CHAPTER 2
THEORETICAL FOUNDATION

2.1. Theoretical Foundation

In order to start a company, a certain amount of money should be needed. Therefore, a certain number of people should be included to run and build a company. In a logical sense, there is no possibility that a single person would be able to start a company using only his/her own capitals. Even though there is a slight probability, that person must be a very wealthy person since they are able to start one. Consequently, this one person who intends to make a project to build a company will surely invites other people for their money and uses it as a help which we would call them by investors. These investors are the ones who will get some privilege from the company since they have invested their money into the company.

A company itself has two aspects to be recognized important which are liability and equity. Before continuing, it is best to know the definitions from each of these aspects first. A liability has a definition of an obligation that binds an individual or company legally in settling a debt. When one is liable for a debt, then it means that they are responsible for paying the debt or settling a wrongful act they have committed. For equity, there are many points of view we need to consider since we are going to discuss more deeply into the theory of dividend. Equity itself is the name given in setting legal principles, in countries that is following the English common law tradition, which supplements some strict rules of law where their application can be harshly operate, so in order to achieve to what sometimes is referred to “natural justice”. It is similar to ‘law’, as many people would often get confused, which in this context is referred to statutory law and common law.

In modern practice, probably the most important distinction between law and equity is the set of remedied that each offers. The most common civil remedy a court of law can award is money damages. However, equity enters injunctions or decrees that directs someone to refrain from acting. Often this form of assistance is in practical terms that are more valuable to complainant.

Equity on its own has a definition of:

1. a stock or any other security representing an ownership interest.
2. The amount of funds contributed by the owners (the stockholders) plus the retained earnings (or losses), regarding a company's balance sheet. Also referred to as "shareholders equity".
3. In the context of margin trading, the value of securities in a margin account minus what has been borrowed from the brokerage.
4. In the context of real estate, the difference between the current market value of the property and the amount the owner still owes on the mortgage. It is the amount that the owner would receive after selling a property and paying off the mortgage.
5. In terms of investment strategies, equity (stocks) is one of the principal asset classes. The other two are fixed-income (bonds) and cash/cash equivalents. These are used in asset allocation planning to structure a desired risk and return for an investor's portfolio.

It is an ownership interest in a corporation in the form of common stock or preferred stock. It also refers to total asset minus total liabilities, in which it is referred to as shareholder's equity or net worth or book value. In real estate, it is the difference between what a property is worth and what the owner owes against that property. In the context of a futures trading account, it is the value of the securities in the account,

assuming that the account is liquidated at the going price. In the context of a brokerage account, it is the net value of the account.

After discussing more thoroughly about what equity is, we should also know about the variables consisted in it. There are two types of variables in equity if we are talking about stocks, which are: Preferred Stock and Common Stock.

A **Preferred stock**, which is also called as preferred share or preference shares, is typically a higher ranking stock than voting shares (common stock), and its terms are negotiated between the corporation and the investor. Preferred stock usually carries no voting rights but may carry superior voting rights to common stock. Preferred stock could be carrying a dividend that is paid out prior to any dividends to common stock holders. Preferred stock may have a convertibility feature into common stock. Preferred stockholders will be paid out in assets before common stockholders and after debt holders in bankruptcy. Terms of the preferred stock are stated in a "Certificate of Designation".

Similar to common stock, preferred stock represents partial ownership in a company, although preferred stock shareholders do not enjoy any of the voting rights of common stockholders. Also unlike common stock, a preferred stock pays fixed dividend if it lacks the financial ability to do so. The benefit to owning a preferred stock is that an investor has greater claim on the company's assets than common stockholders. Preferred shareholders always receive their dividends first and, in the event the company goes bankrupt, preferred shareholders are paid off before common stockholders. In general, there are four types of preferred stock: cumulative preferred, non-cumulative, participating, and convertible.

A **Common Stock** or also called **Voting Stock**, its definition is the stock which gives its stockholders the right to vote on matters of corporate policy and the

composition of the members of the BOC (Board of Commissioners). Voting shares are in contrast to preferred shares, which may have different voting, dividend, or other rights. Typically, common stockholders receive one vote per share to elect the company's board of commissioners. Common shareholders also receive voting rights regarding other company matters such as stock splits and company objectives. In addition to voting rights, common shareholders sometimes enjoy what are called "preemptive rights". A preemptive right allows common shareholders to maintain their proportional ownership in the company in the event that the company issues another offering of stock. This means that common shareholders with preemptive rights have the right but not the obligation to purchase as many new shares of the stock as it would take to maintain their proportional ownership in the company, which is also called junior equity.

A Common Stock, regarding its return, has two types and that is capital gain and dividend. This is about the form the return that the shareholder receives. A Capital Gain, financially defined, is the profit that results from the sale or exchange of a capital asset over its purchase price. If the price of the capital asset has declined instead of appreciated, is called a capital loss. Capital gain occurs in both real assets, such as property, as well as financial assets, such as stocks or bonds. Gain or loss from sale or exchange of a capital asset is a capital gain or loss. In other words, a common stock is an increase in the value of a capital asset that gives it a higher worth than the purchase price. The gain is not realized until the asset is sold. A capital gain may be short term (one year or less) or long term (more than one year) and must be claimed on income taxes. A capital loss is incurred when there is a decrease in the capital asset value compared to an asset's purchase price. Profit that results when the price of a security held by a mutual fund rises above its purchase price and the security is sold

(realized gain). If the security continues to be held, the gain is unrealized. A capital loss would occur when the opposite takes place.

2.2 Dividend

A dividend is the second type of return in a common stock. The definition of a dividend is a payment to the stockholders of a company regarding the profit earned and is given in the same level as the amount of stock each individual have. Usually dividend is given is a periodical time, but sometimes there are some bonus dividend payment which is allocated outside the periodical time. In deciding when to hold a dividend payment of a company, there are three main issues that must be concerned which is (a) announcement date, (b) registering date, and (c) payment date. An announcement date is a date where the board of directors of a company announced when is time to payout dividend with a certain amount for each stock paper held by each stockholder, in total.

A dividend policy is a decision whether the profit earned by the company will be given to the stockholders as a dividend or to be held by the company in the form of a profit and will be used as a investment in the future. If the company decides to spread it as a dividend, then the profit will be decreased and therefore it will decrease the total internal earnings. In the other hand, if the company then decides to keep it, then they have a chance to increase the capability to form an internal capital. By that, an analysis should be made in its relation with the cash flow or capital structure decision as a whole.

As a result from several researches, there are factors which are important in deciding a dividend policy, which are: (1) investment chances available, (2) limitations and alternative capitals, and (3) preferences from a stockholder whether to

receive it now or in the future. Another researcher also mentioned some factors such as: (1) liquidity position, (2) life cycles of a company, and (3) a company controlling ability. According to some articles the author acquired, there are also legal restrictions and inflations factors that will affect a dividend policy. Inside of it, there are several theories about a dividend policy, which are:

2.2.1. Dividend is irrelevant

This theory was mentioned by Modigliani-Miller (MM) in 1963 which concludes that people don't judge a company by the dividend policy that they apply. The profit earned as a result of the increase in stock price because of a dividend payment will be balanced with the decrease of price in favor to the opening sale of new stocks. As a end result, stockholders can receive income from the company in the form of a payment in dividend or in capital gain. Once again, the wealth of a stockholder is not affected by a dividend policy in the present or the future. A stockholder would feel indifferent with a dividend policy. MM proved this mathematically with several assumptions, which are:

- A perfect capital market where every investor acts rational.
- There is no individual tax or company's tax income.
- There is no flotation cost and transaction cost.
- Information's available for each individual mostly that relates to investment chances.
- A dividend policy doesn't affect the company's personal capital.

If the dividend irrelevance theory is *correct*, then dividend payout is of no consequence, and the firm may pursue any dividend payout.

2.2.2. Bird-in-the-hand theory

This theory was advanced by Myron Gordon and John Litner who assumes that the level of gain an investor conditioned will increase as a decrease of dividend payment. Investors feel save to make income in the form of a dividend payment rather than waiting for a capital gain. Dividend payoff is considered saver because of the risk in a capital gain where price is fluctuative and uncertain. That is why investors would prefer to choose dividend instead of capital gain.

This theory had been rejected by MM where their statement is that stock price does not depend on a dividend policy. That is because most investors planned to re-invest their dividend in a stock from a related company or a similar company and in many cases the risk level from the cash flow of a company's operation instead of a dividend policy (Brigham, 1998).

If the bird-in-the-hand theory is *correct*, the firm should set a high payout if it is to maximize its stock price.

2.2.3. Tax Differential theory

This third theory states an opinion that because a dividend has the tendency to have a higher tax compared to capital gain, therefore an investor will ask for a higher profit for the stocks with a higher dividend yield. This theory also suggests that a company should decide a low dividend payout ratio or even not giving dividends at all in order to minimize capital cost and maximize the company's outlook. Other reasons why investors prefer to choose a lower dividend payout in the relation with tax is that the tax for the profit is not being paid until the stock is sold. That reason will be affected by the currency rate in a different period. Another reason why investors prefer a low dividend payout because when a piece of stock is owned by someone until they

died, then the receiver of the stock will use the current value rate, this will result in the sidestepped of the capital profit tax (Brigham, 1998).

If the tax preference theory is *correct*, the firm should set a low payout if it is to maximize its stock price.

2.2.4. Clientele theory

The theory where a stock price will move depending on the demands and goals of investors in reaction to a tax, dividend or other policy change affecting the company. The clientele effect assumes that investors are attracted to different company policies, and when a company's policy changes, investors will adjust their stock holdings accordingly. As a result, the stock price will move.

Consider a company that pays a high dividend and has attracted clientele whose investment goal is to obtain stock with a high dividend payout. If the company then decides to decrease its dividend, these investors will then sell their stock and move to a company who pays higher dividend. As a result, the company's share price will decline.

A decision regarding dividend policy is a decision that relates on how and in what way a dividend payout to the stockholders will be. There are several patterns in a dividend payout that can be chosen by the company as an alternative:

1. *Stable and Occasionally Increasing Dividend per Share*

   This policy makes a stable dividend per share, as long as there is no permanent increase in the earning power and the capability to pay dividend. This is based on the stockholder's psychology, where there is dividend then there is an increase in the stock price and vice versa.

2. *Stable Dividend per Share*

   The basic opinion of this type is when a market has a possibility to value a stock higher when a dividend fluctuates. A company that chooses this policy will pay dividend in a same amount year-to-year.

3. *Stable Payout Ratio*

   In this model, the amount of dividend is counted based on specific percentage from the profit. When profit fluctuates, then the amount of dividend payout will also fluctuate.

4. *Regular Dividend plus Extra*

   A regular dividend is the specific amount that was believed by the management and can be clutched for the future without ignoring the profit fluctuation and the requirements of capital investment.

5. *Fluctuating Dividend and Payout Ratio*

   The amount of dividend and payout ratio is partially made based on the profit and the desired capital investment of a company for each period. Therefore, a dividend and payout ratio follows the profit fluctuation and investment needs.

2.3 Role and Analysis of Financial Report

A financial report gives an accounting description from the company's operation as well as the financial position. A financial report was made by the management with the purpose of the responsibilities for the works that was given by the company's owner (Baridwan, 1990). For companies with the form of a corporation, the management presents the financial report to the parties outside the company, especially the stockholders. These stockholders of a public company is really

important in relation to a financial report because it is crucial for getting feedbacks from the stockholders as the company were the ones given responsibility to manage the stockholders' money. Aside of that, the other external party who uses the financial report is the investors, security analyst, government, employee, supplier, creditor, and clients.

There are two main types of financial report, which are: (1) Balance sheet, which shows the company's wealth position, financial obligation and the company's capital. (2) Profit and loss statement that shows the profit or loss the company gets in a period of time (ex: 1 year). Since it is difficult to understand a financial report in its real form, therefore several steps are made in order to make it easier for people analyze, such as common size, index analysis, and financial ratio analysis.

2.3.1. Common Size analysis

This type of analysis changes the numbers in a balance sheet and profit & loss statement into a percentage based on some basics. For the numbers in the balance sheet, the common base is total asset. For the numbers in the profit & loss statement, sales are what were used as the common base. A presentation in the form of a common size will make it easier for the readers to scan through the changes that happened in the profit & loss statement. The reason for this is that there happens to be problem in comparing a financial report with the companies that is different in size. What is not less important is the common size analysis and financial ratio analysis was actually a cross-section technique where an analysis for a company is compared with a standard, i.e.: industrial standard.

2.3.2. Index analysis

This analysis could complete the common size analysis, by putting the accounts as a percentage from a year base. This analysis changes all the numbers in a financial report from the year base into 100. A year base was not always picked from the earliest year but the years which is considered normal. By that, this analysis was done to compare the development from time to time.

2.3.3. Financial Ratio Analysis

A calculation for financial ratios analysis that reflects certain aspects is needed in order to make this kind of analysis. Financial ratios may be calculated based only from the numbers in the balance sheet, profit & loss, or both balance sheet and profit & loss. According to Bernstein (1995) a ratio is an analysis tool which gives better understanding for the performance and the financial condition compare to an analysis only with the financial data. Helfert (1991) understands that a financial ratio is an analysis instrument for a company's performance which explains the financial correlations, with purpose of showing the changes in operation performance in the past and helps to summarize a trend pattern of those changes, for later it can show the risks and chances to the related company. This shows that even though a financial ratio analysis is based on the data and the past conditions, it was to make chances and minimize risks for the future. Aspects that are consisted in the financial ratio are classified into leverage, liquidity, profitability or efficiency ratio. Leverage ratios also consisted into *debt*, *debt-to-equity ratio*, *debt service coverage*.

a. Liquidity ratio

Liquidity ratio is the ratios that come off the Balance Sheet and hence measure the liquidity of the company as on a particular day i.e the day that the Balance Sheet

was prepared. These ratios are important in measuring the ability of a company to meet both its short term and long term obligations.

The liquidity ratio consists of current ratio, quick or acid test ratio, net working capital with total asset (debt to equity ratio):

a.1. Current Ratio

This ratio is obtained by dividing the 'Total Current Assets' of a company by its 'Total Current Liabilities'. The ratio is regarded as a test of liquidity for a company. It expresses the 'working capital' relationship of current assets available to meet the company's current obligations.

The formula *:*

Current Ratio = Total Current Assets / Total Current Liabilities

a.2. Quick Ratio

This ratio is obtained by dividing the 'Total Quick Assets' of a company by its 'Total Current Liabilities'. Sometimes a company could be carrying heavy inventory as part of its current assets, which might be obsolete or slow moving. Thus eliminating inventory from current assets and then doing the liquidity test is measured by this ratio. The ratio is regarded as an acid test of liquidity for a company. It expresses the true 'working capital' relationship of its cash, accounts receivables, prepaid and notes receivables available to meet the company's current obligations.

The formula:

Quick Ratio = Total Quick Assets / Total Current Liabilities

Quick Assets = Total Current Assets (minus) Inventory

a.3. Debt to Equity Ratio

This ratio is obtained by dividing the 'Total Liability or Debt ' of a company by its 'Owners Equity a.k.a Net Worth'.

The ratio measures how the company is leveraging its debt against the capital employed by its owners. If the liabilities exceed the net worth then in that case the creditors have more stake than the shareowners.

The formula :

Debt to Equity Ratio = Total Liabilities / Owners Equity or Net Worth

b. Profitability ratio or efficiency

Shows how successful a company is in terms of generating returns or profits on the Investment that it has made in the business. If a business is Liquid and Efficient it should also be Profitable.

Profitability ratio or efficiency consists of *ROE*, *ROI*, *profit margin*, and *asset turnover*.

b.1. Return on Sales or Profit Margin (%) :

The Profit Margin of a company determines its ability to withstand competition and adverse conditions like rising costs, falling prices or declining sales in the future. The ratio measures the percentage of profits earned per dollar of sales and thus is a measure of efficiency of the company.

The formula:

Return on Sales or Profit Margin = (Net Profit / Net Sales) x 100

b.2. Return on Assets (ROA)

The Return on Assets of a company determines its ability to utitize the Assets employed in the company efficiently and effectively to earn a good return.

The ratio measures the percentage of profits earned per dollar of Asset and thus is a measure of efficiency of the company in generating profits on its Assets.

The formula:

ROA = (Net Profit / Total Assets) x 100

b.3. Return on Equity or Net Worth (ROE)

The Return on Equity of a company measures the ability of the management of the company to generate adequate returns for the capital invested by the owners of a company. Generally a return of 10% would be desirable to provide dividends to owners and have funds for future growth of the company.

The formula:

ROE or Net Worth = (Net Profit / Net Worth or Owners Equity) x 100

Net Worth or Owners Equity = Total Assets (minus) Total Liability

c. The Capital Structure Ratio

The capital structure of a company is the particular combination of debt, equity and other sources of finance that it uses to fund its long term financing, how a firm finances its overall operations and growth by using different sources of funds. Debt comes in the form of bond issues or long-term notes payable and the Equity is classified as common stock, preferred stock or retained earnings.

When people refer to capital structure they are most likely referring to a firm's debt-to-equity ratio, which provides insight into how risky a company is. Usually a company which is more heavily financed by debt poses greater risk, as this firm is relatively highly levered.

The capital structure ratio shows the percent of long term financing represented by long term debt.

The formula:

$$\text{Capital Structure Ratio} = \frac{\text{long term debt}}{(\text{shareholders equity} + \text{long term debt})}$$

d. Dividend Payout Ratio

The dividend payout ratio measures the percentage of a company's net income that is returned to shareholders in the form of dividends. The payout ratio provides an idea of how well earnings support the dividend payments. The dividend payout ratio provide valuable insight into a company's dividend policy and can also reveal whether those payments appear "safe" or are in jeopardy of possibly being reduced. In this case, the company is generating ample profits to support this relatively modest payment. In fact, if management considered it in the best interests of the company, it could probably afford to raise its dividend payment significantly.

The higher payout ratio will be the typical of the more mature company. On the other hand, an excessively high payout ratio suggests that the company might be paying out more than it can comfortably afford. Not only does this leave just a small percentage of profits to plow back into the business, but it also leaves the firm highly susceptible to a decline in future dividend payments. In some cases, a company will even pay out more than it earns, thus yielding a dividend payout ratio in excess of 100%.

Such extremely high payouts are rarely sustainable and should warn investors that a dividend cut may be on the horizon. Because the act of reducing dividends is usually interpreted as a sign of weakness, when a dividend cut announcement is made, it also usually triggers a decline in the share price.

Even if management finds a way to maintain an extremely high dividend payout ratio for an extended period of time, this strategy usually results in either a dwindling cash position or a rising debt load.

It should be noted, also, that dividend payout ratios can be impacted by a number of factors. For example, different accounting methods yield different earnings per share figures, which in turn influence the ratio. Furthermore, businesses in different growth stages can be expected to have different dividend policies.

Young, fast-growing companies are typically focused on reinvesting earnings in order to grow the business. As such, they generally sport low (or even zero) dividend payout ratios. At the same time, larger, more-established companies can usually afford to return a larger percentage of earnings to stockholders.

When comparing dividend payout ratios, you should also remember that they will vary widely according to industry.

The formula:

$$\text{DPR} = \frac{\text{Total Annual Dividends Per Share}}{\text{Diluted Earnings Per Share.}}$$

Since there are many information's in the financial ratio, the chance of misstatement is also high. Therefore, a statistic model will be important to find the correlation between them. There are two statistic model that can be used to find a correlation between two variables (Foster, 1986) which are: (1) *The Pearson moment correlation statistic* and (2) *The Spearman rank correlation statistic.* Pearson is used when the distribution between the two variables are considered normal, while Spearman does not assume specifically about the distribution between the two variables. This research will be using the Spearman model because if one of the variables in a category (i.e. liquidity and current ratio) has a positive correlation with

the other variables (i.e. quick ratio) then we don’t need to use both variables but only one of them.

In a classic study, Lintner (1950) based on his dividend policy survey to a number of managers, found that there was a target proportion of earnings that determined the dividend policy, which might differ among companies. One firm's policy might be to pay out 40% of earnings as dividends whereas another company might have a target of 50%. This suggest that dividends change with earnings. Empirically, dividends are slow to adjust to changes in earnings. Lintner suggested an empirical model whereby changes in dividends are linked to the level of the earnings, the target payout and the adjustment rate. He asserts that more "conservative" companies would be slower to adjust to the target payout if earnings increased.

Brealey and Myers, stated that a firm which always stuck to its payout ratio would have to change its dividend whenever earnings changed. But the managers in Lintner's survey were reluctant to do this. They believed that shareholders prefer a steady progression in dividends.

Therefore, even if circumstances appeared to warrant a large increase in their company's dividend, they would move only partway toward their target payment.

2.4 Previous researches

Financial ratio has an important role to measure a company’s performance. It has been tested by the research done by Hanafi (1998) who concludes that investors are considering the existence of a financial report regarding the decision making of buying a stock. That conclusion shows that the importance of a financial ratio and a financial report for investors in measuring a company’s performance.

One of the ratios which is important is dividend payout ratio which relates to a dividend policy in a company. A dividend policy is a measurement whether the profit earned by the company will be given to the stockholders as a dividend or will be held to create income as a form of capital gain in order to make it as an investment for the future. This policy is important remembering that investors are putting their trust to the company where they are investing their capitals.

There are a lot of factors that affects dividend policy so that it is difficult to conclude which is the most dominant regarding its effects. With that, references such as previous researches are needed to know which factors are showing effects for the dividend policy. Therefore, the benefit from this research can be gained well for the company as well as for the investors in term of an investation decision making. The benefit from this research to give robust for previous researches about a decision making, thus it will result in a strong theory.

Researches about factors that affects dividend policy had been done by Syahputra (1997) by using some of the ratios such as EPS, PM, ROE, ROA, liquidity, and capital structure to measure a company's performance and its dividend policy. The result from the research is that only the profitability that shows the affection towards dividend policy partially, whereas capital structure and liquidity didn't affected dividend policy relatively.

Another research which correlates with this study is the effect of financial ratio towards dividend that has been studied by Abdullah (2001) where he correlates the relationship of managerial ownership, capital structure, and dividend policy. The study shows that the relationship between managerial ownership, capital structure and dividend policy is insignificant simultaneously. Other researches which also tests the relationship of a capital structure towards dividend is the research been done by

Setyawan and Hartono (2001) where the results are the relationship between capital structure and dividend only happens to companies that has a low level of growth and don't have *blockholder*.

According to Riyanto (1998) there are couples of important factors affecting dividend policy which are (1) liquidity, (2) the need to repay debts, (3) a company's *life cycle*, and (4) a company's controlling power. This opinion has been approved by Effendi (1993) where his research shows that the factors that are affecting dividend are (1) profitability, (2) the risk of a dividend decrease, (3) liquidity, (4) investments, and (5) fundings. That research has also proven more that the most dominant factor regarding a dividend policy is the level of a company's profitability.

One more research in the relation to this research is the relationship between dividend and tax preference done by Chang and Ghon Ree (1990) with the result stating that the amount of dividend payout is affected by the changes in personal income tax with its affecting factors are *growth potential, earning variability, non-debt tax shield, firm size* and *profitability.*

2.5 Factors affecting a dividend policy

Knowing the factors that affects a dividend policy of a company is important. That is because dividend is an investor's income in investing their funds and their purpose of investing. Although it is not easy remembering that there are many factors that could affect a dividend policy. Therefore, this research is about to give solutions on which are the factors that affects a dividend policy based on some of the previous researches. That reason is expected to be fulfilled for all parties both practitioners and academician.

According to several previous researches, there are several factors which affects dividend such as EPS, PM, profitability (ROE and ROA), liquidity, capital structure in its relation with managerial ownership, capital structure, debt payments, a company's life cycles, etc. For that, advanced research are needed to know more which main factor that gives result in affecting a dividend.

This research tested the profitability, liquidity, and capital structure with its effects towards dividend policy. Those factors are chosen because the in some previous researches shows that profitability is proven to have significant effects with dividend policy. Whereas liquidity and capital structure hasn't been proven robust in effecting a dividend policy.

According to Wirjolukito (2003), stated that management will pay dividend to give signal about a company's success to create profit. That signal shows that the company's capability to pay dividend is the main function from profit. Based on that reason, it is known that the higher the level of a company's profit then the higher the fund available to be paid out in the form of a dividend. It is not significant remembering that each company has a different dividend policy. In one side a company prefers to hold the profit to be re-invested and other company prefers to give it out as a dividend. The phenomena would like to be tested in this research is that how does the profitability level affects a dividend payout to the companies in Indonesia especially the ones listed in BEJ.

The second factor or variable would be tested is the effects in term of a dividend payout is the company's liquidity. Liquidity is the capability of a company to pay all of their short term liability and fund the company's operations. With that, a company who has a high level of liquidity will have a high liquid asset to pay their liabilities. A

company who has a higher liquidity asset will easily fulfill the liabilities to pay the dividends for the investors that have many assets.

Companies who have a high liquidity level of course have the capability to pay their dividends higher compared to a less liquid company. That will make consideration to the less liquid companies that their company is relatively less good regarding their performance because the company will have difficulties in paying their liabilities. Based on that, this research is trying to tests on how the liquidity level will affects dividend payout to the companies listed in BEJ.

The third variable being tested in this research is the capital structure. How capital structure is affecting dividend payout has been studied before by Syahputra (1997), Abdullah (2001), and also Setyawan and Hartono (2001). All of their studies shows that capital structure does not have a significant effect towards dividend payout.

In this research, capital structure has a negative effect towards dividend payout. The higher the capital structure then the higher a company has a high long term debt with a high risk also. A company that has a high debt level will be able to pay more dividends but in the end the risk level of the company will increase equity. By that, the level of a dividend payout will be smaller because the increase in risk is not followed with the increase in income (dividend).