DETERMINE THE FINANCIAL PERFORMANCE, COMPANY SIZE, AND DIVIDEND PAYOUT RATIO ON INCOME SMOOTHING OF MANUFACTURING COMPANIES LISTED ON INDONESIA STOCK EXCHANGE

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Abstract: *The objective of this research is to examine the impact of profitability, financial risk, company size, and Dividend Payout Ratio (DPR) on the practice of income smoothing in manufacturing companies listed on the Indonesia Stock Exchange (IDX). Purposive sampling was used to collect the sample for this study, which consisted of 25 manufacturing enterprises listed in IDX from 2017 to 2019. According to the findings, profitability has a positive impact on income smoothing practices. However, income smoothing practices are unaffected by leverage, company size, and DPR.*

Key words: *Income Smoothing, Profitability, Leverage, Company Size, Dividend Payout Ratio*

JEL Classification Codes: *L21, L22, L25*

1. INTRODUCTION

Financial statements are a source of information regarding the condition and performance of the company between the company's internal parties, namely the management and external parties related to the company. Financial reports are intended to provide financial information to interested parties in assessing the company's financial performance. Profit is a critical component and information of financial statements used to evaluate managerial success. Companies listed on the Indonesia Stock Exchange (IDX) prepare financial statements using an accrual basis. The accrual basis was chosen in preparing financial statements because it is expected to increase transparency and accountability and reflect actual financial conditions for decision-making. However, as long as it does not stray from the applicable regulations of Financial Accounting Standards, the accrual basis can provide freedom to management in selecting an accounting method. The selection of accounting methods that management deliberately chooses for specific purposes is known as earnings management. One form of earnings management by the company is the practice of income smoothing. The purpose of earnings management is to make reported

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earnings look stable. According to Ashari & Ramayanti (2019), income smoothing arises due to information asymmetry between managers and shareholders as owners. Many factors influence management to practice income smoothing, one of which is Profitability. Profitability is a tool for making projected company profits because it describes the correlation between profits and capital invested. Profitability is the company's ability to generate profits. Companies with a high level of Profitability reflect management's ability to manage the company to generate profits.

Financial risk (Leverage) is the debt utilized by the company to fund its assets to carry out its operational activities, and it is assumed to influence the practice of income smoothing. The more the firm's debt to finance its assets to carry out its operational activities, the greater the risk faced by the owner, prompting the owner to demand a higher level of return so that the company does not face collapse.

The size of the company also has an impact on income smoothing. Company size is a scale that can be used to categorize businesses based on their total assets, operational size, stock market value, and other factors. The company size is solely defined into three categories: massive corporations, moderate companies, and microenterprises, with the size determined by the company's total assets.

The Dividend Payout Ratio (DPR) is assumed to influence the practice of income smoothing in addition to profitability, financial risk, and business value. The DPR is the percentage of dividends to the company's net income value. Companies tend to establish and implement a dividend policy with a high DPR when profits fluctuate (Lahaya, 2017). As a result, a corporation with a high DPR is more inclined to use income smoothing measures.

The aim of this study is to examine the influence of profitability, financial risk, company size, and DPR on the practice of income smoothing.

2. LITERATURE REVIEW

Income Smoothing is unaffected by the value of leverage as a control variable (Nurliyasari & Saifudin, 2017). This study's findings are congruent with those of A. N. Anwar and Chandra (2017) and Sitorus et al. (2016) in that leverage does not affect income smoothing. However, this contradicts the findings of Megarani et al. (2019) and Hastuti (2017), who found that Financial Leverage had a prominent influence on the practice of Income Smoothing.

Furthermore, according to Wijaya et al. (2020), profitability has a substantial negative impact on Income Smoothing. Meanwhile, the results of research from Yanti & Dwirandra (2019), and Hastuti (2017) state that income smoothing practices are positively affected by profitability. However, according to Handoyo and Fathurrizki (2018) and Maedina (2016), profitability had no impact on income smoothing. The results of research based on Gunawan & Hardjunanto (2020), Purba et al. (2020), and Afriliana (2018) stated that Return on Assets (ROA) has no significant influence on Income Smoothing.

Based on Hastuti (2017), Purba et al. (2020), Wijaya et al. (2020) and Lahaya (2017), Size value has positive significant influence on Income Smoothing. That research is in contrast to the results of research Based on Afriliana (2018), Handoyo & Fathurrizki (2018) and Maedina (2016), which state that firm size does not have a significant effect on income smoothing. Based on Afrilana (2018), the DPR does not impact Income Smoothing. Those findings are consistent with the findings of Lahaya (2017), who found that Income Smoothing is not affected by DPR.

3. METHODOLOGY

The population in this study are manufacturing companies listed on the IDX from 2017-to 2019. In this study, the population of manufacturing companies listed on the IDX in 2017-2019 was 154. The type of research used in this research is quantitative research. The sampling technique used in this research is purposive sampling. The sampling criteria are manufacturing enterprises identified on the IDX from 2017 to 2019 time frame and have published their financial statements successively during the research period, manufacturing companies that have not carried out mergers, acquisitions, and delistings during the 2017-2019 period, companies manufacturing companies that use Rupiah as the reporting currency, manufacturing companies that show positive profits and distribute dividends consecutively during the 2017-2019 financial reporting period.

1. Dependent variable

In this study, the researcher used income smoothing as the dependent variable and the Eckel index (1981) to determine income smoothing. According to Lahaya (2017), the Eckel index distinguishes between firms that adopt income smoothing and those that do not. The calculation of the Eckel index is also expressed in dichotomous data (Yudiaatmaja, 2013), namely nominal data where there are only two categories with conditions:

a. If the Eckel index < 1, the company is smoothing earnings = 1
b. If the Eckel index ≥ 1, then the Income smoothing is not done by the corporation = 0
c. The Eckel Index measures income smoothing using the Coefficient Variation (CV) of net income (net income) and net sales (revenue), which is determined using the equation:

$$\text{Indeks Eckel} = \frac{CV\Delta I}{CV\Delta S}$$

Information:
CV = Variable coefficient of variation
ΔI = Profit varies throughout time.
ΔS = Sales varies over time
CV ΔI or ΔS can be calculated as follows:

$$CV\ \Delta I \text{ or } \Delta S = \sqrt{\sum \frac{(\Delta X - \Delta \overline{X})^2}{n-1}} : \Delta \overline{X}$$

CV ΔI and CV ΔS =
Information:
ΔX = Change in profit (I) or sales (S)
$\Delta \overline{X}$= Average varies in profit (I) or sales (S)
n = Number of observation periods

2. Independent Variable

The independent variables in this study include:

a. Profitability (X_1)

Profitability ratios are used to measure the financial position during a certain period of business activity. The ratio used to proxy Profitability in this study is the ratio of return on assets (ROA). ROA is the ratio used to calculate the company's profit in generating net income on its assets (Anwar, 2019).

$$ROA = \frac{\text{Earning Available for Common Stockholders}}{\text{Total Assets}}$$

b. Financial Risk (X_2)

The debt ratio was employed as a proxy for financial risk in this study. The debt ratio is a method of estimating the debt-to-asset ratio of a firm (Anwar, 2019). This ratio illustrates how much a company 's capability to repay the loans is dictated by its assets.

$$\text{Debt Rasio} = \frac{\text{Total Liabilities}}{\text{Total Assets}}$$

c. Company Size (X_3)

Company size is a scale to determine the size of the company. Company size is calculated using the natural logarithm of total assets, where measurements with total assets are considered more stable because they are not influenced by market conditions Dian, 2018.

$$\text{Company Size} = \text{Ln (Total Asset)}$$

d. Dividend Payout Ratio

The Dividend Payout Ratio or DPR is used to calculate the percentage of profits owned by the company to be distributed to stakeholders in the form of cash dividends. DPR can be calculated using a comparison between cash dividends and net income Afriliana (2018).

$$\text{Dividend Payout Ratio} = \frac{\text{Cash Dividend}}{\text{Net Income}}$$

4. RESULT AND DISCUSSION

The statistical method used in testing this research is a binary logistic regression model to test the effect and determine whether or not there is an effect of Profitability, financial risk, company size, and DPR on the practice of income smoothing manufacturers company listed on the IDX.

Table 1 Variables in the Equation

		B	S.E.	Wald	df	Sig.	Exp(B)
Step 1[a]	X1	14.040	6.884	4.159	1	.041	1251511.321
	X2	1.813	1.873	.937	1	.333	6.130
	X3	-.299	.166	3.230	1	.072	.742
	X4	.434	.365	1.414	1	.234	1.544
	Constant	6.684	4.758	1.973	1	.160	799.201

Source: Processed data

Profitability effects income smoothing methods positively in Indonesian industrial companies listed on the IDX. The Effects indicate that the increasing ROA, where the calculation is seen from the profits owned by the company, then it can influence the company in the possibility of income smoothing. The results of this study follow research that has been carried out by Hastuti (2017) and Maedina (2016), which states that Profitability affects income smoothing practices. Those researches are inversely proportional to the research results from Afriliana (2018), which states that ROA does not affect income smoothing practices, and research results from Gunawan & Hardjunanto (2020) that Income smoothing techniques are unaffected by profitability.

Income smoothing methods in manufacturing firms listed IDX are positively influenced by financial risk. This result argues that managers do not do income smoothing since the judgment of the company's credibility is assessed from financial risk and several other perspectives, such as assessing the type of industry. The findings of this study support the findings of Sitorus et al. (2016), who found that financial risk does not affect income smoothing practices. The findings are also supported by Wijaya et al. (2020) and Gunawan & Hardjunanto (2020), who found that financial risk does not affect income smoothing practices. Those results are inversely proportional to the research results from Hastuti (2017), which states that financial risk affects income smoothing practices.

Income smoothing techniques in manufacturing companies listed on the IDX are positively influenced by firm size. This impact implies that the business size variable has no influence. There is not enough evidence stating that the larger the company, the higher the company's incentive to smooth income. The results of this study follow the research conducted by Handoyo & Fathurrizki (2018), which states that company size has no effect on income smoothing practices and is supported by research from Dian, 2018. Those results are inversely proportional to the research results of Purba et al. (2020) that company size affects the practice of income smoothing.

In manufacturing enterprises registered on the IDX, the DPR has a positive influence on income smoothing strategies.Investors are more interested in returns in the form of shares than dividend payments to avoid paying taxes, so management tends to be reluctant to smooth income. The results of this study follow the research conducted by Lahaya (2017), which states that the DPR has no effect on the practice of income smoothing and is supported by the results of research from Yanti & Dwirandra (2019) that the practice of income smoothing is unaffected by DPR. Those outcomes are in contrast to the findings of research from Handoyo & Fathurrizki (2018) and Gunawan & Hardjunanto (2020), which state that the DPR affects income smoothing practices.

5. CONCLUSIONS AND RECOMMENDATIONS

This study aims to determine whether Profitability, financial risk, company size, and Dividend Payout Ratio (DPR) affect income smoothing practices in manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the 2017-2019 period. Profitability is the only factor that has a positive influence on income smoothing procedures. Income smoothing strategies are unaffected by other factors such as leverage, firm size, and DPR. The test findings demonstrate that the probability value of the profitability variable is less than the significance level of 5%, whereas the probability value of the other variables is larger than 5%.

Based on the findings and limits of the study, researchers would suggest that this research be further expanded by increasing the scope of research sample data to include other sectors of IDX, such as financial institutions and property real estate. Future research is expected to use a more extended period to be more accurate in determining factors that can affect income smoothing practices. Adding other independent variables in further research that can increase the value of Nagelkerker's R Square is more excellent in testing the factors that affect income smoothing besides Profitability, financial risk, company size, and DPR.

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