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RESEARCH ARTICLE

THE MEANING OF NET INCOME AND OPERATING CASH FLOW IN DETERMINING THE DIVIDEND POLICY

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ABSTRACT

Background: The purpose of investors in investing is to obtain income or return, one of which is a dividend. However, the level of dividend income earned by investors varies depending on the company's policy on dividend payout to its investors.
Aim: The purpose of this study is to know the meaning of net income and operating cash flow in determining dividend policy on manufacturing companiesin the consumer goods industry sector listed in Indonesia Stock Exchange on the period 2014-2016.
Methods: Samples are chosen by using purposive sampling technique. The data collected, then analyzed by using multiple linear regression method.
Results: The result of analysis shows that at 0.05 significance level, it is proven that operating cash flow has a significant effect on dividend policy, while net income does not affect dividend policy.
Conclusion: These results indicate that operating cash flow tends to provide meaning in determining dividend policy, so that accountants as the presenter of financial information should focus the presentation of this information as an effort to attract investors to invest in the company's shares, as well as to focus the other important information presented.

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INTRODUCTION

Companies with performance prospects that tend to increase and stable will attract investors to invest in the company's shares, because it reflects the company's financial performance in profitable conditions. In general, the purpose of investors in investing is to obtain income or return, one of which is a dividend (Hidayat, 2010; Puspitaningtyas, 2012; Puspitaningtyas and Kurniawan, 2012; Mustofia *et al*., 2014; Bushra and Mirza, 2015). The rate of dividend income paid to investors depends on the company's policy on dividend payout to its investors. Investors are always expecting high dividend income, but companies have strategic considerations regarding the survival and growth of the company in the future (Puspitaningtyas and Kurniawan, 2012; Jain and Chu, 2013; Mustofia *et al*., 2014). Therefore, not all profits earned by the company will be paid as dividend income for investors. Company policy relating to dividend payout is to determine whether the profit earned by the company in a period will be paid in whole or in part to its investors as dividend income (Mustofia *et al*., 2014; Ali *et al*., 2015; Noviyanto, 2016). This is related to the determination of corporate policy, among others: 1) how much proportion of the profits to be paid as dividend income for investors, and 2) how much proportion of the profits to be reinvested in the company as part of retained earnings. The greater the proportion of the profits paid to investors as dividend income, the less the residual profits to be reinvested in the firm as part of retained earnings (Sutrisno, 2009; Brigham and Houston, 2010; Noviyanto, 2016). As a result, it will minimize the company's ability to increase future growth. The company's growth tends to decline, eventually reducing the growth of dividends in the future. Based on the description, it appears that with regard to the dividend policy may cause two conflicting results. Therefore, dividend policy is important for the future of the company, where in the case of decision-making it must be based on strategic considerations that are expected to bring the company in a profitable condition and able to improve the welfare for its investors in accordance with the company's objectives. Management is required to take the decision to balance the current dividend payout policy and the company's growth rate in the future, so that the value of the company can be improved. There are many factors influencing the dividend policy of a company, two of which are net income and operating cash flow. The purpose of this study is to know the meaning of net income and operating cash flow in determining dividend policy. In order to know the meaning, operationally done by knowing the effect of net profit and operating cash flow to dividend policy.

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Several previous studies have examined the effect of net income on dividend policies and the effect of operating cash flows on dividend policies, but some have shown inconsistencies in outcomes. Ramli and Arfan (2011) proved that net income affects dividend policy. Meanwhile, Noviyanto (2016) proves that net income has no effect on dividend policy. Noviyanto (2016) proves that operating cash flow affects the dividend policy. Meanwhile, Masrifah (2014) proved that operating cash flow has no effect on dividend policy. The level of net profit that a firm can achieve in a period will determine the choice of dividend payout policy to its investors or use it to be reinvested as part of retained earnings. In the event that a company is in a non-profitable condition, the tendency of profit to be obtained will be more widely used to improve the position of its capital structure (Jain and Chu, 2013). In addition, the amount of cash flow sourced from the company's operations becomes an indicator that determines the ability of the company to obtain sufficient cash to pay dividends to its investors.

The dividend policy should consider the factors affecting the allocation of profits for dividend payments and the allocation of profit for retained earnings. One of the main factors to consider is the availability of cash, because even if the company makes a profit but if the amount of available cash is insufficient to pay dividends then the company is likely to take the decision to hold the profits for reinvestment. Therefore, dividend policy can not be determined only with consideration of net income, but it is also important to consider cash flow. There are three activities in the cash flow statement, which are operating activities, investment activities, and financing activities (Syamsuddin, 2007). Of the three activities, which tend to be associated with dividend policy making is cash flow originating from operating activities. Therefore, operating cash flow is an indicator that reflects the company's ability to repay its loan, ability to maintain its operations, ability to pay cash dividends, and ability to make new investments without relying on external funding sources.

Literature Review

The Theory of Dividend Policy

The dividend policy includes a decision on whether profits earned by the company during a period will be distributed to investors as dividend income or will be reinvested as part of retained earnings (Halim, 2007; Al-Twaijry, 2007; Sutrisno, 2009). There are several Dividend Policy Theories, including Theory of Residual Dividend, Modigliani and Miller's Models, and Signal Theory, described as follows. Theory of Residual Dividend suggests that the profits earned by the company in a given period are intended for the welfare of investors or shareholders. However, the habit that occurs is that the profits earned by the company in a period will be partially distributed to investors and some are reinvested as part of retained earnings. The decision to withhold part of the profits is a consideration of the investment opportunity that is predicted to benefit the company in the future. If the predicted rate of return on an investment opportunity is equal to or greater than the required level of profit, the profits to be earned by the enterprise should not be paid in whole or in part to its investors as dividend income. Profit will be distributed to the investors if the predicted profit rate will be obtained from the investment opportunity less than the required profit. Thus, Theory of Residual Dividend represents residual profits that are not reinvested (Kodrat and Herdinata, 2009; Manurung and Siregar, 2009). Modigliani and Miller's Model argue that corporate value is not influenced by a company's ability to earn a profit or earnings power from a company's assets, but its value is determined by investment decisions. Therefore, whether the profit earned will be divided as cash dividends or held for reinvestment, the decision does not affect the value of the company (Pourheydari, 2009; Al-Ajmi and Hussain, 2011; Bushra and Mirza, 2015). Signal Theory suggests that stock prices will likely increase if there is an announcement of dividend increases, and vice versa. Based on this theory, it is not an increase or decrease in dividend that causes an increase or decrease in stock prices, but the prospect of the company contained in the announcement information. Because, according to this theory, dividend announcement has information content (Impson and Karafiath, 1992; Bushra and Mirza, 2015).

Dividend Payout Ratio

This study uses dividend payout ratio as an indicator of dividend policy assessment. Dividend payout ratio is defined as part of the profit paid in the form of dividends to investors. The dividend payout ratio is the ratio of the total dividend per share paid to the investor and the amount of earnings per share in a period (Bodie *et al*., 2009; Puspitaningtyas and Kurniawan, 2012; Noviyanto, 2016).The higher dividend payout ratio is predicted to provide benefits to investors, but assessed will weaken the internal financial, because it will reduce the retained earnings, and vice versa. Therefore, in making dividend policy, management must consider the factors that will assist management in determining the share of the profits to be paid to investors as dividend income.

Net Income and Dividend Policy

Profit is seen as the best indicator of company performance achievement in a period. That is, the high or low performance of the company is reflected in the large or small profits that can be obtained by companies in a period (Stice *et al*., 2009). Therefore, the level of net income is predicted to affect dividend policy. That, the higher the net profit of the company is considered capable of setting a high dividend payout ratio as well, and vice versa. Theoretically, companies that have the ability to earn high net income, considered to make high dividend payouts. However, companies that have the ability to earn high net profits will not necessarily make high dividend payouts, because the company plans to use some of the net profit earned as retained earnings (Noviyanto, 2016). This study predicts that net income affects dividend policy. This prediction refers to the results of studies by Ramli and Arfan (2011), Tirana and Handayani (2011), Christi and Wijayanti (2013), and Wenas *et al*. (2017) which have proved that net income has a significant effect on dividend policy.
H_1: net income affects dividend policy

Operating Cash Flow and Dividend Policy

The cash position reflects the availability of cash from a company. The availability of cash becomes an important factor in determining the amount of dividends to be paid to investors. Cash dividend is the cash outflow for the company. Therefore, if the company takes a policy to pay cash dividends to its investors, then there should be sufficient cash to make the payment.

For companies that have a relatively small cash availability, the dividend payout ratio tends to be small, and vice versa (Sutrisno, 2009; Noviyanto, 2016). This study predicts that operating cash flow affects dividend policy. These predictions refer to the results of previous studies by Manurung (2007), Ramli and Arfan (2011), Christi and Wijayanti (2013), Noviyanto (2016), and Wenas *et al*. (2017) which have proved that operating cash flow has a significant effect on dividend policy.

H_2: operating cash flow affects dividend policy

The Conceptual Framework

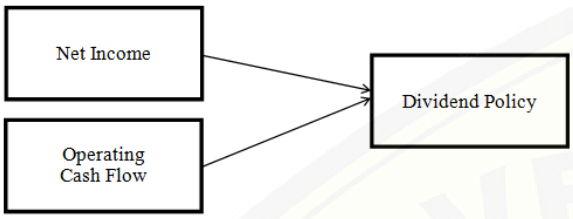

Figure 1. The Conceptual Framework

Based on the relationship between variables that have been described and the hypotheses that have been formulated, the conceptual framework is presented in figure 1.

METHODOLOGY

Population and Sample

The population of this study is a manufacturing company in the consumer goods industry sector listed in the Indonesia Stock Exchange on the period 2014 - 2016, which amounted to 36 companies. Furthermore, the selected sample based on purposive sampling technique with the following criteria:

- Manufacturing companies in the consumer goods industry sectorthat publish financial statements in consecutively during the period 2014 - 2016;
- Selected companies based on the criteria (a) make the payment of cash dividend in consecutively the period 2014 - 2016; and
- Selected companies based on the criteria (a) and (b) have a positive net income in the published financial statementsfor the period 2014 - 2016.

Based on the sample selection criteria, then determined the number of samples of 23 companies. Furthermore, the number of observations is determined based on the pooling technique, ie the number of samples multiplied by the number of years of observation, then obtained the amount of data observed as much as 69 observations.

Sources of the Data

The data used in this study is secondary data, sourced from a summary of financial statements published in website of the Indonesia Stock Exchange (www.idx.co.id).

Variable Operational Definition

There are two categories of variables in this study: 1) dividend policy as dependent variable (Y), and 2) net income and operating cash flow as independent variable (X).

- The dividend policy (Y), measured by dividend payout ratio, is the ratio of dividend per share and earning per share.
- Net income (X_1) shows the amount of excess revenue after deducting the total expenses incurred in the income statement for a period.
- Operating cash flow (X_2) represents the sum of all cash receipts transactions relating to sales revenue and cash disbursements related to overall operating costs.

Technique of the Data Analysis

The data collected, then analyzed using multiple linear regression method, namely: partial test (t test), simultaneous test (F test), and coefficient of determination (R^2). However, prior to regression analysis, a classical assumption test is used to obtain BLUE regression analysis (Best, Linear, Unbiased, and Estimated). The classical assumption test consists of: normality test, multicollinearity test, autocorrelation test, and heteroscedasticity test.

RESULTS AND DISCUSSION

The results of the classical assumptions made in this study suggest that the data available for analysis has met the classical assumption, so that it can be continued for multiple linear regression analysis. The results of multiple linear regression analysis are presented in the following table.

Table 1. The results of multiple linear regression analysis

Variable	B	Std. Error	Beta	t	Sig.
NI	-.275	.080	-.864	-3.817	.112
OCF	.584	.121	1.284	5.688	.001
(Constant)	6.055	1.071		5.679	.000
R		.823			
R square		.671			
Adjusted R Square		.631			
F Value		16.594			
Sig. F		.000			

Source: results of the analysis

Based on these results, at a 0.05 significance level indicates that operating cash flow significantly affects the dividend policy (0.001 < 0.05). That is, the hypothesis stating that the operating cash flow affects the dividend policy is accepted (H_2 accepted). Meanwhile, net income did not affect the dividend policy (0.112 > 0.05). That is, that the hypothesis stating that net income affects dividend policy is rejected (H_1 is rejected). The results of the analysis can be derived in the equation model as follows: DPR = 6.055 + 0.584 OCF + e. The equation model shows that operating cash flow has a positive effect on dividend policy. This means that the higher operating cash flow reflects the higher dividend policy, and vice versa.

F test value of 16,594, significant at the 0.05 level of significance. That is, that the variable net income and operating cash flow as an independent variable simultaneously affect the dividend policy. The coefficient of determination (R^2) is 0,671. That is, the ability of the variable net income and operating cash flow in explaining the variation of dividend policy variables is 67.1%, while the rest of 32.9% is explained by other variables (e) not observed. The results of this study indicate that companies in normal operations are sometimes able to obtain a positive net profit value, but the profit does not reflect the amount of cash availability. This is due, the income is not always in the form of cash, but there are in the form of receivables. Vice versa, sometimes when the company's earnings decrease, but because there is sufficient cash, the company takes the policy to pay dividends to its investors.

Based on these results, it can be concluded that the value of the profit earned by the company in a period is not the main thing that becomes the consideration in determining the dividend policy. Management should also consider operating cash flows that reflect cash availability for a period. Because, the company uses cash in make the payment dividends, so the company must have sufficient cash availability. When the available cash is insufficient for cash dividends, it is possible for the company to make a decision to withhold the profit to be reinvested. Moreover, Pourheydari (2009) argues that the determinant of dividend payout is a stable cash flow. Therefore, the accountant as the presenter of financial information should also focus on presenting the operating cash flow as a consideration for management to make cash dividend payments, while also focusing on presenting other important financial information.

Conclusion

The results of this study prove that operating cash flow significantly influence dividend policy, while net income does not affect dividend policy. These results indicate that operating cash flow tends to provide meaning in determining dividend policy, so that accountants as the presenter of financial information should focus the presentation of this information as an effort to attract investors to invest in the company's shares, as well as to focus the other important information presented.

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