

The Moderating Effect of Corporate Liquidity on the Relationship between Financial Reporting Quality and Dividend Policy: Evidence from Saudi Arabia

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ABSTRACT:

Purpose – We examine the impact of financial reporting quality (FRQ) on dividend policy. We also examine the moderating role of corporate liquidity on the FRQ-dividend policy relationship.

Design/methodology/approach – Our sample contains 113 non-financial companies listed on the Saudi Stock Exchange from 2003 to 2019 (1675 firm-year observations). We use OLS regressions to test our hypotheses.

Findings – We find a positive relationship between FRQ and dividend policy. We also find that the positive effect of FRQ on dividend policy is not strengthened by the presence of corporate liquidity.

Research implications – Our findings offer implications for stakeholders, including investors and others in Saudi Arabia and other developing countries with comparable business environments. This is due to the significant impact of the dividend policy on a company's value, as it is a crucial decision that involves distributing substantial amounts of money to shareholders on a regular basis and interacts with other critical decisions within the company. Therefore, the dividend policy has a crucial role in determining the company's value, which is reflected in its stock prices.

Originality/value – To the best of our knowledge, this is the first study in Saudi Arabia that provides new empirical evidence on the impact of FRQ on dividend policy and the moderating role of corporate liquidity on this relationship.

Keywords: Dividend Policy; Financial Reporting Quality; Corporate Liquidity; Saudi Arabia.

1. INTRODUCTION

Corporate dividend policy is a topic that has received a great deal of attention from financial analysts and academic researchers (Tang et al., 2022). The aim of a corporate dividend policy is to determine the extent to which a company's earnings are distributed to shareholders and thus verify the amount of earnings retained within the company. The dividend policy is an integral part of a company's financial decision-making process, as it relates to two other major decisions – investment and financing. Since the primary objective of all financial decisions is to maximize shareholders' wealth, the determinants of corporate dividend policy are an important contribution to the dividend decision-making process (Tang et al., 2022).

Financial reporting quality (FRQ) plays an important role in reducing information asymmetry by providing appropriate information about the value of the company's investment projects, which reduces the problem of adverse selection when issuing securities (Tran, 2022). Moreover, high-quality financial reporting reduces the issue of moral hazard by facilitating the contracting process. Thus, companies with high FRQ have better access to external financing and, therefore, there is a very low probability that managers will abandon investments in projects with a positive NPV against dividend (Rashid, 2020).

FRQ can influence dividend policy by, for example, reducing underinvestment problem (thereby limiting managers' abandonment of investment opportunities). Underinvestment leads to an increase in the cash flows that managers can use to pay dividend. Consequently, FRQ limits the problem of underinvestment, which reduces dividends FRQ limits the problem of underinvestment, which reduces dividends payout. In short, FRQ can impact corporate dividend policy through reducing agency problems (i.e., those relating to free cash flow and underinvestment), and limiting the financial restrictions imposed on companies if these companies obtain external financing (Koussis et al., 2017).

The results of previous studies that examined the effect of FRQ on dividend policy have varied. For example, Koo et al. (2017) and Trinh et al. (2022) indicate a positive relationship between FRQ and dividend policy. In contrast, Ramalingegowda et al. (2013) find a negative relationship between FRQ and dividend policy, and Tien (2020) reports an insignificant relationship between

the two variables. Thus, based on previous literature that suggests higher levels of FRQ may lead to larger dividend payouts, we posit that FRQ could have an impact on dividend policy.

Corporate liquidity plays an important role in dividend policy, whereby earnings are distributed from the balance of retained earnings or earnings achieved during a specific period (Acikgoz et al. 2018). As companies distribute earnings to shareholders, often in the form of cash, and shareholders' right to the company's earnings stems from the decision made at the annual general meeting to distribute these earnings, these distributions depend on the presence of earnings and the availability of cash in the company, which highlights the important role of corporate liquidity as measured by retained earnings (Koussis et al., 2017).

Based on the above, the research problem can be formulated as two questions: 1) Does FRQ affect dividend policy; and 2) Does this effect differ according to corporate liquidity as a moderating variable? This paper is motivated by two considerations. First, there is a lack of research that investigates the association between FRQ and dividend policy in Saudi Arabia. Second, there is mixed empirical evidence in previous studies (Ramalingegowda et al., 2013; Koo et al., 2017; Tien, 2020; Trinh et al., 2022) that assessed how FRQ changes dividend policy. Thus, there is a need to address this issue in Saudi Arabia as a developing country in which the business settings are different from those in developed countries. This research aims to explore the potential influence of FRQ on dividend policy. Additionally, the study intends to explore whether corporate liquidity moderates the direction and/or strength of the association between FRQ and dividend policy.

This research is of academic significance as it aims to uncover the influence of FRQ on dividend policy and contributes to the literature by investigating the potential moderating impact of corporate liquidity on this relationship. This research area has not been explored extensively in Saudi Arabia. This research is also of practical significance, as it could provide valuable insights for stakeholders, the capital market, and investors in Saudi Arabia by investigating how FRQ influences dividend policy. Therefore, the significance of this research also arises from the viewpoint of the impact of a dividend policy, as dividend payments are frequently substantial and distributed to shareholders on a regular basis, implementing such a policy requires significant institutional decision-making. The company's dividend policy has an impact on all other crucial

decisions made within the organization. Thus, dividend policy plays an important role in influencing firm value.

This paper provides three contributions to the literature. First, we contribute to the existing literature by investigating how corporate liquidity affects the relationship between FRQ and dividend policy. This is a novel approach that extends previous research in this area. Second, to the best of our knowledge, this is the first study to be conducted in a developing country that examines the impact of corporate liquidity on the association between FRQ and dividend policy. This aspect of the research adds to its originality and importance. Third, the number of studies (Ramalingegowda et al., 2013; Koo et al., 2017; Tien, 2020; Trinh et al., 2022) investigating the effect of FRQ on dividend policy is limited. Therefore, this research contributes to the literature in this area by providing additional insights into this important relationship.

Through the use of OLS regression, this paper finds that (a) there is a significant positive effect of FRQ on dividend policy, and (b) the association between FRQ and dividend policy does not vary with a change in corporate liquidity. The study can also assert that the sensitivity analysis conducted corroborates the findings of the basic analysis to a large extent.

The structure of this paper is as follows: Section 2 provides the research background Section 3 reviews the theoretical literature. Section 4 reviews empirical literature and develops research hypotheses. Section 5 outlines the research design. Section 6 presents and discusses the findings. Section 7 concludes the study.

2. BACKGROUND

According to the findings of Hussainey and Al-Nodel (2008) and Al-Matari et al. (2012), the formal rules of Saudi Arabia are significantly influenced by Islamic principles. Furthermore, Solomon (2012) noted that Saudi Arabia's gross domestic product (GDP) accounted for 25% of the total GDP of the Arab world. In addition to its Islamic-based rules and significant contribution to the GDP of the Arab world, Saudi Arabia is also a member of the G20. According to a World Bank report, the Kingdom of Saudi Arabia had one of the largest economies in the Middle East and North Africa region in 2021, according to the GDP for that year.

One of the primary sources of national income in Saudi Arabia is the exportation of petroleum products, which plays a crucial role in maintaining the country's economic stability (Alsultan, 2017). The Ministry of Economy and Planning (2016) observed that more than 60% of Saudi Arabia's entire national income was derived from the export of petroleum products. Approximately 22% of the world's total oil reserves were located in Saudi Arabia, as reported by the Organization of the Petroleum Exporting Countries (OPEC) Annual Statistical Bulletin (2016). OPEC (2017) also predicted that Saudi Arabia was expected to continue holding its position as the top crude oil producer in the world in the future. As per expectations, Saudi Arabia is likely to account for a significant percentage of the oil produced by OPEC members, indicating the country's continued dominance in the global oil market. As Saudi Arabia contributes 34.54% to the total oil production of OPEC, it plays a crucial role in setting oil prices worldwide (OPEC, 2021). The Ministry of Petroleum and Mineral Resources asserts that Saudi Arabia's vast reserves of crude oil will allow the country to continue producing and exporting oil for the next century. According to one Annual Statistical Bulletin (2015), the estimated reserves of crude oil in Saudi Arabia were approximately 266,578 billion barrels, indicating the significant role that the country should continue to play in the global oil industry.

The Ministry of Commerce and Industry (2006) reported that Saudi Arabia joined the World Trade Organization as an active participant in 2005, indicating the country's commitment to global trade and commerce. Thus, it could be stated that Saudi Arabia has undergone multiple reforms in the realms of legal procedures, politics, and business. As a result of these changes, the Saudi Arabian General Investment Authority was founded. The primary goal of this authority is noteworthy: it is to enhance the investment environment in the country by eliminating obstacles and shortcomings within Saudi Arabia.

In 2018, the Saudi Capital Market Authority introduced modifications related to foreign investment in the Saudi capital market, which included recent enhancements to the Rules that aimed to ease the qualification requirements for foreign investors, their affiliates, foreign portfolio managers and their managed funds. According to Alsultan (2017), Tadawul (the Saudi Stock Exchange) held a value of over \$564 billion on the Arab stock market and facilitated uncomplicated entry for foreign investors.

The Saudi Corporate Governance Regulations (Article 9b) assert that firms must declare a clear policy for dividend distribution. Article 9a gives the right to the general assembly to determine “the net profits to be distributed to the shareholders and deduct the reserves if any”. Moreover, Companies Law (Article 125) emphasizes that the general assembly has the right to determine the proportions of the profit to be distributed. Firms are also allowed to create reserves by “setting aside a certain percentage of the net profit” (Article 123).¹

According to Baydoun et al. (2012) and Albassam (2014), the ownership of corporations in Saudi Arabia is largely concentrated among families or the state. Specifically, family-owned businesses make up over 70% of listed firms, whereas the Saudi government holds approximately 30% of listed firms. According to Alfordy (2016), Saudi families had control over more than 41% of the executive board positions in Saudi-listed firms and had a dominating influence on the boards of 68 out of the 168 firms listed in the country. Furthermore, another 17 families had a dominant presence on the boards of other listed companies in Saudi Arabia (Alfordy, 2016). Hence, these environmental variations may drive differing results between nations and are worth studying, especially in informing foreign investors regarding the Saudi capital market.

3. THEORETICAL LITERATURE REVIEW

Dividend are usually defined as payments made to the shareholders as a proportion of their shareholding in the company (Anssari and Al Sabti, 2022). The dividend policy is considered one of the main institutional decisions, as dividend payments are paid to shareholders in a regular manner (i.e., annually or semi-annually) and can include very large amounts, and so this policy interacts with all other important decisions made within the company. The dividend policy plays an important role in influencing firm value (Ben Amar et al. 2018).

Two schools have examined dividend policy, and each has a different opinion regarding this type of policy. The first school maintains that dividend are not important, as it believes that dividend has no effect on firm value. As they see it, greater dividend paid to shareholders lead to a decrease in capital. Miller and Modigliani (1961) were the pioneers of this school. The second

¹ It is worth mentioning that the new Companies Law, which came into effect in January 2023, no longer requires firms to create a statutory reserve, as was mandated in the previous version of the Law.

school includes those who believe in the importance of dividend, as they believe that they increase the firm value. Dividend provides a kind of discipline and commitment in the process of flowing and fulfilling the dividend payout, in addition to being a source of income, and they have an impact on the investors. Those investors who own non-cash shares and need cash face two options: either to sell their cash shares or take a loan in exchange for their shares. In both cases, certain costs (transaction costs) are included, so dividend are preferred. Gordon (1959) and Holder et al. (1998) were the pioneers of this school.

The overall quality of financial reporting, which refers to the extent to which financial reports accurately and fully reflect a company's underlying financial situation, can have an impact on dividend policy through three distinct channels. The first channel, addressing the issue of free cash flow, is intended to tackle the managerial incentive to hoard cash and allocate it to projects that fail to create value for shareholders. High-quality financial reporting can help alleviate this problem by providing more transparency and allowing shareholders to better monitor and communicate with managers. However, regarding the impact of FRQ on dividend, which involves addressing the problem of free cash flow. The outcome view emphasizes the role of FRQ in disciplining managers and reducing their incentives to underpay dividend. This view suggests that higher FRQ makes it less likely that managers will invest in value-destroying projects, which, in turn, makes dividend payments more appealing to them. Therefore, according to the outcome perspective, a rise in FRQ is expected to increase in dividend payouts (Koo et al., 2017).

The second channel involves mitigating financial constraints by alleviating information asymmetry between outside investors and managers. Higher FRQ can help companies access external capital and, therefore, pay higher dividend. The third channel involves disciplining managers' 'quiet life' behavior, whereby executives might opt for a cautious strategy and steer clear of investment prospects that could potentially enhance the value of the company. In situations of underinvestment, there may be a surplus of cash flows, which could tempt managers to pay out dividend over what is appropriate. However, high-quality financial reporting can encourage managers to pursue value-increasing investments, reducing the likelihood of overpayment of dividend (Koo et al., 2017).

Several studies (e.g., Baker et al., 2007; Rommens et al., 2012; Liu and Espahbodi, 2014; Lawson and Wang, 2016; Ofori-Sasu et al., 2017) have demonstrated the importance of dividend policy. The importance of dividend policy is evident in that it plays an important role in influencing firm value, reducing the relationship between the risk of profit manipulation and auditors' fees, reducing audit risk, and affecting shareholder value.

Several studies (e.g., Adjaoud and Ben-Amar, 2010; Wang et al., 2011; Al-Shubiri et al., 2012; Al-Najjar and Kilincarslan, 2016; Jiraporn et al., 2016; Sindhu et al., 2016; Elmagrhi et al., 2017; Khan et al., 2017; Arif et al., 2020; Fadaha et al., 2020; Lloren-Alcantara, 2020; Tahir et al., 2020; Bakri et al., 2021; Bataineh, 2021; Jovković et al., 2021; Das Mohapatra and Panda, 2022; Islam and Adnan, 2022; Kullab et al., 2022; Medyawati and Yunanto, 2022) have indicated that the determinants of dividend policy are as follows: accounting earnings, ownership structure, corporate governance, corporate credit rating, managerial ability, capital structure, inflation, interest rates, return on equity, market value-to-book value of equity ratio, liquidity, growth opportunities, and cash holding, but the current research was limited to examining FRQ.

4. EMPIRICAL LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

This section presents previous research investigating the correlation between FRQ and dividend policy. It then discusses studies that have explored the influence of corporate liquidity as a factor in determining dividend policy. Furthermore, the potential moderating impact of corporate liquidity on this relationship is examined within the context of relevant theories. As a result, this aids in understanding the theoretical basis on which the research hypotheses were formulated.

FRQ AND DIVIDEND POLICY

Koo et al. (2017) and Abdullah et al. (2023) indicated that the expected association between FRQ and dividend policy depends on agency theory and signaling theory. According to agency theory, FRQ can influence a dividend policy by (1) easing cash flow problems, (2) constraining agency problems, and (3) reducing underinvestment problems. Signal theory suggests that a

company's announcement of increased dividend payout is an indicator of a company that has strong prospects. One form of investment inefficiency is the presence of underinvestment resulting from the unavailability of the necessary financing to seize the available investment opportunities as a result of the high cost of financing (Verdi, 2006).

According to signalling theory, the management of projects that bring good news attempts to disclose this information to distinguish themselves from projects that have bad news. Thus, increasing the quality of financial reporting reduces the problem of underinvestment, as it causes managers to prefer to abandon investment projects with a positive net present value (underinvestment), which will lead managers to pay high dividend (Tran et al., 2017).

The review of the literature has shown a lack of research that has explored the effect of FRQ on dividend policy. Indeed, of those few studies, there is controversy among researchers over findings regarding the effect of FRQ on dividend policy. For example, Koo et al. (2017) and Trinh et al. (2022) found a positive relationship between FRQ and the dividend policy. In contrast, Ramalingegowda et al. (2013) found a negative relationship between FRQ and dividend policy, and Tien (2020) noted an insignificant relationship between the two variables. The following is a brief presentation of these studies, in chronological order.

Ramalingegowda et al. (2013) aimed to study the effect of FRQ on dividend policy in the USA. The research discovered an inverse relationship between FRQ and dividend policy, but a positive relationship between FRQ and investment efficiency. In another work, Koo et al. (2017) examined the impact of FRQ on dividend policy and, more generally, the central importance of the effect of FRQ on corporate policies. Although the majority of the literature reviewed focuses on examining the influence of FRQ on firms' financing and investment decisions, only a few studies have examined the effect of FRQ on dividend policy. Koo et al. (2017) found a positive relationship between FRQ and dividend policy in terms of reducing agency problems (i.e., those relating to free cash flow and underinvestment).

Tien (2020) also examined the impact of FRQ on dividend policy and relied on the use of multiple regression in examining the study hypotheses. The study found an insignificant relationship between FRQ and dividend policy in the stock market in Vietnam. Trinh et al. (2022)

examined how FRQ changes dividend policy. The study found a positive correlation between FRQ and dividend policy.

As mentioned to earlier, the Saudi Corporate Governance Regulations (Article 9b) assert that firms must declare a clear policy for dividend distribution. Article 9a gives the right to the general assembly to determine “the net profits to be distributed to the shareholders and deduct the reserves if any”. Moreover, Companies Law (Article 125) emphasizes that the general assembly has the right to determine the proportions of profit to be distributed. Firms are also allowed to create reserves by “setting aside a certain percentage of the net profit” (Article 123). Accordingly, we believe that FRQ could affect dividend policy. This gives rise to the formulation of the first alternative hypothesis, which can be stated as follows:

H1: FRQ positively affects dividend policy.

THE MODERATING EFFECT OF CORPORATE LIQUIDITY ON THE RELATIONSHIP BETWEEN FRQ AND DIVIDEND POLICY

There is a dearth of studies that have considered the impact of corporate liquidity on dividend policy. Braouezec and Lehalle (2010), for example, studied the effect of corporate liquidity on dividend policy and found that the policy plays an important role in influencing firm value. The study's results suggest that dividend policy is a critical factor in shaping firm value, as it indicates a noteworthy and adverse relationship between dividend policy and corporate liquidity as measured by retained earnings.

Koussis et al. (2017) investigated the effect of corporate liquidity, as measured by retained earnings, on dividend policy. They employed multiple regression analysis in their study to evaluate the research hypotheses. According to the study, there exists a significant and negative correlation between dividend policy and corporate liquidity, as indicated by retained earnings. Sari et al. (2022) also investigated the effect of corporate liquidity on dividend policy, using multiple regression to test the study’s hypotheses based on data for companies listed on the Indonesian Stock Exchange during the period 2016–2020. The study found that corporate liquidity, as measured by the current ratio, had no significant impact on dividend policy.

The findings from various studies (e.g., Braouezec and Lehalle, 2010; Koussis et al., 2017) suggest that the dividend policy varies based on the level of corporate liquidity. Conversely, some studies (e.g., Hamidzadeh and Zeinali, 2015) suggest the prospect of regard as corporate liquidity as one of the determinants of FRQ. As a result of findings regarding the impact of corporate liquidity on dividend policy, we anticipate that the combination of corporate liquidity and FRQ will generate a novel interactive variable that will have an impact on the association being examined. Thus, we implemented an approach that would enable corporate liquidity to be treated as a moderating variable in the relationship.

Braouezec and Lehalle (2010) and Koussis et al. (2017) suggest that there has been a lack of focus on examining the effect of corporate liquidity on the relationship between FRQ and dividend policy. However, our perspective is that the interaction between corporate liquidity and FRQ is anticipated to influence the intensity and/or direction of the relationship between FRQ and dividend policy. This gives rise to the formulation of the second alternative hypothesis, which can be stated as follows:

H2: Corporate liquidity moderates the relationship between FRQ and dividend policy.

5. RESEARCH DESIGN

Figure 1 shows our conceptual model. It shows that the primary independent variable is FRQ, which is anticipated to have an impact on dividend policy as the dependent variable. It is also expected that corporate liquidity will moderate the FRQ-dividend policy relationship.

(Insert Figure 1 here)

FRQ AND DIVIDEND POLICY MODEL

To test H1, which concerns the influence of FRQ on dividend policy, the following OLS regression model is used:

$$\text{Dividend}_{(it)} = \beta_0 + \beta_1 \text{FRQ}_{(it-1)} + \beta_2 \text{FS}_{(it)} + \beta_3 \text{Lev}_{(it)} + \beta_4 \text{ROA}_{(it)} + \beta_5 \text{Complexity}_{(it)} + \epsilon_{(it)} \quad (\text{Model 1})$$

Where:

$Dividend_{(it)}$: Dividend payout.

$RQ_{(it-1)}$: FRQ.

$FS_{(it)}$: Firm size.

$Lev_{(it)}$: Leverage ratio.

$ROA_{(it)}$: Return on assets.

$Complexity_{(it)}$: The complexity of processing.

CORPORATE LIQUIDITY MODERATING MODEL

To empirically test H2, which investigates the moderating impact of corporate liquidity on the correlation between FRQ and dividend policy, an estimation is conducted on the multiple regression model shown below:

$$Dividend_{(it)} = \beta_0 + \beta_1 RQ_{(it-1)} + \beta_2 Corp.liq_{(it-1)} + \beta_3 RQ * Corp.liq_{(it-1)} + \beta_4 FS_{(it)} + \beta_5 Lev_{(it)} + \beta_6 ROA_{(it)} + \beta_7 complexity_{(it)} + \epsilon_{(it)} \quad (Model 2)$$

Where:

$Dividend_{(it)}$: Dividend payout.

$RQ_{(it-1)}$: FRQ.

$FS_{(it)}$: Firm size.

$Lev_{(it)}$: Leverage ratio.

$ROA_{(it)}$: Return on assets.

$Complexity_{(it)}$: The complexity of processing.

$Corp.liq_{(it-1)}$: Corporate liquidity.

$RQ * Corp.liq_{(it-1)}$: The interaction between corporate liquidity and FRQ.

SAMPLE SELECTION

Following the exclusion of financial institutions, such as banks and insurance companies, the initial sample for the study comprised solely non-financial companies that were listed on the Saudi Stock Exchange through the period from 2003 to 2019. The financial sector was eliminated from the sample as it is regulated and governed by the Saudi Central Bank and arguably follows different financial reporting practices. In addition, Sharif and Lai (2015) claim that the financial sector has “different structures and policies”. The period of this study starts from 2003 due to data availability. Additionally, the period of the COVID-19 pandemic (2020 and beyond) is excluded from the sample because there is evidence that firms were pursuing an income-decreasing earnings management strategy, as found in Liu and Sun (2022).² The study sample items needed to fulfil the following conditions: (1) the firms during the study period had to be listed on the Saudi Stock Exchange; (2) their annual financial statements had to be available for the study period; and (3) Consistent with previous studies (e.g., Rosner, 2003; Alhadab et al., 2015), six observations per year were necessary for each sector to estimate discretionary accruals.

Table 1 shows the selection of the sample, which involved excluding firms operating in financial services-related sectors, as well as those in other sectors that failed to meet the above-mentioned criteria. As a result, data were gathered for a total of 113 firms from 9 sectors, The data availability allowed for the generation of a total of 1,675 observations of firm-year, covering the period from 2003 to 2019.

(Insert Table 1 here)

MEASUREMENT OF THE VARIABLES

Dependent variable

The dependent variable is dividend policy. It is measured for fundamental analysis purposes by common dividend scaled by total assets (Trinh et al., 2022), and it was measured according to sensitivity analysis based on MV of equity was utilized to scale the common dividend.

Independent variable

The first case of COVID-19 in Saudi Arabia was confirmed on 2 March 2020.²

The independent variable is FRQ. It is measured for fundamental analysis purposes by using discretionary accruals based on the model developed by Kothari (2005)³ (Salehi et al. 2022). It was measured according to sensitivity analysis through the FRQ was evaluated by employing the Dechow and Dichev (2002) model, which is based on the basic variables in Jones (1992) as modified by McNichols (2002), to compute discretionary accruals. This approach served as an alternative measure of FRQ.

Moderating variable

The moderating variable is the interaction between the FRQ and corporate liquidity. It is measured by the interaction between the FRQ dummy variable and corporate liquidity. Corporate liquidity can be measured by RE scaled by total assets (Siahaan et al., 2020).

Control variables

We identified four control variables, which are explained in detail in Table 2 of the Appendix. Trinh et al. (2022) emphasized the significance of a firm's size as a determinant of dividend payout, with larger firms enjoying accessing capital markets at a reduced cost with greater ease, and thus being able to pay higher dividend to shareholders. The size of a firm can be gauged by its total assets measured using the natural logarithm (Trinh et al., 2022). We anticipate positive coefficients for firm size, the reason for this is that larger companies generally have higher levels of cash flows and less growth, enabling them to pay out higher dividend (Trinh et al., 2022). On the other hand, we anticipate that the coefficient for debt, which indicates a company's leverage, will be negative, because highly leveraged companies face greater financial risks and higher costs of funding, making it challenging for them to keep pace with dividend payments (Trinh et al., 2022). The leverage ratio can be calculated as the ratio of debt to assets (Trinh et al., 2022). Another variable, return on assets (ROA), indicates a company's profits, which can be measured as the ratio of net income to total assets. We anticipate a positive relationship between ROA and dividend, as profitable firms have more room to manoeuvre when deciding on the amount of dividend payments and are more motivated to utilize dividend discipline to address agency issues. (Trinh et al., 2022).

Following previous studies (e.g., Rosner, 2003; Alhadab et al., 2015), six observations were required for each sector³ per year to estimate discretionary accruals.

Finally, complex processes can be measured by the sum of inventory and account receivables divided by total assets (Trinh et al., 2022).

(Insert Table 2 here)

6. EMPIRICAL RESULTS AND DISCUSSION

This section presents the descriptive statistics for the research variables used in the regression models and discusses the results. This is followed by the outcomes of the hypothesis testing.

DESCRIPTIVE STATISTICS

The descriptive statistics for all variables used in the research model analysis are presented in Table 3. Based on the table, The mean values of the variables are situated near their corresponding minimum and maximum values, as can be seen, suggesting that the data is diverse and does not contain any anomalous values. Furthermore, Table 3 shows that the mean of FRQ is lower than its standard deviation.

(Insert Table 3 here)

Table 4 presents the Pearson correlations. A correlation coefficient lower than 0.7 indicates a weak correlation between the independent variables, indicating the absence of multicollinearity. Based on the sample data, none of the correlation coefficients between the independent variables exceed 0.5. Therefore, we conclude that there is no multicollinearity between the variables.

(Insert Table 4 here)

EMPIRICAL RESULTS

This section presents the regression models estimated to test the research hypotheses yielded the following empirical outcomes.

Results of the FRQ and Dividend Policy Model

The primary aim of testing the first hypothesis is to assess how FRQ is associated with dividend policy. The findings of the regression analysis using OLS are presented in Table 5. The

results of this study align with what was anticipated, indicating that FRQ has a positive impact on dividend policy. Table 5 demonstrates that the coefficient of FRQ is both statistically significant and positive. Table 5 lists the outcomes of the analytical testing of H1. It is clear from the table that the adjusted R^2 is 0.095, which indicates that 9.5% of the changes that occur in a dividend policy can be explained by variations in the independent variable (FRQ). The relevance of the model is supported by the statistical test findings, whereby the model's p-value is less than the 0.05 acceptable level of significance, which confirms the validity of the model to test the relationship under study. According to the statistical study findings, FRQ significantly and positively affects a firm's worth. As a result, the alternative hypothesis, H1, is supported and the null hypothesis is disproved. The findings are consistent with previous research that demonstrates a meaningful and positive relationship between FRQ and dividend policy, as documented by Koo et al. (2017) and Trinh et al. (2022).

The findings of our study support signalling theory, in that when a project has good news, project managers may attempt to disclose this information to differentiate it from projects with bad news. Increasing the quality of financial reporting can reduce underinvestment problems, as it encourages managers to pursue investment projects with positive net present value rather than abandoning them. This can lead to higher dividend being paid by managers.

(Insert Table 5 here)

Results of the Corporate Liquidity Moderating Model

The main objective of testing the second hypothesis is to examine how the relationship between FRQ and dividend policy is affected by corporate liquidity. The results of the OLS regression analysis are reported in Table 6. As shown in Table 6, the statistical analysis reveals that the model is significant ($p < 0.05$), and R^2 has increased from 9.5% to 9.8% (rounded). Accordingly, H2 is not supported, indicating that the impact of FRQ on dividend policy does not differ with a change in corporate liquidity. This result is in line with Sari et al. (2022) in demonstrating that there is a non-significant association between corporate liquidity and dividend policy.

(Insert Table 6 here)

The outcomes of the hypothesis testing are presented in Table 7.

Table 7: Summary of hypothesis testing

	Research hypotheses	Result
H1	FRQ positively affects dividend policy.	Supported
H2	Corporate liquidity moderates the relationship between FRQ and dividend policy.	Not Supported

SENSITIVITY ANALYSIS

The sensitivity of the results was evaluated by using two different measures of FRQ and dividend policy. The FRQ was evaluated through the computation of discretionary accruals using the Dechow and Dichev (2002) model, which was developed based on the basic variables in Jones (1992) as modified by McNichols (2002). We scale the common dividend by the MV of equity and use this new measure as a proxy for dividend policy. The findings are presented in Table 8. The table shows that the model is significant ($p < 0.05$), this suggests that the results have statistical significance. The findings in the table support the first hypothesis (H1). The findings in Table 8 are consistent with prior research that demonstrated a significant and positive relationship between FRQ and dividend policy, as documented in Koo et al. (2017) and Trinh et al. (2022).

(Insert Table 8 here)

The outcomes of investigating the second hypothesis (H2) are presented in Table 9. According to Table 9, the model is statistically significant ($p < 0.05$). However, the coefficient of the interactive variable, $RQ*Corp.liq$, is -0.009 and statistically insignificant ($p > 0.05$). Accordingly, H2 is not supported, indicating that corporate liquidity has no moderating role of the FRQ-dividend policy relationship.

(Insert Table 9 here)

The outcomes of the hypothesis tests, conducted using basic and sensitivity analyses, are presented in Table 10. Based on the findings of the hypothesis testing, it can be inferred that there

is consistency between the results obtained from the sensitivity analysis and those from the fundamental analysis.

(Insert Table 10 here)

7. CONCLUSION

This study examined the relationship between FRQ and dividend policy. In the context of Saudi Arabia, the analysis shows a positive and significant relationship between FRQ and dividend policy. The findings are in line with prior research (Koo et al., 2017; Trinh et al., 2022). The findings are robust, as sensitivity analysis was conducted by using alternative measures for the main variables. With regard to the impact of corporate liquidity on the association between FRQ and dividend policy, the analysis shows that the presence of corporate liquidity does not strengthen the relationship between the two variables.

The investigation into how FRQ influences dividend policy can provide valuable insights for various groups, such as investors, the capital market, and other stakeholders. The research findings can also be generalized to other developing countries that share similar business environments to that in Saudi Arabia. This is because the decision to distribute significant amounts of money to shareholders regularly through dividend interacts with other crucial decisions within a company and has a significant influence on its value, as reflected by its stock prices. As such, understanding the crucial role of the dividend policy in determining a company's value can have practical implications for various parties.

It is important to consider some limitations when interpreting the results of this research. First, non-financial firms in the Saudi context were used to investigate the association between FRQ and dividend. Thus, generalizing the findings might not be applicable to financial firms, non-listed firms, or companies that present their financial reports using a foreign currency. Second, we only tested the moderating effect of corporate liquidity. Consequently, omitting companies' characteristics that could impact dividend policy could be considered an additional limitation of this paper. The rate of growth in sales, firm age, and the M-to-B ratio are suggested to be examined to overcome this limitation. Finally, it is important to consider the study purposes, the timeframe of the study, the sample used, and the specific criteria for selecting firms when concluding the findings of this research.

Finally, it is advised that future research be carried out to achieve a more profound understanding of ways to enhance dividend policies. For instance, a potential area of research in this regard could be to analyse how ownership structure affects dividend policy. Another potential area of research would be to examine how corporate governance practices might have an impact on dividend policy. Another avenue of research could be to investigate how debt covenant violations may affect dividend policy.

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Appendices

Figure 1: Research model

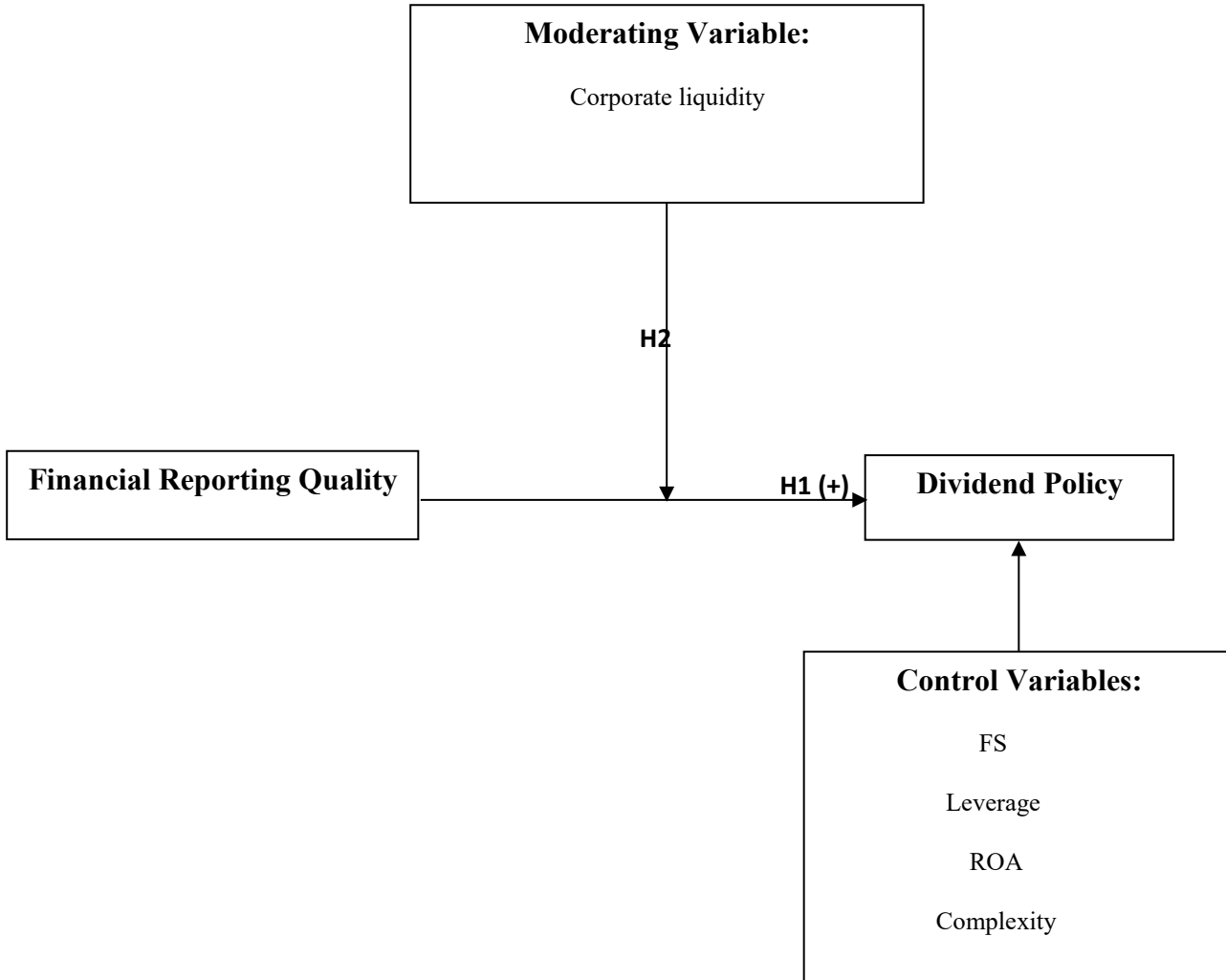


Figure 1: Research model

Table 1: Determining the sample

Sector	Sample companies	%
Materials	42	37
Food and Staples Retailing	6	5
Capital Goods	12	11
Retailing	8	7
Health Care	7	6
Consumer Services	10	9
Food and Beverages	12	11
Real Estate Management and Development	10	9
Consumer Durables and Apparel	6	5
Total	113	100

Table 2: Measuring the variables

Variable	Type (predicted sign)	Measurement
Dividend Policy (<i>Dividend</i>)	Dependent	Dividend policy can be measured by common dividend scaled by total assets (Trinh et al., 2022).
Financial Reporting Quality (<i>RQ</i>)	Independent (+)	This is a measure calculated using discretionary accruals based on the model developed by Kothari (2005) ⁴ (Salehi et al. 2022).
Firm Size (<i>FS</i>)	Control +/-	Firm size can be measured by the natural logarithm of total assets (Trinh et al., 2022).
Leverage (<i>Lev</i>)	Control +/-	The debt-to-assets ratio is a metric that can be used to quantify leverage (Trinh et al., 2022).
Return on Assets (<i>ROA</i>)	Control +/-	ROA can be measured as the net income divided by total assets (Trinh et al., 2022).
Complex Processes (<i>Complexity</i>)	Control +/-	Complex processes can be measured by the summation of inventory and account receivables scaled by total assets (Trinh et al., 2022).
Corporate Liquidity (<i>Corp.liq</i>)	+/-	Scaling retained earnings by total assets (Siahaan et al., 2020).
<i>RQ*Corp.liq</i>	Moderating (+/-)	The interaction between the FRQ dummy variable and the variance in corporate liquidity.

Following the earnings management literature (e.g., Rosner, 2003; Alhadab et al., 2015), six observations were ⁴ required for each sector per year to estimate discretionary accruals.

Table 3: Descriptive statistics

Variable	Min.	Max.	Mean	Std. deviation
Dividend	0.0000	0.953	0.033	0.020
RQ	-0.889	0.8803	0.043	0.156
FS	4.281	8.681	6.328	0.718
LEV	0.0001	0.9608	0.359	0.205
ROA	-0.776	0.439	0.054	0.044
Complexity	0.00000	0.929	0.218	0.177
	3			
Corp.liq	-0.789	0.556	0.070	0.059
RQ*Corp.liq	-0.237	0.304	0.103	0.028

N=1,675

Table 4: Pearson correlation coefficients

Correlation	Dividend	RQ	FS	LEVER	ROA	Complexity	Corp.liq	RQ*Corp.liq
Dividend	1.000							
RQ	-0.205**	1.000						
FS	0.119**	-0.220	1.000					
LEV	-0.081**	0.008	0.430	1.000				
ROA	0.175**	-0.208	0.033**	-0.157	1.000			
Complexity	0.084**	-0.202	-0.194	0.316	0.3133	1.000		
Corp.liq	0.239**	-0.475	0.218	-0.091	-0.4282	-0.1894	1.000	
RQ*Corp.liq	0.032	-0.240	0.047**	0.034**	-0.1201	-0.4638	0.0268	1.000

* The statistics are based on a sample of 1,675 firm-year observations over the period 2003–2019.

** Correlation is significant at 5%.

Table 5: Findings from the OLS analysis of the FRQ and dividend policy model

Variable	Results of testing H1	
	β	p-value
RQ	0.097	0.000
FS	0.218	0.000
LEV	-0.211	0.000
ROA	0.113	0.000
Complexity	0.172	0.000
R ²	0.097	
Adjusted R ²	0.095	
F-statistic	35.954	
Sig.	0.000	
N	1,675	

Table 6: Outcomes of the model with corporate liquidity as a moderator

Variable	Results of testing H2	
	β	p-value
RQ	0.014	0.777
<i>Corp.liq</i>	0.137	0.006
<i>RQ*Corp.liq</i>	-0.009	0.717
FS	0.203	0.000
LEV	-0.191	0.000
ROA	0.105	0.000
Complexity	0.162	0.000
R ²	0.101	
Adjusted R ²	0.098	
F-statistic	26.857	
Sig.	0.000	
N	1,675	

Table 8: OLS results of the financial reporting quality and dividend policy model

Variable	β	p-value
RQ	0.080	0.000
FS	0.233	0.000
LEV	-0.352	0.000
ROA	0.357	0.000
Complexity	0.231	0.000
R ²	0.265	
Adjusted R ²	0.263	
F-statistic	120.272	
Sig.	0.000	
N	1,675	

Table 9: Regression results of the corporate liquidity moderating model

Variable	β	p-value
RQ	0.088	0.000
<i>Corp.liq</i>	0.101	0.000
<i>RQ*Corp.liq</i>	-0.009	0.713
FS	0.185	0.000
LEV	-0.319	0.000
ROA	0.342	0.000
Complexity	0.188	0.000
R ²	0.273	
Adjusted R ²	0.270	
F-statistic	89.405	
Sig.	0.000	
N	1,675	

Table 10: Contrasting the outcomes of the primary and sensitivity analyses

Research hypothesis	Results under fundamental analysis	Results under sensitivity analysis
H1: Financial reporting quality positively affects dividend policy.	Supported	Supported
H2: Corporate liquidity moderates the relationship between financial reporting quality and dividend policy.	Not Supported	Not Supported