The Influence of Profitability and Growth Opportunity on Dividend Payment of the Firms in the Miscellaneous Industry Sector in Indonesia Stock Exchange

Author’s Details:

(1) Dr. Siti Rahmi Utami, Lecturer, Green Economy Department, Faculty of Green Economy and Digital Communication, Surya University, Indonesia  
(2) Stacia Dorothy Tobing &  
(3) Anglia Agnes Longkutoy, Green Economy Department, Faculty of Green Economy and Digital Communication, Surya University, Indonesia

ABSTRACT

The objectives of our research are to examine the impact of profitability and growth opportunity on dividend payment. After analyzing the data of firms in Indonesia over the sample period 2009-2013, by using regression and correlation analysis, for testing hypotheses 1 and 2 to investigate the impact of profitability and growth opportunity on dividend payment, we made the conclusion. For hypothesis 1, we find that there is a positive insignificant effect of profitability on dividend payment, while for hypothesis 2 we conclude that growth opportunity has a positive and significant effect on dividend payment. These implied that the higher profitability and growth opportunity of the firms, the higher dividends pay to firm’s shareholders.

Key Words: Profitability, Growth Opportunity, Dividend Payment

1.0. BACKGROUND

When a company decided to go public, it means that the firm will issue the stocks to the public. Society will buy the stock of this firm with the aim to get the return which consists of capital gain and dividend. However, this investment is accompanied by the risks that caused the stock price quite fluctuative. The sustainable stockholders should minimize the risks by recognizing and analyzing what factors that can effect the fluctuations of return, as they expect to gain the return from their investment.

Dividend payment is a distribution of earnings (income) to shareholders based on the number of shares invested. This distribution will reduce retained earnings available for the company. Based on the results of previous studies, many factors can affect the dividend payments, such as firm’s profitability and growth opportunity. The theory also explains the relationship between profitability, growth opportunity, and dividend payments.

Profitability is a measure of the overall company's ability to generate profits with the overall amount of assets available in the enterprise. The higher this ratio, the better the financial condition of the company. Profitability of the firms can be measured by using ROA (Return on Assets) and ROE (Return on Equity). Meanwhile, companies that have high growth opportunity will have a high value of investments. A growth company tends to have very profitable reinvestment opportunities for its own retained earnings. Thus, it typically pays little to no dividends to stockholders.

Therefore, growth opportunities and return on asset are the two variables which affect the decision to pay the dividend. However, to what extent profitability and growth opportunity can effect the dividend payments is varied. Therefore, we conduct this research for testing the effect of firm’s profitability and growth opportunity on dividend payments of the firms from miscellaneous industrial sector.

The rest of this paper is consisted of 4 sections. Section of literature review explains theory, the previous research, and formulate hypotheses on the subject matter of the study. Section of research methodology is to explain the test of a number of hypotheses relating to our research focus. Section of hypotheses testing analyses and discusses the results of research, and the last section is drawing conclusion.

2.0. LITERATURE REVIEW

2.1. Theory

2.1.1. The Life Cycle Theory of Dividends

The life cycle theory of dividends predicts that a firm will begin paying dividends when its growth rate and profitability are expected to decline in the future. This is in sharp contrast to the signaling theory of
dividends, which predicts that a firm will pay dividends in order to signal to the market that its growth and profitability prospects have improved, i.e., that dividend initiations and increases convey “good news.”

The empirical evidence on dividend initiations and changes generally supports the life cycle theory of dividends but is contrary to the signaling theory. Benartzi, Michaely and Thaler (1997) found that dividend increases are not followed by an increase in the earnings growth rate, while dividend reductions are associated with an improvement in the growth rate. Grullon, et.al., (2002) found that firm profitability declines following a dividend increase, and increases following a dividend decrease.

2.1.2. Agency Theory

A higher relative dividend payout or a higher effective dividend yield is expected to minimise agency costs, as dividends lower the level of available liquidity which increases the potential default risk of firms. Hence, the higher are dividends relative to earnings, the stronger is the focus likely to be on future earnings performance as a means of maintaining the current dividend payout level.

2.1.3. The Middle-of-the-Roaders

The middle-of-the-roaders, Miller, Black, and Scholes, maintains that a company’s value is not affected by its dividend policy. Unlike the other two parties, they emphasize that the supply of dividends is free to adjust to the demand. Therefore, if companies could increase their stock price by changing their dividend payout, they would surely have done so. Presumably, dividends are where they are because no company believes that it could add value simply by upping or reducing its dividend payout. The middle-of-the-roaders explain that companies would not supply such a large quantity of dividends unless they believed that this was what shareholders wanted. But that still leaves a puzzle. Even in the days when there was a large tax disadvantage to dividends, many shareholders were apparently happy to hold high-payout stocks (Brealey, Myers, Allen, 2011).

2.2. Previous Research

The previous studies that examine the relationship between profitability, growth opportunity, and dividend payment are as follow. The recent interest in the life cycle theory of dividends may perhaps be traced to Fama and French’s (2001) study of the dividend payment behavior of publicly-traded U.S. firms. They investigated the patterns and determinants of payout policy over the period 1926-1999. Their results pointed to life cycle factors playing a major role in the decision to pay cash dividends. In particular, their findings shown that dividend-paying firms were large and highly profitable. These firms have retained earnings that are sufficient to cover their capital investments. On the other hand, firms that have never paid dividends were small and not as profitable as dividend-paying firms. These firms have many investment opportunities that require external financing because their capital spending was far greater than their earnings.

Using a sample of publicly-traded U.S. firms in the period 1972-2002, De Angelo et al. (2006) found support for the theory. They documented a positive relation between the proportion of dividend-paying firms and the ratio of retained earnings to total equity and total assets, after controlling for firm characteristics such as profitability, growth, firm size, leverage, cash balances and dividend history. Thus, a firm was more likely to be a dividend payer when its main source of financing is internally generated earnings. They also found similar results for dividend initiations and omissions.

Denis and Osobov (2008) extended the evidence to five other countries, namely, Canada, United Kingdom, Germany, France, and Japan. In those five countries as well as in the United States, they found that the propensity to pay dividends was strongly associated with the ratio of retained earnings to total equity. However, Megginson and von Eije (2008) reported no such association between the ratio of retained earnings to total equity and the propensity to pay dividends in their study of dividends and repurchases at firms listed in fifteen European Union countries. But they found that firm age, size, and past profitability are positively related to the propensity to pay dividends as predicted by the life cycle theory.
To test their maturity hypothesis, or what is essentially the firm life cycle theory of dividends, Grullon, Michaely and Swaminathan (2002) used a sample of New York (NYSE) and American stock exchange-listed firms that increased or decreased their dividends in the period 1967-1993. One of their main findings was, in terms of profitability, they found that the return on assets of dividend-increasing firms declines after the dividend increase. In sum, their evidence supports the theory. Dividend increases signal a decline in risk and profitability as the firm has reached a more mature stage in its life cycle.

Bulan, Subramanian and Tanlu (2007) found evidence supportive of the firm life cycle theory of dividends. Dividend initiators are firms that are larger, more profitable, have higher cash balances but fewer growth opportunities compared to firms in the same life cycle stage that have never paid dividends. Thus, dividend initiators are mature firms. They found further evidence of firm maturity in the type of payout policy that firms adopt. Prior work shown that firms use stock repurchases to pay out volatile cash flows but use regular cash dividends to pay out permanent cash flows. Their evidence shown a positive relation between repurchasing activity and the probability of initiating a dividend, i.e. repeated repurchases indicate that a firm is moving towards maturity as its cash flows stabilize. The firm ultimately pays out its excess cash flows in the form of cash dividends.

Bulan, Subramanian and Tanlu (2007) also found that no significant improvement in profitability or growth occurs around the initiation. DeAngelo, DeAngelo and Stulz (2006) found that the probability that a firm pays dividends is significantly related to the mix of (internally) earned capital and (externally) contributed capital in its capital structure. Firms with a greater proportion of earned capital are more likely to be dividend payers. The evidence on the change in systematic risk around dividend changes is ambiguous. While Grullon et al. (2002) found that firms that increase dividends experience a decline in systematic risk, Bulan et al. (2007) found that systematic risk does not decline after dividend initiations.

2.3. Conceptual Framework

From theory and results of previous research explained above, the conceptual framework is as follows.

![Conceptual Framework](image)

2.4. Hypotheses Formulation

Based on previous research, we examine the impact of profitability and growth opportunity on dividend payment by using the following hypotheses:

**H1:** Firm’s profitability has positive significant impact on dividend payments.

**H2:** The dividend payment is negatively influenced by growth opportunities.

3.0. RESEARCH METHODOLOGY

3.1. Data and Sample
Data have been collected from the Indonesia Stock Exchange (IDX) with a sample period of 2009-2013. Our research population consists of companies from the miscellaneous industrial sector. The Miscellaneous Industry Index consists of all listed companies that are engaged in the miscellaneous sector. We have considered using 8 companies from that sector as our sample, which consist of Astra International Tbk, Astra Otoparts, Indospring Tbk, Indo Kordsa Tbk, Gajah Tunggal Tbk, Goodyear Indonesia Tbk, Welcome Perfect Tbk, and Indomobil Tbk.

3.2. Data Analysis and Hypotheses Testing

We formulate two equations in this study. Equations (1) to (2) will be analyzed using regression analysis to examine causal relationships between each dependent and independent variable. The purpose of testing hypotheses 1 and 2 is to determine to what extent the effect of profitability and growth opportunity on dividend payment.

\[ \text{DIV} = \alpha + \beta \times \text{Profitability} + \varepsilon \]  
\[ \text{DIV} = \alpha + \beta \times \text{Growth Opportunity} + \varepsilon \]  

3.3. Variables Measurement

The dividend payment indicates the percentage of profits distributed by the company among shareholders out of the net profits, or what remains after subtracting all costs from a company’s revenues. Dividend payout ratio is cash dividends divided by stock price. Growth opportunity is measured as the growth rate of sales (Jensen et al., 1992; Holder et al., 1998; Chen et al., 1999; Manos, 2002; and Travlos, 2002). In this study, we use total revenue to measure growth opportunity. Profitability is the ratio of net profits to the amount of money that shareholders have put into the company. Return on equity has been used in several studies as a proxy for firm profitability (Aivazian et al., 2003, Gwilym et al., 2004.) and we use return on asset as proxy for profitability.

4.0. RESULTS AND ANALYSIS

Sample data of the miscellaneous industrial sector is processed into an SPSS program with Pearson Correlation and Regression analysis and the results are as follows.

Table 1: Model Summary

<table>
<thead>
<tr>
<th>Model Summary</th>
<th>( R )</th>
<th>( R^2 )</th>
<th>Adjusted ( R^2 )</th>
<th>Std. Error of the Estimate</th>
<th>Durbin-Watson</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>.491</td>
<td>.241</td>
<td>.185</td>
<td>342 19485</td>
<td>2.292</td>
</tr>
</tbody>
</table>

Table 1 shows the coefficient of determination, or simply R-squared. Its value is always between 0 and 1, and interpreted as the percentage of variation of the response variables explained by the regression line. Adjusted R-squared shows predictors profitability and growth opportunity of 0.185 with dividend payment as dependent variable. This means that 18.5% of the reasons why the firms pay dividend could be explained by the predictors, and 81.5% could be explained by other variables.
From table 2 above we can see that, we find a positive significant effect of growth opportunity on dividend with 0.007 level of significance and 2.910 t-values. The interpretation of this result is that firms with higher growth opportunities tend to pay dividends payment.

Regarding profitability and dividend, result shows a positive but not significant effect of profitability on dividend payment. The significant value on this variable is 0.598 with t-value of 0.534. It indicates that firms with high profitability tend to increase insignificant amount of dividend payments to their shareholders.

The correlation matrix above shown that profitability and growth opportunity of the firms have positive correlation with dividend payment. It indicates that firms which have high profitability and growth opportunity tend to increase dividend payment.

Meanwhile, tests of regression assumption carried out before analyzing the regression coefficients of variables. This assumption represents the ideal condition of reality (Van Horne, 1998). Tests are as follows. Multicollinearity of several sets of explanatory variables to test whether there is a linear relationship between the population means of the response variable and the explanatory variables. The objective of the test is to analyze the correlation between independent variables. Tolerance values, VIF, and correlation matrix are indicators to test multicollinearity. Tolerance value and VIF are still good as each values of these tests are from 0 to 1 and below 10 (table 2). From correlation matrix, we can indicate that the dividend payment is positively associated with firm’s profitability and growth opportunity. Autocorrelation is an assumption which means that information on some errors do not provide information to other errors. Test of
autocorrelation will test whether a linear regression model has a correlation between the errors in period t with an error in period t-1 (before). Durbin Watson (DW) test statistic testing the correlation between errors. Our test statistic value is between 0 and 4 (table 1).

5.0. CONCLUSION

After analyzing the data of firms in Indonesia over the sample period 2009-2013, by using regression and correlation analysis, for testing hypotheses 1 and 2 to investigate the impact of profitability and growth opportunity on dividend payment, we made the conclusion. For hypothesis 1, we find that there is a positive insignificant effect of profitability on dividend payment, while for hypothesis 2 we conclude that growth opportunity has a positive and significant effect on dividend payment. Therefore, these results imply that the higher profitability and growth opportunity of the firms, the higher dividends payment for the firm’s shareholders.

REFERENCES