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Profitability, Company Size, Financial Leverage, and Dividend Payout Ratio Influencing Income Smoothing Practices

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Abstract

This study examines and analyzes the effect of profitability, company size, financial leverage, and dividend payout ratio on income smoothing practices. The population used in this study are mining companies listed on the Indonesia Stock Exchange (IDX) for the 2015-2018 period. This study uses secondary data with a sample of 10 companies selected by purposive sampling method. Data analysis was performed using statistics with SPSS 21 tools. Based on the data analysis results using the t-test, it was known that partially profitability, company size, financial leverage, and dividend payout ratio did not significantly affect income smoothing practices. Based on the results of data analysis using the F test, it is known that simultaneously profitability, company size, financial leverage, and dividend payout ratio do not have a significant effect on income smoothing practices.

Keywords: Profitability, Company Size, Financial Leverage, Dividend Payout Ratio, Income Smoothing Practices

1. Introduction

Financial statements are only used to find out earnings information regardless of how the profit process is obtained (Nugraha & Dillak, 2018). Management realizes the importance of earnings information. Power tends to perform dysfunctional behavior, namely practicing income smoothing to overcome various conflicts between the government and multiple parties interested in the company (Budiasih, 2009). Companies that practice income smoothing will be able to control excess returns when the company announces earnings. Suppose the disclosed earnings information is good news for investors. In that case, the stock price will increase and provide an extra return for investors to attract other investors' attention to investing in the company. Conversely, if the company information is bad news, the stock price will fall and cause investors to sell or withdraw their investment from the company. It is expected to increase external parties' perceptions regarding the company's management performance by displaying relatively stable earnings.

This research refers to previous research conducted by Soewati & Arum (2018), which discusses the effects of profitability, financial leverage, and dividend payout ratio on the practice of income smoothing in manufacturing companies. His research results state that profitability, economic power, and dividend payout ratio significantly affect income smoothing practices. Iskandar & Suardana's research (2016) discusses the effect of company size, return on assets and winner/loser stock on income smoothing practices in manufacturing companies. The result states that company size and return on assets affect income smoothing practices.

The update made in this study is to add the dependent variable that is income smoothing practices in mining companies listed on the Indonesia Stock Exchange. This study combines the independent variables and dependent variables from the research of Soewati & Arum (2018), Iskandar & Suardana (2016), which are used as the basis of research. This study takes the variables of profitability, financial leverage, and dividend payout ratio from the analysis of Soewati & Arum (2018), the company size variable from Iskandar & Suardana (2016) research. The researchers chose mining companies because the practice of income smoothing for mining companies had never been studied before.

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Research by Azhara, Nazar & Kurnia (2017) shows that the variable profitability and dividend payout ratio does not affect income smoothing, while the varying company size significantly affects income smoothing. Research conducted by Soewati & Arum (2018) examined the effect of profitability, financial leverage, and dividend payout ratio on income smoothing practices. The results showed that the variables of profitability, economic power, and dividend payout ratio had a significant effect on income smoothing practices.

Iskandar and Suardana's research (2016) examined the factors that influence the practice of income smoothing on the IDX during the 2010-2013 period. The results showed that the variable company size and return on assets affected income smoothing practices, while the variable had winner/loser stock no effect on income smoothing practices. Haini & Andini (2014) researched the impact of return on assets, dividend payout ratio, debt to equity ratio, and institutional ownership on income smoothing practices. His research shows that the variable return on investments, dividend payout ratio, and debt to equity ratio significantly affect income smoothing practices. In contrast, institutional ownership has no significant impact on income smoothing practices. Pratiwi & Damayanthi's (2017) research shows that the variables of company size, profitability, and dividend payout ratio positively affect income smoothing.

H1 : Profitability partially affects the Income Smoothing Practices of mining companies listed on the IDX in 2015-2018.

H2 : Company size partially affects the Income Smoothing Practices of mining companies listed on the IDX in 2015-2018

H3 : Financial Leverage partially affects the Income Smoothing Practices of mining companies listed on the IDX in 2015-2018

H4 : Dividend Payout Ratio partially affects the Income Smoothing Practices of mining companies listed on the IDX in 2015-2018

3. Research Design and Method

This study uses secondary data sources in the form of financial statement documents of companies listed on the IDX during the 2015-2018 period. The population of this research is 55 mining companies. The sampling technique used in this study was purposive sampling. The reason for selecting the sample using purposive sampling is that not all pieces have the research criteria. The sampling criteria are as follows:

Table 1.

Research Sample Criteria

No	Sample Criteria
1	Mining companies listed on the Indonesia Stock Exchange for four consecutive years from 2015 - 2018
2	Mining companies that report losses in their financial statements from 2015 - 2018. Because the data required is about profits, companies with suffered losses are not included in the sample.
3	The mining company that distributed dividends to investors from 2015 - 2018

Source: Data processed (2019).

This study uses multiple linear regression analysis to determine whether there is an effect of the independent variable on the dependent variable. For research using the SPSS 21 output, it can be seen in the table coefficients.

Regression equation:

$$Y = \alpha + \beta 1X1 + \beta 2X2 + \beta 3X3 + \beta 4X4 + e$$

Description:

Y = Income Smoothing Practices
a = Constant
X1 = Profitability
X2 = Firm Size
X3 = Financial Leverage
X4 = Dividend Payout Ratio
β1- β4 = Regression Coefficient
e = Standard Error

Table 2.

Variable Measurement

Variable	Measurement
Profitability	Profitability is measured using Return On Asset because this is used to measure the company's abilit y with the total funds invested in assets, which are used for company operations to generate profits.
Firm Size	Company size is assessed from the company's Total Assets, calculated using the natural logarithm of total assets. Natural logarithms are used to refine real asset data and are expected to reduce the differences in total assets that are too large between companies.
Financial Leverage	The debt measures financial leverage to total assets ratio, which shows how much assets are used t o guarantee a debt. The level of power is generated by dividing total debt by total company assets.
Dividend Payout Ratio	**The dividend payout ratio is** measured by comparing dividends per share with earnings per share. This ratio looks at the salaries for share (income) paid out as dividends to investors. Any other portion that is not returned will be reinvested in the company.
Income Smoothing	Income smoothing will be measured using the Eckel Index, which will differentiate between companies that practice income smoothing and those that do not. The profit used to calculate the Eckel Index is net income. A company is considered to be practicing income smoothing if the income smoothing index is less than one and is given the symbol 1. A company is deemed not to practice income smoothing if the income smoothing index is more significant than one and is given the character 0

Source: (Ratih, 2012; Hanafi & Abdul, 2009; Prabayanti, 2010)

4. Results and Discussion

Statistical Analysis

Table 3 shows that the profitability variable has a standard deviation of 0.09770 and a mean of 0.1320. The firm size variable has a standard deviation of 1.31019 and a mean of 29.3175. The variable financial leverage has a standard deviation of 0.09990 and a mean of 0.3470. The variable dividend payout ratio has a standard deviation of 57,95780 and a mean of 13,0700. The income smoothing variable has a standard deviation of 4.66005 and a mean of 1.4068.

Table 3.

Descriptive Statistical Test Results

	N	Mean	Std. Deviation
Profitability	40	.1320	.09770
Firm Size	40	29.31751	.31019
Financial Leverage	40	.3470	.09990
Dividend Payout Ratio	40	13.0700	57.95780
Income Smoothing Practices	40	1.4068	4.66005

Source: Data processed (2019)

Table 4 shows the multiple linear regression equation as follows:

$$Y = -10.648 +6,353X1 +0,161X2 +18,392X3 +0,009X4$$

The analysis test results show a constant value of 10.648, indicating no influence from the independent variables, namely profitability, company size, financial leverage, and dividend payout ratio. The income smoothing will decrease. The value of b1 shows a value of 6.353 and has a positive regression coefficient sign; it indicates that there is a direct influence between the profitability variable and the income smoothing practice variable, which means that if there is an increase in the profitability variable with the assumption that the variable company size, financial leverage, and dividend payout the ratio is in a fixed condition, the income smoothing will increase. The value of b2 shows a value of 0.161 and has a positive regression coefficient sign; this indicates that there is a direct influence between the firm size variable and the income smoothing practice variable, which means that if there is an increase in company size with the assumption that the variables are profitability, financial leverage, and dividend payout. The ratio in the conditions remains the smoothing earnings would have increased. The value of b3 shows a value of 18.392 and has a positive regression coefficient sign; this indicates a direct influence between the financial leverage variable and the income smoothing practice variable, which means that if there is an increase in the financial leverage variable, assuming that the variables are profitability, company size, and dividend payout

the ratio is in a fixed condition, the income smoothing will increase. The value of b4 shows a value of 0.009 and has a positive regression coefficient sign; this indicates a direct influence between the dividend payout ratio variable and the income smoothing practice variable, which means that if there is an increase in the dividend payout ratio variable, assuming that the variable profitability, company size, and financial leverage is in a stable condition, the income smoothing will increase.

Table 4.

Results of Multiple Linear Regression Analysis

Model		Unstandardized Coefficients		Standardized Coefficients
		B	Std. Error	Beta
1	Constant	-10.648	19.548	
	Profitability	6.353	7.7687	.133
	Firm Size	.161	.716	.045
	Financial Leverage	18.392	9.469	.134
	Income Smoothing Practices	.009	.013	.110

Source: Data processed (2019)

Table 5 shows the results of the t-test for the profitability variable on income smoothing practices, the value of t-count (0.826) < t-table (2.030) with a significance level of 0.414 > 0.05; these results indicate that the profitability variable does not have a partially significant effect on income smoothing practices. For the variable firm size on income smoothing practices known value of t-count (0.225) < t-table (2.030) with a significance level of 0.823> 0.05; these results indicate that the variable firm size does not have a significant effect partially against income smoothing practices. For the financial leverage variable on income smoothing practices, the value of t-count (1.942) < t-table (2.030) with a significance level of 0.06 > 0.05; these results indicate that the variable financial leverage does not have a partially significant effect on the income smoothing practices. For variable dividend payout ratio on income smoothing practices known value of t-count (0.658) < t-table (2.030) with a significance level of 0.515 > 0.05; these results indicate that the variable dividend payout ratio does not have a partially significant effect on income smoothing practices

Table 5.

Results of t-test

Model	t	Sig.
Profitability	.826	.414
Firm Size	.225	.823
Financial Leverage	1.942	.060
Income Smoothing Practices	.658	.515

Source: Data processed (2019)

Discussion

The results of testing the first hypothesis indicate that this hypothesis is rejected. This result is because profitability has shown how the company's management performance. Although company profits tend to fluctuate, classified earnings information can attract investors to invest so that management does not need to even out profits. Prayudi & Daud (2013) explain that profitability does not affect income smoothing because profitability has become the public spotlight, especially investors and creditors. Companies may try not to take actions that endanger the company's credibility. This study supports the research of Revinsia, Rahayu & Lestari (2019), which found that there was no significant influence between profitability and income smoothing practices carried out by the company. However, it is different from the research results (Astiti, 2017; Putri, Rahayu & Yudowati, 2016; Haini & Andini, 2014), which state that profitability has a significant effect on income smoothing.

The second hypothesis testing proposed is rejected. These results explain that the company's size cannot influence income smoothing practices, so that the total assets are not appropriate to be the benchmark for the company. When the company size value increases, the company's tendency to do income smoothing decreases. Large companies tend to do less income smoothing than companies that are smaller in size. This is because large companies are seen as more critical by shareholders and outsiders. So that large companies get more substantial pressure to present credible financial reporting. The study results

support the research (Framita, 2018; Nugraha & Dillak, 2018; Setyani & Wibowo, 2019), which shows that company size does not affect income smoothing practices. However, these study results are different from research effects (Azhara, Nazar & Kurnia, 2018; Iskandar & Suardana, 2016; Pratiwi & Damayanthi, 2017) that company size has a significant impact on income smoothing practices.

The third hypothesis testing proposed is rejected. These results indicate that investors do not want to take risks to invest if financial leverage is high (Setyani & Wibowo, 2019). This study's results support the research of (Utari, Gustini & Tripermata, 2017; Setyani & Wibowo, 2019), which show that financial leverage does not affect income smoothing. However, it is different from the research results (Algery, 2013; Widhyawan & Dharmadiaksa, 2015; Astuti, 2013), which states that financial leverage has a significant effect on income smoothing.

The fourth hypothesis testing proposed is rejected. The size of the company's profits will affect the size of the dividends to be distributed. However, the dividend size does not affect management's decision to report a higher yield than it should be because dividends are not the primary consideration for investors to invest. The study's results support research (Widhyawan & Dharmadiaksa, 2015; Azhara, Nazar & Kurnia, 2018), which found that the dividend payout ratio does not affect income smoothing practices.

5. Conclusions

This study indicates that profitability, company size, financial leverage, and dividend payout ratio partially do not affect the practice of income smoothing. The observation period in the study was only four years of observation, namely from 2015 - 2018. The research sample obtained is limited in number, only ten companies, so the results obtained may be less than optimal in revealing profit smoothing companies and not profit smoothing companies, especially in mining companies. Further researchers are advised to examine similar topics using other variables that haven't been used in this study, such as operating profit margin and other variables. The results of this study suggest using models or other index measurements such as the Michelson index to classify companies that practice income smoothing and those that do not by adding a more extended research period so that maximum results can be obtained.

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