

# CHAPTER I

## INTRODUCTION

### 1.1 BACKGROUND OF THE STUDY

In today's world, every company often face the problem of company funding. The capital market becomes an alternative funding in supporting companies in Indonesia. Capital market is a financial long term instrument either in the form of capital or debt in which issued by the government or private company. One part of the capital market is Indonesia Stock Exchange (IDX). Mining industry is one of the largest sectors listed in IDX. Along with economy growth, the need for energy also continue to grow, hence, mining industry's roles to be a provider of energy resources create a big impact to economic development in Indonesia (Siregar et al., 2017) .

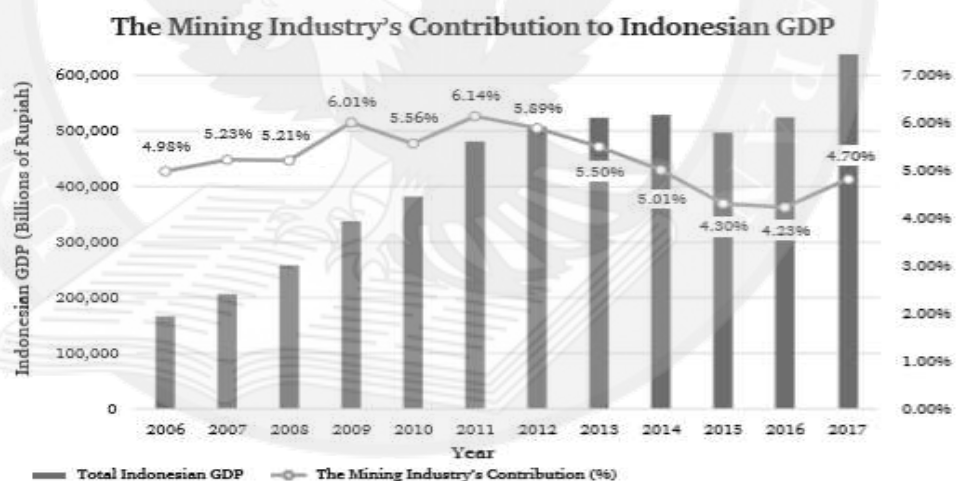


Figure 1.1 Mining industry's contribution towards GDP (2006 – 2017)

Source: Bank Indonesia

Despite the fact that it remains a huge supporter of the Indonesian economy, it creates the impression that the mining part's commitment is disappearing. The mining business' contribution to Indonesian GDP has constantly declined, from 6.1% in 2011 to 4.2% in 2016, however 2017

demonstrates a slightly higher commitment, of 4.7%. The ascent may be because of the expansion in costs, particularly for coal, as the pattern shows up emphatically associated with changes in production costs.

According to PwC analysis (2018), as the contribution of mining industry, especially coal mining companies, to Indonesia has also fallen off in the last few years. This weakening will cause funding problems that can affect mining companies' financial condition. Investors may slowly move their investment to other sectors that are more promising than mining industry.

This phenomenon can happen because the stock returns in the form of dividend received by investor is not optimal. As a consequence, this will have an impact on dividend distribution or return expected by Investors. Dividend distribution means that earnings given to shareholders in the form of cash, stock, or other property. (Kusuma et al. , 2018)

Each company has a policy to determine the distribution or usually is called dividend policy. Dividend policy is a firm decision in determining the amount of profit to be distributed in the form of dividends or retained earnings for future investments. (Kusuma et al. , 2018)

Dividend policy remains a controversial problem in accounting research. It still continues to be puzzle researches for more than half a century for many researchers. The dividend decision is one of the main issues in the firm in which has a relationship between firm's financing and investment decisions. The decision to distribute profit and the retained earnings for expanding the business are always in conflict. High dividend payout will give positive impact to the shareholders, while it will be harmful in the long term because the profit can't be used for the further expansion. On the contrary, low dividend and high retained earnings can increase long term benefit to the company (Elmi and Mutri , 2016).

According to Elmi and Mutri (2016), dividend policy is a significant corporate issue and may be closely related to most of the financial and investment decision made by companies. Furthermore, it is

also essential for shareholders to know several factors that influence dividend payment so that they can have enough information to decide when to invest their money.

Profitability of the company is the primary factor of a firm's capacity to pay dividends. Profitability means firms that continually gain more profit are in a better position to pay dividends. Profitability also reflects the company's ability to make a profit that have a relationship with sales, assets or equity. Consequently, Investors will, of course, interested in analyzing profitability of the company. They will always demand for high return in the form of dividends (Sartono, 2010).

This research will focus on return on equity to determine the profitability of the company. Return on equity is a ratio that measure the rate of return of shareholders and at the same time shows the ability to generate profits that can be shared with shareholders. In other words, ROE shows whether the company effectively uses equity to generate profits. The greater the values of return on equity, the higher the expected return from investors tend to be. High value of return on equity shows that the company is more profitable. Because dividends are distributed from the net profits obtained by the company, the amount of profits will affect the amount of dividends to be distributed.

In addition, the dividend decision also lead to agency problems. These problems may lead large company to face delegacy cost because it increase incapability of shareholders. This can happen because the bigger the firm, it will be harder to control and monitor the management of the company (agency cost). It can be simply said that manager can choose dividend policy in which enhance their own private benefit rather than enhancing the value of shareholders.

Due to the agency conflict, then agency cost is needed. Agency cost means that there must be extra payment paid to agency so that the result can be the same with the principal goals. There is a way to minimize agency cost which is institutional ownership. By having

institutional ownership in the companies, institutional investors will ask managers to manage companies well in order to increase the value of the company. Institutional owners will supervise managers' performance as they have power to support management performance (Rais & Santoso, 2017).

**Table 1.1 Table Phenomenon**

COMPANY (YEAR)	ROE	IO	DPR
MYOH (2013)	0.2222	0.7869	0.3301
MYOH (2014)	0.2674	0.7869	0.3713
MYOH (2015)	0.2650	0.7869	0.3238
MYOH (2016)	0.1978	0.6357	0.8002
MYOH (2017)	0.1200	0.6357	1.5533

Source: Prepared by the Writer (2019)

Table 1.1 shows PT. SAMINDO Tbk. (MYOH) condition from the year of 2013 to 2017 by 3 indicators which are Return on Equity (ROE) , Institutional Ownership (IO) and Dividend payout ratio (DPR). From the year of 2013 to 2014, when ROE is increasing, DPR is also increasing. However, from the year of 2015 to 2017, When ROE is decreasing, DPR is increasing. These condition shows two different pheonemon that are needed to be know further.

While, Institutional Ownership is decreasing from the year of 2015 to 2016, it can be seen that the dividend payout ratio is increasing. It means that Institutional Ownership has inverse relationship with Dividend payout ratio. However, from the year of 2016 to 2017 there is a constant number of institutional ownership by 0.6356, but, it can be seen that the dividend payout ratio still increase from 0.8002 to 1.5533.

**Table 1.2 Table Phenomenon**

COMPANY (YEAR)	ROE	IO	DPR
ITMG (2013)	0.2391	0.6500	0.8859
ITMG (2014)	0.2228	0.6506	0.6344
ITMG (2015)	0.0756	0.7019	0.6416
ITMG (2016)	0.1440	0.6514	1.5355
ITMG (2017)	0.2637	0.6514	1.0478

Source: Prepared by the Writer (2019)

Table 1.2 shows PT. Indo Tambangraya Megah Tbk. (ITMG) condition from the year of 2013 to 2017 by choosing ROE, IO and DPR as indicators. As it can be seen from the year of 2014 to 2015, ROE is decreasing, however, DPR is inversely increasing. Different condition from the year of 2015 to 2016, when ROE is increasing, DPR is increasing as well.

As it can be seen that the number of IO from the year of 2014 to 2015 is increasing, the DPR is also increasing. Meanwhile, from the year of 2015 to 2016 the IO is decreasing, however the DPR is also still increasing.

Hence, this company also experience the same condition as PT. Samindo Tbk. These phenomenon make the writer wants to conduct a further research about the effect of Return on Equity and Institutional Ownership towards dividend payout ratio.

As many researchers have been doing several research with different variables affecting the dividend policy and still cannot give the general agreement. It motivates the writer to analyze more about the effects of some factors towards dividend policy.

This research itself will use Return on Equity (ROE) to determine profitability. In addition, institutional ownership will be proxied by its own formula. While, dividend policy will be proxied by Dividend Payout Ratio (DPR).

The application of the using of return on equity compared to other indicators as the indicator of profitability has been used by Zulkifli et al., (2017). In addition, the researcher stated that there is an insignificant effect and inverse relationship of return on equity toward dividend policy. In addition, According to Syamsuddin (2011), return on equity can represent companies' capability in generating profit as a whole with the total equity available in the company. While, the research conducted by Nugraheni and Mertha (2010) in which Institutional ownership has a direct and significant effect on dividend policy in manufacturing companies.

Many previous studies have use additional different independent variables, such as growth rate, firm size, interest rate, and many other factors. Thus, the results of the study are not consistent with each other. This research will focus more on profitability and institutional ownership in order to clarify the significance of both variables towards dividend policy.

As mentioned before, the growth of mining industry was not stable, which was not inline with the economic growth of Indonesia from the year 2013-2017. Another reason of choosing mining industry as the object of the research is that mining activities include exploitation and exploration activities. It means mining industry needs large capital to run the activities. At the same time, this industry requires involvement of many investors to strengthen capital of the company. It means that mining industry in Indonesia has a huge opportunity for investors to invest. In this research, huge industry and a lot of companies' data are needed in order to identify and analyze the affects of profitability and institutional ownership towards dividend policy.

Based on the background study and all explanation above, the writer is interested to do research with a tittle **“THE EFFECTS OF PROFITABILITY AND INSTITUTIONAL OWNERSHIP ON**



## **DIVIDEND POLICY IN MINING INDUSTRY LISTED IN INDONESIA STOCK EXCHANGE FROM THE YEAR OF 2013 - 2017.”**

### **1.2 PROBLEM LIMITATION**

The purpose of this paper is to examine the effects of profitability and institutional ownership on dividend policy in mining industry listed in the Indonesia Stock Exchange from the year 2013 - 2017. Hence, this research will limit its problems about dividend and some factors, such as profitability and institutional ownership, affecting dividend policy. Secondary data was applied in this study.

### **1.3 PROBLEM FORMULATION**

1. Is there a significant effect of profitability ratio partially to dividend policy?
2. Is there a significant effect of institutional ownership partially to dividend policy?
3. Is there a significant effect between profitability ratio and institutional ownership simultaneously to dividend policy?

### **1.4 OBJECTIVE OF THE RESEARCH**

1. To test and provide empirical evidence about the significant effect of profitability partially to dividend policy
2. To test and provide empirical evidence about the significant effect of institutional ownership partially to dividend policy
3. To test and provide empirical evidence about the significant effect between profitability and institutional ownership simultaneously to dividend policy

## **1.5 BENEFIT OF THE RESEARCH**

### **1.5.1 THEORETICAL BENEFIT**

This research would like to provide empirical evidence and scientific contribution that contains a company's internal report information affecting its dividend policy. Besides, it can also be a further reference for improving more factors affecting dividend payout policy and surely enrich previous research.

### **1.5.2 PRACTICAL BENEFIT**

As this research will examine more about dividend payout policy. It will surely give some significant impact. For shareholders, This research is expected to give some additional information and knowledge regarding dividend policy. Then, shareholders can know how to decide while investing in Indonesia's good prospect companies.

Furthermore, this research is expected to be a recommendation for company in order to have more notice on implementation of institutional ownership in which can affect dividend policy of the company. Lastly, when both companies and investors can increase their performance, it would also attract foreign investors to invest in Indonesia.

## **1.6 SYSTEMS OF WRITING**

### **CHAPTER I: INTRODUCTION**

This chapter contains of: Background of study - as dividend policy has been a controversial problem in accounting research, hence, the writer is interested to do a further research. Problem limitation - limit the problem in order to be more focus on independent and dependent variable. Problem formulation- contains questions of significant effect and simultaneous effect. Research objective- to test and provide the empirical evidence about the significance effect. Benefit of the research- consists of theoretical and practical benefit. Systems of writing- consists of the structural of this research.



## CHAPTER II: LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

This chapter will evaluate about: Grand Theory- consists of agency and signaling theory that support in this research. Theoretical background- consists of theory of independent and dependent variable. Previous research- consists of prior research in which can support the significance effect of this research's variables and to differentiate this research with the previous one. Hypothesis development- the relationship of profitability, institutional ownership and dividend policy. Research Model- the frame of independent variables and dependent variables. Framework of thinking- briefly explain an introduction about this research in a diagram.

## CHAPTER III: RESEARCH METHODOLOGY

This chapter consists of: Research design- is the quantitative method which uses a secondary data. Research object- mining industry that listed in Indonesia Stock Exchange from the year of 2013-2017. Data collection method- from Indonesia Stock Exchange, Bank Indonesia, Journals, and Website. Operational variable definition and variable measurement- the definition and method measurement of independent and dependent variable. Data Analysis Method- how to analyze the data and the hypothesis.

## CHAPTER IV: DATA ANALYSIS AND DISCUSSION

This chapter will elaborate about: General view of "Research Object" is mining industries that are listed in Indonesia Stock Exchange starting from 2013-2017. Data analysis is using SPSS 25 version which consists of descriptive statistic, classical assumption test: normality test, heteroscedasticity test, multicollinearity test, and autocorrelation test, multiple linear regression, hypothesis testing: partial test (t-test), simultaneous test (f-test), and coefficient determination (adjusted  $R^2$ ). Discussion contains of the results of hypothesis.

## CHAPTER V: CONCLUSION

This research contains of: Conclusion- the final result of profitability and institutional ownership whether it has a significant effect towards dividend policy or not. Implication- the impact of significant effects towards dependent variable. Recommendation-the solution for this research if there is any factor that does not in line with the theory and recommend for the next researcher.

