# CHAPTER I

# INTRODUCTION

## 1.1 Background of the Study

One of the primary financial objectives of a company is to maximize its value. The value of the company is contingent on investment, financing, and dividend decisions. The company's value is maximized when its assets are financed at the lowest possible cost. This rule applies to all capital structure components, including the owner's capital. The cost of the equity is implicit but is reflected in the required return that compensates the investor for the risk assumed and is realized through dividends and capital gains (Prša et al., 2022).

The capital market is where investors conduct investment activities. Investors interested in investing their funds can anticipate dividends or capital gains as returns on their investments. A capital gain is the profit realized from the difference between the purchase and sale prices of a security. A portion of the net income will be distributed to the shareholders. The number of dividends distributed by the company is determined by its policies or regulations. There are no regulations dictating the minimum quantity of dividends that must be paid, so each company has its own dividend policy. The General Meeting of Shareholders decides whether or not the company will pay dividends, as well as the number of dividends to be paid (Widyasti & Putri, 2021).

Dividends are yearly payments made from a company's profits to its shareholders. In most cases, when other variables remain steady or events that will occur during the calculating year are known, the dividends to be paid may be predicted based on the profits produced by the company in the year prior to the dividends were issued. Typically, a fraction of the earnings is allocated towards dividend payments, while the remaining portion is either reinvested or retained as earnings. This necessitates a decision regarding the proportion of profits to be disbursed as dividends to stockholders. The concept of dividend policy pertains to the decision-making process regarding the quantum of dividends to be disbursed and the feasibility of retaining them as retained earnings for potential future reinvestment by the organization (Jeradu, 2021).

The concept of dividend policy pertains to the determination of the dividend amount to be disbursed and the consideration of whether to retain profits for future reinvestment within the organization. Furthermore, the magnitude of the dividend is contingent upon the magnitude of the profit generated, thereby prompting companies to engage in profit fluctuations. Companies that adopt a dividend policy characterized by a high dividend payout ratio are exposed to greater risk compared to companies that employ a low dividend payout ratio.

In contrast, the value of the company's dividend policy is exceptional. Companies with the ability to distribute dividends to shareholders are regarded to have a solid performance because it is expected that they can generate profits and give close attention to investors. However, some investor’s view dividend distribution as a negative signal because they believe company managers are unable to identify profitable investment opportunities; this assumption can result in a decline in the company's market value due to diminished investor interest.

Therefore, management frequently has difficulty making dividend decisions (Ulfah & Mulya, 2018).

Profitability ratio is the degree of net profit that a company can generate from its operations. The company's ability to pay dividends is proportional to its ability to generate profits. Consequently, this ratio is a crucial determinant in the distribution of dividends from companies (Wahyuni, 2021). Wahyuni (2021) stated that the effect of profitability on dividend policy is significant. The relationship between profitability and dividend policy exhibits a positive correlation, indicating that higher profits lead to increased distribution of corporate dividends to investors and shareholders. In case the company's profit margin islow, it will correspondingly allocate dividends of a smaller amount to its investors and shareholders. A company's exceptional financial performance can be indicated by its high profits, which may also result in increased dividends and heightened investor interest in investing their capital in the company. This can lead to greater returns for investors. Corporations with substantial earnings tend to distribute dividends on a regular basis, based on the amount of their profits.

Profitability frequently acts as a key factor in deciding whether a company should pay dividends. Dividends are a transfer of corporate earnings or shareholder gains to the company. With a high ROA, a company can maximize profits by efficiently using its assets. This will allow the company to pay out more cash dividends to shareholders, raising the dividend payout ratio (Tjhoa, 2020).

To conclude, when a company's profitability increases, the Dividend Payout Ratio also increases. Companies that can successfully generate profits will issue high sums of dividends to shareholders as a means of providing them with positive signals.

The leverage ratio pertains to the utilization of assets and sources of funds by a company, wherein the company incurs fixed costs or expenses in the process of utilizing said assets or funds (Kartika & Nuswandari, 2022). Cristna et al. (2021) stated that the effect of leverage on dividend policy is significant. The higher the debt-to-equity ratio, the greater the company's reliance on external parties, specifically creditors. The company's reliance on external parties means that it can use its debt to fund its operational activities, thereby increasing profits and enabling it to distribute dividends annually. However, the company must effectively monitor its leverage level to ensure that it remains within secure limits and is always under control. Therefore, the company does not need to reduce the dividends it will pay out to shareholders. If the debt does not exceed the company's normal capacity, companies with a high level of debt can expand and develop innovative products, which can increase the company's net profit.

Leverage reflects a company's debt-to-asset ratio and how much assets were used as collateral. Leverage shows how the company can meet shareholder responsibilities. The company prioritizes debt payments due to leverage. Thus, leverage raises the company's risk (Nainggolan & Wahyudi, 2023).

To conclude, if a business decides to use leverage, a company will borrow money and engage in a repayment agreement, much like an individual would witha credit card or loan. However, if leverage is used excessively, the company could go bankrupt. However, if leverage is managed sensibly and cautiously, it can boost the company's profits. When a company's leverage ratio is high, it poses a significant threat to its ability to meet its financial obligations. The company's dividend policy will become more challenging to manage because of this failure. When it comes to investors, the liquidity of a business is seen as a tool for predicting the amount of earnings that will be generated. According to the conditions of credit contracts, the Current Ratio is frequently utilized as a ratio for the purpose of measuring the sustainability of a business. Nainggolan & Wahyudi (2023) stated that there is a beneficial relationship between liquidity and dividend policy. When a business has a high level of liquidity, it indicates that the company is able to meet its short-term commitments, which allows the company to have the financial flexibility to pay high dividends. For the business to carry out its activities, it requires financial assistance from outside sources in the form of loans or debt. Which debts does the business think it can pay back given its current financial situation. Companies that are considered liquid state that they can make their short-term loan payments within a time frame that is appropriate given the company's strong financial situation.

The presence of liquidity is a crucial factor in ensuring the continuity of a business enterprise, as it indicates the availability of adequate and readily convertible assets that can be utilized to meet the obligations of maturing debts. On the contrary, a company that exhibits low liquidity is indicative of its inability to meet its financial obligations prior to their due dates, thereby rendering it susceptible to financial challenges (Atrill & McLaney, 2021).

To conclude, when a company has a high Current Ratio, it indicates the company can pay its short-term obligations and dividends. Investors clearly believe in the company's dividend-paying possibility, as evidenced by its high Current Ratio. As a result, the dividend policy benefits from increased liquidity. Investors clearly have faith in the company's dividend-paying possibility, as evidenced by its high Current Ratio.

Indonesia's economy is bolstered by various sectors, including manufacturing, transportation, and real estate, among others. According to a report by the Ministry of Industry, there has been a notable rise in the manufacturing sector's contribution to Indonesia's Gross Domestic Product (GDP) in recent years, signifying its crucial role in the country's economy (Kemenperin, 2023). According to Mr. Airlangga Hartarto, the Coordinating Minister for Economic Affairs of the Republic of Indonesia, the manufacturing sector has made significant contributions to both customs revenue and employment income.

Thus, an increase in the national GDP may also signifies the increase or the strengthening of the market’s purchasing power which eventually make manufacturing companies needs to expand their business and to achieve this goal, companies expect financial assistance from external parties to assist the company's operational activities, such as shareholders. And as previously stated above, one of the ways to attract potential shareholders is promising dividends.

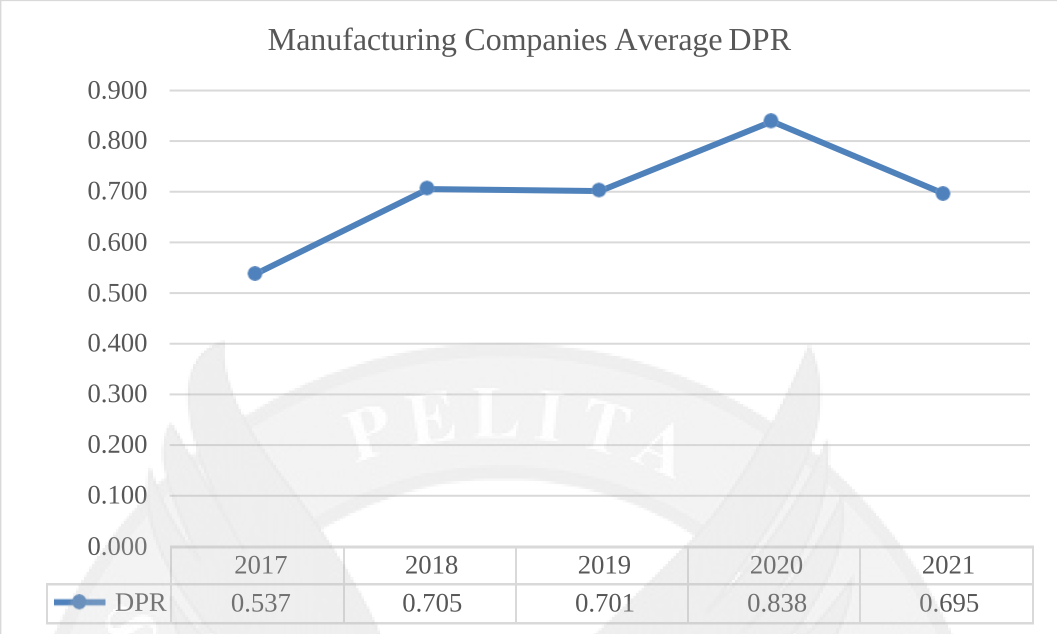


**Figure 1.1 Chart of The Average Dividend Payout Ratio from Manufacturing Companies**
Source: Prepared by The Writer (2023)

According to the data presented in Figure 1.1, the average dividend payout ratio for manufacturing companies during the period spanning from 2017 to 2021 is observed to be 0.537, 0.705, 0.701, 0.838, and 0.695, respectively. These findings suggest that there was a significant 31.33% increase in the average DPR in 2018 when compared to the previous year, 2017. However, in 2019, there was a slight decrease of 0.6% in the average DPR compared to the preceding year, 2018. Furthermore, it is noteworthy that there was a significant 19.57% increase in the average DPR in 2020 when compared to the previous year, 2019. However, it is important to highlight that this favorable pattern was not sustained, as the average DPR in 2021 experienced a notable decline of 17.07% when compared to the preceding year, 2020.

During the year 2017 to 2021, some of the followings are the data gathered from manufacturing companies listed on the Indonesia Stock Exchange which include 3 companies as the analysis which is BUDI (PT Budi Starch & Sweetener Tbk), GGRM (PT Gudang Garam Tbk), and INDF (PT Indofood Sukses Makmur Tbk). The data are as follows:

**Table 1.1 The Phenomenon of Profitability, Leverage, and Liquidity toward Dividend Policy**

| No | Name of the Company | Year | ROA | DER | CR | DPR |
|---|---|---|---|---|---|---|
| 1 | PT Budi Starch & Sweetener Tbk | 2017 | 0,016 | 1,460 | 1,007 | 0,246 |
| | | 2018 | 0,015 | 1,766 | 1,003 | 0,357 |
| | | 2019 | 0,021 | 1,334 | 1,006 | 0,351 |
| | | 2020 | 0,023 | 1,241 | 1,144 | 0,402 |
| | | 2021 | 0,031 | 1,157 | 1,167 | 0,294 |
| 2 | PT Gudang Garam Tbk | 2017 | 0,116 | 0,582 | 1,936 | 0,651 |
| | | 2018 | 0,113 | 0,531 | 2,058 | 0,644 |
| | | 2019 | 0,138 | 0,544 | 2,062 | 0,460 |
| | | 2020 | 0,098 | 0,336 | 2,912 | 0,654 |
| | | 2021 | 0,062 | 0,517 | 2,091 | 0,892 |
| 3 | PT Indofood Sukses Makmur Tbk | 2017 | 0,058 | 0,877 | 1,523 | 0,537 |
| | | 2018 | 0,051 | 0,934 | 1,066 | 0,702 |
| | | 2019 | 0,061 | 0,775 | 1,272 | 0,334 |
| | | 2020 | 0,054 | 1,061 | 1,373 | 0,385 |
| | | 2021 | 0,062 | 1,070 | 1,341 | 0,368 |

Source: Prepared by Writer (2023)

According to the table above, PT Budi Starch & Sweetener Tbk's ROA experienced a significant increase in 2020-2021 where there was also a significant decrease in the value of DPR. It shows a contradictory pattern when profitability was compared to dividend policy. Another contradicting pattern also occurs at PT Gudang Garam Tbk's ROA experienced a significant decrease during the year of 2019-2020. Meanwhile, the DPR of PT Gudang Garam Tbk increased significantly. In this investigation, profitability is determined using Return on Assets (ROA).If the degree of company profitability is high, a greater proportion of the company'sprofit will be distributed to investors as dividends.

PT Indofood Sukses Makmur Tbk's DER experienced a decrease for the year 2018-2019, while their DPR also decrease for that year. On the other hand, PT Budi Starch & Sweetener Tbk's DER and DPR increase for the year 2017-2018.

Lower DER ratios are better. A low DER shows that the company's debt / liabilities are lower than its assets, so it can pay off all its bills in the event of insolvency. The contrary situation, the higher the DER, shows that the company's debt/liability is greater than its net capital, resulting in a big external burden. The growing weight of duties to others shows that the company's funding sources are highly reliant on outsiders. The company's financial health suffers if it fails to manage its debt well.

Lastly, liquidity of PT Indofood Sukses Makmur Tbk that proxied by CR increased while the DPR was decreasing for the year of 2018 until 2019. In contrast, PT Gudang Garam Tbk’s CR decrease significantly while the DPR increase for the year of 2020 until 2021. The higher the Current Ratio, the more liquid a company's assets are and the more capable it is of paying its current liabilities. However, the high Current Ratio may also indicate that the company's assets are not being utilized to their fullest potential.

On the contrary, a conflicting matter arises when comparing the average DPR (Dividend Payout Ratio) of manufacturing companies to the two companies that function as the subjects of data analysis in this chapter. According to Figure 1.2 presented below, it is obvious that the DPR of PT. Gudang Garam Tbk (GGRM) does not align with the average DPR of manufacturing companies. Specifically, the DPR of GGRM for the years 2017 to 2021 are 0.651, 0.644, 0.46, 0.654, and 0.892, respectively. Based on the data presented in Figure 1.3, it is evident that the DPR of PT. Indofood Sukses Makmur Tbk (INDF) does not align with the average DPR of manufacturing companies. Specifically, the DPR of INDF from 2017 to 2021 is 0.537, 0.702, 0.334, 0.385 and 0.368, respectively.

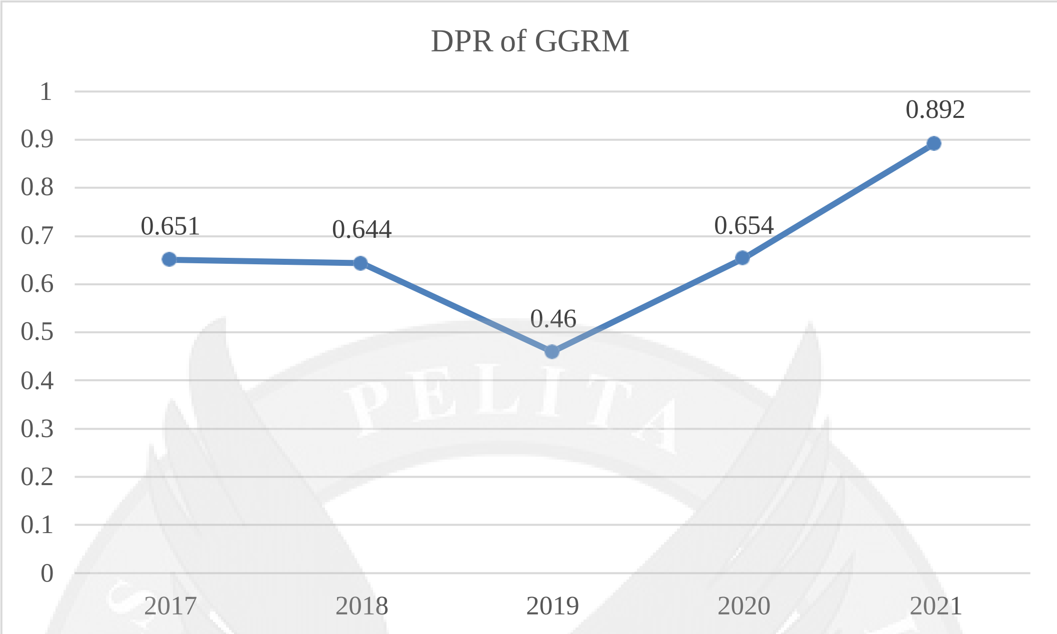


**Figure 1.2 Chart of PT Gudang Garam Tbk Dividend Payout Ratio**
Source: Prepared by Writer (2023)

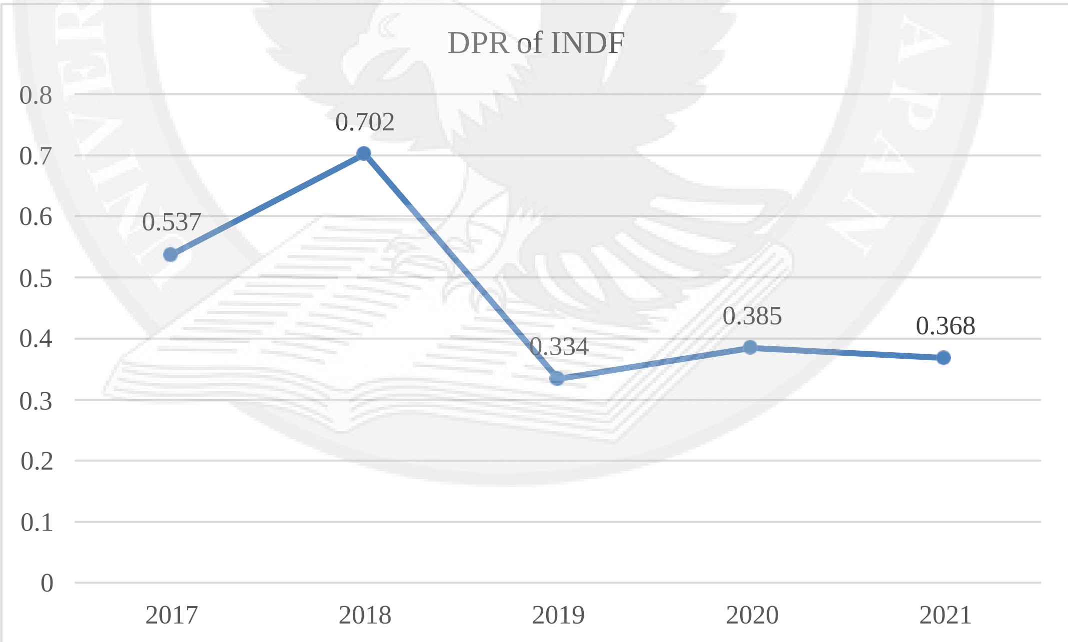


**Figure 1.3 Chart of PT Indofood Sukses Makmur Tbk Dividend Payout Ratio**
Source: Prepared by Writer (2023)

Based on the background of the study that has been provided and explained above, it encourages the writer to do research entitled ***"The Effect of Profitability, Leverage and Liquidity Toward Dividend Policy on Manufacturing Companies Listed on the Indonesia Stock Exchange"***.

## 1.2 Problem Limitation

In order to avoid deviations from the topic, the writer set some problem limitations as below:

1. The object of this research is manufacturing companies classified as consumer goods industry listed at Indonesia Stock Exchange from 2017 to 2021.
2. In this research, the dependent variable is Dividend Policy (DPR), while the independent variables are Profitability (ROA), Leverage (DER), and Liquidity (CR).

## 1.3 Problem Formulation

According to the previously outlined background, the formulation of the research problems are as follows:

1. Does Profitability has significant effect toward Dividend Policy on Manufacturing Companies listed on the Indonesia Stock Exchange partially?

2. Does Leverage has significant effect toward Dividend Policy on Manufacturing Companies listed on the Indonesia Stock Exchange partially?
3. Does Liquidity has significant effect toward Dividend Policy on Manufacturing Companies listed on the Indonesia Stock Exchange partially?
4. Do Profitability, Leverage and Liquidity have significant effect toward Dividend Policy on Manufacturing Companies listed on the Indonesia Stock Exchange simultaneously?

## 1.4 Objective of the Research

The research's objectives are as follows:

1. To find out whether Profitability has significant effect toward Dividend Policy on Manufacturing Companies listed on the Indonesia Stock Exchange partially.
2. To find out whether Leverage has significant effect toward Dividend Policy on Manufacturing Companies listed on the Indonesia Stock Exchange partially.
3. To find out whether Liquidity has significant effect toward Dividend Policy on Manufacturing Companies listed on the Indonesia Stock Exchange partially.

4. To find out whether Profitability, Leverage and Liquidity have significant effect toward Dividend Policy on Manufacturing Companies listed on the Indonesia Stock Exchange simultaneously.

## 1.5 Benefit of the Research

### 1.5.1 Theoretical Benefit

Theoretically, the writer expects that this study can be used as the literature material for studies and references for other academics who want to do further research on dividend policy. The writer also hopes that this research's results can increase knowledge and insight about the effect of profitability, leverage, and liquidity toward dividend policy.

### 1.5.2 Practical Benefit

Practically, the writer expects that this research can be used as follows:

1. For Scholars

   It is expected that this research can supply information, references, and empirical evidence to other researchers who want to conduct research in the same field of study.

2. For Investors

   The outcomes of this study are expected to provide information as well as illustrations regarding the condition of the companies, especially those studied in this research.

3. For Other Stakeholders

   This study is anticipated to give useful information to stakeholders according to their dividend.