CHAPTER I

INTRODUCTION

1.1 Background of the Study

For publicly owned company, the management primary objective is stockholder wealth maximization, which is to increase the market share price. Management must strive to make decision that can maximize the stock price, including dividend policy and financial performance. (Brigham & Houston, 2007; Kacaribu & Munthe, 2023)

Firm value is an essential term in the financial landscape of corporations since it contains the evaluation of company's worth, which is primarily expressed through the stock price and market capitalization of a firm. As the value of a firm goes higher, it often shows investor trust in company's operational efficiency and future growth potential, which can lead to additional investment and a more positive market perception. (Haryono et al., 2024)

The Price to Book Value ratio is used to evaluate the value of a company. This ratio evaluates a company's market value in relation to its book value, providing insights into how effectively a business utilizes its assets to generate returns for its shareholders. A PBV ratio above one signifies that the market value of the company surpasses its book value. This may indicate positive prospects for expansion and solid results from the company's activities. (Fenandar & Raharja, 2013; Pamuji & Hartono, 2020)

According to the quarterly Gross Domestic Product (GDP) report from the Central Statistics Agency of Indonesia for the years 2020 to 2023, the Average Distribution of Indonesia's GDP (percent) for 2020–2023 is dominated by manufacturing at 19.03%.

Table 1. 1 Average GDP 2019-2023

Average Distribution of GDP (percent), 2020–2023		
No.	**Sector**	**Percentage**
1.	Agriculture, Forestry, and Fisheries	12,98%
2.	Mining, and Quarrying	9,54%
3.	Manufacturing	19,03%
4.	Construction	10,21%
5.	Wholesale and Retail Trade, Car, and Motorcycle Repair	12,91%
6.	Others	35,34%

Source: *Badan Pusat Statistik (2023)*

Manufacturing firms are essential to the global economy, particularly due to their capital-intensive nature and the necessity of large-scale production to satisfy consumer demand. Financial strategies, such as dividend policy and overall financial performance, are particularly crucial in defining the long-term sustainability and market value of these organizations since they are frequently faced with fluctuating market conditions, economic cycles, and high levels of competition. In the manufacturing industry, efficient financial management is of the utmost importance since companies must maintain a balance between the requirement to reinvest in operations and the requirement to give returns to shareholders.

Additionally, due to the cyclical nature of many manufacturing industries, businesses frequently go through periods of both growth and decline of their operations. This changing environment makes it even more important to have good financial plans that can help keep things stable and boost growth even when times are challenging. As an illustration, dividend policies can serve as a signal of a business's financial health and attract investors; nevertheless, the success of the company's finances directly effects investor confidence and the valuation of the firm.

The dividend policy is influenced by the necessity to reconcile shareholder interests with the company's financial stability. Companies generally determine the percentage of net income to allocate for dividends, which may be issued as cash dividends or stock dividends.(Septiani et al., 2020)

When corporations announce dividends, they convey a message to the market about their financial health and profitability. For several investors, dividends signify a return on their investment and an indication of the company's capacity to provide stable earnings.

Signaling theory is frequently utilized in relation to dividend policy, indicating that dividend payments might act as a signal to investors about companies' prospective. Increase in dividends can enhance firm value by signaling financial stability and growth potential to the market (Zulfikar et al., 2020)

According to Myron Gordon and John Lintner, return on equity falls as dividend payout rises because investors are less likely to realize capital gains from the retained earnings than they are to receive dividend payments. They called this as bird-in-the-hand theory. However, Merton Miller and Franco Modigliani (MM) called this thesis as fallacy because he considered that most investors would reinvest their dividends in the shares of the same or similar companies. Therefore, he suggests that an increase in dividend is therefore an indication for investors that the company's management expects strong profitability in the future. Conversely, a decline in dividends suggests that management anticipates low future earnings. MM theory is aligned with signaling theory. If MM's point of view is accurate, then the variation in stock prices after an increase or decrease in dividends does not indicate a preference for dividends over retained earnings. In contrast, market changes only convey that dividend announcements contain information about future profitability. (Brigham & Houston, 2021)

Agency theory suggests that establishing a dividend policy is crucial, as it can create a conflict of interest between management and shareholders. This dynamic can lead to divergent objectives and priorities, necessitating careful consideration and strategic alignment to ensure that the interests of both parties are adequately addressed. Shareholders typically prefer that all profits be distributed as dividends, whereas the management team favors reinvesting these profits to facilitate the company's plans and growth. (Riyani, 2020)

Zulfikar claims that a dividend policy enhances the value of the company. This study suggests that organizations employing good dividend management strategies could experience a rise in their market worth. The phenomenon was attributed to the effective management of dividend distribution, which successfully minimized the allocation of surplus cash flows towards investments that were deemed unprofitable. (Zulfikar et al., 2020) A further study conducted by Bataha indicates the worth of firms within the energy sector that are registered on the Indonesia Stock Exchange is significantly positively impacted by dividend policy. This is because the fundamental objective of investors is to enhance their overall welfare through the anticipation of returns manifested as dividends. Meanwhile, the company itself is driven by the necessity for sustained growth, a critical factor for ensuring its ongoing sustainability and for providing benefits to its shareholders. (Bataha et al., 2023)

On the other hand, Istia's findings present an alternative conclusion, indicating that the dividend policy does not have a significant effect on the value of companies in the transport, utilities, and infrastructure sectors registered on the Indonesia Stock Exchange (IDX) from 2019 to 2021. The conclusion drawn is that the company's earning power serves as the primary determinant of its firm value, rather than the distribution of dividends to shareholders. (Istia et al., 2023)

A company's financial performance is a crucial factor in determining its worth. Good financial performance is often indicated by a company's stable revenues, good profit margins, and effective cost management, which frequently results in an increase in share prices. This increased market value reflects investor confidence and a conviction in the company's capacity to continue its expansion and generate future cash flows. A well-managed company that can weather economic volatility and capitalize on market possibilities is indicated by a track record of favorable financial outcomes that has been generated on a constant basis. Nonetheless, unpleasant financial outcomes might undermine investor confidence, potentially resulting in a decline in stock prices and the overall worth of the company. (Abbas et al., 2023)

According to (Noviyati & Agustiningsih, 2023), corporate value is positively impacted by financial performance as indicated by return on assets. A positive financial performance indicates that the business can turn a profit from all of the assets used for operations. The improvements of asset productivity are contributing to the generation of net profit, thereby enhancing the appeal of a company to potential investors.

Conversely, research conducted by (Ningsih et al., 2021) indicates that a company's value remains unaffected by Return on Assets (ROA). This lacks impact may stem from investors perceive the company as less efficient in utilizing its assets. As a result, they assign reduced significance to the ROA indication in their investment decisions, rendering ROA ineffective in influencing firm value.

Building upon the research gap identified in the studies referenced earlier, this study introduces firm size as a moderating variable to offer a new perspective and contribute novelty to the existing body of research. By incorporating firm size into the analysis, the study aims to explore how it influences the connection between dividend policy and financial performance toward firm value.

Larger firms typically have access to a higher number of benefits, including economies of scale, increased market power, and increased financing access. It is possible for larger companies to have greater flexibility in their dividend policies since they have more consistent cash flows and more access to capital markets. (Widawati, 2023)

Larger companies typically have more resources at their disposal, allowing them to manage these assets more efficiently. Being larger also enhances a company's visibility, which helps build public confidence in its products. This, in turn, can lead to higher sales and increased profitability, benefiting shareholders and raising the overall value of the company. (Mudjijah et al., 2019)

Following the explanation provided, the author will undertake a study titled: **"The Effect of Dividend Policy and Financial Performance Toward Firm Value with Firm Size as Moderating Variable"**. The research will conduct tests for manufacturing firms registered on IDX from year 2017-2023.

1.2 Problem Formulation

According to the preceding background research, the issues of the study are as follows:

1. Does dividend policy have a significant effect on firm value in manufacturing firms registered on IDX?
2. Does financial performance have a significant effect on firm value in manufacturing firms registered on IDX?
3. Does firm size have a significant effect on moderating dividend policy toward firm value in manufacturing firms registered on IDX?
4. Does firm size have a significant effect on moderating financial performance toward firm value in manufacturing firms registered on IDX?

1.3 Objective of the Research

In light of the previously outlined problem formulation, the aims of this study are as follows:

1. To determine whether dividend policy have effect on firm value on manufacturing firms registered on IDX.

2. To determine whether financial performance have effect on firm value in manufacturing firms registered on IDX.
3. To determine whether firm size have a significant effect on moderating dividend policy toward firm value in manufacturing firms registered on IDX.
4. To determine whether firm size have a significant effect on moderating financial performance toward firm value in manufacturing firms registered on IDX.

1.4 Benefit of the Research

This study aims to offer valuable contributions for both the author and the audience, encompassing theoretical insights as well as practical advantages.

1.4.1 Theoretical Benefit

This research can be beneficial in terms of theory to provide literature material or as a comparison material for future writers who will conduct research related to Firm Value on Manufacturing firms registered on IDX with Dividend Policy and Financial Performance as the Effect and Firm Size as Moderating.

1.4.2 Practical Benefit

This study may offer practical advantages, as outlined below:

1. Benefit for Companies

The results of this study are anticipated to enhance management's understanding of the relationship between dividend policy and financial performance concerning firm value, with firm size acting as a mediator in manufacturing firm.

2. Benefit for Investors

The outcome of this research is expected to enhance the study's findings, aiding investors in making more educated investment decisions regarding companies.

3. Benefit for Researchers

This research aims to examine how dividend policy and financial performance affect firm value, with firm size acting as a mediator, specifically in the context of manufacturing enterprise.

1.5 Problem Limitation

In order to maintain focus on the subject, the author established the following problem constraints:

1. The sample employed in this study is manufacturing firms registered on IDX
2. The timeframe utilized in this study is 5 years, from 2017-2023
3. Firm Value is applied as dependent variable. On the other hand, dividend Policy and Financial Performance is employed as independent variable. In addition to this research, moderating variable is adopted which is firm size