

The Effect of Debt Policy, Profitability, and Liquidity on Dividend Policy (Study on JII 70 index Companies, IDX 2019-2021)

Himmatul Khairi

himmatulkhairi@uinbukittinggi.ac.id, Islamic Business and Economic Department, UIN Bukittinggi

<p>Article Information:</p> <hr/> <p>Keywords: Debt Policy; Profitability; Liquidity; Dividend Policy;</p> <hr/> <p>Article History: Received : July 24, 2023 Revised : Aug 31, 2023 Accepted : Sep 10, 2023</p> <hr/> <p>Cite This Article: Khairi, H. (2024). The Effect of Debt Policy, Profitability and Liquidity on Dividend Policy. <i>Indikator: Jurnal Ilmiah Manajemen dan Bisnis</i>, 8(1), 20-28. doi:http://dx.doi.org/10.22441/indikator.v8i1.21735</p>	<p><i>Abstract</i></p> <hr/> <p><i>The purpose of this study is to investigate the impact of debt policy (measured by Debt to Equity Ratio), profitability (measured by Return on Asset), and liquidity (measured by Current Ratio) on dividend policy (measured by Dividend Payout Ratio). The study focuses on companies listed on the Indonesia Stock Exchange (IDX) under the Jakarta Islamic Index 70. Secondary data from financial statements spanning three consecutive years (2019 to 2021) were utilized for the analysis. The research employed purposive sampling, resulting in a sample of 44 companies, and multiple linear regression analysis was employed to test the research hypotheses. The findings indicate that, collectively, debt policy, profitability, and liquidity significantly influence the dividend policy of companies within the Jakarta Islamic Index from 2019 to 2021. However, when considering individual variables, only profitability demonstrates a significant impact on dividend policy among the listed companies from 2019 to 2021</i></p>
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INTRODUCTION

The main focus of a company is to maximize the value of wealth owned by the owners or shareholders (wealth of the shareholders). This goal is in line with the company's ability to operate the company optimally. This is reflected in the maximum profit with the right use of resources such as by optimizing the composition of the capital structure, either from debt or from equity. Debt is funds from external parties while equity can be in the form of authorized capital and share capital. This activity is the task of financial managers, namely capital budgeting decisions and financing decisions. Capital budgeting decisions are concerned with what real assets the company should acquire while financing decisions are concerned with how these assets should be financed (Al-Malkawi et al., 2010). Company operations and competitiveness can be optimized with increased capital investment from investors.

Debt policy refers to a company's decision on external funding. Companies often tend to place higher levels of debt as it reduces the tax payable. However, investors are highly sensitive to this level of debt, especially when it comes to dividend policy. A high proportion of debt will cause the company to pay more attention to paying off its obligations than distributing profits to share investors.

Expected returns from shareholders are in the form of capital gains and dividends. Capital gain is the margin that investors receive due to the difference between selling shares and buying shares at different times. Dividends are the return of funds paid by the company to shareholders as part of the profits generated. Dividend policy has an important impact, both internally for the company itself and externally, namely to creditors and shareholders. (Ahmad & Wardani, 2014; Risman et al., 2021). Dividend policy is a decision-making process regarding the extent to which cash profits will be retained by the company for future investment purposes,

as well as which part of the current retained earnings will be paid to investors (Kania, 2005). Dividend policy involves two opposing interest groups, namely shareholders who expect to receive dividends and the company's need to maintain retained earnings (Arilaha, 2009). However, not all companies pay dividends and dividend payments are not guaranteed at all times. Dividend policy can differ from company to company, depending on the financial needs and long-term goals of the company. The amount of dividend distribution policy each year is based on the company's conditions such as decisions for company development (Pattiruhu & Paais, 2020).

Dividend distribution is a decision made by company management based on several considerations, one of which is the amount of profit earned by the company. In fact, not a few investors believe that income through dividends is an attractive factor for investors, both for reasonable returns and positive signals from investors on management performance (Kania, 2005). Managers are generally reluctant to reduce the amount of dividends to be distributed to shareholders, because shareholders consider dividend distribution as a positive signal about the condition of the company (Frankfurter & Jr, 2002). This indicates that investors have the assumption that the company has good value and can provide benefits as a return on investing their funds.

Indonesia, home to the world's largest Muslim population, has its own Islamic capital market that encourages the operation of muamalah in line with sharia law. The Jakarta Islamic Index (JII), Indonesia Shariah Stock Index (ISSI), Jakarta Islamic Index 70 (JII70 Index), and IDX-MES BUMN 17 are the four Islamic stock indices that make up Indonesia's current Islamic capital market. The JII70 Index tracks the performance of 70 Islamic stocks that are actively traded on the Indonesia Stock Exchange (IDX). The IDX selects stocks from the Indonesian stock market that are eligible for inclusion in the JII70 stock index. Islamic equities with the highest capitalization as measured by the Indonesia Shariah Stock Index (ISSI) meet these requirements.

LITERATURE REVIEW

Dividend Policy

Dividend policy is a decision whether the profit generated by the company will be distributed to shareholders as dividends or will be kept as retained earnings. If the distribution of dividends to shareholders increases, the amount of retained earnings will decrease. However, if the company focuses more on growth, the amount of retained earnings will increase so that the dividend distribution will be lower. There are several theories that form the basis for determining dividend policy, namely:

(1) Irrelevant Dividend Theory

In 1961, Miller and Modigliani proposed the theory of dividend irrelevance. The company's dividend policy is irrelevant to the value of the company because higher dividends will require more stock sales to raise funds for investment programs. An important assumption here is that future market value will remain unaffected by current dividends. Miller and Modigliani's dividend irrelevance argument is elegant, but it does not explain why firms, the public, and investment analysts are so interested in dividend announcements (N. Bhattacharya, 2007).

If a company thinks that internal growth is more profitable than investment opportunities available to shareholders elsewhere, then it will choose to keep profits and reinvest them into the business. Companies that are able to manage their cash flow effectively tend to maintain and even increase dividend payments over time (Ahmed, 2015). In addition,

part of the dividend puzzle arises from the fact that dividends are usually taxed at a higher rate compared to income from capital gains.

(2) Bird in the Hand Theory

Firm value can reach its maximum with a high dividend payout ratio. Investors have the perception that the benefits obtained through dividends are better than the benefits expected from the increase in stock value. Investors prefer cash in hand to future capital gains due to lower risk (Baker & Powell, 2012).

(3) Tax Differential Theory

Investors are more likely to choose capital gains over dividends because of the tax liability on dividends. According to this theory, investors can defer tax payments by choosing capital gains, making it a more desirable option (N. Bhattacharyya, 2007).

(4) Clientele Effect.

Clientele Effect refers to the tendency of companies to attract the type of investors who have a preference for a particular dividend policy. According to Miller and Modigliani, the company plans to implement a special dividend policy in order to attract a group of investors who are interested in the policy (N. Bhattacharyya, 2007).

Debt Policy

Debt policy is a decision taken by a company to meet payments through the use of external sources of funds in the form of debt. Debt policy reflects the company's funding strategy which involves accepting long-term debt to support the company's operations. Decisions regarding the company's debt policy are directly related to the company's capital structure, because debt is one of the elements that play a role in achieving an optimal capital structure. Aivazian et al (2003) in Al-Najjar & Belghitar (2011) stated that companies with low debt levels with collateral assets have greater financial ability to pay dividends. However, in the research of Myers & Bacon (2004), the significance of dividend cash flow is as a signaling mechanism to shareholders, because even in high growth situations, companies are willing to increase debt to finance dividend increases.

In this study, Debt to Equity Ratio (DER) is used as an indicator to measure debt policy. DER is a ratio to calculate the company's ability to finance its operations through loans provided by shareholders. A higher DER indicates that the company uses a higher proportion of debt and has a lower proportion of equity capital.

Research Pattiruhu & Paais (2020), Wijayanto & Putri (2018) shows that DER has a positive and significant effect on dividend policy. However, Apriliani & Natalylova (2017), Ahmad & Wardani (2014), Mauris & Nora (2019) do not show that the level of debt has an effect on dividend policy.

H1: Debt policy has a positive effect on Dividend Policy in companies incorporated in JII70.

Profitability

Profitability refers to a company's ability to generate profits through the sale of assets and the use of specific share capital. Companies that have a stable profit level are able to generate greater free cash flow, which in turn can allow for higher dividend payments (Naceur et al., 2006). Investors expect a maximum rate of return, while company management considers the decision to retain some profits as reinvestment to improve company performance (Pattiruhu & Paais, 2020). Baker & Powell (2012) research found that company managers in Indonesia consider factors such as income stability and current and expected future income levels as the most important dividend determinants. Research by Apriliani & Natalylova (2017), Pattiruhu & Paais (2020), Ahmad & Wardani (2014), Lestari et al., (2017), and (Monika & Sudjarni,

2017) shows that profitability has a positive and significant effect on dividend policy. However, research by Ahmed (2015) and Estuti et al., (2019) shows that liquidity has no effect on dividend policy.

H2: Profitability has a positive effect on dividend policy in companies that are members of the JII.

Liquidity

Research shows that liquidity is a major determinant of the decision to pay dividends (Al-Najjar & Belghitar, 2011). Dividend policy is not only used to signal the level of possible income but also income volatility (Adil et al., 2011). The amount of dividends given is proportional to the high level of liquidity. This is in line with the research of Ahmed (2015), Lestari et al., (2017) and Monika & Sudjarni (2017). However, in research Pattiruhu & Paais (2020), Ahmad & Wardani (2014), Apriliani & Natalylova (2017), Wijayanto & Putri (2018), Mauris & Nora (2019) show that liquidity has no effect on dividend policy.

H3: Liquidity has a positive effect on Dividend Policy in companies incorporated in JII70.

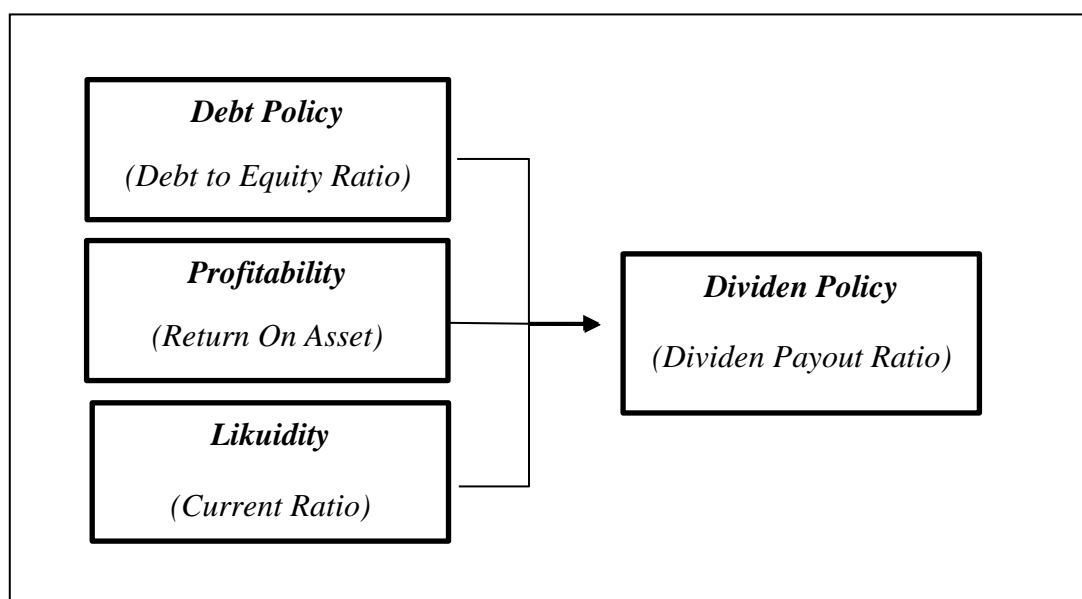


Figure 1. Research Framework

METHOD

Research Design

This study uses a hypothesis testing method and has a correlational type of relationship between the dependent variable and the independent variable. This research is an empirical study that combines cross-sectional and time series (panel data) approaches. The subjects of this research are companies listed in the Jakarta Islamic Index 70 sharia stock index. The period studied covers 2019 to 2021.

Research Sample

The research sample was carried out using purposive sampling method based on predetermined criteria. The criteria used in sampling in this study include:

1. The sample consists of companies listed in the Jakarta Islamic Index 70 index on the Indonesia Stock Exchange in the period 2019 to 2021.
2. The sample consists of companies that provide dividend distribution during the period 2019 to 2021.
3. The sample consists of companies that issue complete annual reports, including financial statements and audit reports, which can be accessed by the public.
4. The sampled companies provide the data needed to calculate the research variables in full and in detail.

Operational Definition of Research Variables

1. Debt Policy
Debt policy is a company funding policy that comes from external parties. Debt Policy is measured using the Debt Equity Ratio (DER) ratio which compares total debt to total company equity.
2. Profitability
Profitability shows the profit the company earns from its operational activities. One measurement of profitability is the Return on Asset (ROA) ratio, which is a ratio that shows the company's ability to generate profits from its assets.
3. Liquidity
Liquidity reflects the company's ability to meet short-term obligations. One way to measure the company's liquidity is with the Current Ratio (CR) which indicates the company's ability to meet its current obligations.
4. Dividend Policy
Dividend policy refers to the company's decision regarding the distribution of profits to shareholders or retaining them as capital for the next period. In this study, the Dividend Payout Ratio (DPR) proxy is used, which measures the ratio between dividends per share and earnings per share.

Data Analysis Technique

In this study, the panel data analysis method was used using Eviews 12. Before conducting regression analysis, a classical assumption test was carried out to ensure that the regression model used did not experience problems related to normality, autocorrelation, multicollinearity, and heteroscedasticity. If all assumptions are met, then the analysis model is considered valid.

The analysis model applied in this study is panel data regression. The purpose of regression analysis is to determine how much influence the independent variable has on the dependent variable. The regression equation used in this model is as follows:

$$N = b_0 + b_1\text{Debt} + b_2\text{Prof} + b_3\text{Liq} + e$$

Where:

- N : Company Value
b₀ : Constant
Debt : Debt Policy
Prof : Profitability
Liq : Liquidity
e : Error Term

Furthermore, hypothesis testing will be carried out by considering the Coefficient of Determination (R² and Adjusted R²), Statistical Test "F" and Statistical Test "t" to test the effect of each independent variable on the dependent variable.

RESULTS AND DISCUSSION

Result

From the sample selection criteria, 26 companies were obtained that met the purposive sampling criteria. Therefore, there are 79 observations that become the object of research over a span of 3 years. The data used in this study have met the classical assumptions, including normal data distribution, and have gone through the testing stage to check for multicollinearity, heteroscedasticity, and autocorrelation. Panel Data-based Multiple Regression used as The fixed effects model emerged as the winner in a series of tests conducted on the panel data using the Chow and Hausman tests. The multiple regression results using the fixed effects model are as follows:

$$y = 2.24 - 0.08\text{debt} - 0.35\text{prof} + 0.54\text{liq} + e$$

The value of 0.6126 for Adjusted R-Square indicates that the model explains the variance in the independent variables satisfactorily. According to the findings, the independent variables in the model adequately explain 61.26 percent of the observed variance in the dependent variable; the remaining 38.74 percent relates to matters outside the scope of this investigation.

Table 1. Regression analysis results

Sample: 2019 2021				
Periods included: 3				
Cross-sections included: 26				
Total panel (balanced) observations: 78				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-2.246636	0.440910	-5.095449	0.0000
DEBT	-0.086147	0.152225	-0.565918	0.5740
PROF	-0.356649	0.107041	-3.331883	0.0016
LIQ	0.547820	0.311639	1.757868	0.0850
Effects Specification				
Cross-section fixed (dummy variables)				
R-squared	0.753490	Mean dependent var	-0.741486	
Adjusted R-squared	0.612628	S.D. dependent var	0.616499	
S.E. of regression	0.383704	Akaike info criterion	1.200811	
Sum squared resid	7.214212	Schwarz criterion	2.077023	
Log likelihood	-17.83163	Hannan-Quinn criter.	1.551575	
F-statistic	5.349117	Durbin-Watson stat	2.745999	
Prob(F-statistic)	0.000000			

Source: Secondary data, Eviews processing (2023)

In addition, for all independent variables, the f-statistic test returned a significance level of 0.0000. If the p-value is less than 0.05, then the independent variables have a statistically significant influence on the combined dependent variable. T-statistics are used to determine how much influence each independent variable has on the outcome variable. Only the

profitability variable has a p-value below the statistical significance threshold. This suggests that the profitability variable does play a considerable role in determining the interest yield.

Discussion

In line with H1, dividend policy is affected by debt policy. Debt policy, as evaluated by the debt-to-equity ratio, has a t-count of -0.56 and a significant probability of 0.574, according to the test findings. If the t-count is negative, it indicates that a company's dividend payout ratio is negatively correlated with its debt burden. That is, the greater the debt burden in the company's capital structure, the smaller the dividend payout ratio. There is no statistically significant relationship between debt policy and dividend policy if the significance value is greater than 0.5. Therefore, our study confirms that a firm's dividend policy is not affected by its debt policy or debt structure. This suggests that, high or low debt, corporations still consider paying dividends to shareholders.

The negative relationship found suggests that in a high debt structure, high interest costs will occur. This interest cost requires high funding, thus causing the consideration to distribute dividends to be smaller. The results of this study are consistent with the research of Zainuddin & Mananohas (2020), Ivory & Suryono (2020) and Ulfa et al., (2021).

Hypothesis 2 suggests that profitability affects dividend policy, and the data supports this with a t-value of -3.33 at a significance level of 0.0016 for profitability defined by Return on Assets (ROA). If the t-count is negative, this indicates that a company's dividend policy is negatively correlated with its profitability; in other words, the more profitable the company, the smaller its dividend payout.

Also, a significance score of less than 0.5 indicates that earnings significantly affect dividend decisions. This shows how the profit for the year affects the dividend policy. The negative correlation in this model suggests that dividend payouts are not directly related to the financial health of the company. A significant dividend payout is not guaranteed regardless of the profitability of the company. Dividend distribution is based on dividend patterns in previous years, profit and cash flow stability, and expected future profit levels (Baker & Powell, 2012). The results of this study are in accordance with research Pattiruhu & Paais (2020) and Ulfa et al., (2021).

Using the ratio of current assets to current liabilities as a proxy for liquidity, the test findings show that liquidity affects dividend policy (H3; see also H1 and H2), with a t-value of -1.75 and a significant probability of 0.085. If the t-count is negative, this indicates that there is an inverse relationship between a firm's liquidity and its dividend policy; in other words, a high t-count does not guarantee a high dividend payout ratio.

Furthermore, if the significance value is greater than 0.5, then liquidity has no significant effect on dividend policy. The word "liquidity" is used to characterize a company's ability to pay for its day-to-day operations and other short-term commitments. This means that dividend payments are not based on the company's cash flow. A company's ability to pay dividends should not be assumed simply because it has sufficient cash. When deciding on dividend policy, businesses should also consider operational interests, short-term responsibilities, and investment choices. The results of this study are in accordance with the research of Zainuddin & Mananohas (2020) and Pattiruhu & Paais (2020).

CONCLUSION

The purpose of this study is to evaluate the impact of debt policy, profitability, and liquidity on dividend distribution decisions. The results show that the three factors collectively affect dividend policy by 61.29%. However, upon further analysis, it was found that profitability has a more significant influence individually on dividend policy. A company's profitability, which reflects the level of profit earned, plays an important role in determining dividend distribution policy. The possibility of dividend payouts increasing as the company's profits rise seems intuitive.

However, research shows that the choice of dividend payout is not significantly affected by debt policy. This suggests that corporations with a capital structure that involves both creditors and shareholders give equal weight to the interests of both groups when making decisions about dividend distribution.

The research also shows that the liquidity status of the company has no significant effect on dividend policy. The ability to pay dividends does not depend on a firm's liquidity, which is its ability to meet short-term commitments and finance its operations.

The findings of this study are consistent with previous research that shows profitability to be a more important element in dividend policy than debt and liquidity strategies.

High-capitalization Islamic equities included in the Jakarta Islamic Index are used as the sample for this analysis. Alternative research objectives, longer study period, and inclusion of additional elements that may influence dividend policy with alternative proxies are all possibilities for further investigation.

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