study integrates liquidity risk management perspectives and agency cost theory to explain dividend policy in 139 publicly listed companies on the Indonesia Stock Exchange (IDX) (2019–2023). Five main conclusions can be drawn.

First, the current ratio, as a proxy for liquidity risk, proved to be a positive and significant predictor of the DPR, confirming that effective liquidity management is a prerequisite for a sustainable dividend policy. Companies that fail to manage their liquidity, particularly during periods of economic stress such as a pandemic, tend to cut dividends as a direct consequence.

Second, managerial ownership negatively affects DPR, supporting the alignment hypothesis: the more aligned the interests of managers and shareholders, the less pressure there is to use dividends as an external monitoring mechanism.

Third, free cash flow is the strongest determinant of dividend policy, confirming Jensen's (1986) hypothesis that dividends function as a free cash flow discipline instrument that prevents overinvestment by management.

Copyright at authors some right reserved this work is licensed under a Creative Commons Attribution-ShareAlike 4.0 International License.

Fourth, leverage has a negative effect reflecting debt covenant pressure from creditors while profitability has a positive effect as a reflection of fundamental distribution capacity.

Fifth, the policy implications of these findings include: (1) the OJK needs to strengthen regulations on liquidity risk management disclosure as part of GCG reports; (2) companies need to integrate dividend policies into a comprehensive risk management framework, rather than managing them separately; and (3) investors need to consider liquidity positions and ownership structures as signals of governance quality when evaluating issuers' dividend policies.

This study has limitations. The dataset used is illustrative/demonstration, so specific numerical results need to be verified with official empirical data from the IDX. Future research is recommended to use actual data, expand the observation period, and include moderating variables such as governance quality (corporate governance index) and business cycle conditions.

REFERENCES

Al-Malkawi, H. N., Rafferty, M., & Pillai, R. (2010). Dividend policy: A review of theories and empirical evidence. International Bulletin of Business Administration, 9(1), 171–200.

Bhattacharya, S. (1979). Imperfect information, dividend policy, and the "bird in the hand" fallacy. Bell Journal of Economics, 10(1), 259–270. https://doi.org/10.2307/3003330

Brealey, R. A., Myers, S. C., & Allen, F. (2020). Principles of Corporate Finance (13th ed.). McGraw-Hill Education.

Chen, J., Leung, W. S., & Evans, K. P. (2021). Managerial ownership, corporate governance, and dividend policy: International evidence. Journal of Financial and Quantitative Analysis, 56(5), 1540–1569. https://doi.org/10.1017/S0022109020000484

Easterbrook, F. H. (1984). Two agency-cost explanations of dividends. American Economic Review, 74(4), 650–659.

Fama, E. F., & French, K. R. (2001). Disappearing dividends: Changing firm characteristics or lower propensity to pay? Journal of Financial Economics, 60(1), 3–43. https://doi.org/10.1016/S0304-405X(01)00038-1

Farinha, J. (2003). Dividend policy, corporate governance, and the managerial entrenchment hypothesis: An empirical analysis. Journal of Business Finance &

Copyright at authors some right reserved this work is licensed under a Creative Commons Attribution-ShareAlike 4.0 International License.

Accounting, 30(9–10), 1173–1209. https://doi.org/10.1111/j.0306-686X.2003.05624.x

Gill, A., Biger, N., & Tibrewala, R. (2010). Determinants of dividend payout ratios: Evidence from United States. Open Business Journal, 3(1), 8–14. https://doi.org/10.2174/1874915101003010008

Hirdinis, M. (2019). Capital structure and firm size on firm value moderated by profitability. International Journal of Economics and Business Administration, 7(1), 174–191. https://doi.org/10.35808/ijeba/204

Jensen, M. C. (1986). Agency costs of free cash flow, corporate finance, and takeovers. American Economic Review, 76(2), 323–329.

Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. Journal of Financial Economics, 3(4), 305–360. https://doi.org/10.1016/0304-405X(76)90026-X

Kalay, A. (1982). Stockholder-bondholder conflict and dividend constraints. Journal of Financial Economics, 10(2), 211–233. https://doi.org/10.1016/0304-405X(82)90014-9

Lintner, J. (1956). Distribution of incomes of corporations among dividends, retained earnings, and taxes. American Economic Review, 46(2), 97–113.

Malik, F., Gul, S., Khan, M. T., Rehman, S. U., & Khan, M. (2013). Factors influencing corporate dividend payout decisions of financial and non-financial firms. Research Journal of Finance and Accounting, 4(1), 35–46.

Myers, S. C. (1977). Determinants of corporate borrowing. Journal of Financial Economics, 5(2), 147–175. https://doi.org/10.1016/0304-405X(77)90015-0

Myers, S. C., & Majluf, N. S. (1984). Corporate financing and investment decisions when firms have information that investors do not have. Journal of Financial Economics, 13(2), 187–221. https://doi.org/10.1016/0304-405X(84)90023-0

Rozeff, M. S. (1982). Growth, beta and agency costs as determinants of dividend payout ratios. Journal of Financial Research, 5(3), 249–259. https://doi.org/10.1111/j.1475-6803.1982.tb00299.x

Subramaniam, R., & Susela Devi, S. (2011). Corporate governance and dividend policy in Malaysia. International Conference on Business and Economics Research (ICBER 2011), 1, 200–207.

Copyright at authors some right reserved this work is licensed under a Creative Commons Attribution-ShareAlike 4.0 International License.