

## Influence of Fundamental Factors on Dividend Payout Policy: Study on Construction Companies Listed on Indonesian Stock Exchange

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### Abstract

This study examines the fundamental factors that influence the dividend payout policy, namely leverage, liquidity, free cash flow, firm size, firm growth, business risk and profitability. Several previous research results indicate differences in research findings. This study was conducted on five construction contractor companies listed in Indonesia Stock Exchange during 2010 to 2016. Multiple regression analysis was operated through SPSS 20 program and hypotheses testing simultaneously with F-test and partially with t-test. The results show that all independent variable are important factors in dividend payout policy, and firm size is the most dominant factors affecting dividend payout policy.

**Keywords:** Construction contractor companies, Dividend payout policy, Fundamental factors, Indonesia Stock Exchange.

### INTRODUCTION

The number of national construction contractors that are listed on the Indonesia Stock Exchange from 2010 to 2016 amounted to 10 companies. However, only 5 companies which pay dividends regularly every year in that period. They are PT. Adhi Karya Tbk, PT. Pembangunan Prumahan Tbk, PT. Jaya Konstruksi MP Tbk, PT. Wijaya Karya Tbk and PT. Total Bangun Persada Tbk. As one of the business types in Indonesia, the construction service business is required to give profit to its shareholders. The company engaging in the property and construction sectors are more likely to pay dividends compared to other business fields [1]. Dividend policy is one of the most controversial issues in the financial sector, but it still remains a puzzle, whether the dividend payout policy may influence a company's value or not [2]. Dividend payout policy is a critical financial decision because it is involved in determining the value of money that should be distributed to the shareholders as profit or internally reinvested. Fundamentals economic factors - that are part of the capital structure and working capital companies also influence dividend payout policy. Participate in initiating the discussion on dividend payout policy as one of the fundamental components of our corporate policy [3]; [4]; [5]. It is seen as an issue of interest in financial literature.

### Leverage

Leverage is the company's ability to use assets or funds that have fixed costs or fixed costs (or fixed assets) to increase the level of income (return) for the company owner [6]. Leverage is divided into three types, namely operating leverage, financial leverage and total leverage [6]. Leverage is closely related to the financial obligations of the company, which must be settled with the other parties. Leverage or debt is one of the sources of corporate financing, originating from another party. In this case, it is called a creditor where the fund yielding from debt is used to run the company's operations.

### Liquidity

Liquidity is an indicator of the company's ability to pay all short-term financial liabilities at maturity by using current assets available [6]. Mehta (2012) states that the liquidity or cash position (cash flow) is an important factor in determining the dividend payout policy. The size of the short-term liquidity position of the firm is by comparing the current assets value with the current liabilities value, where the current assets cover a large percentage of the total investment of the company, while current liabilities are part of the short-term liabilities and obligations of the company. These measures are the current ratio, quick ratio and networking capital [6].

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**Free Cash Flow**

Free cash flow is the cash flow available for capital reserves that can be used for reinvestment after fulfilling all of the business needs [7]. Free cash flow can be defined as excess cash to be used to fund projects with positive net worth [8]. Conflict interest arises when shareholders and managers want to determine dividend size to be paid by the availability of *free cash flow* [9]. state that managers can benefit themselves using excess cash [8]. Therefore, companies should pay dividends to reduce intentions and help managers from spending more money on futile projects.

**Company size**

Company size is the number and variety of production capacity and the ability of a company to process the production or the amount and variety of corporate services that can be provided simultaneously to its customers [10]. Managers have a larger control over big companies whose ownership is more dispersed and shareholders have little incentive and little ability to monitor the course of operations, as described in agency theory. Thus, large companies will distribute dividends to block the agency costs [11].

**Firm growth**

The growth factor of the company is also one of the factors that can influence the dividend payout policy [12]. Companies with growing income will tend to pay dividends in small amounts due to high capital demand during the company rapid growth. High-growth firms cost a lot of money to invest in their businesses. Growing companies are trying to improve internal finance and limit their dividend payments because financing with external borrowing is usually higher in interest than using internal funds [13].

**Business Risk**

Business risk is a level of risk on the company assets if the company does not use debt on its operational activities [14]. Business risk is related to high cash flow fluctuations [13]. During the declining period or when facing the business risk, dividend payments of the company should be reduced to maintain the level of equity [1].

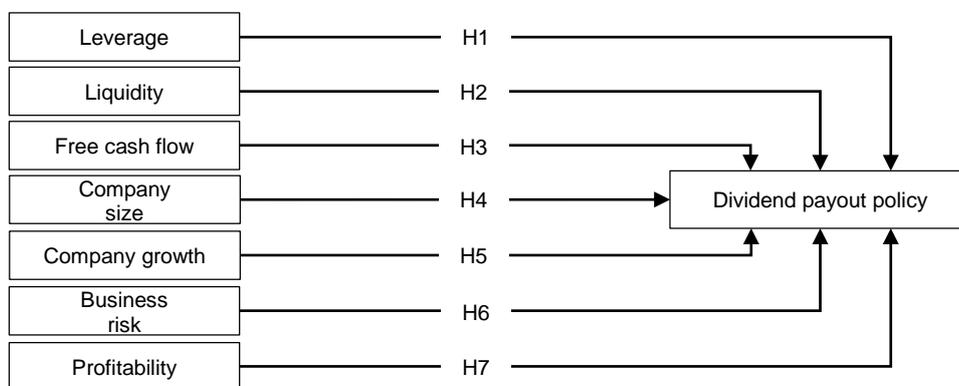
**Profitability**

Profitability is often used as a key indicator of a company's profitability capability. For the shareholders of a company, profitability is used as a reference for determining the amount of the dividend payer on the profit of the results of operations within a certain period. Some financial terms represent a value of financial ratios related to the profitability are gross profit margin, net profit margin, return on investment (ROI) or return on assets (ROA) and return on equity (ROE) [6].

**HIPOTHESES**

The distribution of dividend by a company is a sign given by the company itself in order to show that the company has performed well in carrying out its operations [14]. A policy can increase the payout of dividends if the manager believes that a high dividend payout can be sustained in the future. Thus, the dividend distribution containing the explanation of the company's performance condition will be in good condition in the present and future (Lintner, 1956). Figure 1 shows the conceptual framework of this study.

The relationship between leverage and dividend payout policy has been tested in research which shows that leverage has a positive effect on dividend payout policy [15]; [16]; [17]; [18]; [19]; [20].



**Figure 1.** Conceptual Framework  
Source: Previous Research Results, 2017

It proves that the company's funds are used to pay corporate liabilities to other parties. Thus, it is necessary to maintain internal sources of the fund rather than to distribute them to shareholders in the form of dividends. In contrast, research results shows a positive relationship between Leverage and the dividend payout policy [21]; [22]; [23]. Their research results show that funds obtained from other parties, in the form of loans or debts, allow the company to freely distribute profit or return to shareholders in the form of dividends. Therefore, the following hypothesis is proposed:

H1 Leverage significantly affects the dividend payout policy

A weak liquidity position makes dividends difficult to pay due to lack of cash [24]. Managers can benefit themselves with excess cash, therefore the company must pay dividends to reduce free cash flow and protect managers from spending more money on futile projects [11]. The relationship between liquidity and dividend payout policy has been tested in a study which indicates that the liquidity factor influence positively and statistically significant to dividend payout policy [17]; [18]; [19]; [20]. On the other hand show that liquidity has a negative but statistically insignificant effect on dividend payout policy [21]; [19]. Therefore, the following hypothesis is proposed:

H2 Liquidity significantly affects the dividend payout policy

Managers can benefit themselves with surplus cash, so the company must pay dividends to reduce goodwill and fortify the manager in the effort to spend more money on futile projects [11]. That the free cash flow has a positive effect and statistically insignificant to the dividend payout policy [22]. On the contrary show that free cash flow has a negative effect but statistically insignificant on dividend payout policy [21]. Meanwhile, free cash flow has a negative effect and statistically significant on the dividend payout policy [18]. Therefore, the following hypothesis is proposed:

H3: Free cash flow significantly affect the dividend payout policy

When the company grows larger, it shows that they have a higher level of asymmetry information resulting in the higher costs of the agency. Show

that company size has a positive effect and statistically insignificant on the dividend payout ratio [15]; [18]; [20]; [23]. Instead, show that company size has a negative effect and statistically significant on the dividend payout policy [21]; [16]. Therefore, the following hypothesis is proposed:

H4: Company size significantly affects the dividend payout policy

Company growth is one of the factors that could affect dividend payout policy [12]. That the growing company tries to improve their internal financial and restrict dividend payments [13]. The reason is that financing with external loans usually has higher interest rates than using internal fund. The growth of the company has a positive effect and statistically insignificant on the policy of dividend payments [21]; [17]. Meanwhile, that company growth has a negative effect and statistically insignificant on the dividend payout policy [15]. Therefore, the following hypothesis is proposed:

H5 Corporate growth significantly affects the dividend payout policy

That business risks are associated with high fluctuations in cash flows [13]. Indicate that business risk influences negatively to the dividend payout policy that will minimize the company's possibility of paying the dividend [15]; [22]. In contrast, that the business risk factors have a positive influence on the dividend-sharing policy [20]; [23]. Thus, invested or risk-bearing businesses can pay their dividends to the shareholders. Therefore, the following hypothesis is proposed:

H6 Business risk significantly affects the dividend payout policy

Companies with more advantages will be more likely to pay dividends to shareholders comparing to the company that does not have the advantage. That profitability has a positive effect on dividend payout policy [15]; [16]; [17]; [18]; [22]. Instead, that profitability negatively affects the dividend payout policy [20]; [23]. Therefore, the following hypothesis is proposed:

H7 Profitability significantly affects the dividend payout policy

This study examines the fundamental factors that influence the dividend payout policy, namely leverage, liquidity, free cash flow, company size, business risk, and profitability. Several previous research results indicate the difference in research results. Hence, it is necessary to do research by testing the effect of leverage, liquidity, free cash flow, company size, corporate growth, business risk and profitability of dividend payout policy.

**RESEARCH METHOD**

This study uses a quantitative paradigm approach, namely the method testing of the theory by examining the relationship between variables [26]. The characteristics of companies as the research population are: (1) construction contractor companies listed on the Indonesia Stock Exchange respectively during the study period from 2010 to 2016; (2) the company has a value of equity without negative value in a row during the study period; and (3) the company pays dividend in a row during the study period. Based on these criteria, there are 5 companies as the members of this research population. The research data combine 7-year time data and cross-section data from 5 companies. The research data is obtained from published sources in the form of the balance sheet and income statement ended on 31 December each year. The source of financial information from Indonesia Capital Market Directory, 2010 - 2016 obtained from Indonesia Stock Exchange and other related sources. The method of collecting data in the form of documentation is taken from existing documents containing past events. This method is used to obtain secondary data in the form of financial statements, stock prices and all information related to the company required in this study. Analysis of this research data is multiple regression analysis. Modeling regression analysis with seven independent variables and one dependent variable in the form of equation Y

$= \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + e$ , where Y is the dividend payout policy,  $\beta_0$  is a constant,  $\beta_1-7$  is the beta coefficient of the dependent variables ( $X_1$  = Leverage,  $X_2$  = Liquidity,  $X_3$  = free cash flow,  $X_4$  = company size, firm growth  $X_5 = X_6$  = business risk,  $X_7$  = profitability,  $e$  = error term). A hypothesis test is conducted simultaneously with the F-test and partially by t-test with a level of error  $\alpha = 5\%$ .

**RESULTS AND DISCUSSION**

Table 1 shows the F test results (simultaneous influence) with error rate  $\alpha = 5\%$ . The value of F arithmetic is 5,270, while F table ( $\alpha = 0.05$ ; db regression = 7: residual db = 27) is 2,373. Because F arithmetic > F table is  $5.270 > 2.373$  or Sig value.  $F (0.006) < \alpha = 0.05$  then the regression analysis model is significant. This means that  $H_0$  is rejected and  $H_1$  is accepted, it can be concluded that the dependent variable (Dividend Payout Policy) can be significantly influenced by independent variables (Leverage ( $X_1$ ), Liquidity ( $X_2$ ) Free Cash Flow ( $X_3$ ), Company Size ( $X_4$ ), Growth ( $X_5$ ), Business Risk ( $X_6$ ), Profitability ( $X_7$ )).

**Table 1. F Test Result (Simultaneous)**

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	46.412	7	6.630	5.270	0.001
Residual	33.972	27	1.258		
Total	80.383	34			

Source: Secondary data processed, 2017

Table 2 shows the result of t-test (partial influence) from each independent variable to the dependent variable. The effect of the test result is partial compared with the significance value t with the probability error value of  $\alpha = 5\%$ . The t-test result between  $X_1$  with Y obtains the t-count value of (2.116) bigger than t-table (2.052) or sig. t

**Table 2. T-Test Result (Partial)**

Variables	t	Sig.	t Table	Information
(Constant)	3.070	0.005		
Ln_X1	2.116	0.044		Significant
Ln_X2	-0.403	0.690		Not significant
Ln_X3	0.928	0.362		Not significant
Ln_X4	-2.954	0.006	2.052	Significant
Ln_X5	2,475	0.020		Significant
Ln_X6	0.640	0.528		Not significant
Ln_X7	0.494	0.626		Not significant

Source: Secondary data processed, 2017

(0.044)  $< \alpha = 0.05$  then the effect of  $X_1$  to Y is significant which means that  $H_1$  is accepted. The t-test result between  $X_2$  and Y obtains the t-count value = - 0.403 smaller than t-table (2.052) or sig. t (0.690)  $> \alpha = 0.05$  then the effect of  $X_2$  to Y is not significant, which means  $H_2$  is rejected. The t-test result between  $X_3$  and Y obtains the t-count value of (0.928) smaller than t-table (2.052) or sig. t (0.362)  $> \alpha = 0.05$  then the effect of  $X_3$  to Y is not significant, which means  $H_3$  is rejected. The t-test result between  $X_4$  and Y obtains the t-count value of (2.954) bigger than t-table (2,052) or sig. t (0.006)  $< \alpha = 0.05$  then the effect of  $X_4$  to Y is significant, which means  $H_4$  is accepted. The t-test result between  $X_5$  and Y obtains the t-count value of (2.475) greater than t-table (2.052) or sig. t (0.020)  $< \alpha = 0.05$  then the effect of  $X_5$  to Y is significant, which means  $H_5$  is accepted. The t-test result between  $X_6$  and Y obtains the t-count value of (0.640) smaller than t-table (2.052) or sig. t (0.528)  $> \alpha = 0.05$  then the effect of  $X_6$  to Y is not significant, which means  $H_6$  is rejected. The t-test result between  $X_7$  and Y obtains the t-count value of (0,494) smaller than t-table (2.052) or sig. t (0.626)  $> \alpha = 0.05$  then the effect of  $X_7$  to Y is not significant, which means  $H_7$  is rejected.

The results show that the influence of leverage on dividend payout policy is significant and positive. The increase of Leverage gives a significant impact on the dividend payout policy as the company continues to pay the dividend to its shareholders. This finding is in line with the research conducted by Hashemi and Akhlagi (2010) which show a significant positive relationship between leverage, dividend policy, and profitability. Influence of liquidity to the dividend payout policy is not significant and negative. Liquidity does not affect the dividend payout policy. This finding supports the research conducted that liquidity is not significant in dividend payment [27]; [28]; [2]; [29]. The effect of *free cash flow* on dividend payout policy is not significant and positive. The availability of cash does not have a big impact on the company because the company can still pay the dividend in a large amount. This finding is in line with the research conducted that the *free cash flow* factor has a positive effect and statistically insignificant on the dividend payout policy [22]. The increase of Company Size does not directly raise the dividend payout to the shareholders. The company's exposure becomes the dominant impact on the dividend payout policy but the increase in company size does not necessarily increase the amount of dividend to be paid. This finding is in

line with the research conducted that company size has a negative effect and statistically significant on the dividend payout policy [21]; [16]; [1]. The company growth's influence against dividend payment policy is significant and positive. Company Growth is very important for the company to pay the dividend. Therefore, the rise in growth will also improve the portion of the dividend payment to the shareholders. On the other hand, the Company with growing income is likely to pay the dividends in the small amount due to the high demand for capital when the company is growing rapidly. This finding is in line with the research conducted that the company's growth has a positive effect and statistically significant on the dividend payout policy [1]. The company with rapid-growth certainly has a large external financing needs with the result that the company does not have to pay the dividend in large amount. The influence of the business risk to the dividend payment policy is not significant and positive. Even the company with risky business type can still pay the dividend. In other words, the company can still pay dividend considering the risky business they are operating. This finding is in line with the research conducted that business risk has an insignificant effect on the dividend payout policy [1]. Thus, the company can still pay dividend to its shareholders despite its risky business. The effect of profitability on dividend payout policy is insignificant and positive. Profitability has no important role in the dividend payout policy because the company can still pay its dividend even when the company does not generate profit. This finding is in line with the research conducted that profitability negatively and insignificantly affects the dividend payment policy [1].

## **CONCLUSION AND SUGGESTION**

### **Conclusion**

All of the tested independent variables are important factors in the dividend payment. Therefore, the contractor company should keep the liquidity, free cash flow, and growth to avoid financial profitability problems and to expand the business scale and diversify the existing risk. The role of the third party in financing through leverage is very important in conducting the business. Especially when the company wants to expand their business. This can also be used to pay the dividend. Furthermore, the company size is the indicator of small large of the business scale. Thus, the company can expand their business in order to pay the dividend maximally. The last part

is that the higher the company's growth, the higher the dividend payment. The reason is that high-growth company indicates no issue in its finance.

#### **Suggestion**

The management division of the company should maintain and increase their service quality. The Company Size has the most dominant effect on the Dividend Payment Policy through increasing the sales, expanding the investment to generate larger profit. By doing so, the manager has more freedom to increase the dividend payment to the stakeholder.

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