

## **Chapter 1**

### **INTRODUCTION**

#### **1.1 Background**

One of the most critical decisions that have been made by financial managers is dividend decision (Hashemijoo, M. et al., 2012). This decision related with re-distribution of earning toward its shareholders. Although it looks as easy as ABC, however the decision can be complicated, since it has direct impact to the firms and the shareholders both existing and potential shareholders such as affect the liquidity position of the company (Gitman, et al., 2012), and have indirect impact to the future performance of the company as well such as influence future expansion plan (Gitman, et al., 2012). The action of dividend distribution would be responded differently between insider (management) and outsider (shareholders) due to the presence of asymmetric information. Therefore, the distribution of dividend will be interpreted differently among external shareholders. The distribution of higher cash dividend indicated the strong liquidity position of the firm, and the ability to maintain the sustainability growth due to sufficient cash (Black, 1976). Conversely, the reluctance of financial managers to distribute dividend would indicate the signal of cash deficiency and restrict the company's ability to grow.

Since five decades ago, it has remained ambiguous whether such kind of dividend policy would affect share price or not. Some prominent researchers believe share price and dividend policy are relevant, yet, some believe the opposed opinion. The definite conclusion of this study is still remaining unclear (Jensen, et al., 1984). Started from the most well known classical view of Modigliani and Miller (1961), stated that dividend policy is irrelevant to the share market price. However, their theory followed strict assumptions that considered as unrealistic in the real world, such as insider and outsider know the same level of information. Some empirical researches in the real world do not support this theory. According to Bajaj and Vijh in 1990, there is a great impact of dividend changes on share prices and the impact of dividend yield is stronger in small firms.

Contrary to Modigliani and Miller belief, Gordon and Lintner (1956) developed “bird in the hand” theory stated dividend policy is relevant. Both theories had disclosed the supporting evidence and calculation; however the underlying assumptions were different. Thus, actually both theories could be acted as complementary to each other.

From the elaboration above, it is implied that dividend policy could affect share market price up to some degree and under certain circumstances. In the real world, dividend distribution is a routine decision that must be made by financial managers. Since this decision leave the obvious dilemma regarding the

distribution current profit to increase current shareholders wealth or retained some portion of profit to achieve higher growth in the future, thus managers need to consider variety kinds of complicated factors, especially regarding the impact to the share price. With such kind of dilemma exist, however no corporate finance theory has produced definite conclusion regarding the impact of dividend decision toward share price.

Thus, the author is intrigued to discover the correlation between dividend policies and share market price for Indonesian case. The initial hypothesis that developed by the author stated, “The share market price is affected by the dividend decision”. This research will be applied toward the companies that listed in Indonesia Stock Exchange and are classified as a part of Kompas 100 Index. The complication in practice and the lack of theoretical guidance have challenged the author to perform the empirical research in Indonesia context. Hence, the title of this thesis is “The impact of Dividend Policy on Share Price in the Indonesian Stock Market.”

## **1.2 Scope**

This thesis investigates the impact of dividend payout ratio and dividend yield on share price of public companies that was included in Kompas100 index calculation. The data for the financial statement is taken from Indonesian Stock Exchange website, bloomberg and the official company website. All the data would be taken for 4 years period, which is from 2008 – 2011.

### **1.3 Aims and Benefits**

#### **1.3.1 Aims**

Corresponding with the title of the paper, this paper is aimed to analyze the impact of dividend policy on share price on the firms that included in the Kompas100 index, thus the author can draw a conclusion how large the portion of dividend payout ratio and dividend yield will influence the share price that reflected the value of the company. Thus, the author can give a feedback or suggestion in order to make a improvement in the near future.

#### **1.3.2 Benefits**

The author would like to attribute of this research for several groups in the society, specifically researchers, academicians, finance managers, investors and the Indonesian finance literature.

First and foremost, this research would hopefully give contribution to internal company. This study is expected to be an input for the finance managers to take decisions on dividend policy.

Secondly, managers and directors may or may not find this research useful for evaluating their dividend policy. The results of this research will provide irrelevant information regarding to pay or not to pay dividends, which enable them to assess the efficiency of their dividend policies. Hence, managers and

directors might gain more insights about the importance of paying dividends to shareholders that can guide in making decisions pertaining to dividends.

Lastly but not least, this research would offer a relevant, objective and up to date information regarding the dividend policy to the investors. As for the investors, this study offers relevant information that is useful for investors in selecting and executing investment and making decisions in terms of dividend payment. Recently, many foreign and local investors in Indonesia are becoming more curious and concern about the development of stock market in Indonesia. Hence, this research would equip all both from potential investor and existing investors.

#### **1.4 Thesis Structure**

In this paper, the author is trying to discuss and arrange it in five chapters in order to provide a better overview about the contents of this paper.

##### Chapter 1 – Introduction

This chapter gives a big picture of this thesis, which consists of background, scope, aims, and benefits of the thesis. It also covers the thesis structure.

##### Chapter 2 – Theoretical Framework

This chapter covers fundamental concept of dividend and all the relevant and useful theories that can be used as the foundation in writing this paper. In addition

to, this chapter will cover all the theories that matter to the dividend policy and decisions.

### Chapter 3 – Research and Methodology

This chapter elaborates the process of hypothesis development and the methodology used in the research, such as the research design, the type of data used in the research, the time and place where research is being managed and the data analysis used by the author.

### Chapter 4 – Findings and discussion

This chapter presents the research resulting from the research and in depth discussion about the research.

### Chapter 5 – Conclusion and recommendation

This final chapter concludes the research, summarizes the research process and results, and accommodates answers to research questions. In addition to, it also offers recommendations to the conclusion of this study and rooms for further improvements and researches.