THE INFLUENCE OF FINANCIAL PERFORMANCE AND DIVIDEND POLICY ON FIRM VALUE

(Study at Manufacturing Companies Listed on Indonesian Stock Exchange period of 2010-2012)

THESIS

Submited to Fulfill the Term of Master Program

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ABSTRACT

Pristiana Widyastuti, Master of Business Administration in Faculty of Administrative Science, Brawijaya University, 2014. "The Influence Of Financial Performance And Dividend Policy On Firm Value (Studi at Manufacturing Companies Listed on Indonesian Stock Exchange period of 2010-2012)" Supervisor : Prof. Dr. Suhadak, M.Ec; Co-Supervisor: Dr. M.Al Musadieq,MBA; Wen-His Lydia Hsu,MCM,PhD.

This study aims to examine the financial performance and dividend policy as factors that is affecting firm value. The indicators of financial performance are Return on Asset (ROA), Return on Equity (ROE), Net Profit Margin (NPM). The indicators of dividen policy are Dividend Payout Ratio (DPR) and Dividend per Share (DPS). Then, the indicators of firm value are Stock Price, Price to Book Value (PBV) and Price to Earning Ratio (PER). The object of the research is manufacturing companies that listed on Indonesia Stock Exchange (IDX) for the period of 2010-2012. Based on the statistic test use Partial Least Square (PLS), this research revealed that financial performance has significantly positive influence on dividend policy, dividend policy has significantly positive influence on firm value, financial performance has significantly positive influence on firm value. The result of this research supports Lintner Model (1956) that found there are relationship between dividend policy and firm value.

Keyword: *financial performance, dividend policy, firm value, manufacturing companies*

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CHAPTER I

INTRODUCTION

1.1 Background of the Research

The goal of company's establishment is not only to maximize their profit but also to maximize the shareholder wealth. Profit maximization stresses the efficient use of capital resource, whereas maximization of shareholder wealth maximizes market value of the existing shareholder's common stock. Profit maximization might result in increased profits, but this clearly is not in the best long-run interests of the firm. The preferable goal of the firm should be maximization of shareholder wealth. The chosen maximization of shareholder wealth can be seen through the value of its stock. The better value of a stock will be the better for the company. A high stock price will reflect the value of good company, in addition to the stock owners will prospers, it will attract investors to invest (Keown et al, 1985).

As the investors, they purchase share because they want to earn a good return on their investment without undue risk exposure. "They measure of an investment policy is the effect it has on the value of capital employed concept that sometimes called enterprise value", (Quiry et al., 2009:629). Enterprise Value (EV), also known as firm value is an important concept for investors, because it is an indicator for assessing the company's overall market. Firm value is the price that the prospective buyer is willing to pay. So that, the valuation knowledge is necessary allows a firm to grow and prosper. There are three primary reasons for every entrepreneur and executive should understand how the firms are valued and master the process of valuation: (Norton, 2003:23)

1) Make decisions to optimize company value when you run a business
2) Obtain the best price and terms when you buy a business
3) Obtain the best price and terms when you sell a business

The expected value of an investment can be seen from a company's share price. A share price is the price of a single share of a number of saleable stocks of the company, derivative or other financial asset. As mentioned above, the statement of Keown et al. (1985), the high share price indicates that the company has the good prospect in the futures; it also indicates good firm value perspective to the investor. Stock price of company can be seen from closing price in the stock trading activity. It can be seen directly in daily or weekly. Based on explanation above, the stock price is necessary indicators that reflect the firm value.

Enterprise value is normally estimated by summing the market value of equity and the book value of net debt, assuming that the difference between the book value of debt and the corresponding market value is rarely enormous. (Quiry et al., 2009) Firm's value is indicated by price to book value (PBV), which is the level of market confidence in the future prospects of the firm. PBV describe how big the markets appreciate the book value of a firm's stock. The higher this ratio indicates that the investor believes the good firm's prospects.

In addition price to book value, price to earnings ratio (PER) is also used by investors to predict the firm's ability to generate earnings in the future. This ratio compares the price per common share with earnings per common share. According to Moradi (2010), price to earnings ratio is percentage of dividing share price per earnings in each year. The higher PER indicates the higher rate of

growth opportunities, conversely the lower PER typically indicates the lower growth rate.

Methods for measuring firm value are based on 4 things such as balance sheet based method, statements based method, good will based method and discounted cash flow based method. This methods used in these measurements are based on perspective accountant valuation. The accountant valuation can be seen by the financial performance analysis. The important of financial performance analysis is used to as tools in firm valuation because it helps the financial analyst gauge returns and risks.

The company's financial performance is reflected through financial statements published information. Financial statement is the end of the accounting process with the aim of providing financial information that could explain the condition of the firm during the period. Fridson and Alvarez (2002:4) described, "The primary goal in financial reporting is the dissemination of financial statements that accurately measure the profitability and financial condition of a company." Financial information has the function as an information tool of management accountability to owners of the company. This information is used to as depiction of the success indicators and as consideration in decision making.

Financial ratio is used to measure financial performance. Based on Fabozzi and Peterson (2003:125), financial ratio analysis is to select the relevant information primarily the financial statement data and evaluate it. One of ratios that seen by investors or analysts namely the profitability ratio. According to Brigham and Houston (2010), the profitability ratios examined thus far provide useful clues as to the effectiveness of a firm's operations and show the combined

effects of liquidity, asset management, and debt on operating results. The concept of relationship between financial performance and firm value is supported by previous research of Sudiyatno (2012), he reveals the firm performance as a barometer of the success of the company will be seen as a benchmark for investors to invest. Accounting statements provide different measurements to measure the firm performance, such as return on assets (ROA) or return on equity (ROE). His research founds that corporate performance (ROA) has a positive and significant impact on firm value.

Return on equity (ROE) is one of profitability ratio which represents information linked to investor. Depend on Fridson and Alvarez (2002:288), "Return on Equity which has already been alluded to, measures a firm's productivity of equity and therefore provides an indication of its ability to attract a form of capital that provides an important cushion for the debt holders". Whereas Brealey et al. (2011) measure the return on equity (ROE) as the income to share holders per dollar invested that calculated by net income per equity. ROE analysis shows not only determine the amount of income earned by the capital investments, but also find out more quality obtained by the company's earnings. Researchers need to use ROE that can provide relevant information to investors as profits level overview that will gotten by investor if they invest in the company.

In addition, profitability ratio includes return on asset (ROA). ROA is used to evaluate how good the firm uses its assets in its operations. According to Brealey et al. (2011), return on assets measures the income available to debt and equity investors per dollar of the firm's total assets that calculated by after tax interest plus net income per total assets. As an investor, ROA information is used to see how companies can maximize their assets to get a great rate of return.

ROA shows the rate of return on every dollar assets invested. Iswati (2007) reveal the concern urges of company's managers is in maximizing the ratio of profitability because profits also functions as parameter to evaluate management performances, so that the investor's attention is only on profit information without paying attention the procedure which is applied by the company to produce profit. That's why researcher would need to reveal this ratio.

Financial performance can be seen from investment growth which is usually reflected in its long or short term profitability. Net profit margin (NPM) shows how much profit of company makes for every dollar it generates in revenue or sales. According to Pandey (2005), net profit margin is formulated by profit after taxes divided by sales. A consistently high net margin indicates the competitive advantage of a company. The NPM ratio is created for benchmark of profitability ratio that used to compare the success of a company to their competitors in the same industry looked by profit margin from sales revenue.

Beside to financial performance of the firm, firm value can be seen from the company's ability to pay dividends. The dividend payout of firm's is important not only the offers source of cash flow to the shareholders but also information relating to firm's current and future performance. Making the right decision and payment of dividend policy is necessary to maximize firm's value and shareholder value. The company's managers should be based shareholder preferences. Investors prefer to have the company distribute income as cash dividends or to have the company repurchase stock or reinvestment, both of which should result in capital gain. Gordon (1963) and Lintner (1956) in Imran et al., (2013) explained that dividend payments can positively change the market value of the firm. Based on research of Ashamu (2012), among other thing finds out that the changes in

the payout ratio of a company significantly determine the changes in the value of the company. This concept is relevant with "Bird in Hand Theory" states that dividends are less risky than capital gains since they are more certain. Investors would therefore prefer dividends to capital gains (Amidu, 2007). Actually, There is no general agreement whether dividends should or should not be paid but according to the signaling theory, "Firms that pay dividends seem to maintain a relatively stable dividend, either in terms of a constant or growing dividend payout or in terms of a constant or growing dividend per share. And when firms change their dividend either increasing or reducing (cutting) the dividend the price of the firm's shares seems to be affected." (Fabozi and Peterson, 2003: 559).

Dividend payments are important decisions that depend primarily on the firm's dividend policy. Dividend policy concerning the use of profits to shareholders rights. For companies, dividend policy is a policy that is set in such a way to distribute profits to shareholders. "The dividend policy of the firm can be defined as the firm's position on whether the firm should distribute the free cash flows as dividends or keep the free cash flows in the company" (Peerden, 2011). Pandey (1999) in Ashamu (2012) stated firmly that "Dividend policy is a decision by the financial manager whether the firm should distribute all profit or retain them or to distribute a portion and retain the balance. Dividend policy is an important aspect of corporate finance and dividends are major cash outlays for many corporations."

There is a tendency of the stock price will go up if there is a increase in dividend announcement, and the stock price will go down if there is a decrease in the dividend announcement. The amount of this dividend could affect stock prices. If the high dividends paid, then the stock price tends to be high so that the

value of the company is high, otherwise, if dividends are paid low, then the company's stock price is also low. The dividend payment will give an idea of the value of the company and this decision will affect the investors to determine their judgment.

The research of Ashamu (2012), finds out among other thing that the changes in the payout ratio of a company significantly determine the changes in the value of the company. The policy of regular dividend payout should not be changed arbitrarily since it has a serious effect on the investor's attitude and the financial standing of the organization. The higher dividends distributed to shareholders makes the company's performance will be better and ultimately an assessment of the company's stock price will be reflected through the better (Rozeff, 1982 inMcGraw, 2009).

Dividend payout ratio (DPR) represents the dividend policy because of the essential a decisive portion of profits to be distributed to shareholders, and which will be retained as part of retained earnings. (Miller and Modigliani, 1961 in Saxena, 1995), it has developed an irrelevant dividend, which is then followed by several studies that discuss the payment of dividends and the variations in dividend payout policy and a range of variation in dividend payout policy with a focus on market imperfections. Brigham and Houston(2006) also argue that the managers believe that investors prefer companies that follow the dividend payout ratio's stable. In line with research of Asahumu et al. (2011), the payout ratio of a company has significantly determines the changes in the value of the company. In addition, dividend per share (DPS) is ratio that shows the distributed cash dividend divided by number of shares.

Based on the explanation above, the dividend policy has closely related with firm value. The dividend payment show relation with the ability of the company makes a profit. If the company makes a high profit, the ability to pay dividends is also high. It is mean that dividend policy has closely related with financial performance too. According to background of the research, researcher need to do research about how far the influence relationship among financial performance, dividend policy and firm value.

Since the issuance of deregulation package in Banking and Indonesia Capital Markets that is open to foreign investors in 1988-1990, the exchange activity seen increasing in Indonesia. Recently, the activity of the Indonesia Stock Exchange, total share and firm listed increased year by year during 2007-2011 as shown in Table 1.1.

Table 1.1 Development of the Indonesian Stock Trading in Stock Exchange (IDX) Period 2007-2011

Period	Total Trading			Daily Trading Averages			Market Capitalization	Firm Listed	Total Share
	Volume (Million of Share)	Value (Billion Rp)	Frek (Year X)	Volume (Millin of Share)	Value (Billion Rp)	Frek (Year X)	(Billion)		(Million of Share)
2007	1.039.542	1.050.154	11.861	4.226	4.269	48	1.988.326	383	1.128.174
2008	787.848	1.064.528	13.417	3.283	4.436	56	1.076.491	398	1.374.412
2009	1.467.659	975.135	20.977	6.090	4.046	87	2.019.375	398	1.465.655
2010	1.330.865	1.176.237	25.919	5.432	4.801	106	3.247.097	420	1.894.828
2011	1.203.550	1.223.441	28.023	4.873	4.953	113	3.537.294	440	2.198.133

(Source: IDX BAPEPAM-LK Fact Book, 2011:13).

Based on the development of the activity of the Indonesia Stock Exchange, some companies are going public to investing. Through these exchanges, the companies can attract the easy way for investors to invest in the company.

Based on, National Industrial development as stated in Presidential Decree Number 28 Year 2008 on the Indonesian National Industrial Policy, Deputy Minister of Industry, Alex Retraubun, stated that the manufacturing industry is one of the main foundations of economic growth in Indonesia. It happened since the fourth quarter of 2012 to the present. Average rate of growth, according to Alex, placing Indonesia as the country ranked second in Asia, after China, which is experiencing the highest growth. Trade Minister Gita Wirjawan, expressed fascination Indonesian manufacturing industry is very large. The proof, China has expressed interest to invest in infrastructure and manufacturing in Indonesia. (http://www.kemenperin.go.id).

As follow ASEAN - China Free Trade Agreement (CAFTA) in January 2010, the terms of foreign direct investment, manufacturing sector does continue to be the most popular sector in the economy. Investment in the sector rose up by more than 62% percent year on year. Because of the rising wages in China are likely to prompt companies in labor-intensive industries like TCF to diversify their operations to Indonesia. Indonesia's auto industry is also likely to benefit as more Japanese automakers set up new supplier networks. In order to, the recent boost in manufacturing output growth can be attributed to domestic demand, which has increased particularly for basic metals, food, chemicals, and automotive parts. Domestic demand has been remarkably resilient since the start of the global financial crisis, growing by 6.4 percent in the first quarters of 2012 on the backs of investment and private consumption.

Based on the reasons above, the manufacture industry is one of motors for increasing the economic growth in Indonesia. The manufacture industry has a special attraction for investors, both foreign and domestic. Measurement of firm value has been important thing for the company to attract its investors. This measurement provides the information about firm value as determinant factors for investor to make investment decision. So that, it is used to the reason for the researchers chose the manufacturing industry as a sample in this study.

Some of researches have been done by previous researchers in discussing the factors of financial performance and dividend policy that affect on firm value. There are some researches explain about the relationship between financial performance and dividend policy. A good financial performance indicate a higher profit of the company, it will provide a rate of return to shareholders in the form of dividends and retained earnings with a high nominal anyway. Based on research of Priya (2013), attempt to analyze the dividend policy ratios and firm performance during 2008 to 2012 of selected Hotels & Restaurants in Sri Lanka, provided the result an increase in the financial well being of a firm tends to positively affect the dividend policy of firms. The study by Amidu (2007) showed a positive and significant relationship between return on assets, return on equity, growth in sales and dividend policy. The result revealed that dividend policy affects a profitability of firm performance. Agyei et al. (2011) studied from the financial statements of 16 commercial banks in Ghana for a period 1999-2003, revealed that dividend payout has a positive relationship with firm performance and this is significant at 2%. Banks management that pay out dividend, they tend to send out good signals about the bank's performance and therefore attracting more customers.

Ashamu (2011) find out that the dividend policy that's represented by changes of payout ratio (DPS and POR) of the company significantly determines the changes in the value of the company (EPS). In line to Uwuigbe (2012) doing research about the relation among finance performance (ROE) and dividend policy (DPO). He founds that there is a significant positive association between the performance of firms and the dividend payout. Afza and Tahir (2012) support this concept, they reveals that dividend payout ratio remain the most important determinant of PER. In line to Moradi et al., (2010) the results showed that DPR is a reverse relationship of these actors with PER. Different with them, the unrelated dividend approach argued by Miller and Modigliani (MM) in 1961 in Brealey et al. (2011), MM asserted that the value of the firm is not influenced by the dividend policy in ideal conditions. MM argued that investors would not pay high prices for stocks with higher dividends when they do not need dividend to obtain cash. Relevance with MM, Geng and Liu (2011), showed enterprise value has a negative correlation with the incremental and the digressive cash dividend per share (DPS)

The financial performance can influence the firm value, the previously research was founded by Taani (2011) discusses the condition of the company that represent earnings per share (EPS) is significantly influenced by the financial ratio such as NPM, ROE, CR, DER, TATO, PBV, TA, CFO/Sales but based on regression result for analysis data only ROE, DER and PBV that consistently significant on EPS. Whereas Sudiyatno (2012) showed that financial leverage represented by NI, ROA and ROE for firm performance and firm value has a significant negative result effect on the significance level of less than 1% of the company performance, a significant and positive effect on the level of

significance of 5% of the value of the company which is firm value's represented by Tobin's Q indicators. From both of researches can be concluded that the only one of same indicators of financial performance variable namely ROE can affect the firm's value. Differ with both of researcher above, Thin et al. (2012) has a result of research about financial performance that is indicated by ROA, ROE, and EPS affecting firm value (indicated by stock performance). The result shows that ROA, ROE and EPS have significant relationship to stock price.

Based on previous research, there are several factors that influence firm value. Balke and Wohar (2005) explained that the dividend is to be the principal determinant of the level of stock prices. The research argues that the decompositions of stock price movements are very sensitive to what assumptions one makes about the presence of permanent changes in either real dividend growth or excess stock returns. In this case dividend growth is indicated by price dividend ratio (P/D). In order to Adefila et al., revealed study at Nigeria Stock Exchange represent that dividends affect the demand for share price and subsequently the value of the firms. But the dividend policy doesn't affect the value of firms. It's because currently share price is fixing in regulated by the Security and Exchange Commission (SEC) in respect of the quoted companies.

The research study is different if compare to the others previous research, especially for research variable. In this study combines the financial performance and dividend policy as a factors affecting firm value. The boarders of study stresses on ROA, ROE, NPM as financial performance indicators, DPR and Dividend per share as Dividend Policy indicator, Stock Price, PBV and PER as firm value indicators. The object of research is Manufacture sector that listed in Indonesia Stock Exchange for the period of 2010-2012.

2.1 Research Questions

Based on the description of the background, there are the research questions in this study:

1) Does the financial performance has a significant effect on dividend policy?
2) Does the dividend policy has a significant effect on the firm value?
3) Does the financial performance has a significant effect on the firm value?

3.1 Research Objective

Based on the above subject matter, the objectives of this study are:

1) Analyzing and describing the significance effect of the financial performance on dividend policy.
2) Analyzing and describing the significance effect of the dividend policy ont he firm value.
3) Analyzing and describing the significance effect of the financial performance on the firm value.

4.1 Contribution of the Research

The results of this study are expected to provide theoretical and practical contribution to many parties associated with this study, namely:

1) Theoretical contribution

   This study is expected to provide empirical evidence regarding the effect of financial performance and dividend policy on firm value, study at manufacture sector that listed on the Indonesia Stock Exchange (IDX).

2) Practical contribution

a) This study is expected to provide the empirical evidence regarding the effect of financial performance and dividend policy on firm value so that it can help the company to determine strategy based on firm value measurement.

b) This study can used to determine company's policy in term of increasing firm value for the futures.

c) This study contribute information about the influences of financial performance and dividend policy on firm value for the investors, it can used to consideration factors for investment decision making.

CHAPTER II

THEORITICAL BACKGROUND

2.1 Financial Performance

2.1.1. Definition of Financial Performance

Financial Performance Terms of financial performance is often associated with the financial condition of the company. Generally, to measure the financial condition of the company is focusing on the financial statements and non-financial data as another supports data. According to Bhunia (2010), "the financial performance analysis identifies the financial strengths and weaknesses of the firm by properly establishing relationship between the items of the balance sheet and profit and loss account". Mohammadi (2012), "financial performance has a broad concept, including economic growth, return, and productivity, using the financial ratios in the performance assessment can be appropriate for companies and their counterparts". The term of financial performance is not only used to measure of a firm's overall financial health in period of time, but also can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. In order to, Business Dictionary described that "Financial performance is measuring the results of a firm's policies and operations in monetary terms. These results are reflected in the firm's return on investment, return on assets, value added, etc." The financial performance of a company is a firm performance measurement using financial information and monetary term.

2.1.2 Financial Analysis

Financial analysis is a tool of financial management to evaluate of the financial condition and operating performance of a business firm, an industry, or even the economy, and the forecasting of its future condition and performance. The data for financial analysis are distributed by marketing, production, accounting or financial information vendors. Financial analysis may be used not only to evaluate the performance of the firm, but also its divisions or departments and its product lines. Analyses may be performed both periodically and as needed, not only to ensure informed investing and financing decisions, but also as an aid in implementing personnel policies and rewards systems. Financial analysis also can be used to determine the credit worthiness of a new customer, to evaluate the ability of a supplier to hold to the conditions of a long-term contract, and to evaluate the market performance of competitors. (Fabozzi and Peterson (2003). According to Brigham and Houston (2004), financial statement analysis involves comparing the firm's performance with that of other firms in the same industry and evaluating trends in the firm's financial position over time. These studies help management identify deficiencies and then take actions to improve performance. It can be concluded that financial analysis is important to do as benchmark of the company's performance.

2.1.3 Financial Ratio

There are two points of view for using financial measurement. From an investor's standpoint, predicting the future is what financial statement analysis is all about, while from management's standpoint, financial statement analysis is useful both to help anticipate future conditions and, more important, as a starting

point for planning actions that will improve the firm's future performance. The standpoint of financial analysis can easily measure using financial ratio.

Financial ratio is one of the tools of financial analyses. Brigham and Houston (2004) said that the financial ratios are designed to help one evaluate a financial statement. Financial ratio analysis selects the relevant information in financial statement data and evaluates it. A ratio is a mathematical relation between two quantities. Ratios can be classified according to the way they are constructed and the financial characteristic they are described. There are as many different financial ratios as there are possible combinations of items appearing on the income statement, balance sheet, and statement of cash flows. Financial ratios is used to evaluate five aspects of operating performance and financial condition: (Fabozzi and Peterson, 2003: 764-765)

1) Return on investment

   Return on investments ratios tell us how much of each dollar of an investment is generated in a period. The Du Pont system breaks down return ratios into their profit margin and activity ratios, allowing us to analyze changes in return on investments.

2) Liquidity

   Liquidity ratios tell us about a firm's ability to satisfy short-term obligations. These ratios are related closely to a firm's operating cycle, which tells us how long it takes a firm to turn its investment in current assets back into cash.

3) Profitability

Profitability ratios tell us how well a firm manages its assets, typically in terms of the proportion of revenues that are left over after expenses.

4) Activity

Activity ratios tell us how efficiently a firm manages its assets; that is, how effectively a firm uses its assets to generate sales.

5) Financial leverage

Financial leverage ratios are used to assess how much financial risk the firm has taken on. There are two types of financial leverage ratios component percentages and coverage ratios. Component percentages compare a firm's debt with either its total capital (debt plus equity) or its equity capital. Coverage ratio is reflect a firm's ability to satisfy fixed financing obligations such as interest, principal repayment, or lease payments.

Boundary of research in this study are using financial ratios such as return on assets (ROA), Return on Equity (ROE) belonging to the return on investment ratios and Net Profit Margin (NPM) belonging to the leverage ratio, which has been described previously in the background of study. There are explanation about these ratio related of the study are follows:

1) Return on Assets

According to Fabozzi and Peterson (2003), return on assets ratio is used to evaluate how good the firm uses its assets in its operations.

The formulation of ROA is:

$$\text{Return on Asset} = \frac{\text{Net Income}}{\text{Total Asset}}$$

Fabozzi and Peterson (2003:724)

Return on assets is an indicator of how profitable of company before leverage and compared with other companies in the same industry. The number of ROA tells how many dollars of earnings derive from each dollar of asset's control. It's a useful number for comparing competing companies in the same industry.

2) Return on Equity

According to Lesakova (2007), return on equity is net income after taxes to common equity measures the return earned on the common stockholder´s investment. ROE is a measure the efficiency of owner´s capital. ROE estimate of the earnings of invested equity capital, or alternatively, the percentage return to owners on their investment in the firm. The formula of ROE is:

$$\text{Return on Equity} = \frac{\text{Net Income}}{\text{Shareholder Equity}}$$

Fabozzi and Peterson (2003:728)

ROE shows how well a company uses investment funds to generate earnings growth. ROEs between 15% and 20% are generally considered good.

3) Net Profit Margin

According to Fabozzi and Peterson (2003),the net profit margin represents the net income generated from each dollar of sales. NPM is used to evaluate both operating and financing decisions, it needs to compare net income (earning after deducting interest and taxes) with sales. The formula of NPM is following:

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Sales}}$$

Fabozzi and Peterson (2003:738)

NPM is one of profitability ratios, it is measure how good a firm is managing its expenses. NPM is included in profit margin ratios which is compare components of income with sales. This ratio show the factors make up a firm's income and are usually expressed as a portion of each dollar of sales.

2.2 Dividend Policy

2.2.1 Definition of Dividend and Dividend Policy

Company can return cash to their shareholders in two ways by paying a dividend or by repurchasing shares. They can distribute cash as dividend or they can buy back some of the outstanding shares. Remembering the company's objective is to maximize shareholders wealth, the company's managers should be based shareholder preferences. Investors prefer to have the company distribute income as cash dividends or to have the company repurchase stock or else plow the earnings back into the business, both of which should result in capital gains, (Brigham and Houston, 2004). In this study, the return of the

shareholders is focus on the payout through cash dividend. According to Horne and Wachowicz (2005:591), "Dividend is a payment made out of a firm's earnings to its owners, in the form of either cash or stock. The most common type of dividend is a cash dividend". Besides to Gitman (2008:560) explain that "expected cash dividend are the key return variable from which owners and investors determine share value. The represent a source of cash flow to stockholders and provide information about the firm's current and future performance". According to the Columbia University Encyclopedia in Kola (2007), Paying out cash dividends is one of the ways in which companies can share their net earnings generated by the business with its shareholders. Dividends disbursements are based on a percentage of the stock par value or a certain sum per share of non-par-value stocks. It can be concluded that, the dividend is a distribution of net income or cash flow by a company in a given time period to the shareholders.

Kola (2007) described that the policy mean as implies this consistency over time and that payouts do not simply evolve in an arbitrary and random manner. Payout policy is about how much the company should give back to its shareholders and what for should this payment take. So that, the term of dividend policy can be described as a judgment in determining how much the profits to be distributed as dividends. In line with Horne and Wachowicz (2005:595), dividend policy is the time pattern of dividend payout. The pattern of firm should pay out a percentage of its earnings. Beside to Nissim &Ziv (2001) in Uwuigbe et al. (2012), "Dividend policy is the regulations and guidelines that a company uses to decide to make dividend payments to shareholders.

2.2.2 Dividend Form Payment

According to Gitman (2008) described the types of dividend payment are:

1) Cash Dividend

   Cash dividends are the cash flow that a firm distributes to its common stockholders.

2) Stock Dividend

   Stock dividend is the payment to existing owners of a dividend in the form of stock.

3) Stock Split

   Stock split is a method commonly used to lower the market price of a firm stock by increasing the number of shares belonging to each shareholder.

4) Stock Repurchase

   Stock repurchase include obtaining shares to be used in acquisition having shares available for employee stock plans and retiring shares.

2.2.3 Dividend Payment Procedure

The payment of cash dividend to the shareholder is decided by firm's director at quarterly or semiannual meetings. Horne and Wachowicz (2005):

1) The standard method of cash dividend payment
   a) Dividends per share as terms of dollars per share
   b) Dividend yield as percentage of the market price
   c) Dividend payout as percentage of net income or earnings per share

2) There are payment dates of cash dividend:

a) Declaration date. The date on which the board of directors passes a resolution to pay a dividend.

b) Ex-dividend date. The date two business days before the date of record, establishing those individuals entitled to a dividend.

c) Date of record. The date by which a holder must be on record to be designated to receive a dividend.

d) Date of payment. The date on which the dividend checks are mailed.

2.2.4 Dividend Controversy

Dividend policy raises issues that occur between directors and company managers. It can be acknowledged that there are differing views among shareholders on dividend policy. Some argue that increasing dividend payments will increases a firm value. Second view argues that high dividend payouts will reduces firm value. The third view claim that dividends should be irrelevant and all effort spent on the dividend decision is wasted. Malkawi (2010)

Based on the differ views above, it is emerge three theories of dividend policy there are:

1) Bird-in-the- hand' argument

This theory argues that the high dividends increase share value.

2) Tax-preference argument

This theory argue that the low dividends increase share value.

3) The dividend irrelevance hypothesis

This theory is based on Miller and Modigliani that argued regardless of how the firm distributes its income, its value is determined by its basic earning power and its investment decisions.

In order to Gitman (2008) explained three arguments:

1) Dividend Irrelevance Theory

The theory claims that the firm's value is determined solely by the earning power and risk of its assets (investment) and that the manner in which it splits its earning stream between dividends and internally retained (and reinvested) funds does not affect this value.

2) Dividend Relevance Theory

The theory advanced by Gordon and Lintner that there is a direct relationship between a firm's dividend policy and its market value

3) Bird-in-the-hand argument

The belief, in support of dividend relevance theory, that investors see current dividend as less risky that future dividends or capital gains.

2.2.5 Types of Dividend Policy

There are many views on dividend policy adopted by the company. The following kinds of dividend policy according to Horne and Wachowicz (2005):

1) Residual dividend approach

A policy under which a firm pays dividends only after meeting its investment needs while maintaining a desired debt equity ratio.

2) Dividend Stability

Means the amount of the dividend per share paid each year is relatively fixed for a certain period. The firm can choose between at least two types of dividend policies. First, each quarter's dividend can be a fixed fraction of that quarter's earnings. This is a cyclical dividend policy in which dividends will vary throughout the year. Second, each quarter's dividend can be a fixed fraction of yearly earnings, implying that all dividend payments would be equal.

In order to Gitman (2008:570), explained three types of dividend policy commonly use, there are:

1) Constant Payout Ratio Dividend Policy

A dividend policy based on the payment of certain percentage of earnings to owners in each dividend period

2) Regular Dividend Policy

A dividend policy based on the payment of a fixed-dollar dividend in each period

3) Low regular-and-extra dividend policy

A dividend policy based on paying a low regular dividend, supplemented by an additional dividend when earnings are higher than normal in a given period

4) Extra Dividend

An additional dividend optionally paid by the firm if earnings are higher than normal in a given period.

2.2.6 Factors Affecting Dividend Policy

There are factors that are considered in establishing a dividend policy: (Gitman, 2008:566-569)

1) Legal Constraints

This term prohibit corporation from paying out as cash dividend any portion of the firm's legal capital, which is typically measured by the par value of a common stock. Legal capital to include not only the par value of common stock but also any paid-in capital in excess of par.

2) Contractual Constraints

These constraints prohibit the payment of cash dividend until a certain level of earnings has been achieved, or may limit dividends to a certain dollar amount or percentage of earnings. Constraints on dividends help to protect creditors from losses due to the firm's insolvency.

3) Internal Constraints

The firm's ability to pay cash dividends is generally constrained by the amount of liquid assets (cash and marketable securities) available.

4) The Firm's Prospect Growth

The firm's financial requirements are directly related to how much it expects to grow and what assets it will need to

acquire. It must evaluate its profitability and risk to develop insight into its ability to raise capital externally.

5) Owner Considerations

The firm must establish a policy that has a favorable effect on the wealth of the majority of owners. First consideration is the tax status of a firm's owners. A second consideration is the owner investment opportunities and the last consideration is the potential dilution of ownership.

6) Market Considerations

Market's probable response to certain types of policies is also helpful in formulating dividend policy. Stockholders are believed to value a fixed or increasing level of dividend as opposed to a fluctuating pattern of dividends. A final market consideration is informational content; shareholders often view a dividend payment as a signal of the firm's future success.

2.2.7 Ratios of Dividend Payment

Estimating how much the firm should pay dividend, there are some ways to calculate. The calculation use the financial ratio includes dividend payout ratio and dividend per share.

1) Dividend payout ratio:

Dividend payout ratio (DPR) is the percentage of earnings paid to shareholders in dividends. The payout ratio provides an idea of how well earnings support the dividend payments. More mature companies tend to have a higher payout ratio. According to Zakaria et al., (2012), DPR relies on an

accounting measure (net income). It calculation is based on the ratio of dividend per share to earnings per share

$$DPR = \frac{\text{Yearly Dividend per Share}}{\text{Earning per Share}}$$

A reduction in dividends paid is looked poorly upon by investors, and the stock price usually depreciates as investors seek other dividend-paying stocks. A stable dividend payout ratio indicates a solid dividend policy by the company's board of directors.

2) Dividend per share:

Dividend per share (DPS) is ratio that shows the distributed cash dividend divided by number of shares.

$$DPS = \frac{\text{Cash Dividend}}{\text{number of share}}$$

2.3 Firm's Value.

2.3.1 Definition of Firm's Value

Firm's value of the company is very important because the high firm value will be followed by higher shareholder wealth. The higher of share price will followed by the firm value. This theory is in line with the purpose of the firm. Financial managers are charged with the responsibility of making decisions that maximize owners' wealth. This responsibility translates into maximizing the value of shareholders' equity.

If the market for stocks is efficient, the value of a share in a corporation should reflect the good investor's expectations in the future. Firm's shareholders want maximum value and the maximum honest of share price. To reach this goal, the company needs to invest in real assets that are worth more than they cost. (Brealey et al., 2011)

There are different viewpoint about the notion of a firm's value among buyers or sellers. Fernandez (2013) argues that the seller will give a very high value to its material resources, as they are able to continue producing. The seller's viewpoint, the aim is to ascertain what should be the minimum value at which it should accept the operation. Besides to, the buyer's viewpoint, the basic aim is to determine the maximum value it should be prepared to pay for what the company it wishes to buy is able to contribute.

It is very important that a company identify the fundamental parameters that have most influence on the value of its shares and on value creation. Obviously, each factor's importance will vary for the different business units. The equity's value depends on three primary factors (value drivers): Expectations of future flows; Required return to equity; and Communication with the market. The growth of future flows depends on the return on investments and the company's growth. The required return to equity depends on a variable over which the company has no control, the risk-free interest rate, and on the equity's risk which, in turn, we can divide into operating risk and financial risk. The communication with the market factor not only refers to communication and transparency with the markets in the strict sense but also to

communication with: analysts, rating companies, regulatory agencies, board of directors, employees, customers, distribution channels, partner companies, suppliers, financial institutions, and shareholders. (Fernandez, 2013)

2.3.2 The purposes of Firm's Value

A valuation may be used for a wide range of purposes: (Fernandez, 2013)

1) In company buying and selling operations:
   a) For the buyer, the valuation will tell him the highest price he should pay.
   b) For the seller, the valuation will tell him the lowest price at which he should be prepared to sell.
2) Valuations of listed companies:
   a) The valuation is used to compare the value obtained with the share's price on the stock market and to decide whether to sell, buy or hold the shares.
   b) The valuation of several companies is used to decide the securities that the portfolio should concentrate on: those that seem to it to be undervalued by the market.
3) Public offerings: The valuation is used to justify the price at which the shares are offered to the public.
4) Inheritances and wills: The valuation is used to compare the shares' value with that of the other assets.
5) Compensation schemes based on value creation: The valuation of a company or business unit is fundamental for quantifying the value creation attributable to the executives being assessed.

6) Identification of value drivers: The valuation of a company or business unit is fundamental for identifying and stratifying the main value drivers

7) Strategic decisions on the company's continued existence: The valuation of a company or business unit is a prior step in the decision to continue in the business, sell, merge, milk, grow or buy other companies.

8) Strategic planning:

a) The valuation of the company and the different business units is fundamental for deciding what products/business lines/countries/customers to maintain grow or abandon.

b) The valuation provides a means for measuring the impact of the company's possible policies and strategies on value creation and destruction.

2.3.3 The Method of Valuation

Fernandez (2013) describes the four main groups comprising the most widely used company valuation methods. There are balance sheet-based methods, income statement-based methods, mixed methods, and cash flow discounting-based methods.

1) Balance sheet-based methods (shareholders' equity)

These methods seek to determine the company's value by estimating the value of its assets. These are traditionally used methods that consider that a company's value lies basically in its balance sheet. They determine the value from a static viewpoint, which, therefore,

does not take into account the company's possible future evolution, money's temporary value.

a) Book value: A company's book value, or net worth, is the value of the shareholders' equity stated in the balance sheet (capital and reserves). This quantity is also the difference between total assets and liabilities, that is, the surplus of the company's total goods and rights over its total debts with third parties.

b) Adjusted book value: This method seeks to overcome the shortcomings that appear when purely accounting criteria are applied in the valuation.

c) Liquidation value: This is the company's value if it is liquidated, that is, its assets are sold and its debts are paid off. This value is calculated by deducting the business's liquidation expenses (redundancy payments to employees, tax expenses and other typical liquidation expenses) from the adjusted net worth.

d) Substantial value: The substantial value represents the investment that must be made to form a company having identical conditions as those of the company being valued. It can also be defined as the assets' replacement value, assuming the company continues to operate, as opposed to their liquidation value. Normally, the substantial value does not include those assets that are not used for the company's operations (unused land, holdings in other companies, etc.)

e) Book value and market value: In general, the equity's book value has little bearing with its market value which shows the

price/book value PBV ratio of several international stock markets.

2) Income statement-based methods

Unlike the balance sheet-based methods, these methods are based on the company's income statement. They seek to determine the company's value through the size of its earnings, sales or other indicators. Thus, for example, it is a common practice to perform quick valuations of cement companies by multiplying their annual production capacity (or sales) in metric tons by a ratio (multiple).

a) Value of earnings: According to this method, the equity's value is obtained by multiplying the annual net income by a ratio called PER (price earnings ratio).

b) Value of the dividends: Dividends are the part of the earnings effectively paid out to the shareholder and, in most cases, are the only regular flow received by shareholders. This value can be expressed DPS (Dividend per Share).

c) Sales multiples: This valuation method, which is used in some industries with a certain frequency, consists of calculating a company's value by multiplying its sales by a number.

d) Other multiples: In addition to the PER and the price/sales ratio, some of the frequently used multiples are: Value of the company / earnings before interest and taxes (EBIT); Value of the company / earnings before interest, taxes, depreciation and amortization (EBITDA); Value of the company / operating cash flow; Value of the equity / book value

3) Goodwill-based methods

Generally speaking, goodwill is the value that a company has above its book value or above the adjusted book value. Goodwill seeks to represent the value of the company's intangible assets, which often do not appear on the balance sheet but which, however, contribute an advantage with respect to other companies operating in the industry (quality of the customer portfolio, industry leadership, brands, strategic alliances, etc.). These methods apply a mixed approach: on the one hand, they perform a static valuation of the company's assets and, on the other hand, they try to quantify the value that the company will generate in the future. Basically, these methods seek to determine the company's value by estimating the combined value of its assets plus a capital gain resulting from the value of its future earnings: they start by valuing the company's assets and then add a quantity related with future earnings.

a) The classic valuation method
b) The simplified abbreviated goodwill income method or the simplified UEC method.
c) Union of European Accounting Experts (UEC) method.
d) Indirect method.
e) Anglo-Saxon or direct method.
f) Annual profit purchase method.
g) Risk-bearing and risk-free rate method

4) Cash flow discounting-based methods

These methods seek to determine the company's value by estimating the cash flows it will generate in the future and then discounting them at a discount rate matched to the flows' risk. The mixed methods described previously have been used extensively in the past. However, they are currently used increasingly less and it can be said that, nowadays, the cash flow discounting method is generally used because it is the only conceptually correct valuation method. In these methods, the company is viewed as a Company valuation methods cash flow generator and the company's value is obtained by calculating these flows' present value using a suitable discount rate. Cash flow discounting methods are based on the detailed, careful forecast, for each period, of each of the financial items related with the generation of the cash flows corresponding to the company's operations, such as, for example, collection of sales, personnel, raw materials, administrative, sales, etc. expenses, loan repayments. Consequently, the conceptual approach is similar to that of the cash budget. In cash flow discounting-based valuations, a suitable discount rate is determined for each type of cash flow. Determining the discount rate is one of the most important tasks and takes into account the risk, historic volatilities; in practice, the minimum discount rate is often set by the interested parties (the buyers or sellers are not prepared to invest or sell for less than a certain return, etc.).

Based on the extent of the problem, this study only focus on assessed the firm value through a balance sheet-based methods using

price to book value PBV as an indicator and price-to-earnings ratio PER as an indicator of the income statement-based methods. As in the studies that have been done before by Penman (1997) which combines the P/BV and P/E simultaneously. As already Penman explained that investors use a simple way to approximate a value of company uses information available through the balance-sheet and income statement.

2.3.4 Stock Price

According to Investor word (http://investorword.com), stock price is the cost of purchasing on an exchange. Stock price can be seen from closing price in exchange trading activity. Based on Investopedia (http://www.investopedia.com), closing price is the final price at which a security is traded on a given trading day. The closing price represents the most up-to-date valuation of a security until trading commences again on the next trading day.

The price of a stock fluctuate fundamental is due to the theory of supply and demand. Like all commodities in the market, the price of a stock is sensitive to demand. However, there are many factors that influence the demand for a particular stock. The fields of fundamental analysis and technical analysis attempt to understand market conditions that lead to price changes, or even predict future price levels.

2.3.5 Price to Book Value Ratio (PBV)

Price to book ratio PBV is a ratio used to compare a stock's market value to its book value. P/BV is calculated by dividing the current closing price of the stock by the latest quarter's book value per share.

Branch and Gale (1983), the price-to-book PBV ratio is a basic measure of the relative value that the market places on a share of stock, P/BV is the best easily accessible measure of the assets which lie behind each share. This ratio provides a very useful index of how much value the market places on the firm as a going concern (market price of stock) as opposed to the bundle of assets (book value per share). The higher of P/BV show the more favorably the market views the company and its prospects. The P/BV suggests that the firm's value as a going concern is actually below the value its assets. Weston and Copeland (2008) mentioned that price to book value ratio describes how big the market appreciate book value of shares of company. The higher P/BV means market believe about the company's prospects.

According to Weston and Copeland (2008:244), the formula for price to book value is the stock price per share divided by the book value per share:

$$PBV = \frac{\text{Market Price per Share}}{\text{Book Value per Share}}$$

The price to book value formula can be used by investors to calculate the reasonable of stock price of the company. The higher ratio implies that the market is willing to pay more than the equity per share. The lower ratio shows that the market is willing to pay less. The Price to Book Ratio formula is used to compare a company's net assets available to common shareholders relative to the sale price of its stock.

2.3.6 Price to Earning Ratio

2.3.6.1 Definition of Price to Earning Ratio

A commonly used of company's performance measurement over a period of time is using earning, which is often stated in terms of a return earnings scaled by the amount of the investment. Many investors are interested in how the earnings are valued by the market. Another ratio beside price to book value that is commonly uses the price to earnings ratio PER. This ratio compares the price per common share with earnings per common share. Price to earning ratio is calculated by dividing the market price per share by the earnings per share. (Fabozzi and Peterson, 2003). According to Weston and Copeland (2008), price to earning ratio describes market appreciation in the company's ability to generate profits:

$$\text{PER} = \frac{\text{Market Price per Share}}{\text{Earning per Share}}$$

Price to earnings ratio PER indicates the magnitude of every dollars of corporate earnings and a measure of the relative price stock of company. Valuation price to earnings ratio PER used in this study because the calculations show the reasonableness of the value of the stock price. P/E indicates the size of the power company to earn profit that will come. The higher value of P/E will show the high value of the company and vice versa. This certainly

will help investors to determine the variables that other assessment.

Price to earning ratio PER as an important index measuring stock investment value and reflecting stock market development status, price-earning ratio is not only useful for department of banking custody to make sound regulation measures but also helpful for investors to distinguish stock investing risk and select advisable invest strategy. This statement is in line with Afza and Tahir (2012) explanation that fund managers and investors mostly rely on price to earnings ratio for analyzing relative attractiveness of equity investments and use it as a valuation technique for performance evaluation of individual stocks, sectors and markets.

2.3.6.2 The factors affecting Price to Earning Ratio

Graham and Dame (1934) in Yuehong considered that the major factors affecting price to earning ratio are factors coming from investors and companies. Reilly et al. (1983) in Afza and Tahir (2012) showed results that P/E ratio increased with an increase in dividend payout, realized earnings growth, and dividend growth. It's decreased with an increase in business failure rate, risk-free return, inflation and earnings volatility. Research of White (2000), Malkiel showed in agreement with others, stated that P/E should increase with D/E and earnings growth while decreasing with higher risk and interest rates. In order to, Siegel (1994) concluded that P/E would rise with D/E and

that a low market P/E would portend above-average long-term returns.

Based on the explanation above it can be concluded that, the P/E is strongly influenced by the dividend payout, earnings growth and interest rate. The higher profit growth shows the higher price earnings ratio. This is because the company's prospects in the future seen from its earnings growth. The high corporate profits show the high earnings per share, it means that the company has a good level of profitability. So, it can increase the confidence of investors to invest in the company. The high of payout ratio shows the high its price earnings ratio. Dividend payout ratio determine the amount of dividends received by shareholders and the amount of dividends it can positively affect stock prices, especially in the capital markets to pursue a strategy that has dominated the dividend as the main target, the high of dividend show the high price earning ratio. The higher of required rate return shows the lower price earnings ratio, if the gains from such investments is smaller than the rate of profit in intimated, it's mean that the investment less attractive, so it can cause a decline in the stock price and vice versa.

2.4 Previous Research

The table bellow provide the research previous related to the influence of financial performance and dividend policy to firm value.

Table 2.1 Previous Research

No	Researcher	Title	Result of research	Similarity	Dissimilarity
1.	Khalaf Taani and Mari'e Hasan Hamed Banykhaled (2011)	The Effect Of Financial Ratios, Firm Size And Cash Flows From Operating Activities On Earnings Per Share	The results show that profitability ratio (ROE), Market ratio (PBV), cash flow from operation/sales, and leverage ratio (DER) has significant impact on earning per share	ROE and PBV	EPS
2.	Bambang Sudiyatno and Elen Puspitasari (2012)	The Company's Policy, Firm Performance, And Firm Value	NI, ROA and ROE for firm performance and firm value have a significant and positive effect on the value of the company use Tobin's Q	ROA and ROE	NI and Tobin's Q

No	Researcher	Title	Result of research	Similarity	Dissimilarity
3.	Bo Eriksena and Thorbjorn Knudsen (2003)	Industry And Firm Level Interaction Implications For Profitability	SMEs is used to measured the enterprise value has a significant codetermining to financial performance data return on assets (ROA)	ROA	SMEs
4.	Uwalomwa Uwuigbe, Jimoh Jafaru and Anijesushola Ajayi (2012)	Dividend Policy And Firm Performance	There is a significant positive association between the performance of firms use ROE as variable and the dividend policy use dividend payout ratio as variable.	ROE and DPR	DER
5.	Sajid Gul, Mardan, Bilal Ahmad, Shafiq Ur Rehman, Mehran Shah (2011)	Taxes And Dividend Policy	The profitability using ROA have significant positive influence on DPR. The leverage using DER has significant negative influence on DPR	ROA and DPR	DER.

No.	Researcher	Title	Result of research	Similarity	Dissimilarity
6.	Chengxuan Geng and Chenxi Liu (2011)	A Research About How The Dividend Policy Influences The Enterprise Value On The Condition Of Consecutive Cash Payoff	Enterprise value (Tobin's Q) has a negative correlation with the incremental and the digressive cash dividend per share (DPS), and has a positive correlation with the stable cash dividend per share (DPS)	dividend policy on firm's value	Differences variables and indicators.
7.	Dr Talat Afza and Ms. Samya Tahir (2012)	Determinants Of Price-Earnings Ratio	Dividend payout ratio and Tobin's Q remain the most important determinant of P/E ratios.	Dividend policy and firm value.	Tobin's Q
8.	Kathelijn Peerden (2011)	The Relationship Between Firm's Dividend Policy And Expected Earnings Growth	Payout ratio and dividend yield, were found to be significant within the expanded model of earning growth using earning yield.	DPR and Dividend Yield	Earning Yield.

No	Researcher	Title	Result of research	Similarity	Dissimilarity
9.	S.O Asahumu, James O. Abiola, S.O Bbadmus (2011)	Dividend Policy As Strategic Tool Of Financing In Public Firms	The payout ratio of a company significantly determines the changes in the value of the company (EPS). The negative relationship between Earnings per share (EPS) and Pay-Out Ratio (POR)	Dividend policy and firm value.	EPS and POR
10.	Dmitriy Kostyuk (2011)	Dividend Payout. Its Impact On Firm Value	Payout policy positive dependence between portfolio return and income distributed among shareholders	Dividend policy and firm value.	Different variables and indicators.

No	Researcher	Title	Result of research	Similarity	Dissimilarity
11.	Andrew Limento and Neneng Juaeriah (2012)	The Determinant Of The Stock Price In Publicly Listed Transportation Industry	The result is ROA, ROE, NPM, CR, DER, PBV, Inflation, SBI and GDP have insignificant correlation with Stock Price. TAT and EPS are the factors that have significant correlation with stock price.	ROA, NPM and ROE	CR, Inflation, SBI, GDP, TAT and EPS.
12.	Pitabas Mohanty (2009)	Evidence Of Size Effect On Stock Returns In India	Size and price-to-book-value were negatively correlated with stock returns. Earnings-to-price ratio and market leverage were found to be positively correlated with stock returns.	PBV and PER	Firm size

No	Researcher	Title	Result of research	Similarity	Dissimilarity
13.	Lan Sun (2012)	Information Content Of PE Ratio, Price-To-Book Ratio And Firm Size In Predicting Equity Returns	PE ratios and firm size do not have power in predicting stock returns. However, significant returns are found to be associated with low Price-to-book ratios.	PER	Firm size
14.	Mehdi Moradi, Mahdi Salehi and Shahnaz Honarmand (2010)	Factors Affecting Dividend Policy: Empirical Evidence Of Iran	The results of the study there is a direct relationship between dividend (DPR) and profitability (total value of a firm's assets). However, the results also DPR reveal that there is a reverse relationship of these actors with P/E, beta rate and debt ratio	DPR and PER	Tota and BETA

Source: Data Processed

CHAPTER III

CONCEPTUAL FRAMEWORK AND HYPOTHESIS

3.1 Conceptual Framework

The purpose of the establishment of a company can't be separated from efforts for the welfare of its shareholders. These objectives can be achieved when the company is able to increase the value of its company. The high value of the company would be able to prosper its owner. The company's value can be seen from the price of share. When a company has a good financial performance so that it can generate high profit, the company will provide a rate of return to shareholders in the form of dividends and retained earnings with a high nominal anyway. These assumptions indicate that while the company distributed a dividend in high value, automatically share price will be high, so high value that the company will be achieved.

Based on the concept of the mind, in more detail can be compared with previous studies that financial performance to be one of the fundamentals aspect to assessment the company condition. Public or prospective investors need the information relating financial performance; it is used as a basis for investment decisions. The company makes analysis about its financial performance by financial ratio. The object of measurement includes financial statement information such as balance sheet or income statement. There are some ratios as financial performance indicators, such as return on investment, activity, profitability, liquidity and leverage. The measurement of financial performance which used in this study is profitability

ratio. The indicators of profitability ratio include return on asset, return on investment, and net profit margin. These ratios show how the company can generate their profit. The company use this ratio as benchmark to measure how good the financial performance.

Research previous on the subject has been done by Taani (2011) that doing research of measurement the impact of financial ratios on EPS. The research using profitability, liquidity, debt to equity, market ratio, size which is derived from firm's total assets, and cash flow from operation activities as independent variables and EPS (Earning per Share) as dependent variable. The results show that profitability ratio (ROE), Market ratio (PBV), cash flow from operation/sales, and leverage ratio (DER) has significant impact on earning per share. In contrast to Taani, Lan Sun (2012) assume that Price to earning ratio (PER), Price-to-book ratios (PBV) and the firm size has effect in stock return. The results of research suggest that P/E ratios and firm size do not have power in predicting stock returns. However, significant returns are found to be associated with low Price-to-book (PBV) ratios.

Making the right decision and payment of dividend policy is necessary to maximize firm's value and shareholder value. Dividend policy as variable influence on the firm's value, it is in because the dividend policy of the center of attention for many parties such as shareholders, creditors, and other external parties that have an interest from the information issued by the company. To be concluded, dividend policy not only can influence the financial performance, but also the firm's value. This statement supported by previous research of Moradi (2010), he serves firm size, beta, price to earning ratio, debt to equity ratio, profitability, earnings growth as

independent variables, whereas dividend payout ratio as the dependent variable. According to the results of the study there is a direct relationship between dividend and profitability. Furthermore, the results of the study show that there is no meaningful relationship between the dividend policy and a company's size and rate of retained earning. Whereas, Ashamu (2012) finds out that the changes in payout ratio of a company significantly determine the changes in the value of the company. The policy of regular dividend payout should not be changed arbitrarily since it has a serious effect on the investor's attitude and the financial standing of the organization.

Based on the results of explanation above, the current study analyzed the influence between variables by combine ROA, ROE and NPM as the independent variable of financial performance. The dividend payout ratio and dividend per share are an indicator variable of dividend policy. Whereas the stock price, PER and PBV as the dependent variable of the firm's value, whereas, The conceptual framework of this study can be described as follows:

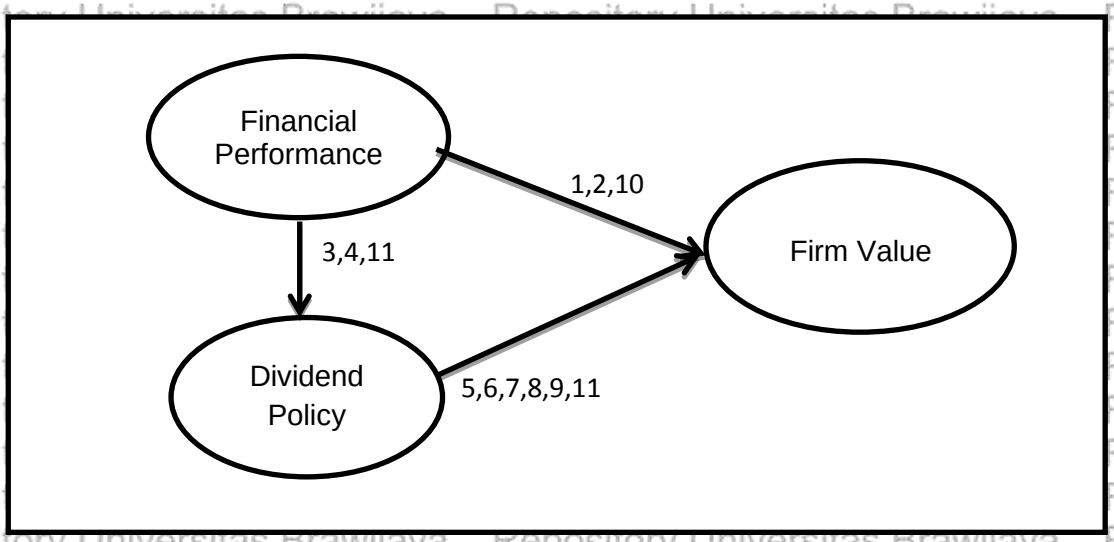


Figure 3.1 Conceptual Model

The following information about supporting journal of this conceptual model are :

1) Khalaf Taani and Mari'e Hasan Hamed Banykhaled (2011), The Effect Of Financial Ratios, Firm Size And Cash Flows From Operating Activities On Earnings Per Share
2) Bambang Sudiyatno and Elen Puspitasari (2012), The Company's Policy, Firm Performance, And Firm Value
3) Uwalomwa Uwuigbe, Jimoh Jafaru and Anijesushola Ajayi (2012), Dividend Policy And Firm Performance
4) Sajid Gul, Mardan, Bilal Ahmad, Shafiq Ur Rehman, Mehran Shah (2011), Taxes And Dividend Policy
5) Chengxuan Geng and Chenxi Liu (2011), A Research About How The Dividend Policy Influences The Enterprise Value On The Condition Of Consecutive Cash Payoff
6) Dr Talat Afza and Ms. Samya Tahir (2012), Determinants Of Price-Earnings Ratio
7) Kathelijn Peerden (2011), Determinants Of Price-Earnings Ratio
8) S.O Asahumu, James O. Abiola, S.O Badmus (2011), The Relationship Between Firm's Dividend Policy And Expected Earnings Growth
9) DomitriyKostyuk (2011), Dividend Payout. Its Impact On Firm Value
10) Andrew Limento and Neneng Juaeriah (2012), The Determinant Of The Stock Price In Publicly Listed Transportation Industry
11) Mehdi Moradi, Mahdi Salehi and Shahnaz Honarmand (2010), Factors Affecting Dividend Policy: Empirical Evidence Of Iran

3.2 Hypothesis Development

Based on the assumptions that have been corroborated by the theoretical basis, the researchers can draw tentative conclusions about the research study. The tentative conclusion is called the hypothesis. According to Singh:2006:60, "the term hypothesis is a tentative statement about the solution of the problem. Hypothesis offers a solution of the problem that is to be verified empirically and based on some rationale. These hypotheses contain variables which must be labelled and then operationally defined to construct predictions. These steps might be considered the logical stages of the research. These stages are followed by methodological stages, which culminate in the development of research design and development of measures and finally in the finding themselves".

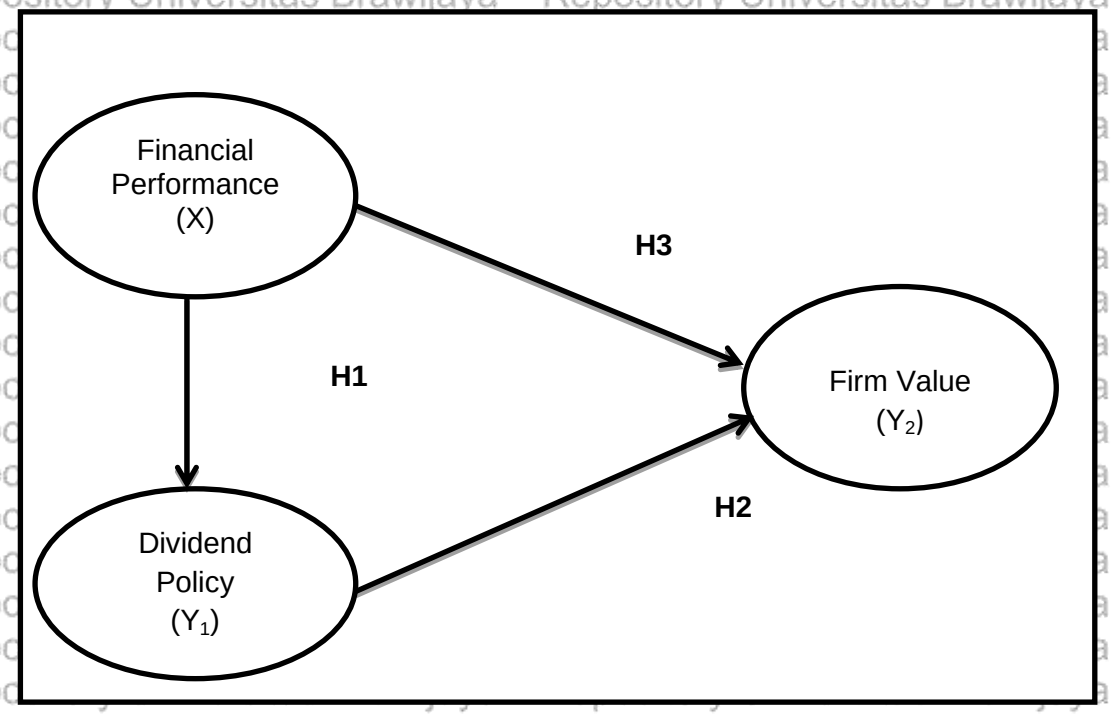


Figure 3.2 Hypothesis Model

3.2.1 The relationship between financial performance and dividend policy

The amount of shareholder dividend paid based on the amount of profits from the company. Composed of dividend are set out in a policy, called the dividend policy. The company's attempt to generate profits can be assessed from financial performance. It's concluded that financial performance has an influence on the composed of dividend policy. In this study represented financial performance ROA, ROE and NPM. This study is in line with previous studies Uwuigbe (2012) that finds out a significant positive association between the performances of firms (indicated by ROE) on the dividend policy (indicated by DPR).

H1: Financial performance has significant positive effect on dividend policy

3.2.2 The relationship between financial performance and firm value

Assessment of a company's performance can be seen on the company's ability to generate profits. Company's profits is not only as an indicator of a company's ability to funds their shareholder, but also an element in the creation of firm's value that indicates the company's prospects in the future. In this study, ROA, ROE and NPM are used to measurement of financial performance ratios. Previous research has been carried out by Sudiyatno (2012), his research founds that corporate performance (ROA) has a positive and significant impact on firm value (Tobin's Q).

H2: Dividend policy has significant positive effect of the firm value

3.2.3 The relationship between dividend policy and firm value

Dividend policy should be designed as objectives for the manager of a company to determine how much net income will be distributed in the form of dividends to shareholders. The composed of dividend policy is to calculate the amount of dividend paid by a company which is able to look at the composition of financing in the financial structure. The purposes of dividend distribution to shareholders aim to prosper owners. The amount of the dividend divided by the company's shareholders will indicate the level of prosperity of a company. The greater value of the dividend will demonstrate good corporate financial performance, the high financial performance show a high value of the company. It can be concluded that the dividend policy has an influence on the firm value. This study uses the DPR and the dividend yield as indicator measurements. This statement is supported by a previous study by Ashamu (2012), among other thing finds out that the changes in the payout ratio of a company significantly determine the changes in the value of the company.

H3: Financial performance has significant positive effect on the firm value:

Based on the previous discussion above, so that the research variable relationship can be figured out as follows:

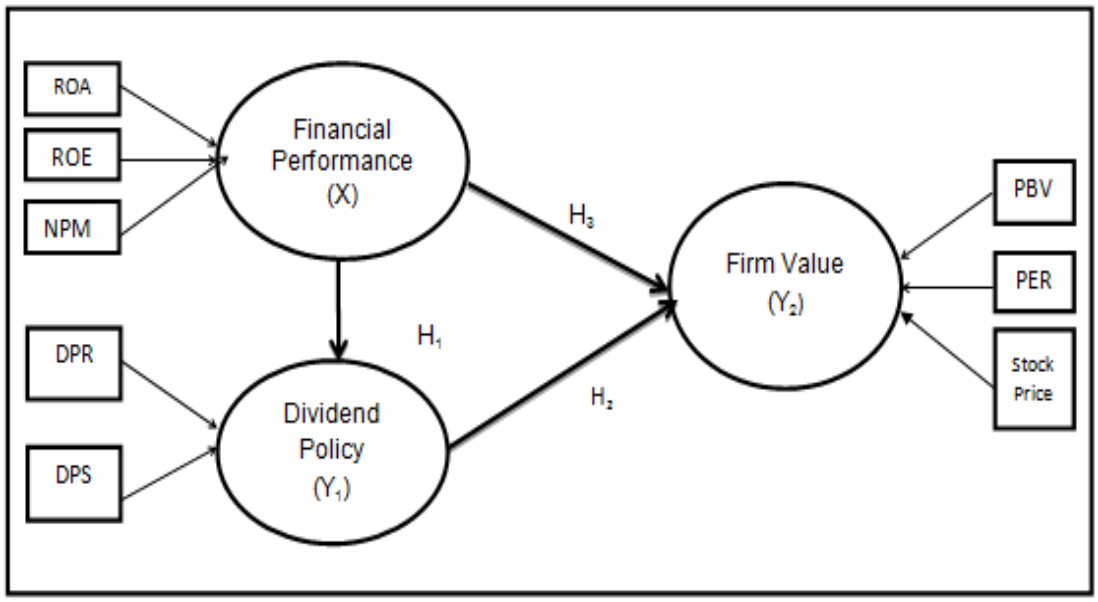


Figure 3.3 Research Variables Relationship

Symbol information:

ROA : Return on Asset

ROE : Return on Equity

NPM : Net Profit Margin

DPR : Dividend Payout Ratio

DPS : Dividend per Share

PBV : Price to Book Value

PER : Price to Earning Ratio

CP : Clossing Price

CHAPTER IV

RESEARCH METHOD

Based on the research question which has been described previous, it needs a study of research to accomplish the research objectives. Singh (2006:1) described, "Research is simply the process of arriving as dependable solution to a problem through the planned and systematic collection, analysis and interpretation of data. Research is the most important process for advancing knowledge for promoting progress and to enable man to relate more effectively environment to accomplish his purpose and to resolve his conflicts". According to George J. Mouly in Singh (2006:2), "Research as the systematic and scholarly application of the scientific method interpreted in its broader sense, to the solution of social studies al problems; conversely, any systematic study designed to promote the development of social studies as a science can be considered research." Therefore, research means to observe the appearing phenomenon from time to time, requires a method to conduct research step by step in different dimension.

According to Khotari (2004:2) explained, "The purpose of research is to discover answers to questions through the application of scientific procedures". According to Singh (2006:4), "The main function of research is to improve research procedures through the refinement and extension of knowledge". In performing research operations, research methods or techniques refer to the methods the researchers used. Research methods are as all those methods/techniques that are used for conductioning of study.

Furthermore, in this study, researcher use quantitative research approaches. Based on Greener (20

08:17), "A quantitative approach to research is likely to be associated with a deductive approach to testing theory, often using number or fact and therefore a positivist or natural science model, and an objectivist view of the objects studied". According to Collis and Hussey (2009:7), "Quantitative approach is using to addressing their research question(s) and design a study that involves collecting quantitative data (and/or qualitative data that can be quantified) and analyzing them using statistical methods". Quantitative research's objective is to develop and employ mathematical models, theories and/or hypotheses pertaining to phenomena. The process of measurement is to provide the fundamental connection between empirical observation and mathematical expression of quantitative relationship.

4.1 Research Type

Related to purposes of study, this research uses explanatory research type. The reason of choosing this type is because this study attempts to explain the relationship between variables through hypothesis testing, whereas the data used generally in the form of numerical values calculated through statistical tests. According to Collis and Hussey (2009), Analytical or explanatory research is a describing the characteristics, to analyzing and explaining why or how the phenomenon being studied is happening. Thus, analytical research aims to understand phenomena by discovering and measuring causal relations among them. This research study also called hypothesis testing and the range of this study seeks to provide an overview of the research object.

4.2 Research Location

Research location in this research is at Indonesia Stock Exchange (IDX). The choosing research location is due to IDX as a place that has a role to delivering the real time information and facilitating Capital Markets practice transact directly in the capital market. In addition, the data source is obtained via the website at www.idx.com. The site is the official website from the Indonesia Stock Exchange (DX) that informs regarding capital market activity reports.

4.3 Population And Sample

4.3.1 Population

The population of this study is the all companies in the manufacture sector that have registered in the Indonesia Stock Exchange in 2010-2012 consecutively. There are 124 companies listed.

4.3.2 Sample

The sample selected should be as representative of the total population as possible in order to produce a miniature cross-section. In this study, the sampling technique use non-random sampling that better known as non-probability sample. Non probability sampling technique is chosen because this sampling technique based on considerations particular, so that every member of the population does not have the same opportunity to be elected to the sample. According Kumar (1996:160), "Non-probability sampling design is used when the number of elements in a population is either unknown or cannot be individually identified".

The sampling method was taken using the purposive random sampling. The idea of purposive random sampling is to pick out the sample in relation to some criterion, which is considered important for the particular study. This method is appropriate when the study places special emphasis upon the control of certain specific variables. According to Singh (2006:90), "The purposive sampling is selected by some arbitrary method because it is known to be representative of the total population, or it is known that it will produce well matched groups".

The members of the sample will be selected in such a way that the sample formed to represent the reflecting of the population. In this study, there are some criteria to selecting sample:

1) Manufacture companies in Indonesia Stock Exchange (IDX) period 2010-2012.
2) Manufacture companies that resulted financial report and published in Indonesia Stock Exchange (IDX) period 2010-2012 continuously.
3) Manufacture companies that distributed dividend in Indonesia Stock Exchange (IDX) period 2010-2012 continuously.
4) Manufacture companies that reported the positive profit year by year in Indonesia Stock Exchange (IDX) period 2010-2012.

Based on criteria of sampling method has obtained 32 manufacturing companies in this research.

4.4 Data Types, Sources of Data And Data Collection Method

4.4.1 Data Types

The data used in this study are the quantitative data. Quantitative data in this study is a financial statement of the manufacture companies in period 2010-2012 that listed on the Indonesia Stock Exchange. Based on Singh (2006:214), "The quantitative data provide the nature of the characteristic or trait. They have the verbal exposition of the trait. There is much scope for logical manipulation is the interpretation of result. The trait is not quantifiable".

4.4.2 Sources of Data

Based on the source, the data used in this study is entirely external secondary data. This source of data is chosen because the data can't be gotten directly from the company, but is obtained in the form of data that has been collected, processed and published by others, namely the Indonesian Stock Exchange. The form of the data is gotten via internet (www.idx.co.id). The data source includes financial report and company's summary for the period of 2010 – 2012. According to Khotari (2004:111), "Secondary data means data that are already available i.e., they refer to the data which have already been collected and analyzed by someone else".

4.4.3 Data Collection Method

The method of data collection is documentation technique. Researcher collect the data by recording and copying the financial report of manufacture companies from the historical IDX document for the period of 2010-2012.

4.5 Research Variable

The research variables that will be used in the research model, namely:

1. Independent variable(X) is the variable that affects other variables. The independent variables used in this study are comprised of the financial performance (X).
2. Dependent variable(Y) is the variable that influenced by independent variables. The dependent variable in this study are and Dividend Policy (Y_1) and the Firm Value (Y_2).

4.6 Definition of Operational Variable

Operational variables are used to define a construct of research into variables that can be measured. Singh (2006:67) described. "Operational definition should be more specific than those used in ordinary discourse. In other words any special term which must be used in the statement of the problem may require an operational definition to ensure clarity. Particular clarification should be given terms which are used in the formulation of testable hypothesis". There are three variables in this research, two of independent variables and one of dependent variable:

1) Independent variable (X)

The independent variable is a stimulus variable or input operates either within a person or within environment to affect his behavior. It is that factor which is measured, manipulated or selected by the experimenter to determine its relationship to observed phenomena. (Singh, 2006:63). In this research, the independent variable is Financial Performance (X). The indicators of financial performance include Return on Asset (ROA), Return on Equity (ROE), Net Profit Margin (NPM). For more details about the definition of these, see the table 4.1.

2) Dependent variable

The dependent variable is a response variable or output. The dependent variable is the factor which is observed and measured to determine the effect of the independent variables. It is the variable that will change as a result of variations in the independent variable. It is considered dependent because its value depends upon the value of the independent variable. (Singh, 2006:64). In this research, there are two dependent variables namely Dividend Policy (Y_1) and Firm Value (Y_2). The indicators of Dividend Policy (Y_1) include Dividend Payout Ratio (DPR) and Dividend per Share (DPS). Whereas, the indicators of Firm Value (Y_2)include Price to Book Value (PBV), Price to Earning Ratio (PER) and Stock Price. For more details about the relationship of these variables, this is design of operational variable as follows:

Table 4.1 Operational Variable

Variable	Definition	Indicator
Financial Performance (X)	Financial performance analysis is one of the many tools useful in valuation because it helps the financial analyst gauge returns and risks. (Fabozzi and Peterson, 2003)	1) Return On Asset (ROA) $ROA = \frac{\text{Net Income}}{\text{Total Asset}}$ 2) Return On Equity (ROE) $ROE = \frac{\text{Net Income}}{\text{Shareholder Equity}}$ 3) Net Profit Margin (NPM) $NPM = \frac{\text{Net Income}}{\text{Sales}}$
Dividend Policy (Y_1)	The dividend policy of the firm can be defined as the firm's position on whether the firm should distribute the free cash flows as dividends or keep the free cash flows in the company (Peerden, 2011)	1) Dividend Payout Ratio (DPR) $DPR = \frac{\text{Yearly Dividend per Share}}{\text{Earnings per Share}}$ 2) Dividend per Share (DPS) $DPS = \frac{\text{Cash Dividend}}{\text{Number of Share}}$
Value of Firm (Y_2)	Firm value is the price paid by the prospective buyer is willing if the company is sold (Norton, 2003)	1) Price to Book Value Ratio (PBV) $(PBV) = \frac{\text{Market Price per Share}}{\text{Book Value per Share}}$ 2) Price to Earning Ratio (PER) $PER = \frac{\text{Market Price per Share}}{\text{Earning per Share}}$ 3) Stock Price • Yearly Average Closing Price

Source: Data Processed

4.7 Measurement Scale

According to table of operational variable above, this is can seen ratio scales used. Ratio scale is used to represent the amount number of variable such as ROA, ROE, DER, DPR, DPS, PBV, PER and CP. Ratio scale represents the actual amounts of variables which are the all statistical techniques are usable with ratio scales and all manipulations that one can carry out with real numbers can also be carried out with ratio scale values. (Khotari, 2204).

4.8 Data Analysis Method

After collecting data, researcher must analyze the data to interpretative the purpose of study. The data analysis method use statistical method. Statistical method has contributed a great deal in the general process of analysis of research data. In this study, researcher use partial least square as a statistical method. It's because a statistics is a measure based on a sample. The sample is used to estimate a parameter of population selected.

4.8.1 Definition of Partial Least Square

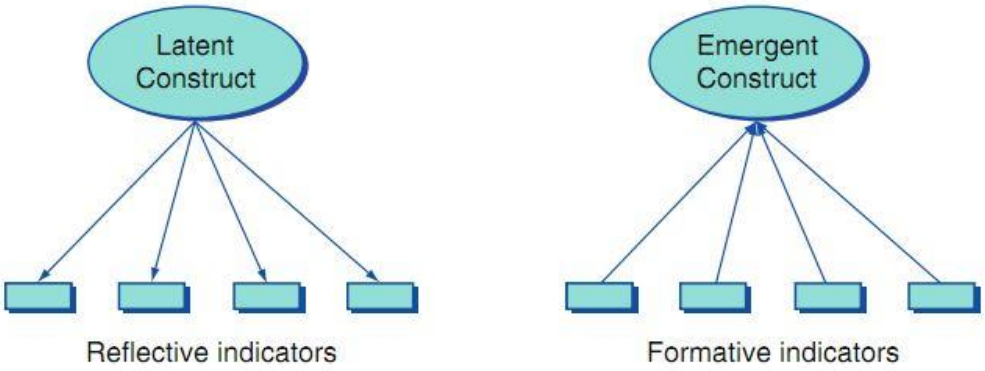
Statistical techniques using partial least square (PLS) data analysis. PLS can be used to analyze the variety independent variable and make it as a variable called latent variables. According to Abdi (2010), "Partial least squares (PLS) regression (a.k.a. projection on latent structures) is a recent technique that combines features from and generalizes principal component analysis (PCA) and multiple linear regression. Its goal is to predict a set of dependent variables from a set of independent variables or predictors. This prediction is achieved by extracting from the predictors a set of orthogonal factors called latent variables which have the best predictive power."

This study uses a partial least square structural equation model (PLS-SEM) approach as a model of data analysis. According to Hair et al. (2011), PLS-SEM is a causal modeling approach aimed at maximizing the explained variance of the dependent latent constructs. PLS-SEM estimates loadings of the indicator variables for the exogenous constructs based on their prediction of the endogenous constructs, not their shared variance among indicator variables on the same construct. Thus, the loadings in PLS-SEM are in a way their contribution to the path coefficients.

There are two models of indicators for the latent variable on Partial Least Square, namely formative indicator model and normative indicator model. According to Vinziet.al., (20120), "The reflective indicators model is obtain weights that meant to form the single best score to maximally predict its own measures". Reflective indicator model assumes that the covariance between the measurements described by a variant that is a manifestation of the latent constructs. The indicator is an indicator of the effect (effect indicator). Direction of causality is from the construct to the indicators of measurement, so that the construct explained variance measurement.

Vinzi et.al., (2010) explain, "The formative modeling objective is to obtain weights that create the best variety score or construct such that it maximally correlates with the neighboring constructs". Formative indicator model assumes that each measurement is bound affect the latent constructs. Construct is determined by measuring indicators, so that the whole meaning of the composite latent constructs derived from measurement indicators. Models should not assume or require a correlation between sizes (completely uncorrelated). Therefore, the factor analysis of the construct

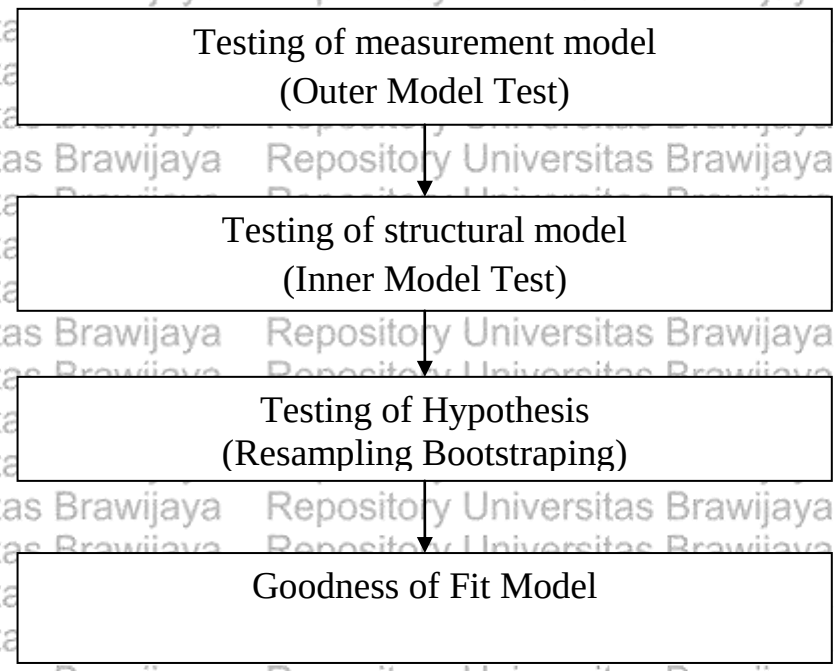
validity when doing testing, reducing the consequences of a formative indicator measurement models will potentially change the meaning of the construct.



Source: Vinziet.al., (2010:665)

Figure 4.1 Reflective Indicator Model and Formative Indicator Model

4.8.2 Step of Partial Least Square Testing



4.8.2.1 Designing Measurement Model (Outer Model)

Outer model or measurement model defines how each block of indicators related to the latent variables. The constructs of latent variable is examining the significance and relevance of the indicators. According to Sarstedt et al., (2014), outer model test facilitate the immediate testing of the weights' significance based on the normal distribution instead to running a bootstrapping routine, a re-sampling technique that draws a large number of subsamples (typically 5000) from the original data. After compute bootstrap and standard errors, which allow for the computation of t-values (and p-values) for each indicator weight. T-values would show the significance of the weights may be determined to make the following decisions: first, statistically significant, the second is non-significant but the indicator's loading is 0.50 or higher, the indicator is still retained, provided that theory and expert judgement support, third the weight is non-significant and the loading is low (i.e., below 0.50), the indicator should be deleted from the measurement model.

4.8.2.2 Designing Structural Model (Inner Model)

Model Inner or Structural Models describing the relationship between latent variables based on substantive theory. According to Hair et al., (2011) structural model typically referred to as the inner model in the PLS-SEM context which shows the relationships (paths) between the latent constructs. The assessment of the model's quality is based on two criteria assessment. First criteria is coefficient of determination (R^2). The R^2 is a measure of the variance explained in each of the endogenous constructs and is thus a measure of the model's predictive accuracy (in terms of in-

sample prediction). The R^2 ranges predictive accuracy obtained values of 0.75, 0.50 and 0.25 may be considered substantial, moderate and weak, respectively (Hair et al., 2011; Henseler et al., 2009 in). Second criteria is cross-validated redundancy (Q^2) and the path coefficients. Q^2 is used to predicting relevancy of constructive model, meanwhile the computation of the path coefficients linking the constructs rests on a series of regression analyses. Based on Sarstedt et al., (2014), the strength and significance of the path coefficients is evaluated for the relationships between the constructs. The assessment of formative indicator weights, the significance assessment builds on boot-strapping standard errors as a basis for calculating t-values for the path coefficients. In terms of relevance, path coefficient values are standardized on a range from -1 to +1, with coefficients closer to +1 representing strong positive relationships and coefficients closer to -1 indicating strong negative relationships.

4.8.2.3 Constructing Path Diagram Modeling

The following information explaining the modeling of Path Diagram there are:

ξ: exogenous latent variables

η: endogenous latent variables

λ_x: Loading factor exogenous latent variables

λ_y: endogenous latent variable factor Loading

β: coefficient of the endogenous variables influence endogenous variables

Y: The coefficient of the variable effect of exogenous variables on endogenous

ς: Error Model

δ_x: measurement error on the manifest variables to the latent exogenous variables

ε: the measurement error on the manifest variables for the endogenous latent variable

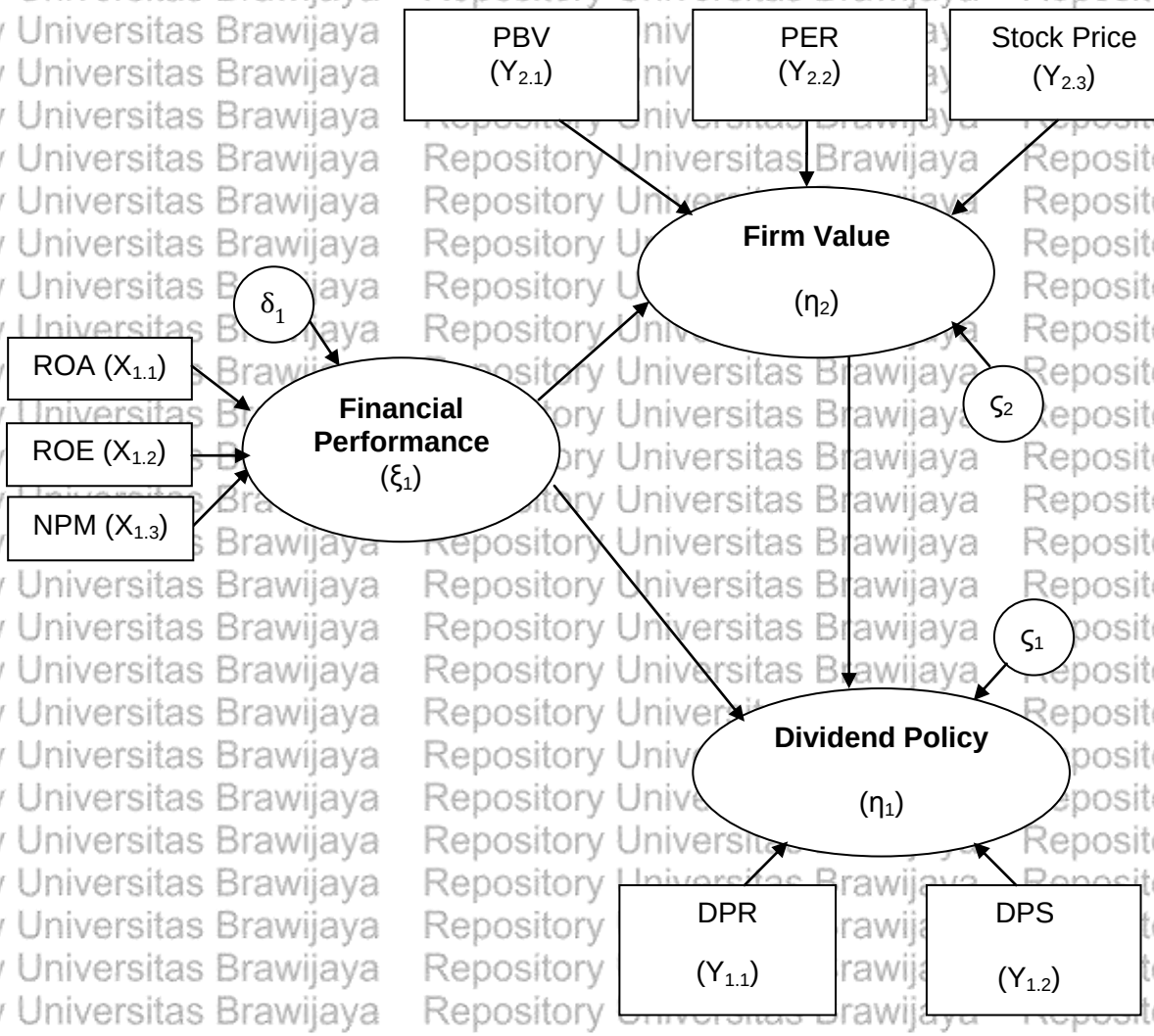


Figure 4.2 Path Diagram Modeling

4.8.2.4 Conversion Chart Path to Systems of Equations

1) Basic equation model of Outer Model can be written as follows:

Model I (Financial Performance) : $\xi_1 = \Pi_\xi ROA + \Pi_\xi ROE + \Pi_\xi NPM + \delta_x$

Model II (Dividend Policy) : $\eta_1 = \Pi_\eta DPR + \Pi_\eta DPS + \delta_{y1}$

Model III : $\eta_2 = \Pi_\eta PBV + \Pi_\eta PER + \Pi_\eta CP + \delta_{y2}$

2) Inner Model basic equation model can be written as follows:

Dividend Policy : $\eta_1 = \Pi Financial\ Performance_\xi + \varsigma_x$

Firm Value : $\eta_2 = \Pi Financial\ Performance_\xi + \delta_x +$ η Dividend Policy + εy

CHAPTER V

RESULT AND DISCUSSION

5. 1 Partial Least square Result

5.1.1 Outer Model Test

Outer model testing (measurement model) is testing the latent construct scores' outer proxies are computed as linear combinations of the values of all (standardized) indicators associated with a particular latent construct whereby represents the outer weight or loading coefficient.

5.1.1.1 Financial Performance Variable

Financial performance variable has measured by using three formative indicators, namely return on asset (ROA), return on equity (ROE) and net pofit margin (NPM). Outer weight and outer loading results is as follows:

Table 5.1 Test of Financial Performance

Financial Performance	Original Sample	Sample Mean	Standard Deviation	Standard Error	T-Statistic
ROA	-0.2408	-0.2112	0.2061	0.2061	1.1684
ROE	1.2001	1.1760	0.1317	0.1317	9.1117
NPM	-0.0143	-0.0258	0.0948	0.0948	0.1505

Table 5.2 Outer Loadings

Financial Performance	Original Sample
ROA	0.7590
ROE	0.9903
NPM	0.3993

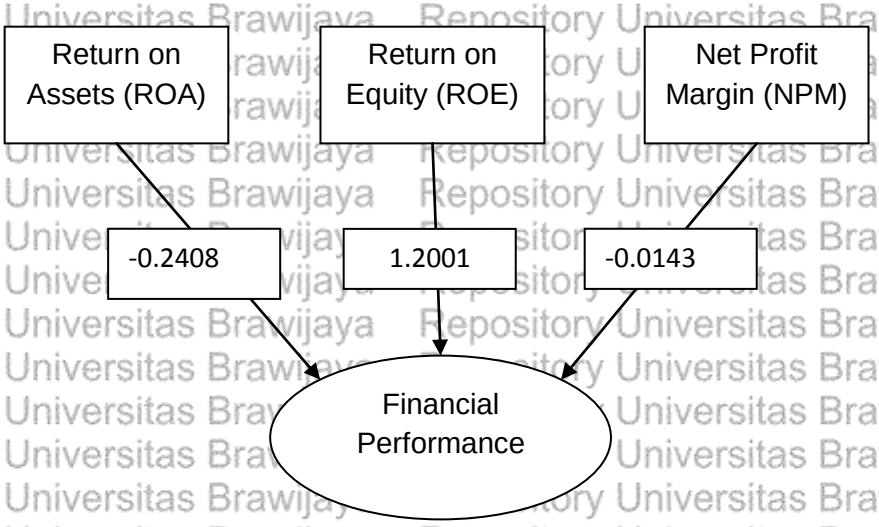


Figure 5.1 Result of Financial Performance Test

Table 5.1 and Figure 5.1 showed that ROA and NPM has path coeficient -0.2408 and -0.0143, t-statistic less than 1.96 which are significant level 1.1684 and 0.1505 (p-value < 0.05). Based on table 5.2, the outer loading of ROA is 0.7590 more than 0.5 but the path coeficient showed negatif value. In order to, NPM has outer loading 0.3993 which is less than 0.5. It indicated that ROA and NPM has been not valid and insignificant in measuringg financial performance. These indicators has to be drooped out of analysis. While, ROE has path coeficient 1.2001 and t-statistic greater than 1.96 with significant level 9.1117 (p-value < 0.05). It indicated that ROE has been valid and significant in measuring financial performance.

5.1.1.2 Dividend Policy Variable

Dividend Policy variable has measured by using two formative indicators, namely dividend payout ratio (DPR) and dividend per share (DPS). Outer weight and outer loading results is as follows:

Table 5.3 Test of Dividend Policy

Dividend Policy	Original Sample	Sample Mean	Standard Deviation	Standard Error	T-Statistic
DPR	0.2657	0.1855	0.4080	0.4080	0.6512
DPS	0.8955	0.8413	0.2170	0.2170	4.1273

Table 5.4 Outer Loadings

Dividend Policy	Original Sample
DPR	0.5057
DPS	0.9667

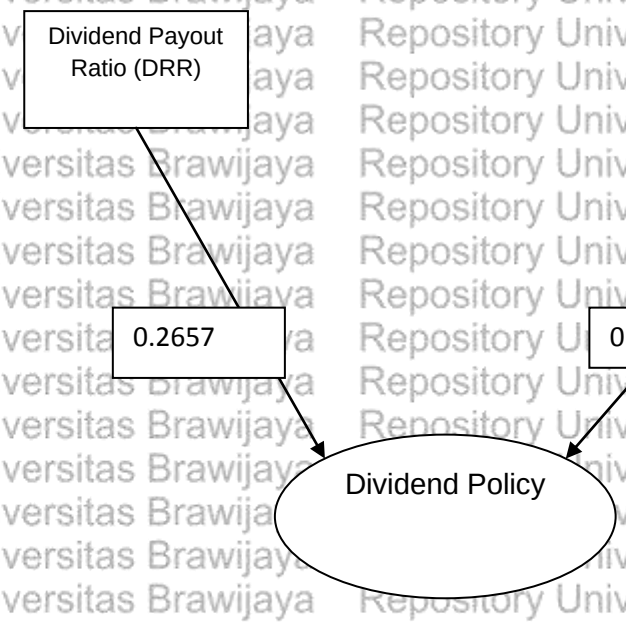


Figure 5.2 Result of Dividend Policy Test

Table 5.3 and Figure 5.2 showed that DPR has path coeficient 0.2657 t-statistic less than 1.96 which is significant level 0.6512 (p-value < 0.05). Based on table 5.4, DPR indicators can't be dropped because the outer loading is 0.5057 (more than 0.5). While, DPS has path coeficient 0.9667 and t-statistic greater than

1.96 with significant level 4.1273 (p-value < 0.05). It indicated that DPR and DPS has been valid and significant in measuring dividend policy.

5.1.1.3 Firm Value Variable

Firm value variable has measured by using three formative indicators, namely price to book value (PBV), price to earning ratio (PER) and clossing price (CP). Outer weight and outer loading results is as follows:

Table 5.5 Test of Firm Value

Firm Value	Original Sample	Sample Mean	Standard Deviation	Standard Error	T-Statistic
PBV	1.0266	1.0371	0.0412	0.0412	24.9440
PER	-0.2603	-0.2112	0.2061	0.2061	1.1684
CP	0.1263	0.1137	0.0612	0.0612	2.0631

Table 5.6 Outer Loadings

Financial Performance	Original Sample
PBV	0.9660
PER	0.1984
CP	0.4746

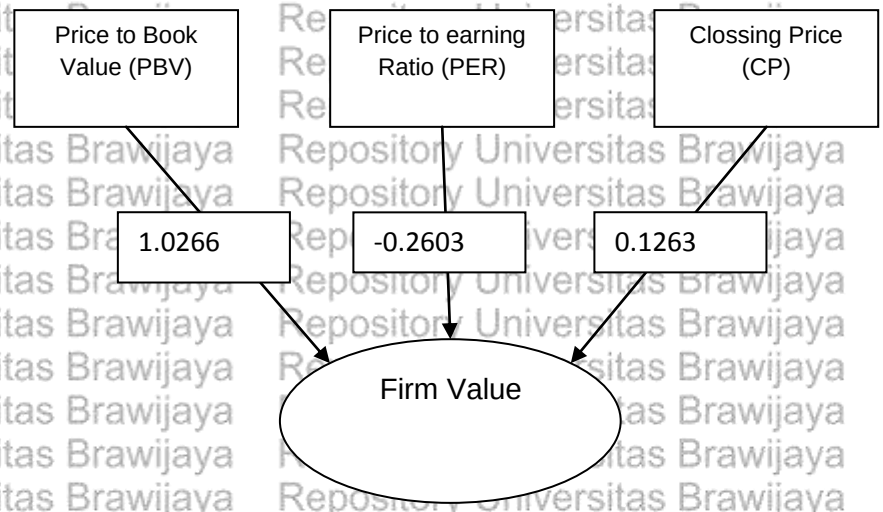


Figure 5.3 Result of Firm Value Test

Table 5.5 and Figure 5.3 showed that PBV and CP has path coeficient 1.0266 and 0.1263, t-statistic more than 1.96 which are significant level 24.944 and 2.0631 (p-value < 0.05). It indicated that PBV and CP has been valid and significant in measuring financial performance.While, PER has path coeficient -0.2603 and t-statistic less than 1.96 with significant level 1.1684 (p-value < 0.05). Based on table 5.6, the outer loading is also less than 0.5. It indicated that PER has been not valid and insignificant in measuring financial performance. These indicators has to be drooped out of analysis.

5.1.2 Outer Model Modification

The outer model modification is used to determine the fit model for represent outer measurement model.

5.1.2.1 Financial Performance Variable

The fit model of financial performance for represent outer measurement model such as table and figure bellow:

Table 5.6 Fit Model of Financial Performance

Financial Performance	Original Sample	Sample Mean	Standard Deviation	Standard Error	T-Statistic
ROE	1.000	1.000	0.0000	0.0000	0.0000

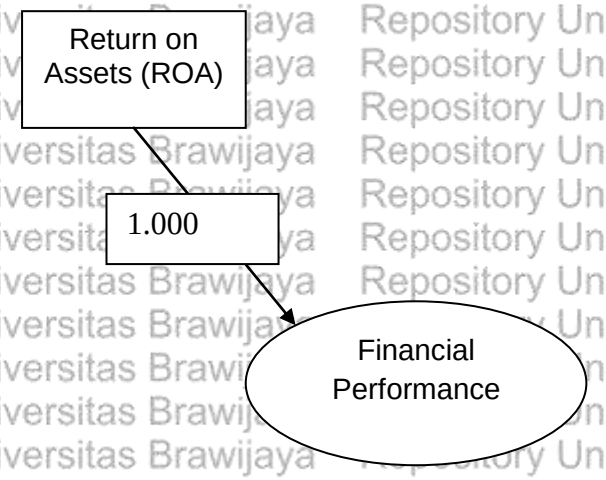


Figure 5.4 Result of Financial Performance Test (Fit Model)

ROE has path coeficient 1.000 and t-statistic 0.000, it means that ROE has been single indicator in measuring financial performance.

5.1.2.2 Dividend Policy Variable

The fit model of dividend policy for represent outer measurement model such as table and figure bellow:

Table 5.7 Fit Model of Dividend Policy

Dividend Policy	Original Sample	Sample Mean	Standard Deviation	Standard Error	T-Statistic
DPR	0.5228	0.5316	0.3019	0.3019	1.7315
DPS	0.7238	0.6509	0.2474	0.2474	2.9257

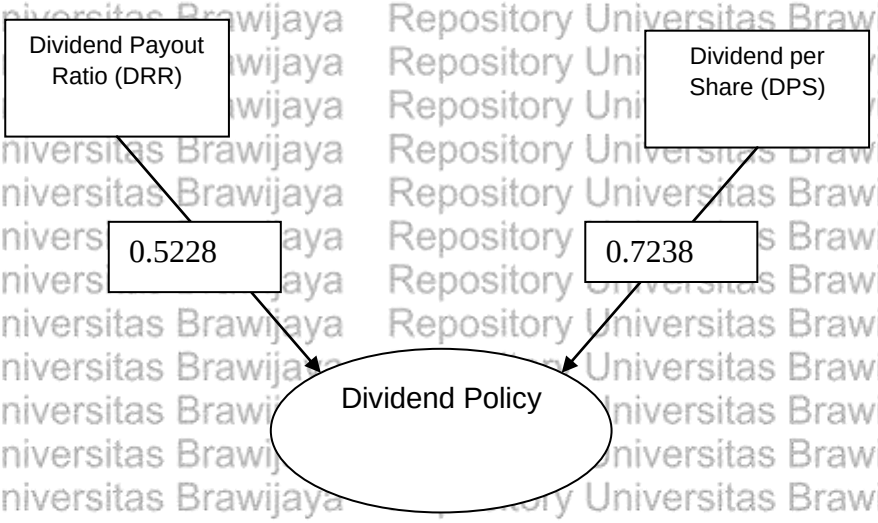


Figure 5.5 Result of Dividend Policy Test (Fit Model)

DPR and DPS has path coeficient 0.5228 and 0.7238, DPR has t-statistic 1.7315 less than 1.96 but the outer loading is more than 0.5, while DPS has t-statistic greater than 1.96 with significant 2.9257 (p-value < 0.05). It indicated that DPR and DPS has been valid and significant in measuring dividend policy.

5.1.2.3 Firm Value Variable

The fit model of firm value for represent outer measurement model such as table and figure bellow:

Table 5.8 Fit Model of Firm Value

Firm Value	Original Sample	Sample Mean	Standard Deviation	Standard Error	T-Statistic
PBV	0.9203	0.9206	0.0371	0.0371	24.8149
CP	0.1720	0.1675	0.0650	0.0650	2.6466

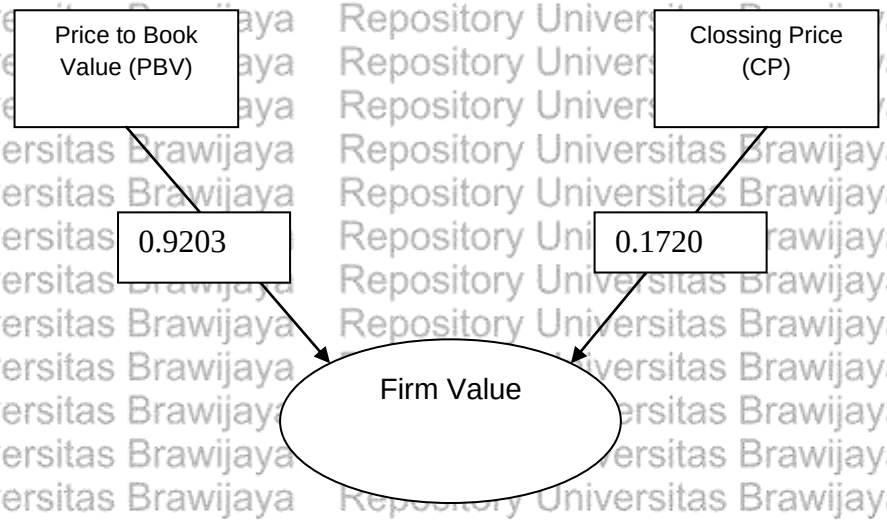


Figure 5.6 Result of Firm Value Test (Fit Model)

PBV and CP has path coeficient 0.9203 and 0.1720, t-statistic greater than 1.96 with significant level 24.8149 and 2.6466(p-value < 0.05). It indicated that PBV and CP has been valid and significant in measuring financial performance.

5.1.3 Inner Model Test

Inner model testing (structural model) was used to compute proxies for the structural model relationships. This test was used to analyze correlations based on latent construct scores as proxies for structural model relationships. The structural model can be concluded as hypothesis testing. The testing had conducted with t-test as in regression analysis. The result from hypothesis testing are follows:

Table 5.9 Hypothesis Testing For Inner Model

Variable	Original Sample	Sample Mean	Standard Deviation	Standard Error	T-Statistic
FP -> DP	0.1476	0.1431	0.0450	0.0450	3.2822
DP -> FV	0.1638	0.1761	0.0746	0.0746	2.1975
FP -> FV	0.8686	0.8597	0.0392	0.0392	22.1685

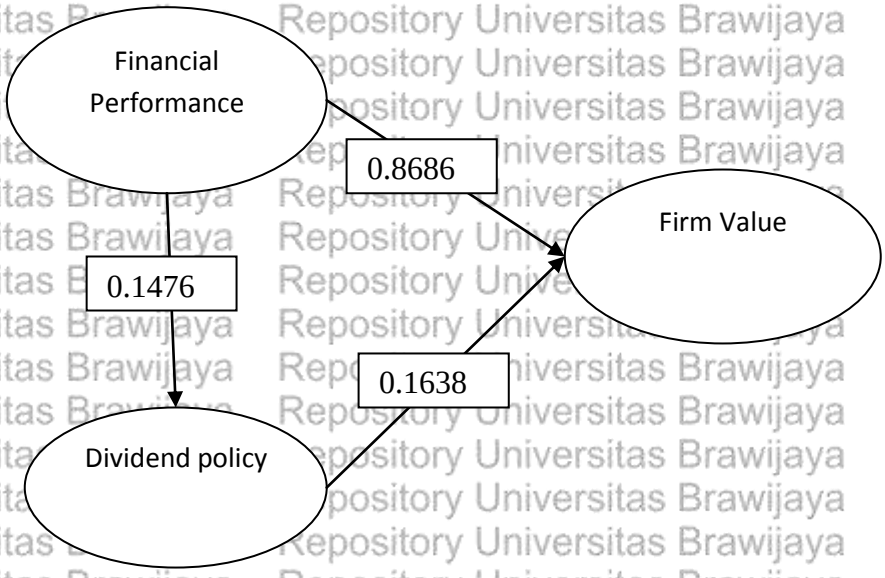


Figure 5.7 Path Diagram

Table and Figure showed the result of hypothesis testing from this research. Then the explanation of this result as are follows:

1. The result revealed statistically significant positive influence between the proxy of financial performance on dividend policy. Based on PLS analysis has been known that path coefficient 0.1476 and t-statistic 3.2822 (p-value < 0.05). Positive path coefficient indicate that the greater of ROE will raise of DPR and DPS. The greater equity of company indicates that company has ability to finance their own sources and decreases the risk

of bankruptcy of companies. It can be seen by investor as a good prospect in the future.

2. The result revealed statistically significant positive influence between the proxy of dividend policy on firm value. Based on PLS analysis has been known that path coefficient 0.1638 and t-statistic 2.1975 (p-value < 0.05). Positive path coefficient indicate that the greater of DPS and DPR will raise of PBV and CP.This positive relation describes the distribution of dividend has a special attraction to the investor. The firm use dividend policy as toolsfor financial signaling to the outsider the stability and growth prospect.
3. The result revealed statistically significant positive influence between the proxy of financial performance onfirm value. Based on PLS analysis has been known that path coefficient 0.8686 and 22.1685 t-statistic (p-value < 0.05). Positive path coefficient indicate that the greater of ROE will raise of PBV and CP. The higher equity of company will be seen as good prospect in the future to earn a higher profit. The higher profit attract the investor to invest in the company, so that PBV and CP also will be higher.

5.1.4 Goodness and Fit

Goodness and fit structural model in PLS is needed to predicting the relevance model (Q^2) . Those value calculated based on R^2 from endogenous variables, there are:

1. Dividend policy variable obtained R^2 0.027
2. Firm value variable obtained R^2 0.776

Predictive relevance formula as follows:

$$Q^2 = 1- (1- R_1^2) (1- R_2^2)$$

Q^2= 1- (1- 0.000729) (1- 0.6027176)

Q^2= 1- (0.999)(0.397)

Q^2= 0.6033

Predictive relevance value is 0.603 or 60.33%. This indicate that the information which contained on the data can be explained 60.33% by model. While the 39.67% explained by another variable which is not contained in the model and error.

5.2. Hypothesis Testing

5.2.1 Hypothesis 1: the proxy of financial financial performance has significant positive effect on dividend policy

The research result obtained significantly positive influence between the proxy of financial performance on dividend policy. Based on PLS analysis revealed patch coefficient is 0.1476 and t-statistic 3.2822 (p-value < 0.05). Positive path coefficient indicate that the greater equity of company indicates that company has ability to finance their own sources and decreases the risk of bankruptcy of companies. It's also means that the company profitability based on equity generates the higher amount of shareholder dividend paid by DPR and DPS (as dividend policy indicator). The result of study is consistent with previous studies by Uwuigbe (2012) that finds out a significant positive association between the performances of firms (indicated by ROE)on the dividend policy (indicated by DPR).

5.2.2 Hypothesis 2: the proxy of dividend policy has significant positive effect of the firm value

The research result obtained significantly positive influence between the proxy of dividend policy on firm value. Based on PLS analysis revealed path coefficient is 0.1638 and t-statistic 2.1975 (p-value < 0.05). Positive path coefficient indicate that the greater of dividend policy will raise the market price that shown by PBV and CP. The higher market price is shown as the high level of company prosperity. This positive relation describes the high distribution of dividend will be seen by the investor as signaling of stability and growth prospect. This result support the concept of "Bird in Hand Theory", dividends are less risky than capital gains since they are more certain. Investors would therefore prefer dividends to capital gains (Amidu, 2007). This recearch also support the previous research that have been conducted by Gordon (1963) and Lintner (1956) in Imran et al., (2013) explained that dividend payments can positively change the market value of the firm.

5.2.2 Hypothesis 3: the proxy of financial performance has significant positive effect of the firm value

The research result obtained significantly positive influence between the proxy of financial performance on firm value. Based on PLS analysis has been known that path coefficient 0.8686 and 22.1685 t-statistic (p-value < 0.05). Positive path coefficient indicate that the greater of ROE will raise of PBV and CP. The higher financial performance will be seen by investor if company has prospect to generate the higher profit in the future. The higher profit attract the investor to invest to the company, the demand of investment will increasing stock price. This investment will be seen as a signal related companies growth and expected

return in the future and also will increasing market value that shown by price to book value. This result support existing previous research by Sudiyatno and Puspitasari (2012), which found ROA and ROE for firm performance have a significant and positive effect on the value of the company.

CHAPTER VI
CONCLUSION AND RECOMMENDATION

6.1 Conclusions

The objects of this study is to examine the financial performance and dividend policy as a factors affecting firm value of manufacturing companies that listed in Indonesia Stock Exchange (IDX) period of 2010-2012. However there is 60.33% of the data and variable explained by the model. This research reveals three result are as follows:

1. The result revealed statistically significant positive influence between the proxy of financial performance on dividend policy, it means that a good financial performance of the manufacturing companies indicate the higher dividend pay out distribution, the investor will see as advantage investment. This result is relevance with Agyei et al. (2011) that pay out dividend tend to send out good signals about the company performance and therefore attracting more customers.
2. The result revealed statistically significant positive influence between the proxy of dividend policy on firm value. The higher distribution of dividend will be seen by investor as profitable prospect. This result is consistent with "bird in hand theory by Litner Model (1956) on the realationship of dividend policy on firm value.
3. The last result of this study revealed statistically significant positive influence between the proxy of financial performance on firm value, the good financial performance of manufacturing company will increase the

market value that reflected by the high share price and price to book value. It is relevance with Sudiyatno (2012), the firm performance is used to barometer of the success of the company will be seen as a benchmark for investors to invest. Following from this study, future studies can look at the effect of dfinancial performance and dividend policy on the firm value with more indicators or variable.

6. 2 Recommendations

1. This research is limited to Indonesia market share wholly semistrong of market efficiency, the other kind of strong market efficiency can be observed use this model to enlarged the result of research.
2. This research expected to get a large sample, but in the reality the sample only 28% from the total population. The period of research could be developed longer and wider to obtain more samples. The diverse sample would be more representative for the application of the model.
3. For future research, it is suggested to add more variables which have influence on maximazing firm value as investment decision, capital structure or macro economic. Meanwhile, additional indicators in the same variable can be used to represent the factors that form in each variable. It will further enrich the knowledge concerning about financial performance, dividend policy and firm value.
4. It is suggested to use data of stock price movement that seen by the difference between current and previous price. This kind of data further represent the actual stock price movement.

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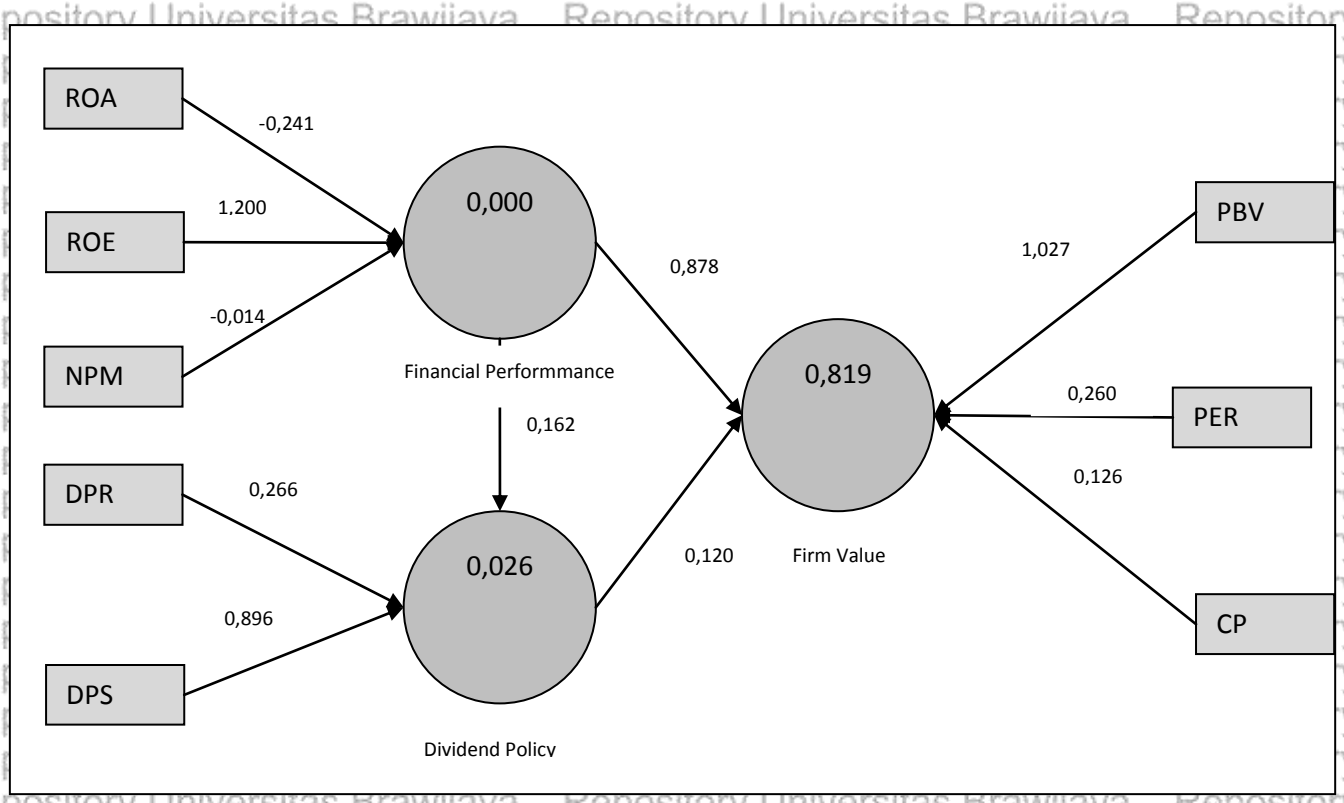
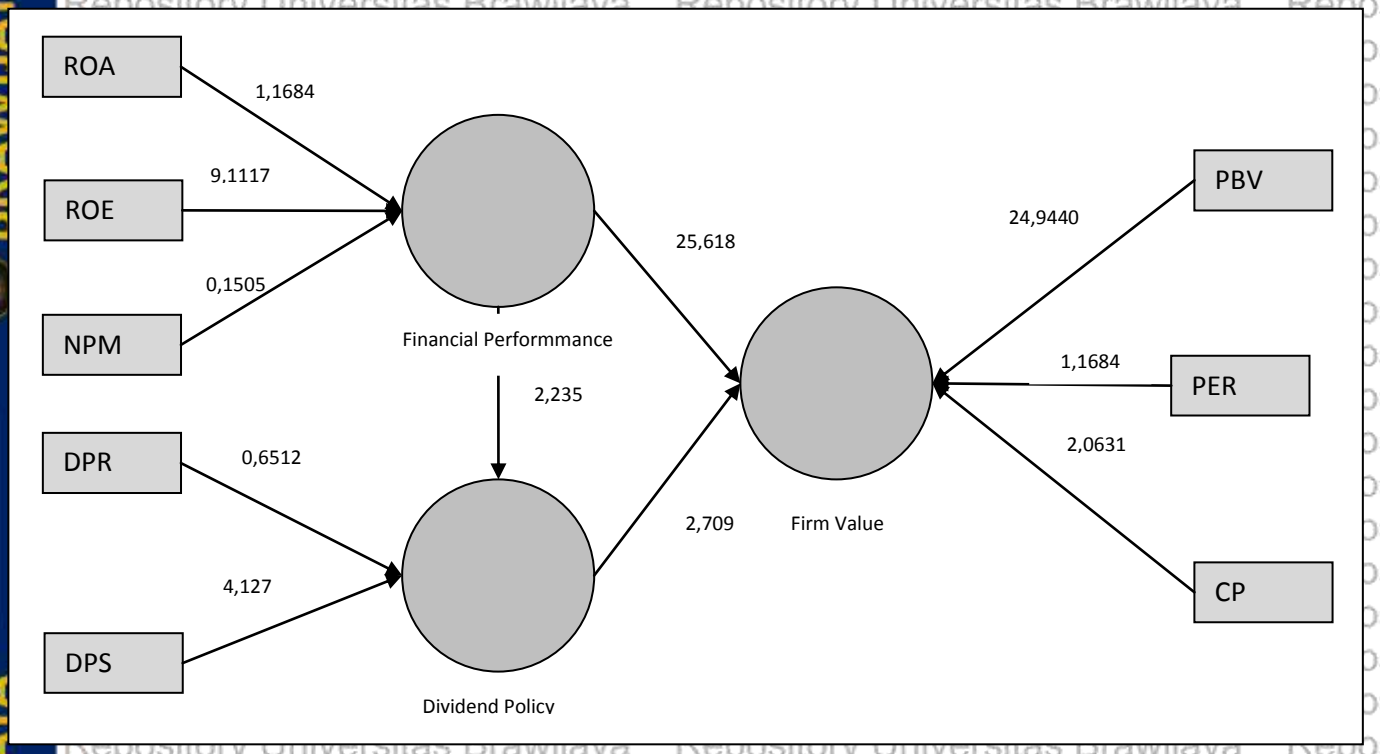
APPENDIX 1

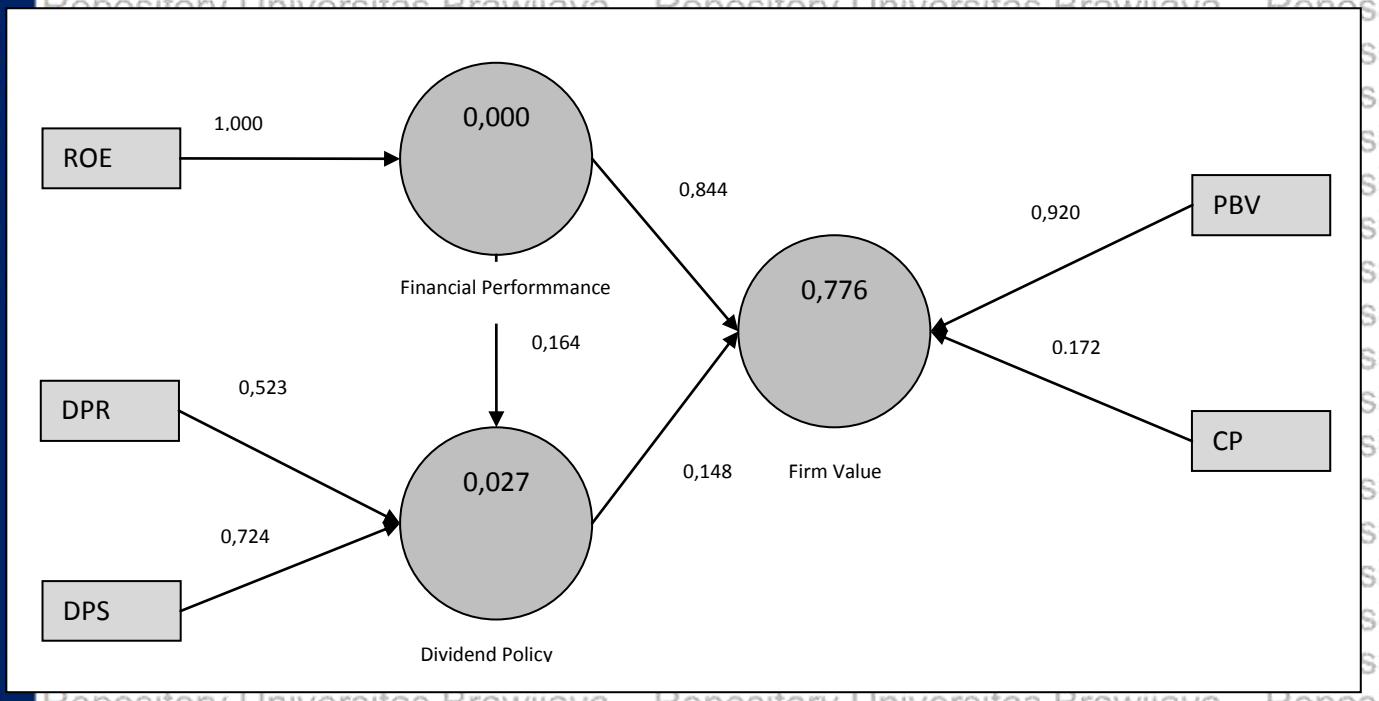
Algorithm First



Bootstraping Test



Algorithm Test After Modification



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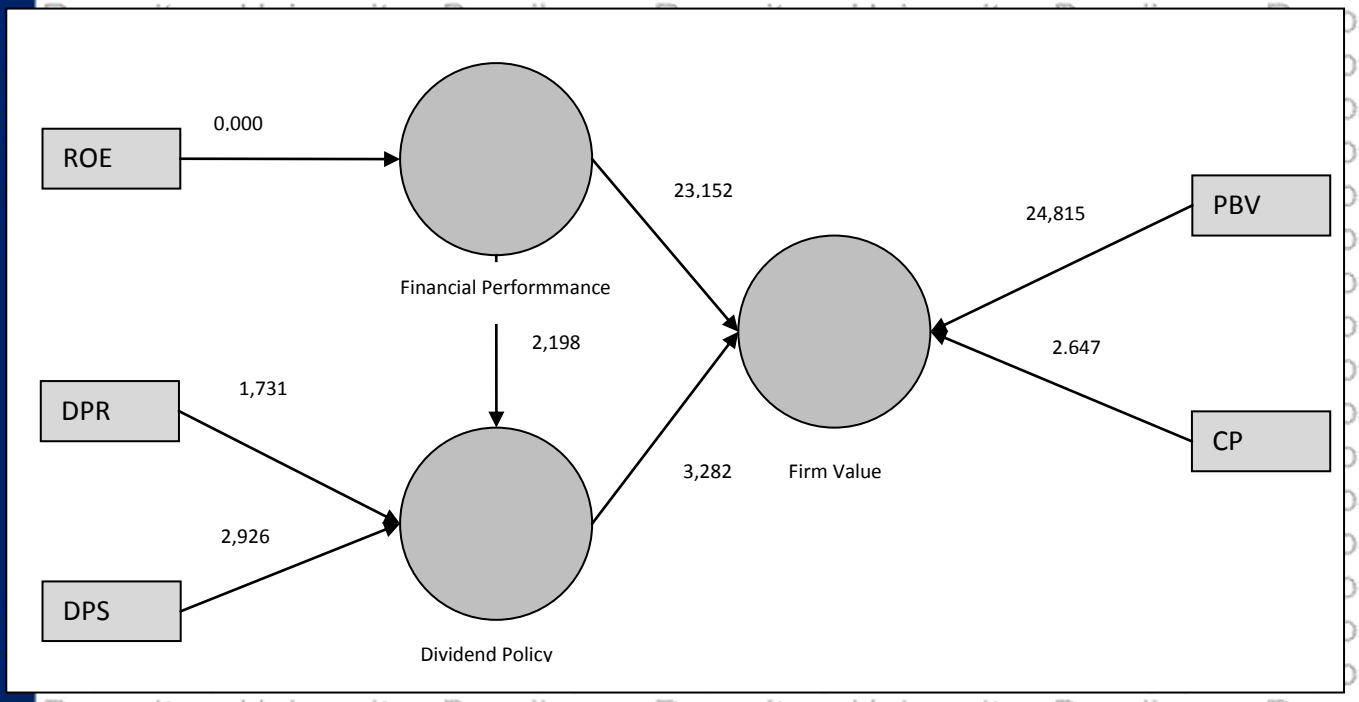

Appendix 2

No	Code	Company Name
1	AMFG	PT. Asahimas Flat Glas. Tbk
2	ARNA	PT. Arwana Citramulia. Tbk
3	ASII	PT. Astra International. Tbk
4	AUTO	PT. Astra Otoparts. Tbk
5	BRAM	PT. Indo Kordsa. Tbk
6	BRNA	PT. Berlina. Tbk
7	CPIN	PT. Charoen Pokphand Indonesia. Tbk
8	DLTA	PT. Delta Djakarta. Tbk
9	DVLA	PT. Darya-Varia Laboratoria. Tbk
10	GDYR	PT. Goodyear Indonesia. Tbk
11	GGRM	PT. Gudang Garam. Tbk
12	GJTL	PT. Gajah Tunggal. Tbk
13	INDF	PT. Indofood Sukses Makmur. Tbk
14	INTP	PT. Indocement Tunggal Prakarsa Tbk
15	JPFA	PT. Japfa Comfeed Indonesia. Tbk
16	KAEF	PT. Kimia Farma. Tbk
17	KLBF	PT. Kalbe Farma. Tbk
18	MAIN	PT. Malindo Feedmill. Tbk
19	MLBI	PT. Multi Bintang Indonesia. Tbk
20	MRAT	PT. Mustika Ratu. Tbk
21	SCCO	PT. Supreme Cable Manufacturing and Commerce
22	SMGR	PT. Semen Indonesia. Tbk
23	SMSM	PT. Selamat Sempurna. Tbk
24	TCID	PT. Mandom Indonesia. Tbk
25	TKIM	PT. Pabrik Kertas Tjiwi Kimia. Tbk
26	TSPC	PT. Tempo Scan Pacific. Tbk
27	ALMI	PT. Indocement Tunggal Prakarsa Tbk
28	ICBP	PT. Indofood CBP Sukses Makmur Tbk
29	MERK	PT. Merck Tbk.
30	ROTI	PT.Nippon Indosari Corpindo Tbk.
31	SIPD	PT. Sierad Produce Tbk.
32	SMCB	PT. Holcim Indonesia Tbk.
33	SQBB	PT. Taisho Pharmaceutical Indonesia Tbk.
34	TOTO	PT.Surya Toto Indonesia Tbk.
35	UNVR	PT. Unilever Indonesia Tbk.

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