Dividend Policy Perspective: Findings from the Survey Research to Triangulate Research on Investment Decision

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Abstract- The purpose of the company is basically to maximizing profit which is short-term oriented, and maximizing company’s in long term orientation. The views that financial management seeks to combine optimal investment decisions, financing and dividend policy decisions and combining the three that will maximize the value of the company. This paper discussed the perspectives of investment decision and dividend policy toward capital structure that need to be given about dividends. This is because dividends can provide useful information in equity valuation. Dividends are not direct measures of performance. The study argued that while theory tells us that there need not be any relationship between current dividends and expected future dividends, there is the possibility that management can use dividend policy to signal their view of the company’s prospects.

Index Terms— investment decision, dividend policy, capital structure, survey research

I. INTRODUCTION

A longstanding literature in corporate finance, dating back to at least Miller and Modigliani (1961), addresses the “information content of dividends” hypothesis, under which managers’ dividend decisions convey information about their firms’ future earnings prospects. Many empirical studies investigate the notion that managers use dividends to signal the future earnings prospects of their firms. Although it is well known that stock prices react when firms announce unexpected changes in dividends, the evidence generally does not support the idea that unexpected changes in dividends provide information about future earnings changes (see Allen and Michaely, 2002; Brav et al., 2003 for further details).

It is true that theory does not provide much guidance about what attributes of earnings firms signal through their dividend policies. Under the most common interpretation of the information content of dividends hypothesis, changes in firms’ dividends should map directly into changes in future earnings. As noted above, however, this prediction is not supported in the data. Part of the reason for this is the fact that dividend policy has become increasingly smooth and conservative over time. Dividend increases occur much more often than dividend decreases, and the magnitude of decreases in dividends is much larger than that of increases.

This leads Allen and Michaely (2002) to conclude that “the empirical evidence provides a strong prima facie case against the traditional dividend signaling models.” The survey evidence in Brav et al. (2003) also firmly rejects the traditional notion of signaling. Recent dividend policy evidence reinforces the view that the conventional view of dividend signaling is unlikely to hold.

Further, Fama and French (2001) found that the proportion of US firms paying regular cash dividends has declined dramatically, from 66.5 percent in 1978 to 20.8 percent in 1999. In spite of this, DeAngelo, DeAngelo, and Skinner (2004) found that aggregate real dividends paid by US firms increased over the same period, and show that this is due to a large increase in the concentration of dividend payments. Perhaps most dramatically, DeAngelo et. al. (2004) show that the top 25 dividend payers account for over one half of aggregate US dividends in 2001. This evidence makes it unlikely that managers use dividend policy to signal changes in their firms’ earnings.