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Factors affecting dividend policy: Evidence from manufacturing company in Indonesia

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Abstract

The goal of the current research was to prove the effect of profitability, liquidity, leverage, company growth and company size to the dividend policy. Object of the research was manufacturing companies listed in Indonesia Stock Exchange, period 2016 – 2018. Sampling method used purposive sampling. Method of data analysis used Structural Equation Modeling (SEM) with Warp PLS 4.0. Based on the analysis, profitability, company growth and company size significantly affected to dividend policy, while liquidity and leverage did not significantly affect to dividend policy. For future research, it should make synthesis research with other factors influencing dividend policy. For go public companies, knowing that dividend policy is one of the most considerations by investors in investing, they should make the best dividend policy to attract investors to invest.

Keywords: Profitability, liquidity, leverage, company growth, company size and dividend policy.

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1. Introduction

Manufacturing industry is raw material treatment to be end product or on work-product. The industry has an important role in supporting the progress of Indonesia economy. In the period of the research, manufacturing industry is undergoing the decline. It is caused by the business war between US and China, the strength of AS dollars curs and the poor performance of export because of slowing global economy growth. Therefore, the investor role is needed to stabilize the Indonesia economy condition. Economy indicator often used by investors to see business condition in manufacturing sector is Purchasing Managers Index Manufacturing (PMI-Manufacture). Eventhough weak, up to Desember 2018, index of PMI manufacture is still in expansive level, namely 51,2 (Kontan.co.id). The government has tried to attract investor interest, whether it is through foreign capital investment or domestic capital investment. Dividend policy is interesting to be analysed, especially in manufacturing companies listed in Indonesia Stock Exchange. Dividend policy is management policy to determine profit proportion for investors and profit proportition to fund company operation. One of factors considered by capital investor before investing their stock is dividend return rate. The main purpose of investors to invest is getting welfare through income in the form of dividend or capital gain. Investors tend liking the stable level of dividend return.

Brigham and Houston [1] stated that dividend sharing proportion does not determine company value. A company value is measured based on the capability in booking the profit. For investors, divident gain is saver than capital gain. The management must be accurate in making decision concerning dividend policy. The investors's interest and company internal funding must be balanced. Dividend policy in manufacturing sector in declining phase can be affected by many factors. One of the factors influencing the divident policy is profitability. Return on asset (ROA) as proxy of profitability is used to measure profitability ration ROA giving description about to what extent profit gained by a company uses its owned activa. The increase of ROA value reflects the capability of the company in booking the profit, that will be retained earning or will be paid to investors in the form of dividend. Hanif & Bustaman [2] and Wicaksono & Nasir [3] found that profitability significantly affects to dividend policy. The different result is stated by Sari & Sudjarni [4], Laim [5], and Swastyastu [6] finding that profitability does not affectto the dividend policy. The other factor influencing the dividend policy is liquidity. Liquidity counted by using Current Ratio (CR) in the current research, describes to what extent a company is capable in meeting its current liabilities using current asset by the company. The dividend shar-

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ing will increase if CR values is high. Nevertheles, if debt level owned by a company is higher, the dividend sharing by the company will decline [7]. However, the measure does not describe the level of liquidity wholly of each current asset component [8]. Sari & Priyadi [7] and Wicaksono & Nasir [3] stated that liquidity does not affect to dividend policy. The other result is found in the research of Sari & Sudjarni [4] and Mawarni & Ratnadi [9] finding that there is a significant effect between liquidity and dividend policy.

The other factor affecting dividend policy is leverage. Leverage is one of important components because it covers funding and company performance. Company performance candecline because of higher leverage. In such situation, a company will be difficult to meet its obligation. In the research, leverage ratio is described by Debt to Equity Ratio (DER). DER is the comparation between the amount of company liabilities to own capital. A company with higher leverage will retain the profit and use to fund the liabilities and share the dividend in small portion. The research of Hanif & Bustaman [2] and also Wicaksono & Nasir [3] found that leverage does not significatly affect to dividend policy. Conversely, Sari & Sudjarni [4] found that leverage significantly affect to dividend policy. The other factor influencing the dividend policy is company growth. Indicator of company growth can be seen from selling level. The selling growth that increase will give opportunity for the company to grow and develop. Most of profit of company operation result will be used to fund the growth. A company with higher growth will tend minimizing the dividend sharing to the investors. Sari & Priyadi [7], Sari & Sudjarni [4], and Wicaksono & Nasir [3] in their research found that company growth significantly affects to dividend policy. On the other hand, Laim [5], Ahmad [10], and Swastyastu [6] found that company growth does not affect to dividend policy. The last factor affecting dividend policy is company size (CS). CS can be counted with total active the company has. The big company has a bigger opportunity to enter capital market if compared with the smaller one [3]. A company getting funding from external resource should share part of the profit gained to the investors. Hanif & Bustaman [2] and Wicaksono & Nasir [3] found that CS does not affect to dividend policy. The different result was found by Devi & Erawati [11] and Ahmad [10] finding that CS affects to dividend policy significantly. Based on the phenomena and research gap, it can be proposed questions whether ROA, CR, DER, Growth and CS have significant effect to dividend policy.

2. Literature Review and Hypothesis Development

Agency theory and signalling theory is grand theory in the current research. ROA is capability of company ratio to gain profit using its owned asset. Meanwhile dividend is part of net profit after tax accepted by shareholders. In other side, management want the profit be retained to reinvest to fund the company operation. Therefore, ROA can be one of factors being able to influence dividend policy of a company. It is in line with the research of [2, 3], and [10] finding that profitability significantly affect to dividend policy. H_1: ROA affects to dividend policy.

CR is company capability in paying current liabilities using liquid asset. Paying dividend is out cashflow and constitutes one of obligations of principal to the shareholders. Based on signalling theory, CR value is a signal of company capability in paying its current liabilities and one of them is paying dividend. The higher percentage of CR does not guarantee the higher dividend paying of principal. Referring to agency theory, between management and shareholders, there is different interest. Management has interest to use liquid asset as funding of company operation and not always act in line with investors's interest. Thus, it can be concluded that CR significantly affect to dividend policy. It is in line with the research of [4] and [9] finding that liquidity has significant effect to dividend policy. H_2: CR affects to dividend policy.

DER is a ratio to measure the capability of company in fulfilling all liabilities using its own capital. The ratio will affect management in making a policy. If viewed from agency side, higher liability ratio will cause a company more focused on paying the liabilities than sharing the dividend. Thus, the investor's interest to gain dividend as return is not fulfilled yet as long as the level of liabilities is still high. If related with signalling theory, DER value of a company can be negative signal for a company. The number indicated by the ratio can decrease the investor's interest to invest his fund. Investors in law usually considers the ratio number to forcast the return for his investment in the future. Thus, it can be concluded that DER affects to dividend policy. It is in line with the research of [4] and [10] finding that DER significantly affects to dividend policy. H_3: DER significantly affects to dividend policy.

A company growing will tend using the profit gained to fund the growth. Agency theory postulates that in determining the dividend policy, it often occurs conflict of interest between management and investors. Investors want profit of company shared as dividend, while management tend retaining it to reinvest or use the profit to fund the growth of the company. The company growth indicates that there is a better prospect to gain higher profit in the future. Based on signalling theory, it gives positive signal for company and can attract investors to invest. It is assumed that growth will affect to dividend policy. It is in line with the research of [7, 4], and [3] finding that growth significantly affects to dividend policy. H_4: Growth significantly affects to dividend policy.

CS can be measured based on number of asset owned by company. Big company will be easier to ob-

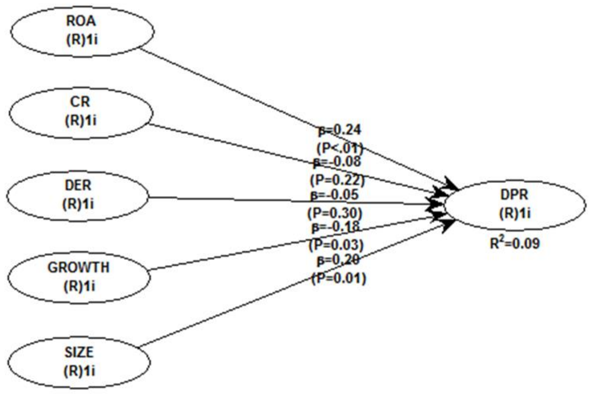

Figure 1: Research result.

tain fund from external because they have better stock market access. It indicates that flexibility and capability of company to get bigger fund is better. If it is related with signalling theory, CS measured by total asset is able to send positive signal for financial report users, especially investors. Thus, the bigger company has an obligation to pay the return to the investors higher than the smaller one. If seen from agency side, investors want dividend return of fund invested in a company listed in stock exchange. In other side, management has interest to reinvest the fund to get higher return. Written contract between investors with the principal is one of the ways to minimize the conflict of agency. Thus, it is concluded that CS has significant effect to dividend policy. It is in line with the work of [11] and [10] finding that there is significant effect between CS and dividend policy. H_5: CS significantly affects to dividend policy

3. Research Method

Population of the research was all manufacturing companies listed in Indonesia Stock Exchange. Purposive sampling is a technique used to choose sample of research. The measurement of ROA is EAT/Total Asset, CR is Current asset/current liabilities, DER is Total liabilities/Equity, Growth is Selling, CS is natural log of total assets, DP is DPS/EPS. Partial Least Squares-Structural Equation Modeling (SEM) was used to run path analysis with latent variable. PLS can be used for analysing secondary data [12 – 15]. Statistic analysis was chosen because of having many benefits [16].

4. Result and Discussion

Manufacturing companies listed in Indonesia Stock Exchange in the period of 2016-2018 was the object of the research. The number of population was 155 companies. Based on the criteria, 35 companies were the samples. Thus, the sample data in the research were 105 data, namely: 35 companies for 3 years. The average block VIF (AVIF) value of 1,261 showed that the AVIF value was ideal and it is accepted. The average full collinearity VIF (AFVIF) value of 1,210 also revealed the ideal one and accepted AFVIF value. Moreover, the GoFtenenhaus value (GoF) of 0,308 which indicated that the value was middle.

4.1 The effect of ROA on DP

Based on data analysis, it is known that ROA significantly affects to dividend policy. The higher the dividend value is shared, the higher the company can book the profit. It is in line with the signalling theory stating that a company shares the dividend as signal of company's success in booking the profit. Different with the agency theory, such condition often causes agency conflict. Management (agent) has different interest with shareholders (principal). Nevertheles, by sharing the dividend, it can increase the welfare of shareholders so that the trust toward the company will increase. Though often occuring conflict becuase of profit booked, based on the research, agent really pays attention to the principal's interest to share dividend as part of return. It proves that the level of ROA will affect to management in determining dividend policy. The research finding is in line with [2, 3], and [10] stating that profitability measured by ROA significantly affect to dividend policy. However, it is not in line with the research findings of [4, 5], and [6] finding that profitability does not affect to dividend policy.

4.2 The effect of CR to dividend policy

Based on partial test result, CR does not affect to dividend policy. Based on signalling theory, CR value can be a signal of capability of a company in fulfilling the short term liabilities using his own current assets, included sharing dividend. However, liquidity of each component of current assets is not always measured with CR. There are still many other rations, such as liquidity ratio (quick ratio, cash ratio, and cash turnover ratio). If CR does not affect to dividend policy, it can be the other ratio of liquidity affecting the dividend policy.Viewed from agency side, agent will tend using liquid asset owned to fund company operation. Moreover, period of the research is in the phase of declining. The US curs strengthening causes company need more fund to run the business. Of the elaboration, it can be concluded that in determining the proportion of dividend sharing, management does not consider CR value. CR is prioritized to know the internal fund sufficiency to fund the company operation and fulfill its current liabilities. The finding supports the research result of [7] and [3] stating that liquidity measured with CR does not affect to dividend policy. However it is in line with the finding of research of [4] and [9] finding that liquidity has significant effect to dividend policy.

Table 1. Hypothesis testing results.

Path	Direct Effect		Remark
	Coefficient	p-value	
ROA → DPR	0,243	0,005	H_1 is accepted
CR → DPR	-0,075	0,217	$H_2$is rejected
DER → DPR	-0,051	0,300	H_3 is rejected
Growth → DPR	-0,182	0,027	H_4 is accepted
Size → DPR	0,205	0,014	H_5 is accepted
Indikator Model Fit			
Average Path Coefficient (APC)	0,151	0,028	
Average R-square (ARS)	0,095	0,080	
Average Adjusted R Squared (AARS)	0,049	0,153	

4.3 The effect of DER to dividend policy

Based on partial test result, DER is a a liability ratio owned by company. The ratio describes the capability of the company to fulfill all liabilities using its own capital. If seen from agency theory, a company with high level of liability will tend paying its liabilities than paying the dividend. However the finding of the research indicated that DER does not affect to dividend policy. Liability is one of funding resources. A company having many funding resources will tend developing his business. Thus, liability level is not always as negative signal for company. The level of resources of funding does not affect to management in making financial policy, and one of them is dividend policy. The finding is in line with the result of research of Hanif & Bustaman (2017) and Wicaksono & Nasir (2014) stating that leverage does not affect to dividend policy. However, the finding of the research does not support the research finding of Sari & Sudjarni (2015) and Ahmad (2014) stating that DER significantly affect to dividend policy.

4.4 The effect of Growth to dividend policy

Based on partial test result, DER is a a liability ratio owned by company. The ratio describes the capability of the company to fulfill all liabilities using its own capital. If seen from agency theory, a company with high level of liability will tend paying its liabilities than paying the dividend. However the finding of the research indicated that DER does not affect to dividend policy. Liability is one of funding resources. A company having many funding resources will tend developing his business. Thus, liability level is not always as negative signal for company. The level of resources of funding does not affect to management in making financial policy, and one of them is dividend policy. The finding is in line with the result of research of [2] and [3] stating that leverage does not affect to dividend policy. However, the finding of the research does not support the research finding of [4] and [10] stating that DER significantly affect to dividend policy.

4.5 The effect of CS to dividend policy

Based on partial test result, CS in the research is measured based on total asset ratio. Total asset ratio had by a company is a signal offunding used to operationalize company. Big companies tend easier to enter capital market and get external fund. External fund is derived from share publishing oblige to company to pay shareholders dividend. Seen from agency side,of capital invested, principals want to get returns. Capital managed well will increase business operation so that CS will also increase. The increase of CS indicates the capability of company in paying dividend. Therefore, the change of CS will influence agent in making dividend policy. The research is in line with the result of research of [11] and [10] finding that CS significantly affect to dividend policy. However, it is not in line with finding of research of [2], and [3] stating that CS does no affect to dividend policy.

5. Conclusion

The conclution of the research is that profitability, company growth and CS significantly affect to dividend policy, while liquidity and leverage do not affect to dividend policy. The limitation of the research is that the value of adjusted R square is just 4,9%, 95,1% dividend policy variable is affected by other variables out of model. Therefore, for future researchers, they should make synthesis research by taking into account other factors that influence dividend policy. Thus, the variables used are more varied and obtain better research models. While for go public companies, knowing thats dividend policy is one of the important things considered by investors in investing, they should make the best dividend policy to attract investors to invest.

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