

Analysis of the Effect of Information Asymmetry on Dividends

L. Ernestin, W.R. Murhadi & B.S. Sutejo
University of Surabaya, Surabaya, Indonesia

ABSTRACT: This study aims to examine the effect of information asymmetry on the dividend policy of non-financial companies listed on the Indonesia Stock Exchange. Basically, there is information asymmetry between managers and investors in which investors only know company information through dividend information, while managers have all the company's actual internal information. The study used a sample of companies that pays dividends listed on the Indonesia Stock Exchange and a control variable of growth opportunity (market-to-book ratio, asset structure), firm size, firm risk, and profitability. The findings of this study concluded that information asymmetry does not significantly influence the dividend policy of non-financial companies listed on the Indonesia Stock Exchange. The dividend payment is not influenced by the high or low asymmetry of the available information; this is because the dividend payment policy is an expensive policy.

Keywords: information asymmetry, dividend policy, growth opportunity, profitability, risk

1 INTRODUCTION

A dividend is a topic that always attracts attention and essential to study because according to La Porta et al. research (1999), dividends are noteworthy in countries with a poor investor protection environment. Where in emerging markets, formed markets prone to be inefficient and information asymmetry is higher. When investors invest in emerging markets, the investment tends to be riskier but expected returns are higher than in industrialized countries. When the market becomes more volatile, uncertainty increases. Uncertainty in the market obscures the information available to investors and as a result, information asymmetry increases in emerging countries (De Wet 2004). It is becoming increasingly difficult for investors to distinguish between good and bad borrowers. In addition, the company's future information cannot be used as a measure of corporate information asymmetry (Hussainey and Al-Najjar, 2011). Not only that, this topic is interesting because it is against several theories related to dividends, namely pecking order theory. Myers and Majluf (1984), in their pecking order theory, suggested that companies can prevent investment fund shortages and decrease the company value by reducing dividends derived from information asymmetry. Based on the research mentioned above, it is crucial to

know whether there is an effect of information asymmetry between managers and investors on company dividend policies.

Lin, et al. (2017) studied the relationship between information asymmetry, dividend policy, and ownership structure of companies in China. The results of this study concluded that there was a significant negative result between information asymmetry and split share structure reform on dividend policy that implies that dividends are capable of conveying information in the market. Meanwhile, Basiddiq and Hussainey (2012) scrutinized a significant positive relationship between some analysts and dividend policy, which implies that there is a strong negative significant relationship between information asymmetry and dividend policy. Indirectly, Basiddiq and Hussainey's (2012) research supports agency theory and pecking order theory but does not support dividend signaling theory. Another study by Hussainey and Al-Najjar (2011) used an independent variable in the form of future-oriented information as a proxy for information asymmetry. The results from this study indicated a significant positive relationship between the level of future-oriented information on dividend policy, where it indicates that there is a significant negative relationship between information asymmetry and dividend policy in which a

low level of asymmetry will help to reduce conflict of interest between managers and investors and reduce agency costs. Li and Zhao (2008) argued that analysts' forecast error and dispersion earnings provide a significant negative result on dividend policy, where it reflects that there is a significant negative relationship between information asymmetry and dividend policy. This study revealed that companies with low information asymmetry tend to pay higher dividends. This finding does not support the dividend signaling theory.

This study aims to determine the effect of information asymmetry on company's dividend policy and used control variables namely the market-to-book ratio variable (Lin et al. 2017, Basiddiq & Hussainey 2011, Hussainey & Al-Najjar 2011), asset structure (Lin et al. 2017, Basiddiq & Hussainey 2012, Li & Zhao 2008), firm size (Basiddiq & Hussainey 2012, Hussainey & Al-Najjar 2011, Li & Zhao 2008), profitability (Lin et al. 2017, Basiddiq & Hussainey 2012, Li & Zhao 2008), and firm risk (Lin et al. 2017, Hussainey & Al-Najjar 2011, Li & Zhao 2008).

2 RESEARCH METHODS

This study used a sample of 365 years of observation on non-financial companies listed on the Indonesia Stock Exchange that paid dividends over the 2013-2017 period consecutively. Moreover, it used panel data with the dependent variable used was the dividend payout ratio calculated using the total dividends received by the stockholders divided by net income in the same period. The independent variable used was Information Asymmetry (ASY) obtained by using a company's idiosyncratic risk proxy. Idiosyncratic risk can be calculated using a standard deviation of the company's daily stock return regression residuals compared to the value-weighted market return (Dierkens 1991; Krishnaswami & Subramaniam, 1999). The implicit assumption signifies that residual volatility reflects the uncertainty of company information. Roll's (1988) idiosyncratic volatility will increase when managers possess private information that does not exist in the market. In order to calculate idiosyncratic risk, this research used the capital asset pricing model. Then information asymmetry can be predicted through idiosyncratic risk volatility. Idiosyncratic risk volatility was obtained from the standard deviation of idiosyncratic risk residuals. Market-to-book ratio (MB) was calculated from the ratio of value per common stock to book value per equity. Asset structure is a com-

parison of fixed assets and total assets that can be used to determine the amount of fund allocation for each component of assets. Asset Structure (ASSTRUC) was calculated from the ratio of fixed assets and total assets of the company. Company Size (SIZE) was calculated using the natural logarithm of total assets. Company performance was measured using Return on Assets (ROA) that is the ratio between net income and total company assets. Firm Risk (RISK) was calculated using a proxy beta (β). Beta measurements used the Single Index Model with the slope function with beta calculations over the previous five years from the calculated period (t-5).

3 RESULTS AND DISCUSSIONS

After the Chow test and Hausman test have been conducted, it is known that the best model is the fixed effect model.

Table 1. The Results of Regression

Variables	Coefficients	t-Statistics
ASY	-0.00533	-0.07861
MB	0.002762	4.012042***
ASSTRUC	0.039687	1.785743*
SIZE	-0.01755	-2.12418**
ROA	-0.2772	-5.93596***
RISK	0.01337	4.162025***
R-Squared	0.707006	
Adjusted R-Squared	0.627099	
F-Statistic	8.847828	
Prob (F-Statistic)	0.000000	

The information asymmetry variable had a coefficient of -0.00533 and a significance level of 0.9374 that reflects that the information asymmetry variable has an insignificant negative relationship on the dividend policy variable. This result is supported by research conducted by Hussainey and Walker (2009) and Li and Zhao (2008), but contrary to research conducted by Lin, et al. (2017), Basiddiq and Hussainey (2012), and Hussainey and Al-Najjar (2011) that concluded a significant negative relationship between information asymmetry and dividend policy. According to research by Li and Zhao (2008) and Alamdari (2016), information asymmetry does not affect dividend policy. It reflects that the information asymmetry influences the dividend policy. That although in developing countries, information asymmetry occurs due to market inefficiencies, it turns out that this does not affect management policies in paying dividends. According to agency theory, a dividend payment can be used to reduce conflict of interest between managers and investors as a means of preventing inefficient

use of project income under information asymmetry, because dividend payments reduce financial resources controlled by managers (Rezaei and Torkzadeh, 2010).

Dividend payment was not influenced by the high or low information asymmetry available because the dividend payment policy is an expensive policy so that companies must provide large amounts of funds for dividend payments; therefore companies prone to adopt conservative policies with stable dividend payments and refuse to reduce dividend payments (Murhadi, 2008 and Brav et al., 2005). Furthermore, this is likely because companies in Indonesia are companies that consist of family firms. Family ownership has been dominating companies registered in Indonesia. Private institutions are representations of family ownership. Mahadwartha (2007) postulated that a lower level of outside shareholders would increase dividend payments in order to meet the personal wealth of the founding shareholders. Managerial ownership negatively affects dividend policy. Companies that have managerial ownership tend not to pay dividends because managerial ownership and dividend policy are a binding mechanism on the agency theory perspective.

The results for this study revealed that the market-to-book ratio had a significant positive effect on dividend policy, even though the hypothesis of this study concluded a negative relationship between market-to-book ratio and dividend policy. This reflects that there has been a type 1 error, meaning the result of the study showed that H_0 was rejected while H_0 is actually correct. Companies' high market-to-book ratio denotes their high growth opportunity. Usually, companies that have high growth opportunities tend to have a high level of information asymmetry (Myers and Majluf's, 1984; Core, 2001; and D'Mello and Ferris, 2000). Additionally, managers in high-growth companies have more knowledge about the company's investment opportunities and expected future cash flows from existing company assets (Smith and Watts, 1992). Little (1960) found that companies with high-growth in the current period prone to grow high in the upcoming period. Therefore, to convince investors upon a healthy company condition, high future growth prospects and earnings, the company uses information asymmetry to pay high dividends as a signal that the company is in good condition.

The findings from this study showed that asset structure had a significant positive effect on dividend policy, even though the hypothesis of this study pointed out that there is a negative relationship between asset structure and dividend policy. The company's fixed asset is one of the common meth-

ods used to calculate company information asymmetry. Companies that have large amounts of fixed assets on the balance sheet have more significant information asymmetry because the cost of verifying the information is also high (Baker and Gompers, 2012 and Upadhaya et al., 2013). The significant relationship of asset structure on dividend policy supports agency cost theory. Companies that have high fixed assets can use high debt so that higher fixed assets will facilitate collateral in debt submission (Murhadi, 2011). The existence of debt will reduce agency conflict (Mollah, 2000).

The results from this study showed that size had a significant negative effect on dividend policy, even though the hypothesis of this study showed that there is a positive relationship between size and dividend policy. Yarram and Dollery (2015) stated that company size could be used as an asymmetrical level of information within a company. In general, large-scale companies have more information available than small-scale companies. Large-scale companies will usually be observed by analysts from securities companies and investment managers, which make the companies, cannot carry out financial reengineering. It drives lower information asymmetry because of the availability of more information and leads to a decrease in dividend function as a signal that makes companies tend to pay lower dividends. It is in contrast to small-scale companies that do not get public attention whereby to communicate its health condition; the company pays more substantial dividends to shareholders (Murhadi, 2011).

The results of this study indicated that profitability had a significant negative effect on dividend policy, even though the hypothesis of this study stated that there is a positive relationship between profitability and dividend policy. Companies with high profitability tend to use retained earnings for funding sources; this is in line with pecking order theory and tends to pay lower dividends. This is corresponding to research by Jozwiak (2014), Dewi (2008), and Tanzania (2010). Dividend policy is an expensive policy because companies must prepare large amounts of funds (Murhadi, 2010 in Kamel 2016). The dividend policy set by the company provides much information about the company, so the company tends to apply a conservative dividend policy in a stable manner (Murhadi 2010).

The results from this study suggested that the firm's risk had a significant positive effect on dividend policy, even though the hypothesis of this study shows there is a negative relationship between firm risk and dividend policy. High company risk shows a positive relationship that information

asymmetry also tends to be high (Paulo and Martins, 2014). This supports previous studies by Easley et al. (1996) and Aslan et al. (2011). High information asymmetry is due to the cost to reduce this asymmetry is quite expensive compared to the benefits derived from the cost of capital (Armstrong et al., 2010). In addition, company risk can be a signal that investors expect high returns. Investors expect high returns through two elements of capital gains and dividends. Thus, companies that have high risk tend to pay high dividends. Chen and Steiner (1999) in Putri and Nasir (2006) pointed out that at high risk, managers will choose high-risk projects with the objective of getting high returns. As companies earning high returns, the companies' dividends paid will also be high, this pinpoints a good signal to investors.

4 CONCLUSION

This study concluded that of the six variables used, two variables of size (SIZE) and profitability (PROF) showed significant negative result, three variables of Market-to-book ratio (MB), asset structure (ASSTRUC), and firm risk (RISK) indicated significant positive results, and one variable of information asymmetry (ASY) showed insignificant result. This study had a limitation in terms of a limited number of observations, insignificant results, and there are still many other variables, which affect dividend policy that can be examined. Further studies are therefore expected to use more variables that have not been studied in research with a similar topic, for example, insider or outsider ownership, ownership structure, split share reform, etc.

REFERENCES

- Alamdari. (2016). Relationship between Information Asymmetry and Dividend Policy of Companies Listed in TSE. *IJABER*, 14(10), 7047-7057.
- Baker, H. K., & Powell, G. E. (2012). Dividend Policy in Indonesia: Survey Evidence from Executives. *Journal Asia Business Studies*, 6(1), 79-92.
- Basiddiq & Hussainey. (2012). Does asymmetric information drive UK dividends propensity? *Journal of Applied Accounting Research*, 13, 284 – 297.
- Brav, et al. (2005). Payout Policy in the 21st Century. *Journal of Financial Economics*, 77, 483–527.
- Core, J. E. (2001). A Review of The Empirical Disclosure Literature: Discussion. *Journal of Accounting and Economics*, 31(1), 441–456.
- D'Mello, R., & Ferris, S. P. (2000). The Information Effects of Analyst Activity at the Announcement of New Equity Issues. *Financial Management*, 78–95.
- Dierkens, N., (1991). Information Asymmetry and Equity Issues. *Journal of Financial and Quantitative Analysis*, 26, 181-199.
- Hussainey & Al-Najjar. (2011). Future-Oriented Narrative Reporting: Determinants and Use. *Journal of Applied Accounting Research*, 12(2), 123-138.
- Hussainey & Walker. (2009). The Effects of Voluntary Disclosure and Dividend Propensity on Prices Leading Earnings. *Accounting and Business Research*, 39(1), 37-55.
- Krishnaswami, S., Spindt, P., & Subramaniam, V. (1999). Information Asymmetry, Monitoring, and The Placement Structure of Corporate Debt. *Journal of Financial Economics*, 51, 407-434.
- La Porta, R. et al. (1999). Corporate Ownership Around the World. *Journal of Finance*, 471-577
- Li & Zhao. (2008). Asymmetric Information and Dividend Policy. *Financial Management*, 673 – 694.
- Lin, et al. (2017). The Relationship among Information Asymmetry, Dividend Policy and Ownership Structure. *Finance Research Letters*, 1-12.
- Murhadi. (2009) Studi Pengaruh Good Corporate Governance Terhadap Praktik Earnings Management pada Perusahaan Terdaftar di PT Bursa Efek Indonesia. *Jurnal Manajemen dan Kewirausahaan*, 11(1), 1-10.
- Murhadi. (2008). Studi Kebijakan Deviden: Anteseden dan Dampaknya terhadap Harga Saham. *Jurnal Manajemen dan Kewirausahaan*, 10(1), 1-17.
- Mollah, et al. (2000). The Influence of Agency Costs on Dividend Policy in The An Emerging Market: Evidence from The Dhaka Stock Exchange.
- Myers, S. C. (1984). Capital Structure Puzzle. *Journal of Finance*, 39 (3), 575-592.
- Myers, S. C., and Majluf, N. S. (1984). Corporate Financing and Investment Decisions When Firms Have Information That Investors Do Not Have. *Journal of Financial Economics*, 187-221.
- Paulo and Martins. (2008). Information Asymmetry in Stock Trading, Economic and Financial Characteristics and Corporate Governance in the Brazilian Stock Market. *USP, Sao Paulo*, 25(64), 33-45.
- Rezaei, F. and Torkzadeh, K. (2010). Effect of Ownership Structure on Dividend Policy of The Firms Listed in TSE. *Stock Exchange, Issue 16*, 79-99.
- Roll, R. (1988). R2. *Journal of Finance*, 43, 541-566.
- Smith, C.W. and Watts, R.L. (1992). The Investment Opportunity Set and Corporate Financing, Dividend and Compensation Policies. *Business -Financial Research and Policy Studies*.
- Yarram, S. R., and Dollery, B. (2015). Corporate Governance and Financial Policies: Influence of Board Characteristics on The Dividend Policy of Australian Firms. *Managerial Finance*, 41 (3), 267-285.