

THE INFLUENCE OF CREATIVE ACCOUNTING AND OTHER FACTORS TO DIVIDEND PAYOUT RATIO

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Abstract: *The objective of this research is to analyze the influence of creative accounting, liquidity, size, leverage, return on equity and sales growth on dividend payout ratio. Population in this research is all listed manufacturing companies in Indonesia Stock Exchange during 2010 to 2012. Samples are obtained through purposive sampling method, in which 37 listed manufacturing companies in Indonesia Stock Exchange meet the sampling criteria resulting 111 data available are taken as sample. The result of this research shows that return on equity and sales growth have influence to dividend payout ratio. On the other hand, creative accounting, liquidity, size and leverage do not influence dividend payout ratio.*

Keywords: Dividend Payout Ratio, Creative Accounting, Liquidity, Size, Leverage, Return on Equity, Sales Growth.

Abstrak: Tujuan dari penelitian ini adalah untuk menganalisis pengaruh akuntansi kreatif, likuiditas, ukuran, leverage, laba atas ekuitas dan pertumbuhan penjualan pada rasio pembayaran dividen. Populasi dalam penelitian ini adalah semua perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia selama tahun 2010 hingga 2012. Sampel diperoleh melalui metode purposive sampling, dimana 37 perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia memenuhi kriteria pengambilan sampel sehingga 111 data yang tersedia diambil sebagai sampel. Hasil penelitian ini menunjukkan bahwa return on equity dan pertumbuhan penjualan berpengaruh terhadap rasio pembayaran dividen. Di sisi lain, akuntansi kreatif, likuiditas, ukuran dan leverage tidak mempengaruhi rasio pembayaran dividen.

Kata kunci: Dividend Payout Ratio, Creative Accounting, Liquidity, Size, Leverage, Return on Equity, Sales Growth.

INTRODUCTION

Every day, managers make a lot of decisions regarding the business. One of the most important decisions that they should make is regarding the dividend policy for the company. It is because dividend is perceived as one of the way to reflect the company's operation. Miller and Modigliani (1961) in Gitman and Zutter

(2012) stated that consistent with dividend irrelevance theory, in the perfect markets, the distribution of dividends do not affect the value of the company. However, the perfect market is impossibility exists. Thus, there are many theories regarding the dividends that affect the company value, such as the agency theory, signaling theory, and bird-in-hand theory (Shah et al., 2010).

When a company earns profit, the company pays a portion of dividend to the shareholders and maintains the remaining for investment and operation (Haider et al., 2012). Increase in dividend is mostly seen when earnings is also increase and vice versa. Because dividend is determined by the earnings, there are many viewpoints regarding the relationship between dividend and earnings. One might say that dividend can predict the earnings of the firm, while other viewpoint is the other way around (Shah et al., 2010). Because this very inter-related relationship between dividend and earnings, it is no wonder that managers place emphasis in the way earnings are reported.

In order to maintain regular dividend payment, the company has to maintain their profit. In condition of inconsistent earnings such as losses or much bigger profits, the management tends to smooth their earnings. This earnings management is also called creative accounting. According to Amat and Goethorpe (2005) in Hamdan (2010), creative accounting is more popular in USA as earnings management. While the term creative accounting is usually used in Europe, creative accounting is described as the management's action to manipulate the reported income to distort the true operations of the company.

The relationship between creative accounting and dividend payment can be either positive or negative. The positive relationship explained that in order to pay dividend, a company have to earn a profit in that particular year. Thus, the managers tend to manage earnings to get profit to pay dividend (Haider et al., 2012). On the other side, the negative relationship is supported by dividend-retention problem (Godfrey, 2010) that explained about manager's preference to distribute dividends smaller than what the principal prefer. This problem occurs because managers retain the money to pay their salaries, benefits and to expand the business rather than to distribute it to the principal. This relationship motivates

researcher to conduct this research. It is also interesting to research whether dividend payout induces companies to manage earnings (Shah et al., 2011).

There are still limited researches and publications regarding the issue of the influence of creative accounting and other factors to dividend payout ratio, especially in Indonesian context. Prior researches are mostly done in Pakistan and China. Thus, the researcher is being motivated to research about the factors affecting dividend payout ratio especially creative accounting in manufacturing companies listed in Indonesian Stock Exchange.

Agency Theory

Agency theory can be used to explain the creative accounting practices and dividend payments. Agency theory describes the relationship between the owner of the firm that also called as the principal and the agents or managers that do the operation of the firm. Jensen and Meckling (1976) in Godfrey (2010) stated that agency relationship happens when one party which is the principal (owner) engage another party which is the agent to act in behalf of the principal and held the decision-making authority.

As in human nature to maximize their own interest, agents tend to maximize their own profit and do not act according to the principal's best interest as first intended. Agency conflict happens because of the difference between the principal and agents' interest. The principal monitors the operation that is done by the agents through the reported financial statements. However, the control to prepare the reports is on the agents' authority. This will lead to practice that is done by the managers to fulfill their objective.

The agency cost theory says that a firm that distribute dividend is reassuring shareholders that their money is not wasted by the managers. Thus, the dividend paid will increase the firm's value (Gitman and Zutter, 2012). This agency theory can also explain

about the dividend-retention problem that arises when managers prefer to pay dividend less than what the shareholders prefer (Godfrey, 2010). This happens because the managers want to retain the earnings to maximize their interest with higher salaries, benefits, and to increase the power of the firm under their management.

Signaling Theory

Because the owners do not involved in operations of the business, the information that the managers and owners shared will be different. This gap of information is called asymmetric information. Because of this, agents use the signaling theory to signal expectations and intentions for the future of the firm (Godfrey, 2010). With distributing dividends, outsider will perceived it as a positive signal that the company is profitable.

Bird-in-hand Theory

Bird-in-hand theory describes about the shareholders' preference of cash dividends rather than the capital gain (bird-in-bush theory). This theory describes that shareholder prefer to get the certain profit through cash dividend immediately rather than the uncertain capital gain. These will affect the dividend policy to pay dividends regularly (Malik et al., 2013).

Creative Accounting and Dividend Payout Ratio

Creative accounting can be defined as the use of accounting policies to report financial statement in behalf of managers. Financial statement held the earnings information that is used by internal and external users for decision making. This information also shows the performance of the company and the value of the firm. Thus, management is encouraged to do creative accounting in order to shows good performance. Because of this creative accounting, the credibility of financial statement is on question when financial statement is used to evaluate the performance. The concept of creative accounting based on agency theory

explained that the creative accounting act is influenced by conflict of interest between agent and principal.

Creative accounting occurs in three ways: (1) via the structuring of certain revenue and/or expense transactions; (2) via changes in accounting procedures; and/or (3) via accruals management (Roodposthi and Chashmi, 2011). The most damaging but commonly used is by the accrual, because investors did not expect the extent of accruals management. Accrual is the difference between earnings and the cash flow from operating activities.

One of the accrual components is discretionary accrual, which is the adjustment to cash flow made by managers. This adjustment will cause the financial statement to be reported not according to the real condition. It enables the managers to manipulate earnings because managers have control in short term period for discretionary accruals components and use them to transfer earnings from one period to another.

Most companies prefer to maintain their dividend policy, as a change in policy is often perceived as instability and cause negative impact to stock price (Aurangzeb and Dilawer, 2012). While companies want to pay dividends, they must have positive earnings in that particular year. Thus, it is believed that managers manage earnings to reflect stable earnings and conceal the losses of a company. With positive managed earnings, managers could maintain or even increase the dividend payout ratio. Therefore, some argue that the higher creative accounting practices that happened in a firm will increase the dividend payout ratio.

H₁ Creative Accounting has influence to the dividend payout ratio.

Liquidity and Dividend Payout Ratio

Liquidity is one of the important factors regarding the dividend payments, since dividend represents the cash outflow (Malik et al., 2013). Liquidity represents the firm's ability to fulfill its

short-term obligations when they come due (Gitman and Zutter, 2012). Most commonly used basic measures of liquidity are current ratio and quick (acid-test) ratio. According to Malik et al. (2013), the measurement used in this research is current ratio.

A more liquid company has more stable cash flow and also greater ability to pay dividends (Malik et al., 2013). Companies prefer to maintain their liquidity at certain level as a safeguard for financial flexibility and uncertainty. By paying dividend, the liquidity level of the firm will decrease because of the cash outflow. Thus, the higher liquidity a firm has will also increase the dividend payout ratio, because the firm has more cash to be paid to shareholders.

H₂ Liquidity has influence to the dividend payout ratio.

Firm Size and Dividend Payout Ratio

Firm size represents about how big the firm is and it can be measured by the total company's asset, total sales and market capitalization. This research uses the total company's asset as the measurement of the firm size following the prior research by Scott and Martin (1975) in Shah et al. (2010).

According to Redding (1995), large firms have better opportunity to raise funds at lower cost and easier entry to the capital market. Therefore, larger firms could obtain external funding easier. They do not depend much on the internal funding by retained earnings and may distribute higher dividends. According to Stiglitz (1973) in Moradi et al. (2010), small firms which is in its growth stage retains their earnings for expanding their size. Thus, smaller firms do not distribute dividends, while larger firms distribute higher dividends.

H₃ Firm Size has influence to the dividend payout ratio.

Leverage and Dividend Payout Ratio

Leverage is the ratio between total company's liabilities and total company's assets. This ratio shows how much of the company's

assets that were invested by liabilities. According to Kieso et al. (2011), one of the reasons of why companies did not pay dividends equal with their available retained earnings is to fulfill the debt covenants or agreement with the creditors. The greater liabilities a firm has, the greater risk a firm is unable to meet the debt covenant.

According to Chritchley and Hansen (1989) in Rizqia et al. (2013), the manager's effort to reduce the information gap between managers and shareholders through dividend payout can increase conflict between firm and creditors. This happens because by increasing dividend payout, company will have less money to reinvest and use the external funding. Relationship between financial leverage with dividends policy arises from restrictive debt covenants of creditor. In order to meet the debt covenant such as required retained earnings, companies will pay lower dividends (Jensen et al., 1992 in Rizqia et al., 2013). Thus, the higher company's financial leverage, the lower dividend paid by the companies.

H₄ Leverage has influence to the dividend payout ratio.

Return on Equity and Dividend Payout Ratio

There are many ways to measure profitability. They enable analysts to evaluate the firm's profit with respect to a given level of sales, a certain level of assets, or the owners' investment (Gitman and Zutter, 2012). One of the tools to measure profitability that is used in this research is return on equity (ROE). Return on equity measures the rate of return on the ownership interest of common stock owners, which is generally referred as shareholders' equity. In other words, ROE measures a company's efficiency of generating profits from shareholders' equity. High profitability will generate more cash flow in the future and thus firms are expected to distribute higher dividends (Jensen et al., 1992 in Rizqia et al., 2013). This predicts the positive impact of return on equity to dividend payout ratio.

H₅ Return on Equity has influence to the dividend payout ratio.

Sales Growth and Dividend Payout Ratio

Sales growth represents the growth of the company in terms of its sales. The proxy used in this research is percentage of change in sales. The signaling theory showed that it is more preferable for higher growth company to pay more dividends (Malik et al., 2013). This signals investor that the company has higher growth opportunities. Moreover, firms with fast

growth distribute higher dividend to attract investors (Hafeez and Attiya, 2008). This theory predicts the positive relationship of sales growth and dividend payout ratio.

H₆ Sales Growth has influence to the dividend payout ratio.

RESEARCH METHODS

This research is a causality research. Samples are selected using purposive sampling method. Here are the selected samples:

Table 1 Sample Selection

Criteria Description	Total Companies	Total Data
Manufacturing firms consistently listed in Indonesia Stock Exchange from the year 2009 to 2013	117	351
Manufacturing firms which do not consistently paid cash dividend from 2011 to 2013.	(73)	(219)
Manufacturing firms which do not consistently earned profit from 2009 to 2012	(0)	(0)
Manufacturing firms which do not report their financial statements using IDR currency from the year 2009 to 2013	(6)	(18)
Manufacturing firms which financial statement period do not ended as of December 31 st	(1)	(3)
Number of sample	37	111

Dividend payout ratio is the dependent variable in this research. The measurement of this variable is adapted from the measurement by previous researchers (Shah et al., 2010; Haider et al., 2012, Aurangzeb and Dilawer, 2012) which use cash dividend is divided net income after tax.

The measurement of creative accounting is adapted from the measurement by previous researchers (Shah et al., 2010; Haider et al., 2012) which use absolute value of discretionary accruals as the measurement of creative accounting. The modified Jones model (1995) is used to calculate the discretionary accruals as a proxy of creative accounting. This model is used because Dechow et al. (1995) in Hamdan (2010) reported that the modified-

Jones model is the most powerful model to detect earnings management and also the most recent model. Value of discretionary accruals is the residual value of the results of the following regression

$$TAC_t = a_1 + a_2(\Delta Rev_t - \Delta Rec_t) + a_3PPE_t + e$$

Where TAC_t total accruals on period t (net income - operating cash flow), ΔRev_t change of revenue, ΔRec_t change of receivable, PPE_t property plant and equipment in year t.

Liquidity measures the firm's ability to meet the short-term obligation when it comes due. To measure liquidity, Malik et al. (2013) use the current ratio which is a ratio scale. Firm size describes about how big the firm is and can be measured by natural logarithm of total assets. This model is adapted from Shah et al. (2010),

Haider et al. (2012), and Aurangzeb and Dilawer (2012). Leverage is the ratio between total company's liabilities and total company's asset. This variable can be measured by total liabilities divided by the total assets. The measurement of this variable is adapted from the measurement by previous researcher (Hamdan, 2010).

Return on equity measures the overall effectiveness of management in generating profits with its available shareholders' equity. This variable can be measured by dividing net income of firm i for year t with book value of total shareholders' equity of firm i for year t.

Consistent with prior researchers (Shah et al., 2010; Haider et al., 2012; Aurangzeb and Dilawer, 2012). Sales Growth is described as the change of sales from previous years' sales as an indication of a company's growth. The relationship of sales growth and dividend payout ratio is previously used by Malik et al. (2013) and Hafeez and Attiya (2008).

RESULT AND DISCUSSIONS

The result of descriptive statistics test is shown in the table below:

Table 2 Descriptive Statistics

Variable	Minimum	Maximum	Mean	Std. Deviation
Dividend Payout Ratio	0.03	1.21	0.4457	0.27059
Creative Accounting	1.71E10	1.08E13	8.543E11	1.719E12
Liquidity	0.67	11.74	3.1276	2.28711
Size	25.08	32.84	28.5223	1.72914
Leverage	0.09	0.74	0.3673	0.17055
Return on Equity	0.02	1.22	0.2626	0.20050
Sales Growth	-0.27	0.72	0.1514	0.12300

The result of hypothesis test is as follow:

Table 3 Hypothesis Test Result

Variable	Coefficient	Significance
Creative Accounting	2.148E-14	0.180
Liquidity	-0.005	0.750
Size	-0.009	0.566
Leverage	-0.356	0.109
Return on Equity	0.664	0.000
Sales Growth	-0.357	0.069

Adjusted R² 0.257, F_{6,104} 7.351 Sig. 0.000

The t-test result shows that creative accounting has significance level 0.180 which is above 0.05, means that H₁ is rejected. This shows that creative accounting has no influence on dividend payout ratio. Liquidity has significance level 0.750 which is above 0.05, means that H₂ is rejected. This shows that

liquidity has no influence on dividend payout ratio.

Size has significance level 0.566 which is above 0.05, means that H₃ is rejected. This shows that size has no influence on dividend payout ratio. Leverage has significance level 0.109 which is above 0.05, means that H₄ is

rejected. This shows that leverage has no influence on dividend payout ratio.

Return on equity has significance level 0.000 which is below 0.05, means that H_5 is accepted. This shows that return on equity has positive influence on dividend payout ratio. The coefficient of return on equity is 0.664 and can be interpreted as if the return on equity is higher, the dividend payout ratio will be higher or otherwise.

Sales growth has significance level 0.069 which is below 0,1, means that H_6 is accepted. This shows that sales growth has influence on dividend payout ratio. The coefficient of sales growth is -0.357 and can be

interpreted as if the sales growth is higher, the dividend payout ratio will be lower or otherwise.

CONCLUSION

Based on the hypothesis testing, return on equity and sales growth have influence on dividend payout ratio while creative accounting, liquidity, size and leverage have no influence on dividend payout ratio. The research population is relatively small, which is only manufacturing companies. The recommendations that can be used for future research are expanding the research population into non-financial companies.

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