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Profitability is a Mediation Variable of Debt on Dividend Payout Indonesian Agriculture Companies

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Original Research Article

Abstract

Dividend policy is described as one of the difficult challenges for economists in the financial sector. In this study, the debt and profit chosen are the factors that influence dividend payout. The research method uses conclusive causality with data sourced from the Indonesia Stock Exchange (IDX). The population of this study was agricultural companies listed on IDX in the period 2009-2016 and used a purposive sampling method for their selection. The results showed that profitability had a positive effect on dividends, while debt had no significant effect. However, debt is found to have a significant positive effect on profitability. Primarily, profitability is found as an intervening variable for dividend payout.
Keywords: Profitability, Debt, and Dividend Payout.
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INTRODUCTION

Dividend policy is described as one of the difficult challenges for economists in finance as well as researchers who have not fully understood the factors that influence dividend policy and how these factors interact [1]. There are a lot of debates about the role of dividend decision making in shares prices. Academic persons and corporate managers disagree about whether the value of a firm is independent of its dividend policy. Despite many researches intending to solve the dividends dilemma, dividend policy has remained a controversial issue [2].

Factors that are considered in measuring dividends are leverage. The leverage indicator used is Debt to Equity Ratio (DER). Debt to Equity Ratio reflects the ability of a company to fulfill its obligations, which is indicated by several parts of its own capital that will be used to pay off debt. A few study from Gonzalez [3], Al-Malkawi [4], and Hashemi [5] states that the Debt to Equity Ratio has a negative effect on dividends. On the other hand, Al Thaleb's research [6] states that Debt to Equity Ratio has a positive effect on dividends, whereas in Mehta's [7] study, Gill *et al.* [8], and Afza [9], states that Debt to Equity Ratio is declared as having no influence on dividends.

The effect of Debt to Equity Ratio on profitability shows that the higher the Debt to Equity Ratio, the greater the burden on the company to outsiders. It is very likely will degrade the performance of the company, because the level of dependence on outside parties is increasing, it is in line with research conducted by Babalola [10]. While Debt to Equity Ratio is stated to be positively related to return on Equity by Mulyadi [11]. However, this is contradictory to the Dissanayake [12] study which states that the Debt to Equity Ratio is stated to have no effect on Return on Equity.

Previous researchers have found profitability as one of the most important determinant of the dividend payout policy. Profitability itself is the level of net profit obtained by the company in carrying out its operations. The profit that can be shared with shareholders is profit after the company fulfills all of its fixed obligations, namely interest and tax. This study uses Return on Equity (ROE) as a measuring instrument. The main consideration is that Return on Equity is a derivative of ROI so that the output is a result that can better describe profitability [13]. Based on previous studies by Gill *et al.* [8], Al-Malkawi [4], Al Thaleb [6], and Haleem [14], all of them indicate that profitability has a positive influence on dividends. However, Mehta's research [7] states that Return on Equity has a negative influence on dividends, while research of [15, 9] states that ROE is declared to have no influence on dividends.

This study will test Profitability as an intervening variable between the independent variable and the dependent variable. The very dominant influence of profitability in the company dividends in previous studies, as well as the disparity in the results of research that examined the effect of Debt to Equity Ratio on Dividend Payout Ratio, causing this study to predict the independent variable Debt to Equity Ratio indirectly affects the Dividend Payout Ratio variable.

LITERATURE REVIEW

Dividend

Increase and decrease in dividend payments have major impact on stock prices of the firms. Announcement of increase in dividend payments tends to be related with increase in stock price and announcement of decrease in dividend payments tends to be associated with decrease in stock price around the time of the dividend announcement. Such market process is known as dividend announcement effect. A dividend is a portion of company's earnings that is paid to its shareholders out of the retained earnings. It is declared by the company's board of directors. Companies pay dividends to transfer their profits directly to their shareholders. A company's willingness and ability to pay dividends regularly to shareholders from retained earnings gives the investors insight information about its future growth and performance. The decision to disburse dividends is based on market imperfections due to information asymmetries between management and investors [16]. Kwan [17], Penman [18], AL-Deehani [19] and Woolridge [20] examined some models for explaining dividend behavior. They suggest that dividends changes convey signals to the market about the future of the firm.

In this study, in measuring dividend rates the author used the Dividend Payout Ratio (DPR) as a benchmark of the cash dividends distributed. The dividend payout ratio determines the amount of profit that can be retained as a source of funding. The greater the retained earnings, the less amount of profit allocated to pay dividends. Conversely, if the company prefers to share profits as dividends, then it will reduce the portion of retained earnings and reduce internal funding sources [21].

Profitability

Profitability is an indicator of company characteristics that management does in managing corporate wealth as indicated by the profits that generated [13]. In this study, to predict return on investment in the form of dividends, Return on Equity (ROE) is used. Return on Equity (ROE), is the ratio between earnings after tax (EAT) and total equity derived from deposits of owner's capital, profits not shared, and other reserves collected by the company. The amount of the ROE ratio is strongly influenced by the amount of profit obtained by the company, because the higher the profit earned, it will increase ROE [13].

Debt

Debt to Equity Ratio is the financial ratio which will measure the capability of company in fulfilling the long term obligation, or in the other words it shows company's capability in covering their total liability by using their own capital [22]. Debt policy enables creditor to obtain more information on the company's prospect. The shareholders make into good use of debt policy to share the cost of supervision with the obligation owners/holders in as such that management is encouraged to act disciplinarily to avoid bankruptcy. Ghosh *et al.* [23] stated that managers of good-prospect Company would give signals to the investors by issuing debt instead of self-capital. The use of debt over the target of normal capital structure will enlarge flat-interest burden and bring about the company's *financial distress*. Debt has a significant negative effect on dividend decisions and dividend payouts [24].

METHODOLOGY

Conclusive causality research was chosen in this study to determine a causal relationship which would later manipulate one or more independent variables and control other connecting variables [25]. The population of this research is all agriculture companies that are listed on the Indonesia Stock Exchange (IDX) during 2009-2016 periods. Sampling is taken by purposive sampling technique, which is the selection of sample members based on certain criteria. The criteria used in this study include; Companies that distribute dividends six times during the period 2009-2016. Four companies were selected, namely PT. Astra Agro Lestari Tbk, PT. PP London Sumatra Indonesia Tbk, PT. Sampoerna Agro Tbk, and PT. Tunas Baru Lampung Tbk.

In this study, path analysis techniques were used. Path analysis tests the regression equation which involves several exogenous and endogenous variables at once, allowing testing of mediating / intervening / intermediate variables. Besides, path analysis using SPSS can also measure the direct and indirect relationships between variables in the model through the Sobel test [26].

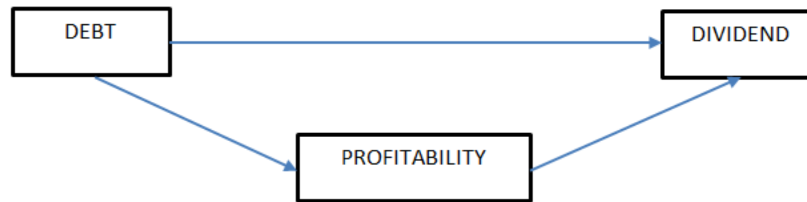

Fig-1: Research Model

Table-1: Direct Effect

	Coeff	s.e.	T	Sig(two)
b (YX)	2.685	4.030	.666	.508
b (MX)	41.287	4.129	9.999	.000
b (YM.X)	.300	0.120	2.502	.015
b (YX.M)	-9.703	6.282	-1.547	.128

RESULTS

The first result in the table above shows (YM.X) that profitability has a positive significant effect on dividend payout with a probability of 0.015 <0.050. These results indicate that the higher the profitability percentage, the higher dividends are distributed. The results of this study are in line with the previous one by Gill *et al.* [8], Al-Malkawi [4], Al Thaleb [6], and Haleem [14] which show that profitability has a positive influence on dividends.

The second result in the table above shows (YX.M) that debt does not have a significant effect on dividend payout with a probability of 0.127> 0.050. These results indicate that the size of the company's debt does not affect the level of dividends distributed. The results of this study are in line with the previous one by Gill *et al.* [8], Al-Malkawi [4], Al Thaleb [6], and Haleem [14] which show that profitability has a positive influence on dividends. The results of this study are similar to the research of Mehta [7], Gill *et al.* [8], and Afza [9], which states that Debt to Equity Ratio is declared not to have an influence on dividends.

The third result in the table above shows (MX) that debt has a positive significant effect on profitability with a probability of 0.000> 0.050. These results indicate that the greater the company's debt will increase the profitability of the company. The results of this study are in line with the previous one by Gill *et al.* [8], Al-Malkawi [4], Al Thaleb [6], and Haleem [14] which show that profitability has a positive influence on dividends. The results of this study are similar to the results of Mulyadi's [11] study which states that Debt to Equity Ratio is positively related to return on Equity.

Table-2: Indirect Effect (Sobel Test)

	Value	s.e.	LL 95 CI	UL 95 CI	z	Sig(two)
Effect	12.388	5.127	2.338	22.483	2.416	.015

Table 2 above shows the indirect influence of debt to payout dividends. This significance value is smaller than the probability level of 0.050, which means that profitability is an intervening variable to the influence of debt on dividends. This result shows a positive direction, meaning that debt that increases and is followed by an increase in profitability will increase the potential for dividends distributed to shareholders.

CONCLUSION

The first result of this study shows that there is a positive influence between the profitability of agriculture companies on dividends distributed. Agriculture company's shareholders can make it as the basis for their investment decision. Investors can choose agriculture companies with increasing profitability trends in hopes of getting a bigger dividend. For companies, this result will become evidence for managers to shareholders, that any increase in profits will increase the dividend opportunities shared with shareholders.

Debt is found to have a positive influence on company's profitability. In agriculture companies, it was found that the greater the debt will increase the ability of companies to generate profits. This result can occur because the debts carried out by agriculture companies are productive for investment and the company's operational processes, so that the increase in debt will result in better operational capabilities and increased profits. Debt is not found as a factor that directly affects dividend distribution. However, if we look at the main findings in this study which show that profitability is an intervening variable between debt and dividends, then this result can show the dominant influence of profitability on dividends, so that debt cannot affect dividends directly but must go through profitability first.

The main findings of this study indicate the positive direction of the intervening variable, meaning that the increased debt of agriculture companies must be followed by an increase in profitability, then it can increase the potential dividends distributed to shareholders. The main findings of this study can be used as the basis for further research to make profitability an intervening variable on the variables that will be tested for the influence on payout dividends.

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