CHAPTER I

INTRODUCTION

1.1 Research Background

In order to maximize the value of the company, it requires optimal effort from a manager. A manager is required to make decisions carefully and integrated decisions. Accuracy is very crucial in decision making, especially financial decisions such as investment decisions, funding decisions and dividend decision (Van Horne and Wachowizs, 2009). Certain financial decision will affect other financial decisions and the impact on the value of the company (Fama and French, 1998), and good combination of the decisions will maximize the company's value (Hasnawati, 2005). Yet, several research denied if there are any relationship exist between financial decisions especially on dividend and investment. (Miller and Modigliani, 1961; Yagan, 2015; Boumosleh, 2012)

Researches that studies any relationship between investment and dividend have been an enigma and remained such a puzzle. Several research has been studied over long period of time, but yet, many researchers had come to different conclusions. Recent work by Yagan (2015) shows that the corporate investment failed to increase by 2003 dividend tax cut and subsequent surge in dividend payouts. Other research by Boumosleh, (2012) finds that the firm, whether it chooses not to pay or reduce the dividend, could raise some capital for potential investment.

Several earlier studies focused on the relationship between investment and dividends had also been conducted. (Fama, 1974; Smirlock and Marshall,1983) found that no significant relationship exists between dividend payouts and investment. Both studies also show negative relation i.e dividend payouts will decline when the corporate investment rises. As for Miller and Modigliani (1961), stated in a perfect capital market, the only determinant of the firm value is investment policy alone. They stated that the dividend policy is irrelevant and the optimal investment decision by a firm is independent of how such decision is financed.

They suggest that the investment decisions should never be determined by dividend decisions, and it's the other way around, the dividend decisions need not be affected by investment in actual market practices. However, it has been found that dividend policy does seem to matter, and relaxing the M&M's perfect capital market assumptions, DeAngelo and DeAngelo (2006) argue that dividend payout policy and investment policy matters exactly the same. They suggest that, in order to maximize the firm value, it requires the payout policy to be optimized.

The results of the research are somehow, has some contradictions. Fama (1974), Smirlock and Marshall (1983), both find that there is no significant relationship exist between dividend payouts and investment. While others pointed to a significant interaction between investment and dividends (e.g., Dhyrmes and Kurz, 1967), and is the result also supported by Mathur et al. (2015) that find most firms, even the average firm, did not exhibit a negative relationship between dividend payouts and investment. DeFusco et al. (2014) conducted a research on

US firms observed over the period 1950-2006 by examining the long-term dynamic relationships between investment, earnings and dividends. Using various methods like variance decomposition and impulse response functions, they showed that investment and dividend payout correlate with each other in both the short and the long run via earnings. Hussain and Ahmed (2013) conduct a study that shows that investment and dividends have bidirectional causality. Rather than making investment, the profits are more allocated towards paying dividends, which means every decision affects each other.

Economist, policy makers, and managers alike tend to have interest on the relationship between corporate investment and dividend payouts. Several empirical investigations mentioned such as Blouin et al. (2011), Edgerton (2013), Chetty and Saez (2005), and also Yagan (2015) showed that the 2003 dividend tax reduction decision resulted to a higher dividend payout. Fama and French (2001) conducted a research in the U.S. firms between the year of 1926 and 1999 an the result of the research was the proportion of firms paying dividend declines dramatically after the year of 1978. i.e., the proportion of dividend payers peak at 66.5% in 1978 but fell down to only 20.8% in 1999. This evidence indicates that due to a surge in new listings of small companies as growth stage, the lower the amount of the dividend payers. Grullon et al. (2002) propose the maturity hypothesis, that when a company move from growth stage to higher stage (mature stage), they tend to increase the dividends. As the company move stages from growth to mature, its investment opportunities decline, which in turn, would lead to the cash flow to increase. Fama and French (2001) argued that firm's life cycle may affect dividend policy.

A life-cycle test theory was conducted by DeAngelo et al (2006) and Stulz (2006) by examining whether the earned/contributed capital mix is related to the probability to pay dividend, and the result indicates a positive significant relation. The earned/contributed capital mix not only resulted in a positive significant relation with the probability of a firm to pay dividend, but also with the controlling for profitability, growth, firm size, total equity, cash, balances, and dividend history. These results are also supported by the research conducted by Al-Malkawi (2007) who stated that a corporate dividend policy in Jordan determinants are: age, size, and profitability of the firm. In sum, most of the research or studies have used the earned capital structure as basic measure of firm's life cycle measurement (Chay amd Suh, 2009; Wang et al, 2011; Thanatawee, 2011). The business life cycle theory described by Adizes (1979) stated that firm's operating strategy and the change of its life cycle should be adjusted accordingly. Churchill and Lewis (1983) propose that a company has different goals at each different business life cycle stages. The changes of life cycle of a firm may affect the policy and strategy, therefore the firm needs to be keep updated and the adjustment to the firm's current situation/current life cycle.

Several studies found that a firm life stage hold an important role and determinant factor (DeAngelo et al., 2006; Fama and French, 2001; Grullon et al., 2002). Life cycle can also help policy makers have a better understanding of the impact of policies that can affect payouts. But most studies only focus on the effect of company's life cycle stages with certain financial decision policies without correlating other factors that may affect the financial decision at the first place.

Dividends tend to be paid by mature, established firms, plausibly reflecting a financial life cycle in which young firms face relatively abundant investment opportunities with limited resources so that retention dominates distribution, where the mature firms are better candidates to pay dividends because they have higher profitability and fewer attractive investment opportunities, (DeAngelo et al., 2006) and empirical evidence suggests that a firm's dividend policy may depend on the stage of the firm's life cycle. For example, younger firms may distribute less cash dividends, with higher growth opportunities but lower profitability. As in the opposite, more mature firms with higher profitability but lower growth opportunities may distribute more cash dividends. Therefore, author interested in examining this research-focusing on the last stage of company's life cycle, stagnant stage.

Following the previous research, this research also will be added with two more variables; Cash Flow and Firm Value and author will examine whether these two variables has any significant effect on Dividend payout of the company at stagnant stage. This research will be titled: **"THE DIVIDEND PAYOUT DETERMINANTS OF COMPANY AT STAGNANT STAGE" (Empirical Study on Companies Listed in Indonesia Stock Exchange 2014-2017).**

1.2 Problem Statement

Referring to the research background and based on several studies that has been presented above, it can be concluded the relationship between investment and dividend still be such an enigma and puzzle of the literature over a long period of years, especially during significant stages of company's life cycle. Therefore, author concludes that the formulation of the problems which will be presented on this study will be:

1. Is there any significant relationship between current period dividend payouts and investment on the company at stagnant stage?
2. Does investment cause any significant effect on dividend when the company at stagnant stage?
3. Does cash flow cause any significant effect on dividend when the company at stagnant stage?
4. Does firm value cause any significant effect on dividend when the company at stagnant stage?

1.3 Research Objectives

According to the problem statements stated above, this research aims to achieving the following research objectives:

1. To analyze and examine the existence of significant relationship between firm's current period dividend payouts and investment of firms at stagnant stage
2. To analyze and examine whether investment effects dividend on the company at stagnant stage
3. To analyze and examine whether cash flow effects dividend on the company at stagnant stage

4. To analyze and examine whether firm value effects dividend on the company at stagnant stage

1.4 Research Contribution

1. For Writer

   The benefits of this research is to give information or to add more knowledge and more insight to author about company's policy decision

2. To Business Practitioners

   Analysis result obtained from this research is expected to give more insights to managers, economist, or policy makers to be a consideration for the management of a firm.

3. For Academic

   This research provides benefits to the development of science in the field of Corporate Governance. This research is expected to be a material for readers from academic to broaden the insight and development of research related to dividend and investment on a company.

4. For Future Researches

This study is expected to give additional insights to conduct further research about the relationship between dividend payout and investment at stagnant stage of firm's life cycle.

1.4 Writing Systematic

CHAPTER I : INTRODUCTION

This chapter consist of backgrounds of this research, problem statements, research objectives, research benefits, and writing systematics.

CHAPTER II : THEORITICAL FRAMEWORK

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

CHAPTER III : RESEARCH METHODOLOGY

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 be discussing the general description of sample, statistic descriptive, result of hypothesis test, and discussion of data analysis.

CHAPTER V : CONCLUSION

This chapter consists of conclusions, limitations, and recommendations of this research, and also there will be suggestions for future research