
THE SIGNALS OF DIVIDEND

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ABSTRACT

Dividend decisions is a type of policy that earnings should be distributed to shareholders and sometimes contrast with the interest by insiders whether to retain or reinvest. The objective of this study is to examine the determinants of dividend policy on 230 listed firms in period of 2010 to 2011 and conducts logistic regression for hypothesis testing. This study finds that profitability, firm size, and institutional ownership are significant to dividend policy while managerial ownership is insignificant. This findings indicate that most of listed firms of the sample of this study determine the dividend policy based on profits. This study also finds that more larger the firms or institutional ownership then they tend to increase the dividends. Limited to sample, this study proves that agency theory is not applicable for dividend policy in Indonesia as the managerial ownership have no relationship with the dividend policy.

Keywords : profitability, firm size, institutional ownership and managerial ownership

1. INTRODUCTION

Dividend is the other form of firm profits which distributed by firms to the shareholders. There are many reasons why companies choose to pay dividends or not. Some companies choose to turn profits into dividends, but there are also companies that choose to invest from income earned. The actual motivation of the company paying the dividends is unclear.

This study aims to find the factors that affect the financial dividends in companies listed on the Indonesian Stock Exchange. Furthermore, whether there is a relationship between the characteristics of different financial connection with the company pays dividends or not? What factors are affecting the dividend payment strategy? The study also sought to explore which of the dividend policy theories that explain the behavior of such dividends.

2. LITERATURE REVIEW

Dividend irrelevance theory of Miller and Modigliani (1961) states that firm value and shareholder wealth of the decision berubungan not have to pay dividends or not. Shareholders can hold its own "homemade", if the company does not pay a dividend, the shareholder can sell the shares and make homemade dividends. Brigham and Houston (2004) clarify that if firm pays more dividend then shareholders will elect to use an excess of dividends to purchase additional shares. Both of these arguments underlining assumption of the irrelevance hypothesis, where this argument stating that there is no distinction between capital gains and dividends. This makes the shareholders do not want to pay high prices for stocks with high dividends.

The recent studies provide evidences that dividend irrelevance theory is not based on perfect capital market. The results of different empirical studies present evidences that the dividend distribution normally relevant to value and wealth of firm shareholders. One of the assumptions is the bird in hand theory which suggested by Lintner (1956). Lintner (1956) states that dividend is positively link to value of firms. Investors will invest in stocks that pay dividends at this time than to invest in stocks with retained earnings and pay dividends in the

future. This argument is based on the high degree of uncertainty with respect to capital gains and dividends paid in the future. Dividends paid today is more predictable than capital gains, since the stock price is determined by the market and not by the manager, this is what makes the high level of uncertainty. However, Gordon (1962) states that based on the rationale that the more distant future, the higher the level of uncertainty with respect to capital gains and dividends. Capital gains in the future could present a high return over the dividend payment date, there is no guarantee that investors will accumulate a high return in relation to the high degree of uncertainty.

Signaling theory is a theory which states the relationship between the dividend by the stock price. Bhattacharya (1979) says that dividends serve as a signal of future cash flows. Although there are no tax benefits on dividends, the company will choose to pay dividends in order to provide a positive signal to shareholders and outside shareholders. Bhattacharya assumes that investors have perfect information with respect to dividends and capital gains, as well as higher taxes on dividends than capital gains. Baker (2009) says that the resources companies such as accounting data and reports future prospects are not fully reliable because it does not depict the company's profitability in the future. Therefore, investors have imperfect information with respect to the company's profit, the company must find another way to reassure foreign investors about the cash flow and future earnings. The increase in dividend payments is one signal to investors, even if the dividends taxed higher than capital gains, investors are willing to pay higher taxes on dividends to replace it with a positive signal of dividends with respect to the value of the shares.

Another theory is the agency theory. Rozeff (1982) examines the relationship between dividend payments and corporate factors. The results of the study suggested a link between the number of shareholders with dividend payments. According to Rozeff (1982), the firms with ownership of large external shareholders have to pay high dividends to reduce agency conflict. These results indicate that there is a negative relationship between payment diiden with risk, insider ownership and growth. While the dividend payment of insider ownership has a negative relationship, because of the presence of large shareholdings by insiders, the company does not have to pay high dividends. Additionally, Rozeff (1982) suggests that possibility of future growth have an impact on the dividend growth compared to the past that have been realized. According to Jensen and Meckling (1976), agency costs are costs incurred between the principals (stockholders), and agents (management). Where principals hiring and delegating agent with the goal of maximizing the welfare of principals. Only the stock and debt that can be used as a claim against the company. However, Jensen and Meckling (1976) do not present strong evidence with respect to the effects of agency costs on dividend policy. Easterbrook (1984) to test whether dividend payments could be used to minimize the agency costs that occur between managers and investors. There are two factors that affect a company's agency costs, monitoring costs and risk aversion preferences of managers.

Another theory that explains the agency costs is free cash flow as suggested by Jensen (1986). Jensen (1986) clarifies that agency costs arise as the increase in free cash flow because shareholders have to supervise to prevent managers of businesses increase investment spending and unfavorable. Similarly, Agrawal and Jayaraman (1994) confirm that ratio of equity dividend payments by firms is higher than levered firms that constitute the control group. Further equity firms, with low managerial ownership is high paying dividends. Overall dividends and managerial ownership is a substitute mechanism to reduce agency costs on equity firms. The studies of Pruitt and Gitman (1991), Fama and French (2000), Al-Kuwar (2009), and Al-Malkawi, Twairesh, and Harery (2013) provide evidences that profitability has a significant relationship with the payment dividends. Firm size is one of the factors that determine the dividend payment as confirmed by Redding (1997), Al-Kuwar

(2009), Shubiri (2011), and Mehta (2012). Based on those review, the hypothesis of this study are as follows:

- Ha1: Profitability have a significant effect on dividend policy
- Ha2: The size companies have a significant effect on dividend policy
- Ha3: Institutional ownership significant effect on dividend policy
- Ha4: Managerial ownership significant effect on dividend policy

3. RESEARCH METHOD

This study used data from audited financial statement provide by Indonesia Stock Exchange over period of 2010 to 2011. Table 1 presents the sample of this study. This study selects the sample by uses purposive sampling method and get 230 firms with 460 as total observation.

Tabel 1. Sample

SECTOR	
Agriculture	13
Mining	30
Basic industry and chemical	56
Miscellaneous Industry	39
Trade, Services & Investment	92
Total	230

The dependent variable of this study is dividend policy which measured by dummy where 1 is for firms who pay dividends and otherwise is 0. The independent variables of this study are profitability, firm size, institutional ownership, and managerial ownership. Profitability is the ability of the company makes a profit in relation to sales, total assets and own capital. Profitability is measured by using the return on assets and calculated by ratio of net income over total assets. The size of firms is based on total assets held and measured by natural logarithm of total assets. Institutional ownership is the percentage of shares held by institutional owners and ownership by a blockholder, such as ownership of the individual or on behalf of individuals in the top 5 percent but not included in group of insider ownership. This study measures institutional ownership as percentage of number of shares held by institutional over outstanding shares. Managerial ownership is ownership by the management of the board of commissioners and directors who took possession of managerial decisions. This study measures managerial ownership as percentage of number of shares held by insider over outstanding shares. This study conducts logistic regression and assess its fit model as suggested by Ghozali (2009) and notes the model for hypothesis testing as follow:

$$D_{\text{dummy}} = \beta_0 + \beta_{\text{ROA}} + \beta_{\text{Size}} + \beta_{\text{Ins}} + \beta_{\text{Man}}$$

4. RESULTS AND DISCUSSIONS

Table 2 presents descriptive statistics and shows that profitability as measured by ROA has a minimum value of -132.03, 341.56 maximum values, average and standard deviation 7.4043 25.46743. Size or the size of the company has a minimum value of 8.00, the maximum value of 19:00, an average of 13.7848, standard deviation of 1.95131. Institutional ownership is represented by midnight Inst has a minimum value, maximum value of 0.99, an average of 0.4217 and a standard deviation of 0.36613. As for Managerial ownership is denoted by 0:00 Man having a minimum value, maximum value of 0:36, an average of 0.0062, standard deviation of 0.03697.

Table 2. Descriptive statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	460	-132.03	341.56	7.4043	25.46743
Size	460	8.00	19.00	13.7848	1.95131
Inst	460	0.00	0.99	0.4217	0.36613
Man	460	0.00	0.36	0.0062	0.03697

Table 3 presents the model fit test. The test results shows the Chi-square of 14.974 with a significant probability value of $0.060 > 0.05$, the null hypothesis is accepted. This means that the regression model feasible for use in subsequent analyzes, because there is no real difference between the predicted classification by classification were observed. On this result, the model of this study is able to predict the value of observation.

Table 3. Hosmer and Lemeshow's Goodness of Fit Test

Step	Chi-square	df	Sig.
1	14.974	8	0.060

Table 4 shows that Nagelkerke's of R Square is equal to 0.309 which means that the variability of the dependent variable that can be explained by the independent variables is 30.9% and the remains is explained by the variability of variables which outside of the model of this study.

Table 4. Nagelkerke's R Square Model Summary

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	293.730 ^a	0.174	0.309

a. Estimation terminated at iteration number 6 because parameter estimates changed by less than 0 .001.

4.2. Discussion

Table 5 presents the result of logistic regression where ROA, Size, and Institutional are significant at 0.05 while Managerial is insignificant.

Table 5. Result of logistic regression

	B	S.E.	Wald	df	Sig.	Exp(B)
Constant	-12.768	1.620	62.132	1	0.000	0.000
ROA	0.016	0.005	10.476	1	0.001	1.016
Size	0.655	0.098	44.438	1	0.000	1.926
Inst	2.514	0.522	23.168	1	0.000	12.351
Man	5.551	3.018	3.383	1	0.066	257.546

Wald test of ROA is 10.476, the probability is significant at $0.001 < \alpha = 0.05$. Positive direction indicates that the higher the ROA will increase the likelihood of dividend payments. This suggests the hypothesis H_{a1} accepted. The results are consistent with the theory that if there is an increase ROA then dividend payout ratio will be higher. High ROA shows a company's ability to pay high dividends. A positive sign in this study is consistent with the theory or the information content signaling hypothesis, Modigliani and Miller (1961) states that the dividend increase is a signal to investors that management foresees a good income in the future, based on the theory shows that income high through-owned assets are reflected in the return on assets (ROA) showed a positive effect on dividend policy as reflected in the

dividend payout ratio (DPR). La Porta, Lopez, Shleifer and Vishny (2000) state that shareholders would take the cash dividend from the profit of the company. This study supports the research of Jensen, Solberg and Zorn (1992), Han and Suk (1999) and Fama and French (2000).

Wald test of firm size is 44.438, the probability is significant at $0.000 < \alpha = 0.05$. Positive direction indicates that the greater the size of the company will raise the possibility of a dividend payment. This suggests the hypothesis Ha2 accepted. The results of this study support the agency costs theory which states that for a large company have a broad distribution of ownership, has a good deal of control where the implication is reduced agency cost. Lloyd, Jahera and Page (1995) and Holder, Langrehr and Hexter (1998) says that an established company will have easy access to the capital market to raise funds at lower costs, while the company's new and young to be have many difficulties to have access to capital markets. This leads to large companies tend to give higher dividends rather than small companies, because smaller companies have a tendency to result in fewer profits, Fama and French (1995). This study supports the research of Redding (1997) and Al-Makawi (2007).

Wald test of Institutional is 23.168, the probability is significant at $0.000 < \alpha = 0.05$. Positive direction indicates that the higher the Institutional ownership will raise the possibility of a dividend payment. This suggests the hypothesis HA3 accepted. This study supports the theory of free cash flow, where ownership structure of the company will result in a relatively diverse limited ability of owners to monitor and control of the manager would eventually refers to what is called the free cash flow. Payment of dividends is one of the primary control mechanism whereby shareholders can reduce the manager access or misuse of corporate funds, Jensen (1986). Institutional ownership prefer to force companies to pay high dividends in order for managers seeking external funding sources compared to the direct supervision of the manager. This study supports the studies of Han et al. (1999), and Short et al. (2001).

Wald test of managerial is 3383, the significance of the 0066 probability $> \alpha = 0.05$ showed no significant effect of managerial ownership on the variable dividend payments. This shows Ha4 hypothesis is rejected. These results contradict the theory of Jensen and Meckling (1976) states that the separation of ownership and control of the company will result in a conflict of interest between shareholders and management. The impact will increase in line with the wishes of the management to increase the prosperity of themselves. When the proportion of managerial ownership increased, the interests of shareholders and management started to become one it will result in a decrease in dividend payments. The interpretation is because the managerial ownership in Indonesia is relatively small, the descriptive statistics has an average rating of 0.0062, this lead to the managerial ownership has no connection with the dividend policy.

5. CONCLUSION

This study concludes that profitability, firm size and institutional ownership significantly influence the profitability dividen. Relates to dividend distribution, it can be interpreted that companies listed on the Stock Exchange largely basing its dividend payment on the company's profitability. The size of the company can explain the company's decision in the decision whether to pay dividends or not. The larger the company, the greater the probability of the company paying the dividend. The higher the level of institutional ownership in a company, creating greater power by the institutional investors to use the company's profits as dividend payments and then encourage managers to seek funding from outside the company. Managerial ownership has no significant relationship to the company's decision to pay dividends or not, because the portion of managerial ownership in companies in Indonesia are very small.

The relationship between the variables ROA, size, institutional ownership and managerial ownership is based on the theory relating to dividend policy. The decision to pay dividends or not the companies listed on the companies listed on the Indonesia Stock Exchange in accordance with the signaling theory, free cash flow and agency theory. Future studies should use a larger sample to increase the validity of data. Samples should compare between sectors of the companies listed on the Stock Exchange, for example, between the base and the chemical industry sector with the financial sector. This analysis can identify sectors where the most low and high in terms of dividend payments. For the development of further research, we recommend the addition of a variable that could explain the company's decision to pay dividends or not, such as growth, liquidity, earnings and others.

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