# The Effect of Profitability, Free Cash Flow and Financial Distress on Dividend Policy of Manufacturing Companies during the Covid-19 Pandemic

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**Abstract:** Corona Virus Desease 19 (Covid-19), which is one of the pandemics, has an economic impact on manufacturing companies in Indonesia. Companies that make profits or losses during the COVID-19 pandemic must also make optimal policies, one of which is the dividend policy. Dividends are the distribution of the results of the company's operational performance to shareholders either in cash or in the form of shares. The amount of dividend or profit share given to shareholders is decided through the company's dividend policy. This study aims to determine the effect of profitability, free cash flow and financial distress on dividend policy during the COVID-19 pandemic. The population of this study used manufacturing companies listed on the Indonesia Stock Exchange (IDX) during the 2020-2022 period. The sampling technique in this study used purposive sampling, 132 samples were used in this study. Data analysis used multiple linear regression to test and prove the research hypothesis with the help of SPSS version 25. The results of this study indicate that profitability affects dividend policy, while free cash flow and financial distress have no effect on dividend policy.
**Keywords:** Profitability, Free Cash Flow, Financial Distress, Dividend Policy.

## 1. Introduction

Corona Virus Desease 19 (Covid-19) which is one of the pandemics that has been decided by the Word Health Organization (WHO). Dividends are the distribution of the results of the company's operational performance to shareholders either in cash or in the form of shares. The amount of dividend or profit share given to shareholders is decided through the company's dividend policy. The first COVID-19 case in Indonesia was detected on March 2, 2020. The economic crisis caused by COVID-19 has been proven by Baig and Chen (2021) as the cause of a drastic increase in global market volatility and an aggressive decline in stock prices due to disruptions to the global economic outlook and world trade. In Indonesia, research by Umam et al. (2021) and Mulianto, Wijaya, and Jogi (2021) has proven that the COVID-19 pandemic has an economic impact on manufacturing companies in Indonesia. The study observed that there has been a significant decline in profitability since the start of the COVID-19 pandemic. Company profits decrease along with the decline in profitability. When determining how much dividend a company should pay, profit is a criterion that needs to be considered.

Profitability is one of the factors that influence dividend policy. When the company has high profitability, it generates large profits and in the end the profit available for distribution to shareholders will be even greater (Idawati, 2013) in Pradnyawati (2022). Many factors can affect the level of dividend policy of a company, one of which is free cash flow (Andini and Wirawati, 2014 in Trisna and Gayatri 2019). Brigham, (2012: 109) in Purnamasari (2016) free cash flow is cash flow that is actually available to be paid to investors after the company invests in fixed assets, new products, and working capital needed to maintain ongoing operations. Cash dividend policy is basically one of the supervisory mechanisms carried out by shareholders against management (Suharli, 2007 in Putri and Putra, 2017).

During the COVID-19 pandemic, drastic changes to people's daily activities have affected companies' ability to operate. Increased uncertainty certainly affects the company's ability to obtain or maintain optimal financial performance, as a result investors' perception of the company decreases. Companies facing the risk of bankruptcy after the COVID-19 pandemic must make an optimal dividend policy. According to Platt and Platt (2002) in Rasyid (2022), financial distress is a condition where the company is experiencing a financial crisis and is heading towards bankruptcy. Companies that are experiencing a crisis will focus all their resources on survival, so the company does not have the capacity to set aside its resources to external parties. Companies that make more profits during the COVID-19 pandemic must also make optimal policies. This makes the factors that are the basis for determining the company's dividend policy during the COVID-19 pandemic something important to study.

Profitability, free cash flow, and financial distress are just a few examples of variables that have been

studied as predictors in dividend policy research. Research conducted by Gayatri (2018) shows that profitability has an effect and free cash flow has no effect on dividend policy. Meanwhile, research conducted by Nugroho (2020) shows the opposite result. Then, research conducted by Rasyid (2022) shows that financial distress has no effect on dividend policy, while research conducted by Nurwidayanthi (2021) shows the opposite result. On the basis of the contradictions that have been described, the variables of profitability, free cash flow, and financial distress are important to be tested again.

## 2. Literature Review

### 2.1 Agency Theory
Agency theory stated by Jensen &Meckling (1976) is a design that explains the contingent relationship between principal and agent, namely between two or more people, a group or organization. The principal is the party who has the right to make a decision for the future of the company and give responsibility to another party (agent), the principal delegates part of the authority to manage the organization to an agent, including the formulation of dividend policy. Mazur, Dang, and Vo (2020) in Rasyid (2022) say that management acts in the interests of shareholders, responding to increased profits with increased dividends and vice versa.

### 2.2 Dividend SignalingTheory
Dividend signaling theory is the theory that dividend payment announcements are signals that contain information on the company's prospects. This theory was proposed by Stephen Ross and Solomon Ezra (1977). Ross (1977) in Rasyid (2022) revealed that companies that significantly increase their dividend payments experience an increase in company valuation by investors, on the other hand companies that stop or reduce dividend payments face a decrease in company valuation by investors. This shows that the company will always try to improve its image by increasing the portion of profit distributed as dividends so that it is expected to increase the company's value and later improve the quality of the company.

### 2.3 Dividend Policy
One of the important company policies that can influence investors is dividend policy. Dividend policy is a decision whether the profit earned by the company will be distributed to shareholders as dividends or retained in the form of profit for future investment financing according to Antika (2018). Dividends are the distribution of profits earned by the company to shareholders in proportion to the number of shares owned. Some define dividends as the distribution of profits made by a company to shareholders for the profits earned by the company. According to Risal and Lestari (2022) dividend policy is an important decision that is always awaited by stakeholders. Dividends can be defined as payments to company owners taken from company profits, either in the form of shares or cash. This means that only companies that book profits can distribute dividends because dividends are taken from company profits. Dividends earned is one of the reasons investors to invest their funds in a company.

### 2.4 Profitability
According to Hery (2013) in Nurwani (2017) Profitability is a ratio used to measure the company's ability to generate profits with the resources the company has. Companies that have stability in making profits can signal to the public about their ability to pay dividends. Profitability is the most important indicator that can show the company's ability to pay dividends because profitability describes the company's profit in a certain period. Dividends are obtained from the company's net profit so that net profit will affect the amount of dividends to be distributed according to Meidyna and Made (2019).
$H_1$: Profitability affects Dividend Policy

### 2.5 Free Cash Flow
According to Brigham, (2012: 109) in Trisna and Giyarti, 2019 Free Cash Flow is cash flow that is actually available for distribution to all investors (shareholders and debt holders) after the company places all of its investments in fixed assets, new products, and working capital needed to maintain ongoing operations. The concept of free cash flow focuses on cash generated from operating activities after being used for reinvestment needs. The greater the free cash flow, the greater the dividend payout ratio. Vice versa, the smaller the free cash flow, the smaller the dividend payout ratio.
$H_2$: Free Cash Flow affects Dividend Policy

### 2.6 Financial Distress
According to Platt and Platt (2002), financial distress is a condition where the company is experiencing a financial crisis and heading towards bankruptcy. The financial distress model needs to be developed because it

is expected that by knowing the financial distress of a company early, steps can be taken to predict which companies will go bankrupt. Financial distress is something that makes investors' valuation go down because when a company experiences financial distress, it will focus all its resources on survival and the company will reduce or even not pay dividends. The easiest condition to see whether the company is in financial distress is that the company eliminates dividend payments.

$H_3$: Financial distress affects Dividend Policy

## 3. Research Method

### 3.1 Research Design
This research is quantitative research by conducting hypothesis testing. The data used in this study are secondary data from financial reports and independent auditor reports of manufacturing companies listed on the Indonesia Stock Exchange (IDX) in the 2020-2022 company year. The data used in this study comes from the official IDX website, namely www.idx.co.id.

### 3.2 Population and Sample
The population used in this study are manufacturing companies listed on the IDX in 2020-2022. Manufacturing companies were chosen because they have the largest list of companies so as to increase the research population. The sampling technique in this study used purposive sampling. The criteria for companies that will be sampled in this study are as follows:
   a. Manufacturing companies listed on the IDX and provide financial data in the 2020-2022 company year.
   b. Companies that use the Rupiah currency.
   c. Manufacturing companies that distribute dividends in the observation year, namely company years 2020-2022.
   d. Manufacturing companies that present complete data related to research variables during the 2020-2022 company year period.

### 3.3 Type and Sources of Data
The quantitative data in this study are annual financial reports on manufacturing companies on the Indonesia Stock Exchange (IDX) from 2020-2022. The data used in this study are secondary data in the form of annual financial report data listed on the IDX, research journals, and other data that can support this research.

### 3.4 Data Analysis Method
This multiple linear regression analysis is used to analyze the effect of independent variables, namely financial distress, profitability and free cash flow on the dependent variable, namely dividend policy in manufacturing companies listed on the IDX for the period 2020-2022. The following is the regression equation model:

$$DPR = \alpha + \beta_1 ROA + \beta_2 FCF + \beta_3 GSR + e$$

Information:

| | |
|---|---|
| $\alpha$ | = Constant |
| $\beta 1. \beta 3$ | = Regression coefficient |
| DPR | = Dividend Policy |
| ROA | = Profitability |
| FCF | = Free Cash Flow |
| GSR | = financial distess |
| e | = Error term |

### 3.5 Variable Operational Definition and VariableMeasurement
Based on the main problems that have been formulated above, the variables to be analyzed are as follows:

Table 1 Variable Operational Definition and Variable Measurement

| Variable | Definition | Indicators | Source |
|---|---|---|---|
| Dividend policy | Dividend policy is a decision whether the profit earned by the company will be distributed to shareholders as dividends or retained in the form of profit for | $DPR = \dfrac{Dividen\ per\ share}{Earning\ per\ share}$ | Dayangku Dhindha Laksita Maharisht |

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| | | | |
|---|---|---|---|
| | future investment financing. Dividend policy is measured by dividend payout ratio. | | (2022) |
| Profitability | Profitability is a ratio used to measure the company's ability to generate profits with the resources owned by the company. Companies that have stability in obtaining profits can signal to the public about the ability to pay dividends. | $ROA = \dfrac{Net\ Income}{Total\ Assets}$ | Reki Febriano El Rasyid (2022) |
| Free Cash Flow | Free Cash Flow is the cash flow that is actually available for distribution to all investors after the company has placed all its investments in fixed assets, new products, and working capital needed to maintain ongoing operations. | $FCF = \dfrac{CFO - CFI}{Total\ Assets}$ | M. Shidiq Jalu Nugroho (2020) |
| Financial distress | Financial distress is a condition where the company is experiencing a financial crisis and heading towards bankruptcy. The Grover method was developed by Jeffrey S. Grover in 2001. | $GSR = 1{,}650X_1 + 3{,}404X_3 - 0{,}016ROA + 0{,}057$ | Nur Kholifah (2020) |

## 4. Result and Discussion

### 4.1 Descriptive Statistical Analysis

Table 2 Descriptive statistics

| Variable | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| Profitability | 132 | 0,004 | ,364 | ,08263 | ,069053 |
| Free Cash Flow | 132 | -0,207 | ,674 | ,14846 | ,139653 |
| Financial Distress | 132 | -0,740 | 2,125 | ,86564 | ,496158 |
| Dividend Policy | 132 | 0,000 | 1,193 | ,40798 | ,307133 |
| Valid N (list wise) | 132 | | | | |

Source: Data Process, 2023

Based on the results of the descriptive analysis test, it can be explained that the Profitability Variable has a minimum value of 0.004, a maximum value of 0.364, a mean value of 0.08263 with a standard deviation of 0.069053. The company that has the lowest profitability is PT Gajah Tunggal Tbk in 2021, while the one with the highest profitability is PT Mark Dynamics in 2021.

Based on the results of the descriptive analysis test, it can be explained that the free cash flow variable has a minimum value of -0.207, a maximum value of 0.674, a mean value of 0.14846 with a standard deviation of 0.139653. The company that has the lowest free cash flow is PT Hartadinata Abadi Tbk in 2020, while the one with the highest free cash flow is PT Aneka Gas Industri Tbk in 2021.

Based on the results of the descriptive analysis test, it can be explained that the financial distress variable has a minimum value of -0.740, a maximum value of 2.125, a mean value of 0.865564 with a standard deviation of 0.496158. The company that has the lowest financial distress is PT Tempo Scan Pasific Tbk in 2020, while the one with the highest financial distress is PT Mark Dynamics in 2021.

Based on the results of the descriptive analysis test, it can be explained that the dividend policy variable has a minimum value of 0.000, a maximum value of 1.193, a mean value of 0.40798 with a standard deviation of 30.7133. The company that has the lowest dividend policy is PT Diamond Food Indonesia Tbk in 2021, while the one with the highest dividend policy is PT H. M. Sampoerna Tbk in 2021.

**4.2 Classic Assumption Test**
**4.2.1 Normality Test**

Table 3 Normality Test Result

| Variable | Kolmogorov-Smirnov | Sig | Description |
|---|---|---|---|
| Unstandardized residual | 0,105 | 0,106 | Normal |

Source: Data Process, 2023

Based on the test results using Kolmogorov-Smirnov (1-sample K-S) through the Monte Carlo approach, the significance value is 0.106> 0.05, so it can be said that the data is normally distributed.

**4.2.2 Multicollinearity Test**

Table 4 Multicollinearity Test Result

| Variable | Tolerance | VIF | Description |
|---|---|---|---|
| Profitability | 0,469 | 2,133 | No Multicollinearity |
| Free Cash Flow | 0,710 | 1,409 | No Multicollinearity |
| Financial Distress | 0,610 | 1,639 | No Multicollinearity |

Source: Data Process, 2023

Based on the multicollinearity test results above, the tolerance value is greater than 0.01 and the VIF value is less than 10, it can be concluded that the regression model used in this study does not have multicollinearity.

**4.2.3 HeteroscedasticityTest**

Table 5 heteroscedasticity Test Result

| Variable | Sig. (*2-tailed*) | Description |
|---|---|---|
| Profitability | 0,565 | No Heteroscedasticity |
| Free Cash Flow | 0,452 | No Heteroscedasticity |
| Financial Distress | 0,397 | No Heteroscedasticity |

Source: Data Process, 2023

In this test, researchers used the Glejser method which showed that the independent variables had a significance value greater than 0.05. It can be concluded that the regression model in this study does not occur symptoms of heteroscedasticity.

**4.2.4 Autocorrelation Test**

Table 6 Autocorrelation Test Result

| dU | Durbin-Watson | 4-dU | Description |
|---|---|---|---|
| 1,8457 | 2,136 | 2,1543 | No Autocorrelation |

Source: Data Process, 2023

Based on the table above, it is known that the DW value is 2.136, while the requirement for the absence of autocorrelation is DW greater than dU and DW smaller than 4-dU. ThedU value for a sample of 132 and 3 independent variables is 1.8457 and the 4-dU value is 2.1543. So it can be concluded that there are no autocorrelation symptoms in the regression model.

**4.3 Multiple Linier Regression Analysis**

Table 7 Multiple Linier Regression Analysis Result

| Modle | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|
| | B | Std. Error | Beta | | |
| (Constant) | ,298 | ,057 | | 5,192 | ,000 |
| Profitability | 1,301 | ,549 | ,292 | 2,370 | ,019 |

| Free Cash Flow | -,043 | ,221 | -,020 | -,197 | ,844 |
| Financial Distress | ,010 | ,067 | ,017 | ,154 | ,878 |

Source: Data Process, 2023

Based on this table, the regression equation can be found:

$$DPR = 0,298 + 1,301ROA - 0,043FCF + 0,010GSR + \varepsilon$$

Based on the multiple linear regression model above, the direction of the regression coefficient results, this study can be interpreted as follows:

Constant = 0.289, meaning that if the independent variables (profitability, free cash flow and financial distress) are considered constant, the average dividend policy increases by 0.298.

The regression coefficient on the profitability variable is 1.301, which means that if profitability increases by 1% while other variables are considered constant, the dividend policy will increase by 1.301.

The regression coefficient on the free cash flow variable is -0.043, which means that if free cash flow increases by 1% while other variables are considered constant, the dividend policy will decrease by 0.043.

The regression coefficient on the financial distress variable is 0.010, which means that if financial distress increases by 1% while other variables are considered constant, the dividend policy will decrease by 0.010.

### 4.4 Hypothesis Test.
### 4.3.1 F Test

Table 8 F Test Result

| Model | F | Sig. |
|---|---|---|
| Regression | 4,025 | ,009[b] |

Source: Data Process, 2023

Based on the results of the F test output analysis in the table above, it shows a significant value of 0.009 smaller than 0.005, it can be concluded that the independent variables in this study, namely profitability, free cash flow and financial distress, simultaneously affect the dependent variable, namely dividend policy.

### 4.3.2 T Test

Table 9 T Test Result

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|
| | B | Std. Error | Beta | | |
| (Constant) | ,298 | ,057 | | 5,192 | ,000 |
| Profitability | 1,301 | ,549 | ,292 | 2,370 | ,019 |
| Free Cash Flow | -,043 | ,221 | -,020 | -,197 | ,844 |
| Financial Distress | ,010 | ,067 | ,017 | ,154 | ,878 |

Source: Data Process, 2023

Based on the table above, it can be explained as follows:
a) Based on the t test of the first hypothesis ($H_1$), namely profitability. Looking at the t test results in table 4.9, it can be concluded that profitability has a significant value of 0.019 smaller than 0.05. This shows that $H_1$ is accepted. It means that profitability has no effect on dividend policy.
b) Based on the t test of the second hypothesis ($H_2$), namely free cash flow. Looking at the t test results in table 4.9, it can be concluded that free cash flow has a significant value of 0.844 greater than 0.05. This shows that $H_2$ is rejected. It means that free cash flow has no effect on dividend policy.
c) Based on the t test of the third hypothesis ($H_3$), namely financial distress. Looking at the t test results in table 4.9, it can be concluded that financial distress has a significant value of 0.878 greater than 0.05. This shows that $H_3$ is rejected. It means that financial distress has no effect on dividend policy.

### 4.3.3 Adjusted $R^2$ Test

Table 10 Adjusted $R^2$ Test Result

| Modle | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | ,294[a] | ,086 | ,065 | ,297019 |

Source: Data Process, 2023

Based on the table above, it can be seen that the coefficient of determination (Adjusted R2) is 0.065 or 6.5%. This means that the amount of dividend policy variables is influenced by profitability, free cash flow and financial distress variables by 6.5% and the remaining 93.5% of dividend policy is influenced by other variables.

## 5. Result and Discussion

**Profitability affects Dividend Policy**

Based on the results of the research that has been done, it shows that the profitability variable proxied by Return On Assets (ROA) has a significance level of 0.019. The significance level is smaller than 0.05, which means that the first hypothesis ($H_1$) is accepted, so it can be concluded thatthe profitability variable has an effect on dividend policy in manufacturing companies listed on the Indonesia Stock Exchange(IDX) in the 2020-2022 company year.Which means that high and low profitability affects dividend policy.

**Free Cash Flow has no effect on Dividend Policy**

Based on the results showed that the free cash flow variable has a significance level of 0.844. The significance level is greater than 0.05, which means that the second hypothesis ($H_2$) is rejected, so it can be concluded that the free cash flow variable has no effect on dividend policy in manufacturing companies listed on the Indonesia Stock Exchange (IDX) in the 2020-2022 company year.Which means that the high and low free cash flow has no effect on dividend policy.

**Financial Distress does not affect Dividend Policy**

The results showed that the financial distress variable had a significance level of 0.878. The significance level is greater than 0.05, which means that the third hypothesis ($H_3$) is rejected, so it can be concluded that the financial distress variable has no effect on dividend policy in manufacturing companies listed on the Indonesia Stock Exchange (IDX) in the 2020-2022 company year. Which means that the high and low financial distress has no effect on dividend policy.

## 6. Conclusion

### 5.1 Conclusion

Based on the test results and discussions that have been carried out in this study, the following conclusions can be drawn:
1. Profitability affects dividend policy with a significance value of 0.019 less than 0.05. Which means that high and low profitability affects dividend policy.
2. Free cash flow has no effect on dividend policy with a significance value of 0.844 greater than 0.05. Which means that the high and low free cash flow has no effect on dividend policy.
3. Financial distress has no effect on dividend policy with a significance value of 0.878 greater than 0.05. Which means that the high and low financial distress has no effect on dividend policy.

### 5.2 Limitations

Based on the research that has been carried out, there are several limitations in the study, namely:
a. The variables used in this study are only limited to 3 independent variables, namely profitability, free cash flow and financial distress.
b. The sample in this study focuses on manufacturing companies listed on the Indonesia Stock Exchange (IDX), so the research results cannot be generalized to other sector companies on the Indonesia Stock Exchange.
c. The research period used by companies on the Indonesia Stock Exchange for 3 years, namely the 2020-2022 period, so that this research does not represent actual conditions.
d. The research period in 2022 there are still many manufacturing companies that have not published financial data because the research data collection is only until Wednesday, April 05, 2023.
e. The regression results show that the coefficient of determination (Adjust R square) for the dividend

policy variable is only 0.065 or 6.5%, while the remaining 93.5% is explained by other independent variables not included in this study. So the independent variables used in this study are still relatively few.

**5.2 Suggestion**

Based on the results of the analysis and conclusions in this study, there are suggestions that can be considered for future research. This suggestion is expected to provide an overview and more knowledge for future researchers for better results:

1. This study uses independent variables, namely profitability, free cash flow and financial distress to determine the effect on dividend policy. The hope of researchers for further research can use and add other independent variables such as liquidity, company size and growth.
2. This study only uses samples of manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2020-2022. Future researchers are expected to use a wider scope of research
3. This study only uses samples during the COVID-19 pandemic. Future researchers are expected to use comparisons before, during and after the COVID-19 pandemic.

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