CHAPTER I

INTRODUCTION

1.1 Background

Businesses find dividends obvious; meanwhile economists find dividends mysterious (Easterbrook, 1984). Prosperous firms may withhold dividends because internal financing is cheaper than issuing dividends and floating new securities. Worse, dividends do not distinguish well-managed, prospering firms from others. Dividends are hard enough to explain when they occur in isolation; a combination of dividends and simultaneous raising of new capital is downright inexplicable.

Few financial decisions have as significant an impact on a company's equity value and future livelihood as the management of its capital structure and credit ratings. Firms manage capital structure through debt or equity issuance, debt or equity repurchases, dividend increases, acquisitions, new investment, and risk management (Shivdasani and Zenner, 2005). There are many ways in financing strategy. Firms may decide to utilize their internal cash to fund their strategic projects as this is considered as the financing decision with the cheapest cost of fund. The other option is by issuing bonds, which is certificate showing that a borrower owes a specified sum. Issuing bonds are quite a common practice since firms only to make sure it has credibility and access to public debt market. Also, corporate bonds, bonds issued by corporate or firm, are one of the favorite investment choices that can enrich investor's portfolio. Faulkender and Petersen (2005) said that firms with access to the public market debt have higher leverage that is both economically and statistically significant. They consider the possibility that access to public debt markets (having bond rating) is endogenous.

In Indonesia, number of firms, either have access to public debt market or not, have issued bond(s) to hold up their business expansion. Most of these firms are dominated by financial institutions, especially banking companies. Interestingly, even though firms have decided to issue bonds, instead of spending much from their internal cash, dividends are still paid out. In perspective of shareholders, dividend disbursement is most-likely moment to wait. This is the high time when firms' management through their annual stockholders' meeting decides to 'spoon out' part of their earnings as contribution to the shareholders. Dividends are mostly paid in term of cash, thus, internal cash is one of the source of this payment. However, some firms may deem term of stocks as alternative dividends. Not waiting till the book closing of respective business year, interim dividends (early paid dividends) are often treated as payment mechanism, such as in quarter four, considering the earnings booked during three preceding-quarters. According to Byrd et al. (1998), several authors have argued that high levels of debt and dividends reduce agency costs. The fixed payments of corporate debt forge managers to disgorge funds that might have been misused. Dividends also send cash out of the firm, but they may provide a weaker mechanism than debt payments for limiting cash available to managers because dividend payments are not subject to legal obligation as debt service.

1.2 Statement of Problems

Shareholders cannot wait to see their 'return' (in this case, dividend) coming and this dividend usually comes from internal cash of the firm. Part of financial statements mostly preferred and always drive the eyes of many investors to see is 'statements of income' or 'profit and loss statement'. They would like to figure out whether the companies they are investing is profitable and growing their profits or not. Earning per share (EPS) is one of the easiest tools for them to answer their curiosity. Shareholders who already received a satisfied value of dividends previous year or lagged dividend (simplified later as 'lagged dividend per share') will have expectation to gain more this year. Moreover, if the profitability (simplified later as 'earning per share') of company this year shows a growing performance, they may have high belief to raise their pocket of wealth. So, the questions that emerge are as follow:

- Does lagged-dividend per share (DPS_{t-1}) influence dividend per share at time t (DPS_t) significantly?
- Does earning per share at time t (EPS_t) influence dividend per share at time t (DPS_t) significantly?
- Does either company issues bonds or not (Dummy) influence dividend per share at time t (DPS_t) significantly?

- Does size of company influence dividend per share at time t (DPS_t) significantly?

1.3 Purpose and Benefit

This paper examines the correlation between dividend per share at time t and several variables, such as lagged dividend per share and earnings per share. Furthermore, author also conducted research on dividend per share with additional variables which are dummy and size of company. Dummy variable is used to distinguish different treatment of companies that issued bonds and did not issue bonds during period used in this research. Size of company is measured with total assets.

The benefits from this research can be viewed from many categories of people community, both corporate and individual, as follows:

1 For corporate managers and shareholders, this research is expected to give information of factors or conditions that may influence dividends payment. By acknowledging these factors (variables), hopefully managers and shareholders are able take the variables into consideration when assessing any related corporate actions in financial aspect, mostly.

2 For fellow researchers, author believes that this topic still has wide-open aspects to be further observed. Hence, it gives opportunity and start-up idea for the next bonds or dividends related topics.

3 For fellow students, author also believes that this research will provide more specific knowledge or supplementary learning material relating to bonds and dividends subjects which are already discussed in the class.

1.4 Scope and Limitations

In order to finish this paper on time, author utilizes Indonesian (where the author is staying)'s listed firms as observations. Bonds-issuing-firms data which is well recorded by Capital Market and Financial Institution Supervisory Agency (in Indonesia, called *Badan Pengawas Pasar Modal dan Lembaga Keuangan* / *Bapepam–LK*) is available from year 2002 until 2009. Author uses year 2002 up to 2009 data since year 2010 is still ongoing during the paper is written. Then, the dividend per share, earnings per share, and size of total assets data are gathered from financial statements of firms listed in Indonesian Stock Exchange (IDX). Data collected is limited to the firms which have ever issued bonds during period of year 2002 – 2009; so the research does not include all firms listed in IDX. Credit ratings information is obtained from Pefindo's website (Indonesia Credit Rating Company).

1.5 Organization of Report

Author organizes this paper into five chapters as follows:

Chapter 1 Introduction

Chapter 2 Literature Review

Chapter 3 Research Methodology

Chapter 4 Empirical Result

Chapter 5 Concluding Remarks

Introduction chapter discusses background of writing the topic, statement of problems, purpose and benefits, scope and limitations. Literature Review chapter cites related quotes, theory from textbooks, internationally published-journals, websites which support the ideas of this paper. Research Methodology chapter explains the framework, model building, method of analysis, data analysis, variable measurement, population and sample, and data collection. Empirical Result chapter is basically the discussion and analysis to answer of the topic’s problems with its detail observation of samples. Concluding Remarks chapter provides summary of answers to statement of problems or closing points of the whole content of the paper.