

Effect of Dividend Payment on the Earnings Quality

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Abstract—This study Aimed to examine the effect of the payment of dividends on the earnings quality. Payments of dividend in this study were divided into two category that is the status of the payment of the dividend and the size of the dividend. The samples used in this study are 54 companies listed in Indonesia Stock Exchange starting from 2010 to 2014. The method used to select the sample on this study is purposive sampling. The result of this study is the status of the payment of dividend influential and significant positive on the earnings quality. Limitations of this study are limided the manufacturing and retail trade sectors and limit year of study. Researchers can increase subsequent sample of the industry, but it can enter proxy of earnings quality.

Keywords—*Dividend Payment Status, Size Dividend, Earnings Quality*

I. INTRODUCTION

Companies listed in the Indonesia Stock Exchange has the potential to obtain an effective source of funding from external parties. Listed companies (listing) the effect on the exchange have the opportunity for expansion as compared with companies that are listed on the Indonesia Stock Exchange. Until now research on external financing in the capital markets continues to be an interesting issue to be further investigated. Dividends are an important indicator of external funding sources. Dividend distribution is a form of income or profit companies. Investors will assess a company has a sound financial and good profit from the payment of dividends. Dividend is a form of distributions to shareholders either in cash or stock. Profit is a reflection of the company's performance during the period. Profit is one form of assessment of the company to take the decision to distribute dividends or not.

In previous studies have tested various forms of dividend payments by the company. Before going dividend payments, the company through the management will declare dividends. At the time of the dividend announcement contained a signal to investors (signaling theory), as expressed by [1] and [2]. The dividend will reduce the agency conflict between management and investors. Between management and investors have their respective interests (agency conflict) so that the resulting information is not appropriate. Between management and investors are working contacts that binds both (agency teory). Dividend is a form of profit sharing of the results of operations of the company. Profit is the net result of operations in the period used as a reflection of the company's performance. The basic characteristics contained in earnings quality: (1) reflect the company's current operating performance, and (2) be a good indicator on perisitensi company's operating performance in the future. Therefore, profit proxies used in this study tailored to these characteristics. This study adopts the

research of [3] which examined the effect of dividend payments on the quality of earnings in manufacturing companies in Indonesia from 2005-2009. Therefore, researchers interested in studying the same topic but with different industry sectors. The difference with previous studies lies on a sample of companies used researcher namely manufacturing and trading company, the model testing, and years of research

II. THEORETICAL FRAMEWORK

A. Agency Theory

Agency theory is a theory which states that there is a contract of cooperation between management and investors. Investor is the principal authorizes a management that is a party that gets the authority (agency). Based on agency theory, dividends paid have a role to minimize the conflict between management and investors. Research from [4] states that dividends paid by the company will minimize agency costs by helping capital markets to oversee the managerial and corporate performance, so managers will be difficult to manipulate profits.

B. Dividend Signalling Theory

Reference [1] was the first states that the dividend can predict future earnings. Profit is the result of the company's operations during the period. While the dividend is the result of the division of the profits generated by the company. Any profits distributed by the company will give a signal to investors to predict the company's earnings in the future. Companies that pay dividends continuously each year will be considered to have a good performance, and investors found a company that distributed dividends each year has a better return again in the future. In addition to this, if the dividend goes up or down it will not give the signal for good or bad about the company's future earnings.

II. LITERATURE REVIEW

Researchers used reference literature previous studies that examined the relationship of dividend payments with the quality of earnings. Dividends traditional signaling proposed by as in [2] predicts that dividend payments may disclose information about earnings prospects for the future. Where the increase of fees provide a good signal for investors, while the decline in dividend payments give a bad signal for investors.

Reference [5] proved that investors can predict future profits in the company paying the dividends (predictive value). His research showed that companies that pay dividends have a return value of shares (stock return) greater than companies that do not pay dividends. Reference [6]

examines the company accused of fraud financial reporting by Securities and Exchange Commission (SEC). Their study found that companies that commit fraud rarely (not) pay dividends or raise the amount of dividends paid than companies that do not *fraud*. Reference [7] examined the relationship with the dividend distribution of earnings quality. The results of their study stated that companies that pay dividends have better earnings quality than companies that do not pay dividends. The number of larger dividends and dividend distribution also indicates the persistence of earnings quality is better. Reference [3] was the first which became the primary literature in this study to examine the relationship of dividend payments with earnings quality. As a result, companies that pay dividends have earnings quality is relatively better than companies that do not pay dividends. An increase in the dividend and dividend payments also indicates the persistence of earnings quality is better. But in their study a larger amount of dividends does not indicate the quality of a better return than the dividend amount is smaller.

III. HYPOTHESIS DEVELOPMENT

Reference [8] argues that the dividend will give a signal to investors about the credibility of reported earnings and financial strength of the company. Dividend payments made by the company will portray profits as earnings engineered engineering would not produce real cash flow for dividend payments [8]. Reference [3] on the study said the company paying the dividends have earnings quality is relatively better than companies that do not pay dividends. Based on these result, the first hypothesis is:

H₁: Companies that pay dividends have better earnings quality than companies that do not pay dividends.

Dividend itself has some features that are considered to have influence with the quality of earnings. These features include the size, the rise and persistence of dividends. Related to the size of the dividend on research conducted as in [7] found the company paying the dividend in large numbers have earnings quality is better than the company paying the dividends in small quantities as well as companies that do not pay dividends. The results of his research stating that sizes larger dividends expects better earnings quality than the smaller size of the dividend. Companies that have large cash flows will support the dividend payment amount is greater. The second hypothesis is:

H₂: Companies that pay large amounts to have better earnings quality than the company making the distribution in small quantities.

IV. RESEARCH METHOD

A. Samples

Total sample used in this empirically there are 54 companies. Determination of the sample using purposive sampling. While the sample used in this study is a manufacture and trading company (specifically retail) listed on the Indonesia Stock Exchange. The criteria for the sample are: manufacturing and trading company listed in Indonesia Stock Exchange from 1 January 2010 to 31 December 2014, total equity value always positive, companies that have complete data for all variables tested, and companies that use indonesia currency for reporting.

B. Research Models

There are two models used in this study. The research model using previous research as in [3] and [7], but there is a difference in the research model of a second and there is also several control variables were not included. The models are state in these equation:

$$EQ_{it} = \alpha_0 + \alpha_1 DIV_{it} + \alpha_2 SIZE_{it} + \alpha_3 BTM_{it} + \alpha_4 GROWTH_{it} + \alpha_5 LEV_{it} + \epsilon_{it} \quad (1)$$

$$EQ_{it} = \alpha_0 + \alpha_1 BIG_DIV_{it} + \alpha_2 SIZE_{it} + \alpha_3 BTM_{it} + \alpha_4 GROWTH_{it} + \alpha_5 LEV_{it} + \epsilon_{it} \quad (2)$$

C. Variables

The dependent variable used in this research that the quality of earnings. The quality of earnings used in this study used two measures of earnings quality that is ADA (Absolute Value of Performance Adjusted Discretionary Accruals) and AAQ (Firm-Specific Annual Absolute Value Of The Residuals). In this study, all the earnings quality measure used is the accrual basis. The first earnings quality measures used in this research that the absolute value of performance-adjusted discretionary accrual (ADA). Earnings quality measure is based on a model [10].

$$TACC_{it} = \beta_0 + \beta_1 \frac{1}{ASSET_{it}} + \beta_2 (\Delta SALE_{it} - \Delta AR_{it}) + \beta_3 PPE_{it} + \beta_4 ROA_{it-1} + \epsilon_{it} \quad (3)$$

Another variable is AAQ. Unlike the ADA, this measure indicates whether the cash flows are reported on an accrual basis is a picture of the actual cash flows. Similarly, the ADA, when AAQ value is high, the value of earnings quality is also low. AAQ measured using models from [11] as modified by [12], as follows:

$$CAACC_{it} = \beta_0 + \beta_1 CFO_{it-1} + \beta_2 CFO_{it} + \beta_3 CFO_{it+1} + \beta_4 \Delta SALE_{it} + \beta_5 PPE_{it} + \epsilon_{it} \quad (4)$$

The independent variables used in this research there are two variables, namely the status of dividends payment and the size of it. Status dividend payment is symbolized by DIV. DIV is a variable whose value is 1 if the company distributed dividends in year t, and 0 if the company does not distribute dividends in year t. Companies that pay dividends are considered to have better earnings quality. While the amount of dividends to be symbolized by BIG_DIV. In research as in [3] also there are two variables that BIG_DIV and SMALL_DIV. BIG_DIV is a variable whose value is 1 if the company distributed dividends in large numbers, and 0 if company distributed in small dividend.

Four control variables are used such as: firm size, internal growth prospects, external growth prospects and debt structure. Firm Size (SIZE) was used as a control variable according to research [13], which explains the large companies more often avoiding earnings management to avoid exposure of the external environment. Growth happens to the company could occur from internal and external sources of the company itself. GROWTH describes the company's growth prospects are seen from the internal side, namely the operational activities described from sales growth. Book-to-market ratio (BTM) illustrates the company's exposure to growth from the external side. BTM small value illustrates the company's high growth prospects, because the value of small BTM shows the company's

market price is considered expensive (to grow). Thus, the variable BTM has an inverse relationship with growth. In this study, the company's debt structure is proxied by the variable leverage (LEV). Reference [14] concluded that managers of companies with high debt structure tend to manipulate earnings to avoid breaching the debt-convenants. On this basis, the variable LEV is suspected of having a positive sign of the ADA and the AAQ.

V. RESULT AND DISCUSSION

The result from sampling model show that number of sample among 2010-2014 in Indonesian Stock Exchange (IDX) consists 270 sample. Detail recapitulation can be seen at table I below.

TABLE I. DATA SAMPLES IN 2010-2014

Description	Total
Manufacturing and retail sector in IDX	148
Total equity value negative	(8)
Data incomplete	(58)
Not Indonesian currency	(28)
Final result per year	54
Total samples for 2010-2014	270

The descriptive statistic gives information about raw data from samples that divided into two categories, namely dividend payments and dividend size. In dividend payments, from total sample show that 69% samples have paid their dividend and the rest 31% not paid. From 69% category, we found 121 samples (65%) paid big dividend and 66 samples (35%) paid small dividend. To illustrate these categories, we use pie chart to help understand about the data (figure 1 and 2).

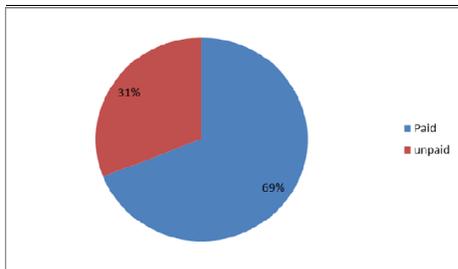


Fig. 1. Dividend payments

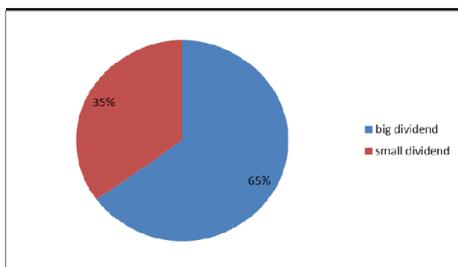


Fig. 2. Dividend size payments

After all data tested with E-views software, the statistic results for first model shows the value of probability (F-statistic) ADA and AAQ respectively 0.000749 and 0.000470, while for the F-statistic for the model of this first study each dependent variable 0.535901 to 0.470442 for the ADA and the dependent variable AAQ. Thus, each of the variables are seen from the probability (F-Statistics) is significant at the level (1%), so it can be concluded that the

independent variable in the first model could be used to explain the dependent variable. Adjusted R² value is positive, ie 8.7% for variable ADA and 5.5% for variable AAQ. This means that the value of the variation changes the ADA and AAQ can be influenced by independent variables such as the status of the dividend distribution, the size of the company, the company's growth prospects, and the structure of the debt, and the rest can be influenced by other variables.

The value for the variable coefficient of -0.026016 and -0.002521 DIV for AAQ. Value of the coefficient is negative indicating that the company making the distribution has a value of ADA and AAQ smaller than companies that do not pay dividends at all. From the regression results obtained probability value t show significant value. Thus, the first hypothesis is accepted. The results of this study have the same hypothesis with the previous hypothesis that states that companies that pay dividends have better earnings quality than companies that do not pay dividends. Reference [3] and [7] proved that the dividend is an indicator of earnings quality. The results of this study are also consistent with studies as in [6] and [5]. The test result first model is presented by table II below:

TABLE II. STATISTICAL RESULT FOR MODEL I

Variables	Variables			
	ADA		AAQ	
	Coefficient	Prob	Coefficient	Prob
DIV	-0.026016	0.2596	-0.002521	0.3590
SIZE	-0.003319	0.4977	-0.000826	0.3627
GROWTH	-0.026802	0.4635	0.005932	0.1813
BTM	-0.001075	0.2884	-0.000101	0.5948
LEV	0.000313	0.4968	0.052346	0.7473
C	0.182659	0.1838	0.034837	0.1659
F-Statistic	0.535901		0.916922	
Prob (F-Stat)	0.000749		0.000470	
R-Squared	1.0%		1.7%	
Adjusted R-square	8.7%		5.5%	

In other hand, from the second model test we have value of probability (F-statistic) ADA and AAQ respectively 0.049137 and 0.044808, while for the F-statistic for these two research model each dependent variable 0.886407 to 0.953122 for the ADA and the dependent variable AAQ. Thus, each of these variables significant at the level (5%), so it can be concluded that the independent variables in the second model can be used to explain the dependent variable. Adjusted R² value is positive, ie 30.63% to 12.62% variable for the ADA and AAQ variables. This means that the value of the variation changes the ADA and AAQ can be influenced by independent variables such as the amount of dividends, company size, growth prospects of the company, and debt structure, and a 69.37% change ADA and 87.38% change AAQ can be affected by other variables that are not included in the model research.

The value for the variable coefficient for BIG_DIV all negative. This result is indicate that the company making the distribution of large amounts of AAQ has a value of ADA and smaller. If you look at the probability only significant variable AAQ than ADA is not statistically significant. Finally, the second hypothesis is rejected. The results is consistent with previous research [3]. Where the amount of the dividend distribution in large numbers do not indicate the quality a good profit. Research from [15] conducted in the United States with a sample of companies listed on

NASDAQ, AMEX and NYSE indicates the company paying the dividends have better earnings quality, but for the amount of the dividend distribution does not affect the quality of earnings. The test result second model is presented by table III below:

TABLE III. STATISTICAL RESULT FOR MODEL 2

Variables	Variables			
	ADA		AAQ	
	Coefficient	Prob	Coefficient	Prob
BIG DIV	-0.023386	0.3579	-0.003135	0.1258
SIZE	-0.004294	0.4439	-0.001020	0.3300
GROWTH	-0.104033	0.0573	0.003823	0.6805
BTM	-0.001216	0.3021	-0.054405	0.7670
LEV	0.000333	0.5013	0.047105	0.7701
C	0.234533	0.1705	0.044915	0.1347
F-Statistic	0.886407		0.953122	
Prob (F-Stat)	0.049137		0.044808	
R-Squared	2.4%		2.6%	
Adjusted R-square	30.63%		12.62%	

VI. CONCLUSION

The results of this study concluded as follows:

1. The dividend payments linked to the quality of earnings. This is consistent with the allegations of the first hypothesis which states that companies that pay dividends have better earnings quality than companies that do not pay dividends at all. Thus, the result of this research contains information and implied dividend earnings quality. The results are consistent with previous studies of [3], [6] and [7].
2. The large sizes of the dividend payments do not indicate the quality of earnings. Research conducted not obtain strong evidence to declare a dividend payer in large size have better earnings quality. The results of this study are not support and in line with research from [3], [7] and [15].

The limitation on this study are: the number of sample only manufacture and trading company on 2010-2014, earnings quality proxy and only in Indonesia. Subsequent researchers can expand the sample with added sectors other industries. The next study may replace another proxy for earnings quality. Subsequent research could examine the

relationship of dividend and earnings quality in addition to the Indonesia Stock Exchange.

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