

**THE EFFECT OF FUNDAMENTAL FACTOR TO DIVIDEND POLICY:
EVIDENCE IN INDONESIA STOCK EXCHANGE**

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ABSTRACT

This paper focus on the effect of fundamental factor on dividend policy of 98 firms listed Indonesia Stock Exchange during the period of 2006 to 2009. This research uses logit regression to know the relationship between independent variable and dependent variable. This research finds that profitability and firm size correlates significantly positive with dividend policy. Liquidity and leverage correlates negative significantly with dividend policy. And the evidence show that growth opportunities do not significantly correlated with dividend policy. But simultaneously all the independent variables correlated significantly on dividend policy. In this study the estimation results indicate that the Count R Squared of 68.62% which means that there are 270 observations from 392 observations can be explained in accordance with predictions.

Keywords: *Fundamental Factor, Profitability, Liquidity, Leverage, Firm Size, Growth Opportunities, Dividend policy, Logit Regression.*

1. INTRODUCTION

The decision to determine how large profit to be distributed to shareholders and how large the cash should be reinvested by the company (retained earnings) is called the dividend policy. Dividend policy is one of important factor that must be considered by management in managing the company. It is because of dividend policy has significant influence both of internal sides (company itself) and external sides such as shareholders and creditors.

Black (1976) said that the behavior of dividend policy is the most contentious issue in the corporate finance literature and still keeps its prominent place both in developing and emerging markets. Many researchers try to uncover the issue regarding the dividend behavior or dynamics and determinants of dividend policy but still didn't have an acceptable explanation for the observed dividend behavior of firm (Ahmed and Javid 2009 : 110). The first determinants of dividend policy was proposed by Lintner (1956) then the model is extended by Fama & Blahnik (1968). Lintner (1956) suggest that firms increase dividend payments only if the manager believes that a high dividend payments are able to be maintained in the future. The research was continued by Fama & Blahnik (1968), they support developed model by Lintner. The results of classic study by Lintner (1956) : 1) The company emphasizes stable dividend payments, and 2). Earning is a major determining factor in dividend policy (Murhadi 2008: 3).

Bhattacharyya (1979), Miller and Rock (1985), John and Williams (1985), John and Lang (1991) states that dividends can be used as an intermediary by the manager to forward the information to private market called "Information signaling theory" of dividends. The research of DeAngelo, DeAngelo and Stulz (2004) observe a highly significant relation between the decision to pay dividends and the ratio of earned equity to total equity or total assets, controlling for firm size, profitability, growth, leverage, cash balances, and dividend history. The empirical research by Adaoglu (2000 : 268) found that companies listed on the Istanbul Stock Exchange (ISE) follow unstable dividend policy and the main factor that determines the amount of cash dividends that will be distributed is the earnings of the corporation in that year. Omet (2004 : 296) suggest that companies which are listed on the Jordanian Capital Market follow stable dividend policies and the empirical result reflect the fact that the imposition of tax on dividends had no impact on the dividend behavior of the sample of company.

In investigating the determinants of dividend policy in Tunisia stock exchange, Naceur et al. (2006 : 18) found that riskier firms with high financial leverage pay out fewer dividends and have lower dividend yields. In Indian case Reddy and Rath (2006 : 80) show that the dividend paying firms are more profitable, large in size and growing. Amidu and Abor (2006) find dividend payout policy decision of listed firms in Ghana Stock Exchange is influenced by profitability, cash flow position and growth scenario and investments opportunities of the firms. Eriotis (2005) reports that the Greek firms distribute dividend each year according to their target payout ratio, which is determined by distributed earnings and size of these firms. Dennis and Osobov (2008) argued that in all six countries that they study, dividends are affected by firm size, profitability, growth opportunities, and the earned/contributed equity mix. Larger and more profitable firms and those with a greater proportion of earned equity are more likely to pay dividends, while the effect of growth opportunities on the likelihood of dividend payments is mixed.

According to Ahmed and Javid (2009: 122) who conducted the study in 320 non-financial companies listed on Karachi Stock Exchange (KSE) in the period 2001-2006 suggests that the factors that significantly affect the dividend policy in Pakistan include: net earnings, ownership concentration,

liquidity, investment opportunities, size of firm, leverage and market to book value of equity. And they found that non-financial companies listed on the KSE in Pakistan are not smooth in paying dividends.

Based the above description, we conclude that the dividend policy in each country is very diverse and the factors that influence to dividend policy in each country is different. While in Indonesia according to Utomo (2008), who has conducted research on 172 companies listed in Indonesia Stock Exchange period 1993-2003 suggest that profitability, Firm size and growth rate significantly influence the dividend policy in Indonesia. Although research on dividend policy is a topic that has long and widely studied, but the results are still mixed. Therefore researchers interested in studying about the dividend policy and try to find the relationship between profitability, liquidity, leverage, firm size and growth opportunities to dividend policy.

2. THEORY STUDY

Dividend

Dividends are payments from corporation income or profits distributed to shareholders in cash or stock. A firm's dividend policy refers to its choice of whether to pay shareholders a cash dividend, how large the cash dividend should be, and how frequently it should be distributed (Smart, Megginson and Gitman, 2004 : 474).

Profitability

This ratio is to measure how efficiently a firm uses their assets to manage its operations (Ross, Westerfield and Jordan, 2009: 89). In this study the profitability calculated by:

$$\text{Earnings before interest per book value of total asset} = \frac{\text{Earnings before interest}}{\text{Total assets}}$$

Liquidity

The liquidity ratio is the company's ability to pay its obligations that must be fulfilled. This research using quick ratio to measure the liquidity of the companies.

$$\text{Acid - test ratio} = \frac{\text{Current assets - Inventories}}{\text{Current liabilities}}$$

Leverage

Leverage ratio consist of financial leverage and operations leverage. Financial leverage used to calculate the financial leverage of a company to get an idea of the company's methods of financing or to measure its ability to meet financial obligations and operations leverage used to measure a company's mix of operating costs, giving an idea of how changes in output will affect operating income.

This research using debt to total assets to measure leverage of firms.

$$\text{Debt to total assets ratio} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

Firm Size

Firm size can be expressed in total assets, sales and market capitalization. In this study the firm size measured by natural logarithm of total assets. The firm size (SIZE) defined as natural logarithm of total assets is expected to have a positive affect on dividend payouts as large more diversified firm are likely to have very low chance of bankruptcy and can sustain higher level of debt.

Growth Opportunities

Life cycle of company can be grouped into several groups, there are introduction, growth, mature and decline. At growth stages the company has a high growth rate through expansion or another corporate action and the company needs fund to financing their growth. In this research growth opportunities is measured by assets growth.

$$\text{Asset growth} = \frac{\text{Total aktiva tahun ini} - \text{Total aktiva tahun lalu}}{\text{Total aktiva tahun lalu}}$$

This studies refers to research that links the factors that influence dividend policy. Thus the results of this study will refer to studies that have been done before. Utomo (2008), who has conducted research on 172 companies listed in Indonesia Stock Exchange period 1993-2003 suggest that profitability, Firm size and growth rate significantly influence the dividend policy in Indonesia. According to Ahmed and Javid (2009 : 122) who conducted the study in 320 non-financial companies listed on Karachi Stock Exchange (KSE) in the period 2001-2006 suggests that the factors that significantly affect the dividend policy in Pakistan include: net earnings, ownership concentration, liquidity, investment opportunities, size of firm, leverage and market to book value of equity. And they found that non-financial companies listed on the KSE in Pakistan are not smooth in paying dividends.

Denis and Osobov (2008) have examined the propensity to pay dividends in six countries (US, Canada, UK, Germany, France and Japan) period of 1994-2002. In all six countries that they study, dividends are affected by firm size, profitability, growth opportunities, and the earned/contributed equity mix. Fama and French (2001) stated that divided payments are influenced by firm size, profitability and growth opportunities on companies listed on NYSE, AMEX, and NASDAQ.

Bulan Subramanian, and Tanlu (2006) find that dividend initiators are large and stable firms with relatively high profitability and cash balances, and low growth rates. In Indian case Reddy and Rath (2006 : 80) show that the dividend paying firms are more profitable, large in size and growing. Amidu and Abor (2006) who conducted research on companies listed on the Ghana Stock period 1998-2003 using dependent variables that include profitability, cash flow (liquidity), risk, tax, institutional holdings, growth in sales and investment opportunities found that the dividend payment policy decisions are influenced by the profitability, cash flow positions, the scenario of growth, taxation and corporate investment opportunities. Eriotis (2005) reports that the Greek firms distribute dividend each year according to their target payout ratio, which is determined by distributed earnings and size of these firms. Bhattacharyya, Mawanni and Morril (2005) who conducted research on the U.S. firm dividend payout period 1992-2001 found that firm size and leverage have a significant negative relationship to dividend. Explained that the high leverage in relation to the high level of financial risk and debt-sevicing requirements, should be associated with lower dividend payments.

Naceur, Goaid and Belanes (2005) examined 48 Tunisian companies period of 1996-2002. The results show that Tunisian firms rely on current earnings and past dividends, dividends are more sensitive to current earnings than prior dividends.

DeAngelo, DeAngelo and Stulz (2004) document that a decision to retain earnings instead of paying dividends would result in firms with little or no long-term debt and enormous cash balances that far outstrip any reasonable estimate of their attractive investment opportunities. The empirical work Baker and Wurgler (2004) focuses on the prediction that the rates of dividend initiation and omission depend on the current "dividend premium," or the difference between the current stock prices of payers and non payers.

By using a sample of companies listing on the Indonesia Stock Exchange in the year 2000-2005 and paid a dividend consistently, Lestanti (2007) found that profitability has a positive effect on dividend policy. Sari (2009) found that firm size, profitability, sales growth and cash holdings have a significant effect on the dividend policy of 154 companies listed on the Indonesia Stock Exchange by using samples from 2006-2007. Sari uses logit regression in her research. Widayasa (2007) examined whether the cash ratio (CR), debt to equity ratio (DER), equity to total assets ratio (ETAR), return on investment (ROI), earnings per share (EPS), rate of sales growth (SG), firm size (SIZE) have effect on the Dividend per share (DPS) at the manufacturing companies listed on the Stock Exchange in 2000-2004. The results are very diverse that is variable CR, ROI and SIZE is negatively related to DPS. While variable DER, ETAR, EPS and SG positively related to DPS.

Based on description, the hypothesis in this study are as follows:

- H1 : Profitability has a positive effect on dividend policy
- H2 : Liquidity has a positive effect on dividend policy
- H3 : Leverage has a negative effect on dividend policy
- H4 : Firm Size has a positive effect on dividend policy
- H5 : Growth opportunities has a negative effect on dividend policy
- H6 : Profitability, Liquidity, Leverage, Firm Size and Growth opportunities simultaneously has significant effect on dividend policy

3. RESEARCH METHODOLOGY

This study uses a discrete dependent variable models with binary type variable or a dummy variable (logit Module, 2005). This type of dependent variable has a value of one or zero.

In the logit, the likelihood of an event expressed as:

$$P_i = E(Y_i = 1 | X_i) = \frac{1}{1 + e^{-(\beta_1 + \beta_2 X_i)}}$$

The equation can also be written as follows:

$$P_i = \frac{1}{1 + e^{-Z_i}} = \frac{e^Z}{1 + e^Z}$$

Where,

$$Z_i = \beta_0 + \beta_1 X_i$$

Let P_i is the probability of an event. And $(1 - P_i)$ is probability of not an event. Now consider the following model of $(1 - P_i)$:

$$1 - P_i = \frac{1}{1 + e^{Z_i}}$$

So that,

$$\frac{P_i}{1 - P_i} = \frac{1 + e^{Z_i}}{1 + e^{-Z_i}} = e^{Z_i}$$

The natural log (Li) of this ratio is called the logit, and therefore the model (6) is called the logit model. Now consider the following model:

$$Li = \ln\left(\frac{P_i}{1 - P_i}\right) = Z_i = \beta_0 + \beta_1 X_i$$

The logit model tell us that the log of the odds ratio is a linear function of explanatory variables. In this model the slope coefficient β_2 , gives the change in the log of the odds ratio per unit change in the X_i . The logit model does not give the probabilities directly.

We illustrate the logit model with our illustrative sample. Let P_i is the probability of paying dividend and $(1 - P_i)$ is probability of not paying dividend. $P_i / (1 - P_i)$ known as the odds ratio, is simply the odds in favor of paying dividends. Now consider the following model to know the relationship between dependent variables (profitability, liquidity, leverage, firm size and growth opportunities) with independent variables (dividend policy) :

$$Li = \ln\left(\frac{P_i}{1 - P_i}\right)$$

$$Li = \beta_0 + \beta_1 \text{Profit} + \beta_2 \text{Liq} + \beta_3 \text{Lev} + \beta_4 \text{SIZE} + \beta_5 \text{Assets GROWTH} + u_i$$

Where:

Li : Log Natural

Profit : Earnings before interest per book value of total assets

Liq : Acid test ratio

Leverage : Debt to total assets

Size : Log natural total assets

Assets Growth : Growth in assets for firm i in period t .

4. RESULT

Table 1 shows the numbers of observations in this study as many as 392 observations. The mean of ratio of earnings before interest per book value of total assets is 0.102179, the median 0.073000 and standard deviation is 0.128620. The mean of acid test ratio is 1.673156 with a median 0.914000 and a standard deviation is 5.121119. The mean of leverage is 0.520691, the median is 0.546590, with a standard deviation is 0.198270. The mean of firm size 28.58594 the median is 28.30850 and standard deviation is 1.293835. The mean of asset growth ratio is 0.164889 with a median is 0.096753 and a standard deviation is 0.752008. Jarque-Bera probability of all variables is less than 0.5, it means that all data not normally distributed variables (Gujarati, 2003). Therefore, this study uses logit.

Table 1: Descriptive statistics all companies

	DIVIDEN	PROF	LIQ	LEV	SIZE	GROWTH
Mean	0.367347	0.102179	1.673156	0.520691	28.58594	0.164889
Median	0.000000	0.073000	0.914000	0.546590	28.30850	0.096753
Maximum	1.000000	0.888000	91.65800	0.969503	32.21100	14.32492
Minimum	0.000000	-0.330000	-4055000	0.024336	26.62000	-0.645347
Std. Dev.	0.482698	0.128620	5.121119	0.198270	1.293835	0.752008
Skewness	0.550334	1.668451	14.72392	-0.272925	0.797664	17.12595
Kurtosis	1.302867	8.913096	249.3168	2.284901	2.928813	322.3960
Jarq-Bera	66.83157	752.9603	1005139.	13.21889	41.65232	1685387.
Prob.	0.000000	0.000000	0.000000	0.001348	0.000000	0.000000
Sum	144.0000	40.05400	655.8770	204.1109	11205.69	64.63644
SumSqDev	91.10204	6.468395	10254.31	15.37059	654.5376	221.1167
Obs.	392	392	392	392	392	392
Cross-sects	98	98	98	98	98	98

Source : Data processed by author using Eviews 7.0

Logit Regression

The estimation in this research using Eviews 7.0 program. In Eviews, there are facilities to strengthen the covariance on logit regression with the procedure Huber / White and GLM. This study uses a procedure Huber / White. Table 4 show the results of estimation regression and table 5 show the results of logit regression.

Table 5 is a logit regression that show the relationship between the independent variables with the dependent variable that can be seen from the coefficients and probability values of each variable and the odds ratio value of each variable. To determine the magnitude of the trend range of independent variables to the occurrence of an event, we can see from the comparison of risk or odds ratio ($e\beta$) of each independent variable (Nachrowi and Usman, 2002).

Table 2: Logit Estimation

VARIABEL	COEFFICIENT	ODDS RATIO	PROB.
C	-4747923	-	0.0668
PROFITABILITAS	7744120	2307,961624	0.0000
LIKUIDITAS	-0.159998	0,852145493	0.0742
LEVERAGE	-1443417	0,236119558	0.0593
SIZE	0.152168	1,164355832	0.1018
GROWTH	-0.025945	0,974388679	0.8909
MC FADDEN R SQUARED	0.155546		
COUNT R SQUARED	0,686224		
LOG LIKELIHOOD	-2176591		
LR STATISTIC	8018423		
PROBABILITY (LR STAT)	0.000000		
OBS WITH DEP = 0	248	TOTAL OBS	392
OBS WITH DEP = 1	144		

Source : Data processed by author using Eviews 7.0

We can see on the table 3 that the McFadden R-Squared value is 0.155546, which means that 15.55% of dividend policy can be explained by the model. And the value of the LR statistic 80.18423 with a probability 0.00000 for the LR statistic, which means less than 0.05 indicating that the independent variables together can explain the model. Explanation of the effect of independent variables with the dependent variable will be explained as follows:

1. The Effect of Profitability on Dividend Policy

The result shows that there is a positive and significant relationship between profitability and dividend policy. Table 2 shows that profitability has an odds ratio value of 2307,961624, we can say that an increase in the percentage earnings before interest per book value of total assets of 100 percent will increase the chances of paying dividend 2307,961624 times. Then we accepted H1 and conclude that profitability has a positive relationship on dividend policy. The evidence is supported by Fama & French (2001), Dennis & Osobov (2008), Reddy & Rath (2005), Amidu & Abor (2006), Naceur *et al* (2005), Bulan & Tanlu (2007), DeAngelo, *et al* (2004), Baker & Wurgler (2004), Ahmed & Javid (2009), Lestanti (2007) and Sari (2009) that stated that there is a positive relationship between profitability and dividend policy. Naceur, *et al* (2005 : 18) suggests that a company which has high profitability and stable earnings tends to pay dividends.

Table 3: Logit Regression

Variable	Coefficient	Std. Error	z-Statistic	Prob.
C	-4.747923	2.589953	-1.833208	0.0668
PROFITABILITAS	7.744120	1.425557	5.432345	0.0000*
LIKUIDITAS	-0.159998	0.089608	-1.785530	0.0742***
LEVERAGE	-1.443417	0.765240	-1.886227	0.0593***
SIZE	0.152168	0.093008	1.636072	0.1018***
GROWTH	-0.025945	0.189176	-0.137147	0.8909
McFadden R-squared	0.155546	Mean dependent var		0.367347
S.D. dependent var	0.482698	S.E. of regression		0.436256
Akaike info criterion	1.141118	Sum squared resid		73.46333
Schwarz criterion	1.201902	Log likelihood		-217.6591
Hannan-Quinn criter.	1.165208	Deviance		435.3182
Restr. Deviance	515.5024	Restr. log likelihood		-257.7512
LR statistic	80.18423	Avg. log likelihood		-0.555253
Prob(LR statistic)	0.000000			
Obs with Dep=0	248	Total obs		392
Obs with Dep=1	144			

Note: The *, ** and *** indicates the significance levels at 1%, 5%, and 10% respectively.

Source : Data processed by author using Eviews 7.0

2. The Effect of Liquidity on Dividend Policy

The results show that there is a negative and significant between Liquidity and dividend policy. The evidence supported by the findings of Lestanti (2007) and Widayasa (2007). Bram, Graham, Harvey and Michaely (2004 : 16) find a relationship between liquidity and dividend policy and this results associated with signaling theory. There is some indication from the interviews that one reason that firms are hesitant to cut dividends is related to signaling.

3. The Effect of Leverage on Dividend policy

The results show that there is a negative and significant relationship between Leverage and dividend policy. The evidence supported by the findings of Lestanti (2007), Ahmed & Javid (2009), DeAngelo, *et all* (2004), Sari (2009) and Bhattacharyya, *et all* (2003). Naceur, Goaid and Belanes (2006: 18) states that companies with high leverage levels tend to pay dividends in small quantities and has a low dividend yield.

4. The Effect of Firm Size on Dividend policy

The results show that there is a positive and significant between firm size and dividend policy. The evidence supported by the findings of Fama & French (2001), Dennis & Osobov (2008), DeAngelo, *et all* (2004), Redy & Rath (2005), Bulan & Tanlu (2007), Baker & Wurgler (2004) and Sari (2009).

5. The effect of Growth Opportunities on Dividend policy

The results show that the assets growth of the firm has no clear association with the dividend policy. Then we accepted the null hypothesis, we conclude that there is no relationship between assets growth with the dividend policy. The evidence supported by the finding of Dennis & Osobov (2008), in all six countries that they had studied, the effect of growth opportunities on the likelihood of dividend payments is mixed.

5. CONCLUSION AND SUGGESTION

Conclusion

The purpose of this study is to test whether the profitability, liquidity, leverage, firm size and growth opportunities have an influence on dividend policy on the Indonesia Stock Exchange 2006-2009 period. This research using logit regression. The analytical results of this study can be summarized as follows:

- Simultaneously that profitability, liquidity, leverage, firm size and growth opportunities have a positive and significant impact on dividend policy as indicated by LR statistic value 80.18423 with a probability of 0.00000 for the LR statistic, which means less than 0.05 that indicating all the variables are able to explain the model.
- In this study Count R Squared is 68.62% which means that there are 270 observations from 392 observations can be explained in accordance with predictions.

Suggestion

This study has several limitations. Limitations of this study may open opportunities for advanced research in the future to increase the numbers of sample within long period, using a new method to explore knowledge on econometric and examine another variables may affect to dividend policy.

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