International Journal of Application on Economics and Business (IJAEB)
Volume 1, Issue 4, 2023. ISSN: 2987-1972

HOW FINANCIAL INFORMATION AFFECTS DIVIDEND POLICY TO ENCOURAGE THE INDONESIAN ECONOMIC SECTOR IN POST COVID-19 PANDEMIC

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Submitted: 10-05-2023, Revised: 14-07-2023, Accepted: 01-09-2023

ABSTRACT

The purpose of this study is to obtain empirical evidence about the factors that influence dividend policy to encourage the post-Covid-19 pandemic Indonesian economic sector. The independent variables in this study are financial information which consists of company size, leverage, risk, free cash flow, diversification loss, earning volatility, and managerial ownership. This research is a quantitative explanatory approach using correlational design through Partial Least Square (PLS). Thirty out of forty-five liquid companies (LQ-45) listed in Indonesia Stock Exchange (IDX) were gathered especially before and during the pandemic-from 2013 until 2020 with the following criteria: The firms that are listed on the Stock Exchange of Indonesia during the years 2013 until 2020 and financial statement data are available for the period of the study. These results show that risk and leverage have a negative impact on dividend policy, but other factors which are free cash flow, size of the company, loss from diversification, volatility of earnings, and managerial ownership had no impact on it.

Keywords: *financial information, dividend policy, leverage, risk, diversification loss*

1. INTRODUCTION

The economic development of a country can be influenced by companies. In Indonesia, the government is currently actively promoting progress in the productive economic sector. Therefore, the government together with the Indonesia Stock Exchange and various capital market institutions encourage the Indonesian as well as foreign investors to be active in activities and investment in the Indonesian capital market.

The company was established to manage resources efficiently and productively, thus can provide benefits to stakeholders. Shareholders are owners of limited liability. They buy shares because they want to get a financial return. For general corporate management, shareholders will elect directors, then appoint managers to administer the company. Managers work on behalf of shareholders. Thus, they should comply with policies that increase shareholder value (Brigham and Houston, 2019). Efforts made by companies to attract investors to invest their capital by offering high returns. The forms of return include profit, cash flow, dividends, interest payments, and capital gain (the difference between the selling price and the purchase price). The dividend is one of the returns obtained from a stock investment (Gitman and Zutter, 2015).

Dividend policy becomes interesting to study to determine the factors that affect dividend policy. Therefore, this study is related to the effect of financial information on dividend policy. (Study on LQ-45 companies listed on the Indonesia Stock Exchange). Dividend decisions can affect firm value and shareholder wealth thus dividend policy deserves management attention (Baker et al., 1993).

According to researchers, financial information plays an important role in dividend policy (Baker et al., 1993), (Shleifer and Vishny, 1991), (Young and Byrne, 2001), (Aasia et al., 2011), (Alli et al., 2003). The findings of (Young and Byrne, 2001) which examined all companies listed on the Stock Exchange of Indonesia in 2005-2006 as 124 companies based on research criteria found that for financial restructuring, managers reduced to cash, issued new debts to pay dividends, could increase asset productivity. On the other hand, leverage also increased risk, profits, dividend payments are positively affected.

A number of variables, such as cash flow, leverage (debt to equity ratio), profitability (return on capital), liquidity (cash ratio), and company size, can influence dividend policy. The factors influencing dividend payout policies have been thoroughly examined by academic study over the years. Despite a large number of studies on this subject, published evidence remains inconclusive (Sponholtz, 2005).

In order to accomplish the goals of this research, more explanation of the responses to the following questions is required. Also, enlighten stakeholders and serve as a foundational literacy resource for additional study; does a company's size, leverage, company risk, free cash flow, diversification loss, earning volatility, and managerial ownership have a major impact on the dividend policy of LQ-45 companies?

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Signalling Theory

Based on signalling theory, company management will voluntarily provide information in the form of financial statements and annual reports to reduce information asymmetry and help shareholders to make better business decisions (Yoon and Starks, 1995).

Dividends as a Reducing Agency Conflict

According to agency theory, a variety of control techniques can be implemented to overcome agency problems, first, by increasing insider ownership concluded by (Crutchley and Hansen, 1989), (Jensen et al., 1992), (Jensen and Meckling, 1976), (Mao, 2003), (Chen et al., 2005) revealed that reducing agency problems can be done by limiting the activities of agents through the provision of appropriate incentives, such as increasing the company's share ownership by management. The interests of shareholders and management will be aligned by this ownership. (Jensen and Meckling, 1976). Secondly, increased financing with debt can be used to reduce or control agency conflicts. They argue that with debt, the firm is obligated to pay back the loan plus interest on a regular basis. Because of this circumstance, management put forth a lot of effort to boost profits in order to pay off the debt. Third, improve monitoring through institutional ownership. Researchers (Shleifer and Vishny, 1986), (Zutter and Smart, 2019) pointed out that institutional ownership is crucial for keeping an eye on manager behavior, particularly for raising takeover value and encouraging management to be more circumspect when taking advantage of opportunities. Fourth, a higher dividend payout ratio will mean less free cash flow and a need for management to look outside of the company for investment funds. (Crutchley and Hansen, 1989).

Dividend Payout Ratio (DPR)

Dividend Payout Ratio is the amount of dividends that must be paid to shareholders determined by a metric and comparing the percentage difference between dividend per share and earnings per share (Zutter and Smart, 2019). So, the perspective that is seen is the growth of cash dividends per share to the profits earned per share.

The Effect of Size on Dividend Policy

The measurement of the size of a company is carried out by transforming the overall asset's natural logarithm (Klaaper and Love, 2002). The larger total asset (size) will increase the company's efficiency and provide prospects for future company growth. Large companies will face higher liquidity-based diversification costs for managers and lower flotation costs (Crutchley and Hansen, 1989). Low flotation costs supported by high dividend payouts suggest that managers from larger companies have a greater incentive to behave opportunistically, compared to small companies (Zahra and Pearce, 1989), (Moses, 1997).
H_1: Size effects the Dividend Policy.

The Effect of Leverage on Dividend Policy

The quantity of assets financed by debt is expressed as leverage. Creditors, not investors or shareholders, are the source of the debt used to fund assets.
H_2: Leverage effects the Dividend Policy.

The Effect of Risk on Dividend Policy

The standard deviation and variance were used to measure the divergence of the value from the expected return value in order to calculate the level of risk. The sensitivity of individual equities to market risk is measured by beta. A stock's contribution to a portfolio's risk is determined by how market fluctuations impact it. (Brealey and Myers, 2000). Beta is calculated by using the formula covariance divided by market variance (Hartono, 2009). Using beta as a measure of market risk, it came to the conclusion that dividend policy and market risk were negatively correlated. This demonstrates how market risk also affects dividend policy. (Rozeff, 1982), (Adel et al., 2008), (Collins, et al., 1996). The increase in beta reflects the increasing market risk. The higher level of risk, it will be more challenging for the business to secure outside funding. As a result, the company's distribution dividends are decreasing since it must use internal sources to support its investment needs. (Kusnadi, 2003).
H_3: Risk effects the Dividend Policy

The Effect of Free Cash Flow on Dividend Policy

Free Cash Flow reflects the cash available or held by managers to meet the company's needs after deducting for financing expenditures and discretionary funds. Free cash flow is a measure of the company's degree of financial flexibility. It is the amount of company cash available for distribution to creditors or shareholders, excluding cash used for fixed asset investments or working capital. It provides investors with evidence that the dividends the company pays out are not merely a way to skirt the market and boost the company's value. (Barclay et al., 1995).
H_4: Free Cash Flow effects the Dividend Policy.

The Effect of Diversification Loss on Dividend Policy

The Diversification Strategy uses the Diversification Loss proxy to describe the diversification losses of managers resulting from increasing their shareholding in the company. The diversification strategy is carried out by managers as a way to expand their business and expand the market (Crutchley and Hansen, 1989). A strong empirical basis has not been found to explain especially to the dividend pay-out ratio. In addition, the diversification loss effect is more on the risk (standard deviation) of the company's return which tends to affect the level of leverage.
H_5: Diversification loss effects the Dividend Policy.

The Effect of Earning Volatility on Dividend Policy

Earning volatility is the degree of quick fluctuations in the business's profits. It is challenging to forecast profit, and it becomes considerably more challenging when volatility is strong. (La Porta et al., 2000). Due to their unstable nature, organizations may find it challenging to obtain external data due to profit volatility. The study's findings demonstrate that high-risk businesses should employ less debt to reduce their probability of bankruptcy (Siregar and Utama, 2008). Earning volatility research in Indonesia has not found a strong empirical basis to be associated with DPR, because the variable earning volatility tends to be used to explain the level of leverage (Brealey and Myers, 2000), they found that lower leverage will result from more profit volatility. On the other hand, according to (Crutchley and Hansen, 1989) companies with higher earnings typically have lower total leverage. This supports the finding that increased earnings volatility raises the cost of bankruptcy, necessitating debt reduction in order to control equity agency expenses. Volatility should have a negative impact on leverage and a positive effect on holdings and dividend pay-out policies. Earning Volatility can be measured using the standard deviation of the rate of return on assets during the study period and is formulated with EARNVOL.
H_6: Earning volatility effects the Dividend Policy.

The Effect of Managerial Ownership on Dividend Policy

Reducing agency conflicts between managers and shareholders can be achieved through the usage of managerial ownership. Because managers cannot affect the percentage of shares owned by institutions, institutional ownership is used as a control variable on management ownership in several institutional studies. However, institutional ownership affects managerial ownership and the usage of debt. (Crutchley and Hansen, 1989). Management's percentage of common stock ownership can be measured as a five-year average percentage of common stock owned directly by officers and directors (Crutchley and Hansen, 1989).
H_7: Managerial Ownership effects on Dividend Policy.

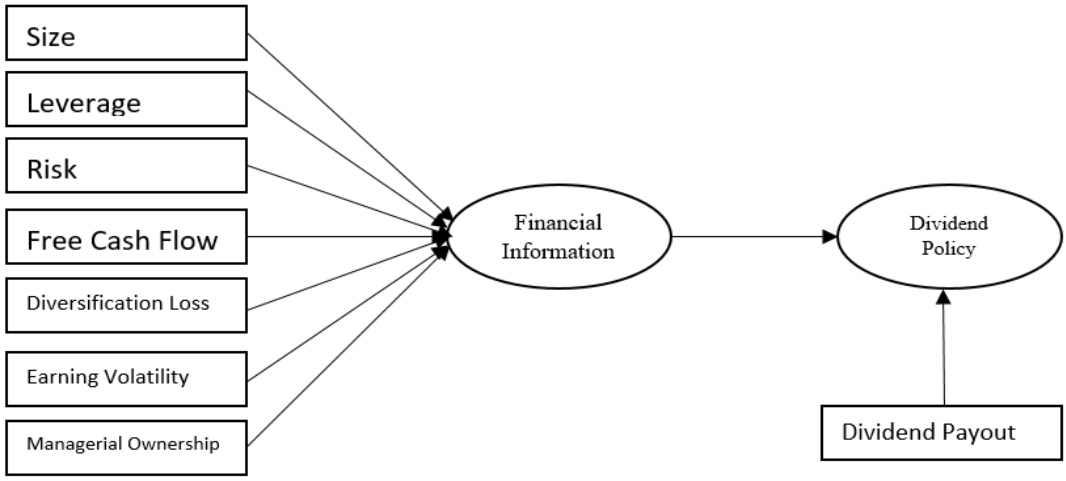

Figure 1 Conceptual Model

$$\text{Dividend Policy}_{it} = \beta + \beta 1\ \text{Size} + \beta 2\ \text{Lev} + \beta 3\ \text{Risk} + \beta 4\ \text{FCF} + \beta 5\ \text{Divloss} + \beta 6\ \text{EarnVol} + \beta 7\text{Own} + \varepsilon_{it}$$

2. RESEARCH METHODOLOGY

This research uses annual financial statement of LQ-45 companies listed in Indonesia Stock Exchange from 2013 until 2020, gathered from Indonesia Capital Market Directory (ICMD).

3. RESULTS AND DISCUSSION

LQ-45 are the most 45 liquid companies that are actively traded on the IDX. and always provide financial statement data, including DER, Risk, Size, Ownership, Free Cash Flow, Earning Volatility, Diversification Loss, and Dividend Payout Ratio from 2013 to 2020.

Table 1 Outer Weights t-Statistics and p-Value

	Outer Weight	t-Statistics	p-Value
DER	0.916327	2.08309	0.018309
DIVL	0.237922	1.233961	0.203961
EV	0.019688	0.135632	0.913632
FCF	0.336377	0.918404	0.218404
OW	0.124477	0.644849	0.181849
RISK	0.382186	2.265867	0.0265867
SIZE	0.374082	0.719146	0.181146

Table 2. Outer Weights t-Statistics and p-Value

	Outer Weight	t-Statistics	p-Value
DPR ---> Dividend Policy	1.005749	1.96573	0.011273

Table 3. Results of Inner Weights

	Original Sample (O)	Sample Mean (M)	Standard ERROR (STERR)	t-Statistics (O/STERR)	p-Value
Financial Information ---> Dividend Policy	-0.407241	0.426302	0.173056	2.353233	0.02368

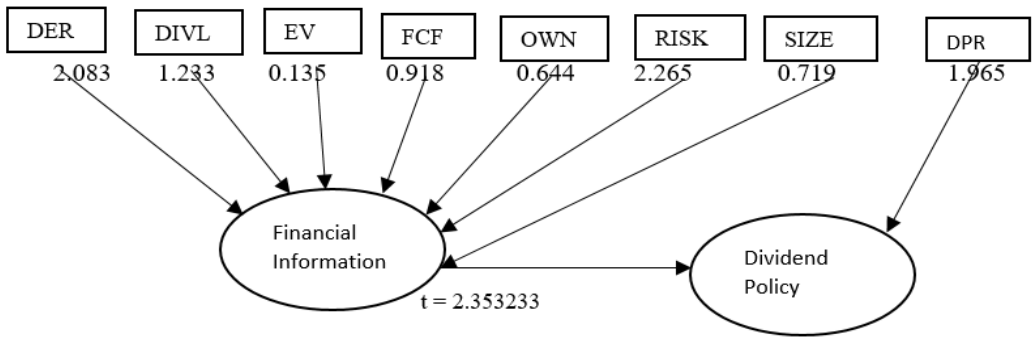

Figure 2. PLS Model

From the seven indicators, it can be concluded that the Leverage (DER) and Risk indicators are the most dominant in measuring the Financial Information variable.

The results of calculations using Smart PLS obtained findings from the Dividend Policy variable analysis as presented in Table 2 above. It can be seen that the Dividend Pay-Out Ratio dimension has a t-statistics value > 1.96 and a p-value < 0.05 so that the DPR dimension can be declared valid in measuring Dividend Policy, and the DPR coefficient is positive (1.0057), it can be concluded that the higher the DPR, the higher Dividend Policy variable.

Table 3 describes the t-statistical regression coefficient of the Financial Information variable to the Dividend Policy Variable is 2.353, because the value of t-statistics is higher than 1.96, and the p-value < 0.05, the results of the analysis show that there is a direct effect of Financial Information variable on Dividend Policy Variable. Considering that the inner weight coefficient is negative, it indicates that the relationship between the two is inversely related. That is, if financial information is high, it will result in a low dividend policy. For

example, dividend payments will be problematic if managers take too much risk, for example in investing, which is only for personal gain.

From the test results above, it can be concluded several things as follows:

The direct effect between Financial Information on Dividend Policy indicated by the t-statistical value of the coefficient regression from the Financial Information variable to the Dividend Policy Variable is 2.353 This number is greater than 1.96, and p-value is less than 0.05. This result shows that there is a direct effect of the financial information variable on the dividend policy variable. Considering that the inner weight coefficient is negative, it indicates that the relationship between those two are inversely related. That is, if financial information is high, dividend policy is low. For example, dividend payments will be problematic if managers take too much risk, for example in investing, which is only for personal gain.

A dividend policy with a high dividend coefficient can also mean that the company more to uses debt to finance its investment and to maintain its optimal capital structure (Emery and Finnerty, 1997). A high DER can also mean that the company's risk is increasing (bankruptcy costs), so that shareholders need additional returns to compensate for the additional risk. The additional return is obtained from dividends in addition to capital gains. This is rational behavior which is the basic assumption of managers' behavior in investing (Miller and Noulas, 1997), (Crutchley and Hansen, 1989), (Chuang et al., 2010) The relationship between debt (DER) and dividends is positive.

As for business risk (RISK), where this business risk also determines the extent of equity risk for the company. A company's reliance on leverage increases with business risk. (debt) to reduce the agency cost of equity (Crutchley and Hansen, 1989). This finding does not support the research results of (Brealey and Myers, 2000), (Rozeff, 1982), (Casey et al., 1999) who found evidence that Systematic Risk had a negative and substantial impact on the ratio of dividend payout. Higher debt is correlated with increased market risk (DER), a company's ability to distribute dividends will be lower (Atmaja, 1999).

FCF is a surplus funds that the business has available to pay out as dividends to its owners. The distribution may take place following capital expenditures by the company, such as the cash purchase of fixed assets. In the results of this study, FCF negatively impacts the DPR. This suggests that if a company reduced the FCF figure, i.e. the company retains or utilizes high free cash flow to maintain capital adequacy, it will result in a higher DPR value. It is considered that LQ-45 companies are able to manage their assets effectively and efficiently and produce good financial performance, being able to meet capital and able to pay a portion of their profits in the form of dividends. This is reinforced by the reality in the LQ-45 banking group company, in 2010 the international rating agency, Fitch Ratings upgraded the ratings of banks in Indonesia, including Bank Mandiri, Bank Rakyat Indonesia, Bank Central Asia, Bank Danamon, due to the increase in average profitability from 2009-2012. These banks distribute dividends every year, and the result is a decrease in the DPR for these banks, there are 71% of business players in the banking sector in Indonesia planning to use excess cash to pay dividends (Bank Permata, 2023). The reality that occurred in 2009-2012 was a decrease in the DPR, besides as many as 20 of the 29 conventional/non-sharia banks listed on the Indonesia Stock Exchange, the majority did not distribute dividends or only once or twice during 4 years. In fact, in terms of company profitability, the majority of these banks showed positive results. The study's conclusions do not align with the agency theory of research. (Jensen et al., 1992), (Crutchley and Hansen, 1989), (Chen et al., 2005) which states that

DPR is positively impacted by FCF. The DPR increases as the FCF increases, or vice versa. According to this study, investors understand the existence of incentives like this, they will underestimate companies whose managers keep a lot of cash in the company, and one way to reduce the agency problem of the size of FCF is to pay dividends to shareholders.

4. CONCLUSIONS AND IMPLICATIONS

Based on the results of the analysis described the previously in the study of LQ-45 companies on the Indonesia Stock Exchange for the 2013-2020 period, the following are some inferences that can be made from the study's findings:

1. There is a significant positive direct effect between the Debt Equity Ratio on the dividend policy. This will be reflected in the higher debt (DER) will result in higher dividends paid (DPR). Shows that the company has the best-targeted capital structure.

2. Business risk and dividend policy have a strong positive direct relationship. This will be reflected in the higher business risk (risk) will result in a higher dividends pay-out ratio (DPR). Indicates that the manager has invested in risky projects as a consequence to obtain additional capital.

Based on problem identification, problem-solving, and research conclusions, the following suggestions can be recommended:

Investors who want to invest must consider variables that are significant to the Dividend Policy, especially for LQ-45 companies such as market risk, debt, company size, and free cash flow. For Investors, with the government's call to investors to encourage the post-covid-19 pandemic economy by looking at the company's financial information; There are several aspects that need to be considered by capital market supervisors and investors as company owners. Related parties are expected to anticipate the actions of unprofessional managers in the use of funds. Government needs to improve regulations on the capital market, as well as regulations for the companies that are listed on the Stock Exchange and regulations for investors so that activities in the capital market can increase even more; Agency theory has not been fully implemented in the largest company (LQ-45).

5. LIMITATIONS & SUGGESTIONS FOR FUTURE RESEARCH

The limited number of companies utilized as samples. This research only focused at seven variables that were thought to effect dividend policy, any extra variables that may have an impact on dividend policy. The research sample can be broadened beyond LQ-45 companies listed on the Indonesia Stock Exchange.

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