

## The Effect of Economic Value Added and Earning Per Share on Dividend Policy: Evidence from LQ-45 Company in Indonesia

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**Abstract:** This research purpose is to analyze the effect of Economic Value Added (EVA) and Earning Per Share (EPS) on Dividend Policy in Indonesia. The populations are LQ-45 Company which listed to Indonesia Stock Exchange (Bursa Efek Indonesia/BEI). Base on the 45 companies listed in the LQ-45 Index, the authors set the criteria needed for data collection related to research variables, including companies consistently distributing dividends during the study period, companies engaged in non-financial fields and had positive profits during the year of observation. On the basis of these criteria, there are only 32 companies that can be further processed. The data was collected using documentation techniques and linear regression models were used to analyze. This study uses EVA and EPS as a ratio to measure what policies which the company will take regarding its profits. EVA is considered the right measurement to use because it focuses on the cost of capital incurred by the company, where the higher value of EVA shows that the company has remaining profits after being used to finance its capital, while EPS concerns the earnings per share that will be received by shareholders for the capital invested. This study findings indicate that simultaneously the Economic Value Added and Earning Per Share variables together have a significant impact on Dividend Policy, whereas partially only Earning Per Share has a significant effect on Dividend Policy.

**Keywords:** Economic Value Added (EVA), Earning Per Share (EPS), Dividend Policy

### INTRODUCTION

It is important for investors to conduct in-depth studies related to companies that are able to provide maximum influence on investors' decisions in investing. One of them is by conducting an analysis to predict future stock prices or what is known as fundamental analysis. Analysis performs fundamental predictions by identifying fundamental factors such as sales growth, dividend policy, and costs. Dividend policy is a company's decision to allocate its profits, so that dividend policy can be used as a "signal" for investors regarding the value of the company. The value of the company will show the company's financial condition which can influence the decision of shareholders to maintain their investment and can attract new investors to invest in the company.

According to Sulistyowati (2010), "Dividend Policy taken by the company can be described through the Dividend Payout Ratio (DPR), which is the percentage of income that will be paid to shareholders in the form of cash dividends, which shows that the size of the Dividend Payout Ratio will affect the decision for investment of shareholders, but on the other hand also affects the company's financial condition". Dividend Policy is a decision that will be taken by a company regarding the profits that they have, whether this profits will be distributed to shareholders in the form of dividends, or it is retained to make investments that will increase profits for the company. If the company makes dividend payments consistently every year, then it can be captured as a good signal to investors regarding the improvement in the company's future performance. Therefore the investors will be interested in investing in the company.

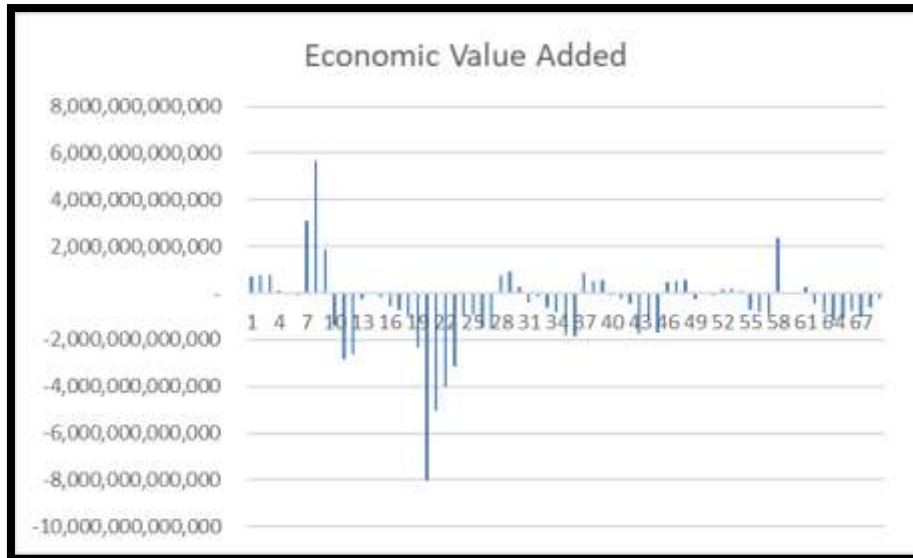
Base on Dividend Payout Ratio data for listed companies in LQ-45 during 2017-2019 shows an increase every year and can be seen in the following figure:



**Figure 1.** Dividend Payout Ratio for LQ-45 Company during 2017-2019

As seen on the figure above, the trend of increasing dividend payout ratio annually shows a value of 8.64862 in 2017, in 2018 increased by 1.17% become 10.09373 and increased again in 2019 until reach 11.9372. It appears that not all companies make the decision to distribute dividends on the profits that they have, but some companies decide to hold their profits for some reason. However, the increasing trend of the dividend payout ratio, which indicates an increase in dividend distribution for LQ-45 issuers, shows that the company has good liquidity.

One of the things that affects dividend policy is the added value of the economy. Economic Value Added (EVA) is a system in financial management that shows a company's ability to cover all operational costs and company capital costs. Costin (2017) stated that "EVA focuses on the additional cost of company capital. By decreasing value of EVA, it can be said that there is no added value in the company because the available profits are not able to meet the expectations of investors, especially shareholders. In this case, it means that the dividend will be received is getting smaller". The value of EVA is expected to show a positive number because it means that company management is able to improve company performance, so that it will have a direct effect on increasing profits and dividend distribution. However, the Economic Value Added data shown by the LQ-45 company is not in line with this theory, where the issuers on the LQ-45 index have an EVA value which tends to show a negative value, but this is inversely proportional to the distribution of dividends each year. The following is the Economic Value Added data which is illustrated through the graph below:



**Figure 2.** Economic Value Added for LQ-45 Company during 2017-2019

The figure above shows that many companies listed in the LQ-45 Index have an EVA value below zero (negative), this shows that the company has a fairly high cost of capital compared to the company's net income.

In addition to analysis of the value of Economic Value Added, analysis of Earning Per Share (EPS) is also important to determine the company's future growth through Earnings Per Share. According to Tjiptono and Henny (2011), "The higher Earning Per Share value, the good news for shareholders because the company will provide high returns to shareholders". Investors can estimate which company will provide a return on their investment by looking at the value of Earning Per Share. The value of Earning Per Share for the LQ-45 issuer shows a value that is directly proportional to the increasing trend of the Dividend Payout Ratio, where the value of Earning Per Share of 45 issuers shows a fluctuating number as shown in the figure below:



**Figure 3.** Earning Per Share Value for LQ-45 Company during 2017-2019

It is important for every company to make the right decisions regarding dividend distribution, this becomes difficult because the profits owned by the company will be chosen to be allocated to two different interests, namely dividend distribution and retained profit. If the company decides to allocate its profits to distribute dividends, it will reduce the company's internal sources of funds, but if the company decides to continue to withhold its profits, the company will have a low value in the eyes of investors.

## LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### Bird in The Hand Theory

Gordon (1956) and Lintner (1962) stated that "Investors would prefer to get paid dividend at present than capital gain in the future. In other words, dividends are more certain for investors than capital gain. They would not accept the proposal to decrease dividend payout in order to increase retained earnings and get bigger capital gains in the future. The longer is the period of time the greater is uncertainty, thus capital gains are more risky for investors than dividends.

The main critics of the bird in hand theory were Modigliani and Miller, who argued that the dividend policy has no impact on the cost of capital, and investors are only interested in total return, they are irrelevant to the proportion of capital gains and dividends. The idea behind criticism of the bird in hand theory is that investors mostly reinvest dividend by purchasing stocks of the same or others companies. So, companies receive back the biggest portion of dividend payouts. Thus, the value of the company or cost of capital is irrelevant to the dividend policy and rather depends on its ability to generate earnings and business risk".

### Signaling Theory

Akerlof (1970) in his work entitled "The Market for Lemons" used the term asymmetric information. Akerlof conducted tests on the used car market, where Akerlof found that if the buyer did not have any information related to the specifications of the product he was going to buy. The buyer would have the same perception of all products that have the same price regardless of the quality of the product, so that disadvantage sellers who sell high quality products. This thinking was later developed by Spence (1978), who argued that "companies that have good performance use financial information to send signals to the market". If the information sent to the market is considered a good signal, investors will be interested in investing their shares. One type of information issued by the company that can be used as a signal for external companies is a report related to dividend policy taken by the company in a given period. The dividend policy can be captured by investors as a signal about the company's potential cash flow in the future.

### Dividend Policy

Dividend according to Blacks Law Dictionary (1990) is "the distribution of current of accumulated earnings to shareholders of corporation pro rate based on the number of share owned". Dividend Policy is a decision that will be taken by a company regarding the profits that they have, whether this profit will be distributed to shareholders in the form of dividends, or it is retained to make investments that will increase profits for the company. If the company makes dividend payments consistently every year, then this can be captured as a good signal to investors regarding the improvement in the company's future performance.

### Economic Value Added (EVA)

O'Hanlon (1998) is a financial analyst for the company Stern Stewart & Co who developed the Economic Value Added method. According to Brigham and Houston (2014), "Economic Value Added is a financial management system that measures the economic benefits of a company in a certain year". Economic Value Added provides an overview of how much the company's ability to provide benefits to shareholders when compared to the cost of capital incurred. The company's operational activities that provide high profits can also generate high added economic value and will affect dividend policies that will be taken by the company.

### Earning Per Share (EPS)

Kasmir (2012) stated that "Earning Per Share is a ratio used to measure the success of management in achieving benefits for shareholders". The value of Earning Per Share shows



the profit that will be received by shareholders based on the number of shares they have. Investors will expect high returns, if the value of Earning Per Share is high. The level of value of Earning Per Share is determined by the profit owned by the company, so the EPS will describe the company's financial performance in a certain period.

### The Effect of Economic Value Added to Dividend Policy

Economic Value Added is a measuring tool that can be used to assess a company's performance by paying attention to shareholders and creditors. Anggraeni (2018) stated that "Economic Value Added reflects the remaining profit from the results of the total cost of capital, including all costs of equity that have been deducted". The remaining profit can be used by the company to distribute dividends to shareholders, the higher the value of EVA shows that the economic value added of a company is getting better and will have an impact on dividend distribution to shareholders. This is also in line with the statement conveyed by Arizona (2016), that EVA reflects the residual income which remains after all capital costs, including the cost of share capital, have been deducted.

### The Effect of Earning Per Share to Dividend Policy

Darmadji (2012) stated that "Earning Per Share is a ratio that reflects the company's ability to generate profits for each outstanding share". Earning Per Share provides information about the amount of net profit that is ready to be distributed to shareholders, so that investors will be attracted to companies that have a large Earning Per Share value. This shows that the greater value of earning per share, the greater company's profit which will have an impact on increasing the amount of dividends that will be distributed by the company.

## METHODS

The sampling method used in this research is purposive sampling. This study uses companies that are listed on the Indonesia Stock Exchange (Bursa Efek Indonesia/BEI) and are included in 45 leading stocks or often referred to as the LQ-45 Index as a population. Base on the 45 companies listed in the LQ-45 Index, the authors set the criteria needed for data collection related to research variables, including companies consistently distributing dividends during the study period, companies engaged in non-financial fields and had positive profits during the year of observation. On the basis of these criteria, there are only 32 companies that can be further processed.

The research model used is an equation using regression to analyze the hypotheses that have been set previously. The equations for testing the overall hypothesis are as follows:

$$DP = \beta_0 + \beta_1EVA + \beta_2EPS + e$$

Where

DP	: Dividend Policy
EVA	: Economic Value Added
EPS	: Earning Per Share
$\beta_0$	: Constanta
$\beta_1, \beta_2$	: Regressions Coefficient
e	: Error

To test the proposed hypothesis, the following hypothesis formulations are used:

1. H0:  $\beta_1, \beta_2 \leq 0$  (Economic Value Added and Earning Per Share partially do not have a positive effect on Dividend Policy)
2. H1:  $\beta_1, \beta_2 > 0$  (Economic Value Added and Earning Per Share partially partially have a positive effect on Dividend Policy)

T test criteria:

1. If the significance level  $> 0.05$  at  $\alpha = 5\%$ ,  $H_0$  is accepted and  $H_1$  is rejected.
2. If the significance level  $< 0.05$  at  $\alpha = 5\%$ ,  $H_0$  is rejected and  $H_1$  is accepted.

## RESULT AND DISCUSSION

This research used equation to see the hypothesis testing result using regression analysis technique. We followed the studies of Costin (2017) and (Haque (2013) to run a model analysis. The result of this research can be described as follow:

**Table 1.** Hypothesis Testing Result

Dependent Variable: DP_Y				
Method: Panel Least Squares				
Date: 01/14/21 Time: 21:14				
Sample: 2017 2019				
Periods included: 3				
Cross-sections included: 32				
Total panel (balanced) observations: 96				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.657137	0.068625	9.575763	0.0000
EVA_X1	-8.38E-15	3.62E-14	-0.231556	0.8176
EPS_X2	0.000288	0.000103	2.795864	0.0069
Effects Specification				
Cross-section fixed (dummy variables)				
R-squared	0.815820	Mean dependent var		0.489881
Adjusted R-squared	0.717789	S.D. dependent var		0.428028
S.E. of regression	0.227383	Akaike info criterion		0.146761
Sum squared resid	3.205598	Schwarz criterion		1.054968
Log likelihood	26.95548	Hannan-Quinn criter.		0.513873
F-statistic	8.322061	Durbin-Watson stat		2.944003
Prob(F-statistic)	0.000000			

Source: E-Views 10 Output (2021), processed by the author

The table above shows the Adjusted R-Squared value of 0.7177. This shows that the Economic Value Added and Earnings Per Share of Dividend Policy is 71.77%, of which 28.23% is influenced by other variables not examined in this study, such as external factors that affect Dividend Policy, namely the state economy, inflation, and so on.

The probability value of F-statistic shows a number of 0.0000 or less than 0.05. This shows that the Economic Value Added and Earning Per Share variables together have an influence on the Dividend Policy and the regression model can be processed further.

### Hypothesis Testing 1

At the 5% significance level, Economic Value Added has no effect on Dividend Policy because the probability value in the table above shows a value of 0.8176 or greater than 0.05.

### Hypothesis Testing 2

At the 5% significance level, Earning Per Share has a positive effect on Dividend Policy because the probability value in the table above shows a value of 0.0069 (less than 0.05) with a coefficient (+) of 0.000288.

## DISCUSSION

### The Effect of Economic Value Added to Dividend Policy

The test results of the Economic Value Added variable show a probability value of 0.8176 or greater than 0.05. This shows that H1 is not supported or Economic Value Added does not affect to the Dividend Policy.

Signal Theory suggests that the company has an obligation to provide a signal to the market, in this case the investor, regarding the company's financial condition. A high EVA value can be a good signal for investors, which shows that the company has a residual profit after it is used to finance the company's capital costs. However, this theory contradicts the trend of dividend distribution in LQ-45 companies. Where most companies listed on LQ-45 have a negative EVA value, but this has no effect on the Dividend Policy taken by the company where the Pividend Payout Ratio has increased in the last three years. The results of this study are in line with research conducted by (Haque, 2013) entitled "Relationship between Dividend Payout and Economic Value Added: A case of square pharmaceuticals limited, Bangladesh", which shows that EVA has no effect on Dividend Policy taken by the company.

### The Effect of Earning Per Share to Dividend Policy

The test results on the Earning Per Share variable show a probability value of 0.0069 or less than 0.05. This shows that H2 is supported or Earning Per Share has an effect on the Dividend Policy.

Tandelilin (2010) stated that "Earning Per Share information is the information that is considered the most basic for investors because it can describe the company's future earnings prospects". This is in line with the increasing trend of Earnings Per Share in LQ-45 companies over the last three years, followed by an increasing trend of dividend distribution. A large EPS value indicates a large level of Earnings Per Share so that it is likely that the company will distribute large dividends. Research conducted by Tandelilin (2010) shows the same results where the higher EPS value of a company, the longer the investors will invest their shares.

## CONCLUSIONS

One of the main objectives of financial management is to maximize shareholder wealth. This is reflected in the company's policy to distribute dividends consistently or to hold profits and invest for the company's profit. This study uses EVA and EPS as a ratio to measure what policies a company will take regarding its profits. EVA is considered the right measurement to use because it focuses on the cost of capital incurred by the company, where the higher the value of EVA shows that the company has remaining profits after being used to finance its capital, while EPS concerns the earnings per share that will be received by shareholders for the capital invested. Hypotheses are formed and tested using hypothesis testing with statistical tools E-Views Version 10 and the results show that EVA has no effect on Dividend Policy while EPS has a positive effect on Dividend Policy.

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