

“The Effect Of Profitability On Dividend Payment Through Income Smoothing As Moderator (Survey On Pharmaceutical Companies Registered In Indonesia Stock Exchanges in Period of 2015-2019)”

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Article History: Received: 10 January 2021; Revised: 12 February 2021; Accepted: 27 March 2021; Published online: 20 April 2021

Abstract : This research was performed quantitatively through explanatory approach. Secondary data from audited financial reports on pharmaceutical companies listed on the Indonesia Stock Exchange were employed and analyzed using Regression Moderation Analysis (RMA). As many as 45 samples were involved and chosen using purposive judgment sampling. The test results showed that the profitability measured by the net profit margin proxy had a significant and negative effect directly on dividend payments as measured by the dividend payout ratio. This was indicated by the significant level of the pair value of 0.0000. The effect of Income Smoothing on dividend payments was positive but not significant with a pair value of 0.8941. The effect of the interaction variable between net profit margin and income smoothing on positive dividend payments was insignificant with a pair value of 0.5768, while the influence of the net profit margin, income smoothing, and interaction variables on dividend payments had a significant and simultaneous effect by 70.81%. The interaction value is greater than 0.05, which is 0.5768, indicating that there is no moderating effect of income smoothing on the relationship between net profit margin and dividend payments. Therefore, income smoothing tends to have a positive relationship, which means that when the income smoothing variable increases, it weakens the conducive relationship with the net profit margin, but income smoothing can strengthen the relationship between dividend payments. This means that the more decrease the net profit margin, the more decrease the ability to pay dividends as well.

Keywords: Net Profit Margin, Income Smoothing, Dividend Pay Out Ratio

1. Background

The drug companies has issued their revenues of up to IDR 246 billion with a net profit of IDR 35 Billion in the 4th Quarter of 2019 (www.ajaib.co.id). Such companies' revenue certainly increases the investor's trust to distribute their dividends to the investors of the company. Pharmaceutical companies have become companies in demand by investors in 2020 since the global corona virus pandemic attacking the world, including Indonesia (www.ajaib.co.id). However, several companies registered on the Indonesia Stock Exchange (IDX) which involve in manufacture fields have conducted income smoothing actions, including PT. Indofarma Tbk and PT. Kimia Farma Tbk, both in 2001 (Arfan, 2006). Based on the investigation results carried out by *Bapepam* (Capital Market Supervisory Agency, 2002), evidence was found on PT. Indofarma Tbk that the company valued goods in the process was rated higher than the supposed value by 28.87 billion. As a result, the price of goods sold were understated and net income were overstated (Arfan, 2006). PT. Kimia Farma was also proven by *Bapepam* to have made a misstatement for the 2001 financial year which resulted in an overstated profit of IDR 32.7 billion, which was 2.3% of sales and 34.7% of the company's net profit (Arfan, 2006, Maotama et al., 2020; Garidzirai et al., 2019).

The practice of income smoothing uses accounting techniques to decrease the fluctuations in net income during a period of time (Rivard et al., 2003). Income smoothing is an intentional practice carried out to reduce the reported incomes variability aiming to decrease the company shares market risk so that it can increase the company's share price (Assih et al., 2000). The definition of income smoothing was also proposed by Bieldman in Belkaoui (2000) as a purposeful action to decrease the normal income by the company.

Bushra, A., & Mirza, N. (2015) found that profitable companies tend to pay higher dividends than losing companies. Sales growth and dividend result are related positively to each other, in which the increase in sales leads to higher profitability and higher dividend payouts. Institutional owners are more likely to keep excess cash and thus remove dividends. Individual owners prefer capital gains rather than dividends given deduction taxes, and management- or family-owned companies avoid dividends, leading to increased agency problems. Arifah and hidayatulloh (2014) revealed that profitability, managerial ownership structure and firm size partially and significantly affected the income smoothing. Meanwhile, financial risk, company value and public ownership structure have no significant effect on income smoothing. Furthermore, profitability, financial risk, managerial, public ownership structures, and company size simultaneously and significantly affect the income smoothing. Khan et. al (2013) stated the profitability of each company they observed positively affects dividend payouts while leverage had no significant effect on companies dividend payments. Furthermore, the control variable log of total

assets also positively affected dividend payments of both industries. Syahwildan (2020) discovered difference between independent variables (DER and income smoothing) and dependent variables (earnings management) existed at the acquisition value of sig 0.00 (less than 0.05). The R Square value obtained in the research was 0.965, indicating that the dependent variable affected the independent variables by 96.5%, while the remaining 3.5% were affected by other variables not observed in the study. This indicated that the difference between the independent variable and the dependent variable was significant. Khan and Shamim (2017) showed that earnings per share affected dividend payments positively in eight sectors including beverages, travel and leisure, fixed line telecommunications, food processing, household goods, personal goods, cars and electricity. However, the other sectors including forestry (paper and board) was negatively related to the dividend payout ratio. In addition, cash flow had affect dividend payments positively in fixed line telecommunications, and affected chemicals, forestry, construction and materials, engineering, beverages, tobacco, travel and recreation, food processing, household appliances, pharmaceuticals and biotechnology, and automobiles negatively. Myers and Bacon (2004) discovered that as the PE of the company gets higher, then the risk will get lower, while the payout ratio will get higher. Furthermore, when the insider ownership gets higher, conversely the dividend payout will get lower. The companies' management involved in the research purposively decreased the dividends so that they can increase their share value as an executive compensation. Companies involved as samples also made efforts in developing exceptional reputation with the shareholders by providing higher dividends so that they could access equity capital for financial growth. Nejad and Alavi (2013) compared companies which conducted smoothing by 78 and companies which did not conduct smoothing by 54. Such number increased slightly compared to previous studies. Furthermore, this research also revealed that income smoothing practices can be done at three profit levels of smoothing of net income, gross profit, and operating profit. Ashari et. al (2013) claimed that the most common objective in income smoothing practice is the operating income. There were four hypotheses which provide correlation between income smoothing practices and company size (total assets) as well as profitability (net income after tax to total assets). This research mainly found that company in riskier industries and Malaysia tend to have less profitable income It is claimed that further research needs to be carried out in new cultural and economic context, so that contribution can be added to the income smoothing practices literature. Another research conducted by Indrawan and Damayanthi (2020) obtained two results regarding income smoothing practices, in which this practices are not directly affected by profitability and negatively affected by company size. Financial leverage positively affected the income smoothing. Yanti and Dwirandra (2019) conducted a research by employing both logistic binary regression and Moderated Regression Analysis (MRA) to analyze their research data. The analysis outcome discovered that income smoothing practices are positively affected by profitability. Such relationship cannot be decreased even by a company with good management. In addition, the payout ratio of dividend is also not able to affect the probability of income smoothing practice positively. Ameer (2007) in his research then added that companies need to decrease their divided payment since it is less rigid and it causes the increase of operational risk which is measured by cash flow volatility. Furthermore, the research also found that there was significant and positive effect of family ownership on the dividend policies of property companies, suggesting that dividend policies were used by these companies to avoid conflicts. Last, significant effect was also found to be provided by diversification related to property companies on company dividend payments. Etemadi and Sepasi (2008) further discovered that the income smoothing practice was present even though the percentage was low. Through univariate analysis that was carried out in the study, it was found that income smoothing practices were tend to be carried out by smaller companies than larger companies. The consistent results obtained indicate that the company's assessment is more concerned with the amount of income than the income flow. Pradipta and Susanto (2019) further also discovered that company value had a positive effect on important income smoothing but negative and significant on the income smoothing practices. This practices ensure investors to perform investment on their companies, but larger companies where investor usually invest are commonly not conducting income smoothing practices. Adeiza et. al (2020) claimed that performance was affected by dividend ratio payments negatively and insignificantly. Inclusively, research concludes that dividend payouts and payout ratios ensures that the companies have strong financial and high profit so that they can convince the shareholders. Lambrecht and Myers (2012) cited Lintner's (1956) that total payment (dividends added by net repurchases) is target adjustment model. Payments facilitate the temporary shocks which occur on current income and adjust to changes in permanent income gradually. Smoothing is done by borrowing or lending, while payments are not deducted to fund capital investments. Ahmed and Javid (2012) carried out dynamic panel data regression on their research obtaining that profitable companies could produce higher free cash flow because they have more stable net income and pay larger dividends. Furthermore, the concentration of ownership and market liquidity affected the dividend payment policy positively. In addition, investment opportunities and leverage affected the dividend payout policies negatively. Market capitalization and company size affected the dividend payout policy indicating that rather than paying dividends to their shareholders, companies prefer to invest in their assets instead. Sherlita and Kurniawan (2013) shows simultaneously or separately on the four independent variables thought to affect the practice of income smoothing apparently no one has proved influential. Thus it can be concluded that firm size, profitability, financial leverage, and net profit margin has no effect on the practice of income smoothing.

Dharmendra (2012) found that Profitability, Taxation and Income Retention are beneficial to increase Dividend Payout Ratio in Indian Passenger Vehicle Industry; while Liquidity and Operating Activities are two variables that affect the Dividend payment decision of the Indian passenger vehicle industry. Indrawan et. al (2018) revealed that concerning the manufacturing companies in Indonesia, their size positively and directly affected the income smoothing practices. This indicates that the greater the company size, the more they will be likely perform income smoothing practices. On the other hand, such practices in manufacturing companies were affected adversely by profitability. It means that the higher the profit obtained by a manufacturing company, the less they will perform income smoothing practices.

Based on the problems encountered, the researchers were interested in conducting research that aims to:

1. identify the effect of the profitability variable measured by net profit margin on the company's ability to pay dividends.
2. identify the Income Smoothing variable as a moderating variable on profitability measured by net profit margin and the company's ability to pay dividends.

Based on the phenomenon and objective described above, thus researchers were interested in performing a literature review research entitled: “**THE EFFECT OF PROFITABILITY ON DIVIDEND PAYMENT THROUGH INCOME SMOOTHING AS MODERATOR (Survey on Pharmaceutical Companies Registered in Indonesia Stock Exchanges in Period of 2015-2019)**”.

2. Literature Review

Income smoothing was defined by Rivard et al., (2003) as an accounting practices to reduce net income fluctuations over a period of time. Meanwhile, Fudenberg and Tirole (1995) defined the terms as an income manipulation process done intentionally at particular time or efforts to reduce the reported income flows, not when increasing the amount of reported income in the long term.

Managers tend to give several reasons in performing income smoothing. Hepworth (1953), Ghozali and Chariri (2007), claimed that the motivation which encourages the income smoothing practice is to improve creditors, investors and employees, and flatten the business cycle through a psychological process.

Meanwhile, Beidleman (1973), Belkaoui (2007) considered two reasons in performing income smoothing practice. The first opinion is based on the assumption that higher dividends are more supported by a stable profit flow than a variable profit flow so that it benefits the company shares value as the overall level of risk of the company decreases. The second argument concerns on the smoothing of the ability to counter the cyclical nature of income reports and is also likely to reduce the correlation between the company expected returns and market portfolio returns.

The income smoothing concept assumes that investors are risk-averse person (Fudenberg and Tirole 1995) and risk-averse managers are encourage to perform income smoothing. Likewise, in relation to creditors, managers also prefer alternatives that produce income smoothing (Trueman and Titman 1988).

Bleidernan (1973) believes that management performs income smoothing for creating a stable profit flow and reducing the covariance of returns with the market while Barnea, et al (1976), Assih (2000) claimed that managers perform this practice to decrease the income fluctuations and increase the investors' ability to estimate the future cash flows. Meanwhile, internal motivation and external motivation are supported by Dye (1988), Suwito and Herawaty (2005) to encourage the income smoothing practices. There are three possible constraints affecting managers to conduct income smoothing practices based on Belkaoui (2004), those are (1) Competitive market mechanism which reduces the number of options available to management, (2) Management compensation schemes which are directly linked to company performance, (3). Threat of management replacement. Furthermore, there are also several media used by the management to perform income smoothing, those are real and artificial smoothing (Dascher and Malcolm, 1970 ; Ghozali and Chariri, 2007). Real smoothing is the actual transactions both occur or do not occur in terms of the effect of smoothing, while artificial smoothing is the accounting procedures implemented for shifting costs and incomes from one period to another. However, in addition to these two media, there is another dimension or media to perform income smoothing, which is classificatory smoothing.

Agency Theory

Jensen and Meckling (1976) is the first who proposed Agency theory as a company owned by an owner (principal) will be managed by a manager (agent) whose management is based on a contract. An agency relationship occurs as a contractual agreement between the shareholders as principals and company management as the agents who are the company managers. In the contract, the owner gives authority to the management in

carrying out the company's operations, including in decision making. This theory recommends that shareholders (as owners or head of company operations) use agent services to do work, but company owners delegate business operations to directors or managers (shareholder agents) (Clarke, 2005). The basic assumption of agency theory is that every individual tries to do everything maximally to optimize their own interests (Schroeder, 2009: 48). Thus, agency problems can occur when some of them (principals) have contracts with other parts (agents) to make decisions for the perpetrators. Agency problems will arise because agents can hide information and manage the company for its own benefit, as what happened in in Adelpia, Enron, WorldCom, and Parmalat. According to Anthony and Govindarajan (2003), "one of the key elements of agency theory is that principals and agents have different preferences or goals".

Dysfunctional Behavior Theory

Dysfunctional Behavior Theory was defined by Hansen and Mowen as an individual fundamental behavior which is different from the organizational goals". Research conducted on dysfunctional behavior found that locus of control and individual's intention have strong correlation to manipulate and cheat (Gable and Dangelo 1994; Comer 1985; Solar and Bruehl 1971). Another definition of dysfunctional behavior was also proposed by Jaworski and Young (1992) as the subordinate's behavior to manipulate the control system for personal purposes by intentionally violating rules and procedures. Related to this theory, there are 2 (two) relevant things those are: 1) Gaming Performance Indicator (Ridgway 1956; Birnberg et al. 1983; Kerr 1975; Porter et al. 1975) and 2) Strategic Information Manipulation (Binberg et al. 1983).

Variables operationalization in this study are:

1. This research included moderating variable (Z) which was measured using Eckel (1981) index. Eckel used Variation Coefficient (CV) of income variable and net income variable. The Eckel index distinguished between companies which conduct income smoothing practices and those which do not conduct the practices. The eckel index formula is as follows (Eckel, 1981: 28-40): $CV\Delta I / CV\Delta S$.

2. This research also used independent variable (X) in the form of profitability, which is proxied by net profit margin (NPM). NPM is the ratio used to measure the company's ability to generate profits from total sales (Brigham and Houston 2021, *Van Horne* dan Wachowicz 2020) (Suryandari, 2012). NPM is measured using a comparison between net income and total sales (Kieso, et al., 2019).

3. Dividend Pay Out Ratio was used as the dependent variable (Y). According to Kieso et al. (2019), dividend policy can be classified into several forms, those are (1) Cash Dividend, the most obliged dividends form used by company, (2) Property Dividend, a distribution to shareholders which is paid with assets other than cash, (3) Liquidating Dividend, a distribution as a return on paid-up capital to shareholders, and (4) Stock Dividend, which is a dividend distribution not in cash, but in the form of sheets stock. Dividend policy was measured using the dividend payout ratio (DPR) with the following formula sales (Brigham and Houston 2020, *Van Horne* dan Wachowicz 2021) :

$$DPR = \frac{\text{Dividend Per Share}}{\text{Earning Per Share}}$$

CHAPTER III. RESEARCH METHOD

This research was conducted by using Regression Moderating Analysis proposed by Andrew F. Hayes with data was processed using SPSS Version 26.0 software. Secondary data were used in this research in the forms of panel data on a ratio scale. Secondary data is defined as data which are already available for research (Sekaran, 2014: 65). According to Harwell (2011), quantitative research is usually conducted to maximize objectivity and replication, generalize research findings and are usually more related to predictions. The population involved were pharmaceutical companies registered on the Indonesia Stock Exchange (BEI) in which a number of samples were chosen based on several criteria (purposive judgment sampling) (Edison, 2018):

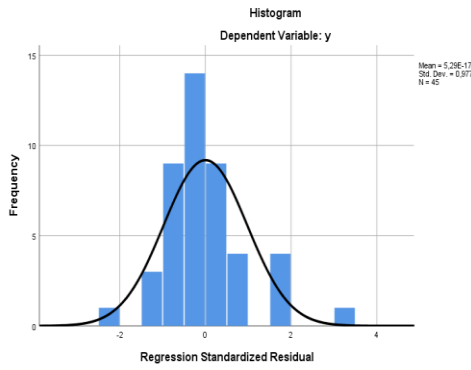
1. Pharmaceutical companies which published complete audited financial statements for 2015 to 2019.
2. Companies which have never been disqualified from the Indonesia Stock Exchange.
3. Companies which are registered on the Indonesia Stock Exchange.

Nine companies were then involved as the research data and observed for 5 (five) years period. Therefore, the total sample in this research was 45 samples.

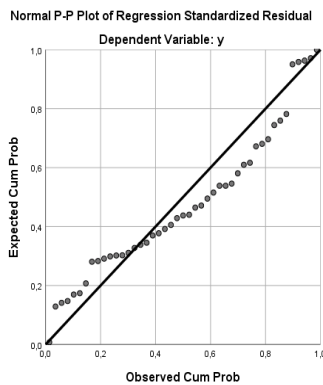
CHAPTER IV. ANALYSIS RESULT AND DISCUSSION

In this chapter, this research first performs a classic assumption test to see normal data:

1. Normality Test



Picture 1. Histogram



Picture 2. Normal P-P Plot

2. Test Multikolinearity

Table 1. Multikolinearitas

Model		Unstandardized Coefficients		Coefficients ^a Standardized		Collinearity Statistics	
		B	Std. Error	Coefficients Beta		Tolerance	VIF
1	(Constant)	1,315	,228				
	x	-7,238	,721	-,848		,982	1,018
	z	,152	,114	,113		,982	1,018

a. Dependent Variable: y

3. Test Autocorelate

Table 2. Auticorelation

Model Summary ^b											
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	R Square Change	Change Statistics			Sig. F Change	Durbin-Watson	
						F Change	df 1	df 2			
1	,840 ^a	,706	,692	1,35251	,706	50,398	2	42	,000	1,663	

a. Predictors: (Constant), z, x

b. Dependent Variable: y

4. Test Heterocedasticity

Tabel 3. Heterocedasticitas

Model	Coefficients ^a				
	Unstandardized Coefficients	Standardized Coefficients	t	Sig.	95,0% Confidence Interval for B

		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	,882	,161		5,472	,00	,557	1,207
	x	,243	,511	,074	,476	,63	-,787	1,274
	z	-,051	,081	-,097	-,627	,53	-,214	,112

a. Dependent Variable: AbsolutResidual

According to Imam Ghozali (2011: 111), the regression model is said to be normally distributed if the plotting data of points depicting the actual data follows a diagonal line. The conclusion is that the model is normally distributed from the histogram and normal pp plot. The data showed no multicollinearity symptoms because the tolerance value was > 0.100 and the VIF value was < 10.00 (Ghozali 2011: 107-108). There is no autocorrelation symptom because the Watson durbine value is between du to 4-du, namely 1.6148 < 1.663 < 2.3852. The heteroscedasticity test uses the glacier test where the coefficient of the significance level of each variable must be greater than 0.05 so that there is no heteroscedasticity problem, the results obtained for x are 0.636 and z is 0.534 at the absolute residual value. After fulfilling the classical assumption test, we perform a moderation test and then the following results are obtained :

Model : 1
 Y : y
 X : x
 W : z

Sample Size: 45
 OUTCOME VARIABLE:
 y

Table 4. Model Summary 1

Model Summary						
R	R-sq	MSE	F	df1	df2	p
,8415	,7081	1,8595	33,1576	3,0000	41,0000	,0000

Table 5. Model Summary 2

Model						
	coeff	se	t	p	LLCI	ULCI
constant	,2238	,2109	1,0607	,2950	-,2023	,6498
x	-7,3697	,7637	-9,6494	,0000	-8,9121	-5,8272
z	,0324	,2422	,1339	,8941	-,4567	,5215
Int_1	,4715	,8382	,5626	,5768	-1,2212	2,1642

Table 6. Covariance Matrix of Regression

Covariance matrix of regression parameter estimates:				
	constant	x	z	Int_1
constant	,0445	,0132	,0120	-,0472
x	,0132	,5833	,0388	-,1966
z	,0120	,0388	,0587	-,1786
Int_1	-,0472	-,1966	-,1786	,7025

Table 7. Test(s) of highest order unconditional interaction

Test(s) of highest order unconditional interaction(s):					
R2-chng	F	df1	df2	p	
X*W	,0023	,3165	1,0000	41,0000	,5768

Focal predict: x	(X)
Mod var: z	(W)

Table 8. Data List Free

x	z	y	.
BEGIN DATA.			
-,1773	-1,8039	1,6227	
,0000	-1,8039	,1652	
,2854	-1,8039	-2,1807	
-,1773	,0000	1,5304	
,0000	,0000	,2238	
,2854	,0000	-1,8795	
-,1773	1,8039	1,4382	
,0000	1,8039	,2823	
,2854	1,8039	-1,5782	

END DATA.

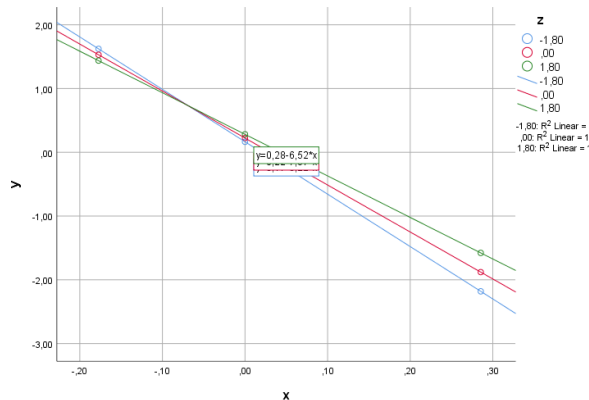
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x WITH y BY z .

Level of confidence for all confidence intervals in output:
95,0000

NOTE: The following variables were mean centered prior to analysis:

z x



The regression formula obtained from the output includes:

$$Y = 0,2238 - 7,3697 X$$

$$Y = 0,2238 - 7,3697 X + 0,0324 Z$$

$$Y = 0,2238 - 7,3697 X + 0,0324 Z + 0,4715 XZ$$

Analysis of SPSS version 26.0 output result:

1. To identify how much variable X affects variable Y.
2. To identify whether the variable hypothesized as a moderating variable really moderates the relationship between variable X and variable Y. This can be seen from the pair value of the variable Int_1 or Interaction_1 which is the result of the multiplication between variable X and the variable hypothesized as a moderating variable.
3. If the P value is significant (<0.05), it means that the variable hypothesized as a moderating variable actually moderates the relationship between variable X and variable Y.

3. Conclusion and suggestion

The following conclusions were summed up based on the outcome obtained:

1. Variable x affects variable y negatively and significantly with $p = 0.0000$.
2. Variable z affects variable y positively but not significant with $p = 0.8941$.
3. The interaction between variables x and z affected y positively but not significant with $p = 0.5768$.
4. Variables x, z and variable of the interaction between those two simultaneously and significantly affect variable y with $p = 0.0000$.
5. The effect of variable observed is 70.81%, while the remaining is affected by other variables which are not observed in this research. The most significant effect is owned by net profit margin on the companies' ability in paying dividends. The results of R Square already contain elements of the moderating variable (Hayes, 2018).
6. The interaction value is higher than 0.05, which is 0.5768, indicating that there is no moderating effect from income smoothing on the relationship between *net profit margin* and dividend payment. Therefore, income smoothing tends to has positive relationship which means that when income smoothing variable increases or getting stronger, then it weakens the conducive relationship with net profit margin. However, income smoothing can strengthen the relationship with dividends payment, indicating that when net profit margin decreases, then dividend payment ability will also decrease.

This research also provides the following suggestions:

1. The relationship between independent variable and dependent variable is very significant, but inversely proportional to the fact that when profits are low, then dividend payments increase. This may illustrate the responsibility of the top management in paying corporate profits in the present from profits held in the past. This means that in the past, many investors did their share investment in the form of retained profit.
2. Income smoothing affects the company's capacity positively but insignificantly to pay dividends. Such condition needs to be considered so that pharmaceutical companies should conduct periodic checks on daily transactions so that they know which transactions cause decrease on profits and affected by the possibility of obstacles or a decrease in the amount of dividend payments to investors.
3. Direct supervision from the Government of the Republic of Indonesia is needed, in this case the Ministry of Finance, over the supervision of the financial statements of companies in Indonesia so that their business processes are integrated and connected with the Ministry of Finance's technology applications so that actions that may lead to fraud can be avoided.
4. Law in terms of financial reporting supervision is needed as a form of regulation that controls, supervises and imposes sanctions for fraudulent corporate behavior that is not in accordance with Financial Accounting Standards as regulated by the Indonesian Financial Accounting Standards Board.

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