CHAPTER I

INTRODUCTION

1.1 Background

For the past couple of years since the pandemic, Indonesia has seen a great growth on its stock exchange that has been consistently growing every year and this is very influential on large companies in Indonesia. This growth is very important because it is one of substantial ways of improving financial growth, especially for companies that aims to go public. The economics development of a country can be measured in many ways, one of which is by knowing the level of capital market. The capital market plays an predominant deed in encouraging initial public offering firms to further increase the performance of firms, one of which is by giving news about incomes and dividends paid to investors (Sitorus, et al., 2021).

The role of the capital market in an economy is crucial. It provides a variety of investment options for investors and serves as a means of channeling funds from investors to entities in need of capital, such as companies, through the sale of stocks and bonds (Hirdinis, 2019). The presence of the capital market allows investors to purchase company stocks with the expectation of receiving returns in the form of dividends and/or capital gains (Sari & Azzahra, 2023). Additionally, issuers can utilize these funds for the company's interests without having to wait for funds from the company's operations.

Investors require information about the company's condition and the capital market before investing their funds. The information needed by the investors should be relevant to their position as potential company owners (Pandiangan, et al., 2022). The first concern is the security of the investment, and the second is the returns or profits from the investment. Every investor on the stock exchange will receive dividends and capital gains from the investment provided. Investors relatively prefer dividends compared to capital gains because it is more reliable to depend on dividends rather than relying on uncertain things such as changes in share prices. Consequently, this characteristic supports the idea of the bird-in-the-hand theory, which states that investors prefer dividends from stock investing to potential capital gains because of the inherent uncertainty associated with capital gains.

As stated by Baridwan 2000:434, Dividend is explained as income distributed after being deducted by expenses to shareholders to which is proportional to the number of shares owned. According to Firer et al 2008, firms tend to make a plan that will benefit the future to increase the chance of a good future in firm's condition in order to distribute dividends every period. The theory of Agency states there is a conflict of interest between shareholders and management and how the conflict could be resolved by proper management to convey accurate information to investors about the rate of return on investment, while the theory of signaling dictates that dividend payments could be a hint to potential investors concerning the firm's condition. Companies with strong financial positions and bright futures tend to exhibit higher debt levels and potentially higher dividend payouts, communicating their confidence in their ability to manage debt and distribute profit (Rehman, 2016). Many factors can influence the ratio of dividend payout by the company, including aspects such as the company's profitability, firm size, leverage, and liquidity. Over time, the firm is also expected to experience growth, which can also influence dividend payout ratio because greater the funds invested in the company, the more assets the company owns, so it can symbolize the company's increasingly rapid growth through the profits it generates (Alhabsji et.al., 2017).

The dividend payout ratio is the proportion of income that will be distributed to investors in the form of dividends and can serve as one of the formulas for knowing dividend payments. A high dividend payout ratio value shows that much of the profit earned by the company is paid for dividends rather than used as retained earnings for operational activities. Given the various variables that may affect dividends distribution, it is difficult to determine which aspects have a positive impact on dividend payout ratio which is showed by various research results that already existed.

One of the susbtantial indicators in the financing component is debt which is defined as an extent to which the company's assets are financed by debt compared to its capital (Wijayanti, 2020). If the application of loan is exorbitant, it will harm the firmbecause the firm will suffer into difficult condition, namely the firm is suffering in a high degree of debt. (Ilham, 2021) Firms with a relatively soaring degree of leverage ratio are significantly needs to rely on the existence of lending which can be acquired externally so that the company is able to finance their operations. On the other hand, firms that possesses a small degree of leverage tend to utilize their resources to fund their operations which is able show the financial risk of the company by assessing the degree of firm's leverage. The ratio of leverage can be described as the application of the firm fixed costs of assets and resources of financial money to optimize future shareholder revenue. On the other hand, The ratio of leverage could potentially become a mandatory aspect that can affect the ratio of dividend payout because companies rely on a mixture of equity and debt to finance their operations, and knowing the amount of debt held by a company is useful in evaluating whether it can pay off its debts.

One crucial factor influencing a company’s ability to pay their dividend is its ability to generate profits for investors that aligns with the investor’s goal of seeking returns. The profits stem from the company's sales and investments. Profitability, as defined by Chen (2004) reflects a company's capacity to generate profits and measures its operational efficiency and asset utilization. Companies with substantial profits tend to attract investor interest. Profitability indicators, such as net margin and gross profit margin, are essential tools for evaluating a company's financial health and efficiency in converting sales into profits (Solomon et al., 2016). These indicators assess the company's ability to generate earnings relative to its revenue, operating costs, balance sheet assets, or shareholders' equity. In order to calculate profitability indicators, it is necessary to consider causal relationships between resources and investments and to analyze the average of the period. Regularly measuring profitability indicators is vital for identifying areas where profit is lagging and for making informed decisions about the company's future (Lela, 2019).

The firm size does have a potential to become a crucial aspect for investor to invest in a firm. This paper uses the amount of size of a firm to calculate firm size. Brigham and Daves (2014) states that a firm's size condition can be asses from specific factors, like the amount of income, assets, and revenue while also considering the amount of money used for tax purposes and other fortunes possesed by the company which could be analyzed from the annual financial report of the firm.

Liquidity has a significant effect on investment and funding firm operation. According to Prastya and Jalil (2020), the term can be defined as a way for a firm to meet imminent obligations by utilizing its current asset. If the firm is more liquid, it can meet its ability to share dividends more effectively.

This research was conducted on non-financial companies listed on the LQ45 Indonesia Stock Exchange in 2018-2022. This research uses The LQ45 index as the object of the analysis because LQ45 is amongst the leading stocks in the Indonesia that computes the mean pointer of forty five stocks of the company that fulfill the largest market capitalization criteria and possess a certain degree of liquidity with along with the market worth.

LQ45 index uses 45 different stocks each time it is updated, depending on the liquidity of stock trading, which occurs twice a year, or every February and August. As a result, investors followed and fluctuated closely with the LQ45 share price. Samosir (2017) stated that the LQ45 Index has advantages, including the collection of 45 companies that have been selected after going through various criteria, namely occupying the top 95% based on the total annual average share transaction value, top 90% based on the annual average market capitalization, the highest position market capitalization with each business sector and the highest order based on trading transaction frequency.

This research is still relevant and useful because as of late the investing activity in Indonesia is at an alarming speed and this activity has a significant effect on large firms in Indonesia. With the rises of small and big firms, this activity could cause a fierce contest between firm. Therefore, this phenomenon inspires firms to take a decision in the investing business like distributing their dividends. Understanding such influence of multiple financial performances on dividend payout ratio can help investors make informed decisions, and help companies optimize their dividend policies to balance the interests of shareholders while still maintaining clear guidelines for managing shareholder expectations.

This research is a continuation of previous research conducted by Mamaro and Tjano. (2019). The difference between these two studies is that the former involves evidence from Top40 JSE firms in South Africa, while this paper involves companies outside the financial category registered in the LQ45 Stock Exchange during 2018-2022. On the other hand, the author chose Indonesia as research because both Indonesia and South Africa are included in the emerging market and therefore create a fair comparison between both top companies listed in their respective stock exchange.

1.2 Problem Formulation

Based on the description above, the problem to be studied are:

1. Is there any positive association between profitability and dividend payout ratio?
2. Is there any positive association between leverage and dividend payout ratio?
3. Is there any positive association between liquidity and dividend payout ratio?
4. Is there any positive association between company growth and dividend payout ratio?
5. Is there any positive association between firm size and dividend payout ratio?

1.3 Research Objective

The purpose of this research is to:

1. Analyze the effect of profitability on dividend payout ratio of company listed in the LQ45
2. Investigate the effect of leverage on ratio of dividend payout of company listed on the LQ45
3. Investigate the effect of liquidity on ratio of dividend payout of company listed on the LQ45
4. Investigate the influence of firm growth in ratio of dividend payout of company listed inside LQ45
5. Analyze the effect of firm size on dividend payout ratio of company listed in the LQ45

1.4 Research Benefit

The results of this research are anticipated to produce valuable information for several subjects.

For academics, it is hoped that this research can add insight and literature related to the influence of financial performances on dividend payout ratio of companies listed on LQ45. For companies, it is hoped that this research can add insight into the influence of financial performances in the percentage of dividend payout so that the companies can decide in designing better and implementing better dividend policies. For investors, the results of this study are expected to provide insight and literature for investors in making investment decisions by assessing the ability of the companies to pay its dividend.

1.5 Writing Systematic

The writing systematic in this research consists of five chapters. The first chapter presents an introduction that discusses the background of the problem, problem formulation, research objectives, research benefits and writing systematics. Furthermore, the second chapter explains the literature review which contains the literature used as a theoretical basis, review of previous research, hypothesis development and conceptual framework. Then, the third chapter contains research methods consisting of research design, population, samples, types and sources of data, research variables along with data analysis methods. Then, the fourth chapter presents the results of the study which contains data analysis and discussion of the results of hypothesis testing. hypothesis test results. Finally, the fifth chapter contains conclusions, limitations and suggestions for future researchers. suggestions for future researchers.