

The Role Of Profitability In The Formation Of Dividend Policy

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Abstract: *This research aimed to determine and provide empirical evidence whether there is an influence of profitability on dividend policy. The population in this research was 78 financial data obtained from 26 companies that had been included in the High Dividend 20 Index for the period 2019-2021. In sampling, the technique was used purposive sampling. The sample used in this research was based on the following criteria: companies that had been included in the High Dividend 20 Index for the period 2019-2021, companies that had been included in the High Dividend 20 Index for three consecutive years, companies that distributed their financial statements regularly during the period 2019-2021. The sample used in this research was 63 financial data from 21 companies with 3 research periods. The method used in this research was verificative analysis. The data analysis technique in this research used panel data regression analysis. Based on the results of hypothesis testing, the profitability ratio had a positive effect on dividend policy.*

Keywords: Profitability Ratio, Dividend Policy, High Dividend 20 Index

INTRODUCTION

The capital market is a meeting place between parties who have excess funds, namely investors, and parties who need funds, namely companies or issuers. Here, transactions are carried out through buying and selling securities (Tandelilin, 2017). The Indonesia Stock Exchange (IDX) functions as an organised system that brings together sellers and buyers of securities, either directly or indirectly. Stocks traded on the IDX can be grouped into sectors and Indices. One of the new indices introduced in the last three years is the High Dividend 20 Index. The Index was launched on 17 May 2018 and measures the price performance of stocks that have paid cash dividends over the past three years with a high Dividend Yield. The stocks included in the High Dividend 20 Index have undergone regular evaluation by experts. Most of these stocks are large caps with good financial reports and are often considered blue chip stocks. This index can be a consideration for investors in choosing companies that offer high dividend payouts.

Investors who invest funds in the capital market can benefit from the shares of companies that have gone public, both in the form of dividends and capital gains (Yakhub & Kristanti, 2022). Investment objectives are not only short-term, but also long-term to increase total income (Yakhub & Kristanti, 2022). Dividends are the distribution of profits given by the company to shareholders, derived from the profits generated by the company (Munawaroh & Ramadhan, 2022).

Dividend policy is a very crucial decision for companies (Safiah & Kuddy, 2021). The amount of dividends to be distributed to shareholders is not the same every year, and depends on the dividend policy taken by each company (Putra, 2022). Dividends are usually paid as a percentage of profits (Putra, 2022). Dividend policy is reflected in the dividend payout ratio (Sari & Suryantini, 2019). This policy is

reflected in the dividend payout ratio, which is the percentage of profit distributed in the form of cash dividends, which can affect the investment decisions of shareholders and, on the other hand, have an impact on the company's financial condition (Sari & Suryantini, 2019).

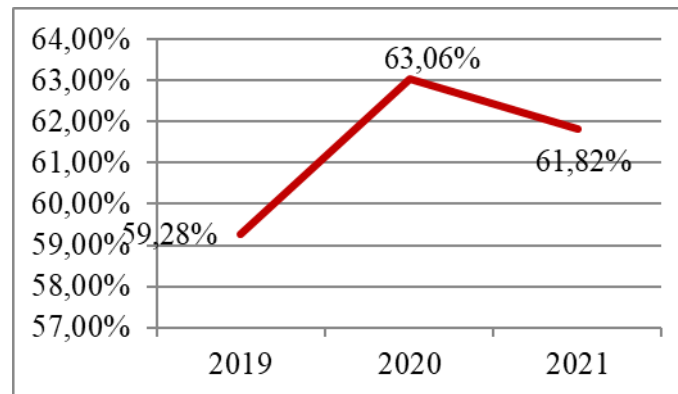


Figure 1. Average Dividend Payout of Companies Included in the High Dividend 20 Index in 2019-2021

Figure 1 is a graph that presents data on the average dividend payout ratio of companies included in the High Dividend 20 Index from 2019 to 2021. Based on the graph above, it can be explained that the average dividend payout ratio of companies included in the High Dividend 20 Index from 2019 to 2021 has a fluctuating value.

The importance of dividend policy taken by the company through the provision of dividends to shareholders is very large, because dividend distribution increases investor interest in buying company shares. Therefore, an evaluation of the factors that influence dividend policy is very necessary (Sari & Suryantini, 2019). The results of research conducted by Sari & Suryantini (2019) concluded that profitability affects dividend policy.

Profitability is defined as the company's ability to earn profits with sales, total assets and own capital (Mnune & Purbawangsa, 2019). One of the measuring tools used to assess how much return shareholders receive from each rupiah invested is Return On Asset (Putra, 2022). The level of company profitability affects the amount of dividends that can be distributed to shareholders (Mnune & Purbawangsa, 2019). When the profit level is high, the dividends paid will generally also be high, while if the profit level is low, the dividends distributed tend to be low as well (Sari & Suryantini, 2019).

RESEARCH METHOD

Methods used

The method that the author will use in this research is verification.

Variable operationalisation

There are two types of variables used in this study, namely independent variables and dependent variables. In this study, the dependent variable is dividend policy (Y). The independent variable used in this study is profitability (X).

1. Dividend policy

Dividend payout ratio (DPR) is the ratio between dividends paid to net income earned and is usually presented in percentage form (Sari & Suryantini, 2019).

$$\text{Dividend payout ratio} = \frac{\text{Dividend per share}}{\text{Earning per share}} \times 100\%$$

Anggraeni (2020) states that there are several important components in the Dividend Payout Ratio (DPR), including:

- a.) Dividend Per Share (DPS) is a ratio that describes how much dividend is obtained per share owned by investors.
- b.) Earning Per Share (EPS) or income per share is a form of profit given to shareholders from each share owned.

2. Profitability

In this study, profitability is projected by return on assets (ROA). Return on Asset (ROA) is the choice because it is considered the most effective in measuring management efficiency in maximising profits. The use of all company assets, both current and fixed, in the calculation of ROA ensures that this metric reflects the optimal use of company resources to generate profits. (Astuti et al., 2023). Return on assets (ROA) can be calculated by comparing earnings after interest and tax (EAIT) to total assets.

$$\text{Return on assets} = \frac{\text{Earning after interest and tax (EAIT)}}{\text{Total assets}}$$

Population and sample

This study uses a population of companies listed in the High Dividend 20 Index for the 2019-2021 period. Sampling was carried out using non-probability sampling method, specifically purposive sampling technique.

The criteria for using the sample used in this study include:

1. Companies that have been included in the High Dividend 20 Index for the 2019-2021 period
2. Companies that are included in the High Dividend 20 Index for 3 consecutive years
3. Companies that share their financial statements regularly during the 2019-2021 period.

Verification Analysis

Normality Test

When the Jarque-Bera probability value > 0.05 , H_0 is accepted and H_a is rejected. If the Jarque-Bera probability value < 0.05 then H_0 is rejected and H_a is accepted. (Description H_0 : Residuals experience normal distribution and H_a : Residuals are not normally distributed).

Panel Data Regression

Panel data regression analysis begins with estimation using three approaches: Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM).

1. The Chow test is used to compare the advantages of the fixed effects model against the common effects model in panel data regression. The hypothesis formed in the Chow test is:

- H_0 : Common Effect Model is better than Fixed Effect Model
- H_a : Fixed Effect Model is better than Common Effect Model
- The conclusion drawn in the Chow Test is the following criteria, when the cross section Chi-square probability value > 0.05 then H_0 is accepted and H_a is rejected. If the cross section Chi-square probability value < 0.05 then H_0 is rejected and H_a is accepted.

2. Hausman test is used to select the best model between random effects and fixed effects. The hypotheses formed in the Hausman Test are:

- H_0 : Random Effect Model is better than Fixed Effect Model
- H_a : Fixed Effect Model is better than Random Effect Model
- The criteria for drawing conclusions in the Hausman Test are when the probability value of random cross section > 0.05 then H_0 is accepted and H_a is rejected. If the random cross-section probability value < 0.05 then H_0 is rejected and H_a is accepted.

3. The Lagrange Multiplier (LM) test is used to determine whether the random effect model is better than the common effect model. The hypothesis formed in the Lagrange Multiplier (LM) Test is:

- H_0 : Common Effect Model is better than Random Effect Model
- H_a : Random Effect Model is better than Common Effect Model
- The criteria for drawing conclusions on the Lagrange Multiplier Test (LM) are when the Bruesch-Pagan probability value > 0.05 then H_0 is accepted and H_a is rejected. If the Bruesch Pagan probability value < 0.05 then H_0 is rejected and H_a is accepted.

Hypothesis Testing

Hypothesis testing in this study using the F test.

Coefficient of Determination

The coefficient of determination (R^2) is used to assess the model's ability to explain variance in independent variables.

RESULT AND DISCUSSION

Research Results

Normality Test

Table 1. Normality Test Results

Jarque-Bera	Probability
2,686274	0,261026

The normality test results in Table 1 show that the Jarque-Bera probability value is greater than 0.05, namely $0.261026 > 0.05$, it means that the panel data regression equation with random effect model estimation has normally distributed residuals.

Panel Data Regression

1. Chow Test

Table 2. Chow Test Results

Redundant Fixed Effects Tests

Equation: Untitled

Test cross-section fixed effects

Effects Test	Statistic	d.f.	Prob.
Cross-section F	0.322419	(20,41)	0.9958
Cross-section Chi-square	9.202423	20	0.9804

Based on the chow test results table in table 5, the cross-section Chi-square probability value is greater than 0.05, namely $0.9804 > 0.05$, it can be concluded that the common effect model is better when compared to the fixed effect model.

2. Hausman Test

Table 3. Hausman Test Results

Correlated Random Effects - Hausman Test

Equation: Untitled

Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	1.345609	1	0.2460

** WARNING: estimated cross-section random effects variance is zero.

The Hausman Test results in Table 6 show that the cross-section random probability value is greater than 0.05, namely $0.2460 > 0.05$, it can be concluded that the random effect model is better when compared to the fixed effect model.

3. Lagrange Multiplier (LM) Test

Table 4. Lagrange Multiplier (LM) Test Results

Lagrange Multiplier Tests for Random Effects

Null hypotheses: No effects

Alternative hypotheses: Two-sided (Breusch-Pagan) and one-sided (all others) alternatives

Test Hypothesis		
Cross-section	Time	Both

Breusch-Pagan	6.454574 (0.0111)	1.321267 (0.2504)	7.775841 (0.0053)
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The Breusch-Pagan probability value from the Lagrange Multiplier (LM) test results can be seen in Table 7 column both which is $0.0053 > 0.05$, it can be concluded that the random effect model is better when compared to the common effect model so that it can be concluded based on the results of the Chow Test, Hausman Test and Lagrange Multiplier (LM) Test that the panel data regression estimate used in this study is the random effect model.

4. Panel Data Regression Equation

$$\text{DPR} = 0,587925221776 + 0,634203793988 \cdot \text{ROA} + [\text{CX}=\text{R}]$$

Then the interpretation is as follows:

- If ROA is equal to 0 and $[\text{CX}=\text{R}]$ is at the reference level: DPR is predicted to be 0.587925221776. This is the base value of DPR.
- An increase in ROA by 1 unit will increase DPR by 0.634203793988 units.

Hypothesis Testing

Table 5. F-test

F-statistic	Prob(F-statistic)
11.93886	0.001006

The F-test table shows that Fcount is greater than Ftable so that profitability has a positive influence on firm value.

Coefficient of Determination

Table 6. Coefficient of Determination

R-squared	0.163683
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Based on the table above, it can be explained that profitability is able to be a factor that affects dividend policy by 16.3% while the remaining 83.7% is the influence of other factors not examined in this study.

Based on the results of data processing, it can be stated that profitability has a positive effect on dividend policy. The results of this study are supported by research conducted by Sari & Suryantini (2019) and Saputra & Gustini (2024)

Discussion

Profitability shows the company's ability to generate profits. (Saputra & Gustini, 2024). One indicator that can be used to measure company profitability is Return on Assets (ROA) (Saputra & Gustini, 2024). This ratio illustrates how effective the company is in utilising all of its assets to generate profit after tax (Sari & Suryantini, 2019). A high ROA indicates optimal asset management to generate profits; the higher the ROA, the greater the company's profit (Saputra & Gustini, 2024). For investors, companies with high ROA values are attractive, as they have the potential to generate more significant levels of profit compared to companies with low ROA values. This often leads to higher dividend payments by companies that excel in terms of ROA (Sari & Suryantini, 2019). Based on signalling theory, companies adjust dividends to show signals about the company's prospects so that investors can surmise information about the company's future profits through signals that arise from dividend announcements both in terms of stability and dividend changes where an increase in the dividend payout ratio can be interpreted as information that the company has good future profitability (Saputra & Gustini, 2024).

CONCLUSION AND SUGGESTIONS

Conclusion

Based on the results of data processing, the conclusion for this study is that profitability has a positive effect on dividend policy.

Suggestions

Suggestions that the authors can convey for the research results are as follows:

1. Companies are advised to actively maintain and increase their profitability. Strategies that can be implemented include increasing sales turnover through effective marketing strategies and reducing inefficient operating costs. This increase in profitability is the foundation for a sustainable and consistent dividend policy.
2. For investors, it is recommended to analyse the company's profitability level before making an investment, especially for those looking for high dividend potential. Profitability analysis can assist investors in identifying companies with promising dividend prospects.
3. Further academic research is recommended to examine the effect of profitability on dividend policy outside the context of the High Dividend 20 Index. This research should consider additional independent variables, such as liquidity ratio, leverage ratio, and company size, to produce a more comprehensive and accurate model.
4. Company management needs to prioritise strategies that increase profitability and operational efficiency. Increasing sales turnover and reducing unnecessary costs are key measures to ensure healthy profitability and support sustainable dividend payments.

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