“Analysis of cash dividend policy in Indonesia stock exchange”

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ANALYSIS OF CASH DIVIDEND POLICY IN INDONESIA STOCK EXCHANGE

Abstract

Dividend policy has been puzzling for researchers for decades. The level of dividend varies not only across industries, but also across countries. This research analyzes the dividend policy of Indonesian public companies, in particular it examines the partial effect of cash ratio, debt ratio, company size, profitability, and asset growth on cash dividend policy in Indonesia Stock Exchange from 2008 to 2015. A total of 102 companies was used as a sample. The samples are divided into four groups: (1) a group of companies paying changeable dividends (Change group), (2) a group of companies paying continuous dividends, but then stop paying dividend (Omission group), (3) a group of companies that initially do not pay the dividends, but then continuously paying dividend (Initiation group); and (4) a group of companies paying constant dividends (Constant group). Results of hypotheses testing using multiple regression analysis show that profitability and asset growth affect dividend policy in all company groups. Company size affects dividend policy in the Change, Initiation, and Constant groups. Debt ratio influences dividend policy only in the Change group.

Keywords dividend policy, asset growth, debt ratio, cash ratio

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INTRODUCTION

Dividend announcement made by the company management is a signal of company development (Miller & Rock, 1985). An increased dividend payment compared to the previous year's payment is a signal that the company has a good prospect in the future. Conversely, dividend deduction is a bad signal, because it indicates a company's lack of liquidity to maintain the level of dividend payment in the future. The announcement of increased dividend needs to be deeply analyzed. However, less experienced market participants will simply receive information without any further analysis. A sophisticated investor needs to analyze information about the increased dividends as a basis for the market participants to evaluate a company's prospect in the future. The announcement of increased dividend by the prospective companies gives an economic signal to the market. But, if it is announced by the non-prospective companies, then the information has no economic value. It happens because dividend payment requires a high cost. This cost arises, because the firms paying high dividends should be consistent for the next period payment. The fact is that only prospective companies can bear it. Sophisticated investors will react positively on the good news of increased dividend as announced by the prospective companies, and they will react negatively on the announcement of increased dividend as announced by non-prospective companies.

The increase in amount of dividend, shown by higher Dividend Payout Ratio (DPR), will attract investors to invest in the company's stocks resulting in stock price increased. However, the irrelevant theory proposed by Miller and Modigliani (1961) states that the company value is not determined by the size of the paid dividends. Decisions on dividend change can be influenced by several factors, such as changes in profits, cash availability, and investment opportunities.

Other factors that may affect dividend policy are company size and financial risk. Company size can be a proxy of the company's life cycle. Big companies are usually in the maturity stage of the life cycle, since they have existed in the business for such a long period. Financial leverage shows the proportion of loan usage or debt as a source of financing. The higher the debt, the higher is the interest expense that could decrease the net profit, which finally affects dividend policy.

Companies with low level of liquidity tend to withhold their profit to pay off short-term liabilities. Companies with high debt ratio use their profits to pay off its due debts so that they tend to retain the profits and decide not to pay high dividends. Managerial ownership might also affect dividend payout policy. Companies with high growth tend to retain their profits to fund their investments (Manneh & Naser, 2015). The thing is that the higher the growth of the company, the greater is the fund needed to support the company's growth, but consequently, the paid dividend will be lower. This means that a company's growth has a negative relation with dividend policy. Compared to small size companies, big companies have easier access to capital markets. Big companies do not depend on its internal funding (retained earnings) to finance their investment projects. Therefore, the dividends will be paid in a high ratio. Meanwhile, small size companies tend to pay a small number of dividends, because most of their profits are used to finance corporate investments, and vice versa (Abor & Bokpin, 2010; Jabbouri, 2016).

Several studies have examined the effect of cash ratio, debt ratio, asset growth, managerial ownership, and company size on dividend policy. Nevertheless, the results of the study are not always consistent. Al-Ajmi and Hussain (2011) and Labhane and Mahakud (2016) show that cash ratio has a positive effect on dividend policy, but Jabbouri (2016) and Khan and Shamim (2017) find a negative effect. Afza and Mirza (2011), Jabbouri (2016), Labhane and Mahakud (2016), and Manneh and Naser (2015) show that debt ratio has a negative relationship with the dividend policy, but Hudiwijono et al. (2018) using Indonesian construction companies report a positive effect. Abor and Bokpin (2010), Jabbouri (2016), Kumar et al. (2012), and Patra et al. (2012) show that asset growth negatively affects dividend policy. Interestingly, Yusof and Ismail (2016) document the negative effect of Malaysian companies. Company size has a negative relationship with dividend policy (Afza & Mirza, 2010). However, some studies report a positive effect (Abor & Bokpin, 2010; Labhane & Mahakud, 2016; Yusof & Ismail, 2016; Singla & Samanta, 2019).

This study tries to re-examine the effect of several variables on the public company's dividend policy for the 2011–2015 data. During that period, there were 117 companies that consistently paid cash dividends. From the data, 99 companies changed their DPR every year. The existing data indicate that some companies increased their DPR, while others decreased, initiated, and even stopped the dividend payment.

The remainder of the paper is organized as follows. Section 1 presents the theoretical review and the development of hypotheses. Section 2 explains the research methods. Section 3 provides findings and discussion. The final section concludes the paper and suggests future research avenue.

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1. THEORETICAL REVIEW AND HYPOTHESES DEVELOPMENT

1.1. Review of related literature

The dividend decision is one type of decision that directly affects shareholder wealth. The amount of dividend is determined by the company's need for investment funds by considering the expected return. The dividend decision consists of two essential things, i.e., the amount the paid dividend and the payment time. Also, the importance of the dividend decision is based on two things. First, a dividend is an investor's income. Second, a dividend can decrease the asset growth, because the amount of reinvested money to the company will reduce.

Empirical evidence shows that dividend policy is unique, because the amount of the DPR varies across companies, industries, and countries (Baker, 2009). Related to this uniqueness, Black (1976) stated that dividend policy is one of the unsolved puzzles in the finance literature. Also, empirical evidence shows that the amount of DPR can be constant from year to year (constant dividend policy) or not constant, and there are some companies initiate their dividend payment (dividend initiation) or even eliminating the dividend payment (dividend omission). These conditions raise the following question: do investors interpret dividend differently?

The company's decision to pay a dividend is part of its funding strategy, because dividend payment needs large liquid funds, but on the other hand, the fund is also needed for investment growth. Dividend policy theories have different implications for stock price behavior in the market. For example, according to the bird in the hand theory, the increase of dividend will be followed by the increase of stock price (Gordon, 1959). In contrast, the tax preference theory states that if a company increases its dividend, the stock price tends to decrease (Litzenberger & Ramaswamy, 1979). The irrelevance dividend proposition states that company value (stock price) is not influenced by the amount of dividend (Miller & Modigliani, 1961). The information about dividend payment will affect stock price behavior in the stock market as the result of investors' actions who take this moment to gain profit. There are several factors that influence management in making dividend policy, i.e., current ratio, debt ratio, profitability, and asset growth.

In practice, dividend payments within a certain period can be classified into four groups, i.e., change dividend, constant dividend, dividend initiation, and dividend omission. Several studies have found that the stock price declines when the dividend payment is stopped or dividend omission (Aharony & Swany, 1980; Asquith & Masulis, 1983) and when the dividend payment is made although previously it was not paid or dividend initiation. Under the company's life cycle theory, the ratio of the dividend payment will be low and not even be paid when the company is in a high growth stage and is gradually increasing to the maturity stage (Gumanti, 2013, p. 23).

1.2. Hypotheses development

This study tests five hypotheses. The proposed hypotheses are developed based on the theory and empirical evidence. They are tested using the multiple regression model and formed in the directional type of hypotheses.

a) The effect of cash ratio on the cash dividend decision

Companies with low level of liquidity tend to pay dividends in small ratio, because their cash is saved to meet the urgent needs of funds, such as to pay company debt when it is due. Bar-Yosef and Venezia (1991) develop a rational equilibrium expectation model of dividend policy. Their model shows that the cash flow is proportional to the optimal dividend. Empirical studies support this prediction. Al-Ajmi and Hussain (2011) and Labhane and Mahakud (2016) find that cash ratio had a positive and significant effect on DPR. This means that higher cash ratio leads to a higher dividend payment. Therefore, this study proposes the following hypothesis:

H_1: *Cash ratio affects cash dividend decision positively.*

b) The effect of debt ratio on the cash dividend decision

The debt ratio is inversely proportional to the DPR. The higher the company's debt ratio, the greater is the profit that must be used to pay off the debt while reducing the amount of paid dividends (Gumanti, 2013). Ravid and Sarig (1991) show a strong relationship between debt level and dividend policy indicating that the level of debt determine the level of dividend level of a company. Manneh and Naser (2015), Jabbouri (2016), Labhane and Mahakud (2016), Yusof and Ismail (2016), and Patra et al. (2017) report that the debt ratio had a negative and significant effect on the DPR. An increase in the debt ratio will lower the DPR, and the decline in the debt ratio will lower the DPR. Accordingly, this study proposes the following hypothesis:

H_2: *Debt ratio affects cash dividend decision negatively.*

c) The effect of profit on cash dividend decision

Lintner (1956) shows that future profitability directly related to managers' decision on dividend level. Thus, when a manager perceives that the company is having good profit prospect, he will increase the dividend payment, and vice versa. High-profit companies tend to retain their profits for future investment, especially when they are planning to expand the business. Meanwhile, the companies that are at the top of their maturity stage have no other investment alternatives but to pay the dividend from their profit. Companies that have stable profits tend to pay dividends with a fixed percentage to maintain their image. Empirical evidence tends to suggest that firm with high profits pay more dividend than a firm with low profits (Abor & Bokpin, 2010; Jabbouri, 2016; Labhane & Mahakud, 2016; Yusof & Ismail, 2016; Singla & Samanta, 2019). That is, an increase in profit will lead to an increase. Therefore, the proposed hypothesis is as follows:

H_3: *Profit affects the cash dividend decision positively.*

d) The effect of asset growth on cash dividend decision

The issue on the relationship between dividend policy and assets growth was first put forward by Miller and Modigliani (1961). They show theoretically that the level of dividend is determined by the level of growth of assets. In the respect, companies tend to retain their profits at its high growth rate. The faster the company grows, the greater the funds needed for the business expansion. Abor and Bokpin (2010), Jabbouri (2016), Labhane and Mahakud (2016), and Patra et al. (2012) report a negative relationship between asset growth and dividend policy. It means that the higher the asset growth, the smaller is the amount of paid dividend. Thus, this study proposes the following hypothesis:

H_4: *Asset growth affects cash dividend decision negatively.*

e) The effect of company size on cash dividend decision

Big companies have a better chance of paying large amounts of the dividend. Small companies have a smaller portion of dividend distribution from their profits (Gumanti, 2013). According to the maturity theory, as the size of the firm increases, their profitability tends to increase (DeAngelo et al., 2006). This will make the investment opportunities to decline, which in turn provide the company with a relatively higher free cash flows. Thus, the size of the company will affect the level of dividend decision. Company size has been found to have a positive and significant effect on the DPR (Abor & Bokpin, 2010; Al-Ajmi & Hussain, 2011; Jabbouri, 2016; Labhane & Mahakud, 2016; Yusof & Ismail, 2016; Kumar & Sujit, 2018; Singla & Samanta, 2019). The larger the company size, the greater is the DPR and the smaller the company size, the smaller is the DPR. Thus, the proposed hypothesis is as follows:

H_5: *Company size affects cash dividend decision positively.*

2. RESEARCH METHODS

The samples consist of the companies implementing a cash dividend policy in 2008–2015. They are divided into four groups. The first group consists

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of companies that change their DPR rate, named Change group. The second group consists of companies that initially paid the dividend, but then decide not to pay the dividend, named as dividend Omission group. The third group consists of companies initially did not pay the dividend, but then decided to pay the dividend, named Initiation group. The last group consists of companies that paid a constant dividend, named a Constant group. The total samples consist of 102 companies from nine industry sectors, as described in Table 1.

Table 1. Samples distribution based on industry sectors

No.	Industry sector	Number of companies
1	Agriculture	5
2	Mining	5
3	Trading and services	20
4	Property and real estate	21
5	Basic and chemical industry	11
6	Miscellaneous industry	6
7	Consumer goods	13
8	Finance	16
9	Infrastructure, utilities, and transportation	5
Total		102

From nine industry sectors, the property and real estate sector pays the most dividends followed by trading and services sector, while the least dividend payment is found in the agriculture, mining, infrastructure, utilities, and transportation sectors. The distribution of the dividend payout frequency during the research period is presented in Table 2.

Table 2. Distribution frequency of the dividend payment from 2008 to 2015

Year	Cash dividend				All sample
	Change	Omission	Initiation	Constant	
2008	48	20	–	14	82
2009	48	20	–	14	82
2010	48	20	–	14	82
2011	48	20	–	14	82
2012	48	–	47	12	107
2013	48	–	47	12	107
2014	48	–	47	12	107
2015	48	–	47	12	107
Total	384	80	188	104	756

Table 2 shows the distribution frequency of dividend payment with several classifications: group one (Change dividend) is the companies that paid changeable dividends in 8 years continuously from 2008 to 2015, that consist of 48 companies with 384 observation data; group two (Omission dividend) is the companies that paid dividend for 4 continuous years from 2008 to 2011 but then did not pay the dividend in the next 4 years from 2012 to 2015, that consist of 20 companies with 80 observation data: group three (Initiation dividend) is the companies that did not pay dividends during 2008–2011, but then paid the dividend continuously in 2012–2015, that consist of 47 companies with 188 observation data, and group 4 (Constant dividend) is the companies that paid constant dividends in 2008–2011 that consist of 14 companies, and in 2012–2015 that consist of 12 companies with 104 observation data. Overall, the observation data were 756. The identification and measurement of variables are presented in Table 3.

Table 3. Identification and measurement of variables

Variable	Symbol	Measurement
Dividend payout ratio	DPR	Dividend per share over profit per share
Current ratio	CR	Current assets over current liabilities
Debt ratio	DR	Total debt over total assets
Company size	Size	Natural logarithm of total assets
Return on asset	ROA	Profit after tax over total assets
Asset growth	Growth	The difference between current and previous year assets deflated by previous year assets

3. RESULTS AND DISCUSSION

3.1. Descriptive statistics

Table 4 presents the descriptive statistics of research variables based on four groups of the company's dividend policy behaviors, i.e., Change, Omission, Initiation, and Constant dividend policy.

Panel A presents data on all samples ($n = 756$). As seen in Panel A, the average of the company's DPR is %38.30. The highest range is %100 and is found at Change group (Panel B), Initiation group (Panel D), and Constant group (Panel E). The average of the smallest DPR is found in the Omission group, i.e., 33.0% (Panel C). The current ratio of the overall sample moves from the lowest 1.0% (Panel B) to the highest 996.0% (Panel C). The average current ratio of the overall sample

Table 4. Descriptive statistic of research variables

Variable	Minimum	Maximum	Mean	Standard deviation
Panel A. All samples, *n* = 756				
Dividend payout ratio	0.030	1.000	0.383	0.125
Current ratio	0.010	9.960	0.839	1.158
Debt ratio	0.080	1.360	0.508	0.223
Ln. size	24.850	34.450	29.210	1.878
Return on assets	0.004	8.830	0.1046	0.340
Growth of assets	–0.510	2.650	0.165	0.232
Panel B. Change dividend, *n* = 384				
Dividend payout ratio	0.034	1.000	0.414	0.222
Current ratio	0.010	6.410	0.911	0.118
Debt ratio	0.090	0.930	0.471	0.215
Ln. size	24.850	34.410	28.820	1.742
Return on assets	0.450	8.830	0.129	0.454
Growth of assets	–0.510	1.220	0.167	0.197
Panel C. Omission dividend, *n* = 80				
Dividend payout ratio	0.030	0.780	0.330	0.180
Current ratio	0.020	9.960	0.862	1.588
Debt ratio	0.080	1.360	0.575	0.267
Ln. size	25.550	33.940	29.190	2.357
Return on assets	0.004	0.260	0.630	0.051
Growth of assets	–0.190	2.650	0.196	0.436
Panel D. Initiation dividend, *n* = 188				
Dividend payout ratio	0.040	1.000	0.353	0.204
Current ratio	0.020	6.280	0.888	1.136
Debt ratio	0.120	0.920	0.517	0.206
Ln. size	26.240	34.020	29.560	1.596
Return on assets	0.005	0.310	0.076	0.063
Growth of assets	–0.200	0.800	0.154	0.144
Panel D. Constant dividend, *n* = 104				
Dividend payout ratio	0.100	1.000	0.391	0.222
Current ratio	0.030	4.650	0.496	0.712
Debt ratio	0.130	0.920	0.630	0.227
Ln. size	27.270	34.450	30.543	1.848
Return on assets	0.010	0.420	0.099	0.108
Growth of assets	–0.150	0.650	0.154	0.133

is 83.9%. Minimal debt ratio varies from the lowest 8.0% (Panel B) to the highest 136.0% (Panel C). The overall profitability is 10.46%, with the highest range is 883% (Panel B), and the lowest is 6.0% (Panel B). The average asset growth is 16.50%, with the highest range is 265% (Panel C) in the Omission group, and the lowest is –51% (D).

The results of regression for the factors affecting cash dividend policy are presented in Table 5.

In all samples and the Change dividend group, the cash dividend payment policy is affected by a company's ability to earn profits on investment, company growth, and company size. The current ratio and debt ratio do not affect the cash dividend payment policy. In the sample of Omission group, the cash dividend payment policy is influenced by the current ratio, company growth, and company size. The debt ratio does not affect the cash dividend payment policy. In the Initiation group, the cash dividend payment policy is affected by a company's ability to earn profits on investments, company growth, and company size. Whereas in the Constant group, the cash dividend payment policy is determined by the current ratio, the ability to earn profits, and the size of the company.

Current ratio positively affects dividend payout decision in the Omission group and negatively affects dividend payout decision in the

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Table 5. Pooling data regression of cash dividend policy

Variable	Prediction	All sample	Dividend			
			Change	Omission	Initiation	Constant
Intercept		–0.037	–0.039	–2.047	–0.685	–0.942
		(–0.311)	(–0.197)	(–2.691**)	(–2.463**)	(–4.684***)
Current ratio	+	0.008	0.002	0.209	0.027	–0.126
		(0.897)	(0.159)	(4.232***)	(1.598)	(–1.889*)
Debt ratio	–	0.017	0.033	0.327	–0.046	0.106
		(0.388)	(0.494)	(1.414)	(–0.507)	(1.101)
Return on assets	+/–	1.247	1.175	0.621	0.761	2.061
		(13.025***)	(8.745***)	(0.962)	(2.624**)	(16.439***)
Growth	–	–0.0149	–0.175	–0.110	–0.389	0.142
		(–4.321***)	(–2.870***)	(–2.919***)	(–3.889***)	(0.982)
Ln. size	–	0.011	0.012	0.068	0.035	0.034
		(2.635***)	(1.733*)	(2.586**)	(3.887***)	(4.937***)
F-statistics		38.911***	16656***	11.485***	7.400***	56.535***
Adj. *R*-square		0.232	0.197	0.656	0.170	0.87.6
No. of observations		756	384	80	188	104

Note: t-stats are in parentheses, ***, **, and * indicate significance at 1%, 5%, and 10% level, respectively.

Constant group. It means that the companies that stop paying dividends, with high current ratios, are increasingly paying dividends, while for the companies paying constant dividends, the higher the current ratio, the lower is the dividend payment. These results support Jabbouri (2016) and Kumar and Sujit (2016). Meanwhile, the debt ratio does not affect cash dividend payment in all groups and all samples. The results of descriptive statistics show that the average debt ratio is almost the same in the range of 50% to 60%, while a low standard deviation indicates that there is no significant difference in the debt ratio. Profit ratio of total assets has a positive effect on the dividend policy in the Change, Initiation, and Constant groups, as well as on all samples, while in the Omission group, the profit ratio does not affect the dividend polity. It means that the higher the ROA, the higher the dividend payment.

The company's growth ratio negatively affects the dividend payment policy in the Change, Initiation, Omission, and all sample groups. While in the Constant group, the company's growth ratio does not affect dividend payment policy, in which the higher the growth of company assets, the lower is the amount of dividend payment. Firm size has a positive coefficient in all sample groups, i.e., the Change, Omission, Initiation, and Constant groups. These results are different from the predictions that company size, as measured by market capitalization, negatively affects dividend policy. However, these findings are in line with Manneh and Naser (2015) that firm size has a positive and significant effect on the dividend payment ratio.

Overall, there are inconsistencies on research findings in each sample group. The current ratio is found to have a positive and significant effect on the dividend payment in the Omission and Constant groups. Of all samples, the current ratio has a positive, but not significant coefficient. However, the opposite results are found in the Change and Initiation groups. These findings support the studies of Jabbouri (2016) and Kumar and Sujit (2016).

The Change group makes dividend payout policy with several considerations related to debt ratio, company size, asset profitability, and asset growth. This is supported by the notion that, on average, the companies in the Change group have smaller company size compare to the whole group average, and these companies have lower average debt, but have a higher DPR ratio than the other three groups. Dividend payout considerations are changeable due to high-profit standard deviation as the basis for the DPR change.

In the Omission group, dividend payout policy is not only affected by asset profitability and as-

set growth, but also by considering the cash ratio, where the higher the cash ratio, the higher the amount of paid dividend. The companies in the Omission group have a very high profit earning ability and higher average growth than the other three groups. The earned profit is not distributed to the shareholders in the form of dividends, but it is used as the retained profits to increase company assets. This condition indicates that the company experiences high growth, so the profit will be used for business expansion. The policy to not paying the dividend is considered as a signal of the availability of a profitable opportunity for the company.

The companies in the Initiation group make a dividend payout policy by considering asset profitability, asset growth, and company size. This is supported by the notion that the companies in the Initiation group have a higher profit than its asset growth that they finally decide to start paying the dividends.

In the Constant group, there are several factors to be considered in making dividend policy, i.e., asset profitability, asset growth, company size, and stable cash ratio. Constant and continuous dividend payments indicate that the company is in a mature position. On average, the companies in this group consist of big size companies with high earning ability, but having low asset growth and low profit. This condition indicates that these companies are trying to maintain a constant dividend payout pattern because they want to send a good signal and create a good company image to the shareholders.

CONCLUSION

This research examines the fundamental factors underlying the dividend policy made by the companies listed on the Indonesia Stock Exchange. Previous studies found that liquidity, profitability, capital structure, company growth, and company size are the factors affecting the decision of cash dividend payment. The empirical evidence is generally consistent with this notion. The results show that the ability to earn profit based on company asset and growth is considered as the factor influencing dividend payment in all company groups, i.e., Change, Omission, Initiation, and Constant groups. In the Change and Constant groups, the dividend payment is also made based on company size in which the larger the company size, the greater the DPR. In the Change group, the debt ratio is a factor affecting dividend policy in which the higher the debt, the lower the amount of dividend paid to the shareholders, because the company sets change dividend policy by considering the interest payment of the company's debt so that dividend payment is low. In the Omission and Constant groups, current ratio affects dividend policy. Current asset condition is the main consideration when a company decides whether to pay or not to pay the dividend.

LIMITATIONS AND SUGGESTIONS

The study notes two limitations. First, the findings reported here do not cover the behavior of dividend policy based on the individual industrial sector. So that it does not show how sensitive the dividend decision when confronted with the characteristics of the sector. Accordingly, the future study may look at more specific industry sector to gain more knowledge on the factors that determine the dividend policy. Second, the study ignores the size effect of DPR for each of the group. We may argue that for the dividend initiation group, the level of DPR may be driven by the management effort to signal good performance. Thus, we suggest that future study may pay more focus on the possible examination on the effect agency problem on the different level of DPR.

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