CHAPTER I

INTRODUCTION

1.1 Research Background

The relationship between dividend and investment, for a long time have been an enigma. In the literature of corporate finance, firm that pays dividend has remained such a puzzle. The firm, whether it chooses not to pay or reduce the dividend, could raise some capital for a potential investments (Boumosleh, 2012). While, Yagan (2015) finds that the dividend tax cut and subsequent surge in dividend payouts failed to increase corporate investment. Mathur et al. (2015) find that policies or tax that relate to dividend payout or profit distribution may lead to reducing cash on hand and, thus, corporate investment—an important driver of real-economy outcomes like firm and worker productivity.

Earlier studies over a long time period such as Fama (1974), Smirlock and Marshall (1983), both find no significant relationship exist between dividend payouts and investment. Both studies also show negative relation i.e. dividend payouts will decline when corporate investment rises. Mathur et al. (2015) find most firms, even the average firm, did not exhibit a negative relationship between dividend payouts and investment.

Miller and Modigliani (1961) argue that, in a perfect capital market, optimal investment decision by a firm is independent of how such decision is financed. They suggest that the investment decision should never be determined by dividend decisions, and dividend decisions need not be affected by investment decision. Though constitutes a large body of literature, the empirical investigation of dividend policy and its interrelation with investment decision has generally lagged behind the theoretical development and the results are at best mixed (Fama, 1974; Fama and French, 2002).

Policy makers and economists alike tend to have an interest on the relationship between corporate investment and dividend payouts. Several empirical investigations mentioned such as Chetty and Saez (2005), Blouin et al. (2011), and Edgerton (2013), among others, Yagan (2015) shows that the 2003 dividend tax reduction led to higher dividend payouts. Fama and French (2001) conducted a research in the U.S. firms between year 1926 and 1999. They found that the proportion of firms paying dividend declines dramatically after 1978. The reason was that new listed firms in the U.S. stock market as newcomers at growth stage. They argued that firm`s life cycle may affect the dividend policy and the firms tend to pay lower dividend payouts.

DeAngelo et al. (2006) conduct a research which observed a highly significant relationship between the decision to pay dividends and the earned/contributed capital structure, controlling for profitability, growth, firm size, total equity, cash balances, and dividend history. They find that earned/ contributed capital structure has a greater impact on the decision to pay dividends than profitability and growth opportunities. These results also are supported by Al-Malkawi (2007) who finds that size, age, and profitability of the firm are determinant of corporate dividend policy in Jordan. In sum, most of studies have used of earned/contributed capital structure as a basic measure of firm's life cycle measurement (Chay and Suh, 2009; Thanatawee, 2011; Wang et al. 2011). Adizes (1979) describes the business life cycle theory, he states that company’s operating strategy should be adjusted according to the change of its life cycle. Churchill and Lewis (1983) propose that a company has different goals at different business life cycle stages. The changes of life cycle of a firm may affect the policy and strategy, therefore the firm needs to update them and adjust to the firm's current situation.

Life cycle of a firm becomes one of the determinant factors in several studies. Previous study by DeAngelo et al. (2006) have examined different aspects in corporate finance in relation to corporate life cycle stages. Life cycle can also help policy makers have a better understanding of the impact of policies that can affect payouts. Anthony and Ramesh (1992) find some firms do not enter the stage of decline but remain in a stagnant stage. The dividend payout in stagnant stage ranked the highest among two other stages i.e growth and mature, although the firms do not experience increasing in sales suddenly. In stagnant stage, some firms do not spend to invest in a large-scale and profits are no longer spend for firm's development. Yet, very few studies focus on the relationship among life cycle especially in stagnant stage and the two major financial decisions; investment and dividend.

Dividend closely related to the investors or shareholders. One of the ways to maximize shareholders wealth is by maximizing the value of firm, where the higher share price, the higher firm value will be. From the shareholders/investors' point of view, this is what they expect to happen. Dividend also related to cash flow which is one of the essential elements in business operation. Firm's cash flow is a source to pay dividend, it informs to the investors how much the amount of cash that firm has in order to pay dividend from its operation activity. Another important thing is debt. Barro (1979) suggests that debt allows corporations to smooth investment and production in the face of variable sales. Debt allows governments to smooth taxes in the face of variable expenditures. Therefore, based on the explanation above this research is aimed to find out the relationship between investment and current period dividend payouts, firm value, cash flows, and total debt in stagnant stage of firm's life cycle stages which based on the situation in Indonesia's manufacturing listed companies.

1.2 Problem Statements

Referring to the research background that has been presented above, it can be concluded that the interrelation between dividend and investment still be such a puzzle or an enigma of the literature over the period of years especially in stagnant stage of firm's life cycle. Therefore, the author concludes that the formulation of the problem which will be presented in this study: Is there any significant relationship (and what kind of; positive or negative) between current period dividend payouts and investment, firm value, cash flows, and total debt when firm is in its stagnant stage of its life cycle.

1.3 Research Objective

According to the problem statements stated before, the objective of this research is to analyze and examine the existence of significant relationship between firm's current period dividend payouts and investment, conditional on firm value, cash flows, and total debt in the firm's last stage (stagnant) of life cycle in Indonesia's manufacturing listed companies.

1.4 Research Benefits

The benefit of this research is to give information or add more knowledge whether it is for the author itself, investors, policy makers or management of the firm and also the future researchers about the relationship between dividend payout and investment in stagnant stage of firm's life cycle.

1.5 Writing Systematic

CHAPTER I : INTRODUCTION

This chapter consists of background of this research, problem statements, research objectives, research benefits, and writing systematic.

CHAPTER II : LITERATURE REVIEW

This chapter consists of theories which is used in this research as a basis and to support this research in order to figure out the solutions to the problems. Also explaining or showing the previous research, theoretical framework, and the hypothesis development.

CHAPTER III : RESEARCH METHODS

This chapter explains research design, type and source of data, data collection method, variable definition, and data analysis.

CHAPTER IV : ANALYSIS & DISCUSSION

This chapter consists of data analysis. This part will discuss the general description of method section, statistic descriptive, result of hypothesis test, and discussion of data analysis.

CHAPTER V : CONCLUSION

This chapter consists of conclusion, limitations, and recommendations of this research and also suggestions for future research.